

# **Magyar Telekom Telecommunications Public Limited Company**

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

**Subject:** Decision on the approval of the 2007 financial statements of the Company

Budapest, April, 2008

**Resolution proposal:**

**The General Meeting approves the 2007 Consolidated Financial Statements of Magyar Telekom Group prepared according to the International Financial Reporting Standards (IFRS), including Balance Sheet Total Assets of HUF 1,135,578 million and**

**Profit after tax for year 2007 HUF 73,056 million (before the deduction of HUF 12,901 million attributable to minority interests).**

**Magyar Telekom Telecommunications  
Public Limited Company**

**Consolidated Financial Statements**

**FOR THE YEAR ENDED DECEMBER 31, 2007**

Prepared in accordance with  
International Financial Reporting Standards  
(IFRS)

# MAGYAR TELEKOM

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**INDEPENDENT AUDITOR'S REPORT  
(Free translation)**

**To the Shareholders and Board of Directors of Magyar Telekom Nyrt.**

We have audited the accompanying consolidated financial statements of Magyar Telekom Nyrt. ("the Company"), which comprise the consolidated balance sheet as of 31 December 2007 (in which the balance sheet total is HUF 1,135,578 million and the profit attributable to the equity holders of the Company is HUF 60,155 million) the consolidated income statement, consolidated statement of changes in equity, and the consolidated cash flow statement, for the year then ended and the notes to the financial statements including a summary of the main accounting policies as well as other disclosures.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to assess whether or not the accounting information disclosed in the business report is consistent with that contained in the consolidated financial statements. We conducted our audit in accordance with Hungarian and International Standards on Auditing and with applicable laws and regulations in force in Hungary. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

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

as evaluating the overall presentation of the financial statements. Our work in respect of the business report was limited to checking it within the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company.

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

*Opinion*

During our work we have audited the components and disclosures along with the underlying accounting records and supporting documentation in the consolidated financial statements of Magyar Telekom Nyrt. in accordance with Hungarian and International Standards on Auditing and, on the basis of our audit work, we have gained sufficient and appropriate evidence that the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. In our opinion, the accompanying financial statements give a true and fair view of the financial position of Magyar Telekom Nyrt. as of 31 December 2007, and of the results of its operation for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU. The business report is consistent with the disclosures in the financial statements.

Budapest, April 10, 2008



Nick Kós  
Partner  
PricewaterhouseCoopers Kft.  
1077 Budapest, Wesselényi u. 16.  
License Number: 001464



Hegedűsné Szűcs Márta  
Statutory auditor  
Licence number: 006838


MAGYAR TELEKOM

CONSOLIDATED BALANCE SHEETS

At December 31,

|  | Notes | HUF                                 |                  | USD                               |
|--|-------|-------------------------------------|------------------|-----------------------------------|
|  |       | 2006<br>as restated<br>(Note 2.1.5) | 2007             | 2007<br>(unaudited –<br>Note 2.1) |
|  |       | (in HUF millions)                   |                  | (million USD)                     |
| <b>ASSETS</b>  |       |                                     |                  |                                   |
| <b>Current assets</b>  |       |                                     |                  |                                   |
| Cash and cash equivalents .....  | 6     | 60,207                              | 47,666           | 276                               |
| Trade and other receivables .....  | 7     | 102,390                             | 103,576          | 600                               |
| Other current financial assets .....   | 8.1   | 21,064                              | 63,443           | 368                               |
| Current income tax receivable .....  | 9.2   | 6,735                               | 1,857            | 11                                |
| Inventories .....  | 10    | 10,460                              | 10,652           | 62                                |
| Non current assets held for sale .....   | 11    | 6,825                               | 4,393            | 25                                |
| <b>Total current assets</b> .....  |       | <b>207,681</b>                      | <b>231,587</b>   | <b>1,342</b>                      |
| <b>Non current assets</b>  |       |                                     |                  |                                   |
| Property, plant and equipment – net .....                                      | 12    | 550,900                             | 534,731          | 3,097                             |
| Intangible assets – net .....  | 13    | 331,740                             | 337,227          | 1,954                             |
| Investments in associates and joint ventures .....                             | 14    | 5,771                               | 4,936            | 29                                |
| Deferred tax assets .....  | 9.4   | 9,575                               | 1,286            | 7                                 |
| Other non current financial assets .....                                       | 8.2   | 23,786                              | 24,965           | 145                               |
| Other non current assets .....   | 15    | 2,142                               | 846              | 5                                 |
| <b>Total non current assets</b> .....  |       | <b>923,914</b>                      | <b>903,991</b>   | <b>5,237</b>                      |
| <b>Total assets</b> .....  |       | <b>1,131,595</b>                    | <b>1,135,578</b> | <b>6,579</b>                      |
| <b>LIABILITIES</b>   |       |                                     |                  |                                   |
| <b>Current liabilities</b>   |       |                                     |                  |                                   |
| Financial liabilities to related parties .....                                 | 16    | 77,756                              | 25,210           | 146                               |
| Other financial liabilities .....  | 17    | 29,903                              | 44,666           | 259                               |
| Trade payables .....   | 18    | 81,392                              | 87,989           | 509                               |
| Current income tax payable .....   | 9.2   | 1,736                               | 2,365            | 14                                |
| Provisions .....   | 19    | 13,004                              | 20,811           | 121                               |
| Other current liabilities .....  | 20    | 110,598                             | 41,977           | 243                               |
| <b>Total current liabilities</b> .....   |       | <b>314,389</b>                      | <b>223,018</b>   | <b>1,292</b>                      |
| <b>Non current liabilities</b>   |       |                                     |                  |                                   |
| Financial liabilities to related parties .....                                 | 16    | 185,432                             | 254,432          | 1,473                             |
| Other financial liabilities .....  | 17    | 20,697                              | 55,038           | 319                               |
| Deferred tax liabilities .....   | 9.4   | 5,647                               | 2,714            | 16                                |
| Provisions .....   | 19    | 3,533                               | 12,886           | 75                                |
| Other non current liabilities .....  | 21    | 8,730                               | 5,797            | 34                                |
| <b>Total non current liabilities</b> .....                                     |       | <b>224,039</b>                      | <b>330,867</b>   | <b>1,917</b>                      |
| <b>Total liabilities</b> .....   |       | <b>538,428</b>                      | <b>553,885</b>   | <b>3,209</b>                      |
| <b>EQUITY</b>  |       |                                     |                  |                                   |
| <b>Shareholders' equity</b>  |       |                                     |                  |                                   |
| Common stock .....   |       | 104,277                             | 104,275          | 604                               |
| Additional paid in capital .....   |       | 27,380                              | 27,379           | 159                               |
| Treasury stock .....   |       | (1,504)                             | (1,179)          | (7)                               |
| Cumulative translation adjustment .....  |       | (1,474)                             | (688)            | (4)                               |
| Revaluation reserve for available for sale financial assets – net of tax ..... |       | -                                   | 118              | 1                                 |
| Reserve for equity settled share based transactions .....                      |       | 49                                  | 49               | -                                 |
| Retained earnings .....  |       | 397,311                             | 385,044          | 2,231                             |
| <b>Total shareholders' equity</b> .....  |       | <b>526,039</b>                      | <b>514,998</b>   | <b>2,984</b>                      |
| <b>Minority interests</b> .....  |       | <b>67,128</b>                       | <b>66,695</b>    | <b>386</b>                        |
| <b>Total equity</b> .....  |       | <b>593,167</b>                      | <b>581,693</b>   | <b>3,370</b>                      |
| <b>Total liabilities and equity</b> .....                                      |       | <b>1,131,595</b>                    | <b>1,135,578</b> | <b>6,579</b>                      |

These consolidated financial statements were authorized for issue by the Board of Directors on March 18, 2008 and signed on their behalf by:

  
 Christopher Mattheisen  
 Chairman and Chief Executive Officer

  
 Thilo Kusch  
 Chief Financial Officer

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

**MAGYAR TELEKOM**

**CONSOLIDATED INCOME STATEMENTS**

|  |     | <b>For the year ended December 31,</b>             |               |               |                               |
|--|-----|--|---------------|---------------|-------------------------------|
|  |     | <b>HUF</b>   |               |               | <b>USD</b>                    |
| <b>Notes</b>   |     | <b>2005</b>  | <b>2006</b>   | <b>2007</b>   | <b>2007</b>                   |
|  |     | <b>(in HUF millions, except per share amounts)</b> |               |               | <b>(million USD)</b>          |
|  |     |  |               |               | <b>(unaudited – Note 2.1)</b> |
| <b>Revenue</b> .....   | 22  | 615,054  | 671,196       | 676,661       | 3,920                         |
| Expenses directly related to revenues .....  | 23  | (145,608)  | (183,553)     | (181,185)     | (1,050)                       |
| Employee related expenses .....  | 24  | (92,783)   | (95,253)      | (120,176)     | (696)                         |
| Depreciation and amortization .....  |     | (114,686)  | (122,249)     | (115,595)     | (670)                         |
| Other operating expenses .....   | 25  | (128,232)  | (137,325)     | (135,394)     | (784)                         |
| <b>Operating expenses</b> .....  |     | (481,309)  | (538,380)     | (552,350)     | (3,200)                       |
| Other operating income .....   | 26  | 8,009  | 3,575         | 4,001         | 23                            |
| <b>Operating profit</b> .....  |     | 141,754  | 136,391       | 128,312       | 743                           |
| Finance expenses .....   | 27  | (34,497)   | (30,102)      | (35,186)      | (204)                         |
| Finance income .....   | 28  | 2,996  | 4,692         | 5,217         | 30                            |
| Share of associates' and joint ventures' profits .....                                     | 14  | 330  | 703           | 934           | 5                             |
| <b>Profit before income tax</b> .....  |     | 110,583  | 111,684       | 99,277        | 575                           |
| Income tax expense .....   | 9.1 | (21,858)   | (24,220)      | (26,221)      | (152)                         |
| <b>Profit for the year</b> .....   |     | <u>88,725</u>                                      | <u>87,464</u> | <u>73,056</u> | <u>423</u>                    |
| <b>Attributable to:</b>  |     |  |               |               |                               |
| Equity holders of the Company (Net income) .....   |     | 78,415   | 75,453        | 60,155        | 349                           |
| Minority interests .....   |     | 10,310   | 12,011        | 12,901        | 75                            |
|  |     | <u>88,725</u>                                      | <u>87,464</u> | <u>73,056</u> | <u>423</u>                    |
| <b>Earnings per share (EPS) information:</b>   |     |  |               |               |                               |
| Profit attributable to the equity holders of the Company ...                               |     | 78,415   | 75,453        | 60,155        | 349                           |
| Weighted average number of common stock outstanding (thousands) used for basic EPS .....   |     | 1,038,803  | 1,040,321     | 1,041,070     | 1,041,070                     |
| Average number of dilutive share options (thousands) .....                                 |     | 417  | 290           | -             | -                             |
| Weighted average number of common stock outstanding (thousands) used for diluted EPS ..... |     | 1,039,220  | 1,040,611     | 1,041,070     | 1,041,070                     |
| Basic earnings per share (HUF and USD) .....   |     | 75.49  | 72.53         | 57.78         | 0.33                          |
| Diluted earnings per share (HUF and USD) .....   |     | 75.46  | 72.51         | 57.78         | 0.33                          |

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



**MAGYAR TELEKOM**

**CONSOLIDATED CASHFLOW STATEMENTS**

|  |   | <b>For the year ended December 31,</b> |                  |                                   |                  |
|--|---|--|------------------|-----------------------------------|------------------|
|  |   | <b>HUF</b>                             |                  | <b>USD</b>                        |                  |
| Notes                                      | 2005<br>as restated<br>(Note 2.1.5)   | 2006<br>as restated<br>(Note 2.1.5)    | 2007             | 2007<br>(unaudited –<br>Note 2.1) |                  |
|  |   | (in HUF millions)                      |                  | (million USD)                     |                  |
| <b>Cashflows from operating activities</b> |   |  |                  |                                   |                  |
|  | Profit for the year .....   | 88,725                                 | 87,464           | 73,056                            | 423              |
|  | Depreciation and amortization .....   | 114,686                                | 122,249          | 115,595                           | 670              |
|  | Income tax expense .....  | 21,858                                 | 24,220           | 26,221                            | 152              |
|  | Finance expenses .....  | 34,497                                 | 30,102           | 35,186                            | 204              |
|  | Finance income .....  | (2,996)                                | (4,692)          | (5,217)                           | (30)             |
|  | Share of associates' and joint ventures' profits .....                        | (330)                                  | (703)            | (934)                             | (5)              |
|  | Change in assets carried as working capital .....                             | (9,800)                                | (2,245)          | 6,897                             | 40               |
|  | Change in liabilities carried as working capital .....                        | 8,212                                  | 8,913            | 25,592                            | 148              |
|  | Income tax paid .....   | (11,479)                               | (19,388)         | (12,343)                          | (72)             |
|  | Dividend received .....   | 1,729                                  | 157              | 72                                | -                |
|  | Interest and other financial charges paid .....                               | (34,235)                               | (33,480)         | (32,528)                          | (188)            |
|  | Interest received .....   | 2,195                                  | 2,002            | 5,742                             | 33               |
|  | Other cashflows from operations .....   | (7,802)                                | (6,797)          | (5,999)                           | (35)             |
|  | <b>Net cash generated from operating activities .....</b>                     | <b>205,260</b>                         | <b>207,802</b>   | <b>231,340</b>                    | <b>1,340</b>     |
| <b>Cashflows from investing activities</b> |   |  |                  |                                   |                  |
|  | Purchase of property plant and equipment (PPE)<br>and intangible assets ..... | 29                                     | (103,587)        | (96,790)                          | (103,097)        |
|  | Purchase of subsidiaries and business units .....                             | 30                                     | (35,927)         | (35,327)                          | (710)            |
|  | Cash acquired through business combinations .....                             | 5                                      | 1,866            | 379                               | 485              |
|  | Cash spun-off through demerger.....   | 2.2.2                                  | -                | -                                 | (1,173)          |
|  | Proceeds from / (payments for) other financial assets – net ...               |  | (22,121)         | (13,495)                          | (39,491)         |
|  | Proceeds from disposal of subsidiaries .....                                  | 5.5                                    | -                | 115                               | -                |
|  | Proceeds from disposal of PPE and intangible assets .....                     |  | 2,529            | 6,798                             | 9,105            |
|  | <b>Net cash used in investing activities .....</b>                            |  | <b>(157,240)</b> | <b>(138,320)</b>                  | <b>(134,881)</b> |
| <b>Cashflows from financing activities</b> |   |  |                  |                                   |                  |
|  | Dividends paid to shareholders and minority interest .....                    |  | (84,551)         | (77)                              | (162,558)        |
|  | Proceeds from loans and other borrowings .....                                |  | 263,329          | 183,051                           | 283,184          |
|  | Repayment of loans and other borrowings .....                                 |  | (242,595)        | (218,619)                         | (230,238)        |
|  | Proceeds from sale of treasury stock .....                                    |  | 1,969            | 491                               | 391              |
|  | <b>Net cash used in financing activities .....</b>                            |  | <b>(61,848)</b>  | <b>(35,154)</b>                   | <b>(109,221)</b> |
|  | Exchange gains / (losses) on cash and cash equivalents .....                  |  | 1,259            | 1,569                             | 221              |
|  | <b>Change in cash and cash equivalents .....</b>                              |  | <b>(12,569)</b>  | <b>35,897</b>                     | <b>(12,541)</b>  |
|  | Cash and cash equivalents, beginning of year .....                            |  | 36,879           | 24,310                            | 60,207           |
|  | Cash and cash equivalents, end of year .....                                  | 6                                      | 24,310           | 60,207                            | 47,666           |

