



EGYÜTT. VELED

# **CONSOLIDATED ANNUAL REPORT**

OF MAGYAR TELEKOM TELECOMMUNICATIONS  
PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2016



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# **CONSOLIDATED FINANCIAL STATEMENTS**

OF MAGYAR TELEKOM TELECOMMUNICATIONS  
PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2016

PREPARED IN ACCORDANCE WITH  
INTERNATIONAL FINANCIAL REPORTING STANDARDS  
AS ENDORSED BY THE EUROPEAN UNION (EU IFRS)



## INDEPENDENT AUDITOR'S REPORT

To the shareholders of Magyar Telekom Telecommunications Public Limited Company

### Opinion

We have audited the accompanying consolidated financial statements of Magyar Telekom Telecommunications Public Limited Company ("the Company") and its subsidiaries (together "the Group") which comprise the consolidated statement of financial position as of 31 December 2016 (in which the consolidated statement of financial position total is MHUF 1 175 529), the consolidated statement of profit or loss and other comprehensive income (in which the total comprehensive income for the year is MHUF 56 725), the consolidated statement of changes in equity, the 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.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

### Basis for opinion

We conducted our audit in accordance with Hungarian National Standards on Auditing ("HNSAs") and with applicable laws and regulations in force in Hungary. Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the consolidated financial statements" section of our report.

We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Hungary. We have fulfilled our other ethical responsibilities in accordance with those requirements.

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

### Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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#### **Key audit matter**

#### **How our audit addressed the key audit matter**

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##### **Goodwill impairment assessment**

As at 31 December 2016, goodwill relating to the MT-Hungary and Macedonia segments amounted to MHUF 191 454 and MHUF 20 199 respectively out of a total goodwill balance of MHUF 218 098.

We agreed the cash flow forecasts used in the impairment assessment to Board approved forecasts. We considered the directors' expectations in respect of material impacts of the external environment and planned operational



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**Key audit matter****How our audit addressed the key audit matter**

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We focused on the impairment assessment of these two segments as they are sensitive to changes in assumptions (in particular the long term growth rate, the discount rate and the assumptions underlying future operating cash flows). The directors concluded that there was no impairment of goodwill.

Details of the nature of the goodwill impairment assessment performed by management is given in notes 4.2 and 13.2 to the financial statements.

improvements and whether these were appropriately reflected in the cash flow forecasts.

We compared actual historical cash flow performance for the segments with previous forecasts and determined whether any differences fell within an acceptable range.

We independently calculated a weighted average cost of capital by making reference to market data and compared the long term growth rate to market data.

We assessed the sufficiency of the sensitivity analysis performed by the directors and performed further sensitivity analyses, primarily focused on changes in operating cash flows.

We read notes 4.2 and 13.2 of the group financial statements.

Based on our procedures, we noted no material exceptions and considered management's key assumptions to be within reasonable ranges.

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**Accuracy of revenue due to complex billing systems**

The accuracy of revenue amounts recorded is an inherent industry risk. This is because telecom billing systems are complex and process large volumes of data with a combination of different products sold and price changes in the year, through a number of different systems.

Total revenue for the group was MHUF 602 651 as disclosed in note 22 of the group financial statements.

For further details of the accounting policies related to revenue, please refer to note 2.12 of the group financial statements.

We evaluated the relevant IT systems and the design of controls, and tested the operating effectiveness of controls over the:

- capturing and recording of revenue transactions;
- authorisation of rate changes and the input of this information to the billing systems; and
- calculation of amounts billed to the customers.

We also tested a sample of items from the customer billing systems to the invoices raised and checked these to the cash received from the customers. Our testing included customer bills for consumer and corporate customers.

We have not identified any material misstatements as a result of our procedures.

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### **Other information: the consolidated business report**

The other information comprises the consolidated business report of the Group. Management is responsible for the preparation of the consolidated business report in accordance with the provisions of the Accounting Act and other relevant regulations. Our opinion on the consolidated financial statements does not cover the consolidated business report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the consolidated business report identified above and, in doing so, consider whether the consolidated business report is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Based on the Accounting Act, in respect of the consolidated business report, our responsibility is to read the consolidated business report identified above and, in doing so, consider whether the consolidated business report has been prepared in accordance with the provisions of the Accounting Act and other relevant regulations, if any.

Because the Company's transferable securities are admitted to trading on a regulated market of a Member State of the European Economic Area, our opinion on the business report shall cover the information prepared under Paragraphs e) and f) of Subsection (2) of Section 95/B, and state whether the information referred to in Paragraphs a)-d) and g) of Subsection (2) of Section 95/B of the Accounting Act has been provided.

In our opinion, the 2016 consolidated business report of the Group, also including the information prepared under Paragraphs e) and f) of Subsection (2) of Section 95/B, is consistent with the 2016 consolidated financial statements and the consolidated business report has been prepared in accordance with the Accounting Act.

As there is no other regulation prescribing further requirements for the consolidated business report, in respect of this, our opinion on the consolidated business report does not express the opinion required by Section (5) h) of 156 of the Accounting Act.

In addition, in light of the knowledge and understanding of the entity and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the consolidated business report, and shall give an indication of the nature of any such misstatements. We have nothing to report in this respect.

We state that the information referred to in Paragraphs a)-d) and g) of Subsection (2) of Section 95/B of the Accounting Act has been provided.

### **Responsibilities of management and those charged with governance for the consolidated financial statements**

Management is responsible for the preparation of the consolidated financial statements that give a true and fair view 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.



In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

### **Auditor's responsibilities for the audit of the consolidated financial statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HNSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HNSAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that gives a true and fair view.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Budapest, 1 March 2017

A blue ink signature of Armin Krug, written in a cursive style.

Armin Krug  
Partner  
PricewaterhouseCoopers Auditing Ltd.  
1055 Budapest, Bajcsy-Zsilinszky út 78.  
Licence Number: 001464

A blue ink signature of Balázs Árpád, written in a cursive style.

Balázs Árpád  
Statutory auditor  
Licence number: 006931



CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Note	At December 31,	
		2015	2016
(in HUF millions)			
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents .....	6	17,558	10,805
Trade and other receivables .....	7	162,762	157,645
Other current financial assets .....	8.1	11,052	5,104
Current income tax receivable .....	9.1	1,356	2,225
Inventories .....	10	12,665	16,643
		205,393	192,422
Assets held for sale.....	11	4,785	1,556
<b>Total current assets</b> .....		210,178	193,978
<b>Non current assets</b>			
Property, plant and equipment .....	12	493,204	483,174
Intangible assets .....	13	478,844	478,263
Investments in associates and joint ventures .....	14	1,000	1,078
Deferred tax assets .....	9.4	47	73
Other non current financial assets .....	8.2	22,950	18,254
Other non current assets .....	15	801	709
<b>Total non current assets</b> .....		996,846	981,551
<b>Total assets</b> .....		1,207,024	1,175,529
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Financial liabilities to related parties .....	16	136,906	72,589
Other financial liabilities .....	17	26,152	22,600
Trade payables .....	18	140,182	136,623
Current income tax payable .....	9.1	1,399	719
Provisions .....	19	7,185	4,493
Other current liabilities .....	20.1	39,142	40,537
		350,966	277,561
Liabilities associated with assets held for sale .....	11	1,217	-
<b>Total current liabilities</b> .....		352,183	277,561
<b>Non current liabilities</b>			
Financial liabilities to related parties .....	16	220,088	247,179
Other financial liabilities .....	17	54,857	50,098
Deferred tax liabilities .....	9.4	23,813	8,740
Provisions .....	19	9,907	9,528
Other non current liabilities .....	20.2	1,245	1,090
<b>Total non current liabilities</b> .....		309,910	316,635
<b>Total liabilities</b> .....		662,093	594,196
<b>EQUITY</b>			
<b>Equity of the owners of the parent</b>			
Common stock .....		104,275	104,275
Capital reserves .....		27,412	27,890
Treasury stock .....		(307)	(825)
Retained earnings .....		337,014	375,660
Accumulated other comprehensive income.....		31,824	31,490
<b>Total Equity of the owners of the parent</b> .....		500,218	538,490
<b>Non-controlling interests</b> .....	21	44,713	42,843
<b>Total equity</b> .....		544,931	581,333
<b>Total liabilities and equity</b> .....		1,207,024	1,175,529

Budapest, February 22, 2017

Christopher Mattheisen  
Chief Executive Officer, Board member

Janos Szabó  
Chief Financial Officer

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



CONSOLIDATED STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	Note	For the year ended December 31,	
		2015	2016
(in HUF millions, except per share amounts)			
<b>Revenues</b> .....	22	656,342	602,651
Direct costs .....	23	(249,377)	(196,869)
Employee related expenses .....	24	(95,160)	(83,327)
Depreciation and amortization .....	12, 13	(113,784)	(117,476)
Other operating expenses .....	25	(131,375)	(136,406)
<b>Operating expenses</b> .....		<u>(589,696)</u>	<u>(534,078)</u>
Other operating income .....	26	6,871	10,990
<b>Operating profit</b> .....		<u>73,517</u>	<u>79,563</u>
Interest income .....	27	946	760
Interest expense .....	28	(21,784)	(18,570)
Other finance expense - net .....	29	(7,338)	(9,005)
<b>Net financial result</b> .....		<u>(28,176)</u>	<u>(26,815)</u>
Share of associates' and joint ventures' profit (loss).....	14	-	78
<b>Profit before income tax</b> .....		<u>45,341</u>	<u>52,826</u>
Income tax.....	9.2	(13,794)	4,397
<b>Profit for the year</b> .....		<u>31,547</u>	<u>57,223</u>
<b>Other comprehensive income</b>			
<b>(all of which may be reclassified subsequently to profit or loss):</b>			
Exchange differences on translating foreign operations .....		(845)	(562)
Revaluation of available-for-sale financial assets .....		44	64
<b>Other comprehensive income for the year, net of tax</b> .....		<u>(801)</u>	<u>(498)</u>
<b>Total comprehensive income for the year</b> .....		<u>30,746</u>	<u>56,725</u>
<b>Profit attributable to:</b>			
Owners of the parent .....		27,715	54,279
Non-controlling interests .....		3,832	2,944
		<u>31,547</u>	<u>57,223</u>
<b>Total comprehensive income attributable to:</b>			
Owners of the parent .....		27,355	53,945
Non-controlling interests .....		3,391	2,780
		<u>30,746</u>	<u>56,725</u>
<b>Earnings per share (EPS) information:</b>			
Profit attributable to the owners of the Company .....		27,715	54,279
Weighted average number of common stock outstanding (thousands) used for basic EPS .....		1,042,352	1,041,799
Average number of dilutive share options.....		118	767
Weighted average number of common stock outstanding (thousands) used for diluted EPS .....		1,042,470	1,042,566
Basic earnings per share (HUF) .....		26.59	52.10
Diluted earnings per share (HUF) .....		26.59	52.06

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



CONSOLIDATED STATEMENTS OF CASH FLOWS

	Note	For the year ended December 31,	
		2015	2016
(in HUF millions)			
<b>Cashflows from operating activities</b>			
Profit for the year .....		31,547	57,223
Depreciation and amortization .....		113,784	117,476
Income tax expense .....		13,794	(4,397)
Net financial result .....		28,176	26,815
Share of associates' and joint ventures' result.....		-	(78)
Change in assets carried as working capital .....		(15,541)	3,421
Change in provisions .....		2,442	(3,218)
Change in liabilities carried as working capital .....		24,204	(614)
Income tax paid .....		(12,787)	(12,254)
Dividend received .....		-	14
Interest and other financial charges paid .....		(28,743)	(24,332)
Interest received .....		967	744
Other non-cash items .....		(1,545)	(5,975)
<b>Net cash generated from operating activities .....</b>		<b>156,298</b>	<b>154,825</b>
<b>Cashflows from investing activities</b>			
Purchase of property plant and equipment (PPE) and intangible assets ...	30	(96,855)	(109,908)
Purchase of subsidiaries and business units .....	31	(16,737)	(128)
Cash acquired through business combinations .....		1,815	-
Proceeds from other financial assets .....		18,832	7,545
Payments for other financial assets .....		(5,695)	(605)
Proceeds from disposal of PPE and intangible assets .....		2,127	10,413
Proceeds from disposal of subsidiaries and business units.....		-	3,484
Payments for interests in associates and joint ventures.....		(1,000)	-
<b>Net cash used in investing activities .....</b>		<b>(97,513)</b>	<b>(89,199)</b>
<b>Cashflows from financing activities</b>			
Dividends paid to Owners of the parent and Non-controlling interest .....		(6,691)	(22,686)
Proceeds from loans and other borrowings .....	17.2	156,916	143,794
Repayment of loans and other borrowings .....	17.2	(187,076)	(184,217)
Repayment of other financial liabilities .....	17.3	(18,923)	(8,676)
Treasury share purchase.....		-	(550)
<b>Net cash used in financing activities .....</b>		<b>(55,774)</b>	<b>(72,335)</b>
Exchange differences on cash and cash equivalents .....		(78)	(44)
<b>Change in cash and cash equivalents .....</b>		<b>2,933</b>	<b>(6,753)</b>
Cash and cash equivalents, beginning of year .....		14,625	17,558
Cash and cash equivalents, end of year .....	6	17,558	10,805

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



CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	pieces	In HUF millions									
		Capital reserves				Accumulated Other Comprehensive Income					Total Equity
	Shares of common stock (a)	Common stock (a)	Additional paid in capital (b)	Reserve for equity settled share based transactions (c)	Treasury stock (d)	Retained earnings (e)	Cumulative translation adjustment (f)	Revaluation reserve for AFS financial assets – net of tax (g)	Equity of the owners of the parent	Non-controlling interests (h)	
<b>Balance at December 31, 2014</b> .....	1,042,742,543	104,275	27,379	17	(307)	310,406	32,276	(92)	473,954	50,444	524,398
Dividend declared to Non-controlling interests (i) ..									-	(9,122)	(9,122)
Equity settled share based transactions (c) .....				16					16	-	16
Acquisition o						(1,107)			(1,107)	-	(1,107)
<b>Transactions with owners</b>											
<b>in their capacity as owners</b> .....		-	-	16	-	(1,107)	-	-	(1,091)	(9,122)	(10,213)
Other Comprehensive income .....							(384)	24	(360)	(441)	(801)
Profit or loss .....						27,715			27,715	3,832	31,547
<b>Total Comprehensive Income</b> .....						27,715	(384)	24	27,355	3,391	30,746
<b>Balance at December 31, 2015</b> .....	1,042,742,543	104,275	27,379	33	(307)	337,014	31,892	(68)	500,218	44,713	544,931
Dividend declared to Owners of the parent .....						(15,633)			(15,633)	-	(15,633)
Dividend declared to Non-controlling interests (i) ..									-	(4,650)	(4,650)
Equity settled share based transactions (c) .....				478	32				510	-	510
Treasury share purchase (k) .....					(550)				(550)	-	(550)
<b>Transactions with owners</b>											
<b>in their capacity as owners</b> .....		-	-	478	(518)	(15,633)	-	-	(15,673)	(4,650)	(20,323)
Other Comprehensive income .....							(371)	37	(334)	(164)	(498)
Profit or loss .....						54,279			54,279	2,944	57,223
<b>Total Comprehensive Income</b> .....						54,279	(371)	37	53,945	2,780	56,725
<b>Balance at December 31, 2016</b> .....	1,042,742,543	104,275	27,379	511	(825)	375,660	31,521	(31)	538,490	42,843	581,333
Of which treasury stock .....	(1,585,207)										
<b>Shares of common stock outstanding</b>											
<b>at December 31, 2016</b> .....	1,041,157,336										

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, 2016. The number of authorized ordinary shares on December 31, 2016 is 1,042,742,543.

### *Voting Rights and Voting*

The holder of each Series "A" ordinary share shall be entitled to one vote at the General Meeting of the Company. The names of shareholders and nominees who intend to participate at the General Meeting shall be registered in the Share Register on the second working day prior to the starting date of the General Meeting. The General Meeting shall adopt its resolutions by a simple majority vote except for resolutions on issues listed in the Articles of Associations, which shall require at least a three-quarters majority of the votes cast. There is no limitation on the rights of non-resident or foreign shareholders to hold or exercise voting rights on the ordinary shares. There is no limitation of voting rights for ordinary shares in the Articles of Association. The Company has no shares assigned with special management rights.

### *Transfer of Shares*

For the transfer of dematerialized share a contract for transfer or other legal title is required and, in that context, the transferor's securities account shall be debited and the new holder's securities account shall be credited with the transferred dematerialized shares. The holder of dematerialized share shall be considered the holder of the securities account on which the dematerialized shares are recorded.

The transfer of any Series "A" ordinary shares is not bound to any restriction or attainment of agreement.

- (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) Reserve for equity settled share based transactions includes the compensation expenses accrued in this reserve related to share settled compensation programs. The December 31, 2015 and 2014 balances of this reserve represent the amount reserved for the Share Matching Plans (Note 24.1).
- (d) Treasury stock represents the cost of the Company's own shares repurchased.
- (e) Retained earnings include the accumulated and undistributed profit of the Group. The distributable reserves of the Company under Hungarian law at December 31, 2016 amounted to approximately HUF 262 billion (HUF 249 billion at December 31, 2015).
- (f) Cumulative translation adjustment represents the foreign exchange differences arising on the consolidation of foreign subsidiaries.
- (g) Revaluation reserve for available-for-sale (AFS) financial assets includes the unrealized gains and losses net of tax on available-for-sale financial assets.
- (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 (Note 21).
- (i) 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.
- (j) In April 2015 Magyar Telekom Plc. acquired a 100% stake in GTS Hungary Kft. from Deutsche Telekom (Note 5.1.2).
- (k) In July 2016 Magyar Telekom Plc. purchased 1,252,616 ordinary shares for the purpose of the Employee Share Ownership Program (ESOP) (Note 24.2), of which the ESOP sold 25,764 shares due to the revision of the number of the participants in the program. The share transactions were carried out on the Budapest Stock Exchange through UniCredit Bank Hungary Zrt., as investment service provider.



Together with the approval of these financial statements for issue, the Board of Directors of the Company proposes a HUF 25 per share dividend distribution (in total HUF 26,067 million) to be approved by the Annual General Meeting of the Company in April 2017. In 2016 Magyar Telekom Plc. declared HUF 15 dividend per share (in total HUF 15,633 million).

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 provider 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 37).

The Company was incorporated in Hungary on December 31, 1991 and commenced business on January 1, 1992. The Company's registered office is Krisztina körút 55., 1013 Budapest, Hungary. Name of the Court of Registration and the registration number of the Company: Metropolitan Court as Court of Registration, Cg. 01-10-041928.

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. Magyar Telekom terminated the registration of its shares and ADSs in the US in February 2012. The Company maintains its American Depository Receipt program on a Level I basis.

The ultimate controlling parent of Magyar Telekom is Deutsche Telekom AG (DT or DTAG). Deutsche Telekom Europe B.V. (Stationsplein 8, 6221 BT Maastricht, the Netherlands), a member of the Deutsche Telekom Group, is the direct owner of 59.21% of the Company's issued shares and voting rights.

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

The Company's Board of Directors (the Board) accepted the submission of these consolidated financial statements of the Company on February 22, 2017 to the Annual General Meeting (AGM) of the owners, which is authorized to approve these financial statements, but also has the right to require amendments before approval. As the controlling shareholders are represented in the Board of the Company that accepted the submission of these financial statements, the probability of any potential change required by the AGM is extremely remote, and has never happened in the past.

Magyar Telekom Plc.'s corporate website is: [www.telekom.hu](http://www.telekom.hu)



## 1.2 Composition of the Group

At December 31, 2015 and 2016 the principal operating subsidiaries of the Group were as follows:

Subsidiaries	Group interest in capital as at December 31,		Activity
	2015	2016	
<u>Incorporated in Hungary:</u>			
T-Systems Magyarország Zrt., Budapest .....	100.00%	100.00%	System integration and IT services
GTS Hungary Kft., Budapest .....	100.00%	100.00%	Alternative ICT provider
Origo Zrt., Budapest .....	100.00%	0.00% (a)	Internet and TV content provider
Telekom New Media Zrt., Budapest .....	100.00%	100.00%	Interactive service provider of telecommunications applications
<u>Incorporated in Macedonia:</u>			
Makedonski Telekom A.D., Skopje (MKT)	56.67%	56.67%	Telecom service provider
Stonebridge A.D., Skopje.....	100.00%	100.00%	Holding company
<u>Incorporated in Montenegro:</u>			
Crnogorski Telekom A.D., Podgorica (CT) .....	76.53%	76.53%	Telecom service provider
<u>Incorporated in Romania:</u>			
Combridge S.R.L., Bucharest.....	100.00%	100.00%	Wholesale telecom service provider
<u>Incorporated in Bulgaria:</u>			
Novatel EOOD, Sofia .....	100.00%	100.00%	Wholesale telecom service provider

At December 31, 2015 and 2016 the joint ventures of the Group were as follows:

Joint ventures	Group interest in capital as at December 31,		Activity
	2015	2016	
<u>Incorporated in Hungary:</u>			
E2 Hungary Zrt., Budapest .....	50.00%	50.00%	Energy services to business customers

(a) In December 2015, the Company signed a share purchase agreement for the sale of the total of its 100% shareholding in Origo Zrt. The closing of the transaction took place in February 2016 (Note 11.1).

The Group's interest in the capital of the above subsidiaries equals the voting rights therein. There is no entity in the Group that is not controlled even though more than half of the voting rights are held. There is no significant entity in the Group that is controlled even though less than half of the voting rights are held.

All subsidiary undertakings are included in the consolidation.

## 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 endorsed by the EU effective as at December 31, 2016 and applicable to Magyar Telekom had been adopted. These consolidated financial statements also comply with the Hungarian Accounting Act on consolidated financial statements, which refers to the IFRS as endorsed by the EU.

The consolidated financial statements are presented in millions of HUF unless stated otherwise.

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 2016

IFRS 11 (amended) The amendment to IFRS 11 explicitly requires the acquirer of an interest in a joint operation in which the activity constitutes a business to apply all of the principles on business combinations accounting in IFRS 3. The application of the amended standard did not result in significant changes in the financial statements of the Group.

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

Certain new accounting standards, interpretations and their amendments have been published that are not mandatory for 31 December 2016 reporting periods and have not been early adopted by the Group. The Group's assessment of the impact of these new standards and interpretations is set out below.

Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 9 Financial Instruments	IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting. In December 2011, in November 2013 and in July 2014, the IASB amended the standard in order to make further changes to the classification and measurement rules and also introduced a new impairment model. These latest amendments now complete the new financial instruments standard.	The adoption of the new standard and its amendments will likely result in changes in the financial statements of the Group, the exact extent of which we are currently analyzing.	The application of the new standard and its amendments is required for annual periods beginning on or after January 1, 2018. Earlier application is permitted.  The European Union has endorsed the standard and its amendments.

Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 15 Revenue from Contracts with Customers	<p>The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and new guidance for multiple-element arrangements.</p>	<p>The adoption of the new standard will result in significant changes in the financial statements of the Group, primarily in respect of the timing of revenue recognition and in respect of capitalization of costs of obtaining a contract with a customer and contract fulfilment costs. The timing of revenue recognition and the classification of our revenues as either service or equipment revenue will be affected due to the allocation of consideration in multiple element arrangements no longer being affected by limitation cap methodology. Considering the current business models, the impact of applying the new standard would result in allocating more revenues upfront. Our operations and associated systems are complex and the currently estimated time and effort necessary to develop and implement the accounting policies, estimates, judgments and processes to comply with the new standard is expected to span a substantial time. As a result, at this time, it is not possible to make reasonable quantitative estimates of the effects of the new standard.</p>	<p>The application of the new standard is required for annual periods beginning on or after January 1, 2018. Earlier application is permitted.</p> <p>The European Union has endorsed this standard.</p>

Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 16 Leases	<p>IFRS 16 requires entities when they are a lessee, to</p> <ul style="list-style-type: none"> <li>▪ recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments on the statement of financial position, initially measured at the present value of non-cancellable lease payments (including inflation-linked payments), and payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease;</li> <li>▪ recognize amortization of right-of-use assets and interest on lease liabilities over the lease term; and</li> <li>▪ separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the statement of cash flows.</li> </ul>	<p>The most significant effect of IFRS 16 will be an increase in right-of-use assets and lease liabilities, the extent of which will have to be determined after thorough analysis. The Group mainly leases cell sites, rooftops, office buildings and retail shops, line and access networks, space on masts or towers and cars that will be affected by the new standard. Details of the Group's leases (including lease commitments) are disclosed in note 33. On the lessor (sell) side, MT Group will mainly have to analyze the extent of which multiple element arrangements with embedded leases may be affected by the revised definition of leases. Other than that, we do not expect a considerable impact on the financial statements of the Group at this time, as lessor accounting itself is not changing significantly through the introduction of IFRS 16.</p>	<p>An entity is required to apply IFRS 16 for annual periods beginning on or after 1 January 2019 and permits to apply the new Leases Standard early, if the entity also applies IFRS 15 Revenue from Contracts with Customers at or before the date of early application.</p> <p>The European Union has not yet endorsed this standard.</p>

There are no other standards or amendments that are not yet effective and that would be expected to have a material impact on the Group in the current or future reporting periods and on foreseeable future transactions.

## 2.2 Consolidation

### 2.2.1 Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

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. 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 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.

As for the measurement of non-controlling interest, 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. 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.

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. The consolidated financial statements include the results of subsidiaries acquired from parties under common control from the date of the closing of the transaction.

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 such disposals.

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 (Other income).

Inter-company transactions, balances and unrealized gains or losses 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.



### **2.2.2 Associates and joint arrangements**

Associates are entities over which the Group has significant influence but not control, generally reflecting a voting right between 20% and 50%.

Joint arrangements are arrangements where the parties are bound by a contractual arrangement of which two or more parties have joint control and which exist only when decisions about the relevant activities require the unanimous consent of the parties sharing the control.

If the parties that have joint control of the arrangement have rights to the net assets of the arrangement, it is a joint venture.

If the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement, it is a joint operation.

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 are adjusted where necessary to ensure consistency with the policies adopted by the Group.

In case of a joint operation, the assets, liabilities, revenues and expenses relating to the joint operation are recognized to the extent of the Group's interest in the joint operation.

For further information on the associates and joint arrangements of the Group see note 14.

## **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.
- Items of Profit or loss and other comprehensive income are translated at annual cumulated average exchange rates.
- All resulting exchange differences are recognized 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 until the date of the sale are recognized in the Profit for the year as part of the gain or loss on sale (Other operating income).

## 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 and other financial liabilities.

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 cash inflows or outflows are discounted by market based interest rates interpolated from the official HUF and EUR Interest Rate Swap.

The fair value of long term financial liabilities is also determined by using discounted cash flow valuation technique. The expected cash inflows or outflows are discounted by market based interest rates interpolated from the official HUF and EUR Interest Rate Swap. 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 (FVTPL)
- loans and receivables
- available-for-sale (AFS)

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

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 incurred for the purpose of selling immediately or in the near term and thus classified as “held for trading”
- Derivative financial assets not involved in an effective hedge relationship are classified as “held for trading”

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

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

- cash and cash equivalents
- bank deposits with original maturities over 3 months
- trade receivables
- employee loans
- other receivables

Loans and receivables are initially recognized at fair value plus any directly attributable transaction costs 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 any impairment on cash and cash equivalents occur, it would be recognized in the Profit for the year (Other finance expense – net).

**(b) Bank deposits with original maturities over 3 months**

Bank deposits with original maturities over 3 months include bank deposits and other liquid deposits and securities with original maturities over three months.

Should any impairment on bank deposits with original maturities over 3 months occur, it would be recognized in the Profit for the year (Other finance expense – net).

**(c) Trade and other receivables**

Trade receivables include the receivables for the services rendered from the customers of the Group while other receivables mainly include advances and prepayments.

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 (Direct cost – 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 more than 1 year 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 other receivable is established to be uncollectible, it is written off with a parallel release of cumulated impairment against Direct costs 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 profit or loss.

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 Direct costs (Bad debt expense).

#### (d) 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 (Other non current assets). 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).

#### 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 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 Other current financial assets.

The AFS measurement category includes:

- 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 AFS financial assets are recognized in Accumulated other comprehensive income (Revaluation reserve for AFS financial assets).

Interest on AFS debt securities calculated using the effective interest method is recognized in the Profit for the year (Interest income). Dividends on AFS equity instruments are recognized in the Profit for the year (Interest income) 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 or loss 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 (Accumulated other comprehensive income) are reclassified from Accumulated other comprehensive income to Profit for the year (Other finance expense – net).

#### 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 derecognize 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 financial liabilities

Loans and other financial liabilities 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 liabilities.

##### (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.

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

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

The Group does not apply hedge accounting, therefore, all derivatives are measured at fair value through profit or loss.

Derivatives are initially recognized at fair value at the date a derivative contract is entered into and their fair values are re-measured at subsequent balance sheet 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 as currencies commonly used in the Group’s operating area except Montenegro, where USD is not commonly used.

#### 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 4.4). 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.

Impairment losses on Inventories are recognized in Other operating expenses.

#### 2.6 Non current assets held for sale

An asset (typically real estate) 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 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 item of PPE or intangible assets 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 has to 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 and borrowing costs. Computer software development costs recognized as assets are amortized over their estimated useful lives. Most computer software capitalized include acquired elements representing the majority of the cost and own costs incurred to a lesser extent. These are considered as non self developed software. Computer software fully developed by own resources represent an immaterial portion of all software, therefore these are not disclosed separately.

Costs associated with the acquisition of long term frequency licenses are capitalized. The present value of the future annual payments for the use of the frequencies are also capitalized if these payments can be estimated reliably, or otherwise recognized as Other operating expenses in the year the payment obligation refers to. 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. Renewal periods are considered in the determination of useful life only if we are sure that it will be realized without further consideration to be transferred.

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 allocated 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 allocates goodwill to its cash generating units determined at operating segment level. See also Note 4.2. Operating segments may include one clearly identifiable company or a group of companies, or certain components of one company and other companies as well.

The Group establishes the segments' 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 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 profit or loss.

## 2.10 Provisions and contingent liabilities

Provisions are recognized when Magyar Telekom has a present legal or constructive obligation (excluding executory contracts) 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 profit or loss line where the actual expense is expected to be incurred. When a provision is released unused, it is released to the same line of the statement of profit or loss where it was originally provided for.

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 (excluding executory contracts) 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.

Customers of the Group are often 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 has collected (or waived) the undelivered element of the deemed bundle.

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

### 2.12.1 Mobile and Fixed line 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, i.e. 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 revenue allocable to a delivered item, however, is limited to the amount that is not contingent upon the delivery of additional items (the non contingent amount). The revenue to be recognized is therefore restricted by the amount received that is not contingent upon undelivered elements of the arrangement.

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. In case the equipment is sold on installments with payment terms exceeding 12 months, the amount of the revenue immediately recognized is the present value of the installments.

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

Revenues from premium rate services 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 determines 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 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 (SI) 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 related costs of these revenues are recognized when the 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 total expected loss is recognized immediately (Direct costs) against a provision.

### **2.12.3 Energy retail revenues – gas and electricity**

Magyar Telekom Plc. entered the liberalized Hungarian gas and electricity retail market in 2010. The purpose of Magyar Telekom Plc.'s participation in the energy market has been to provide more integrated services to its residential and business customers. Magyar Telekom has offered a fixed percentage discount on the energy bills of its residential telecommunications service customers compared to the incumbent service providers' offers at the location of the customers, thereby also ensuring customer retention. We usually offered individual prices to our business customers.