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

**MAGYAR TELEKOM**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

|   | Shares of<br>common stock<br>(a) | Common<br>stock<br>(a) | Additional<br>paid in<br>capital<br>(b) | Treasury<br>stock<br>(c) | Cumulative<br>translation<br>adjustment<br>(d) | Revaluation<br>reserve for AFS<br>financial assets<br>– net of tax<br>(e) | Reserve for<br>equity settled<br>share based<br>transactions<br>(f) | Retained<br>earnings<br>(g) | Share-<br>holders’<br>equity | Minority<br>interests<br>(h) | Equity   |
|---|----------------------------------|------------------------|---|--------------------------|--|---|---|-----------------------------|------------------------------|------------------------------|----------|
| <b>Balance at December 31, 2004</b> .....                               | 1,042,811,600                    | 104,281                | 27,382                                  | (3,842)                  | (3,026)  | -   | 178   | 390,861                     | 515,834                      | 60,097                       | 575,931  |
| Dividend (i) .....  |                                  |                        |   |                          |  |   |   | (72,654)                    | (72,654)                     |                              | (72,654) |
| Dividend declared to minority interests (j) .....                       |                                  |                        |   |                          |  |   |   |                             | -                            | (11,913)                     | (11,913) |
| Business combinations (k) .....   |                                  |                        |   |                          |  |   |   |                             | -                            | 9,447                        | 9,447    |
| Sale of Telit .....   |                                  |                        |   |                          |  |   |   | 495                         | 495                          |                              | 495      |
| Capital injection in TSH .....  |                                  |                        |   |                          |  |   |   | 669                         | 669                          |                              | 669      |
| Share options exercised by managers (m) .....                           |                                  |                        |   | 1,916                    |  |   |   | 196                         | 2,112                        |                              | 2,112    |
| Share options exercised by CEO (m) .....                                |                                  |                        |   |                          |  |   |   | (143)                       | (143)                        |                              | (143)    |
| Share based payments (Note 24) .....                                    |                                  |                        |   |                          |  |   |   | 84                          | 84                           |                              | 84       |
| Change in reserve for AFS financial assets (e) .....                    |                                  |                        |   |                          |  | 149   |   |                             | 149                          | 45                           | 194      |
| Cumulative Translation Adjustment .....                                 |                                  |                        |   |                          | 2,606  |   |   |                             | 2,606                        | 2,141                        | 4,747    |
| Profit for the year .....   |                                  |                        |   |                          |  |   |   | 78,415                      | 78,415                       | 10,310                       | 88,725   |
| <b>Balance at December 31, 2005</b> .....                               | 1,042,811,600                    | 104,281                | 27,382                                  | (1,926)                  | (420)  | 149   | 119   | 397,982                     | 527,567                      | 70,127                       | 597,694  |
| Reduction in capital<br>as a result of merger with T-Mobile H (n) ..... | (43,385)                         | (4)                    | (2)                                     |                          |  |   |   | (12)                        | (18)                         |                              | (18)     |
| Dividend (i) .....  |                                  |                        |   |                          |  |   |   | (76,122)                    | (76,122)                     |                              | (76,122) |
| Dividend declared to minority interests (j) .....                       |                                  |                        |   |                          |  |   |   |                             | -                            | (43)                         | (43)     |
| Sale of Cardnet (o) .....   |                                  |                        |   |                          |  |   |   |                             | -                            | (71)                         | (71)     |
| MakTel’s purchase of its own shares (p) .....                           |                                  |                        |   |                          |  |   |   |                             | -                            | (14,856)                     | (14,856) |
| Result of TSH’s sale of a business unit (l) .....                       |                                  |                        |   |                          |  |   |   | 205                         | 205                          |                              | 205      |
| Share based payments (Note 24) .....                                    |                                  |                        |   |                          |  |   |   | 36                          | 36                           |                              | 36       |
| Share options exercised by CEO (q) .....                                |                                  |                        |   |                          |  |   |   | (106)                       | (282)                        | (388)                        | (388)    |
| Share options exercised by managers (m) .....                           |                                  |                        |   | 422                      |  |   |   | 87                          | 509                          |                              | 509      |
| Change in reserve for AFS financial assets (e) .....                    |                                  |                        |   |                          |  | (149)   |   |                             | (149)                        | (45)                         | (194)    |
| Cumulative Translation Adjustment .....                                 |                                  |                        |   |                          | (1,054)  |   |   |                             | (1,054)                      | 5                            | (1,049)  |
| Profit for the year .....   |                                  |                        |   |                          |  |   |   | 75,453                      | 75,453                       | 12,011                       | 87,464   |
| <b>Balance at December 31, 2006</b> .....                               | 1,042,768,215                    | 104,277                | 27,380                                  | (1,504)                  | (1,474)  | -   | 49  | 397,311                     | 526,039                      | 67,128                       | 593,167  |

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

**MAGYAR TELEKOM**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (continued)**

|  | Shares of<br>common stock<br>(a) | Common<br>stock<br>(a) | Additional<br>paid in<br>capital<br>(b) | Treasury<br>stock<br>(c) | Cumulative<br>translation<br>adjustment<br>(d) | Revaluation<br>reserve for<br>AFS financial<br>assets – net of<br>tax<br>(e) | Reserve for<br>equity settled<br>share based<br>transactions<br>(f) | Retained<br>earnings<br>(g) | Share-<br>holders'<br>equity | Minority<br>interests<br>(h) | Equity   |
|--|----------------------------------|------------------------|---|--------------------------|--|--|---|-----------------------------|------------------------------|------------------------------|----------|
| <b>Balance at January 1, 2007</b> .....                                  | 1,042,768,215                    | 104,277                | 27,380                                  | (1,504)                  | (1,474)  | -  | 49  | 397,311                     | 526,039                      | 67,128                       | 593,167  |
| Dividend (i) .....   |                                  |                        |   |                          |  |  | (72,729)  | (72,729)                    |                              |                              | (72,729) |
| Dividend declared to minority interests (j) .....                        |                                  |                        |   |                          |  |  |   |                             | (13,729)                     |                              | (13,729) |
| Elimination of the “B” share (a) .....                                   | 100                              |                        |   |                          |  |  |   |                             |                              |                              |          |
| Share options exercised by managers (m) .....                            |                                  |                        |   | 325                      |  |  | 66  | 391                         |                              |                              | 391      |
| Excess related to the acquisition of TSH (r) .....                       |                                  |                        |   |                          |  |  | 3   | 3                           | 1,540                        |                              | 1,543    |
| TSH demerger (r) .....   |                                  |                        |   |                          |  |  | 243   | 243                         | (1,312)                      |                              | (1,069)  |
| Reduction in capital   |                                  |                        |   |                          |  |  |   |                             |                              |                              |          |
| as a result of merger with T-Online and Emitel (t) .....                 | (22,700)                         | (2)                    | (1)                                     |                          |  |  | (5)   | (8)                         |                              |                              | (8)      |
| Change in reserve for AFS financial assets (e) .....                     |                                  |                        |   |                          |  | 118  |   |                             | 118                          | 92                           | 210      |
| Cumulative Translation Adjustment .....                                  |                                  |                        |   |                          | 786  |  |   |                             | 786                          | 75                           | 861      |
| Profit for the year .....  |                                  |                        |   |                          |  |  | 60,155  | 60,155                      | 12,901                       |                              | 73,056   |
| <b>Balance at December 31, 2007</b> .....                                | 1,042,745,615                    | 104,275                | 27,379                                  | (1,179)                  | (688)  | 118  | 49  | 385,044                     | 514,998                      | 66,695                       | 581,693  |
| Of which treasury stock .....  | (1,503,541)                      |                        |   |                          |  |  |   |                             |                              |                              |          |
| <b>Shares of common stock outstanding<br/>at December 31, 2007</b> ..... | 1,041,242,074                    |                        |   |                          |  |  |   |                             |                              |                              |          |

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

## MAGYAR TELEKOM

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

- (a) The total amount of issued shares of common stock of 1,042,745,615 (each with a nominal value of HUF 100) is fully paid as at December 31, 2007. In addition to these shares, total shareholders' equity included one Series "B" preference share at the nominal value of HUF 10,000 until September 30, 2007. This Series "B" share was held by the Ministry of Economics and Transport, and bestowed certain rights on its owner, including access to information, and the appointment of a Director. This share could only be held by the Government or its nominee. In order to comply with EU regulations, a new Hungarian regulation in 2007 required the Company to eliminate the "B" share and the special rights attached to it, consequently, the "B" share was transformed into 100 ordinary shares. The number of authorized ordinary shares on December 31, 2007 is 1,042,745,615.
- (b) Additional paid in capital represents the amount above the nominal value of the shares that was received by the Company during capital increases.
- (c) Treasury stock represents the cost of the Company's own shares repurchased.
- (d) Cumulative translation adjustment represents the foreign exchange differences arising on the consolidation of foreign subsidiaries.
- (e) Revaluation reserve for available for sale financial assets includes the unrealized gains and losses net of tax on available for sale financial assets. Any realized gains or losses are taken out of this reserve and recognized in the income statement.
- (f) Reserve for equity settled share based transactions includes the compensation expenses accrued in equity related to share settled compensation programs. When equity instruments are issued or treasury shares are utilized as part of the program, the accumulated balance related to the particular program and employees is utilized, and is taken out of the reserve (Note 24).
- (g) Retained earnings include the accumulated and undistributed net income of the Group. The distributable reserves of the Company under Hungarian law at December 31, 2007 amounted to approximately HUF 248,000 million (HUF 294,000 million at December 31, 2006).
- (h) Minority interests represent the minority shareholders' share of the net assets of subsidiaries, in which the Group has less than 100% ownership.
- (i) In 2007 Magyar Telekom Plc. declared HUF 70 dividend per share (HUF 73 in 2006, HUF 70 in 2005).
- (j) The dividend declared to minority interests in 2005 almost entirely reflects the dividend declared by MakTel, Magyar Telekom's Macedonian subsidiary, to its minority shareholders. In 2006 MakTel did not declare dividends. The amount of dividend declared in 2006 to minorities includes the amount declared to the minority owners of smaller subsidiaries. The amount of dividend declared in 2007 to minorities includes predominantly the amount declared to the minority owners of Maktel and Crnogorski Telekom (CT).
- (k) The increase in minority interests due to the business combinations in 2005 is the result of the acquisition of CT, in which the Group acquired a 76.53% share of ownership (Note 5.3.1).
- (l) In 2006 TSH sold one of its business units to another member of Deutsche Telekom group. TSH's gain on the transaction (HUF 418 million) resulted in an increase of TSH's net assets, the Group's share of which (HUF 205 million) was recognized directly in retained earnings.

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

## MAGYAR TELEKOM

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

- (m) In 2005 Magyar Telekom's CEO and other managers exercised a portion of their share options, and the Company used its treasury shares reserved for the option programs. As a result of these transactions, the Company sold 2,443,341 of its treasury shares to the CEO and other managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 53 million (HUF -143 million recognized against the Reserve for equity settled share based payments and HUF 196 million recognized in Retained earnings). In 2006 managers exercised further options, for which the Company used its treasury shares. As a result of these transactions, the Company sold 538,835 of its treasury shares to the managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 87 million, which was recognized in Retained earnings. In 2007, managers exercised further options, for which the Company used its treasury shares. As a result of these transactions, the Company sold 414,283 of its treasury shares to the managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 66 million, which was recognized in Retained earnings. For more details on the programs see Note 24.
- (n) In 2006 Magyar Telekom Plc. merged with T-Mobile Hungary, its 100% subsidiary. During the merger, the owners of 43,385 shares expressed their intention not to participate as owners in the merged Company. Consequently, the Company withdrew these shares and paid off these owners with a corresponding decrease in Share capital, Additional paid in capital and Retained earnings, and the merged Company was registered with 43,385 less shares.
- (o) In 2006 the Company sold the total of its 72% ownership in Cardnet, which resulted in the reduction of Minority interests (Note 5.5).
- (p) In 2006 MakTel bought 10% of its own shares from the Government of Macedonia during a public tender issued for the sale of the Government shares. As a result of this transaction, Magyar Telekom's share of ownership increased from 51% to 56.67% resulting in a decrease in the minority interest in MakTel (Note 5.2.5).
- (q) On December 5, 2006, Mr. Elek Straub, the former CEO and Chairman of the Company resigned. As part of the resignation agreement, Mr. Straub exercised 1,181,178 of his share options, of which 487,465 would only have vested on July 1, 2007, which was accelerated. The whole transaction was settled in cash instead of shares as intended by the original agreement. By December 31, 2006 the Company had accumulated HUF 155 million (including HUF 7 million for pre-mature vesting) in a Reserve for equity settled share based transactions, of which HUF 106 million was released. The closing balance of this reserve of HUF 49 million at the end of 2006 and 2007 represents the amount reserved for the 103,530 options (granted in 2000) Mr. Straub still has open (Note 24).
- (r) As of January 1, 2007 Magyar Telekom acquired an additional 2% ownership in T-Systems Hungary (TSH) for a cost of HUF 60 million. The acquisition was accounted for at cost as the transaction took place between entities under common control, and resulted in an excess of HUF 3 million recognized in equity (Note 5.1.2).
- (s) As of August 31, 2007 TSH had a legal split (spin-off), as a result of which the net assets and the equity of TSH were divided between the owners, after which Magyar Telekom became a 100% owner of the net assets and equity retained in TSH (Note 5.1.2). As the transaction took place between entities under common control, the spin-off was accounted for at cost, and resulted in an excess of HUF 243 million recognized in equity.
- (t) In 2007 Magyar Telekom Plc. merged with T-Online Hungary's access business line and Emitel, its 100% subsidiaries. During the merger, the owners of 22,700 shares expressed their intention not to participate as owners in the merged Company. Consequently, the Company withdrew these shares and paid off these owners with a corresponding decrease in Share capital, Additional paid in capital and Retained earnings, and the merged Company was registered with 22,700 less shares.

Together with the approval of these financial statements for issue, the Board of the Company proposes a HUF 74 per share dividend distribution to be approved by the Annual General Meeting of the Company in April 2008.

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

# MAGYAR TELEKOM

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1 GENERAL INFORMATION

#### 1.1 About the Company

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

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

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

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

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

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

On February 22, 2005, the Extraordinary General Meeting approved the renaming of Magyar Távközlési Rt. (Matáv) to Magyar Telekom Rt. and the rebranding of its products, which was completed by December 2005. As agreed, DTAG supported the renaming and the product rebranding. The impact of renaming and product rebranding on the consolidated financial statements as of December 31, 2005 included HUF 7,281 million of expenditures accounted for in the operating expenses and a compensation by DTAG of HUF 7,281 million disclosed separately in Note 33

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

On June 29, 2007, Magyar Telekom's Extraordinary General Meeting approved the merger of Magyar Telekom Plc., Emitel Zrt. and the internet access business line of T-Online Magyarország Zrt. (T-Online), both of which were 100% subsidiaries of Magyar Telekom Plc. The remaining business lines of T-Online continued as a separate legal entity under the company name "[origo] Zrt.". As the merger occurred between the parent company and its 100% owned subsidiaries, the transaction did not have any impact on the consolidated financial position of the Group or its operating segments other than as disclosed in the notes to the Consolidated statements of changes in equity. The merger was registered by the Hungarian Court of Registration as of September 30, 2007.

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

**1.2 Investigation into certain consultancy contracts**

As previously disclosed, in the course of conducting their audit of our 2005 financial statements, PricewaterhouseCoopers Könyvvizsgáló és Gazdasági Tanácsadó Kft. identified two contracts the nature and business purposes of which were not readily apparent. In February 2006, our Audit Committee initiated an independent investigation into this matter. In the course of the investigation, two further contracts entered into by Magyar Telekom Plc. raised concerns. To date, the independent investigators have been unable to find sufficient evidence to show that any of the four contracts under investigation resulted in the provision of services to us or to our subsidiaries under those contracts of a value commensurate with the payments we made under those contracts. The independent investigators have been unable to determine definitively the purpose of the contracts, and it is possible that the purpose may have been improper. The independent investigators further identified several contracts at our Macedonian subsidiaries that could warrant further review. In February 2007, our Board of Directors determined that those contracts should be reviewed and expanded the scope of the independent investigation to cover these additional contracts and related transactions. We have approved and have been implementing certain remedial measures designed to enhance our internal controls to ensure compliance with Hungarian and U.S. legal requirements and NYSE listing requirements.

As previously reported, the investigation delayed the finalization of our 2005 financial statements, and as a result we and some of our subsidiaries have failed and may fail to meet certain deadlines prescribed by U.S., Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. To date we have been fined HUF 13 million as a consequence of these delays.

The Hungarian Financial Supervisory Authority, the Hungarian National Bureau of Investigation, the U.S. Securities and Exchange Commission and the U.S. Department of Justice have been informed of the investigation. The Company is in regular contact with these authorities regarding the investigation and are also responding to inquiries raised by and the investigations being conducted by these authorities under U.S. and Hungarian law. The U.S. Department of Justice has recently expanded the scope of its investigation to include the actions taken by the Company in response to the findings of and issues raised by the Company's internal investigation and a related subpoena and further document requests have been issued.

# **MAGYAR TELEKOM**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

### **1.3 Public service concession and license arrangements**

#### **1.3.1 Hungarian Fixed line**

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

According to the Act on Electronic Communications, universal services are basic communications services that should be available to all customers at an affordable price. Universal service providers are entitled to compensation for their net avoidable costs, except for the costs incurred from discount pricing plans offered to residential subscribers. In practice, Magyar Telekom Plc. has not received compensation since 2004.

The NCA assigned 18 relevant markets in the area of electronic communications in 2004. In 2004 and 2005 Magyar Telekom was designated as an SMP (an operator with significant market power) in 12 markets. These included all retail and wholesale voice markets, the market of wholesale leased line and termination, the market of minimum set of leased lines and the wholesale broadband market. At the end of 2006 the analysis of the 18 relevant markets was started again by the NCA. So far the analysis of 13 of these markets has been completed and 4 more are expected to be finalized in the near future. Magyar Telekom's SMP status has been confirmed on each analyzed markets and the same obligations have been imposed with minor modifications resulting in more detailed rules applying to service provision.

Currently in Hungary, retail voice tariffs are regulated in two ways. Price cap methodology is applicable for universal services and - based on SMP resolutions on residential and business access markets – there is another formula used for subscription fees. In addition according to the law, retail prices should be set in accordance with wholesale tariffs providing an acceptable level of retail margins.

According to the Act on Electronic Communications, designated SMP operators like Magyar Telekom are obliged to prepare reference offers for unbundled local loops and bit-stream access (RUO) and to provide these services when there is a request for them by other telecommunications service providers. The reference offer of each SMP must be approved by the NCA. The price of these services has to be cost based and calculated – according to the NCA resolution about the market of wholesale unbundled access to metallic loops published at the end of 2007 - by Long Run Incremental Costs ("LRIC") method as opposed to using Fully Distributed Costs based on a 2003 Ministerial Decree.

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

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

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



## **MAGYAR TELEKOM**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

#### **1.3.2 Macedonian Fixed line**

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

During the exclusivity period MakTel was obliged to provide universal services. On December 27, 2007 the Commission of Agency for Electronic Communications ("Agency") brought decision to publish public tender for the universal provider of electronic communications services in the Republic of Macedonia.

The regulatory framework for the tariff regulation for MakTel is provided in the currently valid Concession Contract. With the enactment of the ECL, the Agency may regulate retail prices of fixed telephony services. MakTel has cost based price obligation for the Regulated wholesale services, fully distributed costs (FDC) methodology until July 2007 and Long Run Incremental Costs methodology ("LRIC") subsequently. Proposal for interconnection fees with LRIC were submitted by the Company in July 2007, Agency approval is expected in the forthcoming period.

Harmonization of the Concession Contracts with the provisions of the ECL is ongoing. Draft version of the Contract for harmonization of the provisions of the existing Concession Contracts with the provisions of ECL was prepared and agreed between the operators (MakTel, T-Mobile Macedonia and Cosmofon) and the Ministry of Transport and Communications. The above mentioned Contract is waiting approval from the representatives of European Commission in order to be signed.

Under the ECL, MakTel has been designated as an SMP in the market for fixed line voice telephone networks and services, including the market for access to the networks for data transmission and leased lines. MakTel as an SMP operator has the obligation to enable its subscribers to access publicly available telephone services of any interconnected operator with officially signed interconnection contract. On November 15, 2006, MakTel signed the first RIO based Interconnection Agreement with an alternative fixed network operator. The launch of the competitors' offers for long-distance, fixed to mobile and international calls started at the end of first quarter of 2007. Number portability was scheduled to be fully implemented by July 1, 2007, however, the implementation of number portability was technically infeasible within the given timeframe. The technical description of interfaces and Central Database (CDB) were issued in March 2007. The agency announced a public tender on April 30, 2007 for the provider of the CDB. The tender was cancelled until further notice. MakTel's estimation is that number portability will be implemented in the company network in the third quarter of 2008.

#### **1.3.3 Montenegrin Fixed line**

The Group's Montenegrin subsidiary, Crnogorski Telekom (CT) is the holder of one of the licenses issued for fixed line telecommunications services in Montenegro. The license allows CT to provide domestic voice and data services as well as VOIP, leased line, public payphone, and cable television, value added, etc. services. A separate license allows CT to provide international telecommunication services. In order not to endanger the launch of its IPTV services, CT applied for and received in 2007 a license to distribute television programs via its network from the Broadcasting Agency, although CT's fixed license from the Telecommunication Agency already allows this activity to be performed.

## **MAGYAR TELEKOM**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

The telecommunications sector in Montenegro is regulated by the 2000 Law. The 2000 Law established the Telecommunications Agency with broad authority and instituted a licensing regime whereby all telecommunications activity must be licensed by the Telecommunications Agency. Although a Competition Law came into force in 2006, a competition agency has not yet been instituted. A Customer Protection Law adopted in 2007 is in implementation phase as well.

Prices of CT must be approved by the Telecommunications Agency. The rebalancing of prices was successfully implemented on September 1, 2007.

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

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

There is no obligation for number portability, local loop unbundling, bit stream access or accounting separation in Montenegro yet. Carrier selection has not been implemented by CT as the imposing legislation was issued by the Agency without legal authority to do so.

In 2007 cable television and WiMax based fixed wireless access operations commenced in Montenegro based on licenses distributed during the year. CT successfully launched its "Extra TV" IPTV service.

Montenegro signed a Stabilization and Association Agreement with the EU and a transitory Agreement is in force since 1 January, 2008. The agreement is very similar to the agreements signed with Croatia and Macedonia requiring the harmonization of the telecommunications regulations with the regulatory framework of the EU. In the case of Montenegro, the expected amendment of the 2000 Law will achieve most of that goal.

#### **1.3.4 Hungarian Mobile**

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

The initial duration of the concession regarding the GSM 900 public mobile radio telephone service is a period of 15 years starting from the execution of the concession agreement (November 4, 1993 to November 4, 2008). On October 7, 1999 an amended concession contract was signed between the Ministry of Transport, Communications and Water Management and T-Mobile HU extending T-Mobile HU's rights and obligations to also provide service in the 1800 MHz band in Hungary to October 7, 2014. As included in the concession contracts, the Minister is entitled to extend the concession period for both services upon their expiration for another 7.5 years without the issuance of a tender invitation. On November 8, 2007, the Company signed the renewed Concession Contract along with the Cooperation Agreement with the Minister that will be effective from November 2008. The new Concession Contract prolonged the duration of the 900 MHz frequency usage right till May 4, 2016.

On December 7, 2004, T-Mobile HU 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. T-Mobile HU was obliged by the term of the license decree to start commercial 3G service within 12 months after the acquisition of the license within the inner city of Budapest, which was completed. We were

## **MAGYAR TELEKOM**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

also obliged to reach a population-wide coverage of 30% within 36 months of license acquisition which was also completed in December 2006. On August 26, 2005 T-Mobile HU started to provide 3G service and has been operating it in compliance with the license conditions.

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

In January 2005 and October 2006 the NCA designated T-Mobile HU as having significant market power in the mobile voice call termination market, and it is currently subject to regulatory obligations regarding the termination charge of calls into its network.

#### **1.3.5 Macedonian Mobile**

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

After the analysis of the market "Call termination services in public mobile communication networks" the Agency on November 26, 2007 brought a decision by which T-Mobile MK and Cosmofon were designated with SMP status and several obligations were imposed (interconnection and access, transparency in interconnection and access, non-discrimination in interconnection and access, accounting separation and price control and cost accounting).

Under the Concession Agreement, T-Mobile MK has the exclusive license to use bandwidth of 25 MHz in the GSM 900 band. T-Mobile MK's use of these frequencies is subject to terms and conditions set forth in the Concession Agreement.

#### **1.3.6 Montenegrin Mobile**

T-Mobile Crna Gora (T-Mobile CG), Magyar Telekom's subsidiary, is the holder of one of three GSM/UMTS licenses issued in Montenegro. T-Mobile CG was launched on July 1, 2000. It arrived as the second mobile telecommunications operator in Montenegro – four years after the first one. The third mobile operator entered the market in 2007. T-Mobile started 3G operations in 2007.

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

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

No obligation for number portability is in force.

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

**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 issued by the International Accounting Standards Board (IASB). The consolidated financial statements also comply with §10 of the Hungarian Accounting Law. All IFRSs issued by the IASB, effective at the time of preparing the consolidated financial statements and applied by Magyar Telekom, have been adopted for use in the European Union (EU) by the European Commission. Therefore the consolidated financial statements also comply with IFRS as adopted by the EU.

The consolidated financial statements are shown in millions of HUF. For the convenience of the reader, the consolidated balance sheet, income statement and cashflow statement for the year 2007 are also presented in millions of U.S. dollars (USD) translated at a rate of HUF 172.61 to USD 1 (the official rate of the National Bank of Hungary at December 31, 2007). These translations are un-audited supplementary information, and are not in compliance with IFRS.

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 2007**

- IFRS 7 Financial Instruments: Disclosures, and the complementary Amendment to IAS 1 - Presentation of Financial Statements – Capital Disclosures. IFRS 7 introduced new disclosures relating to financial instruments. The Group included the additional disclosures required by IFRS 7 in the financial statements.
- IFRIC 8 Scope of IFRS 2. IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2. IFRIC 8 had no impact on the Group's financial statements.
- IFRIC 9 Reassessment of Embedded Derivatives. IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cashflows that otherwise would be required under the contract, in which case reassessment is required. IFRIC 9 had no impact on the Group's financial statements as the Group has an insignificant amount of contracts, which may have separable embedded derivatives in them.
- IFRIC 10 Interim Financial Reporting and Impairment. IFRIC 10 prohibits the impairment losses recognized in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. IFRIC 10 has no effect on annual financial statements, therefore, it had no impact on the Group's present financial statements.

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

**2.1.2 Standards, amendments and interpretations effective in 2007 but not relevant for the Group**

- IFRIC 7 Applying the Restatement Approach under IAS 29 - Financial Reporting in Hyperinflationary Economies. IFRIC 7 provides guidance on how to apply the requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period.

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

- IFRS 8 Operating Segments. Under IFRS 8, segments are components of an entity regularly reviewed by an entity's chief operating decision-maker. Items are reported based on the internal reporting. IFRS 8 also sets out requirements for related disclosures about products and services, geographical areas and major customers. The Group will adopt IFRS 8 in 2009, which will result in a significant restructuring of the Group's segment disclosure. The Group restructured the way chief operating decision makers will decide on allocation of resources as of January 1, 2008, which is significantly different from the reportable segments of the Group. From 2008, the Group's segments are measured at different earnings level, which is not accepted by IAS 14, the current standard on segment reporting. As no comparatives will be available next to 2008, the Group will not early adopt IFRS 8 in 2008.
- IFRS 2 (amended). In January 2008 the IASB published the amended Standard IFRS 2 - Share-based Payment. Main changes and clarifications include references to vesting conditions and cancellations. The changes to IFRS 2 must be applied in periods beginning on or after January 1, 2009. The European Union has not yet endorsed the standard. The Group has no significant share based compensations, therefore, we do not expect the amended standard to have a significant effect on the Group when applied.
- IFRS 3, IAS 27 (amended). In January 2008 the IASB published the amended Standards IFRS 3 - Business Combinations and IAS 27 - Consolidated and Separate Financial Statements. The major changes compared to the current version of the standards are summarized below:
  - With respect to accounting for non-controlling interest (new term for 'minority interest') an option is added to IFRS 3 to permit an entity to recognize 100% of the goodwill of the acquired entity, not just the acquiring entity's portion of the goodwill ('full goodwill' option) or to measure non-controlling interest at its fair value. This option may be elected on a transaction-by-transaction basis.
  - 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 will be 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 net asset acquired.
  - A partial disposal of an investment in a subsidiary while control is retained is accounted for as an equity transaction with owners, and gain or loss is not recognized.
  - 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.

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- Acquisition related costs will be accounted for separately from the business combination, and therefore, recognized as expenses rather than included in goodwill. An acquirer will have to recognize 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 will be recognized in accordance with other applicable IFRSs, as appropriate rather than as an adjustment of goodwill.
- The revised standards require an entity to attribute their share of losses to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- Effects resulting from an effective settlement of pre-existing relationships (relationships between acquirer and acquiree before the business combination) must not be included in the determination of the consideration.
- In contrast to current IFRS 3, the amended version of this standard provides rules for rights that have been granted to the acquiree (e.g. to use its intellectual property) before the business combination and are re-acquired with the business combination.
- The revised IFRS 3 brings into scope business combinations involving only mutual entities and business combinations achieved by contracts alone.
- The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value.

The amended version of IFRS 3 has to be applied for Business Combinations with effective dates in annual periods beginning on or after July 1, 2009. Early application is allowed but restricted on annual periods beginning on or after June 30, 2007. The changes to IAS 27 must be applied in periods beginning on or after July 1, 2009. Early application is allowed. Early application of any of the two standards requires early application of the other standard, respectively. The European Union has not yet endorsed these standards (amended). The Group is currently analyzing the impact the revised standards will have on the financial statements of the Group.