The annual quantity of the electricity and natural gas consumption is estimated based on the actual customer number and their expected consumption as well as historic weather inputs. These estimates are calculated and continuously updated by customer segment in the energy market: universal residential, universal small business and competitive market clients. These segments are further broken down to sub-groups based on their pricing characteristics so that energy costs and revenues can be estimated with

adequate reliability. As time passes during the year, more and more accurate estimates are available for both costs and revenues. Costs and revenues are continuously updated on a year-to-date basis.

Revenues from large business customers (competitive market) are recognized and invoiced based on their actual consumption. Revenues from universal customers are invoiced at flat fee for 11 months, based on the previous year's consumption and the difference between the flat fees charged and the metered annual consumption is settled in the 12th month. Revenues, however, are recognized based on estimated actual consumption throughout the customer year, the beginning of which may be at any time in the year depending on the customer contract date. Due to the large number of customers and sufficient historical data (portfolio effect), the estimated consumption and the resulting costs and revenues are not materially different from the actual amounts.

Revenues from energy retail services are recognized on a gross basis as the delivery of the service is the responsibility of the Company, we determine the prices of these services and bear substantial risks of estimating and purchasing the gas and electricity quantities, resulting in significant "inventory" risks of under or over purchasing the consumed quantities.

## **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 provision, 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. and DT AG are listed and actively traded on the stock exchanges, the share prices and their history are readily available as a basis for fair value calculations.

Bonuses tied to the long term performance of the Magyar Telekom and Deutsche Telekom shares are recognized in the Profit for the year at their time-proportioned fair value 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.

## 2.14 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, usually 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 assets are recognized for all deductible temporary differences arising on investments in subsidiaries, associates and joint ventures to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

Deferred tax liabilities are recognized for all taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, except to the extent that 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 revenue 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 (Other 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 lease liability and interest expense so as to achieve a constant rate of interest on the outstanding 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 (Other 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

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 8–10 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 system integration/information technology (SI/IT), to a lesser extent, from inter-segment support services. In order to concentrate on real performance achieved on third party transactions, the number of overhead related inter-segment cross-charges applied within the organizations of Magyar Telekom Plc. operating in different segments is fairly limited.

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 segment level.

Another important KPI monitored at segment level is capital expenditure (Capex), which is determined as the annual investments in PPE and Intangible assets.

## 2.21 Comparative information

In order to maintain consistency with the current year presentation in the Financial statements and the Notes thereto, certain items have been reclassified for comparative purposes. Material changes in disclosures, are described in detail in the relevant Notes. In 2016 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 leading Hungarian or international financial institutions or Deutsche Telekom. 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 for the reported periods are subject to an average effective income tax rate of approximately 25%, 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 legislations. 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:

- foreign currency risk
- interest rate risk
- 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 KPIs, and monitors their fulfillment annually. At the end of 2016 Magyar Telekom fulfilled both criteria; Total Debt to EBITDA ratio of 1.99 in 2016 (2015: 2.34), the allowed maximum of which would be 2.8 and EBITDA to Interest Expense ratio of 7.34 in 2016, (2015: 6.65), the allowed minimum of which would be 3.0. The Group's Treasury 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's Treasury 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 (2016) and the preceding reporting period (2015). 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. The methods and assumptions used in the sensitivity calculations did not change significantly compared to the previous period. 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 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.

In order to mitigate FX risk in case of FX denominated financial instruments, 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

Several related party loans taken to finance general needs of the Group from the financing vehicle of Deutsche Telekom, Deutsche Telekom International Finance B.V. (DTIF) are denominated in EUR, while, at the same time, cross-currency interest rate swaps are concluded with Deutsche Telekom AG (DT 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.

**Sensitivity analysis**

A reasonably possible strengthening or weakening of the EUR in the table below against HUF as at the end of the reporting period would have affected the measurement of financial instruments denominated in a foreign currency and increased (+)/ decreased (-) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant and ignores any impact of forecast sales and purchases. As the profit or loss effect would be the same as the equity effect, only the former is disclosed.

**In HUF millions**

	<b>Profit or loss</b>	
	<b>Strengthening</b>	<b>Weakening</b>
<b>At December 31, 2016</b>		
EUR/HUF (5% movement)		
Loan .....	(5,546)	5,546
Swap agreements .....	6,041	(6,041)
Net effect .....	495	(495)
<b>At December 31, 2015</b>		
EUR/HUF (5% movement)		
Loan .....	(3,218)	3,218
Swap agreements .....	3,543	(3,543)
Net effect .....	325	(325)

**(b) 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 operators 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 short term 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 liabilities (other than the above described loans) exceed the Group's foreign currency denominated assets, therefore changes of the functional currencies' exchange rates would have the following impact on the profit of the Group.

In order to reduce the above exposure, Magyar Telekom occasionally enters into derivative contracts. The positive fair value of the open short term forward positions was HUF 0.1 billion as of December 31, 2016 (2015: HUF 0.1 billion asset). These positions were opened to hedge the FX risks of future FX payments exceeding FX income.

**Sensitivity analysis**

A reasonably possible strengthening or weakening of the currencies in the table below against HUF and MKD as at the end of the reporting period would have affected the measurement of financial instruments denominated in a foreign currency and increased (+)/decreased (-) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant and ignores any impact of forecast sales and purchases. As the profit or loss effect would be the same as the equity effect, only the former is disclosed.

**In HUF millions**

	<b>Profit or loss</b>	
	<b>Strengthening</b>	<b>Weakening</b>
<b>At December 31, 2016</b>		
EUR/HUF (5% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances .....	(655)	655
Forward agreements .....	467	(467)
Net effect .....	<u>(188)</u>	<u>188</u>
USD/HUF (10% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances .....	(588)	588
Forward agreements .....	200	(200)
Net effect .....	<u>(388)</u>	<u>388</u>
EUR/MKD (10% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances .....	(87)	87
Forward agreements .....	0	0
Net effect .....	<u>(87)</u>	<u>87</u>
USD/MKD (10% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances .....	18	(18)
Forward agreements .....	0	0
Net effect .....	<u>18</u>	<u>(18)</u>



In HUF millions

	Profit or loss	
	Strengthening	Weakening
<b>At December 31, 2015</b>		
EUR/HUF (5% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank ..	(1,056)	1,056
Forward agreements .....	1,897	(1,897)
Net effect .....	841	(841)
USD/HUF (10% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank ..	(931)	931
Forward agreements .....	63	(63)
Net effect .....	(868)	868
EUR/MKD (10% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank ..	(210)	210
Forward agreements .....	0	0
Net effect .....	(210)	210
USD/MKD (10% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank ..	22	(22)
Forward agreements .....	0	0
Net effect .....	22	(22)

As a result of the volatile international capital and securities markets, even a more than 5% fluctuation of the functional currency HUF against EUR, a more than 10% fluctuation of the functional currency HUF against USD and a more than 10% 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 Other finance expense - net (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 mostly 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 affect the cash flows from these instruments.

Due to the extremely low interest rates, even a reasonably possible change in the interest rates would not have a significant impact on the Group's interest income.

**(b) Financial liabilities**

Financial liabilities exposed to interest rate risk are primarily the related party (DTIF, DT AG) 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 76% of the Group's total debt as of December 31, 2016 (2015: 76%).

***Cash-flow sensitivity analysis for variable rate instruments***

Floating interest-bearing debts (including loans swapped to floating interest and excluding loans swapped to fixed interest) made up 24% of the Group's total debt as of December 31, 2016 (2015: 24%).

A reasonably possible change of 100 basis points in interest rates during the reporting period (assuming the year-end balance throughout the reporting period) would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency exchange rates, remain constant. As the profit or loss effect would be the same as the equity effect, only the former is disclosed.

In HUF millions	Profit or loss	
	100bp increase	100bp decrease
<b>At December 31, 2016</b>		
Floating rate instrument .....	(558)	558
IR swap .....	(228)	228
Cash-flow sensitivity (net) .....	(786)	786
<b>At December 31, 2015</b>		
Floating rate instrument .....	(638)	638
IR swap .....	(232)	232
Cash-flow sensitivity (net) .....	(870)	870

**3.1.1.3 Price risk**

As at December 31, 2015, Magyar Telekom had legally binding agreements on natural gas and electricity purchase, which could be materially affected by risk variables such as energy exchange prices or FX prices, or other indices. In order to minimize the risk deriving from such price changes Magyar Telekom made the necessary economic hedge actions for much of the exposure, therefore no relevant risk remained in this field, as a result no sensitivity information for price risk is disclosed. As Magyar Telekom transferred its business energy operations to E2 from 2016, there were no such agreements as at December 31, 2016. See also Note 8.2 and 14.2.

### 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 end of the reporting period 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 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, most of which have short term maturities.

In line with the Group's risk management policy Magyar Telekom Group companies deposit the vast majority of excess cash in banks rated at least BBB+ (or equivalent), or make efforts to get guarantees for these fixed term deposits from banks rated at least BBB+. We, however, also have current accounts in banks with lower rating than this. Moreover, Magyar Telekom prefers to deposit in banks which grants loans to Magyar Telekom to make the compensation of debts and loans possible 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 to 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. There was no significant amount of deposits placed by the Montenegrin subsidiary as of December 31, 2016 (2015: HUF 7.5 billion) while the deposits in Macedonia of HUF 4.2 billion as of December 31, 2016 (2015: HUF 5.2 billion) are fully covered with bank guarantees issued by international financial institutions rated at BBB.

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. The vast majority of these balances are denominated in the functional currency of the countries of operations (HUF in Hungary, MKD in Macedonia and EUR in Montenegro).

In HUF millions	At December 31,	
	2015	2016
Hungary .....	121,910	121,398
Macedonia .....	16,166	15,459
Montenegro .....	7,867	8,882
Other .....	1,137	967
	<u>147,080</u>	<u>146,706</u>

The amounts in the table above are shown net of provisions for impairment losses. The annual bad debt expense of the Group in 2016 was 1.4% (2015: 1.5%) 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 2016 (2015: HUF 6.6 billion) considering only the continuing operations.

There are varying credit checking practices applied across the members of the Group as described below.

## Hungary

Credit checking at the time of the service request is carried out automatically by the credit checking application. 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, reminder message via Telekom APP, telephone calls, reminder letters, reminder emails, restricted service, termination letters and disconnections. In case of medium and large enterprises dunning process starts manually (first reminder letter). After the first step, this process is also automated. Based on the effective laws and regulations and 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 creditability checking and prevention barring, corrective measures during legal relationship for example reminding and disconnection activities, collaboration with collection agencies and collection after legal relationship as litigation process, court proceedings, involvement of the executive unit and factoring. The overdue payments are monitored through a debt escalation procedure based on customer type, credit class and amount of debt, as well as average invoiced amount and number of disconnections. 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 previous traffic revenues. 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

Since 2010, when Customer finance department was formed, a number of processes related to limitation of credit risk have been established, changed and improved. In the period 2010-2014 Montenegro had a constant decline of Bad debt expense and overall improvement of collection rates. In 2015 bad debt results reflected fact that implementation of new billing and delay or skip in dunning process leads to lower collection and increased costs. Together with new billing and CRM a number of processes have been changed including dunning and credit checking processes. These processes were under permanent monitoring and improvement during 2016 too. In 2016, focus was on business customers as well as on new residential customers. Fraud prevention and revenue assurance processes were also affected and the goal was to keep the previously reached level of risk protection while the new system is in stabilization phase by avoiding larger incidents.

### 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's Treasury management aims at maintaining flexibility in funding by keeping committed credit lines available. The undrawn credit lines amounted to HUF 29.7 billion as at December 31, 2016 (2015: HUF 29.0 billion), and the Company also had uncommitted credit lines from Hungarian Banks as at December 31, 2016 and 2015. In addition to the above, Deutsche Telekom confirmed its readiness to finance Magyar Telekom Group's budgeted financing needs until the end of June 2018.

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, 2016 and 2015. 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, 2016 (in HUF millions)**

	<b>Total</b>	<b>within 1 year</b>	<b>1 to 5 years</b>	<b>after 5 years</b>
Trade payables .....	136,623	136,623	-	-
Financial liabilities to related parties .....	348,842	77,082	271,760	-
Bank loans .....	11,534	11,534	-	-
Finance lease liabilities .....	12,429	3,461	4,984	3,984
Other financial liabilities .....	55,175	8,755	15,095	31,325
Total other financial liabilities .....	79,138	23,750	20,079	35,309
Total cash flows	564,603	237,455	291,839	35,309
<u>Open swap positions' cash flows</u>				
Gross cash inflow in EUR million .....	389	36	353	-
Gross cash inflow in HUF million (at spot rate) .....	120,987	11,197	109,790	-
Gross cash outflow in HUF million .....	(124,137)	(10,655)	(113,482)	-
Net cash inflow in HUF million	(3,150)	542	(3,692)	-
<u>Open forward positions' cash flows</u>				
Gross cash inflow in EUR million .....	30	30	-	-
Gross cash inflow in USD million .....	7	7	-	-
Total gross cash inflow in HUF million (at spot rate).....	11,386	11,386	-	-
Gross cash outflow in HUF million .....	(11,230)	(11,230)	-	-
Net cash inflow in HUF million .....	156	156	-	-



<u>December 31, 2015 (in HUF millions)</u>	<u>Total</u>	<u>within 1 year</u>	<u>1 to 5 years</u>	<u>after 5 years</u>
Trade payables .....	140,182	140,182	-	-
Financial liabilities to related parties .....	392,649	145,087	205,427	42,135
Bank loans .....	13,278	13,278	-	-
Finance lease liabilities .....	15,277	4,953	6,057	4,267
Other financial liabilities .....	59,559	9,412	34,706	15,441
Total other financial liabilities .....	88,114	27,643	40,763	19,708
Total cash flows	620,945	312,912	246,190	61,843
<u>Open swap positions' cash flows</u>				
Gross cash inflow in EUR million .....	234	10	90	133
Gross cash inflow in HUF million (at spot rate) .....	73,164	3,243	28,297	41,624
Gross cash outflow in HUF million .....	(72,833)	(2,914)	(27,438)	(42,481)
Net cash inflow in HUF million	330	329	859	(857)
<u>Open forward positions' cash flows</u>				
Gross cash inflow in EUR million .....	121	121	-	-
Gross cash inflow in USD million .....	2	2	-	-
Total gross cash inflow in HUF million (at spot rate).....	38,553	38,553	-	-
Gross cash outflow in HUF million .....	(38,607)	(38,607)	-	-
Net cash inflow in HUF million.....	(55)	(55)	-	-

The average maturity of Magyar Telekom's debt portfolio was 2.64 years as at December 31, 2016 (2015: 2.46 years). The floating interest payments arising from the financial instruments were calculated using the last interest rates fixed before December 31, 2016 and 2015.

### 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 optimum 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 2015 and 2016, the Group's mid and long term target as approved by the Board was to maintain a gearing ratio within 30% to 40%. The gearing ratio at December 31, 2016 was 39.3% (2015: 42.9%). The Company paid HUF 15 dividend per share in 2016, and as a result of the improving trend, the Company's Board recommends to declare a HUF 25 dividend per share at the April 2017 Annual General Meeting.

In addition to the above, according to the Hungarian Civil Code, Magyar Telekom Plc. has to ensure that the Company's Equity under local GAAP 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 581 billion on December 31, 2016 (2015: HUF 545 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 prevailing 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 13 billion (2015: HUF 13 billion). See Notes 12 and 13 for the changes made to useful lives in 2016.

The Group constantly introduces a number of new services or platforms including, but not limited to, the 3G 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 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 proved 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 operating segments of the Group: MT-Hungary, Macedonia and Montenegro in 2016 and Telekom Hungary, T-Systems, Macedonia and Montenegro in 2015. Magyar Telekom changed its reporting structure in 2016. See also Note 32.

In 2016 and 2015, no goodwill had to be impaired.

The tables below show the WACCs and PGRs used in the fair value calculations of the Group's operating segments for the goodwill impairment test conducted in 2016 and 2015. The tables below also include sensitivity analyses that show how much impairment would have been recognized as at December 31, 2016 or 2015 for the goodwill allocated to the operating segments if we changed the sensitive parameters in the calculations.

In 2016 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 25% lower than projected cash flow stream would have on the goodwill.

<b>2016</b>	<b>MT-Hungary</b>	<b>Macedonia</b>	<b>Montenegro</b>
<b><u>WACC</u></b>			
Used in the calculation	6.68%	7.17%	9.70%
If changed to	8.68%	9.17%	11.70%
Potential impairment (HUF million)	-	6,128	1,104
<b><u>PGR</u></b>			
Used in the calculation	1.0%	1.0%	0.0%
If changed to	-4.0%	-4.0%	-5.0%
Potential impairment (HUF million)	-	9,877	261
<b><u>Cash-flow</u></b>			
If changed by	-10%	-10%	-10%
Potential impairment (HUF million)	-	-	-
If changed by	-25%	-25%	-25%
Potential impairment (HUF million)	-	7,050	4,755



In 2015 we disclosed what impact a 2 percentage point increase of the WACC would have on the goodwill. In case of the PGRs we disclosed what impact a 5 percentage point decrease of the PGR would have on the goodwill. In case of the cash flow projections we disclosed what impact a 10% or a 25% lower than projected cash flow stream would have on the goodwill.

2015	Telekom Hungary	T-Systems	Macedonia	Montenegro
<b>WACC</b>				
Used in the calculation	7.00%	7.62%	8.17%	7.64%
If changed to	9.00%	9.62%	10.17%	9.64%
Potential impairment (HUF million)	-	-	252	-
<b>PGR</b>				
Used in the calculation	1.0%	1.0%	1.0%	0.0%
If changed to	-4.0%	-4.0%	-4.0%	-5.0%
Potential impairment (HUF million)	-	-	1,337	-
<b>Cash-flow</b>				
If changed by	-10%	-10%	-10%	-10%
Potential impairment (HUF million)	-	-	-	-
If changed by	-25%	-25%	-25%	-25%
Potential impairment (HUF million)	-	-	2,202	-

The table below shows what changes can be observed in the 10 year plans prepared in 2015 compared to those prepared in 2016.

	Telekom Hungary	T-Systems	Macedonia	Montenegro
Cumulative average growth rate of revenues during the 10 years compared to 2016	n.a.	n.a.	-0.1%	-0.6%
Cumulative average growth rate of revenues during the 10 years compared to 2015	-0.5%	3.3%	0.0%	-1.0%
Cumulative average growth rate of EBITDA during the 10 years compared to 2016	n.a.	n.a.	1.7%	0.1%
Cumulative average growth rate of EBITDA during the 10 years compared to 2015	1.7%	5.8%	1.3%	-0.4%
Cumulative average growth rate of Capex during the 10 years compared to 2016	n.a.	n.a.	0.0%	-11.8%
Cumulative average growth rate of Capex during the 10 years compared to 2015	-3.7%	0.9%	-2.3%	-2.1%

Magyar Telekom's management believes that preparing the value in use (VIU) calculation was unnecessary, since it would have resulted in a lower 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 decline sharply on a long term. Consequently, we did not prepare the value in use calculations for any of the segments.

#### **4.3 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 annually, 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. 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.

#### **4.4 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 18.1 billion in 2016 (2015: HUF 18.9 billion). In addition, agent fees amounted to HUF 7.1 billion in 2016 (2015: HUF 7.1 billion), while the Group's marketing costs amounted to HUF 12.6 billion in 2016 (2015: HUF 13.3 billion).

#### **4.5 Annual fees of mobile licenses**

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 and annual payments. It is judgmental whether we consider the annual fees to be reliably estimable or not. If we consider that we can reliably estimate these annual fees, the present value of those are capitalized as part of the cost of the license, otherwise these are recognized as costs in the period they relate to.

As the conditions of the new license contract concluded in Hungary in 2014 and 2013 (see Note 37.1) substantially changed compared to the old ones, in addition to the initial cost of the new frequencies in 2014 (HUF 59 billion) and the renewal of the old ones in 2013 (HUF 38 billion) we also recognized the discounted present value of the future annual license fees (HUF 39 billion in 2014 and HUF 17 billion in 2013).

In 2013 Magyar Telekom concluded an Authority Contract with the National Media and Infocommunications Authority (NMIAH) on the prolongation of the then existing 900 MHz and 1800 MHz frequencies until April, 2022. The Contract included provisions on lowering the annual fee of these and the 2100 MHz bands in the form of a legislation. The reduction of the annual fees was a result of the Hungarian mobile operators' years of interest enforcement efforts as former fees were far higher than the European average. The probability of the modification of these Authority Contract based fees prior to the expiry of the term has become very low as the parties agreed in all terms and provisions of the contract, including the reduced fees of the bands, until 2022. It would be unprecedented that the annual fees change prior to the expiry of the term of the contract. While the mobile operators took significant efforts prior to the recent amendment to reduce the fees, the lowered fees in the newly concluded contract are more favorable for MT than the fee in the authority decree. Based on the same consideration, the mobile operators also initiated the reduction of the fees of those bands that were outside the scope of the modification of the Authority Contract. The fee of the 2100 MHz band, which can be used until 2019, was reduced by 50% pursuant to the relevant National Media and Infocommunications Authority decree and this was such an extensive reduction that it makes the revision of the fees until the expiry of the contracts in 2019 very unlikely. The mobile operators had reached their objectives as the annual fee obligation was significantly reduced and it is now aligned to the EU trends.



The Authority Contract concluded between the Company and the NMIAH in October 2014 on the use of the new 800MHz, 900 MHz and 1800 MHz frequency bands also includes annual fees that are in line with the ones achieved in 2013, i.e. we considered them reliably estimable to capitalize their discounted present value as part of the cost of the license.

In 2016 Crnogorski Telekom concluded a Contract with the Agency for Electronic Communications and Postal Services of Montenegro (the Agency) on the prolongation of the then existing 900 MHz, 1800 MHz, 2100 MHz and 1900 MHz frequencies until 2031. In addition, Crnogorski Telekom won the rights of use of the 800 MHz FDD and 2600 MHz FDD and TDD frequency blocks in the tender for spectrum licences. See also Note 13 and 37.6. In total the one-off license fee was EUR 27.3 million (approximately HUF 8.5 billion) which was paid in 2016. As this agreement also included annual fees that we considered reliably estimable, their discounted present value was capitalized as part of the cost of the license.

In case of the other frequency license fees of the Group, we did not consider the annual fees to be reliably estimable at the time of acquisition, therefore, those were not capitalized.

## 5 CHANGES IN THE GROUP

### 5.1 Business combinations

#### 5.1.1 Cable TV network and operations

In 2016 and 2015, the Group acquired a number of cable TV businesses in individually insignificant transactions. All these acquisitions qualified as business combinations of the MT-Hungary operating segment. The vast majority of the total purchase price was paid in cash in 2016 and 2015.

The table below shows the summary of the individually insignificant transactions.

In HUF millions	2015	2016
Consideration transferred .....	2,265	58
Less: Fair value of the net assets acquired .....	2,233	39
Add back: Difference between the preliminary and final PPA value .....	-	188
Goodwill .....	32	207

#### 5.1.2 GTS Hungary

The Company acquired a 100% stake in GTS Hungary Kft. from Deutsche Telekom as of April 1, 2015. GTS Hungary is an information and communications technology provider in Hungary that provided fixed voice, internet, data and IT services to ca. 7 thousand business customers and also provided fixed internet and telephony services to ca. 11 thousand residential clients across Hungary, while had a strong domestic and international wholesale operation as well at the time of the acquisition.

The initial purchase price of HUF 14,179 million was paid in April 2015, and additional HUF 90 million was paid in August 2015 based on the actual net cash and working capital of GTS Hungary at the closing of the transaction. GTS Hungary has been a consolidated subsidiary of the Group since April 1, 2015, included in the Telekom Hungary operating segment.

As the business combination took place within the Deutsche Telekom Group, the Company recognized the transaction on the carrying values of GTS Hungary's assets and liabilities as recorded in DT's books as at March 31, 2015, following the common control exemption of IFRS3 by analogy.



The carrying values of assets and liabilities acquired as well as the consideration transferred are disclosed in the table below.

In HUF millions	Carrying values
Consideration transferred .....	14,269
Less: Net assets acquired .....	(13,162)
Difference recognized in retained earnings .....	1,107
 <u>Net assets acquired:</u>	
Cash and cash equivalents.....	1,815
Trade and other receivables.....	1,560
Income tax receivables.....	43
Property, plant and equipment .....	5,480
Intangible assets .....	6,181
Trade and other payables.....	(1,917)
	13,162

The total purchase price was paid in cash in 2015.

Under the Hungarian Accounting Act goodwill is recognized on GTS Hungary, the total amount of which is HUF 6,097 million. There is also no goodwill amortization under the Hungarian Accounting Act, but in case of impairment, the total amount of goodwill recognized is tax deductible according to the corporate tax law prevailing in 2015.

## 5.2 Disposals of subsidiaries

In 2016 Magyar Telekom sold its 100% shareholding in Origo Zrt. This subsidiary was not considered a separate cash generating unit, therefore it did not constitute a discontinued operation. In the Consolidated Statements of cash flows the proceeds from the sale of subsidiaries and business units are disclosed net of the Cash and cash equivalents of the subsidiaries sold. See also note 11.1.

## 5.3 Pro forma information

The following pro forma information shows the most important financial data of the Group, as if the business combinations that took place in that year had been consolidated from the beginning of the year of acquisition, and also how much the business combination contributed to the reported figures since the acquisition date. The table below includes no pro forma information for the cable TV acquisitions in 2016 and 2015 as they were insignificant therefore their contribution to the Group's operations was also insignificant. As Origo was sold on February 5, 2016, and its exclusion from the Group's operations was not significant, it does not effect the proforma information.

In HUF millions	2015	2016
<u>Revenues</u>		
Reported .....	656,342	602,651
Pro forma – if consolidated from beginning of year .....	658,263	n.a.
Current year contribution .....	6,798	n.a.
 <u>Profit for the year</u>		
Reported .....	31,547	57,223
Pro forma – if consolidated from beginning of year .....	31,510	n.a.
Current year contribution .....	1,943	n.a.

## 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.

In HUF millions	At December 31,	
	2015	2016
Cash on hand .....	200	111
Cash in bank (demand deposits) .....	12,590	7,398
Bank deposits with original maturities less than 3 months .....	4,768	3,296
	<u>17,558</u>	<u>10,805</u>

Average interest rates	At December 31,	
	2015	2016
Cash on hand .....	0.00%	0.00%
Cash in bank (demand deposits) .....	0.10%	0.03%
Bank deposits with original maturities less than 3 months .....	0.19%	0.35%
Average interest rate .....	<u>0.12%</u>	<u>0.13%</u>

Cash and cash equivalents by currency In HUF millions	At December 31,	
	2015	2016
EUR .....	8,716	3,568
MKD .....	5,134	3,706
HUF .....	2,988	2,768
USD .....	348	453
Other .....	372	310
	<u>17,558</u>	<u>10,805</u>

Cash and cash equivalents by country of location In HUF millions	At December 31,	
	2015	2016
Macedonia .....	7,999	4,778
Hungary .....	5,901	3,317
Montenegro .....	3,144	2,261
Other countries .....	514	449
	<u>17,558</u>	<u>10,805</u>

## 7 TRADE AND OTHER RECEIVABLES

### 7.1 Trade and other receivables – carrying amounts

In HUF millions	At December 31,	
	2015	2016
Trade receivables from third parties .....	136,486	135,885
Trade receivables from Deutsche Telekom Group companies .....	10,592	10,744
Trade receivables from associates and joint ventures.....	2	77
Total trade receivables ..... (a)	147,080	146,706
Prepayments and advance payments .....	8,401	6,417
Advance payments to Joint ventures (Note 14.2) .....	3,338	912
Other taxes receivable.....	3,653	1,736
Other .....	290	1,874
Total other receivables .....	15,682	10,939
	<u>162,762</u>	<u>157,645</u>

#### (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.

In HUF millions	Carrying amount as of Dec 31, 2016	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
Hungary .....	121,398	104,746	11,116	1,713	627	878	946	1,372
Macedonia .....	15,459	11,477	1,117	379	203	1,018	660	605
Montenegro .....	8,882	6,306	1,152	376	291	324	308	125
Other countries .....	967	746	64	28	24	4	101	0
Total .....	146,706	123,275	13,449	2,496	1,145	2,224	2,015	2,102

In HUF millions	Carrying amount as of Dec 31, 2015	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
Hungary .....	121,910	104,830	11,545	1,523	1,081	1,226	1,163	542
Macedonia .....	16,166	12,896	1,242	494	10	138	496	890
Montenegro .....	7,867	4,030	2,562	261	709	242	30	33
Other countries .....	1,137	1,020	83	18	10	4	2	-
Total .....	147,080	122,776	15,432	2,296	1,810	1,610	1,691	1,465

The vast majority of trade receivables is impaired on a portfolio basis. The vast majority of past due trade receivables is 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 or defaults on installment payments 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 2.5 months of revenue (2015: 2.2 months of revenue). As disclosed in Note 3.1.2, the annual bad debt expense of the Group is approximately 1.4 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 losses and changes therein for 2015 and 2016.

In HUF millions	At December 31,	
	2015	2016
Impairment loss, beginning of period .....	34,767	36,471
Charged to expense – net (included in Direct costs) .....	9,537	8,508
Translation difference .....	(100)	(77)
Impairment losses of acquired companies on acquisition.....	250	-
Utilized .....	(7,983)	(7,312)
Impairment loss, end of period .....	36,471	37,590

The carrying amount of trade and other receivables 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 trade and other 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 2015 and 2016 for the countries of operation of the Group.

In HUF millions	At December 31, 2014	Charged to expense	Translation difference (and rounding)	Impairment losses of acquired companies on acquisition	Utilized (1)	At December 31, 2015
Hungary .....	19,890	8,650	1	250	(7,429)	21,362
Macedonia .....	9,018	391	(68)	-	(136)	9,205
Montenegro .....	5,797	492	(30)	-	(394)	5,865
Other countries .....	62	4	(3)	-	(24)	39
Group .....	34,767	9,537	(100)	250	(7,983)	36,471

(1) Utilized means reversed on derecognition (settlement, write-off or factoring).



In HUF millions	At December 31, 2015	Charged to expense	Translation difference (and rounding)	Impairment losses of acquired companies on acquisition	Utilized (1)	At December 31, 2016
Hungary .....	21,362	7,453	2	-	(7,016)	21,801
Macedonia .....	9,205	293	(37)	-	(91)	9,370
Montenegro .....	5,865	628	(40)	-	(205)	6,248
Other countries .....	39	134	(2)	-	-	171
Group .....	36,471	8,508	(77)	-	(7,312)	37,590

(1) Utilized means reversed on derecognition (settlement, write-off or factoring).

See also Note 3.1.2 for further analysis of credit risks related to Trade and other receivables.

## 8 OTHER FINANCIAL ASSETS

Other financial assets include receivables due within 12 months (current) and due after 12 months (non current) from the financial statement date. These financial assets are exposed to credit risks, for which see more details in Note 3.1.2. The impairment loss accounted or reversed for other current and non current financial assets is not material.

### 8.1 Other current financial assets

In HUF millions	At December 31,	
	2015	2016
Bank deposits with original maturities over 3 months .....	(a) 7,982	950
Finance lease receivable .....	(b) 361	602
Loans and receivables from employees .....	(c) 823	800
Derivative financial instruments contracted with related parties .....	(d) 276	1,505
Derivative financial instruments contracted with third parties .....	(e) 79	-
Other .....	1,531	1,247
	11,052	5,104

(a) The table below shows the Bank deposits with original maturities over 3 months by country where it is deposited. The balance of Bank deposits with original maturities over 3 months decreased mainly as a result of Montenegrin spectrum purchase in 2016.