- IAS 23 Borrowing Costs (Revised March 2007). Under the revised IAS 23 an entity shall capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The Group will adopt IAS 23 in 2008, but does not expect IAS 23 (revised) to have material impact on Group's accounting policies as it is already the Group's accounting policy to capitalize eligible borrowing costs on qualifying assets.
- IFRIC 11 Interpretation to IFRS 2 - Group and Treasury shares transactions. Under IFRS 2 it was not defined exactly how it should be calculated where the employees of a subsidiary received the shares of a parent. IFRIC 11 clarifies that certain types of transactions are accounted for as equity-settled or cash-settled transactions under IFRS 2. It also addresses the accounting for

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share-based payment transactions involving two or more entities within one group. The Group will apply this Interpretation from January 1, 2008. We do not expect IFRIC 11 to have material impact on the Group's accounts.

- IFRIC 12 Service Concession Agreements. This interpretation applies to companies that participate in service concession arrangements and provides guidance on the accounting by operators in public-to-private service concession arrangements. The Group will apply this Interpretation from January 1, 2008. We do not expect IFRIC 12 to have material impact on the Group's accounts.
- IFRIC 13 Customer Loyalty programs. This Interpretation addresses accounting by entities that grant loyalty award credits to customers who buy other goods or services. Specifically, it explains how such entities should account for their obligations to provide free or discounted goods or services to customers who redeem award credits. The Group will apply this Interpretation from January 1, 2009. We do not expect that IFRIC 13 may cause material changes in the Group's accounting treatments (see Note 19.2).
- IAS 1 (revised) - Presentation of Financial statements. Revised IAS 1 introduces overall requirements for the presentation of financial statements, guideline for their structure and minimum requirements for their contents. The Group will apply this Interpretation from January 1, 2009. The Group is currently analyzing the potential changes revised IAS 1 may cause in the presentation of the Group's financial statements.

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

- IAS 32 (amended). In February 2008, the IASB amended IAS 32 with respect to the balance sheet classification of puttable financial instruments and obligations arising only on liquidation. As a result of the amendments, some financial instruments that currently meet the definition of a financial liability will be classified as equity. The amendments have detailed criteria for identifying such instruments. The amendments of IAS 32 are applicable for annual periods beginning on or after January 1, 2009, but are not yet endorsed by the EU. As the Group currently does not have such instruments that would be affected by the amendments, the amendments to the standard are not expected to have any impact on the Group's financial statements.
- IFRIC 14 Interpretation on IAS 19 - The Limit on Defined Benefit Assets, Minimum Funding Requirements and their Interaction. IFRIC 14 provides general guidance on how to assess the limit in IAS 19 Employee Benefits on the amount of the surplus that can be recognized as an asset. It also explains how the pensions asset or liability may be affected when there is a statutory or contractual minimum funding requirement. This Interpretation is not applicable to the Group as the Group has no funded defined post-retirement benefit schemes.

**2.1.5 Changes in disclosures**

**(a) Cash and cash equivalents**

In the 2007 financial statements of Magyar Telekom, the bank balances with original maturities over 3 months have been reclassified and now are shown as financial investments as opposed to the disclosure in prior years, when these were disclosed as cash and cash equivalents, which was not in line with the disclosed policies of the Group. Prior year disclosures have been restated accordingly. The reclassification had no impact on

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equity, net income or EPS.

The table below shows the impact of the above change in disclosure.

|   | <u>2005</u>            | <u>2006</u>     |
|---|------------------------|-----------------|
|   | <u>in HUF millions</u> |                 |
| <u>Cash</u>                                 |                        |                 |
| As reported .....                           | 46,060                 | 77,840          |
| Change .....                                | <u>(21,750)</u>        | <u>(17,633)</u> |
| As restated .....                           | 24,310                 | 60,207          |
| <br><u>Other financial assets – current</u> |                        |                 |
| As reported .....                           | 1,817                  | 2,692           |
| Change .....                                | <u>21,750</u>          | <u>17,633</u>   |
| As restated .....                           | 23,567                 | 20,325          |
| <br><u>Investing cashflows</u>              |                        |                 |
| As reported .....                           | (131,566)              | (122,259)       |
| Change .....                                | <u>(21,750)</u>        | <u>4,117</u>    |
| As restated .....                           | (153,316)              | (118,142)       |

**(b) Reclassifications in the Cashflow statement**

From 2007, the Group has changed the classification of certain items in the Cashflow statement. The classification in the 2005 and 2006 Cashflow statements have been amended to provide comparable information with the 2007 disclosure. The changes affected the following lines:

- Dividend received: Previously included in investing cashflow, included in operating cashflow from 2007
- Interest received: Previously included in investing cashflow, included in operating cashflow from 2007
- Change in finance lease receivable: Previously included in operating cashflow (change in receivables), included in investing cashflow from 2007 (Proceeds from / (payments for) other financial assets – net)

IAS 7 – Cash Flow Statements allows the disclosure of these items in both the operating and the investing section. The Group decided to change its past practice as we believe that proceeds from interest and dividend are closely related to the income generated by the Group, which the operating cashflow mostly reflects. We believe that it also helps the users of the financial statements to determine the ability of the Group to pay dividends out of operating cashflows. On the other hand, investments in finance leases closely related to the telecommunications operations of the Group, are more similar to regular investments in PPE that are disclosed in the investing section of Cashflow statement than regular receivables that are part of working capital.

The table below shows the amounts that were reclassified between the operating and the investing cashflows in prior years.

|                         | <u>2005</u>            | <u>2006</u> |
|-------------------------|------------------------|-------------|
|                         | <u>in HUF millions</u> |             |
| Dividend received ..... | 1,729                  | 157         |
| Interest received ..... | 2,195                  | 2,002       |



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|  |            |
|--|------------|
| Change in investment in finance leases ..... | - (18,019) |
|--|------------|

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**(c) Reclassifications between liabilities and provisions**

See Note 19.5 for the details.

**2.2 Consolidation**

**2.2.1 Subsidiaries**

Subsidiaries in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies as to obtain benefit from its activities, are consolidated.

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

Subsidiaries are consolidated from the date on which control is transferred to the Group, and are no longer consolidated from the date control ceases. The purchase 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 plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets and contingent liabilities of the subsidiary acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the income statement (Other income).

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 predecessor's accounts, and any gains, losses or differences between the carrying amount and the sale-purchase price are recognized in retained earnings.

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

Transactions with minority interests are treated as third party transactions. Gains or losses arising on disposals to minority interests are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of the net assets of the subsidiary.

**2.2.2 Associates and joint ventures**

Associates are all entities over which the Group has significant influence but not control, generally embodying in a shareholding of between 20% and 50% of the voting rights. Joint ventures are entities in which the Group has an ownership of 50% with and equivalent external partner holding the other 50% of the voting rights. Investments in associates and joint ventures are accounted for using the equity method of accounting and are initially recognized at cost. The Group's investment in associates and joint ventures includes goodwill identified on acquisition, 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 income statement (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 entity, 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.

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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 entity. Accounting policies of associates and joint ventures have been adjusted where necessary to ensure consistency with the policies adopted by the Group.

At December 31, 2007 and 2006 the principal operating subsidiaries and associates and joint ventures of the Group were as follows:

| Subsidiaries                            | Group interest in capital<br>as at December 31, |             | Activity   |
|---|---|-------------|--|
|   | 2006  | 2007        |  |
| <u>Incorporated in Hungary:</u>         |   |             |  |
| T-Kábel .....                           | 100.00%   | 100.00%     | Cable TV operator  |
| Dataplex .....                          | 100.00%   | 100.00%     | IT hardware co-location service provider                       |
| T-Online / [origo] .....                | 100.00%   | 100.00% (a) | Internet service and content provider                          |
| Emitel .....                            | 100.00%   | n/a (a)     | Local fixed line telecom service provider                      |
| BCN Rendszerház (BCNR) .....            | 100.00%   | 100.00%     | System integration and IT services                             |
| KFKI-LNX (KFKI) .....                   | 100.00%   | 100.00%     | System integration and IT services                             |
| T-Systems Hungary (TSH) .....           | 49.00%  | 100.00% (b) | System integration and IT services                             |
| Pro-M .....                             | 100.00%   | 100.00%     | Professional Mobile Radio (PMR) network operator (Note 22 (a)) |
| <u>Incorporated in Macedonia:</u>       |   |             |  |
| Makedonski Telekomunikacii (MakTel) ... | 56.67%  | 56.67%      | Fixed line telecom service provider                            |
| T-Mobile Macedonia (T-Mobile MK) .....  | 56.67%  | 56.67%      | Cellular telecom service provider                              |
| Stonebridge .....                       | 100.00%   | 100.00%     | Holding company  |
| <u>Incorporated in Montenegro:</u>      |   |             |  |
| Crnogorski Telekom (CT) .....           | 76.53%  | 76.53%      | Fixed line telecom service provider                            |
| T-Mobile Crna Gora (T-Mobile CG) .....  | 76.53%  | 76.53%      | Cellular telecom service provider                              |
| Internet Crna Gora (ICG) .....          | 76.53%  | 76.53%      | Internet service and content provider                          |
| <u>Incorporated in Romania:</u>         |   |             |  |
| Combridge .....                         | 100.00%   | 100.00%     | Alternative telecommunications service provider                |
| <u>Incorporated in Bulgaria:</u>        |   |             |  |
| Orbitel .....                           | 100.00%   | 100.00%     | Alternative telecommunications and internet service provider   |

(a) In 2007, Magyar Telekom's Extraordinary General Meeting approved the merger of Magyar Telekom Plc., Emitel Zrt. and the internet access business line of T-Online Magyarország Zrt. (T-Online), both of which were 100% subsidiaries of Magyar Telekom Plc. The remaining business lines of T-Online continued as a separate legal entity under the company name "[origo] Zrt."

(b) T-Systems Hungary was an associate of the Group until January 2007, when Magyar Telekom acquired an additional 2% share in TSH. In August 2007, TSH had a legal split (spin-off), as a result of which the net assets and the equity of TSH were divided between the owners, after which Magyar Telekom became a 100% owner of the net assets and equity retained in TSH (Note 5.1.2).

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| Associates / Joint ventures            | Group interest in capital<br>as at December 31, |         | Activity                           |
|--|---|---------|------------------------------------|
|  | 2006  | 2007    |                                    |
| <u>Incorporated in Hungary:</u>        |   |         |                                    |
| Magyar RTL (M-RTL) .....               | 25%   | 25%     | Television broadcast company       |
| IKO-Telekom Media Holding (ITMH) ..... | 50%   | 50%     | Media holding company              |
| Hunsat .....                           | 50%   | 50%     | Satellite telecommunications       |
| T-Systems Hungary (TSH) .....          | 49%   | n/a (a) | System integration and IT services |

- (a) T-Systems Hungary (TSH) became a consolidated subsidiary of the Group in January 2007, when Magyar Telekom acquired an additional 2% share in TSH (Note 5.1.2).

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

## 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, which is the Company's functional and presentation currency.

### 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 income statement (Finance income).

### 2.3.3 Group companies

The results 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 as required by IAS 21 – The Effects of Changes in Foreign Exchange Rates.

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- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet.
- Income statements are translated at average exchange rates.
- All resulting exchange differences are recognized directly in the consolidated equity (Cumulative translation adjustment). When a foreign operation is fully or partially disposed of, exchange differences that were recorded in equity are recognized in the income statement as part of the gain or loss on sale.

**2.4 Financial instruments**

Financial assets include, in particular, cash and cash equivalents, trade receivables and other originated loans and receivables, derivatives and other non-derivative financial assets.

Financial liabilities generally substantiate claims for repayment in cash or another financial asset. In particular, this includes bonds and other securitized liabilities, trade payables, liabilities to banks and related parties, finance lease payables and derivative financial liabilities.

**2.4.1 Financial assets**

The Group classifies its financial assets in the following categories:

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

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

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

Regular way 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 income statement.

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.

**(a) Financial assets at fair value through profit or loss**

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

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

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- Derivative financial assets are classified as “held for trading.” For details please refer to Note 2.4.2./b

Assets in this category are classified as current assets (Other financial assets).

‘Financial assets at fair value through profit or loss’ are subsequently carried at fair value. Gains or losses arising from changes in the fair value of the ‘financial assets at fair value through profit or loss’ category are recognized in the income statement (Other financial income) in the period in which they arise.

**(b) 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 balance sheet date. These are classified as non-current assets.

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

- cash and cash equivalents
- receivables and loans to third parties
- trade receivables
- employee loans
- other receivables (e.g. interest receivables)

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

**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.

**Trade and other receivables**

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the underlying arrangement. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments as well as historical collections are considered indicators that the trade receivable is impaired.

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

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

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

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

Receivables from associates and joint ventures and other related parties are not to be impaired.

When a trade receivable is established to be uncollectible, it is written off against the income statement (Bad debt expense). Subsequent recoveries of amounts previously written off are credited against the same line of the income statement.

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 an 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 income statement.

Amounts due to, and receivable from, other network operators are shown net where a right of set-off exists and the amounts are settled on a net basis (such as interconnection receivables and payables).

**Employee loans**

Employee loans are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

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

**(c) Available-for-sale financial assets (AFS)**

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

The "available-for-sale financial assets" measurement category includes:

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

AFS financial assets are initially recognized at fair value and also subsequently carried at fair value. The unrealized changes in the fair value of monetary and non-monetary securities classified as available-for-sale

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financial assets are recognized in equity (Revaluation reserve for AFS financial assets).

When securities classified as available-for-sale are sold, the fair value adjustments accumulated in equity are recognized in the income statement.

Interest on available-for-sale securities calculated using the effective interest method is recognized in the income statement (Finance income).

The Group assesses at each balance sheet 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.

If any such evidence exists for AFS financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the income statement – is removed from equity and recognized in the income statement. Impairment losses recognized in the income statement on equity instruments are not reversed through the income statement.

**(d) Held-to-maturity investments**

Held-to-maturity measurement category includes non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity.

A typical example of a held-to-maturity investment is a fixed-income security that the Group has acquired with the positive intent and ability to hold to maturity.

**2.4.2 Financial liabilities**

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

- (a) Financial liabilities carried at amortized cost
- (b) Financial liabilities at fair value through profit or loss

**(a) 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”.

**Loans and other borrowings**

Borrowings are recognized initially at fair value less transaction costs, and subsequently measured at amortized costs using the effective interest rate method. The effective interest is recognized in the income statement (Finance expenses) over the period of the borrowings.

**Trade and other payables**

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



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**(b) Financial liabilities at fair value through profit or loss**

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

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

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

The fair value of derivative financial instruments is included in financial assets or financial liabilities (current or non current).

According to IAS 39 the Group considers only those contracts as a separable host contract and an embedded derivative, which are denominated neither in the functional currency of either of the contracting parties nor in a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g. a relatively stable and liquid currency that is commonly used in local business transactions or external trade). The Group has identified EUR and USD (except Montenegro) as currencies widely used in the Group’s operating area.

**2.5 Inventories**

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

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

**2.6 Non current assets held for sale**

Assets held for sale include real estate that is no longer needed for the future operations of the Group, and has been identified for sale, which is expected to take place within 12 months. These assets are accounted for at the lower of carrying value or fair value less cost to sell. Depreciation is discontinued from the date of designation to the held for sale status. When an asset is designated for sale, and the fair value is determined to be lower than the carrying amount, the difference is recognized in the income statement (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

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is also included in the costs if the obligation incurred can be recognized as a provision according to IAS 37 – Provisions, Contingent Liabilities and Contingent Assets.

Government grants relating to the purchase of PPE are deducted from the original cost of the items and are recognized in the income statement 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 interest on related loans.

Subsequent expenditure on an asset that extends the asset's useful life or functionality 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 income statement as depreciation expense.

When assets are sold, the cost and accumulated depreciation are removed from the accounts and any related gain or loss is recognized in the income statement (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.

The useful lives assigned are as follows:

|   | <b>Years</b> |
|---|--------------|
| Buildings .....                           | 10 - 50      |
| Duct, cable and other outside plant ..... | 25 - 38      |
| Other telecommunications equipment .....  | 6 - 15       |
| Other equipment .....                     | 3 - 12       |

**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 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 overheads. Computer software development costs recognized as assets are amortized over their estimated useful lives. As these assets represent an immaterial portion of all software, these are not disclosed separately.

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

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Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets and contingent liabilities of the acquired subsidiary at the date of acquisition. Goodwill 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 include the carrying amount of goodwill relating to the entity sold.

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.

|                                | <b>Years</b> |
|--------------------------------|--------------|
| Software .....                 | 3 - 5        |
| Concessions and licenses ..... | 8 - 25       |
| Other intangible assets .....  | 3 - 10       |

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 cashflows (cash-generating units - CGUs).

Goodwill is allocated to cash generating units. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose. Magyar Telekom allocates goodwill to its primary business segments, and conducts the impairment testing at this level, which is the lowest level at which management monitors goodwill. Goodwill is tested for impairment annually or more frequently if circumstances indicate that impairment may have occurred.

The fair values of investments in subsidiaries listed on active stock exchanges are based on current bid prices. If the market for the shares of subsidiaries is not active or the subsidiaries are not listed and for 100% owned subsidiaries the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cashflow 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 on the goodwill allocated to the cash generating units of the segments. See also Note 4.

Corporate assets which have the distinctive characteristics of not generating cash inflows independently of other assets or groups of assets are allocated to CGUs based on the ratio of carrying amounts of CGUs.

**2.10 Provisions and contingent liabilities**

Provisions are recognized when Magyar Telekom has a present legal or constructive obligation as a result of

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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 expenditure required to settle the present obligation at the balance sheet date.

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

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

#### **2.11 Treasury stock**

When the Company or its subsidiaries purchase the Company's equity shares, the consideration paid including any attributable incremental external costs are deducted from the Shareholders' equity 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 the 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**

##### **2.12.1 Fixed line and mobile telecommunications revenues**

Revenue is primarily derived from services provided to Magyar Telekom's customer subscribers and other third parties using Magyar Telekom's telecommunications network, and equipment sales. 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 IAS18 on the sale of goods and rendering of services are met for the provision of each of the Group's services and sale of goods described below.

Customer subscriber arrangements typically include an activation fee, equipment sale, subscription fee and monthly charge for the actual airtime used. The Company considers the various elements of these arrangements to be separate earnings processes and classifies the revenue for each of the deliverables into the categories as disclosed in Note 22 using the residual method. 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 that is the amount of consideration allocated to the delivered elements of the arrangements equals the total consideration less the fair value of the undelivered elements.

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 balance sheet item as Trade receivables. If the total actual and estimated expenses exceed revenues for a particular contract, the loss is recognized immediately.

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The Group provides customers with narrow and broadband access to its fixed and mobile network. 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 it relates to.

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

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

Revenues from operating leases are recognized on a straight line basis over the period the services are provided.

Revenues from mobile roaming customers of the Group and other service providers are recognized at the time of the usage, and presented on a gross basis.

Value added services mostly include SMS, MMS, WAP as well as directory assistance and similar services. Value added services, where the Group does not act as a principal in the transaction, are included in this category on a net basis. Revenues from premium rate services are also included in this category, recognized on a gross basis when the delivery of the service over Magyar Telekom's network is the responsibility of the Group and the Group also bears substantial risks of these services, otherwise presented on a net basis.

Customers may also purchase public phone cards, prepaid mobile and internet cards which allow those customers to use Magyar Telekom's telecommunications network for a selected amount of time. Customers must pay for such services at the date when the card is purchased. Revenues from the sale of public phone cards, prepaid mobile cards and prepaid internet cards are recognized when used by the customers or when the cards expired with unused 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 appropriate. The revenues and costs of these transit calls are stated gross in these consolidated financial statements as the Group is the principal supplier of these services using its own network freely defining the pricing of the services, and recognized in the period of related usage.

#### **2.12.2 System integration and IT revenues**

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

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

Revenue from systems 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 proportional performance. In the case of contracts

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

### **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.

#### **2.13.2 Pensions**

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

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

#### **2.13.3 Share based compensation**

Magyar Telekom adopted IFRS 2 – Share-based Payment as of January 1, 2005 with retrospective application for those share options that were granted on or after November 7, 2002. The standard requires the Group to reflect in its income statement and balance sheet the effects of share based payment transactions, including expenses associated with transactions in which share options are granted to employees. Accordingly, Magyar Telekom recognizes the costs of services received from its employees in a share based payment transaction when services are received. Magyar Telekom recognizes a corresponding increase in its equity reserves (Reserve for equity settled share based transactions) if the services are received in an equity-settled share based payment transaction. Before the adoption of IFRS 2, the Group did not recognize employee expenses in relation to share based compensations.

If the services are received in a cash-settled share based payment transaction, the Group recognizes the expense against a liability, re-measured at each balance sheet date.

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

Bonuses tied to the long term performance of the Magyar Telekom share are recognized in the income statement at their time-proportioned fair value (Note 24) against an accumulating balance in Provisions.

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**2.13.4 Termination benefits**

Termination benefits are payable whenever an employee's employment is terminated before the nominal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either terminate the employment of current employees according to a detailed formal plan without 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.

**2.15 Borrowing costs**

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Group that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs incurred during that period.

**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 base vary among the countries in which the Group operates.

**2.16.2 Other income taxes**

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

**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 balance sheet 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

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deferred tax liabilities) will be available against which the temporary differences can be utilized.

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

**2.17 Leases**

**2.17.1 Operating lease –Group as lessor**

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

**2.17.2 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 un-guaranteed 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. If the Group retains continuing involvement in the asset transferred, any gains are deferred and recognized over the period of the lease, while losses are recognized immediately. Each lease receipt is then allocated between the receivable and finance 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 as Finance income.

**2.17.3 Operating lease –Group as lessee**

Costs in respect of operating leases are charged to the income statement 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. Each lease payment is allocated between the finance liability and finance charges so as to achieve a constant rate of interest on the outstanding finance balance payable. The finance lease obligations, net of finance charges, are included in the balance sheet (Other financial liabilities). The interest element of the lease payments is charged to the income statement (Finance 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 income statement over the lease term through lower depreciation expense. If the leaseback qualifies as an operating lease, any gains or losses on the sale are



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recognized in the income statement at the time of the sale (Other operating income), while the lease payments are recognized in the income statement (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 equity holders 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 in addition to the number of common stocks outstanding.

**2.19 Dividends**

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

**2.20 Segment reporting**

Magyar Telekom determines segments primarily based on products and services that are subject to risks and returns that are different from those of other businesses. The primary segments are based on the business lines of the Group. Before 2007, Magyar Telekom had two business segments, Fixed line and Mobile. From January 1, 2007, Magyar Telekom split up its fixed line segment to T-Com, T-Systems and Group Headquarters and Shared services. Prior period comparative information was restated accordingly. The Mobile segment remained substantially unchanged.

The Company's secondary format for reporting segment information is geographical.

**2.21 Comparative information**

In order to maintain consistency with the current year presentation, certain items have been reclassified for comparative purposes, including the structure of the financial statements.

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**3 FINANCIAL RISK MANAGEMENT**

**3.1 Financial risk factors**

Magyar Telekom is exposed in particular to risks from movements in exchange rates, interest rates, and market prices that affect its 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 used for this purpose, depending on the risk assessment. However, Magyar Telekom only hedges the risks that affect the Group's cash flow. 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 financial institutions. Nevertheless, hedge accounting is not applied to such transactions, considering that the criteria in IAS 39 are not met.

The fundamentals of Magyar Telekom's financing strategy are established each year by the Board of Directors. The Group's policy is to borrow centrally using a balanced combination of medium term and short term loans, and fixed and floating interest rates on those loans. The Board of Directors has approved two debt protection ratio limits, and monitors their fulfilment annually. At the end of 2006 and 2007 Magyar Telekom fulfilled both criteria, with Total Debt to EBITDA ratio of 1.21 in 2006, 1.56 in 2007 (max 2.5) and EBITDA to Interest Expense ratio of 10.18 in 2006, 8.14 in 2007 (min 3.0). The Board of Directors approves further limits in order to decrease risk exposures, these limits are monitored by the Chief Financial Officer monthly. The Group Treasury is responsible for implementing the finance policy and for ongoing risk management. The details of FX, liquidity and counterparty risk management guidelines are determined and monitored by the Group Treasurer continuously.

**3.1.1 Market risk**

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

Magyar Telekom is exposed to interest and foreign exchange rate risk associated with its debt and anticipated transactions. As the vast majority of the revenues and expenses of the Hungarian entities arise in HUF, the functional currency of Magyar Telekom is HUF, and as a result, Magyar Telekom's objective is to minimize the level of its financial risk in HUF terms.

For the presentation of market risks, IFRS 7 requires sensitivity analyses that show the effects of hypothetical changes of relevant risk variables on profit or loss and shareholders' equity. The periodic effects are determined by relating the hypothetical changes in the risk variables to the balance of financial instruments at the balance sheet date. The balance at the balance sheet date is representative for the year as a whole.

**(a) Foreign currency risk**

The National Bank of Hungary lifted the devaluation of the Hungarian Forint against the Euro in October 2001, after widening the intervention band from +/-2.25% to +/-15% as of May 4, 2001. The introduction of this foreign exchange regulation increased the foreign exchange risk of the Group significantly. In order to mitigate this increased risk, Magyar Telekom minimized its foreign currency borrowings in 2002 and 2003. From 2004, Magyar Telekom is having insignificant amount of foreign currency denominated debts.

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Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Currency risks arise on account of financial instruments being denominated in a currency that is not the functional currency; differences resulting from the translation of 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.

The foreign exchange exposure of Magyar Telekom is mostly related to (i) holding foreign currency cash balances in its subsidiaries in the Southern and Eastern Europe region, and (ii) operating activities through revenues from and payments to international telecommunications carriers as well as capital expenditure contracted with vendors in foreign currency.

The currency sensitivity analysis is based on the following assumptions (at spot rate):

At the Company, major non-derivative monetary financial instruments (liquid assets, receivables, debt instruments held, interest-bearing liabilities, finance lease liabilities, non-interest-bearing liabilities) are either directly denominated in the functional currency or in line with currency hedging policy the effects of exchange rate moves offset each other. Exchange rate fluctuations therefore have no significant effects on profit or loss, or shareholders' equity.

In line with currency hedging policy, Magyar Telekom holds significant amounts of EUR and USD on its bank accounts. The necessary amount is determined by the balance of trade payables and trade receivables in order to hedge the currency risk arising in connection with those liabilities. Exchange rate fluctuations therefore have no significant effect on profit or loss, or equity.

The Group's Macedonian subsidiaries' accumulated cash is partially deposited in EUR and USD linked deposits. The amount of accumulated cash in MKD, EUR and USD in the Macedonian subsidiaries is higher than the trade payables in MKD, EUR and USD of these companies. Compared to the spot FX rate as of December 31, 2006, a 1% weakening of HUF against MKD, EUR and USD would have caused (ceteris paribus) approx. HUF 261 million gain in this net balance. This gain would have amounted to HUF 501 million in 2007. In both years the same respective amount of loss would have been caused in case of a 1% HUF strengthening against MKD, EUR and USD.

Magyar Telekom occasionally enters into derivative contracts for risk reduction purposes. These foreign currency forward contracts are taken to reduce the exchange rate risk related to the foreign exchange denominated payment obligations or receivables.

The fair value of the open short term forward positions was HUF 378 million as of December 31, 2006, while HUF -106 million as of December 31, 2007. These positions were opened to hedge the FX risks of the dividend to be received from Macedonia.

Compared to the FX rate as of December 31, 2006, a 1% weakening of HUF against EUR would have caused (ceteris paribus) approx. HUF 121 million loss in fair value of the open short forward position. Such a loss would have amounted to HUF 174 million in 2007. In both years same respective amount of gain would have been caused in case of a 1% HUF strengthening against EUR.

As a result of the recently (in 2008) introduced free-float of the HUF, more than one percent fluctuation of the HUF against the EUR, and due also to the volatile fluctuation of the EUR against the USD, more than one percent even a 5% fluctuation is possible according to management's estimations.

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**(b) Interest rate risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Magyar Telekom is exposed to financial market risk primarily through interest rate fluctuations. This is due to the fact that changing HUF interest rates affect the fair value of fixed rate debts and also affect the cash outflow through the variable rate debts. By the end of 2003, Magyar Telekom managed to convert almost its entire remaining foreign exchange debt portfolio to HUF, thereby the debt portfolio is only exposed to HUF interest rate fluctuations. To control interest rate risk, a combination of fixed and floating rate debt is used within the HUF portfolio. The fixed rate HUF debt to total HUF debt ratio was 60.52% as of December 31, 2006 and 58.88% as of December 31, 2007.

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. As such, all financial instruments with fixed interest rates that are carried at amortized cost are not subject to cash flow interest rate risk.

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

Changes in market interest rates affect the interest income or expense of non-derivative variable-interest financial instruments, the interest payments of which are not designated as hedged items of cash flow hedges against interest rate risks. Given, that Magyar Telekom had HUF 121 billion floating rate debt as of December 31, 2006, a one percentage point rise in market interest rate would have caused (ceteris paribus) the interest payment to increase by approx. HUF 1.2 billion annually, while a similar decrease would cause the same decrease in interest payments. As the floating rate debt as of December 31, 2007 amounted to HUF 150 billion, in 2007, the interest payment increase would be HUF 1.5 billion annually.

Macedonian subsidiaries of Magyar Telekom had a HUF 57.1 billion deposit as of December 31, 2006, a one percentage point rise in market interest rate would have caused (ceteris paribus) the interest received to increase by approx. HUF 571 million annually, while similar decrease would have caused the same decrease in interest received. The amount of deposits is HUF 75.8 billion as of December 31, 2007, therefore a one percentage point rise in market interest rate would have caused (ceteris paribus) the interest received to increase by approx. HUF 758 million annually.

Montenegrin subsidiaries of Magyar Telekom had HUF 14 billion deposit as of December 31, 2006, a one percentage point rise in market interest rate would have caused (ceteris paribus) the interest received to increase by approx. HUF 140 million annually, while similar decrease would have caused the same decrease in interest received. The amount of deposits is HUF 19 billion as of December 31, 2007, therefore a one percentage point rise in market interest rate would have caused (ceteris paribus) the interest received to increase by approx. HUF 190 million annually.

The Group has insignificant amounts of HUF deposits, therefore, the change in interest rates would have a very minimum impact on the Group's financial statements.

As a result of the volatile international capital and securities markets, a higher fluctuation of the interest rates is also possible according to management's estimations, the exposure to which is mitigated by the balanced portfolio of fixed and variable interest rate borrowings (see above).

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**(c) Other price risk**

As of December 31, 2006 and 2007, Magyar Telekom did not hold any material investments, which could be affected by risk variables such as stock exchange prices or other indices.

**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 is partly represented by the carrying amounts of the financial assets that are carried in the balance sheet. No significant agreements reducing the maximum exposure to credit risk had been concluded as of the reporting date.