In HUF millions	At December 31,	
	2015	2016
Macedonia .....	467	950
Montenegro .....	6,263	-
Germany .....	1,252	-
	7,982	950

## 8.2 Other non current financial assets

In HUF millions	At December 31,	
	2015	2016
Finance lease receivable ..... (b)	1,133	594
Loans and receivables from employees ..... (c)	4,218	4,226
Trade receivables over one year ..... (f)	10,302	8,763
Derivative financial instruments contracted with related parties ..... (d)	6,277	3,763
Financial assets available for sale ..... (g)	278	309
Other .....	742	599
	<u>22,950</u>	<u>18,254</u>

(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 significant past due employee receivables, and the loans are pledged with mortgage.

(d) 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 and 3.1.1.3).

(e) Derivative financial instruments contracted with third parties include the fair value of open currency forwards, cross-currency interest rate swaps and commodity price swaps (see more details in Note 3.1.1.1).

(f) Trade receivables over one year includes receivables from customers paying over 1-2 years in installments for telecommunications equipment sold.

(g) 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 balances in the Statements 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 income tax expenses charged in the Profit for the year.

In HUF millions	For the year ended December 31,	
	2015	2016
Corporate income tax .....	3,311	2,507
Other income taxes .....	8,691	8,260
Deferred income taxes .....	1,792	(15,164)
Total income tax expense .....	<u>13,794</u>	<u>(4,397)</u>

### 9.3 Tax expense reconciliation

The reconciliation between the reported income tax expense and the theoretical amount arising by applying the statutory income tax rates is as follows:

In HUF millions	For the year ended December 31,	
	2015	2016
Consolidated IFRS profit before income tax .....	45,341	52,826
Tax at 19% .....	(8,615)	(10,037)
Impact of different tax rates .....	(a) 1,700	1,567
Tax shield of items not subject to income tax .....	(b) 2,326	659
Tax impact of non deductible items .....	(c) (1,430)	(1,672)
Other income taxes .....	(d) (8,691)	(8,260)
Impact of tax deductibility of other income taxes .....	(e) 1,651	1,569
Energy suppliers' tax .....	(f) (516)	(110)
(De)/recognized deferred tax on tax losses .....	(g) (224)	(485)
Investment tax credit accretion .....	(h) 887	457
Withholding tax on expected dividends.....	(i) (691)	(119)
Other effects related to Macedonia .....	(j) (191)	-
Impact of CIT rate change in deferred tax.....	(k) -	20,828
Income tax expense .....	(13,794)	4,397
Effective tax rate .....	30.4%	(8.3%)

#### (a) Impact of different tax rates

The corporate tax rate in Hungary is 10% for the first HUF 500 million tax base (on an annual basis) of the legal entities, above which the general 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 corporate tax rate is 10% in Macedonia, 9% in Montenegro, 16% in Romania and 10% in Bulgaria in the reported years. This line of the reconciliation also includes the tax impacts of the above differences compared to the 19% general tax rate of Hungary applied to the profit before tax of the Group.

#### (b) Tax shield of items not subject to income tax

This line of the reconciliation primarily includes the tax shield impact of expenses, which are not included in the consolidated profit before tax, but deductible when determining the standalone corporate income tax base. These items include the impairment of investments (including goodwill) in consolidated subsidiaries, the depreciation of assets (or additional values of assets) which are not included in the assets of the consolidated statements of financial position, and which are not considered in the deferred tax calculation.

#### (c) Tax impact of non deductible items

This line of the reconciliation includes the negative tax impact of the expenses included in the consolidated profit and loss, but non deductible when determining the standalone corporate income tax base. These items primarily include the non deductible receivable impairment and write-downs and penalties.

**(d) Other income taxes**

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, determined usually at a substantially higher level than the corporate tax base, but with substantially lower tax rates (max 2%). As the first line of the reconciliation calculates theoretical tax expense calculated using the general corporate tax rate, the Hungarian local business 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 Hungarian local business tax and innovation fee are deductible expenses for corporate tax purposes, the positive tax impact of which is included in this line of the reconciliation.

**(f) Energy suppliers' tax**

This line of reconciliation includes the Energy suppliers' additional tax levied on energy supplier companies' profits in Hungary. The tax base is the profit before tax adjusted by certain items that increase or decrease the tax base. Magyar Telekom Plc. is also considered as an energy supplier company subject to the energy suppliers' additional tax, in proportion to its energy revenues.

**(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 in the foreseeable future. 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) Investment tax credit accretion**

Investment tax credit accretion includes the increase of the net present value of the investment tax credit deriving from the utilization of the tax credits in periods subsequent to the year of recognition. See also Note 9.5.

**(i) Withholding tax on expected dividends**

Macedonia and Montenegro levy a 5% withholding tax on dividend distribution to Hungary. This line of the reconciliation includes solely this amount of withholding tax accruing on the Group's share of the 2014/2015 profits of our Montenegrin and Macedonian subsidiary.

**(j) Other effects related to Macedonia**

In 2015, Magyar Telekom decreased again the issued capital of Stonebridge by HUF 22 billion with no pre-tax impact which resulted in additional tax expenses in the Group. Magyar Telekom, the sole owner of Stonebridge, eliminated the negative capital elements from Stonebridge statutory accounts which earlier prevented the dividend distributions of the Macedonian entities' profit to Magyar Telekom. As a result of this, Magyar Telekom reinitiated the deferred tax calculation on the temporary differences relating to the Group's Macedonian investments.

In 2016 there was no such transaction.

**(k) Impact of CIT rate change in deferred tax**

The Hungarian corporate income tax rate of 10%/19% has been decreased to flat rate 9% as of 1 January 2017 which has already been recognized as of 31 December 2016 in deferred tax positions. This line includes the change of the deferred tax balance triggered by the tax rate change.

#### 9.4 Deferred taxes

Magyar Telekom's deferred tax balances and the movements therein are as follows:

In HUF millions	Balance at Dec. 31, 2014	Effect on profit	Other movements	Balance at Dec. 31, 2015	Effect on profit	Other movements	Balance at Dec. 31, 2016
Deferred tax assets and (liabilities)							
Investment tax credits.....	16,885	(4,406)	(66)	12,413	(1,506)	-	10,907
Net operating loss carry-forward .....	949	(224)	382	1,107	(485)	-	622
Investments in subsidiaries .....	-	240	-	240	(240)	-	-
Withholding tax .....	(301)	(390)	-	(691)	572	-	(119)
Other financial assets .....	(2,353)	1,270	20	(1,063)	738	-	(325)
Impairment of receivables and inventory.....	2,981	921	119	4,021	(2,239)	-	1,782
Property, plant and equipment and intangible assets .....	(20,820)	1,616	(489)	(19,693)	10,066	-	(9,627)
Goodwill .....	(17,585)	(1,840)	-	(19,425)	7,448	-	(11,977)
Trade and other payables .....	97	(9)	6	94	(92)	-	2
Loans and other borrowings .....	(4,424)	165	8	(4,251)	2,770	-	(1,481)
Deferred revenue .....	(4)	30	(45)	(19)	(26)	-	(45)
Provisions for liabilities and charges ..	2,666	835	-	3,501	(1,907)	-	1,594
<b>Total net deferred tax liability .....</b>	<b>(21,909)</b>	<b>(1,792)</b>	<b>(66)</b>	<b>(23,766)</b>	<b>15,099</b>	<b>-</b>	<b>(8,667)</b>
Of which deferred tax liabilities	(22,064)			(23,813)			(8,740)
Of which deferred tax assets	155			47			73

Items included in the other movements column in 2015 indicate the deferred tax opening balance of GTS Hungary as of April 1, 2015, when Magyar Telekom acquired GTS Hungary Kft. from Deutsche Telekom and the currency translation adjustment arising on consolidation.

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 balances accordingly.

The Group's net deferred tax liability balance as at December 31, 2016 was HUF 8,667 million which includes a high amount of individual deferred tax asset and liability items (see in the above table). Of these items, approximately HUF 1,446 million net deferred tax asset is expected to reverse in 2017 (deferred tax asset of HUF 3,351 million and deferred tax liability of HUF 1,905 million).

The Group's net deferred tax liability balance as at December 31, 2015 was HUF 23,766 million which includes a high amount of individual deferred tax asset and liability items (see in the above table). Of these items, approximately HUF 5,426 million net deferred tax asset is expected to reverse in 2016 (deferred tax asset of HUF 6,529 million and deferred tax liability of HUF 1,103 million).

Deferred tax assets arising on investment tax credits are recognized against the capitalized 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 27,521 million at December 31, 2016 (HUF 13,804 million at December 31, 2015).

Deferred tax liability on goodwill is related to the goodwill arising to the acquisition of subsidiaries (Emitel and T-Mobile) in the Company's standalone financial statements, which had merged into Magyar Telekom Plc. The amortization of the statutory amount of the goodwill is a tax deductible expense.

## 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 could apply for a corporate tax reduction. MT accomplished such tax credit programs between 2003 and 2008. The tax credit programs commenced in 2012 and 2013 are "large investment" programs, which enable companies to invest not only in broadband related assets, if the investment value exceeds HUF 3 billion and certain special criteria (i.e. headcount increase) are met. In case of both types of tax credit programs, the potential reduction of the corporate tax charge is defined as a percentage of the companies' capital investment in qualifying assets. As both of these investment tax credits are of a government grant nature, Magyar Telekom recognized the deferred tax asset against the cost of the related investment. There are no unrecognized tax credits. 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 are accreted. This accretion is recognized as an increase in the investment tax credit balance against a reduction in the current year deferred tax expense.

The following table shows the details of the tax credits in HUF millions:

Earned in year	Amount of qualifying investment	Amount of tax credit earned	Accretion recognized in tax expense to date	Tax credit utilized	Tax credit carried forward at December 31, 2016	Tax credit carried forward at December 31, 2015	Expires in year
2006 .....	14,939	4,346	3,786	(8,162)	-	2,213	2016
2007 .....	10,681	2,826	2,757	(3,859)	1,724	1,086	2017
2008 .....	2,165	452	227	(679)	-	-	2018
2012 .....	11,663	3,557	473	(2)	4,028	3,985	2021
2013 .....	14,361	4,618	370	(2)	4,986	4,958	2023
2014 .....	500	162	7	-	169	171	2023
Total .....	54,309	15,991	7,620	(12,704)	10,907	12,413	

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 for all investment tax credits is that the relevant assets have to be operated for at least 5 years. However, for those earned in 2012 and in 2013 certain increase in headcount and/or salary has to be maintained for at least 4 subsequent years following the first year of tax credit utilization. The headcount of the Company has to be increased by 150 and maintained in the subsequent 4 years from the first utilization of the investment tax credit (which is 2012 and 2014). The 2013 tax credit program was finished in January 2014, so the first utilization of 2013 tax credit is in 2014. The base year for both programs is 2011. Management believes that the headcount criterion is not a substantive requirement. There was a significant headcount increase in 2012 due to insourcing of certain activities carried out by subcontractors before and there are further insourcing plans in place. Based on the above, 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 loss carry forwards

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. The table below shows the tax losses carried forward of the Group.

Expires in year	Tax loss carry forwards at December 31, 2015	Tax loss carry forwards at December 31, 2016
2016.....	93	84
2017.....	137	138
2018.....	29,432	22,620
2019.....	88	5,641
2020.....	139	194
2021.....	-	0
2025.....	14,993	7,023
unlimited.....	-	-
Total .....	44,882	35,700
Tax losses for which deferred tax is recognized .....	7,781	6,907
Tax losses for which deferred tax is not recognized .....	37,101	28,793
Total .....	44,882	35,700

The Hungarian corporate tax law was amended as of January 1, 2015 including that all tax loss carry forwards incurred up to December 31, 2014 may be used to reduce the pre-tax profit until no later than December 31, 2025.

### 9.7 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.

### 9.8 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.

### 9.9 IFRS Transition of Magyar Telekom Plc.

As Magyar Telekom Plc. is listed on the Budapest Stock Exchange, it is obliged to adopt IFRS in its statutory financial statements from 2017 in accordance with the Act C of 2000 on Accounting. Other companies of the Group did not elect to adopt IFRS for their local financial statements. The effect of this change on these consolidated financial statements is limited to deferred tax.

## 10 INVENTORIES

In HUF millions	At December 31,	
	2015	2016
Inventory for resale .....	11,112	12,793
Other inventory .....	2,321	4,398
Subtotal .....	13,433	17,191
Less allowances .....	(768)	(548)
	<u>12,665</u>	<u>16,643</u>

The impairment loss accounted or released for inventories is not material therefore no separate table of movements is disclosed.

The Group has no inventory pledged as security as at December 31, 2015 or December 31, 2016.

## 11 ASSETS HELD FOR SALE AND LIABILITIES ASSOCIATED WITH ASSETS HELD FOR SALE

In HUF millions	At December 31,			2016
	2015	2015		
	Origo carrying amounts	Other assets held for sale	Total	Other assets held for sale
<u>Net assets to be disposed of:</u>				
Cash and cash equivalents .....	17		17	
Trade and other receivables .....	1,366		1,366	
Income tax receivables .....	9		9	
Inventories .....	51		51	
Property, plant and equipment .....	302	1,847	2,149	1,556
Intangible assets .....	631		631	
Goodwill .....	562		562	
Total assets held for sale .....	<u>2,938</u>	<u>1,847</u>	<u>4,785</u>	<u>1,556</u>
Trade and other payables .....	(1,060)		(1,060)	
Provisions .....	(157)		(157)	
Total liabilities associated with assets held for sale .....	<u>(1,217)</u>	<u>-</u>	<u>(1,217)</u>	<u>-</u>

### 11.1 Disposal of Origo

In December 2015, the Company signed an agreement for the sale of the total of its 100% shareholding in Origo Zrt. The binding offer on cash free debt free basis was EUR 13.2 million (approximately HUF 4.2 billion).

The closing of the transaction took place on February 5, 2016. Origo had been a consolidated subsidiary of the Group included in the MT-Hungary operating segment. The gain on the sale of Origo was recognized in Q1 2016. See also note 26.

### 11.2 Other assets held for sale

Other assets held for sale include primarily land and buildings identified for sale, which is expected within 12 months, as a result of the continuing improvement of utilization of properties. These assets are presented at carrying amount as no impairment had to be recognized when reclassified as held for sale.



## 12 PROPERTY, PLANT AND EQUIPMENT

In HUF millions	Land and equivalent rights	Buildings	Telecom. equipment	Other equipment	Total
<b>At January 1, 2015</b>					
Cost .....	8,470	156,878	1,176,487	95,475	1,437,310
Accumulated depreciation .....	(2,206)	(52,690)	(820,081)	(73,887)	(948,864)
Carrying amount .....	6,264	104,188	356,406	21,588	488,446
Of which held for sale .....					(668)
					<u>487,778</u>
Carrying amount – January 1, 2015 .....	6,264	104,188	356,406	21,588	488,446
Exchange differences .....	(9)	(209)	(263)	(127)	(608)
Additions due to business combinations .....	-	560	5,914	107	6,581
Changes due to revisions of asset retirement obligations .....	-	(143)	351	-	208
Investments .....	-	4,193	69,678	4,938	78,809
Disposals .....	(157)	(555)	(16)	(236)	(964)
Depreciation charge .....	(76)	(5,157)	(64,651)	(6,763)	(76,647)
Reclassifications .....	1,255	260	(3,064)	1,077	(472)
Carrying amount – December 31, 2015.....	7,277	103,137	364,355	20,584	495,353
<b>At December 31, 2015</b>					
Cost .....	9,551	163,073	1,127,191	94,007	1,393,822
Accumulated depreciation .....	(2,274)	(59,936)	(762,836)	(73,423)	(898,469)
Carrying amount .....	7,277	103,137	364,355	20,584	495,353
Of which held for sale .....					(2,149)
					<u>493,204</u>
Carrying amount – January 1, 2016.....	7,277	103,137	364,355	20,584	495,353
Exchange differences .....	(8)	(132)	(283)	(30)	(453)
Additions due to business combinations .....	-	-	(130)	-	(130)
Changes due to revisions of asset retirement obligations .....	-	(109)	247	-	138
Investments .....	-	1,946	63,283	6,953	72,182
Disposals .....	(462)	(5,254)	(147)	(387)	(6,250)
Depreciation charge .....	(138)	(4,832)	(61,397)	(7,801)	(74,168)
Decrease due to sale of subsidiary.....	-	(54)	(190)	(57)	(301)
Reclassifications .....	(926)	(354)	(616)	255	(1,641)
Carrying amount – December 31, 2016.....	5,743	94,348	365,122	19,517	484,730
<b>At December 31, 2016</b>					
Cost .....	8,194	154,876	1,079,697	104,073	1,346,840
Accumulated depreciation .....	(2,451)	(60,528)	(714,575)	(84,556)	(862,110)
Carrying amount .....	5,743	94,348	365,122	19,517	484,730
Of which held for sale .....					(1,556)
					<u>483,174</u>



The closing balance of Property, plant and equipment (PPE) includes assets in the course of construction in an amount of HUF 62,357 million as at December 31, 2016 (2015: HUF 38,503 million). In the table above the assets in course of construction are shown in the categories where the asset is expected to be classified when placed into service.

Exchange differences include the translation impact arising on the consolidation of foreign subsidiaries of the Group.

Additions due to business combinations include the fair value or carrying value (GTS in 2015) of the assets acquired by Magyar Telekom through business combinations at the time of the acquisition. Differences between the preliminary and the final purchase price allocations are also included in this line.

Changes due to revisions of asset retirement obligations represent the adjustments of the carrying amounts of the assets against a provision for asset retirement obligation (see also Note 19.4).

Investments represent the regular investing activity in PPE assets.

The reclassifications between asset categories or their impact on depreciation expense was not material.

No impairment was identified in 2016 and 2015.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2016 the gross book value of the assets leased back is HUF 3,775 million (2015: HUF 3,232 million) and the net book value is HUF 1,533 million (2015: HUF 1,252 million).

Included mainly in buildings and telecom equipment are also assets leased under finance lease conditions other than sale and lease back. At December 31, 2016 the gross book value of the finance leased assets is HUF 7,211 million (2015: HUF 12,853 million) and the net book value is HUF 3,750 million (2015: HUF 6,869 million).

Included in telecommunications equipment at December 31, 2016 are assets leased under operating lease contracts to customers with a gross book value of HUF 373 million (2015: HUF 540 million) and 0 net book value (2015: HUF 1 million).

The Group has no PPE with restricted titles or pledged as security as at December 31, 2016 or December 31, 2015.

## 12.1 Useful lives

The useful lives assigned to different types of property, plant and equipment are as follows:

	<u>Years</u>
Buildings .....	5–50
Duct, cable and other outside plant .....	3–38
Other telecommunications equipment .....	2–25
Other equipment .....	2–12

The reviews of the useful lives (and residual values) of property, plant and equipment during 2016 affected the lives of a large number of assets including primarily broadband distribution networks, radio equipment, and other telecommunication equipment. The revisions result in the following change in the original trend of depreciation in the current and future years.

<b>In HUF millions</b>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>After 2019</u>
Increase / (decrease) in depreciation expense	(1,294)	(873)	816	846	506



## 13 INTANGIBLE ASSETS

In HUF millions

	Goodwill	Concessions and licenses	Software	Other	Total
<b>At January 1, 2015</b>					
Cost .....	218,502	187,272	261,234	18,206	685,214
Accumulated amortization .....	-	(20,472)	(173,928)	(12,328)	(206,728)
Carrying amount .....	218,502	166,800	87,306	5,878	478,486
Carrying amount – January 1, 2015 .....	218,502	166,800	87,306	5,878	478,486
Exchange differences .....	(37)	(61)	(75)	1	(172)
Additions due to business combinations .....	32	180	299	6,839	7,350
Investments .....	-	1,423	28,474	1,141	31,038
Disposals .....	-	-	-	-	-
Amortization charge .....	-	(14,822)	(20,416)	(1,899)	(37,137)
Reclassifications .....	-	-	472	-	472
Carrying amount – December 31, 2015 .....	218,497	153,520	96,060	11,960	480,037
<b>At December 31, 2015</b>					
Cost .....	218,497	190,658	286,288	18,679	714,122
Accumulated amortization .....	-	(37,138)	(190,228)	(6,719)	(234,085)
Carrying amount .....	218,497	153,520	96,060	11,960	480,037
Of which held for sale .....					(1,193)
					478,844
Carrying amount – January 1, 2016 .....	218,497	153,520	96,060	11,960	480,037
Exchange differences .....	(44)	(45)	(55)	(21)	(165)
Additions due to business combinations .....	207	-	-	(19)	188
Investments .....	-	9,266	29,723	2,084	41,073
Disposals .....	-	-	(28)	-	(28)
Decrease due to sale of subsidiary .....	(562)	(94)	(515)	(4)	(1,175)
Amortization charge .....	-	(15,570)	(25,049)	(2,689)	(43,308)
Reclassifications .....	-	-	1,641	-	1,641
Carrying amount – December 31, 2016 .....	218,098	147,077	101,777	11,311	478,263
<b>At December 31, 2016</b>					
Cost .....	218,098	198,322	296,027	20,444	732,891
Accumulated amortization .....	-	(51,245)	(194,250)	(9,133)	(254,628)
Carrying amount .....	218,098	147,077	101,777	11,311	478,263
Of which held for sale .....					-
					478,263



Exchange differences include the translation impact arising on the consolidation of foreign subsidiaries of the Group.

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 allocations are also included in this line.

Investments represent the regular investing activity in intangible assets. Additions to Concessions and licenses in 2016 include the one-off license fee of certain frequency bands (see also Note 4.5) and any directly attributable costs of preparing these assets for its intended use (e.g. consultancy fees).

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 profit or loss. The reclassifications between asset categories or their impact on amortization expense was not material.

The Group has no intangible assets with restricted title or pledged as security as at December 31, 2016 or December 31, 2015.

### 13.1 Useful lives

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.

	<u>Years</u>
Software .....	2-24
Concessions and licenses .....	3-25
Other intangible assets .....	3-10

The reviews of the useful lives of intangible assets during 2016 resulted in the following change in the original trend of amortization in the current and future years.

<b>In HUF millions</b>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>After 2019</u>
Increase / (decrease) in depreciation expense	23	(88)	201	(181)	45

### 13.2 Goodwill

For the goodwill impairment tests, the total amount of goodwill was allocated to the operating segments of the Group and the recoverable amounts of the operating segments were determined based on fair values less costs of disposal based on Level 3 inputs in the fair value calculations (Note 35.1). The recoverable amounts of the segments disclosed in the table below exclude net debts (Note 3.2), which are not allocated to the segments. For further information, please also see Note 4.2.

In HUF millions	As at December 31,					
	2015			2016		
	Carrying amount of goodwill allocated	operating segment (incl. goodwill)	Recoverable amount of operating segment	Carrying amount of goodwill allocated	operating segment (incl. goodwill)	Recoverable amount of operating segment
MT-Hungary	-	-	-	191,454	807,989	1,392,344
Telekom Hungary	163,320	754,693	1,080,497	-	-	-
T-Systems	27,928	57,111	97,319	-	-	-
Macedonia	20,199	62,926	151,257	20,199	62,316	142,735
Montenegro	6,488	27,352	67,226	6,445	36,240	56,488
Total	<u>217,935</u>	<u>902,082</u>	<u>1,396,299</u>	<u>218,098</u>	<u>906,545</u>	<u>1,591,567</u>

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 2015 and 2016 no goodwill impairment was established for any goodwill of the Group.

### 13.3 Significant individual other intangible assets

The Group's most significant individual other intangible assets are the mobile licenses. The carrying values and remaining amortization periods of the significant licenses are listed in the table below. For further information on these assets, please see Note 37.

In HUF millions	As at December 31,			
	2015		2016	
	Carrying amount	Remaining amortization period (years)	Carrying amount	Remaining amortization period (years)
Hungarian mobile licenses acquired in 2014 (Note 37.1)	92,156	19	87,174	18
Hungarian mobile licenses prolonged in 2013 (Note 37.1)	46,643	6	39,180	5
Montenegrin 4G license (Note 37.6)	-	-	9,051	15
Hungarian 3G license (Note 37.1)	7,135	4	5,358	3
Macedonian 4G license (Note 37.4)	2,885	18	2,713	17
Macedonian 2G/3G license (Note 37.4)	1,204	3	809	2
Other	3,497		2,792	
Total concessions and licenses	<u>153,520</u>		<u>147,077</u>	

## 14 INVESTMENTS IN ASSOCIATES AND JOINT ARRANGEMENTS

### 14.1 Associates

The Group had no significant associates at December 31, 2015 and 2016. The Group had no contingent liabilities or commitments relating to its associates at December 31, 2015 and 2016.

### 14.2 Joint ventures

The only joint venture of the Group at December 31, 2015 and 2016 was E2 Hungary Zrt. established in 2015 by Magyar Telekom Plc. and MET Holding AG. E2 Hungary provides energy services for business customers from 2016. The company's issued capital is HUF 200 million, and additional HUF 1,800 million was contributed as additional paid-in capital which were fully paid by both parties. The joint venture is set up by the parties on a 50:50 ownership basis with balanced rights in the management structure. The investment was recognized at cost in 2015 and E2 Hungary Zrt. is accounted for using the equity method. The company had no significant operational activity in 2015, while the operations of the company resulted in HUF 254 million profit in 2016. As at December 31, 2016 and 2015, the Company made an advance payment to E2 for the energy services to be provided by E2 to the Company and its remaining customers, which amounted to HUF 912 million in 2016 and HUF 3,338 million in 2015.

The Group had no contingent liabilities or commitments relating to its joint ventures at December 31, 2015 and 2016.

The following table shows the total assets and liabilities as at December 31, 2015 and 2016, and revenues and profit for the year ended December 31, 2015 and 2016 of E2, the single significant joint venture of the Group.

In HUF millions	<u>2015</u>	<u>2016</u>
Current assets .....	5,995	19,564
Non current assets .....	73	65
Current liabilities .....	4,112	17,419
Non current liabilities .....	-	-
Revenues .....	-	61,699
Profit/ (Loss) for the year .....	(44)	254

### 14.3 Joint operations

Magyar Telekom and Telenor Hungary agreed in 2015 to jointly operate and develop their 800MHz 4G mobile networks in all parts of Hungary except Budapest. The primary goal of the agreement was to accelerate 4G mobile broadband coverage rollout in the countryside and to offer higher bandwidth to the 4G customers.

The Company assessed the agreement as joint operation as strategic decisions are made jointly by Magyar Telekom and Telenor, and there is no separate vehicle to control the operation of the arrangement. The Company does not share the obligations for liabilities and any returns or expenses beyond the assets included in the agreement. Therefore only the assets owned by the Company are recognized while there is no need to present the partner's assets, liabilities, or revenues and expenses. The charges from MT to Telenor and from Telenor to MT are equal and accounted for and settled on a net basis.

## 15 OTHER NON CURRENT ASSETS

Other non current assets mainly include long-term prepaid employee benefits relating to housing loans provided by the Group to employees at lower than market interest rates (see note 2.4.1.2 (d)).

## 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 (with DT AG) 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 in the past and for dividend payments. These loans, when expiring, are also refinanced by DT, depending on the actual financing need of Magyar Telekom.

The tables below show the details of the financial liabilities towards Deutsche Telekom Group members as at December 31, 2016 and 2015.

<b>December 31, 2016</b>	<b>Carrying amount in HUF millions</b>	<b>Lender</b>	<b>Currency</b>	<b>Interest rate (%)</b>	<b>Fixed / floating</b>	<b>Maturity</b>
	15,000	DT AG	HUF	2.81	fixed	Apr 2017
	7,192	DTIF	EUR	5.20	fixed	May 2017
	38,866	DT AG	HUF	0.70	floating	Cashpool
	3,736	DT AG	EUR	0.28	floating	Cashpool
	1,698	DT AG	USD	0.72	floating	Cashpool
Due within 1 year .....	66,492					
Accrued interest.....	6,097					
Derivatives.....	-					
Total current .....	<u>72,589</u>					
	15,652	DTIF	EUR	4.45	fixed	Nov 2018
	35,000	DT AG	HUF	5.89	fixed	Mar 2019
	20,000	DT AG	HUF	4.98	fixed	Jun 2019
	50,000	DT AG	HUF	4.33	fixed	Oct 2019
	35,000	DT AG	HUF	3.77	fixed	Jun 2020
	40,838	DTIF	EUR	2.26	fixed	Jan 2021
	47,237	DTIF	EUR	5.45	fixed	Jul 2021
Non current.....	243,727					
Derivatives.....	3,452					
Total non current.....	<u>247,179</u>					



December 31, 2015	Carrying amount in HUF millions	Lender	Currency	Interest rate (%)	Fixed / floating	Maturity
	35,000	DT AG	HUF	2.36	floating	Mar 2016
	35,000	DT AG	HUF	7.65	fixed	Sep 2016
	28,415	DTIF	HUF	6.09	fixed	Dec 2016
	14,023	DTIF	HUF	6.16	fixed	Dec 2016
	19,848	DT AG	HUF	1.72	floating	Cashpool
	(524)	DT AG	USD	0.03	floating	Cashpool
	(1,075)	DT AG	EUR	0.00	floating	Cashpool
Due within 1 year .....	130,687					
Accrued interest.....	6,093					
Derivatives.....	126					
Total current .....	136,906					
	15,000	DT AG	HUF	2.81	fixed	Apr 2017
	7,343	DTIF	EUR	5.20	fixed	May 2017
	15,809	DTIF	EUR	4.45	fixed	Nov 2018
	35,000	DT AG	HUF	5.89	fixed	Mar 2019
	20,000	DT AG	HUF	4.98	fixed	Jun 2019
	50,000	DT AG	HUF	4.33	fixed	Oct 2019
	35,000	DT AG	HUF	3.77	fixed	Jun 2020
	41,208	DTIF	EUR	2.26	fixed	Jan 2021
Non current.....	219,360					
Derivatives.....	728					
Total non current.....	220,088					



The table below shows the carrying amounts and fair values of the related party loans.

In HUF millions	At December 31,			
	2015		2016	
	Book value	Fair value	Book value	Fair value
<u>HUF denominated loans</u>				
At fixed rate .....	232,438	237,389	155,000	173,972
At floating rate .....	54,848	54,826	38,866	38,866
	<u>287,286</u>	<u>292,215</u>	<u>193,866</u>	<u>212,838</u>
<u>EUR denominated loans</u>				
At fixed rate .....	64,360	65,219	110,919	120,669
At floating rate .....	(1,075)	(1,075)	3,736	3,736
	<u>63,285</u>	<u>64,144</u>	<u>114,655</u>	<u>124,405</u>
<u>USD denominated loans</u>				
At fixed rate .....	-	-	-	-
At floating rate .....	(524)	(524)	1,698	1,698
	<u>(524)</u>	<u>(524)</u>	<u>1,698</u>	<u>1,698</u>
Accrued interest .....	6,093	6,093	6,097	6,097
Derivatives .....	854	854	3,452	3,452
Total related party financial liabilities .....	<u>356,994</u>	<u>362,782</u>	<u>319,768</u>	<u>348,490</u>

The weighted average interest rate on related party loans was 3.81% in 2016 (4.40% in 2015). 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.

The aggregate balance of the cashpool is a liability which also included cashpool receivables as at December 31, 2015.

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 or breaches in connection with the financial liabilities to related parties.



## 17 OTHER FINANCIAL LIABILITIES

### 17.1 Balances

The table below shows the current balances of Other financial liabilities.

In HUF millions	At December 31,	
	2015	2016
Bank loans .....	(a) 13,070	11,501
Annual frequency fee payable.....	(b) 3,064	3,275
Finance lease payable .....	(c) 3,855	2,344
Debtor overpayment .....	1,329	1,180
Building exchange payable .....	(d) 957	952
Other .....	3,877	3,348
Total other financial liabilities – current .....	<u>26,152</u>	<u>22,600</u>

The table below shows the non current balances of Other financial liabilities.