Cash and cash equivalents held by the Hungarian members of the Group are primarily denominated in HUF and concentrations of credit risk are limited as Magyar Telekom places its cash with substantial credit institutions. Further, excess HUF cash is used for repayment of the HUF denominated loans and borrowings, therefore, the credit risk related to HUF cash is very limited.

Cash and cash equivalents held by the Macedonian subsidiaries are denominated in MKD, EUR and in USD, while the Montenegrin subsidiaries possess cash, cash equivalents and term deposits primarily denominated in EUR. Cash and cash equivalents deposited in these countries runs higher counterparty risk, due to the small amount of internationally substantial financial institutions in those countries. However part of the investments in Montenegro (EUR 7.5 million as at December 31, 2007) is covered with bank guarantees issued by international financial institutions. Significant further guarantees were obtained in 2008 (in an amount of EUR 52.2 million). Credit risk related to bank deposits is limited by the diversification of the cash balances among several independent credit institutions determinant on the local market.

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

The following table represents Magyar Telekom's exposure to credit risk in 2006 and 2007.

|   | <b>At December 31,</b>   |             |
|---|--------------------------|-------------|
|   | <b>2006</b>              | <b>2007</b> |
|   | <b>(in HUF millions)</b> |             |
| Bank deposits .....                       | 77,840                   | 105,719     |
| Trade receivables .....                   | 89,149                   | 95,478      |
| Trade receivables over one year .....     | 586                      | 619         |
| Employee loans .....                      | 5,014                    | 4,610       |
| Derivative financial instruments .....    | 378                      | 57          |
| Loans to third parties .....              | -                        | 1,334       |
| Financial assets available for sale ..... | 458                      | 690         |
| Other current financial assets .....      | 482                      | 636         |

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|                                   |                |                |
|-----------------------------------|----------------|----------------|
| .....                             |                |                |
| Other non-current financial asset | 2,280          | 841            |
| .....                             |                |                |
|                                   | <u>176,187</u> | <u>209,984</u> |

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The following table contains the amount of trade receivables broken down by segments.

| <b>Trade receivables</b> | <b>At December 31,</b>   |               |
|--------------------------|--------------------------|---------------|
|                          | <b>2006</b>              | <b>2007</b>   |
|                          | <b>(in HUF millions)</b> |               |
| T-Com                    | 35,145                   | 33,399        |
| T-Mobile                 | 41,999                   | 49,172        |
| T-Systems                | 11,965                   | 12,194        |
| Headquarters             | 40                       | 713           |
|                          | <b>89,149</b>            | <b>95,478</b> |

T-Systems has primarily large business customers, while T-Com and T-Mobile have a combination of business and residential customers. There's no significant difference between the recoverability of the segments' receivables.

There are varying credibility check / rating practices applied across the members of the Group. The majority of the customers are located in Hungary and served by the Company. For these customers the Company follows the following practice. Credibility check / rating for T-Com and T-Systems customers at the time of the service request is carried out by the Debt Management Office based on the internal database of risky installation locations regulated by an internal directive. Dunning procedures are run automatically by the billing systems including reminder letters, telephone calls, pseudo disconnections, termination letters and disconnections. We apply varying reminder procedures to the different customer groups in which varying deadlines and minimum overdue amounts are applied. After the termination of the contract internal tools, legal proceedings and external partners are involved in the collection procedure. For T-Mobile customers, at service request an internal rating is conducted by the sales representative involving a customer check in the common database of debtors of the Hungarian mobile operators. Reminder procedures run automatically by the billing system including reminder letters, SMSs, telephone calls and disconnections. After disconnection, legal proceedings and external partners are involved in the collection procedure regulated by an internal directive.

In addition, Magyar Telekom is exposed to an additional risk that arises from the possible drawdown of guarantees in a nominal amount of HUF 16.4 billion (2006: HUF 15.7 billion). These guarantees were issued by Hungarian banks on behalf of Magyar Telekom as collaterals to secure the fulfillment of the Group's certain contractual obligations.

### **3.1.3 Liquidity risk**

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

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Prudent liquidity risk management implies maintaining sufficient cash, cash equivalents and term deposits as well as available funding through adequate amount of committed credit lines. The Group Treasury's management aims at maintaining flexibility in funding by keeping committed credit lines available. The available free credit line amounted to HUF 90.4 billion (in 2006) and HUF 48.4 billion (in 2007), and the Company also had in 2006 HUF 13.2 billion and in 2007 HUF 14.4 billion uncommitted credit lines from several Hungarian Banks. In addition to the above, Deutsche Telekom confirmed its readiness to finance Magyar Telekom Group's budgeted financing needs until the end of June 2009. Despite the fact that this has not been formalized in a contract, it can be considered as a "quasi shelf facility".

The average maturity of Magyar Telekom's debt portfolio was 2.45 years in 2006, while 2.58 years in 2007, both of which are in line with the predefined liquidity management limit range of keeping the average maturity of the debt portfolio between 2 and 3 years.

The following two tables summarize the maturity structure of Magyar Telekom's financial liabilities as of December 31, 2006 and 2007.

| <b>December 31, 2006</b><br><b>(in HUF millions)</b> | <b>Total</b>   | <b>within<br/>1 year</b> | <b>1 to 5<br/>years</b> | <b>after 5<br/>years</b> |
|--|----------------|--------------------------|-------------------------|--------------------------|
| Trade payables .....                                 | 81,392         | 81,392                   | -                       | -                        |
| Dividend payable .....                               | 76,165         | 76,165                   | -                       | -                        |
| Financial liabilities to related parties .....       | 306,714        | 92,128                   | 153,915                 | 60,671                   |
| Bank loans .....                                     | 54,567         | 31,986                   | 22,581                  | -                        |
| Finance lease liabilities .....                      | 4,312          | 785                      | 2,662                   | 865                      |
| Nonconvertible bonds and debentures .....            | 194            | 71                       | -                       | 123                      |
| Other current financial liabilities .....            | 1,776          | 1,776                    | -                       | -                        |
| Other non current financial liabilities .....        | 6,405          | -                        | 6,405                   | -                        |
| Other financial liabilities .....                    | 67,254         | 34,618                   | 31,648                  | 988                      |
| Financial liabilities .....                          | <u>531,525</u> | <u>284,303</u>           | <u>185,563</u>          | <u>61,659</u>            |
| <u>Open forward positions' gross cash flows</u>      |                |                          |                         |                          |
| Gross cash outflow in HUF million                    | 12,514         | 12,514                   | -                       | -                        |
| Gross cash inflow in EUR million                     | 48             | 48                       | -                       | -                        |

| <b>December 31, 2007</b><br><b>(in HUF millions)</b> | <b>Total</b> | <b>within<br/>1 year</b> | <b>1 to 5<br/>years</b> | <b>after 5<br/>years</b> |
|--|--------------|--------------------------|-------------------------|--------------------------|
| Trade payables .....                                 | 87,989       | 87,989                   | -                       | -                        |
| Dividend payable .....                               | 151          | 151                      | -                       | -                        |
| Financial liabilities to related parties .....       | 343,997      | 41,290                   | 266,219                 | 36,488                   |



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|   |                |                |                |               |
|---|----------------|----------------|----------------|---------------|
| Bank loans .....                          | 101,253        | 43,292         | 57,865         | 96            |
| Finance lease liabilities .....           | 5,269          | 1,146          | 3,149          | 974           |
| Nonconvertible bonds and debentures ..... | 194            | 71             | -              | 123           |
| Other current financial liabilities ..... | 1,532          | 1,532          | -              | -             |
| Other non current financial liabilities   | 3,827          | -              | 3,827          | -             |
| Other financial liabilities .....         | 112,075        | 46,041         | 64,841         | 1,193         |
| Financial liabilities .....               | <u>544,212</u> | <u>175,471</u> | <u>331,060</u> | <u>37,681</u> |

Open forward positions' gross cash flows

|                                   |        |        |   |   |
|-----------------------------------|--------|--------|---|---|
| Gross cash outflow in HUF million | 17,500 | 17,500 | - | - |
| Gross cash inflow in EUR million  | 69     | 69     | - | - |

The variable interest payments arising from the financial instruments were calculated using the last interest rates fixed before finalization of this disclosure (February 26, 2008).

### 3.2 Capital risk management

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

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt. 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 Minority interest) and net debt. Net debt is calculated as:

- Current and non current financial liabilities to related parties (without accrued interest) – Note 16
- plus Other current and non current financial liabilities (without accrued interest) – Note 17
- less Cash and cash equivalents – Note 6
- less Other current financial assets – Note 8.1.

During 2007, the Group's strategy, which was unchanged from 2006, was to maintain a gearing ratio within 30% to 40%. The gearing ratio at December 31, 2007 was 31.0% (2006: 27.9%). The increase in the gearing ratio during 2007 resulted from the delay of dividend payments after 2005 financials (paid only in 2007 instead of 2006) as a result of the delay of the approval of the 2005 financial statements due to the on-going investigation (Note 1.2).

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**4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

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

**4.1 Useful lives of assets**

The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technological development and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions. We believe that the accounting estimate related to the determination of the useful lives of assets is a critical accounting estimate since it involves assumptions about technological development in an innovative industry. Further, due to the significant weight of depreciable assets in our total assets, the impact of any changes in these assumptions could 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 12 billion.

**4.2 Estimated impairment of goodwill**

Goodwill is no longer amortized, but tested for impairment annually or more frequently. As all of our subsidiaries are either not listed on stock exchanges or there is no active market for their shares, the recoverable amounts of the business units and reportable segments are calculated based on fair value determined by the discounted projected cashflows of these units over the next ten years with a terminal value. This is highly judgmental, which carries the inherent risk of arriving at materially different fair values if estimates used in the calculations would prove to be inappropriate. The Group has an implemented policy to make the impairment test based on a 10-year cashflow projection on reasonable and supportable assumptions that present the management's best estimate on market participants' assumptions and expectations considering recent similar transactions and industry benchmarks. In the 2007 calculations, Magyar Telekom used a weighted average cost of capital before tax (WACC before tax) of 10.41% to 13.41% depending on the country of operations and the sub-sector of telecommunications. Perpetual growth rate estimates range between -1% and +2% also depending on the country of operations and the sub-sector of telecommunications. The WACC was determined based on CAPM (capital asset pricing model) using the average betas of the peer group, 10 year zero coupon yields and the debt ratio between 24.56% and 35.78%, which is in line with the usual indebtedness of listed peer telecommunications companies, while the perpetual growth rates used are in line with the long-term average growth rate for the telecommunications sector.

For the T-Com segment CGU (including T-Com Hungary, MakTel Company and Crnogorski Telekom, etc.), we used a WACC before tax of 11.50% and perpetual growth rate of 0.8%. For the T-Systems CGU (including the T-Systems business line of the Company, KFKI group, BCN group, etc.) , WACC before tax of 13.41% and perpetual growth rate of 1.0% were applied. For the T-Mobile segment (including T-Mobile Hungary, Pro-M, T-Mobile Macedonia, T-Mobile Crna Gora), we used a WACC before tax of 12.44% and perpetual growth rate of 1.9%.

If Magyar Telekom had used a WACC of 16% (an increase of 4.5%) and an unchanged perpetual growth rate compared to the current calculations after the ten year projected period in the same CGU, it would have resulted in an impairment charge of approximately HUF 4,594 million. Any further increase in the WACC or a

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negative growth rate applied would have resulted in further amounts of impairment, initially related to goodwill allocated to the T-COM segment.

**4.3 Estimated impairment of property, plant and equipment, and intangibles**

We assess the impairment of identifiable property, plant, equipment and intangibles whenever there is a reason to believe that the carrying value may materially exceed the recoverable amount and where impairment in value is anticipated. The calculations of recoverable amounts are primarily determined by value in use calculations, which use a broad range of estimates and factors affecting those. Among others, we typically consider future revenues and expenses, technological obsolescence, discontinuance of services and other changes in circumstances that may indicate impairment. If impairment is identified using the value in use calculations, we also determine the fair value less cost to sell (if determinable), to calculate the exact amount of impairment to be charged. As this exercise is highly judgmental, the amount of potential impairment may be significantly different from that of the result of these calculations.

**4.4 Estimated impairment of trade and other receivables**

We calculate impairment for doubtful accounts 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 account receivables balance and our historical write-off experience, customer credit-worthiness and changes in our customer payment terms. These factors are reviewed periodically, and changes are made to the calculations when necessary. In addition, we consider also the nature of the business (residential, business, fixed line, mobile, internet, cable TV, etc.) and the environment in which the Group's entities operate in the various markets. The estimates also involve assumptions about future customer behavior and the resulting future cash collections. If the financial condition of our customers were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the impairment losses recognized so far.

**4.5 Provisions**

Provisions in general are highly judgmental, especially in the cases of legal disputes. The Group assesses the probability of an adverse event as a result of a past event and if the probability is evaluated to be more than fifty percent, the Group fully provides for the total amount of the estimated liability. The assessment of the probability is highly judgmental, as – for example – in Hungary there are very few cases where the appealed NCA decisions have been finally concluded by the Supreme Court. Further, in Macedonia, there is also a lack of sufficient history for CPC decisions appealed against at the Administrative Court.

**4.6 Subscriber acquisition costs**

Subscriber acquisition costs primarily include the loss on the equipment sales (revenues and costs disclosed separately) and fees paid to subcontractors that act as agents to acquire new customers. The Group's agents spend a portion of their agent fees for marketing the Group's products. A part of the Group's marketing costs could also be considered as subscriber acquisition cost. The up-front fees collected from customers for activation or connection are marginal compared to the costs. These revenues, costs and losses are recognized when the customer is connected to the Group's fixed or mobile networks. No such costs or revenues are deferred. These acquisition costs (losses) are recognized immediately as they are not accurately separable from other marketing costs and there is no guarantee of recovering these subsidies from the future revenue generated from the customers. Among these costs, net equipment losses of the Group amounted to HUF 15,932 million, while agent fees amounted to HUF 8,399 million in 2007.

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**5 BUSINESS COMBINATIONS**

**5.1 Acquisitions in 2007**

**5.1.1 MobilPress**

In December 2006, Magyar Telekom agreed to acquire a 100% stake in MobilPress for HUF 600 million plus the dividend to be declared for 2006 (max. HUF 50 million). The transaction was subject to the approval of the Hungarian Competition Authority. The transaction was closed on January 25, 2007, and MobilPress has been consolidated since that date, included in the T-Com segment, while the goodwill is disclosed in the T-Mobile segment. MobilPress is one of the major Hungarian mobile content providers and manages, among others, the t-zones portal, with revenues of approx. HUF 1.5 billion in 2006.

The carrying values of MobilPress's net assets at acquisition as well as the consideration paid are disclosed in the table below. The Group has estimated the fair values of the net assets acquired to equal their carrying values.

| <b>In HUF millions</b>                     | <b>Carrying<br/>values</b> |
|--|----------------------------|
| Purchase price of ownership acquired ..... | 600                        |
| Additional purchase price .....            | 50                         |
| Consideration paid .....                   | 650                        |
| Net assets acquired .....                  | 93                         |
| Goodwill .....                             | 557                        |
| <b><u>Net assets acquired:</u></b>         |                            |
| Cash .....                                 | 64                         |
| Receivables .....                          | 266                        |
| Non current assets .....                   | 56                         |
| Trade and other payables .....             | (285)                      |
| Short term borrowings .....                | (2)                        |
| Non current liabilities .....              | (6)                        |
|  | 93                         |

The total purchase price was paid in 2007.

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**5.1.2 T-Systems Hungary (TSH)**

In December 2006, the Company signed a sale-purchase agreement to acquire an additional 2% ownership in TSH effective from January 1, 2007 for a purchase price of HUF 60 million. TSH had been an associate of the Group since September 2004, with the majority owner being another Deutsche Telekom Group member. As the transaction took place between entities under common control, the acquisition was accounted for at cost. The carrying values of TSH's net assets at acquisition as well as the consideration paid are disclosed in the table below. TSH has been a consolidated subsidiary of the Group since January 1, 2007 included in the T-Systems segment.

| <b>In HUF millions</b>                           | <b>Carrying<br/>values</b> |
|--|----------------------------|
| Purchase price of ownership acquired .....       | 60                         |
| Carrying value of TSH as an associate .....      | 1,540                      |
| Associate goodwill .....                         | 149                        |
| Consideration paid .....                         | <u>1,749</u>               |
| Net assets acquired .....                        | <u>1,752</u>               |
| Excess (recognized in equity) .....              | 3                          |
| <b><u>Net assets acquired:</u></b>               |                            |
| Cash .....                                       | 421                        |
| Trade receivables .....                          | 5,888                      |
| Inventory .....                                  | 146                        |
| Other assets .....                               | 468                        |
| Property, plant and equipment .....              | 925                        |
| Intangible assets .....                          | 3,202                      |
| Trade payables .....                             | (3,471)                    |
| Other financial liabilities .....                | (4,258)                    |
| Provisions .....                                 | (179)                      |
| Total net assets .....                           | <u>3,142</u>               |
| Less: Minority interest .....                    | (1,539)                    |
| Associate goodwill transferred to goodwill ..... | 149                        |
|  | <u>1,752</u>               |

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**5.2 Acquisitions in 2006**

**5.2.1 Orbitel**

On November 29, 2005 Magyar Telekom concluded an agreement to acquire a 100% stake in Orbitel for EUR 7.85 million (HUF 1,944 million). Orbitel is a Bulgarian alternative telecommunications and internet service provider offering countrywide voice and data services to the business community utilizing IP technology. In 2005, the company generated revenues of EUR 11.5 million. Orbitel has been consolidated from the date of the financial closing, February 3, 2006, and is included in the T-Com segment.

The carrying values and the fair values of Orbitel's net assets at acquisition as well as the consideration paid are disclosed in the table below.

| <b>In HUF millions</b>   | <b>Fair<br/>values</b> | <b>Carrying<br/>values</b> |
|--|------------------------|----------------------------|
| Purchase price of ownership acquired .....                                 | 1,944                  |                            |
| Additional costs<br>directly attributable to the business combination .... | 38                     |                            |
| Consideration paid .....   | 1,982                  |                            |
| Net assets acquired .....  | 1,013                  |                            |
| Goodwill .....   | 969                    |                            |
| <u>Net assets acquired:</u>  |                        |                            |
| Cash .....   | 22                     | 22                         |
| Other financial assets .....   | 6                      | 6                          |
| Receivables .....  | 335                    | 335                        |
| Income tax receivable .....  | 7                      | 7                          |
| Inventory .....  | 12                     | 12                         |
| Property, plant and equipment .....  | 524                    | 381                        |
| Intangible assets .....  | 812                    | 221                        |
| Other non current assets .....   | 3                      | 3                          |
| Trade and other payables .....   | (384)                  | (384)                      |
| Loans and other borrowings .....   | (190)                  | (190)                      |
| Net deferred tax liability .....   | (134)                  | (24)                       |
|  | 1,013                  | 389                        |

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separable asset. Further, the customer value recognized only represents the customers and services rendered to them existing on the acquisition date, while the majority of the goodwill represents the value of, and the future revenues from, customers to be acquired from the acquisition date or the planned extension of services.

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**5.2.2 Dataplex**

On December 12, 2005 Magyar Telekom agreed to acquire a 100% stake in Dataplex Kft. for HUF 5.1 billion. Dataplex is a major player in the Hungarian IT hardware co-location market with revenues of around HUF 1.3 billion in 2005. The financial closing of the transaction took place following the approval by the Hungarian Competition Authority, on April 5, 2006, from which date Dataplex has been consolidated in the T-Com segment of the Group.

The carrying values and the fair values of Dataplex's net assets at acquisition as well as the consideration paid are disclosed in the table below.

| <b>In HUF millions</b>   | <b>Fair<br/>values</b> | <b>Carrying<br/>values</b> |
|--|------------------------|----------------------------|
|  | <u>          </u>      | <u>          </u>          |
| Purchase price of ownership acquired .....                                 | 5,113                  |                            |
| Additional costs<br>directly attributable to the business combination .... | 35                     |                            |
| Consideration paid .....   | <u>5,148</u>           |                            |
| Net assets acquired .....  | <u>1,100</u>           |                            |
| Goodwill .....   | 4,048                  |                            |
| <b>Net assets acquired:</b>  |                        |                            |
| Cash .....   | 1                      | 1                          |
| Receivables .....  | 148                    | 148                        |
| Inventory .....  | 6                      | 12                         |
| Property, plant and equipment .....  | 811                    | 801                        |
| Intangible assets .....  | 933                    | 1                          |
| Trade and other payables .....   | (556)                  | (556)                      |
| Loans and other borrowings .....   | (56)                   | (56)                       |
| Net deferred tax liability .....   | <u>(187)</u>           | <u>-</u>                   |
|  | 1,100                  | 351                        |

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separable asset. Further, the customer value recognized only represents the customers existing on the acquisition date, while the majority of the goodwill represents the value of, and future revenues from, customers to be acquired from the acquisition date.

**5.2.3 KFKI Group**

In June 2006 Magyar Telekom signed a share purchase agreement to acquire the 100% ownership of KFKI-LNX Zrt., one of the leading Hungarian IT companies for a purchase price of HUF 8.2 billion plus an optional earn-out payment of HUF 1.5 billion dependent on the 2006 financial performance. The acquisition was closed on September 15, 2006, from which date KFKI Group has been consolidated in the T-Systems segment of the Group. In 2005, KFKI Group's revenues amounted to approximately HUF 17 billion. KFKI-LNX has two 100% owned subsidiaries, ICON and IQSYS.

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The carrying values and the fair values of KFKI Group's net assets at acquisition as well as the consideration paid are disclosed in the table below.

| <b>In HUF millions</b>                                 | <b>Fair<br/>values</b> | <b>Carrying<br/>values</b> |
|--|------------------------|----------------------------|
|  | <u>          </u>      | <u>          </u>          |
| Purchase price of ownership acquired .....             | 8,170                  |                            |
| Additional purchase price contingent upon results .    | 1,500                  |                            |
| Additional costs                                       |                        |                            |
| directly attributable to the business combination .... | <u>170</u>             |                            |
| Consideration paid .....                               | 9,840                  |                            |
| <br>   |                        |                            |
| Net assets acquired .....                              | <u>5,372</u>           |                            |
| Goodwill .....   | 4,468                  |                            |
| <br>   |                        |                            |
| <u>Net assets acquired:</u>                            |                        |                            |
| Cash .....   | 344                    | 344                        |
| Receivables .....                                      | 2,629                  | 2,629                      |
| Income tax receivable .....                            | 33                     | 33                         |
| Inventory .....  | 656                    | 656                        |
| Property, plant and equipment .....                    | 663                    | 632                        |
| Intangible assets .....                                | 5,514                  | 233                        |
| <br>   |                        |                            |
| Trade and other payables .....                         | (2,687)                | (2,687)                    |
| Loans and other borrowings .....                       | (587)                  | (587)                      |
| Provisions .....                                       | (154)                  | (154)                      |
| Net deferred tax liability .....                       | <u>(1,039)</u>         | <u>23</u>                  |
|  | 5,372                  | 1,122                      |

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separable asset. Further, the customer value recognized only represents the customers existing on the acquisition date, while the majority of the goodwill represents the value of, and future revenues from, customers to be acquired from the acquisition date.

The HUF 1,500 million additional purchase price conditional upon the 2006 results was deposited in 2006 and paid in 2007.

**5.2.4 iWiW, Adnetwork, MFactory**

In April 2006, Magyar Telekom acquired the 100% ownership of iWiW Kft, the leading Hungarian online social network, for a purchase price of HUF 1.1 billion. iWiW ('who is who') operates the only online social network for existing friendships and relationships with more than half a million registered members at the time of the acquisition, which made it the fourth most visited web page in Hungary. In 2005 iWiW generated revenues of HUF 5 million.

In May 2006, Magyar Telekom acquired the 100% ownership of Adnetwork Kft, the leading Hungarian online advertisement network for an initial purchase price of HUF 168 million and additional price of HUF 10 million. Adnetwork was established in 2005 and generated revenues of HUF 28 million in 2005.

The above companies have been consolidated in the T-Com segment of the Group from the dates control was taken over by the Group.



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In December 2006, Magyar Telekom acquired a 75.05% stake in MFactory, one of the leading Hungarian mobile content producers and aggregators for HUF 469 million. In addition, the Company also has an option to increase its stake in MFactory to 100% from 2009, while MFactory's minority owners have a put option for their shares. The Group considers this combination of the options to be of a liability nature (in an amount of HUF 166 million), therefore MFactory is consolidated as a 100% subsidiary in the T-Com segment of the Group, while the initial goodwill arising on the business combination is allocated to the T-Mobile segment. MFactory's revenues amounted to HUF 190 million in 2006.

The fair values of the net assets of iWiW equal their carrying values. Due their immaterial size, the fair values of Adnetwork's and MFactory's net assets were estimated to equal their fair values. The carrying values of the net assets of the above companies acquired in individually immaterial business combinations are disclosed in their aggregate amounts in the table below.

| <b>In HUF millions</b>   | <b>Carrying<br/>values</b> |
|--|----------------------------|
| Purchase price of ownership acquired .....   | 1,767                      |
| Further purchase price payable<br>for the remaining shares in MFactory .....                   | 166                        |
| Additional purchase price and costs directly<br>attributable to the business combination ..... | 11                         |
| Consideration paid .....   | <u>1,944</u>               |
| Net assets acquired .....  | <u>83</u>                  |
| Goodwill .....   | 1,861                      |
| <b><u>Net assets acquired:</u></b>   |                            |
| Cash .....   | 12                         |
| Receivables .....  | 73                         |
| Intangible assets .....  | 53                         |
| Income tax payable .....   | (5)                        |
| Trade and other payables .....   | <u>(50)</u>                |
|  | 83                         |

**5.2.5 MakTel – own shares**

In June 2006, MakTel acquired 10% of its own shares at a public auction held by the Macedonian Government (the minority owner) for EUR 60.9 million (HUF 16,579 million including additional costs). Following the share repurchase transaction, Magyar Telekom's voting rights in MakTel increased from 51.0% to 56.7%, while the Macedonian Government's share of ownership fell to 36.8%, with the rest of the shares owned by smaller minority shareholders. The difference between the purchase price of the shares and the decrease in the minority interests was recognized as goodwill in an amount of HUF 1,724 million, all allocated to the T-Mobile segment.

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**5.3 Acquisitions in 2005**

**5.3.1 Crnogorski Telekom (CT)**

In 2005, the Company acquired a 76.53% stake in CT in the course of the privatization tender. The purchase price of the stake was EUR 140.5 million. From this purchase price, Magyar Telekom paid EUR 114.0 million for a stake of 51.12% to the Government of Montenegro and EUR 22.9 million for a stake of 21.92% to minority shareholders. For the remaining 3.49% Magyar Telekom paid EUR 3.6 million through a public offering. CT owns 100% of the share capital of T-Mobile CG, the second Montenegrin mobile company, 100% of the share capital of Internet Crna Gora, and 51% of the share capital of Montenegrocard. The total cost of the acquisition was HUF 35,927 million including directly related expenses.

CT and its subsidiaries have been consolidated since March 31, 2005.

The fair value of the net assets acquired and the consideration paid for the acquisition is disclosed in the table below.

| <b>In HUF millions</b>  | <b>Total</b>   | <b>Net assets<br/>included in the<br/>T-Com segment<br/>on first<br/>consolidation</b> | <b>Net assets<br/>included in the<br/>T-Mobile<br/>segment on first<br/>consolidation</b> |
|---|----------------|--|---|
| Purchase price of ownership acquired .....                                  | 34,954         |  |   |
| Additional costs directly attributable<br>to the business combination ..... | <u>973</u>     |  |   |
| Consideration paid .....  | 35,927         |  |   |
| Fair value of net assets acquired .....                                     | <u>30,805</u>  |  |   |
| Goodwill .....  | 5,122          | -  | 5,122   |
| <b><u>Fair value of net assets acquired:</u></b>                            |                |  |   |
| Cash .....  | 1,866          | -  | -   |
| Receivables .....   | 7,678          | 6,442  | 1,236   |
| Income tax receivable .....   | 339            | -  | -   |
| Inventory .....   | 609            | 426  | 183   |
| Property, plant and equipment .....   | 28,687         | 22,495   | 6,192   |
| Intangible assets .....   | 9,958          | 3,700  | 6,258   |
| Other non current assets .....  | 1,080          | 1,080  | -   |
| Trade and other payables .....  | (3,917)        | (3,148)  | (769)   |
| Loans and other borrowings .....  | (3,290)        | -  | -   |
| Provisions .....  | (1,951)        | (1,914)  | (37)  |
| Net deferred tax liability .....  | <u>(807)</u>   | <u>-</u>   | <u>-</u>  |
|   | 40,252         | 29,081   | 13,063  |
| Minority interests .....  | <u>(9,447)</u> |  |   |
| Total .....   | 30,805         |  |   |

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separable asset. Further, the customer values recognized only represent the customers existing on the

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acquisition date, while the majority of the goodwill represents the value of customers to be acquired from the acquisition date.

**5.4 Pro forma information on business combinations**

The following pro forma information shows the most important financial data of the Group, including the subsidiaries acquired as if they had been consolidated at the beginning of the financial year in which the acquisition was made, and also how much the business combinations contributed to the reported figures since the acquisition date.

|  | <u>2005</u>       | <u>2006</u> | <u>2007</u> |
|--|-------------------|-------------|-------------|
|  | (in HUF millions) |             |             |
| <u>Revenues</u>  |                   |             |             |
| Reported .....   | 615,054           | 671,196     | 676,661     |
| Pro forma – if consolidated from beginning of year .....   | 620,376           | 684,099     | 676,661     |
|  |                   |             |             |
| Current year contribution since date of business combination<br>in the year of acquisition ..... | 20,521            | 12,465      | 4,969       |
| <u>Net income</u>  |                   |             |             |
| Reported .....   | 78,415            | 75,453      | 60,155      |
| Pro forma – if consolidated from beginning of year .....   | 78,049            | 76,267      | 60,155      |
|  |                   |             |             |
| Current year contribution since date of business combination<br>in the year of acquisition ..... | 1,364             | 191         | (1,812)     |

**5.5 Disposals of subsidiaries**

In 2007 the Group sold the total of its 51% ownership in Montenegrocard. In 2006 the Company sold the total of its 72% ownership in Cardnet.

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**6 Cash and cash equivalents**

|  | <b>At December 31,</b>   |               |
|--|--------------------------|---------------|
|  | <b>2006</b>              | <b>2007</b>   |
|  | <b>(in HUF millions)</b> |               |
| Cash on hand .....                             | 1,556                    | 1,487         |
| Cash in banks and other cash equivalents ..... | 58,651                   | 46,179        |
|  | <u>60,207</u>            | <u>47,666</u> |

See also note 2.1.5.