In HUF millions	At December 31,	
	2015	2016
Bank loans .....	(a) -	-
Annual frequency fee payable.....	(b) 48,314	45,215
Finance lease payable .....	(c) 4,525	3,478
Building exchange payable .....	(d) 906	-
Other .....	1,112	1,405
Total other financial liabilities – non current .....	<u>54,857</u>	<u>50,098</u>

There were no defaults or breaches in connection with other financial liabilities.

#### (a) Bank loans

Loans totaling HUF 11,500 million at December 31, 2016 are revolving loans (2015: HUF 11,500 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 0.95% in 2016 (1.88% in 2015).

The following table compares the carrying values and the fair values of the Group's bank loans.

In HUF millions	At December 31,			
	2015		2016	
	Book value	Fair value	Book value	Fair value
<u>HUF denominated bank loans</u>				
At fixed rate .....	-	-	-	-
At floating rate .....	11,500	11,500	11,500	11,500
	<u>11,500</u>	<u>11,500</u>	<u>11,500</u>	<u>11,500</u>
<u>EUR denominated bank loans</u>				
At fixed rate .....	1,566	1,568	-	-
At floating rate .....	-	-	-	-
	<u>1,566</u>	<u>1,568</u>	<u>-</u>	<u>-</u>
Accrued interest .....	<u>4</u>	<u>4</u>	<u>1</u>	<u>1</u>
Total bank loans .....	<u>13,070</u>	<u>13,072</u>	<u>11,501</u>	<u>11,501</u>

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.

#### (b) Annual frequency fee payable

On October 15, 2014 Magyar Telekom and the NMIAH signed the Authority Contract for the use of the 800 MHz, 900 MHz and 1800 MHz frequency bands that came into force on that day. Magyar Telekom acquired the frequency usage rights in the above listed spectrums till June 15, 2034. See Note 37.1 for more details of the agreement. This agreement provides sufficient basis for a reliable estimate of the future annual fees payable related to these Hungarian frequency licenses, as a result of which the present value of the annual fees payable (HUF 39,038 million) was recognized as part of the carrying amount of the licenses as intangible assets, with corresponding current and non current financial liabilities falling due from 2015 to 2034.

On September 6, 2013 Magyar Telekom and the NMIAH signed the modification of the Authority Contract for the use of the 900 MHz and 1800 MHz frequency bands. See Note 37.1 for more details of the agreement. This agreement provides sufficient basis for a reliable estimate of the future annual fees payable related to these Hungarian frequency licenses, as a result of which the present value of the annual fees payable (HUF 17,332 million) was recognized as part of the carrying amount of the licenses as intangible assets, with corresponding current and non current financial liabilities falling due from 2014 to 2022.

#### (c) Finance lease payable

See Note 33.1 for the details of finance leases.

#### (d) Building exchange payable

The Group entered into a real estate transaction in Macedonia in 2012, by which four old buildings were exchanged for a new one. The difference between the cost of the new building (HUF 10.7 billion) and the trade-in value of the old buildings (HUF 6.9 billion) is payable in six yearly instalments, the present values of which were recognized as current and non current financial liabilities.



### 17.2 Proceeds/repayments of loans and other borrowings

Cash payments for regular bank loans and related party loans are included in the Repayment of loans and other borrowings line of the Statements of cash flows.

### 17.3 Repayment of other financial liabilities

Repayment of other financial liabilities in the Statements of cash flows includes the cash payments for other financial liabilities as disclosed below.

In HUF millions	For the year ended December 31,	
	2015	2016
Trade payables classified as financial liabilities .....	10,917	-
Finance lease payable.....	4,270	3,989
Annual frequency fee payable .....	2,652	2,989
Building exchange liability.....	947	887
Other .....	137	811
Repayment of other financial liabilities .....	<u>18,923</u>	<u>8,676</u>

## 18 TRADE PAYABLES

In HUF millions	At December 31,	
	2015	2016
Payable to DT Group companies .....	15,766	16,156
Payable to associates and joint ventures .....	-	1,720
Other trade payables .....	124,416	118,747
	<u>140,182</u>	<u>136,623</u>

## 19 PROVISIONS

In HUF millions	Severance	Share-based payments	Other employee related	Total Employee related	Legal cases	ARO	Other	Total
January 1, 2015.....	2,881	-	1,956	4,837	2,153	6,661	744	14,395
Amounts reversed.....	(345)	-	(75)	(420)	(194)	(222)	(41)	(877)
Additions.....	6,972	217	685	7,874	499	430	1,006	9,809
Acquired through business combinations .	-	-	91	91	-	-	-	91
Reclassification to HFS liabilities.....	-	-	-	-	(122)	-	(35)	(157)
Interest.....	-	-	22	22	7	97	-	126
Exchange rate difference.....	(1)	-	(2)	(3)	(15)	(1)	2	(17)
Amounts utilized (incl. interest component).....	(3,951)	-	(968)	(4,919)	(804)	(23)	(532)	(6,278)
December 31, 2015.....	5,556	217	1,709	7,482	1,524	6,942	1,144	17,092
Of which current.....	4,576	-	94	4,670	1,397	47	1,071	7,185
Of which non current.....	980	217	1,615	2,812	127	6,895	73	9,907
January 1, 2016.....	5,556	217	1,709	7,482	1,524	6,942	1,144	17,092
Amounts reversed.....	(291)	(11)	(179)	(481)	(251)	(264)	(808)	(1,804)
Additions.....	1,074	382	368	1,824	768	402	803	3,797
Interest.....	-	1	12	13	38	107	-	158
Exchange rate difference.....	-	-	(5)	(5)	(4)	-	(1)	(10)
Amounts utilized (incl. interest component).....	(4,258)	-	(580)	(4,838)	(159)	(87)	(128)	(5,212)
December 31, 2016.....	2,081	589	1,325	3,995	1,916	7,100	1,010	14,021
Of which current.....	1,636	-	494	2,130	1,492	11	860	4,493
Of which non current.....	445	589	831	1,865	424	7,089	150	9,528

The Reclassification to HFS liabilities line in the table above included the provision transferred to liabilities held for sale due to the sale of Origo in 2015. See also note 11.1.

The Interest lines in the table above include the subsequent unwinding of the discount applied at initial recognition and the interest element of any provision recognized, as well as the release of the interest / accretion element in case of reversal of provisions.

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, 2016 relates to the stand-by-pool and the employee terminations payable in 2017 in relation to the further efficiency improvement in Magyar Telekom Plc. The stand-by-pool of employees includes 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. This is a way of severance that is not paid in one lump sum but in monthly installments following the discontinuation of services. The majority of the provision for severance as at December 31, 2015 also related to the stand-by-pool and the employee terminations paid in 2016 in relation to the efficiency improvement in Magyar Telekom Plc.

1,265 employees were dismissed in 2016 (2015: 973) from the Group, related to which severance payments were made. The balance of provision as at December 31, 2016 relates to 486 employees and former employees in the stand-by-pool (2015: 956).

The total payments made in relation to employee termination in 2016 amounted to HUF 6,590 million (2015: HUF 5,444 million).

### 19.2 Share-based payments

The bases of the provisions for share-based payments are described in Note 24.1.

### 19.3 Legal cases

Provisions for 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, which are individually not material.

### 19.4 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 2016 or 2015.

### 19.5 Other provisions

Other provisions include guarantee obligations, onerous contracts and further other individually small items.

## 20 OTHER LIABILITIES

### 20.1 Other current liabilities

In HUF millions	At December 31,	
	2015	2016
Deferred revenue and advances received .....	13,920	15,310
Other taxes and social security .....	14,637	14,159
Salaries and wages .....	7,429	5,233
Advances received for asset-related grants .....(a)	-	5,104
Dividend payable to non-controlling interests.....	2,853	461
Other liabilities .....	303	270
	<u>39,142</u>	<u>40,537</u>

**(a) Advances received for asset-related grants**

In 2016 HUF 12.2 billion of EU funds have been granted to Magyar Telekom Group. This is a result of the first and second rounds of a tender aimed at developing digital networks nationwide to cover households in Western and Eastern parts of Hungary with a fixed network capable of reaching speed of at least 30 Mbps. See also Note 2.7 for government grants relating to the purchase of PPE and Note 30 for details of Purchase of PPE and intangible assets.

**20.2 Other non current liabilities**

Other non current liabilities primarily include deferred revenues related to long term projects and customer loyalty programs.

## 21 NON-CONTROLLING INTERESTS

Non controlling interests included the minority shareholders in Makedonski Telekom (MKT) and Crnogorski Telekom (CT).

In HUF millions	MKT	CT	Total
Balance at January 1, 2015 .....	39,679	10,765	50,444
Dividend declared.....	(7,562)	(1,560)	(9,122)
Total comprehensive income.....	2,302	1,089	3,391
Balance at December 31, 2015.....	<u>34,419</u>	<u>10,294</u>	<u>44,713</u>
Dividend declared.....	(3,234)	(1,416)	(4,650)
Total comprehensive income.....	2,134	646	2,780
Balance at December 31, 2016.....	<u>33,319</u>	<u>9,524</u>	<u>42,843</u>

**21.1 Summarized financial information on subsidiaries with material non-controlling interests**

The information below includes the amounts before inter-company eliminations.

**a) Summarized balance sheets**

In HUF millions	MKT		CT	
	2015	2016	2015	2016
Current assets.....	27,976	24,871	23,915	12,907
Current liabilities .....	(25,397)	(23,093)	(13,942)	(14,118)
Non-current assets.....	101,061	98,008	42,157	50,517
Non-current liabilities.....	(3,330)	(2,059)	(1,760)	(2,257)
Net assets.....	<u>100,310</u>	<u>97,727</u>	<u>50,370</u>	<u>47,049</u>



**b) Summarized income statements**

In HUF millions	MKT		CT	
	2015	2016	2015	2016
Revenues .....	53,608	53,414	30,500	28,648
Profit before income tax .....	6,933	6,075	5,552	3,447
Profit for the period .....	6,057	5,132	4,969	2,985

**c) Summarized cash flows**

In HUF millions	MKT		CT	
	2015	2016	2015	2016
Net cash generated from operating activities.....	17,570	18,276	11,730	6,001
Net cash from investing activities .....	(536)	(9,837)	(4,450)	(2,525)
Dividends/capital reduction paid to Controlling interests.....	(9,890)	(6,676)	(5,057)	(4,575)
Dividends/capital reduction paid to Non-controlling interests .....	(5,123)	(3,234)	(1,560)	(1,416)
Other cash flows from financing activities ...	(1,466)	(1,663)	-	1,698
Net cash used in financing activities .....	(16,479)	(11,573)	(6,617)	(4,293)

**21.2 Transactions with non-controlling interests**

There were no material transactions with non-controlling interests in 2016 or 2015 other than the dividend payments.

The only significant non-controlling interest of the Group is the Macedonian Republic, holding shares in MKT. MKT and Magyar Telekom did not execute as part of its normal business activities any transactions that were individually material in the 2016 or 2015 financial year with companies controlled by the Macedonian Republic or companies over which the Macedonian Republic can exercise a significant influence.

## 22 REVENUE

In HUF millions	For the year ended December 31,	
	2015	2016
<u>Mobile revenues</u>		
Voice retail .....	158,399	153,824
Voice wholesale .....	15,978	11,691
Data.....	59,266	64,768
SMS .....	18,564	18,077
Equipment.....	46,922	56,713
Other mobile revenues .....	14,904	14,856
Total Mobile revenue .....	314,033	319,929
<u>Fixed line revenues</u>		
Voice retail .....	59,748	54,528
Broadband retail .....	52,013	52,627
TV .....	42,140	44,174
Equipment .....	8,200	6,524
Data retail .....	10,744	10,399
Wholesale.....	21,636	21,301
Other fixed line revenues .....	17,551	17,656
Total Fixed line revenue .....	212,032	207,209
System integration and IT revenue .....	80,997	68,735
Revenue from energy services.....	49,280	6,778
	656,342	602,651

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.

Revenue from energy services decreased due to exit from the residential gas business as of August 1, 2015 and transfer of the B2B energy business into E2, the joint venture of the Group as of January 1, 2016.

## 23 DIRECT COSTS

In HUF millions	For the year ended December 31,	
	2015	2016
Interconnect costs.....	25,097	21,930
SI/IT service related costs.....	54,524	40,098
Energy service related costs.....	47,919	6,779
Bad debt expense.....	9,537	8,508
Other direct costs.....	112,300	119,554
	249,377	196,869

Other direct costs include costs of mobile and fixed device, accessories and other equipment, agent commissions and non-voice direct costs.

## 24 EMPLOYEE RELATED EXPENSES

In HUF millions	For the year ended December 31,	
	2015	2016
Short term benefits .....	94,733	86,139
Termination benefits (Note 19.1) .....	8,120	3,275
Share settled share based compensations (Notes 24.1.1 and 24.1.2) ...	29	36
Cash settled share based compensations (Note 24.1.3) .....	217	370
Employee share ownership program (ESOP Note 24.2) .....	-	493
Total before capitalization .....	103,099	90,313
Expenses capitalized .....	(7,939)	(6,986)
	<u>95,160</u>	<u>83,327</u>
Total costs expensed in relation to defined contribution plans (including social security contribution).....	21,651	18,809
Average number of employees (full time equivalent).....	10,692	9,488
Closing number of employees (full time equivalent).....	10,357	9,432

### 24.1 Share based compensation programs

#### 24.1.1 Share Matching Plan of Magyar Telekom's CEO

In December 2011 the Board of Directors approved the implementation of the revolving Share Matching Plan of Magyar Telekom. The program was implemented for the CEO of Magyar Telekom starting in 2012. An amount of minimum 10% of the gross annual bonus of the CEO was to be invested in shares of Magyar Telekom. The CEO had 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 was planned to be revolving in 5 consecutive years starting in 2012.

In 2016 HUF 17 million was recognized as expenses for the program (2015: HUF 16 million).

Magyar Telekom implemented amendments to the CEO's Share Matching Plan from July 1, 2015 so that the CEO has to invest in DT shares instead of MT shares. The other principles remained the same.

#### 24.1.2 Share Matching Plan of Deutsche Telekom

As of July 1, 2015, Magyar Telekom Group implemented Share Matching Plan for all executives (cca. 60). Participation in the program is voluntary, with the exception of the CEO, who is obliged to participate in the program with the conditions above.

The participant is required to invest a minimum of 10% of his/her gross annual bonus in Deutsche Telekom shares, with an option to voluntary increase this amount to a maximum of 33.3% (personal investment). These shares shall be kept for at least 4 years (the lock-up period), the participant is granted matching shares upon expiry of the lock-up period. The share allocation ratio of the program (1:1, 1:2 or 1:3) depends on the evaluation of the participant's performance in the previous year. Deutsche Telekom grants the matching shares to the participant based on the acquired Deutsche Telekom shares by the participant within the framework of the program. The program starts annually if the free cash flow target of Deutsche Telekom Group was met in the previous year.

In 2016 HUF 19 million was recognized as expenses for the program (2015: HUF 13 million).

### 24.1.3 Long-term incentive program (LTI)

As of January 1, 2015 Magyar Telekom Group changed its existing LTI program, turning it into a share-based compensation program. Approximately 60 executives may participate in the program. The CEO's participation is unconditional, while other executives may participate only if the evaluation of the participant's performance in the previous year meets the requirements.

LTI is payable in cash tied to the achievement of four key strategic indicators. In the framework of the program, in each year a new four-year tranche is to be launched. Payment is due after the end of the program term depending on the evaluation of the achievement of the pre-set targets (0 to 150%).

At the beginning of the program, the relevant incentive amount is converted into a number of virtual shares of DTAG and awarded to the plan participant in the form of virtual shares (basic number). The annual level of target achievement is determined at the end of each year. This target achievement level is multiplied on a pro rata basis by the basic number of virtual shares awarded. The number of virtual shares calculated using this method shall then be "fixed" for the plan participant as the binding result for that specific year ("annual result"). At the end of the plan term, the four binding annual results shall be added together. The resulting total number of virtual shares shall be converted into cash applying the then prevailing share price of DTAG, which is paid to the plan participants. For dividend payments during the plan term, the virtual shares shall be treated as real shares. The dividends shall be taken into account as follows: The first/second/third dividend payments shall be "reinvested" into virtual shares when the actual dividends are paid on real shares. The fourth (and last) dividend payment shall not be reinvested but paid in cash together with the plan payment following the DTAG shareholders' meeting at which a decision is made regarding this dividend payment. The plan currency is euro.

In 2016 HUF 370 million was recognized as expenses for the program (2015: HUF 217 million).

### 24.2 Share transfer to ESOP Organization

In July 2016 Magyar Telekom launched a Remuneration Policy based employee share ownership program (ESOP) under which Magyar Telekom shares will be distributed to the vast majority of the employees of Magyar Telekom Plc. and T-Systems Hungary Ltd.. This program is in addition to the Company's regular remuneration package. The award of shares is contingent on the Company's actual internal operating Free Cash Flow of MT-Hungary segment of the year ending December 31, 2016 exceeding that of the year ended December 31, 2015. Each eligible individual will be entitled to receive 226 Magyar Telekom shares (in the value of HUF 100,000 calculated on the unweighted average share price of 20 trading days prior to June 30, 2016), along with any entitlement to the dividends attached to such shares and with no lock-up restrictions. In July 2016, the Company purchased 1,261,204 Magyar Telekom shares in the open market, which was completed by 272,432 treasury shares to finance the program. In order to distribute the shares an employee share ownership organization (ESOP Organization) was established by the Company and registered by the Metropolitan Court in 2016, which has its supreme body and management appointed by the founder (i.e. the Company). Upon the confirmation of the improvement of the oFCF of MT-Hungary segment by the Board of Directors in late February 2017, the ESOP Organization is expected to distribute the shares amongst 6,646 employees in April 2017, where each eligible individual will be entitled to receive 226 shares.

In accordance with the ESOP Act the ESOP Organization shall manage the financial instruments provided to the ESOP Organization in accordance with the effective remuneration policies and the Articles of Association of the ESOP Organization.

The ESOP Organization is managed and represented by the managing director. The managing director is vested with powers to solely represent the ESOP Organization. The managing director is nominated and recalled by the Attorney. The managing director shall not be instructed by the Founder or the Participants.

Magyar Telekom transferred 1,533,636 treasury shares in August 2016 to the established ESOP Organization of which it sold 25,764 shares due to the revision of the number of the participants in the program. The ESOP Organization was fully consolidated as at December 31, 2016 as it was controlled by the Company.

In 2016 HUF 493 million was recognized as expenses for the program.

## 25 OTHER OPERATING EXPENSES

In HUF millions	For the year ended December 31,	
	2015	2016
Telecom tax ..... (a)	25,223	24,260
Utility tax ..... (b)	7,649	7,265
Rental and leasing expenses .....	15,820	17,625
Marketing expenses .....	13,298	12,628
Energy costs .....	8,956	9,459
Cost of other purchased services ..... (c)	49,395	54,056
Other operating expenses .....	11,034	11,113
	<u>131,375</u>	<u>136,406</u>

### (a) Telecom tax

Telekom tax was introduced in Hungary for fixed and mobile voice and mobile SMS/MMS services, effective from July 1, 2012. The tax imposed on fixed and mobile usage amounts to HUF 2 per minute and HUF 2 per SMS/MMS for private individual subscribers' subscriptions and to HUF 3 per minute and HUF 3 per SMS/MMS for non-private individual subscribers' subscriptions. The tax is capped at HUF 700 and HUF 5,000 per month per calling number for private and non-private individuals' subscriptions, respectively.

### (b) Utility tax

In 2012 the Hungarian Parliament adopted an act imposing a new tax on utility networks, effective from January 1, 2013. The act provides that a tax of HUF 125 per meter is levied on the owners of ducts providing for electricity, telecommunication, natural gas, heating, water and wastewater services. For telecommunication networks, the level of tax levied depends on the length of ducts: 20% of the HUF 125 per meter is levied on the first 170,000 meter length of ducts, 40% is levied between 170,000 and 250,000 meters, 80% is levied between 250,000 and 300,000 meters, while the total HUF 125 per meter has to be paid for all ducts above 300,000 meters.

### (c) Audit costs included in Cost of other purchased services

Cost of other purchased services among others include expenses incurred in relation to the audit of the standalone and consolidated financial statements of the members of the Group as well as other services provided by PricewaterhouseCoopers (PwC) as follows.

In HUF millions	For the year ended December 31,	
	2015	2016
Audit of the financial statements .....	403	395
Other audit related fees .....	153	160
Other non audit related fees .....	168	121
Total expenses payable to PwC.....	<u>724</u>	<u>676</u>

Audit of the financial statements is the aggregate fees of PwC in connection with the audit of our annual financial statements and services performed in relation to legal obligations and submissions required by regulatory provisions.

Other audit-related fees are the aggregate fees of PwC for reviews of quarterly reports and 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.

Other non audit related fees are fees of PwC primarily related to consulting services and services like participation by Magyar Telekom employees in conferences and training sessions organized by PwC.



## 26 OTHER OPERATING INCOME

In HUF millions	For the year ended December 31,	
	2015	2016
Income on the sale of PPE, Intangible assets and assets held for sale - net .....	1,163	4,249
Gain on sale of Origo (Note 11.1) .....	-	2,149
Income received for the relocation and reconstruction of our own network .....	2,255	1,111
Income from insurance compensation .....	337	302
Income from intra-DT group support services .....	1,242	107
Other operating income .....	1,874	3,072
	<u>6,871</u>	<u>10,990</u>

## 27 INTEREST INCOME

In HUF millions	For the year ended December 31,	
	2015	2016
Interest income on loans and receivables .....	791	678
Finance lease interest income .....	91	38
Reversal of interest element of provisions .....	64	30
Dividend income .....	-	14
	<u>946</u>	<u>760</u>

## 28 INTEREST EXPENSE

In HUF millions	For the year ended December 31,	
	2015	2016
Interest expense payable to DT .....	16,787	13,890
Other interest expense .....	4,026	3,457
Finance lease interest expense .....	1,089	1,185
Accretion / interest on provisions .....	126	158
less: borrowing costs capitalized .....	(244)	(120)
	<u>21,784</u>	<u>18,570</u>

Total Interest expense is shown net of borrowing costs capitalized using average borrowing rates of 3.77%-4.33% in 2016 (2015: 4.17% - 5.17%). When calculating the borrowing rates, Other finance expenses (included in Note 29) are also considered.

## 29 OTHER FINANCE EXPENSE – NET

In HUF millions	For the year ended December 31,	
	2015	2016
Fee expense .....	4,484	4,964
Net foreign exchange losses / (gains) on financial instruments .....	1,095	(29)
Other net foreign exchange losses.....	809	(18)
Losses / (gains) on the subsequent measurement of derivatives contracted with related parties.....	5,867	3,882
Losses / (gains) on the subsequent measurement of derivatives contracted with third parties.....	(177)	79
Losses / (gains) on the derecognition of derivatives contracted with related parties .....	(5,153)	207
Losses / (gains) on the derecognition of derivatives contracted with third parties .....	413	(80)
Losses / (gains) on the derecognition of AFS financial instruments (Reclassifications from Other comprehensive income) .....	-	-
	<u>7,338</u>	<u>9,005</u>

## 30 PURCHASE OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

The table below shows the reconciliation of investments in property, plant and equipment and intangible assets and the cash payments made for these investments. Capitalized borrowing costs are included in the Investments in PPE and intangible assets, where applicable.

In HUF millions	For the year ended December 31,	
	2015	2016
Investments in property, plant and equipment (Note 12) .....	78,809	72,182
Investments in intangible assets (Note 13) .....	31,038	41,073
Total investments in PPE and intangible assets .....	109,847	113,255
Advances received for asset-related grants .....	(a) -	(5,104)
Capitalized leases .....	(b) (4,064)	(1,459)
Change in liabilities relating to capital expenditures .....	(c) (8,928)	3,216
Cash payments for purchases of PPE and intangible assets.....	<u>96,855</u>	<u>109,908</u>

### (a) Advances received for asset-related grants

In 2016 HUF 12.2 billion of EU funds have been granted to Magyar Telekom Group (Details in Note 20.1 (a).) HUF 5.1 billion were received by the Company as advance for this grant, and none of this was used up in 2016. As such grants are deducted from the original cost of the items (Note 2.7), the amount reduces cash payments for purchases of PPE and intangible assets.

### (b) Capitalized leases

Investments in PPE as a result of finance lease transactions do not usually result in immediate cash payments. The cash payments throughout the lease term appear as Repayment of other financial liabilities (Financing cash flow) and Interest and other financial charges paid (Operating cash flow).

**(c) Change in trade payables relating to capital expenditures**

Change in payables relating to capital expenditures includes the effect that the actual cash settlement of the vendor invoices is made subsequent to the recognition of the investment.

**31 PURCHASE OF SUBSIDIARIES AND BUSINESS UNITS**

In HUF millions	For the year ended December 31,	
	2015	2016
Cable TV businesses (Note 5.1.1) .....	2,237	128
GTS Hungary (Note 5.1.2) .....	14,269	-
Daten-Kontor.....	231	-
Cash payments for purchases of subsidiaries and business units .....	<u>16,737</u>	<u>128</u>

Cash payments related to the purchases of subsidiaries and business units include advance payments made before the closing of the transaction, the initial purchase price paid on the closing of the transaction as well as 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 2016 to further simplify the operation on every managerial level of the company. The Group's new operating segments are MT-Hungary, Macedonia and Montenegro. MT-Hungary includes the former T-Hungary segment (residential and SMB customers) and former T-Systems (enterprise segment). The Macedonia and Montenegro segments have not changed. Comparative information has been provided for 2015, including minimum level of estimates as the new structure was introduced in 2016, when it was a simple regrouping of organizations. These numbers have never been reviewed or evaluated by the MC.

The MT-Hungary segment operates in Hungary providing mobile and fixed line telecommunications, TV distribution, infocommunications and system integration services, energy retail services to millions of residential and business customers under the Telekom and T-Systems brands. Small and medium business customers are served by the Telekom brand and key business customers (large corporate and public sector customers) are served by the T-Systems brand. The MT-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 and Romania providing mainly wholesale services to local companies and operators.

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 Management Committee (MC)**

The following tables present the segment information by reportable segment regularly provided to the MC of the Company, 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 Revenue, EBITDA and Capex are the segment measures that are most consistent with the measurement principles used in measuring the corresponding amounts in these financial statements.



**Revenues**

In HUF millions	For the year ended December 31,	
	2015	2016
Total MT- Hungary revenues.....	572,616	520,994
Less: MT- Hungary revenues from other segments .....	(248)	(292)
Telekom Hungary revenues from external customers .....	572,368	520,702
Total Macedonia revenues .....	53,608	53,414
Less: Macedonia revenues from other segments .....	(91)	(81)
Macedonia revenues from external customers .....	53,517	53,333
Total Montenegro revenues.....	30,500	28,648
Less: Montenegro revenues from other segments .....	(41)	(32)
Montenegro revenues from external customers .....	30,459	28,616
Total consolidated revenue of the segments .....	656,344	602,651
Measurement differences / rounding between segment and Group revenue .....	(2)	-
<b>Total revenue of the Group .....</b>	<b>656,342</b>	<b>602,651</b>

**Segment results (EBITDA)**

In HUF millions	For the year ended December 31,	
	2015	2016
MT-Hungary .....	155,731	168,920
Macedonia .....	20,811	19,162
Montenegro .....	10,699	9,439
Total EBITDA of the segments .....	187,241	197,521
Measurement differences / rounding between segment and Group EBITDA .....	60	(482)
<b>Total EBITDA of the Group .....</b>	<b>187,301</b>	<b>197,039</b>
Depreciation and amortization.....	(113,784)	(117,476)
Total Operating profit .....	73,517	79,563
Net financial result .....	(28,176)	(26,815)
Share of associates' and joint ventures' losses .....	-	78
Total Profit before income tax .....	45,341	52,826
Income tax expense .....	(13,794)	4,397
Total Profit for the year .....	31,547	57,223



**Capital expenditure (Capex) on PPE and Intangible assets**

In HUF millions

		As at December 31,	
		2015	2016
MT-Hungary .....		93,796	87,391
Macedonia .....		10,556	10,306
Montenegro .....		5,249	6,481
Total capital expenditure of the segments .....		109,601	104,178
Acquisition of mobile licenses (Note 13) .....		502	9,232
Other measurement differences between segment and Group Capex .....		(256)	(155)
<b>Total investments of the Group in PPE and Intangible assets .....</b>		<b>109,847</b>	<b>113,255</b>

The acquisition of mobile licenses is not considered part of the Capex measure of the segments. 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.

**Revenues**

In HUF millions

		For the year ended December 31,	
		2015	2016
Hungary .....		566,584	515,990
Macedonia .....		53,517	53,333
Montenegro .....		30,459	28,616
Romania .....		4,095	2,982
Bulgaria .....		1,687	1,730
Total revenue of the Group .....		656,342	602,651

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.

**Non current assets**

In HUF millions

		As at December 31,	
		2015	2016
Hungary .....		832,158	815,757
Macedonia .....		98,689	95,918
Montenegro .....		38,313	46,939
Bulgaria .....		3,075	3,086
Romania .....		1,614	1,524
Total excluding Non current financial assets and Deferred tax assets .....		973,849	963,224
Non current financial assets (Note 8.2) .....		22,950	18,254
Deferred tax assets (Note 9.4) .....		47	73
Total Non current assets of the Group .....		996,846	981,551

## 33 LEASES AND OTHER COMMITMENTS

### 33.1 Finance lease – Group as lessee

Finance leases in 2015 and 2016 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 5–15 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, 2015 and 2016 are as follows:

In HUF millions	At December 31, 2015			At December 31, 2016		
	Present value	Interest component	Minimum lease payment	Present value	Interest component	Minimum lease payment
Within 1 year .....	200	795	995	98	786	884
1–5 years .....	576	2,628	3,204	582	2,578	3,160
After 5 years .....	1,169	1,732	2,901	1,257	1,282	2,539
Total .....	1,945	5,155	7,100	1,937	4,646	6,583

Finance leases other than sale and lease back in 2015 and 2016 mainly relate to IPTV set-top-boxes, vehicles and IT equipment. In most cases the contract term of the leases is 2–5 years partly with renewal options and mostly with no purchase options.

Future lease payments under finance leases other than sale and lease back transactions at December 31, 2015 and 2016 are as follows:

In HUF millions	At December 31, 2015			At December 31, 2016		
	Present value	Interest component	Minimum lease payment	Present value	Interest component	Minimum lease payment
Within 1 year .....	3,655	303	3,958	2,246	331	2,577
1–5 years .....	1,994	859	2,853	786	1,038	1,824
After 5 years .....	786	580	1,366	853	592	1,445
Total .....	6,435	1,742	8,177	3,885	1,961	5,846

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 and equipment. The following table includes the future minimum lease payments payable of the Group:

In HUF millions	At December 31,	
	2015	2016
Within 1 year .....	10,478	10,723
1–5 years .....	24,717	26,274
After 5 years .....	8,449	7,085
Total .....	43,644	44,082

The lease commitments represent a high amount of individually immaterial lease agreements, the terms of which vary on a wide range, spanning from 1 to 20 years with renewal options in most cases, but no purchase options.

### 33.3 Finance lease – Group as lessor

Finance leases mainly include 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, 2015 and 2016 are as follows:

In HUF millions	At December 31, 2015			At December 31, 2016		
	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt
Within 1 year .....	361	73	434	602	137	739
1–5 years .....	871	150	1,021	372	54	426
After 5 years .....	264	49	313	222	31	253
Total .....	1,496	272	1,768	1,196	222	1,418

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 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 mobile tower sections and PBX (private business exchange) equipment where Magyar Telekom is the lessor.

In HUF millions	At December 31,	
	2015	2016
Within 1 year .....	1,147	406
1–5 years .....	2,102	418
After 5 years .....	179	298
Total .....	3,428	1,122

### 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 two years.

In HUF millions	At December 31,	
	2015	2016
Property, plant and equipment .....	3,767	4,697
Intangible assets .....	4,579	5,174
Total .....	8,346	9,871

### 33.6 Purchase commitments for businesses

As at December 31, 2016 and 2015 the Group had no significant committed business combinations.

## 34 RELATED PARTY TRANSACTIONS

No impairment was recognized for receivables from related parties in the reported years.

### 34.1 Deutsche Telekom Group and the Federal Republic of Germany

#### 34.1.1 Deutsche Telekom Group

Deutsche Telekom AG is the ultimate (indirect) controlling owner of Magyar Telekom Plc. holding 59.21% of the voting rights attached to the Company's shares. Deutsche Telekom Group has a number of fixed line, mobile and IT service provider subsidiaries worldwide, with whom Magyar Telekom Group has regular transactions.

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 and balances with DT Group.

In HUF millions	2015	2016
Revenues from services provided to DT Group companies .....	17,242	16,867
Costs of services provided by DT Group companies.....	(11,644)	(11,886)
Income from support services provided to DT Group companies .....	1,242	107
Interest expense to DTIF .....	(5,825)	(4,449)
Interest expense to DTAG .....	(10,962)	(9,441)
Dividend paid to parent company .....	-	9,262
Accounts receivable from DT Group companies .....	10,592	10,744
Accounts payable to DT Group companies .....	(15,766)	(16,156)
Loans payable to DTIF.....	(106,798)	(110,919)
Loans payable to DTAG .....	(243,249)	(199,300)
Fair value of swap agreements with DTAG – asset .....	6,553	5,268
Fair value of swap agreements with DTAG – liability .....	(854)	(3,452)

Deutsche Telekom has pledged its support for Magyar Telekom's budgeted financing needs through to June 30, 2018.



### 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' meetings, the Federal Republic of Germany represents a solid majority at the shareholders' meetings 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 2016 or 2015 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 and the transactions with them are not material.

E2 Hungary Zrt. is a joint venture of the Magyar Telekom Group since July 9, 2015. The company had no operational activities in 2015 and provided energy services for business customers from 2016.

As at December 31, 2016 and 2015, the Company made an advance payment to E2 for the energy services to be provided by E2 to the Company and its remaining customers, which amounted to HUF 912 million in 2016 and HUF 3,338 million in 2015.

### 34.3 Board and Supervisory Board members

In HUF millions	For the year ended December 31,	
	2015	2016
Remuneration of the members of the Board of Directors .....	16	16
Remuneration of the members of the Supervisory Board .....	63	63
Loans granted to the members of the Board of Directors .....	-	-
Loans granted to the members of the Supervisory Board.....	4	2

Loans granted to the members of the Supervisory Board are limited to the employee delegates and had been granted to them in their capacity as employees.

### 34.4 Key management

Key management has been identified as the members of the Company'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.

In HUF millions	For the year ended December 31,	
	2015	2016
Salaries and other short-term employee benefits .....	1,568	1,727
Contractual termination expense .....	-	-
Share based compensation (Notes 24.1.1 and 24.1.2) .....	24	33
	1,592	1,760



Of which costs expensed in relation to defined contribution plans (including social security contribution).....	349	347
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The Group does not provide loans to its key management.

## 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, 2016 and 2015.

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:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1)
- inputs other than quoted prices included within Level 1 observable for the asset or liability, either directly or indirectly (Level 2)
- 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. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques, mainly by applying the discounted cash flow method. The cash flow estimations are based on the relevant underlying contracts and the discount rates are calculated based on the interest rate benchmarks applicable for the relevant maturities and currencies (BUBOR, BIRS, EURIBOR, EUR swap yields). Foreign exchange conversion is made based on central bank FX fixings (preferably that of the Central Bank of Hungary). 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, 2016**

In HUF millions	Carrying amount				Total	Fair value
	Loans and receivables	Held-to-maturity	Available-for-sale (Level 1)	FVTPL (Level 2)		
Cash and cash equivalents .....	10,805	-	-	-	10,805	10,805
Bank deposits with original maturities over 3 months.....	950	-	-	-	950	950
Trade receivables within one year .....	146,706	-	-	-	146,706	146,706
Trade receivables over one year.....	8,763	-	-	-	8,763	9,316
Loans and receivables from employees.....	5,026	-	-	-	5,026	5,027
Derivative financial instruments contracted with related parties .....	-	-	-	5,268	5,268	5,268
Finance lease receivable .....	1,196	-	-	-	1,196	1,230
Financial assets AFS.....	-	-	309	-	309	309
Other current .....	1,247	-	-	-	1,247	1,247
Other non current .....	599	-	-	-	599	439
<b>Total .....</b>	<b>175,292</b>	<b>-</b>	<b>309</b>	<b>5,268</b>	<b>180,869</b>	<b>181,297</b>

**December 31, 2015**

In HUF millions	Carrying amount				Total	Fair value
	Loans and receivables	Held-to-maturity	Available-for-sale (Level 1)	FVTPL (Level 2)		
Cash and cash equivalents .....	17,558	-	-	-	17,558	17,558
Bank deposits with original maturities over 3 months.....	7,982	-	-	-	7,982	7,982
Trade receivables within one year .....	147,080	-	-	-	147,080	147,080
Trade receivables over one year.....	10,302	-	-	-	10,302	10,884
Loans and receivables from employees.....	5,041	-	-	-	5,041	5,613
Derivative financial instruments contracted with related parties .....	-	-	-	6,553	6,553	6,553
Derivative financial instruments contracted with third parties.....	-	-	-	79	79	79
Finance lease receivable .....	1,494	-	-	-	1,494	1,582
Financial assets AFS.....	-	-	278	-	278	278
Other current .....	1,531	-	-	-	1,531	1,531
Other non current .....	742	-	-	-	742	994
<b>Total .....</b>	<b>191,730</b>	<b>-</b>	<b>278</b>	<b>6,632</b>	<b>198,640</b>	<b>200,134</b>

Loans and receivables are measured at amortized cost, while available-for-sale and held-for-trading assets are measured at fair value.

Fair value through profit or loss assets include derivative financial instruments, the fair values of which are based on a discounted cash flow method. The calculation is prepared by Magyar Telekom based on money market interest rate curves, basis swap points and spot FX rates from Reuters database published at the last working day of the reporting period. The present value of the expected future cash flows are discounted to the reporting date using money market interest rates and basis swap points in the specific currency from



Reuters and exchanged to HUF using spot FX rate. The difference between the HUF present value of the payable and receivable is accounted for as assets or liabilities.

The carrying values of assets measured at amortized cost with short times to maturity approximate their fair values.

Financial assets available for sale include insignificant investments in equity instruments, all measured at fair value, which is the Macedonian stock exchange price of the equity instruments.

**35.1.2 Financial liabilities – Carrying amounts and fair values**

**December 31, 2016**

In HUF millions	Carrying amount		Total	Fair value
	Measured at amortized cost	FVTPL (Level 2)		
Financial liabilities to related parties.....	316,316	3,452	319,768	348,490
Bank loans .....	11,501	-	11,501	11,501
Trade payables.....	136,623	-	136,623	136,623
Payable for building exchange transaction.....	952	-	952	952
Frequency fee payable.....	48,490	-	48,490	53,051
Finance lease liabilities .....	5,822	-	5,822	9,305
Debtors' overpayment.....	1,180	-	1,180	1,180
Other current .....	3,348	-	3,348	3,348
Other non current .....	1,405	-	1,405	1,452
<b>Total .....</b>	<b>525,637</b>	<b>3,452</b>	<b>529,089</b>	<b>565,902</b>

**December 31, 2015**

In HUF millions	Carrying amount		Total	Fair value
	Measured at amortized cost	FVTPL (Level 2)		
Financial liabilities to related parties.....	356,140	854	356,994	362,782
Bank loans .....	13,070	-	13,070	13,072
Trade payables.....	140,182	-	140,182	140,182
Payable for building exchange transaction.....	1,863	-	1,863	1,917
Frequency fee payable.....	51,378	-	51,378	53,758
Finance lease liabilities .....	8,380	-	8,380	7,815
Debtors' overpayment.....	1,329	-	1,329	1,329
Other current .....	3,877	-	3,877	3,877
Other non current .....	1,112	-	1,112	1,188
<b>Total .....</b>	<b>577,331</b>	<b>854</b>	<b>578,185</b>	<b>585,920</b>

Derivatives are measured at fair value, while all other financial liabilities are measured at amortized cost.

Additional fair value information on the loans and other borrowings is provided in Notes 16 and 17.

The carrying values of the current financial liabilities measured at amortized cost approximate their fair values.

FVTPL liabilities include derivative financial instruments, the fair values of which are calculated the same way as FVTPL assets disclosed above in Note 35.1.1.

**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 2016 and 2015.

2016 In HUF millions	From interest	From subsequent measurement			From derecog- nition	From fee expense	Total net gain / (loss)
		At fair value	Currency translation	Impair- ment loss			
Available-for-sale financial assets (Level 1).....	-	64	-	-	-	-	64
FVTPL financial instruments (Level 2).....	-	(3,961)	-	-	(127)	-	(4,088)
Loans and receivables .....	678	-	(536)	(8,508)	-	(4,824)	(13,190)
Financial liabilities measured at amortized cost.....	(17,304)	-	565	-	-	(96)	(16,835)
Net gain/(loss) on financial instruments.....	(16,626)	(3,897)	29	(8,508)	(127)	(4,920)	(34,049)

2015 In HUF millions	From interest	From subsequent measurement			From derecog- nition	From fee expense	Total net gain / (loss)
		At fair value	Currency translation	Impair- ment loss			
Available-for-sale financial assets (Level 1).....	-	44	-	-	-	-	44
FVTPL financial instruments (Level 2).....	-	(5,690)	-	-	4,740	-	(950)
Loans and receivables .....	791	-	415	(9,537)	-	(4,401)	(12,732)
Financial liabilities measured at amortized cost.....	(20,737)	-	(1,510)	-	-	(49)	(22,296)
Net gain/(loss) on financial instruments.....	(19,946)	(5,646)	(1,095)	(9,537)	4,740	(4,450)	(35,934)

The tables above include the amounts before capitalization of borrowing costs (See Note 28).

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 Offsetting financial assets and financial liabilities

For the financial assets and liabilities subject to enforceable netting arrangements, each agreement between the Group and the counterparty (typically roaming and interconnect partners) allows for net settlement of the relevant trade receivable and payable.

The following trade receivables and trade payables are subject to offsetting agreements, and are presented after netting in the Consolidated statements of financial position.

In HUF millions	At December 31, 2015		At December 31, 2016	
	Trade and other receivables	Trade payables	Trade and other receivables	Trade payables
Gross amounts of recognized financial instruments.....	166,508	143,928	160,926	139,904
Gross amounts of financial instruments set off.....	(3,746)	(3,746)	(3,281)	(3,281)
Net amounts of recognized financial instruments presented in the statement of financial position.....	162,762	140,182	157,645	136,623

### 35.4 Other disclosures about financial instruments

Magyar Telekom is also exposed to risks that arise from the possible drawdown of guarantees in a nominal amount of HUF 10.2 billion as at December 31, 2016 (2015: HUF 11.3 billion). These guarantees were issued by 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 significant drawdown of the guarantees happened in 2016 or 2015, 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 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 Hungary

#### 36.2.1.1 Guarantees

Magyar Telekom Plc. is exposed to risks that arise from the possible drawdown of guarantees for which see more details in Note 35.4.

## 37 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 and annual payments.

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

### 37.1 Hungarian Mobile

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). The National Media and Infocommunications Authority of Hungary (NMAIAH) is the supreme supervisory body and is responsible for secondary legislation making and the preparation of relevant decrees.

In June 2012, the Hungarian Parliament adopted the modification of the Electronic Communications Law extending the scope of competence and tasks of the NMAIAH. Pursuant to the amendment, all spectrum related issues are dealt with by the NMAIAH, including the management of concession contracts.

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.

The Company won a tender for a spectrum usage right license for a 26 GHz block on April 30, 2009. On May 14, 2012 the NMAIAH granted frequency assignment decision to Magyar Telekom for 4 pieces of basic spectrum blocks (2 x 28 MHz each) in the 26 GHz band. Furthermore Telekom acquired GTS Hungary Ltd's blocks in the 26 GHz band for 114,6 million HUF net, and has a usage right for it from November 1, 2016.

The Company filed an auction bid in December 2011 with the NMAIAH for the right of use of unused spectrum in the 900 MHz frequency band, related to the provision of mobile telecommunications services. The spectrum can be utilized in a technology-neutral manner. The NMAIAH announced its first-instance decision on the result of the 900 MHz auction (Auction) on January 30, 2012. Magyar Telekom won the right of use of two duplex frequency blocks of 1 MHz each for a period of 15 years.

On September 6, 2013 Magyar Telekom and the NMAIAH signed the modification of the Authority Contract on the use of the 900 MHz and 1800 MHz frequency bands. The main stipulations of the modification are the following:

- Magyar Telekom's frequency usage rights in the 1800 MHz frequency band otherwise expiring on October 7, 2014 and in the 900 MHz frequency band otherwise expiring on May 4, 2016 were prolonged and harmonized until April 2022.
- Magyar Telekom will retain frequency usage right also until April 2022 on the two duplex 1 MHz frequency blocks in the 900 MHz frequency band won in the 900 MHz auction in 2012. Accordingly, Magyar Telekom currently has frequency usage rights of 10 MHz duplex frequency blocks in the 900 MHz frequency bands and of 15 MHz duplex blocks in the 1800 MHz frequency band.
- The initial fee of the prolongation and harmonization of 900 MHz/1800 MHz frequency licences was HUF 38 billion. However, Magyar Telekom was required to pay HUF 34 billion out of the aforementioned amount, considering the expiry of the frequency blocks won in 2012 being changed from the original 2027 date to 2022.

On May 22, 2014, the NMAIAH published the "Documentation for the tender announced in the subject of spectrum licences for broadband services". Blocks in 800 MHz / 900 MHz / 1800 MHz / 2600 MHz and 26 GHz frequency bands were auctioned.

On September 29, 2014 the NMIAH published the tender results so that Magyar Telekom acquired the following frequencies for an aggregate amount of HUF 58,650 million:

- 2 x 10 MHz in 800 MHz
- 2 x 2 MHz in 900 MHz
- 2 x 30 MHz in 2600 MHz
- 2 x 10 MHz in 1800 MHz.

On October 15, 2014 Magyar Telekom and the NMIAH signed the Authority Contract on the use of the 800MHz, 900 MHz and 1800 MHz frequency bands that came into force right on that day. For the new bands the frequency license and radio permission were issued on October 17, 2014 to Magyar Telekom.

As a result of the last tender Magyar Telekom acquired frequency usage rights in the above listed spectrums till June 15, 2029. The Authority Contract can be prolonged with further 5 years if all requirements defined in the contract are met.

The Company is subject to number portability regulation since 2004, applicable only in case of other mobile operators. The Company is designated as an SMP operator in the mobile wholesale call termination market (new M2, old M7 market) and subject to regulatory obligations regarding the termination charge of calls into its network, mobile termination rate (MTR). At the end of August 2011, the NMIAH made its third new market analysis decisions. On the mobile voice market the three mobile operators had to cut their wholesale prices by 40% in three steps. The last mobile market resolution was published on March 18, 2015 with a newly defined pure Bottom-Up Long Run Incremental Costing model (pure BU-LRIC) resulting in an MTR of 1.71 HUF/min net cost based fee.

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 first EU roaming regulation prescribed a glide-path that mandated annual reductions of wholesale and retail prices. (EU Roaming Regulation I.)

As of July 2009 the EU also introduced regulated tariffs for SMS and data roaming similarly to the regulation of voice roaming. (EU Roaming Regulation II.)

As of July 1, 2012 the EU further broadened the European roaming regulation with a new regulatory measure: separate sales of regulated roaming services. As a result Magyar Telekom had to implement the technical possibility to host an Alternative Roaming Provider in its network and also it allows its own customers to use Local Break-out solutions within the EU offered by a foreign EU member country's mobile operator from July 1, 2014. (EU Roaming Regulation III.)

The last EU roaming regulation was approved by the EU Parliament on October 27, 2015. By this last regulation European MNOs are obliged to offer a "Roam Like At Home Plus Surcharge" model from April 30, 2016. Implementation of the surcharge is optional. Furthermore a "Full Roam Like At Home With Fair Use Policy Possibility" model is to be applied from June 15, 2017. Implementation of the fair use policy is also optional (EU Roaming Regulation IV.). As a result, European retail roaming price levels for voice, SMS and data will be equal to domestic prices. The Commission implementing regulation (EU) 2016/2286 of 15 December 2016 is laying down detailed rules on the application of fair use policy and on the methodology for assessing the sustainability of the abolition of retail roaming surcharges and on the application to be submitted by a roaming provider for the purposes of that assessment. The implementation regulation is in force since 6 January 2017.

### **37.2 Hungarian Fixed line**

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. The NMIAH published its request for proposal on the provision of universal services on November 4, 2013. The Company submitted a bid for access on fixed location and for national directory enquiry service. MT was designated by NMIAH as a universal service provider for public payphones (came into force on June 1, 2014); for fixed line access (came into force on July 1, 2014) and for directory services, phonebook (came into force on August 1, 2014).

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 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 is Hungary's leading fixed line broadband service provider in the wholesale market and one of the leading ones in the retail market. In accordance with the effective resolution, all retail fixed 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. Both the current fees and retail minus (RM) values of wholesale broadband services are specified in the current RM resolution of the NMIAH. Approval process of the new fees for RM23 time period was closed by the resolution from October 1, 2016. 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. We assume that the retail minus methodology will be modified with the next market resolutions and a new BU-LRIC+ methodology will also be used in the regulated wholesale fixed broadband market from Q2 2017.

SMP operators are obliged to prepare reference unbundling offer 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 is based on Top-Down Long Run Incremental Costs (TD-LRIC) approach. The next 3a and 3b market analysis will result in a BU-LRIC+ model that is going to be built by the advisor of the NMIAH. Magyar Telekom will remain an SMP in these markets and also will be obliged to submit its next MARUO in Q2 2017 with an assumed approval in Q2 2017.

As a result of the fourth round of the market analysis procedure, the NMIAH published its new market analysis resolutions on call origination and termination (M2 and M3), in 2013. Main amendments are the following: obligations are extended to all telephone operators (altogether 124 providers), due to the scheme applied by the NMIAH both termination fees were determined symmetrically which is different from the practice of the past years. Relevant change to previous decisions was the new cost calculation methodology, which is pure BU-LRIC instead of TD-LRIC+. It is assumed to have a further price decrease with the next market analysis round.

SMPs are also obliged to prepare reference offer for interconnection (RIO), containing applicable fees, and to provide these services in accordance with the reference offer when there is a request towards them by other telecommunications service providers. The new fixed termination fee had been set for all SMP operators already from January 1, 2014. The new MARIO and the call origination and supplementary interconnection service fees came into force on September 1, 2014.

SMP operators are obliged to enable carrier selection to their subscribers regardless the access technology the voice service is offered (VoIP is also CPS obliged).

Fixed line telecommunications service providers are obliged to provide number portability on their networks starting January 1, 2004.

### 37.3 Energy services in Hungary

Magyar Telekom has been providing electricity and natural gas services in Hungary since May 2010 as an electricity and natural gas supplier.

Magyar Telekom's energy revenues contain energy fees, system operator relevant fees and other fees. In case of the residential customers and a part of the business customers (universal customers) the sales price is based on the Universal Service Providers' (USP) price which is regulated by the Minister of National Development.

Magyar Telekom decided to exit from the residential segment of the gas market with effect from July 31, 2015, following changes in the energy market environment. From October 1, 2016 Magyar Telekom seized its operation in the public procurement gas market as the natural gas services segment of the energy business was outsourced to E2 Hungary Zrt., a joint venture owned by Magyar Telekom Plc. and MET Holding AG to operate in the business and public procurement segment of the Hungarian gas and energy market.

The exit from the gas business has no direct impact on the residential electricity service that is still provided by Magyar Telekom. However, as with residential gas, the Company will remain watchful as to how any future developments in the market environment might impact our operations, and if deemed necessary, be swift to take appropriate action.

In accordance with the agreement of the owners, Magyar Telekom transferred its business energy operations to E2 and serves the business customers through its joint venture.

### 37.4 Macedonian Mobile

The Group is also present in the Macedonian mobile market through its subsidiary, Makedonski Telekom AD Skopje (MKT, previously T-Mobile). The Macedonian telecommunications sector is regulated by the Electronic Communications Law (ECL) enacted in March 2014 as primary legislation and rulebooks as secondary legislation.

On September 5, 2008 the Agency, ex officio, issued a notification to T-Mobile 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 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. Due to changes in the bylaws the 900 MHz band was opened for UMTS technology and based on T-Mobile's request the radiofrequency license was changed so that these frequencies are now available for both GSM and UMTS technology.

After the analysis of the wholesale (WS) market "Call termination services in public mobile communication networks" the Agency in 2007 brought a decision by which T-Mobile was designated with SMP status on this market. The price regulation on this relevant market continues as AEC conducts periodical analysis of the market and updates the price regulation models.

In 2008 a decision for granting three 3G licenses was published. 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.

In 2010 T-Mobile was designated with SMP status on the wholesale market "Access and call origination in public mobile communication market". Based upon Agency's decision, in 2010 T-Mobile published a Referent Access Offer consisted of the following regulated services:

- call origination for Mobile Virtual Network Operator (MVNO)
- call origination for national roaming operator,
- SMS origination for MVNO and
- SMS origination for national roaming operator.

There hasn't been a second round analysis on this market since 2010, and there hasn't been MVNO or national roaming operator on T-Mobile network. An MVNO, Albafone hosted on ONE network entered the Macedonian market and started commercial operations in 2013.

In 2011, the Agency published the final analysis of the wholesale (WS) market "SMS termination in public mobile communication networks", and in May 2011 all 3 mobile operators were designated with SMP status on this relevant market. In July 2011 the RIOs were approved by the Agency with the regulated SMS termination price being symmetrical for all 3 operators but remaining the same as before the regulation.

On December 19, 2014, amendments of the ECL were enacted. One of the most important changes was implemented by Article 75-a, which regulates the prices of international roaming. According to this article, the AEC has the right with the Decision to determine the maximum prices for services which are offered to roaming users from countries the Macedonian Republic concluded agreement with for the reduction of prices of roaming services in public mobile communication networks, on reciprocal base, which cannot be higher than the prices of the same services in the EU. In the period of 3 years from 2015, the prices will be reduced to the maximum determined.

The Director of the AEC brought a Decision on December 10, 2014 for the value of points for calculation of annual fee for the usage of radiofrequencies (RF). The value of the points is 0.8 EUR (approximately HUF 250) which means that all annual fees for radiofrequencies are reduced by 20% from January 1, 2015, compared to the previous value. Formulas for the calculation of annual RF fees are defined in the relevant rulebook.

An auction procedure concluded in August 2013 awarded the whole 790 – 862 MHz band together with the unassigned spectrum in the 1740–1880 MHz band for LTE technology in a public tender. Each of the 3 Macedonian mobile operators acquired an LTE radiofrequency license of 2x10 MHz in the 800 MHz band and 2x15 MHz in the 1800 MHz band. Each license was acquired for a one-off fee of EUR 10.3 million (approximately HUF 3.2 billion). The license is for 20 years, until December 1, 2033, with an extension option for 20 years, in accordance with the ECL.

In 2013 the Agency conducted the second analysis on the WS SMS termination market and in October 2013, public debate was opened on the proposed new regulated prices symmetrical for all 3 operators and 75% below the prevailing price. After completion of the public debate, the Agency upheld its position to lower the regulated wholesale price for SMS termination by 75% for all 3 operators and the price became effective from January 1, 2014.

In 2013, T-Mobile was designated as SMP on the relevant WS market "Call termination services in public telephone network at a fixed location" by the Agency. Based upon the Agency's decision, TMMK RIO was modified by including this service.

The new ECL was enacted on March 5, 2014. The ECL is aligned with the EU 2009 electronic communications' regulatory framework. The process of harmonization of the existing secondary legislation with the new ECL was conducted through 2014.

In 2014, T-Mobile on its own decision returned 5 MHz of the spectrum owned in the 2100 MHz band as the company had not used this part since the assignment in 2008 and was not planned to be used in the future either.

In October 2014, VIP Operator and ONE announced a merger of their business in Macedonia consisting of mobile, fixed, internet and transmission of audiovisual content. The Competition Authority approved the merger in July 2015.

After new market analyses on relevant market for mobile access (MVNO and national roaming regulation) in April 2016 AEC brought a Decision for SMP designation of MKT and one.VIP.

Regulatory remedies imposed by AEC: joint dominance of one.VIP and Makedonski Telekom, same remedies for both operators:

- mobile access obligation for all MVNO hybrid types (including Reseller),
- cost based price for Full MVNO
- retail minus (-35%) for Reseller,
- obligation for access to MMS services and mobile data based on technology neutrality (including 4G access)

In July 2016, MKT published new referent access offer for mobile access and services in line with regulation.

An MVNO, Lyca mobile hosted on one.VIP network entered the Macedonian market and started commercial operations in July 2016. Fulfillment of full MVNO obligations by Lycamobile is still under investigation by Competition Authority (ex officio).

NRA analyzed efficient use of RF's granted to operators. Revocation of One.VIP RF 900 and 1800 MHz as of March 2017 is expected. These RFs will be subject to Public tender already announced in AEC annual program for 2017 with possibility for new MNO and/or MVNO. However, One.VIP will have still competitive advantage due to significant amount (20 MHz) of spectrum on 800 MHz band.

### **37.5 Macedonian Fixed line**

In April 2012, the Agency published the general Regulatory strategy for the period of the next 5 years (2012-2016). The official document is "Five years regulatory strategy of AEC". Main focuses of the strategy are: fostering of wholesale and retail services regulation, introduction of methodology of pure Long Run Incremental Costs (LRIC) for fixed and mobile voice services, SMS etc, Next Generation Access (NGA) and Fiber To The Home (FTTH) regulation in line with NGA recommendation and refarming and frequency allocation for 4G services.

With amendments of the Rulebook for retail regulation, the Agency specified the manner and procedure for regulation of the retail prices for fixed voice telephone networks and services of the operator with significant market power on relevant retail markets. Ex-ante retail regulation shall be based on price squeeze methodology. These activities have resulted in price decrease of some wholesale and retail services of MKT. On retail side, standard monthly subscription for business customers was decreased (on equal level with residential). During the last 2 years, following EU and market trend deregulation on some markets started: deregulation of trunk segment of leased lines and avoiding regulation of Ethernet leased line services; removal of regulation of minimal set of leased lines (retail); removal of WLR (Wholesale Line Rental) obligations; lighter retail regulation on traditional fixed voice services. MKT has a cost based price obligation for the Regulated wholesale services, using Long Run Incremental Costs methodology (LRIC). In August 2012 the Agency published draft results from its own developed LRIC Bottom-up costing model for Local Bitstream (cost based) and for retail and wholesale Leased Lines, ducts and dark fiber and minimal set of leased lines (cost based). As a result, on January 15, 2013 AEC brought a decision for decrease of fees and approved the changed Reference offer for provision of physical access and usage of electronic communication infrastructure and associated facilities (ducts and dark fiber). New fees were implemented as of February 1, 2013. AEC also approved the Reference offers for WS DLL (wholesale digital leased line), Local bitstream access and minimal set of leased lines and new changed methodologies of calculation of prices (length dependent) are implemented. WS DLL and Local bitstream access fees were decreased from December 1, 2012 and fees for minimal set of leased lines from January 1, 2013.

The Agency for Electronic Communication (AEC) approved new prices for duct rental services on January 18, 2013. The prices were determined by the AEC according to the LRIC methodology. The approved prices are less than half the previous prices set by MKT.

Rulebook for physical access was amended in April 2015 and as of June 2015 MKT referent access offer was in line with the changes in Rulebook.

In the beginning of year 2015, regulation on access to fiber is implemented, with Local Bitstream Access over NGA on level 3 and 4 and VULA (Virtual Unbundled Local Access) regulation on level 2. Announced introduction of new technologies by MKT for retail customers will lead to introduction on new wholesale access products and reshaping the regulatory obligations.

Based on AEC's operational plan for 2016 additional regulation on IMS (over the top) services could be expected.

In the middle of year 2016 obligation for IP interconnection (following the PSTN to IMS migration) was prolonged latest until middle of 2017 for all operators with interconnection with Makedonski Telekom, and until end of 2017 for interconnection between mobile or alternative operators. Decrease of FTRs is expected in beginning of year 2017, due to finished migration to only one national interconnection point with all domestic operators.

In the process of approval additional changes were made (new interconnection prices based on "Top down LRIC" costing model were included). There are new prices for termination with no peak or off-peak prices. Changes in the IP MATERIO came into force from January 1, 2014. Regional and local termination prices will exist until last Time division multiplexing (TDM) switch is extinguished.

Final document for Broadband market analyses (Market 8) was published on August 1, 2014. For the first time the Agency imposed regulation of access to broadband services over optical access network. All existing obligations for the copper network remain unchanged. All obligations are only for MKT as SMP (significant market player) on the broadband market.

In December 2014 the AEC brought a Decision for designation of MKT as SMP (Significant market power) on market 8.

Third analysis of market 9 and 10 (Transmission and termination segments of Leased Lines (LL) and market 8 (Wholesale broadband-Bitstream access) was finished in November 2014. As a result of the analysis, on market 9 and 10 transmission segments of the LL were deregulated and on market 8 regulations of fiber based products of MKT were included.

In December 2014 the AEC brought a Decision for designation of MKT for SMP (Significant market power) on market 9-Terminating segments of leased lines in the geographical area of Republic of Macedonia.

In December 2014 the AEC brought a Decision for designation of MKT for SMP (Significant market power) on market 1- Access to public telephone networks at a fixed location for residential and business customers including all types of networks technology neutral.

Relevant retail Market 3 (Minimum set of leased lines) was deregulated in March 2016.

According to the Rulebook for technical conditions and building infrastructure (from 15th of July 2014), Makedonski Telekom AD is obliged to build its infrastructure underground in urban areas with over 15,000 citizens for buildings for collective living with more than eight apartments, MKT has Digital Agenda obligation for coverage of 100% and 50% of all Macedonian households with 30 Mbps and 100 Mbps broadband speed respectively, with technology neutral basis until end of year 2020.

AEC analyzes for retail fixed market published and based on MKT initiatives AEC announced deregulation of retail fixed services.

AEC issued decision for refund to MKT for USO net cost for 2015, following MKT relevant submission in 2016.

Tender for USO provider is published, requested amount for refund is the main criteria. MKT is preparing proposal for its participation on the tender with the following considerations:

- Amount to refund for Fix access and access to disabled users (voice and internet of min. 2Mbit/s)
- Amount to refund for PP and Complete directory and directory enquiry services

Tender for USO provider is completed and bids announced, MKT and R3 Infomedia (for the Telephone Directory) are only bidders and won the tender.

### 37.6 Montenegrin Mobile

Crnogorski Telekom (CT), the Group's Montenegrin subsidiary is providing mobile services under the "T" brand. CT is registered as one of three GSM/UMTS providers in Montenegro.

The telecommunications sector in Montenegro is regulated by the Law on Electronic Communications (the eLaw) that came into force in August 2013. The eLaw is based on the 2009 EU regulatory framework.

Multi-band spectrum auction completed in 2016. CT won superior package which will ensure CT's position in the mobile segment for the next 15 years. CT acquired two new RF bands in 800 MHz and 2.6 GHz as well as prolonged usage for existing three bands: 900 MHz, 1800 MHz and 2.1 GHz.

As a result of the market analysis performed by the Agency for Electronic Communications and Postal Services of Montenegro (the Agency or NRA) in 2011 and 2013, CT is designated as an SMP in the Wholesale market of termination of voice calls in its own mobile network and on the Wholesale market on access and origination of calls in mobile networks based on the second round of respective market analysis in 2015. Interconnect rates were determined by the Regulator based on benchmark to be valid from January 1, 2017 and included in updated ROs.

Mobile number portability was introduced in 2011.

In 2013 the NRA applied the three criteria test to the Retail mobile services market. This market did not fulfill the three criteria test, so it was not subject to ex ante regulation.

In 2012, the NRA adopted Cost Accounting Methodology for mobile networks to be applied by all three operators. In October 2016, the NRA approved Crnogorski Telekom's mobile 2015 regulatory reports based on LRIC model.

### **37.7 Montenegrin Fixed line**

The Group's Montenegrin subsidiary, Crnogorski Telekom 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 NRA issued to CT a Fixed line license that is valid from January 1, 2002 for a period of 25 years. In 2004, the Ministry of the Economy prescribed a special one-time fee for the provision of international traffic services, which was paid by CT. In October 2007, the Broadcasting Agency of Montenegro issued to CT a license for building and distributing / broadcasting radio and TV programs to customers (IPTV license) for a period of ten years.

As a result of the second round of market analysis, completed at the end of 2013, CT was designated as an SMP operator in all seven relevant markets defined in old EU Commission Recommendation 2007/879/EC. Local loop unbundling (including fiber access), bitstream access, wholesale leased line and carrier pre-selection, other than on old Market 4, where prices remained as determined in the previous round in 2010, the NRA obliged CT to apply prices from cost model provided in the 2013 regulatory reports.

Carrier pre-selection was introduced in 2011 and carrier selection was already implemented in 2008. Number portability was introduced in 2011.

RIO rates were determined by the NRA based on cost model results provided in the 2015 regulatory reports.

In 2015 the NRA again designated CT as SMP on the 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 as well as cost based retail price regulation for voice services. Decreased prices of voice service were applied as of December 25, 2016. The NRA also designated CT as SMP on Retail broadband internet access services market and imposed cost based prices. Price decrease both in Wholesale and Retail market was imposed in December 2016 based on CT fix Cost Model for 2015.

In May 2011, the NRA adopted Cost Accounting methodology that had to be applied by CT. In October 2016, the NRA approved Crnogorski Telekom fix 2015 regulatory report prepared based on LRIC model.

## 38 EVENTS AFTER THE REPORTING PERIOD

### 38.1 Sale of Crnogorski Telekom A.D.

In January 2017, the Company signed a share purchase agreement with Hrvatski Telekom d.d. for the sale of the total of its 76.53% shareholding in Crnogorski Telekom A.D. for a total consideration of EUR 123.5 million (approximately HUF 38.1 billion). Summarized financial information of Crnogorski Telekom A.D. is disclosed in Note 21.1. The closing of the transaction also took place in January 2017.

### 38.2 Acquisition of SERVERINFO

In October 2016 T-Systems Magyarország Zrt. signed an agreement with WING Group to buy 100% of SERVERINFO-INGATLAN Kft. As a result of the transaction Magyar Telekom Group gains ownership of the property where its highly secure data center with state of the art technical infrastructure is located. The value of the transaction is EUR 14.4 million (approximately HUF 4.4 billion). SERVERINFO-INGATLAN Kft. manages the rentals and the maintenance of the property where the data center of T-Systems Magyarország Zrt. is located. The majority of the consideration relates to the fair value of the property. The closing of the transaction took place in January 2017.

Budapest, February 22, 2017.



Christopher Mattheisen  
Chief Executive Officer, Board member



János Szabó  
Chief Financial Officer



## **CONSOLIDATED BUSINESS REPORT**

MAGYAR TELEKOM TELECOMMUNICATIONS  
PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2016

## INTRODUCTION

The Company's activities are described in Note 1 of the Consolidated Financial Statements, while the business report provides additional information on the following topics:

- THE COMPANY'S SHARE CAPITAL, VOTING RIGHTS AND TRANSFER OF SHARES
- CORPORATE GOVERNANCE
- PEOPLE POLICY
- COMPENSATION OF MEMBERS OF THE BOARD OF DIRECTORS, SUPERVISORY BOARD, AND MANAGEMENT COMMITTEE
- RESEARCH AND DEVELOPMENT
- REAL ESTATE, SITES OF OPERATION
- SUSTAINABILITY
- ENVIRONMENT PROTECTION
- CORPORATE COMPLIANCE
- ECONOMIC ENVIRONMENT
- TARGETS AND STRATEGY
- INTERNAL CONTROLS, RISKS AND UNCERTAINTIES
- ANALYSIS OF FINANCIAL RESULTS FOR 2016
- SUBSEQUENT EVENTS BETWEEN THE END OF THE YEAR AND THE RELEASE OF THE REPORT

## 1 THE COMPANY'S SHARE CAPITAL, VOTING RIGHTS AND TRANSFER OF SHARES

As of December 31, 2016, the share capital of Magyar Telekom Plc. was HUF 104,274,254,300, consisting of 1,042,742,543 Series "A" dematerialized ordinary shares. All Series "A" ordinary shares have a nominal value of HUF 100. Rights and obligations related to Series "A" ordinary shares are described in detail in the Articles of Association Section 2 ([http://www.telekom.hu/about\\_us/investor\\_relations/corporate\\_governance/corporate\\_governance\\_documents](http://www.telekom.hu/about_us/investor_relations/corporate_governance/corporate_governance_documents)). Information concerning our ownership structure as of December 31, 2016 is described in the following table:

<u>Shareholder</u>	<u>Number of shares</u>	<u>Percentage of share capital</u>
Deutsche Telekom Europe B.V.....	617,436,759	59.21
Publicly traded .....	423,720,577	40.64
Treasury shares.....	1,585,207	0.15
	1,042,742,543	100.00

Deutsche Telekom Europe B.V. owning 59.21% of the Company's voting rights is member of the Deutsche Telekom Group. The ultimate controlling parent of Magyar Telekom is Deutsche Telekom AG (DT or DTAG).

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

### 1.1 Voting Rights and Voting

The holder of each Series "A" ordinary share shall be entitled to one vote at the General Meeting of the Company. The names of shareholders and nominees who intend to participate at the General Meeting shall be registered in the Share Register on the second working day prior to the starting date of the General Meeting. The General Meeting shall adopt its resolutions by a simple majority vote except for resolutions on issues listed in the Articles of Associations, which shall require at least a three-quarters majority of the votes cast. There is no limitation on the rights of shareholders to hold or exercise voting rights on the ordinary shares. There is no limitation of voting rights for ordinary shares in the Articles of Association. The Company has no shares assigned with special management rights.



## 1.2 Transfer of Shares

For the transfer of dematerialized share a contract for transfer or other legal title is required and, in that context, the transferor's securities account shall be debited and the new holder's securities account shall be credited with the transferred dematerialized shares. The holder of dematerialized share shall be considered the holder of the securities account on which the dematerialized shares are recorded.

The transfer of any Series "A" ordinary shares is not bound to any restriction or attainment of agreement.

## 2 CORPORATE GOVERNANCE

### 2.1 Annual General Meeting

The General Meeting has the exclusive right to approve and amend the Articles of Association (section 5.2. (a)) unless otherwise provided by law or the Articles of Association. According to the Articles of Association, the Board of Directors is entitled to make decisions regarding any change in the sites, branch offices and – except for the main activity – the scope of activities of the Company and in relation to this, to modify the Articles of Association (section 6.4.(p)).

### 2.2 Board of Directors

The detailed rules on the scope of authorities and operation of the Board of Directors are detailed in 6.4 of the Articles of Association and in the Rules of Procedure of the Board of Directors ([http://www.telekom.hu/about\\_us/investor\\_relations/corporate\\_governance/corporate\\_governance\\_documents](http://www.telekom.hu/about_us/investor_relations/corporate_governance/corporate_governance_documents)). The rules of competence regarding the capital increase and purchase of treasury shares are detailed in Sections 5.2 (b) and (p) as well as 6.4. (l) and (m) of the Articles of Association. The General Meeting by its Resolution No. 8/2016 (IV.12.) authorized the Board of Directors to purchase Magyar Telekom ordinary shares for 18 months starting from the date of approval of the resolution. See the detailed description of the authorization on the General Meetings section of our website.

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 to the General Meeting or to other corporate bodies by the Articles of Association or by the Hungarian laws. The Board of Directors draws up, at the end of each business year, a report for the General Meeting and quarterly to the Supervisory Board on the management of the Company, the assets of the Company, the financial situation of the Company and the business policy of the Company.

Pursuant to the Articles of Association, the Board of Directors consists of a minimum of six and a maximum of eleven members elected by the General Meeting for a term of three years, unless otherwise provided by the General Meeting. Members of the Board of Directors can be removed or re-elected at any time by the General Meeting. On December 31, 2016, there were eight members of the Board of Directors.

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



On December 31, 2016, members of the Board of Directors, their principal occupation and the years of their original election were as follows:

<u>Name</u>	<u>Born</u>	<u>Principal Occupation</u>	<u>Member since</u>
Christopher Mattheisen.....	1961	Chief Executive Officer of Magyar Telekom Plc.	2006
Dr. Mihály Patai.....	1953	Chairman-CEO of Unicredit Bank Hungary Ltd.	2012
Günter Mossal .....	1961	Vice President for Area Management Board Area Europe, DT AG	2012
György Mosonyi .....	1949	Chairman of the Supervisory Board of MOL	2012
Ralf Nejedl.....	1970	Senior Vice President B2B, DT AG	2016
Frank Odzuck .....	1959	Chief Executive Officer of Zwack Unicum Plc.	2006
Dr. Ralph Rentschler .....	1960	Senior Vice President Finance, Group Headquarters and Group Services, DT AG	2003
Kerstin Günther .....	1967	Chairman of the Board of Directors of Magyar Telekom Plc., Managing Director of Deutsche Telekom Pan-Net, DT AG	2013

The members' assignment lasts until May 31, 2019.

### 2.3 Management Committee

Pursuant to the Rules of Procedure of the Board of Directors, the Board of Directors established a Management Committee in 2000. The Management Committee carries out its activities based on its Rules of Procedure approved by the Board of Directors, which is available on the Company's website ([http://www.telekom.hu/about\\_us/investor\\_relations/corporate\\_governance/management\\_committee](http://www.telekom.hu/about_us/investor_relations/corporate_governance/management_committee)).

Management Committee membership shall last from the date of the assignment or from the date set forth therein as the date of the assignment, to the termination of the assignment, due to any reasons.

On December 31, 2016, the members of the Management Committee and the years of their original election were as follows:

<u>Name</u>	<u>Born</u>	<u>Current position</u>	<u>Member since</u>
Christopher Mattheisen .....	1961	Chief Executive Officer of Magyar Telekom Plc.	2006
András Gyenes <sup>i</sup> .....	1969	Chief Commercial Officer Residential	2015
János Szabó .....	1961	Chief Financial Officer	2013
Dr. Balázs Máthé .....	1968	Chief Legal and Corporate Affairs Officer	2010
Tibor Rékasi.....	1973	Chief Commercial Officer Enterprise, Chief Executive Officer of T-Systems Hungary Ltd.	2013
Éva Somorjai <sup>ii</sup> .....	1966	Chief Human Resources Officer	2007
Walter Goldenits <sup>ii</sup> .....	1970	Chief Technology and IT Officer	2013
Péter Lakatos.....	1975	Chief Commercial Officer SMB	2013

<sup>i</sup> MC membership terminated on January 10, 2017.

<sup>ii</sup> MC membership terminated on December 31, 2016.

## 2.4 Supervisory Board

The Supervisory Board carries out its activities based on Section 7 of the Articles of Association and its Rules of Procedure approved by the General Meeting ([http://www.telekom.hu/static/sw/download/SB\\_RulesofProcedure\\_20150415.pdf](http://www.telekom.hu/static/sw/download/SB_RulesofProcedure_20150415.pdf)). The Supervisory Board shall examine all submissions to be submitted to the General Meeting and present its opinion thereof at the General Meeting. The General Meeting may pass a resolution on a report pursuant to the Accounting Act and the use of the profit after income tax only upon receipt of the written report of the Supervisory Board. The Supervisory Board makes a proposal directly to the General Meeting regarding the election, remuneration and removal of the Statutory Auditor.

Pursuant to the Company's 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, unless otherwise provided by the General Meeting. The Central Workers' Council of Magyar Telekom nominates one-third of the Supervisory Board members (employee representatives). Meetings of the Supervisory Board have a quorum if two-thirds of its elected members but at least 3 members are present.

On December 31, 2016, the members of the Supervisory Board, their principal occupation and the years of their original election were as follows:

<b><u>Name</u></b>	<b><u>Born</u></b>	<b><u>Principal Occupation</u></b>	<b><u>Member since</u></b>
Dr. László Pap.....	1943	Budapest University of Technology and Economics, Professor	1997
Dr. János Bitó .....	1936	Chairman of the Thesis and Final Examination Board at Pázmány Péter Catholic University, Information Technology Faculty	2010
Sándor Hartai	1966	Expert of TU Wholesale Directorate, Magyar Telekom	2016
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	Managing Director of EUTOP Vienna, Budapest and Prague	2006
Tamás Lichnovszky .....	1962	Chairman of the Central Workers' Council, Magyar Telekom	2010
Martin Meffert .....	1960	Responsible for Corporate Governance issues of Magyar Telekom, Makedonski Telekom and Slovak Telekom at the Group Headquarters of Deutsche Telekom AG.	2009
Éva Őz.....	1957	Controlling Manager of Controlling Directorate, Chairwoman of the Workers' Council of Central Functions, Magyar Telekom	2012
Dr. Károly Salamon .....	1954	Managing Director, MIS Kft.	2010
Zsoltné Varga.....	1969	Quality Manager, Magyar Telekom	2008
Dr. Konrad Wetzker.....	1950	Chairman, School of Management of Corvinus University of Budapest	2011

The members' assignment lasts until May 31, 2019.

## 2.5 Audit Committee

The Audit Committee executes its duties pursuant to the Articles of Association Section 7.8, and its own Rules of Procedure ([http://www.telekom.hu/static/sw/download/AC\\_Rules\\_of\\_Procedure\\_03\\_12\\_2015.pdf](http://www.telekom.hu/static/sw/download/AC_Rules_of_Procedure_03_12_2015.pdf)). The members of the Audit Committee have been elected by the General Meeting from the independent members of the Supervisory Board for the same period as their membership in the Supervisory Board.

On December 31, 2016, the members of the Audit Committee were as follows:

- Dr. János Illéssy
- Dr. János Bitó
- Dr. Sándor Kerekes
- Dr. László Pap
- Dr. Károly Salamon

## 2.6 Remuneration and Nomination Committee

As of September 20, 2013 certain nomination related tasks were assigned to the Remuneration Committee and its name was changed to Remuneration and Nomination Committee.

The Remuneration and Nomination Committee is established by the Board of Directors of the Company to function as supporting body of the Board of Directors of the Company regarding the remuneration and certain nomination related issues of the members of the corporate bodies and the top executives of the Company in accordance with the Rules of Procedure.

([http://www.telekom.hu/static/sw/download/Rules\\_of\\_Procedure\\_of\\_the\\_Remuneration\\_and\\_Nomination\\_Committee\\_ENG\\_2013\\_0920.pdf](http://www.telekom.hu/static/sw/download/Rules_of_Procedure_of_the_Remuneration_and_Nomination_Committee_ENG_2013_0920.pdf)).

The Remuneration and Nomination Committee, among others, makes recommendations to the Board of Directors on the establishment and/or termination of employment, and the modification of the employment contract of the chief officers, as well as the remuneration package of the chief officers, including setting and evaluating annual individual targets. The Remuneration and Nomination Committee holds at least two meetings each year.

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

On December 31, 2016, the members of the Remuneration and Nomination Committee were as follows:

- Dr. Ralph Rentschler
- Frank Odzuck
- Kerstin Günther

## 2.7 Corporate Governance and Management 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 recommendations 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, 2008 and in 2012. The Recommendations effective from time to time is available at the website of the Budapest Stock Exchange: <https://www.bse.hu/Products-And-Services/Rules-and-Regulations/BSE-Rules>

In line with the current regulations, the Board of Directors of Magyar Telekom Plc. approved the Corporate Governance and Management Report of the Company (report) prepared in accordance with the Corporate Governance Recommendations and submitted it to the General Meeting. The report – along with other corporate governance related documents - is published at the Corporate Governance section of the website:

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

Companies listed on the stock exchange are required to express their views on their corporate governance practices in two ways. In the first part of the report they have to give account of the corporate governance practices applied by their company in the given

business year, including their corporate governance policy, and a description of any unusual circumstances. In the second part of the report, in accordance with the "comply or explain" principle, they have to indicate their compliance with those recommendations included in specified sections of the CGR ("R" - recommendation) and whether they apply the different suggestions formulated in the CGR ("S" - suggestion). In the case of suggestions, companies shall only indicate whether they apply the given guideline or not; there is no need for a specific explanation.

The Corporate Governance Declaration on the Compliance with the Corporate Governance Recommendations, and regarding certain questions the possible alterations and their explanations are included in the report. Sections 1 to 5 of the above report include the description and operation of the Board of Directors, the Supervisory Board, the relevant committees and executive management. Section 6 of the report includes a description of the internal controls and risk management procedures, while Section 8 of the report describes our disclosure policies and insider trading guidelines. In Sections 9 to 10 the method of exercising shareholders' right and the rules on conducting the General Meeting is summarized, while Section 11 contains the Remuneration Statement. The Company complies with the vast majority of the 150 recommendations and suggestions, however in the business year of 2016 in case of 10 recommendations and 6 suggestions it has not or not completely complied with due to the ownership and organizational structure or processes of the Company.

The Board of Directors, through the internal audit area, carried out an evaluation of the Company's disclosure processes in 2016 again. Based on the evaluation, the disclosure controls and procedures of the Company were effective and designed to ensure a proper basis for the timely and accurate disclosures to the market participants required under the respective accounting, capital markets and company law regulations.

## 2.8 Diversity

The Social Charter, Diversity Policy and the updated Equal Opportunities Plan of Magyar Telekom set the general human rights principles of the group. Magyar Telekom Group rejects any discrimination on gender, age, disability, ethnic origin and race, religion and sexual orientation, and rejects all forms of discrimination in the workplace, and expressly support the realization of equal opportunities and diversity among colleagues, by taking into consideration the cultural and legal particularities. To ensure non-discrimination and equal opportunities at workplace has high priority.

The achievement of diversity goals is practiced by the company under the equal opportunities plan, which covers all employees. Our aim is to sensitize our employees, for which a program has been launched and we supported the young romas catching up by participating in the Integrom Program.

Social Charter [http://www.telekom.hu/static-tr/sw/file/Social\\_Charter.pdf](http://www.telekom.hu/static-tr/sw/file/Social_Charter.pdf)

Diversity Policy: [http://www.telekom.hu/static-tr/sw/file/Diversity\\_Policy.pdf](http://www.telekom.hu/static-tr/sw/file/Diversity_Policy.pdf)

Equal Opportunities Plan: [https://www.telekom.hu/static-tr/sw/file/Magyar\\_Telekom\\_Eselyegyenlosegi\\_Terv\\_2016\\_2020\\_en.pdf](https://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_Eselyegyenlosegi_Terv_2016_2020_en.pdf)

## 3 PEOPLE POLICY

We have renewed our People Strategy and identified its pillars we wish to focus on in 2016 and 2017 in line with Magyar Telekom's Business Strategy. Prior to and in preparation for that, we transformed our HR organization and operating model in the second half of 2015 in order to support the achievement of the ambitious goals set forth in our Business Strategy by an efficient and customer-focused HR.

The implementation of our corporate-level People Strategy encompassing two years is a task shared by the whole company, i.e. managerial and non-managerial personnel alike. HR facilitates the process by actions, tools and solutions.

### 3.1 People strategy from the aspect of the Company's

- Efficient company – focus on Total Workforce Management (TWM) cost, thus enabling flexible and efficient management of expenses
- Competitive company – elaboration and safeguard of competitive edge based on human capital through recruitment-selection, supported by training development and remuneration
- Energized company – international, diverse and healthy organization focused on wellbeing (physical, mental and social wellbeing), that experiences success

### 3.2 People strategy from the aspect of the employees

The message of our Business Strategy is that “We are building a successful ICT company with satisfied customers and dedicated colleagues”.

Our colleagues are the building blocks of that success. We implement our strategic goals with them.

We are building a competitive edge on the skills and attitude of future Telekom people.

In 2016-2017, we build our People Strategy around 4 pillars: brand and recruitment, training-development, remuneration and wellbeing.

We keep an eye on the required personal traits of the future Telekom people even in course of recruitment-selection. We segment our positions in recruitment to reach the right people by our ads. We have reviewed and renewed our online recruitment means and channels.

The objective set by another pillar of the People Strategy is achieved through the development of our employees and the expansion of their experience.

The emphasis is on self-development, for which we provide the necessary funds, digital content and online means.

We can improve the satisfaction and commitment of our employees by continuing to provide competitive remuneration packages and our diverse and wide range of benefits.

Magyar Telekom has placed in the focus of its strategy for 2017 the implementation of the digital business model, the essence of which is the exploitation to the fullest extent of new technologies in maintaining contact with customers, enhancing confidence and, eventually, value creation. In order to support the achievement of the above, HR has reviewed its internal operating model and introduced online services for non-managerial and managerial employees alike, as well as strives to incorporate the HR tools that influence corporate culture into online solutions, thus supporting the successful introduction of the new business model. People strategy pillars in 2016-2017:

- Employer brand building – we create a livable and likeable workplace, which is satisfactory for our employees and offers an attractive perspective in the labor market through its future oriented methods of work. We put greater emphasis on using social media solutions in building the brand.
- Recruitment-selection – We use segment-based online recruitment channels and means to select the best candidate for the specific positions. During the selection process, we seek the attitude and personal traits defined as requirements for future Telekom employees.
- Remuneration – We retain our competitive edge in the market with our total compensation package and we are forerunners in the market with our innovations in compensation methods. We make our company attractive for employees by means of our wide range of benefits. We have 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– We are building a digital Telekom, thus put an increasing emphasis on collaborative digital tools and solutions that enable and inspire self-development. Online training catalogue, online training materials, online coachbank and mentoring, online knowledge sharing (Share).
- Wellbeing – We take action for each other and ourselves in order to maintain our physical, mental and social wellbeing. Energized employees make us successful. We draw employees' attention to conscious preventive health efforts, volunteer work, sustainability and work-life balance.

The principles of justice and equal footing are set out in the basic standards articulated in our Code of Ethics published in 1997. Alternative forms of employment like telework, part-time work, flex-work, employment of disabled persons provide possibilities for the practical implementation of the principle of equal footing.

Equality at work and in life – is a principle that manifests in Telekom's operation. In order to enforce the principle, we adopted for the fourth time an Equal Opportunity Plan together with the employee representative bodies. The Equal Opportunity Plan contains the goals and tasks the company plans to support colleagues.

In the period of 2016-2020, our equal opportunity efforts focus on

- promoting physical and mental wellbeing,
- a family-friendly mentality,
- equal opportunities for women, including female executives,
- and the cooperation of different generations.

### 3.3 Headcount

The following table provides information on the number of full-time employees, including full-time equivalents, of Magyar Telekom Plc. and its consolidated subsidiaries:

	2014	2015	2016
Magyar Telekom Plc. ....	7,046	6,670	6,281
Magyar Telekom Plc. and its consolidated subsidiaries .....	10,883	10,357	9,432

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

	2014	2015	2016
MT- Hungary/Telekom Hungary <sup>i</sup> .....	7,347	7,002	7,879
T-Systems Hungary <sup>i</sup> .....	1,518	1,487	–
Macedonia .....	1,362	1,327	1,019
Montenegro .....	656	541	534
Total .....	<u>10,883</u>	<u>10,357</u>	<u>9,432</u>

<sup>i</sup>The operating segments of the Group: MT-Hungary, Macedonia and Montenegro in 2016 and Telekom Hungary, T-Systems, Macedonia and Montenegro in 2015 and 2014. Please refer to the Note 32. to Consolidated financial statement

### 3.4 Total Workforce Management

From 2009, Magyar Telekom introduced the 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.

### 3.5 Workforce Reduction and Redeployment

In recent years centralization, technological improvements and attrition have allowed us to reduce the size of our workforce. While overall personnel levels are falling, the number of highly skilled employees is increasing. We plan to further reduce the number of our employees in the long term, though in 2017 we do not have plans for headcount reduction at the Hungarian operation.



According to the terms of the agreement with Employee Representative Bodies, in order to keep salaries at competitive levels, as from January 1, 2017, employee salaries, excluding senior management, at the parent company will rise by 5.5% on average, and 3.1% at T-Systems Magyarország Zrt.

The above measures are expected to induce approximately HUF 2.4 billion growth in 2017 employee-related expenses at the Group level.

### **3.6 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 collective bargaining agreement must be renegotiated annually. If the employment is terminated due to reasons related to the employer's operation, employees are entitled to a specific amount of severance pay surplus, which depends on the tenure of the employee.

In addition to the collective bargaining agreement, employees of our Hungarian operations are generally covered by the Act I of 2012 on the Labor Code, which imposes various restrictions on the involuntary termination of employment. The 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 the Company 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 V of 2013 on the Civil Code one third of the Supervisory Board shall consist of employee representatives. The employee representatives in the Supervisory Board are nominated by the Central Workers' Council considering the opinion of the trade unions operating at the Company. Persons nominated by the Central Workers' Council shall be elected by the General Meeting to the member of the Supervisory Board, except if disqualifications exist in respect of the nominated persons. On December 31, 2016, four members of the Supervisory Board were employee representatives. These members were Tamás Lichnovszky, Zsoltné Varga, Éva Óz and Sándor Hartai.

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

### **3.7 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. In case of certain benefits, employee's individual contribution is a prerequisite of the employer's contribution. The way social benefits and discretionary benefits are granted is set out in the Collective Agreement and related regulations.

We provide employees with telecommunication allowances, subsidized meals, interest-free housing loans (such loans are not offered or extended to the Company's Board of 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' pension, health and self-aid savings, provided he is member of the voluntary fund, which provides private pension and health insurance as well as social benefits supplementing government pension and health benefits. We do not, however, guarantee payment by the fund to its members. At December 31, 2016 approximately 68% of employees of Magyar Telekom Plc. participated in the pension-, 44% in the self-aid-, and 63% in the health fund.



### 3.8 Human rights

Social Charta of Deutsche Telekom Group and Magyar Telekom Group is a voluntary commitment (based on the Decree of July 22, 2003 of the Group Board of Directors) on behalf of the employer side to comply with the minimal social standards throughout the entire company group. It contains basic principles regarding labor relationships and conditions of employment. We expect compliance with the standards from our vendors as well. Via the Social Charta, these social standards are mandatory for the entire company group, and are available to anyone. Magyar Telekom submits annual reports on the compliance with the 9 basic principles set forth in the Social Charta.

The Social Charta and more details: [https://www.telekom.hu/static-tr/sw/file/Social\\_Charter.pdf](https://www.telekom.hu/static-tr/sw/file/Social_Charter.pdf) and [http://www.telekom.hu/about\\_us/society\\_and\\_environment/society/equal\\_opportunities](http://www.telekom.hu/about_us/society_and_environment/society/equal_opportunities)).

Magyar Telekom strives to ensure equal chances for its employees, and to improve the situation of certain underprivileged employee groups. As part of this effort, from 2008 Magyar Telekom have accepted Equal Opportunities plans valid for periods of several years. Currently the Equal Opportunities Plan IV is in force, which determined guiding principles and an action plan for the 2016-2020 period. In addition, Magyar Telekom is open to join similar government, business and civil initiatives in order to achieve equal social opportunities.

Equal Opportunities Plan IV: ([http://www.telekom.hu/static-tr/sw/file/Magyar\\_Telekom\\_Eselyegyenlosegi\\_Terv\\_2016\\_2020\\_en.pdf](http://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_Eselyegyenlosegi_Terv_2016_2020_en.pdf)).

These policies are published and declare measurable indicators concerning the human rights, and developing goals on these fields. The existence of these policies helps to fortify the employee's awareness and the engagement to legitimate behavior.

Giving support to the respective disadvantaged employee groups and to provide them equal opportunities require additional efforts and human resources.

Magyar Telekom can rely on its top management that is committed to sustainability and expects high performance regarding the compliance with human rights. These extra efforts are supported by the Chief Executive Officer and the Chief Human Resources Officer personally

### 3.9 ESOP Organization

In July 2016 Magyar Telekom launched a Remuneration Policy based employee share ownership program (ESOP) under which Magyar Telekom shares will be distributed to the vast majority of the employees of Magyar Telekom Plc. and T-Systems Hungary Ltd. This program is in addition to the Company's regular remuneration package. Please refer to Note 24.2 of the Consolidated Financial Statements for detailed system of control and mechanism of the employee share scheme.

## 4 COMPENSATION OF MEMBERS OF THE BOARD OF DIRECTORS, SUPERVISORY BOARD, AND MANAGEMENT COMMITTEE

The aggregate compensation of the members of the Board of Directors in their capacity as Board members was HUF 16 million in 2016.

The aggregate compensation of the members of the Supervisory Board in their capacity as Supervisory Board members was HUF 63 million in 2016.

The total compensation expenses (including social security and other payroll-related taxes as well as contractual termination expenses) of the members of the Management Committee (MC) was HUF 1,750 million in 2016.

On December 31, 2016, three of the eight MC members have an employment contract with fixed duration. Pursuant to Hungarian legislation, if an employment contract is terminated before the end of its term, the absence fee received for the remaining period is up to 12 months. The notice period is two months for three of the five indefinite contracts, and six months for the remaining two contracts. For two contracts the severance payment is in accordance with the Labour Code and the Collective Agreement, for the rest of the contracts the severance payment is between 3 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 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 the Share Based Compensation programs, see Note 24.1 of the Consolidated Financial Statements.

## 5 RESEARCH AND DEVELOPMENT

### Hungary

In 2016, the Research and Development activities at Magyar Telekom covered the maintenance of R&D grant project launched and won in the frame of a tender obligation of the National Research, Development and Innovation Office.

In 2016, in addition of the tender obligation, we have launched several products and services projects developments, which are based on the R&D activities of 2015, for example, Big Data related "Mobile Insight" data acquisition module. Besides that, certain functionalities have begun its real operation within the topic of smart watch R&D (for example: Smart Watch Mobile Payment application)

In 2016, we have launched new, smaller R&D projects, especially in the area of Big Data, IoT and TV/ Entertainment. These first results are expected at the beginning of 2017.

In addition to innovative domestic SMEs, the R&D tasks are performed by Magyar Telekom's own research, product and service development staff. Besides the above, the Company exploits synergies resulting from its internal and external knowledge base, and takes efforts to establish partnerships with well-known innovation centers and institutions of university education. Our main partners are renowned Hungarian universities, research institutes such as Budapest University of Technology and Economics, Corvinus University of Budapest, University of Szeged, University of Debrecen, and the Hungarian Academy of Sciences.

In the school year of 2016/17, in cooperation with Technical University of Berlin, data science and data technology department has been established at the Faculty of Informatics, Eötvös Loránd University. The department sponsored by Magyar Telekom's parent company, Deutsche Telekom's research and development division, the Berlin Telekom Innovation Laboratories (T-Labs in brief). In the frame of the cooperation, Magyar Telekom will support the department's research and development activities. In 2016, we have launched R&D themes about Smart City and Fraud.

Beyond the above, Magyar Telekom deems it important to support knowledge transfer projects of R&D nature as well; thus it participates actively as a professional cooperating partner and in the EU knowledge transfer program EIT ICT Labs KIC the Company joined in 2012, they are working together in more international R&D tender initiatives.

### Macedonia

Makedonski Telekom (MKT) continues with its determination and its work to be innovation and technology leader on the market.

This year, we continued our successful Smart City story, by upgrade of the Automatic vehicle location and Smart ticketing system for the public transport providers in the City of Skopje. With this project MKT helps to lead the transformation of Skopje into a modern and smart city. As a proof for our dedication and competences in this area, on the 2016 World Congress on Information Technology (WCIT) in Brazil, our smart public transportation solution has been awarded with the WITSA Global ICT Excellence Award in the "sustainable growth" category.

Further to this project, MKT is continuously pursuing other opportunities in the area of Smart City. In particular, in 2016 we put into demo operation a project for the smart light system in MKT premises, with the aim to show and to prove that the implementation of such smart light system would bring the electricity and maintenance costs savings for the cities, while maintaining the street lighting according to the required standards.

Apart of the Smart City business area, we drive full force exploring of other business possibilities for growth and development, in the field of finance, health, education etc, especially considering their business prospects and potentials in terms of top line growth of our ICT and B2B business in overall.

MKT as firm supporter of the new era of smart, connected way of life and working, in 2016 have started pilot project in the area of Smart school as well. Hybrid Classroom pilot project is about implementation of ICT assisted solution for interactive learning at classes and at distance, in two secondary schools in the City of Skopje. Implementation of this project aims at creating positive change of way of education, providing advanced, self-driven, collaborative and interactive classroom experience for youngsters. As well its aim is to demonstrate how use of technology could support the quality and efficiency of the education, thus impacting the long-term development of the educational system as well as the society and economy.

Also, utilizing the potential coming out from the EU funded projects in the smart Internet of Things (IoT) solutions, e-government, etc., was under close loop as well.

In addition to the business development activities explained above, in 2016 we put focus in the development of the projects and products for digitalization and smart working for the business segment, which we believe that are growing market potentials in the forthcoming years, expected to be driven by the advantages of the efficiency of ICT in daily workflows systems and networks, as well as by the transparency and accountability of such solutions.

Under the motto - INNOVATION SYNERGIES – WIN WITH PARTNERS, concerning the technology partnerships, this year we got recertification of our Cisco Gold and Microsoft Silver Data Center partnerships, as well as we became EMC Cloud solution provider, that are confirmations for our competences in the areas of enterprise networks, collaborations, network securities and Data Center technologies. These competences deemed to be crucial assets on which we can leverage further in our ICT business development activities.

Competitive pressure in conjunction with saturated Telco market, complexity of business environment with multiple and more sophisticated customer segments, multiple vendors and complex service offerings, fast changes in the technology with new technology paradigm targeting for one universal IP network and cloud based service delivery platform, as well as changes in the regulations, are only part of the challenges that MKT will face in the next few years.

In order to keep sustainable business and major revenue streams in very complex telecommunication environment, as well as proactively influence to market trends with new business opportunities, MKT is aiming to keep technology leadership position and ensure growth through service improvement and innovation by continuous development of its infrastructure.

Development of infrastructure and investment in Technology should encompass the following objectives/trends: broadband performance, integrated service delivery platforms, efficiency and quality leadership, self-service enablers, cloud concept and “virtual” infrastructure, cost efficiency, flexibility and responsiveness – reduced time-to-market, as well as competence development.

During 2016, we have made significant steps towards achievement of our goals with development of telecommunication network, service platforms and supporting systems.

In order to ensure high quality Broad Band (BB) performance, BB market and technology leadership, MKT is continuously investing in fix and mobile access development. At the end of 2016, more than 147,000 homes passed installed capacity or 26.6% MKT network households' coverage with FTTH was reached. Significant improvement was also done in LTE rollout, reaching 60% territory coverage and 80% population coverage.

Alongside extensive mobile BB access rollout, during 2016, high focus was set on the network quality, which is confirmed by P3 “Best in Test” certificate which represents an internationally recognized acknowledgement for quality of mobile network, as well as well as by the National Report for Network Quality Parameters prepared by the Agency.

The growth of BB access and continuous traffic increase are supported with further development of IP Core and transport network as cornerstone of all services. In 2016, IP Core & Transport Network Modernization project started with its implementation which includes



modernization, reorganization and extension of all IP Core Network elements, Transport and Aggregation systems. MKT managed to install full DWDM network and finalize IP Core implementation in ~ of territory of Macedonia. After successful Proof of Concept initial Migration of services was performed. In Mobile area, SW upgrade of MGW and SGSN were performed in order to extend support of MSS and EPC. Additional PGW/GGSN and MSC-BC SW upgrades are planned and will be conducted in Q1 2017. In this time frame, CUDB project for upgrade of HLR/FNR and HSS-EPC on joint CUDB platform has been started and will continue in 2017.

Also project for improvement of transport network redundancy based on building redundancy of all major cities based on 3 sided physical and logical path protection, creation of smaller protection rings by implementing new fiber optical routes between major sites and introduction of 2 sided network redundancy on all other IP Core sites as started.

The increased mobile internet traffic is also supported with the modernization of the backhaul solutions for mobile base stations through fibre connections or radio links.

In terms of Service Platforms, during 2016, IPTV server platform was upgraded and IPTV storage was replaced and extended with higher capacity for deploying new VoD (Video on Demand) assets. Project for IPTV Headend enhancement and extension was based on replacing encoders with HD capabilities and implementing new management system. New OTT TV platform was implemented and for the first time was launched new service for Magenta customers to provide better customer TV experience.

Implementation of Single Sign-On (SSO) system has been finished providing possibility to MKT customers to log in with single ID and password and gain access to connected systems. Hybrid Access Solution was implemented which aggregates the bandwidth of both DSL and LTE transmission links and create a single, powerful broadband pipe between the network service node and customer's Broadband CPE.

New SMS GW was implemented and migration of content providers was done. Also, during 2016 Starhome platform for Inbound Roaming management was fully upgraded. Improvement of existing payment services and features, also and integration of new bank as a issuer and acquirer with mobile payment platform was done.

In order to provide higher efficiency, better flexibility and fast response in the provisioning, fault clearance and other processes in technology domain, we finalized implementation of New Generation OSS, Broad Band Service Assurance (BBSA), and Trouble Ticketing (TT) extension.

## Montenegro

In 2016, CT continued to compete for the best customer experience based on constantly improving technology leadership.

In the area of access networks CT ensured superior FTTH speeds to 22% of flats in Montenegro. In order to utilize copper potential and provide more competitive ADSL speeds, CT introduced vDSL technology enabling significantly higher speeds. In August 2016, CT won superior spectrum package bringing great advantage in terms of 4G quality and coverage, aiming to increase 4G coverage countrywide and thus clearly differentiate from local competition. Such differentiation comes by speeding up the LTE 800 expansion and introducing carrier aggregation (CA) of 800+1800MHz bands. Already in 2016, CT achieved speeds of 300Mbps (2CA) and 450Mbps (3CA) in live network and extended 4G population coverage to 78%. In the areas that are not possible to cover with FTTx in economical way, CT is combining 4G and ADSL potential, by further Hybrid access roll-out, ending 2016 year with 1.6k commercial customers.

In the area of innovative platforms and tools, newly introduced convergent, real time Billing & CRM system enabled potentiating fix mobile convergent offers. In that sense, CT's fix & mob products' portfolio is completely refreshed and renewed.

CT's technology leadership on local market is once again confirmed by "Best in Test in the Mobile Benchmark in Montenegro" certificate, performed by independent company (P3 communications). Besides, CT achieved best results in quality of mobile services according to benchmark done by National Regulatory Agency of Montenegro.

In the area of social responsibility, CT won the Award for Corporate Social Responsibility, in the category "Community Care". The Award was given by Montenegrin Employers Federation, for "Za svako dobro", a long-term donation program that aims to support and promote socially responsible projects in area of education, environment and digital inclusion.



## 6 REAL ESTATE, SITES OF OPERATION

We have one of the largest real estate holdings in Hungary and we are also a major real estate owner in Macedonia and Montenegro. We use substantially all of these properties for telecommunications installations, offices, warehouses, garages and shops. Our equipment and machinery primarily consist of switches, communication towers and other telecommunications equipment. In order to increase the utilization of real estates and increase efficiency, we make efforts to sell our surplus properties.

### Headquarters of major member companies of the Group

- Magyar Telekom Plc.: Hungary, 1013 Budapest, Krisztina krt. 55.
- T-Systems Magyarország Zrt.: Hungary, 1117 Budapest, Budafoki út 56.
- Makedonski Telekom A.D.: Macedonia, 1000 Skopje, Kej 13 Noemvri, No. 6.
- Crnogorski Telekom AD: Montenegro, 81000 Podgorica, ul. Moskovska 29.
- Combridge S.R.L.: Romania, Municipiul Sfantu-Gheorghe, Strada 1 DECEMBRIE 1918, parter comercial, nr. VI, Bloc 6, Judet Covasna
- Novatel EOOD: Bulgaria, Sofia 1404, Bulgaria blvd. 45A.

### Hungary

Out of the number of 1723 buildings that take place on the 1481 sites of Magyar Telekom Plc, 56% is owned by the company, 5 % is jointly owned and the rest 39% is leased. These figures do not contain the technology sites, from these type of sites we have 5936.

The total area of properties used by Magyar Telekom Plc. as of December 31, 2016 was 557 680 m<sup>2</sup>. The majority of sites used in our operations are smaller than 100 m<sup>2</sup>. The largest site is our headquarters building located at Krisztina krt. 55 in Budapest, with floor space of over 30,000 m<sup>2</sup>

### Macedonia

At the end of December 2016, MKT radio access network consisted of 709 physical sites on which there are 670 2G base stations, 686 3G base stations and 345 4G base stations. 91% of the site infrastructure (towers) is in possession of MKT and 9% is leased.

The total area that is used by MKT is around 109, 853m<sup>2</sup> as of December 2016, out of which around 45, 578 m<sup>2</sup> are in sole possession of MKT and in great part (54 %) is attributable to 2 major buildings, the headquarters and the main technical building. The remaining 64,275 m<sup>2</sup> are in joint possession with Macedonian Post.

### Montenegro

The number of sites used by Crnogorski Telekom for fixed line services is 237, out of which 62% are owned by the Company, and 38% leased. Total area of properties used by Crnogorski Telekom as of December 31, 2016 was 28,912 m<sup>2</sup> out of which 27,093 m<sup>2</sup> (94%) were owned by the Company.

The total number of mobile sites used for telecommunications towers and antennas by Crnogorski Telekom as of December 31, 2016 is 359, out of which 60% are with infrastructure owned by the Company, 1% jointly owned and 39% leased.

## 7 SUSTAINABILITY

Magyar Telekom has been addressing the sustainability implications of its operations for close to twenty years, and in 2000, it was one of the first Hungarian companies to establish a sustainability unit that managed environmental issues in the beginning and coordinates sustainability processes now. Its sustainability activities are characterized by comprehensive, long-term plans, and the Company is currently implementing its fourth five-year sustainability strategy.

Being a leading ICT provider of the region, we set an example and provide opportunities by our forward-looking thinking, innovative, sustainable products and services and responsible conduct, we contribute to the establishment of a renewable society and environment.



Magyar Telekom committed to support the ten principles set forth by the UN Global Compact since 2009 in the areas of human rights, environment and anti-corruption, the results of which are also addressed by our Sustainability Reports.

Magyar Telekom's sustainability activities and achievements are comprehensively discussed in the annual Sustainability Reports, which aims to make the Group's environmental, social and economic activities transparent to everyone.

The present report includes reference only to certain key topics of our sustainability approach, namely human rights, employees, environment protection and compliance.

## 7.1 Sustainability strategy

Magyar Telekom's fourth Sustainability Strategy, encompassing the 2016-2020 five-year period, has been compiled in harmony with the Company's other strategies. Its main objective is to make sustainability an integral part of Magyar Telekom's business.

The main directions of creating the new strategy have been influenced by not only the strategic achievements we have already made in the previous period, but also the expectations of responsible investors, EU directives, industrial and corporate trends, as well as local, i.e. Hungarian conditions and consumption patterns.

To achieve that aim, we defined three major areas of focus:

### Climate protection

Our goal is to make our customers climate-conscious, too, and to be an authentic and responsible company that helps them along that journey. It is our ambitious objective to generate revenue from our climate protection activities, as the ICT world offers especially great potential for that, at the same time to push Magyar Telekom Group's actual CO<sub>2</sub> emission below 100,000 tons. In order to achieve the above, in addition to the emission decreasing initiatives, we also need to work on elaborating "green" services specifically.

### Education

We want to assume a role in educating the public and our customers. Our goal is to directly or indirectly reach 100,000 people in Hungary with our trainings by the end of the period covered by the strategy. We shall primarily focus these trainings on two areas: programs aimed at eliminating the digital gap and the succession pool of the industry.

### Digitally enabled sustainability

- Being a sustainable digital company, it is our clear expectation that our customers should also use sustainable digital services. To that end, we strive to pursue responsible marketing and activities that enable and inspire others, as well as are based on sharing. In this context, our goal is that awareness about Magyar Telekom, as a sustainable company should reach 50%. Awards and recognitions achieved in 2016:
  - CEERIUS sustainability index membership
  - Experience Leader AwardThe Most Innovative Partner Of The Year: T-Systems Hungary
- The survey conducted among the public in 2016 showed that 20.7% of the responders name Magyar Telekom and its offer brands as a company of a leading role in sustainability, while 63% cannot name any companies at all. The concept of sustainability is known by 30% among the public in 2016. 86% of our employees familiar with the concept of sustainability and 64% named Magyar Telekom as a sustainability leader.

## 7.2 Initiatives concerning stakeholders

In 2016 we organized the Sustainability Roundtable Discussion for the 17th time, the objective of which is to have an open dialogue with our stakeholders for the sake of understanding the demands towards Magyar Telekom Group, discussing the arising problems, and to provide a suitable background for thinking together and co-operating in building a sustainable future.

In 2008 our Company founded the DELFIN (the word for dolphin in Hungarian) award, which in Hungarian stands for "Award for a Committed, Sustainable, and Innovative Generation". With the DELFIN award Magyar Telekom wants to promote the idea of a sustainable development and recognize efforts made towards this goal. The award is given to suppliers offering outstanding performance in the field of sustainability, in four categories:

- Support of equal opportunity and promotion of non-discrimination inside and outside the Company;
- Innovation in the interest of sustainability;
- Sustainability education and awareness raising;
- Investment and development related to climate protection.

A jury of experts decides which submitted project should receive the award. The ninth award ceremony took place on June 10, 2016, as part of the Sustainability Roundtable. In 2016, we recognized organizations and businesses promoting sustainable, innovative solutions and sustainability education and awareness raising.

The ninth Sustainability Day event took place on September 24, 2016. The topic of the day was revolving around the chance of smart age. Record number, five thousand visitors attended the event where they participated in panel discussions on the three pillars of sustainability and examined pieces of works submitted to the creative design exhibition as well as exhibitors.

The event presented an opportunity to hand over the Sustainability Media Award for the sixth time by the members of the Sustainability Media Club - established by Magyar Telekom. Awards were distributed in three categories: "Bottom View" - for case studies describing NGO and local community matters, "Wide-angle view" - for the description of nationwide environmental and economic issues and "E-world" - for case studies describing digital education and digital literacy initiatives primarily focusing on children. The award amounted to HUF 500 000 for each category.

In 2016, we continued to sensitize our employees to social issues by organizing volunteer work events. Those interested could join our volunteer efforts as part of the Telekom Smart Digital programs, as well as other program like charitable teambuilding exercises. In 2016 was the first Telekom Volunteer Day, where 1000 employees and their relatives participated and planted 1000 plants. In 2016 1500 colleagues worked 11,412 hours of volunteer work, by means of which a theoretical amount of HUF 53.6 million was thus donated to the society.

In 2016 we continued the "hello holnap!" employee point collection. In the third year of the initiative 2,321 points were collected by 1,017 colleagues. The first three employees who collected the most points were given a Csepel bike voucher.

The children's protection website of Magyar Telekom dedicated to threats caused by children's media consumption. The website provides information to parents not only about ICT technologies, devices and content, but also about threats caused by their usage and consumption, as well as possible preventive measures. More details are available on:

[http://www.telekom.hu/about\\_us/society\\_and\\_environment/society/protection\\_of\\_our\\_children](http://www.telekom.hu/about_us/society_and_environment/society/protection_of_our_children).

On November 1, 2013, Magyar Telekom introduced its tariff package called "hello holnap!", which was designed to accommodate specific needs of handicapped people. Since 2014, the tariff package is also available for members of the Hungarian National Autistic Society. In 2016 we renewed the fleet package, by providing more services for lower price. Now, that our subscriber can involve one family member or helper into the package.

We launched the "hello holnap!" mobile app on September 27, 2014, by which we drew attention to Telekom's sustainability efforts in particular and sustainable lifestyles in general. By using the app, users can collect "hello holnap!" points and donate them, converted into real money by Telekom, to non-governmental organizations of their choice. The success of the mobile application in 2016 is best represented by the fact that it has more than 9,000 downloads and it is one of the most popular Telekom applications.

One pillar of atypical staffing is telework, which is one of the most important sustainability aspects of the Future Work project. Working from home in the framework of the project launched in July 2014 enabled the Company's employees to save time and mileage. Thus, drivers can relieve the environment of as much as 1.8 million kilometers and ten years of travel.

In 2013 Magyar Telekom was among the first Hungarian companies that supported civilian organizations to cultivate community gardens in empty properties of the Company. In 2015 three community gardens started their operation. One of them, the 2600 square meter "Kerthatár" garden in Soroksári street offers land for 100 gardens. It is one of the biggest of such facilities in Budapest. The initiative ran successfully in the three community garden in 2016 as well.

### 7.3 Annual Sustainability Report

Magyar Telekom Group has committed, among other things, to publish reports about its sustainability performance annually. When the reports are compiled the GRI (Global Reporting Initiative) guidelines are applied, thus ensuring compliance with the principle that the reports have to be the cornerstones ensuring transparency and international comparability. Since 2007 Magyar Telekom has prepared reports adhering to the highest level of compliance with international standards each year, thus the 2013 Sustainability Report was the seventh to meet the requirements of the GRI A+ application level.

The 2014 and 2015 Sustainability Report was compiled along the new Fourth-Generation Principles set forth by the Global Reporting Initiative (GRI G4). It was applied on comprehensive level and includes more information about the Group's sustainability performance. The independent assurance and certification of compliance with the GRI G4 criteria was conducted by PricewaterhouseCoopers along the ISAE 3000 international standard.

Further details on the sustainability performance of the Company can be found in the annual reports available on:

[https://www.telekom.hu/about\\_us/society\\_and\\_environment/sustainability\\_reports](https://www.telekom.hu/about_us/society_and_environment/sustainability_reports)

## 8 ENVIRONMENT PROTECTION

Magyar Telekom Group as one of the leading info-communication service provider in Hungary – 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 its activities in a regulated and controlled way, fulfilling the EU requirements and complying with international standards. Magyar Telekom Group's environmental commitment and responsibilities are published in Magyar Telekom Group's Environmental Policy which contains obligations for the Group members individually and for the Group in total:

[https://www.telekom.hu/static-tr/sw/file/Magyar\\_Telekom\\_environmental\\_policy.pdf](https://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_environmental_policy.pdf)

### Environment and climate protection performance

In 2016, Magyar Telekom procured 201 GWhs of electric power from renewing resources, which is 100% of the Company's total electric power consumption.

In spring 2016, we relaunched again TeleBike, Magyar Telekom's employee bike rental system. In 2016, TeleBike offered 53 regular bikes and six electric bikes, which were added to the fleet in 2014. Employees can commute between five sites, the offices of the Company located in Budapest and the sites of T-Systems Magyarország Zrt. In 2016, TeleBike had 1,561 registered users and 5,965 rents. During the year 10,200 kms were ridden and due the system 2 tons of CO<sub>2</sub> emission was eliminated.

We introduced a bonus-malus system based on compliance with or deviation from average emission values of benefit cars. We spent 50% of the amount collected as malus payment by users of cars with emissions above the reference values on decreasing our CO<sub>2</sub> footprint. One of our objectives for 2016 was that we still operate as a carbon neutral company. To this end we purchase electric power from power plants that use renewable energy sources and we entirely carbon-neutralized our fossil energy consumption footprint. With this we achieved that we are the one and only carbon neutral major enterprise in Hungary.

In 2016 Magyar Telekom continued its efforts to operate as an energy effective company. These days instead of solutions that would represent a huge leap forward, the aggregate of several smaller transformation and caring projects may jointly help us to further reduce energy consumption. Our proven ventilation technology has been upgraded this year. We implemented the so-called wardrobe type equipment thereby reduced the operation time of air-conditioners in order to save electric energy. Currently the main objective is to fine-tune the existing solutions. But new solutions are also implemented as a result of the global PSTN (Public Switched Telephone Network) replacement project. With this we take a huge step forward in the field of air conditioner replacement (reducing R22 gas consumption) and we implement lower performance power supply equipment as well. We have replaced our power supply equipment in several huge machine rooms; the improved efficiency rate resulted in millions of savings. A similar magnitude of savings is

generated by the replacement of hundreds of smaller power supply units. We continued the merge of fixed line and mobile power supply operations at specific sites. Due to lower consumption we reduced our forecast electricity demand at our service provider. Smart cooling technology also develops quickly and it brings continuous results. This year we also replaced several boilers. The increase of the temperature of machine rooms is managed as a global project from containers to entire exchanges, regardless of their size. The use of temperature resistant accumulators and accumulator coating is a preparatory phase of the project. As a pilot project we equipped four buildings with LED lighting. We also take care of saving water: We installed perlators in various premises. The investment in this equipment may return within a period of six months. This represents almost 1 million HUF saving per year. For us, the decrease of energy consumption is a global project. We strive to reduce energy consumption directly or indirectly within the frame of every development. This will result in lower consumption figures in the long run.

## 9 CORPORATE COMPLIANCE

When shaping the compliance program of the Magyar Telekom Group, the goal was to ensure that the Magyar Telekom Group pursues its business activity with maximum awareness of and commitment to the compliance with the applicable laws and legal provisions, in accordance with the strictest norms of ethical business conduct. To this end, we issued decrees addressing the potentially arising compliance-related risks, and we apply the procedures set out in these decrees and arrange continuous training courses for our employees related to these procedures. We established clear concise processes to report, examine, follow up and correct suspected cases of non-compliance.

The Corporate compliance program is supervised by the Group compliance officer. The Group compliance officer reports directly to the Audit Committee, and cooperates with the Board of Directors, the Supervisory Board and the management. The Corporate compliance program focuses on the Code of Conduct.

Code of Conduct of the Magyar Telekom Group contains the summary of the compliance requirement within the company, sets common values of the Group and is a key to the strong position, reputation and successful future of Telekom. The Code of Conduct applies to everyone within the Magyar Telekom Group from the employees to the members of the Board. In addition, contracted partners of the Magyar Telekom Group also have to know and accept these values, when registering to the procurement website.

In the year 2010 an external independent party audited the implementation of the Compliance program, and we were awarded a certificate of compliance with the external expectations and of the implementation of the system. The program was revised in 2013, including other related areas as well – such as procurement, internal audit, HR, sales. The audit was not aimed only at the implementation and control of the system in the different areas, but it measured the operational efficiency of the control system. We met the expectations and were awarded by a certificate issued by Ernst&Young as independent external party.

The first distance learning course addressing compliance was started in 2008 in the topic of “Conscious recognition of fraud and corruption”. Since then we have been providing a general eLearning course for our new employees, mandatory for all colleagues joining to the company. The course is completed with the acceptance of the Code of Conduct. Since the start of the program, 65 581 distance learning courses were completed by the employees on group level, related to topics, such as compliance awareness, supplier due diligence, anti-corruption measures, incompatibility or insider trading.

On the top of that, our company has arranged personal training sessions for employees working in professional areas exposed to compliance and abuse related risks – both within the parent company and Hungarian and international subsidiaries – in the topics of organized anti-corruption behavior, screening of contracted partners and rules of giving and accepting gifts.

In 2016 – similarly to the practice of the previous years – risk analyses were conducted with the participation of organizations and subsidiaries of Magyar Telekom Nyrt. Based on the results of the survey, a comprehensive audit was prepared for the potential compliance and abuse risks, the result of which was submitted to the Audit Committee of the Company.

During the year we check the soundness of the reports submitted to our company in connection with unethical behavior, and if necessary, we act on these reports. In case we identify actual abuses, we take care of the necessary and adequate countermeasures. Magyar Telekom published all cases of corruption and the related countermeasures in accordance with the related applicable laws and legal provisions.

## 10 ECONOMIC ENVIRONMENTS

The telecommunications industry is undergoing a major change globally. Worldwide trends are driving towards an integrated telecommunications, information, media and entertainment market. The increasing need for mobility and interactivity together with local specifics create a new set-up in our economic environment in terms of infrastructure, servicing and new types of business models.

### Hungary

Traditional telco markets are shrinking on midterm. Market for voice services (both mobile and fixed) is saturated resulting in decreasing pricing and revenues. There is an increasing demand for data services driven by content consumption but strong competition puts pressure on prices. The fixed voice market as a major revenue and profit source is declining, mobile has started to follow this trend with stagnant customer base and lower prices. The fixed market is characterized by fixed-mobile integrated bundles, with broadband becoming a core element of service offerings. We expect continued consolidation in the fixed arena with network developments and growing competition. An increasing technology platform-based competition is fueled by the government's Digital Hungary program. The extensive development program aims to cover every household in Hungary with high-speed internet (HSI > 30 Mbit/s) access until the end of 2018. The digitalization of technology, services and education are key pillars of the country's competitiveness and the quality of life of its citizens.

Mobile market characterised by great quality and coverage from network perspective. Meanwhile the mobile voice market is characterized by increasing ratio of flat rate packages; the appearance of new market players is expected with strong impact on the market in mid-term. There is a fierce competition in broadband and content services and the battle for customer contracts has shifted from prices to quality in communication, especially focusing on network coverage and speed. The mobile broadband uptake still fuels the overall mobile market. However, the increasing regulation, in particular the abolishment of roaming fees and the decrease in mobile termination rates, is putting further pressure on market players.

The growing economic in recent years had a positive effect on the households' budget. The growing budgets however are hard to translate into growing telco spending.

### Macedonia

The Macedonian telecommunication market is in consolidation and stabilization phase affected by challenging political, economical and competitive situation.

The instable political environment continues and negatively influences the business development in Macedonia. Early elections were scheduled for 11th December 2016 and discussions about forming the new Government are taking place in the beginning of 2017.

The political crisis and the slowdown in investments impacted GDP growth negatively. GDP growth was 3,8% in YE 2015 and the National Bank of the Republic of Macedonia foresees 2,3% GDP growth for 2016 and 3,5% for 2017. Inflation rate changed from -0,3% in YE 2015 to 0,2% YE 2016. Unemployment rate decreased to 23,4% in Q2 2016 compared to 26,1% in YE 2015.

The political crisis negatively impacted investment inflow as well. FDI decreased from 203 m. EUR YE 2015 to 27 m EUR Q2 2016.

With the official merge of VIP and ONE (2nd & 3rd mobile operators on the market) in 2015, the newly established legal entity one.VIP overtook the market leadership in mobile and TV service revenues market share in mobile and in payTV. In fixed voice and broadband Makedonski Telekom maintained the leading positions.

VIP, One and Blizoo announced their merger under the vip brand name VIP in May 2016. With this the one.VIP brand that was established in 2015 disappeared. VIP introduced a new portfolio including strong FMC offers addressing all customers in its mobile and fixed network.

British telco operator, Lycamobile, the largest international MVNO started operating in Macedonia in July 2016. Macedonia became the 21st country in the international Lycamobile network. Lycamobile provides its services via VIP's network.

MKT launched new FMC commercial and Business offers after the legal merger of T-Mobile Macedonia and Makedonski Telekom starting in September 2015 (Magenta 1, Magenta Business, Magenta Cool, Smart tariff). The new tariffs and proposition addressing new segments were very well accepted in the local market and generated new revenues for the company. MKT's effort on developing customer satisfaction and the permanent investment into MKT's mobile and fixed networks shows result in a outstandingly high and positive Brand perception and image.



## Montenegro

As announced on January 10, 2017, Magyar Telekom has disposed of its majority stake in Crnogorski Telekom. Following the closing of the transaction, the Montenegrin operation will no longer be consolidated into Magyar Telekom's financials. Please refer to Note 38.1 of the Consolidated Financial Statements.

## 11 TARGETS AND STRATEGY

### 11.1 Outlook

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

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 other 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 their own unique business environment, and we are subject to circumstances and events that are unforeseen or are beyond our control. The global economy recovered from the crisis but waiting for the impacts of Brexit and Trump effect. Our business environment is largely depends on the monetary policy of the FED, the growth of the Chinese and European economy and the movements of EU funds

### Hungary

Magyar Telekom is facing several competitive and regulatory risks to growth in 2017: the expected entry of Digi into the mobile market; the ongoing obligation to register for prepaid services; and the prepaid and business mobile segments remaining very competitive. However, as an integrated operator, we believe that we are well positioned to address these challenges by maximizing the telecommunication share of wallet in household spending through further growth in our 4Play Magenta 1 subscriber base and leverage off our HSI network.

By the end of December 2016, more than 2.8 million households were covered by high speed internet, with penetration figures still on an upwards trajectory and the ratio of higher bandwidth package subscribers continuing to grow.

In addition, the SI/IT market is expected to grow further, underpinned by higher EU fund inflows; our intention is to increase our market share through a greater focus on high margin system integration projects.

### Macedonia

In Macedonia, the mobile market consolidated in 2015, due to the merger of the second and third biggest players on the market (VIP and ONE). In 2016 we managed to increase our market share by 3ppt within a year and it now exceeds 50%. However, there is the potential for the market to become more competitive with the advent of flat rate pricing in 2017.

The fixed line segment remains fragmented despite the acquisition of Blizoo by VIP in 2015. The structural decline in the fixed line voice market is to some extent compensated by sustained growth in the fixed line broadband market, while the TV market has already reached saturation point. We expect these trends to continue, along with a rise in bundled offers.

We also expect regulatory pressures in Macedonia to intensify in the future as it is the intention of the regulatory body to widen the scope of wholesale regulation (bitstream and cost based pricing). Another expectation is that all operators will be obliged to bury underground any aerial cables situated in urban areas. Furthermore, implementation of the next phase from mid-2017 of the Balkan roaming regulation agreement will result in retail and wholesale prices declining to be in line with EU roaming III levels.

Despite the risks stemming from the current environment in Macedonia, we believe that a stabilization in revenues along with cost efficiency improvements will lead to a sustainable turnaround in EBITDA.

## Montenegro

As announced on January 10, 2017, Magyar Telekom has disposed of its majority stake in Crnogorski Telekom. Following the closing of the transaction, the Montenegrin operation will no longer be consolidated into Magyar Telekom's financials. Please refer to Note 38.1 of the Consolidated Financial Statements.

### 11.2 Revenue, EBITDA, Capex, FCF and dividend targets

In 2016, with regards to revenue and EBITDA, we have outperformed on our previously announced guidance, whilst managing to reach our 50 billion forint free cash flow target a year earlier than expected. Our total revenues came to 602.7 billion forint for the full year with EBITDA at 197.0 billion forint. This outperformance was driven by a favorable fourth quarter in Hungary, where our increased marketing activities and higher level of subsidies led to a better than anticipated uplift to sales of both mobile handsets and data packages. Growth in EBITDA was also supported by rise in profitability at our SI/IT services in Hungary due to a strategic focus on higher margin projects.

Looking ahead to 2017, we are facing several competitive and regulatory risks to growth, such as the expected entry of Digi into the mobile market, further cuts in the EU roaming rates and the ongoing obligation to register prepaid SIMs; while both the prepaid and business mobile segments are likely to remain very tight. At the same time the fixed line market is experiencing increasingly competitive regional 3Play offers, a situation undoubtedly intensified by the rollout of optical networks by Digi and UPC, with the latter having only recently started to do so. However, as an integrated operator, we believe that we are well positioned to address these challenges in Hungary in terms of maximizing the telecommunication share of the household spending wallet by further expansion of our 4Play Magenta 1 subscriber base, a bundled offering that largely differentiates us from our competitors.

At the same time however, we do not assume that our results will remain immune to these headwinds. Stripping out any contribution from our Montenegrin business, whose sale was finalised in January this year, we now expect revenues to decrease to around 560 billion forints to reflect the negative competitive and regulatory impacts. Our aim is to mitigate these revenue pressures through seeking additional operational efficiencies, such that excluding the one-off profits from the sale of Infopark (building G) and Origo, we expect EBITDA to remain largely stable at around 182 billion forints. Despite Capex (excluding spectrum acquisitions and annual frequency fee capitalizations) for 2016 being slightly higher than originally planned, we still expect it to decline to around 85 billion forint in 2017. Although we still expect to continue with our fixed network investments in Hungary in terms of providing high speed internet access, coupled with further investments in our mobile network, both these programs will be less capital intensive than in the preceding two years. Furthermore, as we are nearing the completion of a number of efficiency enhancing projects, Capex related to the IP migration and integrated CRM and billing systems will accordingly be lower.

Based on the current operating and regulatory environment and outlook, we expect the Company to pay HUF 25 dividend per share in relation to 2017 earnings.

Public guidance:

	Public guidance for 2016	Actual 2016		Public guidance for 2017	
		with CT	without CT <sup>1</sup>	Previous targets	New targets
<b>Revenue</b>	around HUF 595 billion	HUF 603 billion	HUF 574 billion	HUF 560-570 billion	around HUF 560 billion
<b>EBITDA</b>	around HUF 193 billion	HUF 197 billion	HUF 188 billion	HUF 181-185 billion	around HUF 182 billion
<b>Capex<sup>2</sup></b>	ca. 10% y-o-y decline	HUF 105 billion	HUF 98 billion	ca. 15% y-o-y decline	around HUF 85 billion
<b>FCF</b>	-	HUF 50 billion	HUF 57 billion	surpassing HUF 50 billion <sup>3</sup>	around HUF 55 billion <sup>4</sup>
<b>Dividend</b>	HUF 25 per share	HUF 25 per share		-	HUF 25 per share

<sup>1</sup> excluding Crnogorski Telekom financials

<sup>2</sup> excluding spectrum acquisitions and annual frequency fee capitalization

<sup>3</sup> after minority dividend payments

<sup>4</sup> excluding the transaction price of the disposal of the majority ownership in Crnogorski Telekom



### 11.3 Strategy

#### Hungary

As a result of our focused strategic efforts, Magyar Telekom maintained its leading position in its Hungarian fixed voice, broadband, pay TV, mobile and ICT businesses in 2016, we successfully improved customer retention and delivered strong volume figures. We built a world class 4g mobile network and massively improved our fixed line HSI coverage in the past years

Based on our improved network capabilities we aim to provide services to all segment and customer on voice, TV broadband and IT markets The strategic objective in the mid-term is to become more agile, enhance efficiency, simplify the product and services portfolio, increase process automation and online customer servicing. As an integrated provider we continue to deliver a unique customer experience supported by our leading brand and best technology.

While anticipating new competencies required by the changing customer behavior, technological advances, and new business models, we aim to exploit our abilities to become a leader in all digital services around the home for both customers and third parties. We continue to identify and leverage new business opportunities in e-health, cloud, IoT, finance and insurance services, support customer retention and new revenue streams both in the residential and business segments. As a result of the changed market environment we decided to exit from the residential gas market. At the same time, we established a joint venture that provides energy services for business customers in order to improve and optimize our energy operations.

Following our strategy enables us to exploit and develop our extended customer base, improve efficiency and capture growth opportunities in an extended market of information and communications technology and related industries, which secures stable cash generation in the long run.

#### Macedonia

In Macedonia the competition on mobile and the fixed-line business is increasing due to the established duopoly at the market. Due to its worsening market position VIP started gain market share with market disrupting pricing. To address new challenges MKT introduced new growth strategies in Consumer & Business Segments called "GoDigital" corporate program.

The main pillars planned for GoDigital strategy are:

- Go Digital - Digitalize customer journey and business architecture
- Value Leadership - Keep stable core revenues in all segments, increase postpaid value, optimize market invest and win the households; Pre-paid-to-postpaid-to-fmc (magenta 1) migration (in both b2c & b2b)
- Customer Excellence – Superior Customer & Network Experience
- Access Everywhere – Technology Leadership - Lead in network innovation in FTTH, vdsl, LTE, hybrid (xDSL +LTE), Wireless
- Lean Telco – agile and efficient telco
- Corporate Culture – Empowerment in times of change.

#### Montenegro

As announced on January 10, 2017, Magyar Telekom has disposed of its majority stake in Crnogorski Telekom. Following the closing of the transaction, the Montenegrin operation will no longer be consolidated into Magyar Telekom's financials. Please refer to Note 38.1 of the Consolidated Financial Statements.

## 12 INTERNAL CONTROLS, RISKS AND UNCERTAINTIES

### 12.1 The presentation of the systems of internal controls and the evaluation of the activity in the relevant period

Magyar Telekom's management is committed to establish and maintain an adequate internal control system to ensure the reliability of the financial reports, and minimize operating and compliance risks. Our internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in conformity with International Financial Reporting Standards (IFRS) as adopted by the European Union.

For the business year 2016 we fully accomplished control documentation and evaluation in the IT supported ICS<sup>i</sup> system. Transaction Level Controls describe the controls built into our business processes that have been designed and operated to ensure that material misstatements in each significant financial account and disclosure within the financial statements are prevented or detected in a timely manner.

Complete evaluation of our internal control system is based on the method established in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The operation of the internal control system is supported also by the independent internal audit function. Beyond tasks regarding the risk based internal audit work plan, contributes to the enhancement of the internal control processes and to the reduction of existing risks through ad-hoc audits. The Internal Audit area follows up the implementation of the measures defined on the basis of the audits. The Supervisory Board and the Audit Committee receive regular reports on the findings of the audits; measures, based on the findings and fulfilment of tasks.

In line with the criteria of the adopted internal control framework, management evaluates the effectiveness of internal control system within each financial year. Management's assessment for 2016 is still in progress, but based on the already available information, we believe that internal control system has been operating effectively to prevent potential material misstatements in the financial statements, and minimize operating and compliance risks.

The Company's shareholders are being informed about the operation of our internal control system through our public reports.

The management and Board of Directors of Magyar Telekom are committed to conduct all business activities of Magyar Telekom Group according to the highest legal and ethical standards. Based on this commitment the Board of Directors established the Corporate compliance program of Magyar Telekom.

The Corporate compliance program is applicable to all bodies, organizations, employees of Magyar Telekom Group, and advisors, agents, representatives as well as to all persons and organizations that work on behalf of the Company or its subsidiary.

The Corporate compliance program of Magyar Telekom ensures that the business activities of the Group are conducted with observing and in compliance with the relevant laws to the outmost extent, according to the highest standards of training and commitment. It requires the realization of guidelines and processes that manage potential compliance risks and implement specific processes in order to report, investigate, monitor and correct suspected or actual lack of compliance.

<sup>i</sup> Internal Control System

### 12.2 The utilization of financial instruments, risk management and hedging policies

It is our policy that all disclosures made by us to our security holders and the investment community, are 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. To achieve these objectives we developed and have continuously enhanced our risk management policies.

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

In 1999, we established a formal risk management system. This system has been operating in an integrated way with the risk management system of Deutsche Telekom since 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 an internal regulation on risk management were issued. 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 Company. All of our subsidiaries, business units, divisions and entities are obliged to identify and report their operational risks on a quarterly basis. After the evaluation of these risks, results are reported to our management, to the Board of Directors and to the Audit Committee.

For the sake of prompt disclosure of all risk items influencing investors' decisions, we enhanced our risk management procedures by adding a new element. 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 the 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.

### 12.3 Risk factors

Our financial condition, results of operations or the trading prices of our shares could be materially adversely affected by any of the risks described below. These risks are not the only risks we face. Additional risks not currently known to us, or risks that we currently regard as immaterial, could also have a material adverse effect on our financial condition, results of operations or the trading prices of our shares.

- Our operations are subject to substantial government regulations, further restrictions related to consumer protection were published; the change of the price setting methodology of already regulated wholesale products and new type of regulated access services are probable, which can result in adverse consequences for our business and results of operations;
- Net neutrality regulation has no defined framework in Hungary yet. Case-by-case decisions of the Regulatory Authority may hinder innovation.
- Mobile providers have to implement roaming fair use policy and cost control over their subscribers. These 'roam like at home' regulation may be a base for fraud and a loss of revenues.
- We are subject to more intense competition in the fixed business due to meeting our competitors on more and more area as a result of the network roll-outs
- Beyond current market players in Hungary, DIGI also acquired 2x5 MHz spectrum block in the 1800 MHz band and 1x20 MHz spectrum block in the 3400-3600 MHz band, and will most probably enter the mobile market as a new player in the first half of 2017;
- Prepaid registration obligation might negatively affect our business
- The future of our current operational model is subject to currently unforeseeable changes in the future business environment;
- Developments in the technology and telecommunications sectors may result in impairment of the carrying value of certain of our assets;
- Our business may be adversely affected by actual or perceived health risks associated with mobile communications technologies;
- System failures could result in reduced user traffic and revenue and could harm our reputation;
- Loss of key personnel could weaken our business;
- The regulatory environment in Macedonia is getting stricter, since the Regulatory Body's aim is at widening the scope of wholesale regulation (bitstream and cost based pricing).
- More intense competition in Macedonia driven by VIP being an integrated player as well
- Our share price may be volatile, and the ability to sell our shares may be adversely affected due to the relatively illiquid market for our shares and ADSs;
- The value of our investments, results of operations and financial condition could be adversely affected by economic developments in Hungary and other countries;
- Unpredictable changes in the Hungarian tax regulations may have an adverse effect on our results;
- Fluctuations in the currency exchange rate could have an adverse effect on our results of operations;
- Disputes and litigation with regulators, competitors and other parties could have an adverse effect on our results of operations.
- The number of cyber attacks have been evolving at an exponential rate recently worldwide. Although Magyar Telekom provides services with highest security-standards and constantly tests and updates its cyber security countermeasures, it cannot be fully excluded that the Company will be subject of a cyber attack.

## 12.4 Financial risk management

The classification of the group's financial instruments is described in detail in Note 2.4 and the financial risk management of the Group is described in detail in Note 3 of the Consolidated Financial Statements.

## 13 ANALYSIS OF FINANCIAL RESULTS FOR 2016

### Key Performance Indicators

	At December 31,	
	2015	2016
Revenue (HUF million) .....	656,342	602,651
Mobile revenues.....	314,033	319,929
Fixed line revenues.....	212,032	207,209
System Integration/Information Technology revenues .....	80,997	68,735
Energy service revenues.....	49,280	6,778
EBITDA (HUF million) .....	187,301	197,039
EBITDA margin.....	28.5%	32.7%
Operating margin.....	11.2%	13.2%
Net income margin .....	4.2%	9.01%
Capex to sales ratio .....	16.7%	18.8%
ROA ratio <sup>i</sup> .....	3.3%	5.9%
ROE ratio <sup>i</sup> .....	6.5%	11.0%
Net debt (HUF million).....	409,393	376,557
Net debt ratio (net debt to total capital) .....	42.9%	39.3%

<sup>i</sup> ROA is calculated as Profit for the period divided by the average total assets and ROE is calculated as Profit for the period divided by the average equity excluding Non-Controlling interest

### 13.1 Revenues

Total revenues amounted to HUF 602.7 billion in 2016 compared to HUF 656.3 billion in 2015, principally as a result of the partial exit from the energy business, along with lower SI/IT revenues. Revenues remained roughly stable in Macedonia whilst both the Hungarian and Montenegrin operations witnessed declines.

**Mobile revenues** increased by 1.9% to HUF 319.9 billion in 2016, compared to HUF 314.0 billion in 2015. Lower mobile voice and SMS revenues were more than offset by higher mobile data and equipment revenues.

- Voice-retail revenues decreased by 2.9% to HUF 153.8 billion in 2016, reflecting declines in Hungary and Macedonia. In Hungary, the positive effects of the improving postpaid ratio (59.2% vs. 56.4%, end-2016 vs. end-2015) and increasing penetration by the flat rate Next tariff were outweighed by a decline in the business segment along with lower roaming revenues as a result of EU regulation. In Macedonia, the improvement in the postpaid segment was more than offset by a smaller prepaid customer base in absolute terms and lower ARPU (average revenue per user), as well as a drop in roaming revenues driven by the Balkan roaming agreement. Within Montenegro, growth in both the pre- and postpaid customer bases compensated for lower postpaid ARPUs and usage, resulting in broadly stable revenues overall
- Voice-wholesale revenues dropped by 26.8% to HUF 11.7 billion in 2016, driven by the significantly lower (76%) regulated mobile termination rate (MTR) that came into effect in Hungary on April 1, 2015 (thereby negatively impacting like-for-like first quarter results), slightly offset by higher minutes of use (MOU). In Macedonia, a decrease in international incoming traffic over the year caused lower voice-wholesale revenues for 2016 compared to 2015; similarly the case for Montenegro, which also experienced a decrease in termination tariffs
- Data revenues increased by 9.3% to HUF 64.8 billion in 2016, driven by higher subscriber numbers and usage in all three countries

- SMS revenues dropped by 2.7% to HUF 18.1 billion in 2016. This slight decline was due to a combination of the lower number of SMSs sent (principally within our small-medium business segment and our Macedonian and Montenegrin operations) that were almost offset by the growth in Hungarian mass messaging revenues
- Mobile equipment revenues increased by 20.9% to HUF 56.7 billion in 2016, thanks to improvement across the Group's footprint. Equipment sales grew significantly due to third party export sales in Hungary, a higher average selling price in Macedonia, and the greater number of handsets sold in Montenegro

**Fixed line revenues** amounted to HUF 207.2 billion in 2016, compared to HUF 212.0 billion in the previous year, representing a 2.3% decline. The improvements in broadband and TV revenues were unable to match the declines in voice retail, equipment, data and wholesale revenues.

- Voice-retail revenues decreased by 8.7% to HUF 54.5 billion in 2016, mainly driven by the continuing structural declines in the customer base and usage levels, along with a reduction in average tariff levels across all segments
- Broadband retail revenues slightly increased by 1.2% to HUF 52.6 billion. Within Hungary, the effect of an enlarged customer base along with flat ARPUs led to a 2.2% rise in sales; whereas improving ARPUs and a slight decline in the customer base in Macedonia resulted in flat revenues. In Montenegro, increasing cable-based competition and regulatory pressures combined resulted in a 8.6% year-on-year decline
- TV revenues increased by 4.8% to HUF 44.2 billion in 2016. The improvement was mainly driven by the growing Hungarian IPTV subscriber base combined with rising ARPUs. The increasing popularity of interactive television is reflected in growing number of IPTV subscribers now constituting 62% of the Group's TV revenues
- Fixed equipment revenues declined by 20.7% to HUF 6.5 billion in 2016, due to lower sales of TV sets, tablets and laptops to retail customers in Hungary
- Data retail revenues declined by 3.2% to HUF 10.4 billion reflecting pricing pressure and lower access numbers in the Hungarian enterprise segment, along with a smaller contribution from leased line services in Macedonia and Montenegro
- Wholesale revenues declined by 1.5% to HUF 21.3 billion in 2016 as a result of lower fixed incoming domestic and international traffic levels witnessed at both our Macedonian and Montenegrin operations which more than offset the growth in Hungary (due to the additional GTS revenues recorded in the first quarter of 2016)

**System Integration (SI) and IT revenues** amounted to HUF 68.7 billion, compared to HUF 81.0 billion in the previous year. The main factor behind this 15.1% decline was a significant drop in the number and size of public contracts awarded to Magyar Telekom following the ending in 2015 of a seven year EU funding cycle and consequent temporary stemming of EU fund inflows into Hungary. Furthermore, 2015 SI/IT revenues were also boosted by large projects in Macedonia and Montenegro that were not repeated in 2016.

**Energy Services** revenues decreased to HUF 6.8 billion in 2016 compared to HUF 49.3 billion in 2015, representing a 86.3% decline, due to the planned exit from the residential gas business on August 1, 2015 and transfer of the B2B energy business into the joint venture (E2) with MET Holding AG with effect from January 1, 2016. We still believe that we will not exit the residential electricity business before June 2017.

### 13.2 Direct costs

Direct costs improved by 21.1% year-on-year to HUF 196.9 billion in 2016, mainly due to a sharp decline in energy service related costs and lower SI/IT related costs, which compensated for the increase in other direct costs.

- Interconnect costs improved by 12.6% to HUF 21.9 billion in 2016, reflecting the effect of the Hungarian MTR cut in the first quarter of 2016. In Macedonia, higher traffic volume led to increased payments to domestic mobile operators, while in Montenegro lower international voice and shrinking SMS traffic resulted in lower payments to domestic and international operators
- SI/IT service related costs declined by 26.5% in 2016, in line with lower SI/IT revenues across all three operations. At the same time, the SI/IT gross margin improved significantly, from 32.7% in 2015 to 41.7% in 2016
- Energy service related costs in Hungary decreased by HUF 41.1 billion to HUF 6.8 billion in 2016, as a result of the exit from the residential gas business and transfer of the B2B energy business into the joint venture (E2) with MET Holding AG
- Bad debt expenses improved by 10.8% to HUF 8.5 billion in 2016, primarily owing to a significantly higher impairment loss in 2015 related to receivables due from a major Hungarian enterprise customer. This improvement in bad debt expenses can also be attributed to liquidity checks, factoring in the residential mobile business and a more efficient collection process in Macedonia
- Other direct costs deteriorated from HUF 112.3 billion in 2015 to HUF 119.6 billion in 2016 due to higher TV and other content related costs (mainly attributable to the new content fee), increased cost of mobile equipment, accessories and other equipment sales, in line with higher sales volume

### 13.3 Gross margin

Gross margin remained broadly stable at HUF 405.8 billion as a result of lower direct costs compared to 2015, which offset the effect of shrinking revenues in 2016.

### 13.4 Employee-related expenses

Employee-related expenses improved by 12.4% year-on-year to HUF 83.3 billion, owing to higher severance-related expenses in 2015 coupled with lower headcount in 2016. The 8.9% decrease in the average number of employees was primarily driven by the Origo sale, the headcount reduction program in Hungary, as well as the outsourcing project in Macedonia.

### 13.5 Hungarian sector specific special taxes

Hungarian sector specific special taxes decreased by 4.1% year-on-year to HUF 31.5 billion. Utility tax expenses declined by HUF 0.4 billion, primarily due to a five year tax holiday granted as of 25 June, 2015. This relates to network investments and upgrades which enable internet access of least 100 Mbps. Secondly, taxable network records were refined in Q1 2016 compared to the same period of 2015. Furthermore, telecommunication tax expenses improved driven by changes in customer behavior.

### 13.6 Other operating expenses

Other operating expenses increased by HUF 6.4 billion year-on-year to HUF 104.9 billion, mainly driven by developments in Hungary including: the higher advisory fee related to the HSI development for the Digital Welfare Program, higher marketing expenses and increased sponsorship activities, higher maintenance, repairs, and remedial work expenses and the parallel operation of legacy and next generation IT platforms. Furthermore, office rental fees also increased following the sale of Infopark building G, which we now rent, while maintenance costs went up in both Macedonia and Montenegro due to outsourcing to Ericsson.

### 13.7 Other operating income

Other operating income improved by HUF 4.1 billion year-on-year to HUF 11.0 billion primarily due to the one-off profits realized on the sales of Infopark building G and Origo in Q1 2016. These counterbalanced the lower income generated from network construction works in Hungary.

**13.8 EBITDA**

EBITDA increased by 5.2% year-on-year to HUF 197.0 billion in 2016, driven by a stable gross margin, savings on employee-related expenses and higher other operating income, which offset the increase in other operating expenses.

**13.9 Depreciation and amortization**

Depreciation and amortization (D&A) expenses deteriorated by 3.2% to HUF 117.5 billion in 2016. Software activation related to the new billing and Customer Relationship Management systems caused higher depreciation costs in 2016 in both Hungary and Montenegro. Furthermore, capitalization of the recently acquired mobile frequencies and content rights also contributed to higher D&A at Crnogorski Telekom, while in Macedonia, thanks to prolonged useful life of optical cable assets, D&A improved by 6.2% year-on-year.

**13.10 Operating profit**

Operating profit increased from HUF 73.5 billion in 2015 to HUF 79.6 billion in 2016 for the reasons described above.

**13.11 Net financial result**

Net financial loss narrowed from HUF 28.2 billion in 2015 to HUF 26.8 billion in 2016, representing an improvement of 4.8%. The result was primarily due to a lower average interest rate expense, driven by favorable changes in the market conditions and a decreasing amount of loans.

**13.12 Income tax**

Income tax decreased from an expense of HUF 13.8 billion in 2015 to an income of HUF 4.4 billion in 2016. The primary reason for this change was the reduction in the corporate income tax rate from 19% to a flat rate of 9% as of 1 January, 2017, which was reflected in the Q4 2016 deferred tax position. As a result, the amount of deferred tax liabilities declined by HUF 16.8 billion year-on-year.

**13.13 Profit attributable to non-controlling interests**

Profit attributable to non-controlling interests decreased from HUF 3.8 billion in 2015 to HUF 2.9 billion in 2016 due to lower profit for the period generated by international subsidiaries.



13.14 Cash flows

HUF millions	1-12 months 2015	1-12 months 2016	Change
Operating cash flow	156 298	154 825	(1 473)
Investing cash flow	(97 513)	(89 199)	8 314
Less: Proceeds from other financial assets - net	(13 137)	(6 940)	6 197
Investing cash flow excluding Proceeds from other financial assets – net	(110 650)	(96 139)	14 511
Repayment of other financial liabilities	(18 923)	(8 676)	10 247
<b>Free cash flow</b>	<b>26 725</b>	<b>50 010</b>	<b>23 285</b>
Proceeds from other financial assets - net	13 137	6 940	(6 197)
Proceeds from/Repayment of loans and other borrowings - net	(30 160)	(40 423)	(10 263)
Dividend paid to shareholders and Non-controlling interests	(6 691)	(22 686)	(15 995)
Repurchase of treasury shares	0	(550)	(550)
Exchange differences on cash and cash equivalents	(78)	(44)	34
<b>Change in cash and cash equivalents</b>	<b>2 933</b>	<b>(6 753)</b>	<b>(9 686)</b>

Free cash flow

Operating cash flow

Net cash generated from operating activities amounted to HUF 154.8 billion in 2016, compared to HUF 156.3 billion in 2015. Main reasons for the decrease of HUF 1.5 billion were the following:

- HUF 9.7 billion positive change due to the higher EBITDA in 2016 than in 2015
- HUF 21 billion positive change in active working capital due to the transfer of the energy services for business customers to E2 and also due to the offsetting effect of the advance given to E2 in 2015. Furthermore the changed terms of the installment receivables in 2016 also contributed to this positive change through the decrease in installment receivables as the length of the installment period has been shortened
- HUF 5.0 billion negative change in active working capital due to higher level of inventory in 2016 than in 2015 as a result of business decision which was also triggered by volume discount
- HUF 6.1 billion negative change due to lower net addition to severance provision in 2016 than in 2015
- HUF 0.6 billion positive change due to higher net addition of litigation provision in 2016 than in 2015
- HUF 0.5 billion positive change in tax payments due to lower CIT tax payments in Macedonia in 2016 as a result of additional tax payment in 2015 related to the changes of the tax law, no such payment in 2016 which was partly offset by the higher local tax paid in 2016 than in 2015
- HUF 20.9 billion negative change in passive working capital due to the higher payment of the SI/IT services and also the higher payment of handset suppliers which was partly mitigated by the net lower payment of certain opex and group creditors and was also alleviated by lesser continuous decrease in the volume of energy suppliers in 2016 than in 2015 as a result of the launch of E2's operation in the energy market
- HUF 1.3 billion negative change in passive working capital due MTR debtor overpayments (invoiced and collected using old rate, accounted at new rate as revenue)
- HUF 4.4 billion positive change due to the lower interest paid mainly caused by the refinance of certain loans which resulted in more favorable credit terms
- HUF 4.4 billion negative change mainly due to the accounting net result of the sale of Origo Zrt. and Infopark building G

Investing cash flow excluding proceeds from other financial assets – net

Net cash used in regular investing activities amounted to HUF -96.1 billion in 2016, compared to HUF -110.6 billion in 2015. Main reasons for the HUF 14.5 billion lower cash outflow were the following:

- HUF 14.8 billion positive change mainly due to the net cost of the acquisition of GTS Hungary in Q2 2015
- HUF 3.4 billion negative effect due to more CAPEX spending in 2016 than in 2015 mainly caused by the purchase of the new spectrum in Montenegro, as opposed to the CAPEX spending in MT-Hungary segment which showed a decrease compared to the same period of 2015
- HUF 9.6 billion negative change due to higher amount of CAPEX creditors paid in 2016 than in 2015 which was partly offset by the EU government grant advance received in 2016
- HUF 3.4 billion positive change due to the sale of Origo Zrt.
- HUF 8.3 billion positive change due to the sale of buildings mainly due to the sale of Infopark building G
- HUF 1.0 billion positive change due to the establishment of E2 in 2015, there was no such payment in 2016

#### Repayment of other financial liabilities

Repayment of other financial liabilities decreased from HUF -18.9 billion in 2015 to HUF -8.7 billion in 2016. Main reason for the lower payment was the combined effect of the following:

- HUF 10.9 billion positive change due to trade creditors with extended payment term were paid as financial liability in 2015 (recognized as financial liability in 2014). There were no such payments in 2016.
- HUF 0.7 billion negative change due to higher payment of content right liability in 2016 than in 2015

Free cash flow (FCF) overall increased from HUF 26.7 billion in 2015 to HUF 50.0 billion in 2016 due to the reasons described above.

#### **Proceeds from other financial assets - net**

Proceeds from other financial assets - net decreased by HUF 6.2 billion, the reason for the decrease are the followings:

- HUF 5.7 billion lower cash inflows from derivatives in 2016 compared to 2015
- HUF 8.0 billion higher amount of Maktel's cash was invested as bank deposits over 3 months in 2016 in net terms
- HUF 7.5 billion lower amount of CT's cash was invested as bank deposits over 3 months in 2016 in net terms

#### **Repayment of loans and other borrowings - net**

The negative change was due to the higher loan repayment in 2016 to DTAG than in 2015.

#### **Dividend paid to Owners of the parent and Non-controlling interest**

Dividend paid to Owners of the parent and Non-controlling interest increased by HUF 16.0 billion mainly as a result of Magyar Telekom's dividend payment to its Owner and Non-controlling interest in 2016, there was no dividend payment in 2015

#### **Repurchase of treasury shares**

The change is due to the repurchase of treasury shares for ESOP (Employee Share Ownership Program) Organization in 2016, there was no such payment in 2015

#### **Exchange differences on cash and cash equivalents**

The change in exchange differences on cash and cash equivalents had no significant effect in 2016 compared to 2015

### 13.15 Statements of Financial Position

The most significant change in the balances of the Statements of Financial Position from December 31 2015 to December 31 2016 can be observed in the following lines:

- Cash and cash equivalents and Other current financial assets
- Trade and other receivables
- Property plant and equipment and Intangible assets
- Financial liabilities to related parties (current and non-current parts)
- Retained earnings

Cash and cash equivalents decreased by HUF 6.8 billion and the Other current financial assets decreased by HUF 5.9 billion from December 31, 2015 to December 31, 2016. The decrease is partially due to the dividend payment to the non-controlling interest of the Montenegrin and Macedonian subsidiaries and on the other hand due to the payment for the right of use of the new frequency blocks by the Montenegrin subsidiary. Further details of changes of Cash and cash equivalents are covered by the Consolidated Statement of Cash flows.

Trade and other receivables decreased by HUF 5.1 billion from December 31, 2015 to December 31, 2016. The decrease is mainly due to the decrease of the energy related receivables due to the exit from the energy business. E2 launched its operation from January 1, 2016 and started to provide energy services for business customers.

Property plant and equipment (PPE) and intangible assets together (including Goodwill) decreased by HUF 10.6 billion from December 31, 2015 to December 31, 2016. The main reason for the decrease is that the depreciation and scrapping of assets exceeded the capital expenditure of assets.

The current and non-current parts of Financial liabilities to related parties together decreased by HUF 37.2 billion from December 31, 2015 to December 31, 2016. The change is mainly caused by the repayment of DT group loans.

Deferred tax liabilities decreased by HUF 15.1 billion from December 31 2015 to December 31 2016. The main reason for the decrease is due to the decrease of Hungarian corporate income tax rate from 10%/19% to 9% flat rate as of 1 January 2017.

Retained earnings increased by HUF 38.6 billion from December 31, 2015 to December 31, 2016. The change is due to the HUF 54.3 billion increase of the profit attributable to owners of the parent generated in 2016 year-to-date opposed to the HUF 15.6 billion decrease as a result of the dividend declaration for 2015.

There has not been any other material change in the items of the Consolidated Statement of Financial Position from December 31, 2015 to December 31, 2016. The less significant changes in balances of the Consolidated Statements of Financial Position are largely explained by the items of the Consolidated Statement of Cash Flows for 2016 and the related explanations provided above in section 13.14 Cash flows.

## 14 SUBSEQUENT EVENTS BETWEEN THE END OF THE YEAR AND THE RELEASE OF THE REPORT

### 14.1 Sale of Crnogorski Telekom A.D.

In January 2017, the Company signed a share purchase agreement with Hrvatski Telekom d.d. for the sale of the total of its 76.53% shareholding in Crnogorski Telekom A.D. for a total consideration of EUR 123.5 million (approximately HUF 38.1 billion). Summarized financial information of Crnogorski Telekom A.D. is disclosed in Note 21.1. The closing of the transaction also took place in January 2017.

### 14.2 Acquisition of SERVERINFO

In October 2016 T-Systems Magyarország Zrt. signed an agreement with WING Group to buy 100% of SERVERINFO-INGATLAN Kft. As a result of the transaction Magyar Telekom Group gains ownership of the property where its highly secure data center with state of the art technical infrastructure is located. The value of the transaction is EUR 14.4 million (approximately HUF 4.4 billion). SERVERINFO-INGATLAN Kft. manages the rentals and the maintenance of the property where the data center of T-Systems Magyarország Zrt. is located. The majority of the consideration relates to the fair value of the property. The closing of the transaction took place in January 2017.

Budapest, February 22, 2017



Christopher Mattheisen  
Chief Executive Officer, Board member



János Szabó  
Chief Financial Officer

## Declaration

We the undersigned declare that

- the attached annual financial statements which have been prepared in accordance with the applicable set of accounting standards and to the best of our knowledge, gives a true and fair view of the assets, liabilities, financial position and profit or loss of Magyar Telekom Plc. and the undertakings included in the consolidation as a whole, and
- the business report gives a fair view of the position, development and performance of Magyar Telekom Plc. and the undertakings included in the consolidation as a whole, together with a description of the principal risks and uncertainties of its business.

Budapest, 2017. április 7.



Christopher Mattheisen  
Vezérigazgató  
az Igazgatóság tagja



Szabó János  
Gazdasági vezérigazgató-helyettes