**7 Trade and other receivables**

|   | <b>At December 31,</b>   |                |
|---|--------------------------|----------------|
|   | <b>2006</b>              | <b>2007</b>    |
|   | <b>(in HUF millions)</b> |                |
| Trade receivables from third parties .....              | 80,387                   | 88,588         |
| Receivables from Deutsche Telekom Group companies ..... | 7,991                    | 6,878          |
| Receivables from associates and joint ventures .....    | 771                      | 12             |
| Trade receivables .....                                 | <u>89,149</u>            | <u>95,478</u>  |
| Prepayments and advance payments .....                  | 4,329                    | 4,674          |
| Other taxes receivable .....                            | 3,318                    | 1,204          |
| Other .....   | 5,594                    | 2,220          |
| Other receivables .....                                 | <u>13,241</u>            | <u>8,098</u>   |
|   | <u>102,390</u>           | <u>103,576</u> |

The table below shows the impairment loss and changes therein related to Trade and other receivables for 2006 and 2007. No impairment had to be recognized for receivables from related parties. The closing balance as at December 31, 2007 also includes the impairment charged for finance lease receivables (disclosed in Note 8) in an amount of HUF 1,500 million (Note 36.2):

|   | <b>At December 31,</b>   |                |
|---|--------------------------|----------------|
|   | <b>2006</b>              | <b>2007</b>    |
|   | <b>(in HUF millions)</b> |                |
| Impairment loss, beginning of period .....                      | 29,991                   | 28,781         |
| Charged to expense (included in Other operating expenses) ..... | 5,066                    | 5,775          |
| Impairment losses of acquired companies on acquisition .....    | 116                      | -              |
| Utilized and translation differences .....                      | <u>(6,392)</u>           | <u>(4,293)</u> |
| Impairment loss, end of period .....                            | <u>28,781</u>            | <u>30,263</u>  |

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Analysis of the age of trade receivables that are past due as at the reporting date but not impaired:

| Trade receivables<br>(in HUF<br>millions) | Carrying<br>amount as<br>of Dec. 31,<br>2006 | of which:<br>neither<br>impaired nor<br>past due on the<br>reporting date | of which: not impaired on the reporting date and past due in the<br>following periods |                 |                 |                  |                   |                     |
|---|--|---|---|-----------------|-----------------|------------------|-------------------|---------------------|
|   |  |   | less than<br>30 days  | 30 - 60<br>days | 61 - 90<br>days | 91 - 180<br>days | 181 - 360<br>days | over<br>360<br>days |
| Trade receivables                         | 89,149                                       | 67,453  | 12,941  | 2,373           | 1,655           | 2,093            | 1,759             | 875                 |
|   | Carrying<br>amount as<br>of Dec. 31,<br>2007 |   |   |                 |                 |                  |                   |                     |
| Trade receivables                         | 95,478                                       | 73,977  | 14,066  | 2,762           | 1,425           | 2,026            | 853               | 369                 |

The tables below show trade receivables by segments with analysis of the age of trade receivables that are past due as at the reporting date but not impaired:

| Trade receivables<br>(in HUF<br>millions) | Carrying<br>amount as<br>of Dec 31,<br>2006 | of which:<br>neither<br>impaired nor<br>past due on the<br>reporting date | Of which: not impaired on the reporting date and past due in<br>the following periods |                 |                 |                  |                   |                     |
|---|---|---|---|-----------------|-----------------|------------------|-------------------|---------------------|
|   |   |   | less<br>than 30<br>days   | 30 – 60<br>days | 61 – 90<br>days | 91 – 180<br>days | 181 – 360<br>days | over<br>360<br>days |
| T-Com .....                               | 35,145                                      | 24,835  | 6,345   | 964             | 915             | 1,008            | 642               | 436                 |
| T-Systems                                 | 11,965                                      | 9,973   | 1,190   | 266             | 170             | 153              | 58                | 155                 |
| .....                                     |   |   |   |                 |                 |                  |                   |                     |
| T-Mobile .....                            | 41,999                                      | 32,612  | 5,406   | 1,143           | 563             | 932              | 1,059             | 284                 |
| Headquarters ...                          | 40  | 33  | -   | -               | 7               | -                | -                 | -                   |
| Total .....                               | 89,149                                      | 67,453  | 12,941  | 2,373           | 1,655           | 2,093            | 1,759             | 875                 |

| Trade receivables<br>(in HUF<br>millions) | Carrying<br>amount as<br>of Dec 31,<br>2007 | of which:<br>neither<br>impaired nor<br>past due on the<br>reporting date | Of which: not impaired on the reporting date and past due in<br>the following periods |                 |                 |                  |                   |                     |
|---|---|---|---|-----------------|-----------------|------------------|-------------------|---------------------|
|   |   |   | less<br>than 30<br>days   | 30 – 60<br>days | 61 – 90<br>days | 91 – 180<br>days | 181 – 360<br>days | Over<br>360<br>days |
| T-Com .....                               | 33,399                                      | 24,035  | 5,498   | 1,304           | 794             | 1,165            | 360               | 243                 |
| T-Systems                                 | 12,194                                      | 9,940   | 1,715   | 237             | 111             | 129              | 35                | 27                  |
| .....                                     |   |   |   |                 |                 |                  |                   |                     |
| T-Mobile .....                            | 49,172                                      | 39,373  | 6,818   | 1,202           | 501             | 726              | 453               | 99                  |
| Headquarters ...                          | 713   | 629   | 35  | 19              | 19              | 6                | 5                 | -                   |
| Total .....                               | 95,478                                      | 73,977  | 14,066  | 2,762           | 1,425           | 2,026            | 853               | 369                 |

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**8 Other financial assets**

**8.1 Other current financial assets**

|  | <u>At December 31,</u> |               |
|--|------------------------|---------------|
|  | <u>2006</u>            | <u>2007</u>   |
|  | (in HUF millions)      |               |
| Bank deposits with original maturities over 3 months ..... | 17,633                 | 58,053        |
| Finance lease receivable ..... (a)                         | 1,856                  | 4,011         |
| Loans and receivables from employees ..... (b)             | 1,040                  | 861           |
| RDC receivable ..... (c)                                   | 151                    | 152           |
| Derivative financial instruments ..... (d)                 | 378                    | 57            |
| Other .....  | 6                      | 309           |
|  | <u>21,064</u>          | <u>63,443</u> |

See also note 2.1.5.

**8.2 Other non current financial assets**

|  | <u>At December 31,</u> |               |
|--|------------------------|---------------|
|  | <u>2006</u>            | <u>2007</u>   |
|  | (in HUF millions)      |               |
| Finance lease receivable ..... (a)             | 16,163                 | 17,558        |
| Loans and receivables from employees ..... (b) | 4,305                  | 4,233         |
| RDC receivable ..... (c)                       | 992                    | 841           |
| Trade receivables over one year ..... (e)      | 586                    | 619           |
| Financial assets available-for-sale ..... (f)  | 452                    | 678           |
| Other .....                                    | 1,288                  | 1,036         |
|  | <u>23,786</u>          | <u>24,965</u> |

(a) See Note 32.3 for more information on Finance lease receivable. Other than the impairment charged on one of the receivables (Note 7), the rest of the receivables is considered fully recoverable.

(b) Loans and receivables from employees primarily represent the housing loans provided to the employees of the Group. There are no past due employee receivables, and the loans are pledged with mortgage.

(c) RDC receivable represents Crnogorski Telekom's receivable from the Government of Montenegro originating from the Share Transfer Agreement on the sale of ownership in the Radio Difuzni Centar D.O.O., Podgorica (RDC) entered into on December 10, 2004.

(d) Derivative financial instruments as at December 31, 2006 include the fair value of open currency forwards, while the December 31, 2007 balance also includes the fair value of cross-currency interest rate swaps.

(e) Trade receivables over one year mainly includes receivables from customers paying over 1-2 years in

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installments for telecommunications equipment sold.

(f) Financial assets available for sale include insignificant investments in equity securities.

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**9 Income tax**

**9.1 Income tax expense**

The table below shows the tax expenses charged in the 3-year period presented in the income statement.

|                                       | <b>For the year ended December 31,</b> |               |               |
|---------------------------------------|--|---------------|---------------|
|                                       | <b>2005</b>                            | <b>2006</b>   | <b>2007</b>   |
|                                       | <b>(in HUF millions)</b>               |               |               |
| Corporate income tax .....            | 11,686                                 | 6,423         | 6,088         |
| Other income taxes .....              | 8,366                                  | 8,529         | 11,028        |
| Deferred income taxes .....           | 1,806                                  | 9,268         | 9,105         |
| <b>Total income tax expense .....</b> | <b>21,858</b>                          | <b>24,220</b> | <b>26,221</b> |

**9.2 Current income tax receivable and payable**

Current income tax receivable and payable in the balance sheet 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.

**9.3 Tax rate reconciliation**

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

|   | <b>Note</b> | <b>For the year ended December 31,</b> |                 |                 |
|---|-------------|--|-----------------|-----------------|
|   |             | <b>2005</b>                            | <b>2006</b>     | <b>2007</b>     |
|   |             | <b>(in HUF millions)</b>               |                 |                 |
| IFRS profit before income tax .....                     |             | 110,583                                | 111,684         | 99,277          |
| Tax at 16% .....  |             | (17,693)                               | (17,869)        | (15,884)        |
| Impact of different tax rates .....                     | (a)         | 435                                    | (323)           | (2,381)         |
| Tax on items not subject to tax .....                   | (b)         | 1,394                                  | 2,405           | 1,651           |
| Tax on non deductible items .....                       | (c)         | (1,093)                                | (1,955)         | (1,107)         |
| Impact of tax incentives .....                          | (d)         | 897                                    | 778             | -               |
| Other income taxes .....                                | (e)         | (8,366)                                | (8,529)         | (11,028)        |
| Impact of tax deductibility of other income taxes ..... | (f)         | 2,008                                  | 2,701           | 2,873           |
| Withholding tax .....                                   | (g)         | -                                      | (2,034)         | (1,684)         |
| Un/Derecognized deferred tax on tax losses .....        | (h)         | -                                      | (255)           | 73              |
| Broadband tax credit accretion .....                    | (i)         | 560                                    | 861             | 1,267           |
| <b>Income tax expense .....</b>                         |             | <b>(21,858)</b>                        | <b>(24,220)</b> | <b>(26,221)</b> |

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

The corporate tax rate in Hungary was 16% in 2005 and in the first 8 months of 2006. As of September 1, 2006 a so called Solidarity tax was introduced in Hungary, which is an extra 4% tax on a base very similar to the



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corporate tax base, with fewer adjusting items from accounting profit before tax to arrive at the tax base. The tax rate reconciliation for 2007 also includes 16%, while the difference arising due to the introduction of the Solidarity tax is included in this line of the reconciliation.

The Group is also present in foreign countries where the tax rate is generally lower than in Hungary. The tax rate in Macedonia was 15% in 2005 and 2006, while the enacted tax rate for 2007 is 12%, while from 2008 this is reduced further, to 10%. Deferred tax balances have been recalculated accordingly.

The corporate tax rate is 9% in Montenegro, 16% in Romania, 15% in Bulgaria, and 25% in the Ukraine.

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.

**(b) Tax on items not subject to tax**

Items not subject to income tax consist primarily of donation for non-profit organizations and R&D cost deductible from corporate income tax base, as well as the share of associates' and joint ventures' profit as it is included net of tax in the Profit before income tax. This line of the reconciliation includes the tax impact of the above items.

**(c) Tax on non deductible items**

This line of the reconciliation shows the tax impact of the non deductible expenses, including premature receivable write-downs, certain impairment losses and entertainment expenses.

**(d) Tax incentives**

Tax incentives included the tax impact of qualifying investments in property, plant and equipment in Macedonia, which can be utilized as a reducing item in the calculation of the corporate tax base.

**(e) Other income taxes**

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, determined at a substantially higher level than the corporate tax base. As the first line of the reconciliation calculates theoretical tax expense calculated using the corporate tax rate, the Hungarian local business tax and the innovation fee impose additional tax expenses for the Hungarian entities of the Group.

**(f) Deductibility of other income taxes from the corporate tax base**

These Hungarian other income taxes are deductible expenses for corporate tax purposes. In addition, a certain percentage of the local business tax paid is deductible further from the corporate tax base (50% in 2005 and 100% in 2006 and 2007).

**(g) Withholding tax**

The Group is present through its subsidiaries in Macedonia, which introduced withholding tax of 5% on dividend distribution to Hungary as of January 1, 2006. Montenegro also levies a 5% withholding tax on dividend distribution to Hungary. The reconciliation includes the amount of deferred tax calculated and recognized on the undistributed profits of these subsidiaries that are expected to be subject to withholding tax in case of dividend distributions.

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**(h) Un/Derecognized deferred tax on tax losses**

Deferred tax asset is created on tax losses only to the extent that the realization of the related tax benefit is probable. Deferred tax assets on tax losses that will probably not be recovered are un/derecognized.

**(i) Broadband investment tax credit accretion**

Broadband investment tax credit accretion shows the increase of net present value of the investment tax credit deriving from the utilization of the tax credits in year(s) following the year of recognition.

**9.4 Deferred taxes**

Magyar Telekom's deferred tax balances are as follows:

|   | Balance at<br>Dec. 31,<br>2005 | Income<br>statement<br>effect | Other<br>move-<br>ments | Balance at<br>Dec. 31,<br>2006 | Income<br>statement<br>effect | Other<br>move-<br>ments | Balance at<br>Dec. 31,<br>2007 |
|---|--------------------------------|-------------------------------|-------------------------|--------------------------------|-------------------------------|-------------------------|--------------------------------|
| (in HUF millions)   |                                |                               |                         |                                |                               |                         |                                |
| <u>Deferred tax assets and (liabilities)</u>  |                                |                               |                         |                                |                               |                         |                                |
| Investment tax credits .....  | 10,656                         | 856                           | 2,788                   | 14,300                         | (4,273)                       | 3,561                   | 13,588                         |
| Net operating loss carry forward .....  | 6,076                          | (4,859)                       | -                       | 1,217                          | (676)                         | -                       | 541                            |
| Investments in subsidiaries .....   | (900)                          | (300)                         | -                       | (1,200)                        | (213)                         | -                       | (1,413)                        |
| Withholding tax .....   | -                              | (2,034)                       | -                       | (2,034)                        | (1,606)                       | -                       | (3,640)                        |
| Other financial assets .....  | 24                             | (350)                         | 19                      | (307)                          | 322                           | (23)                    | (8)                            |
| Impairment of receivables, inventory...<br>Property, plant and equipment<br>and intangible assets ..... | 3,728                          | (678)                         | -                       | 3,050                          | (488)                         | -                       | 2,562                          |
| Goodwill .....  | (7,565)                        | (88)                          | (1,388)                 | (9,041)                        | (641)                         | 211                     | (9,471)                        |
|   | (1,864)                        | (2,262)                       | -                       | (4,126)                        | (2,965)                       | -                       | (7,091)                        |
| Trade and other payables .....  | 104                            | 259                           | -                       | 363                            | (781)                         | -                       | (418)                          |
| Loans and other borrowings .....  | 156                            | 123                           | -                       | 279                            | (156)                         | -                       | 123                            |
| Deferred revenue .....  | 157                            | (157)                         | -                       | -                              | 293                           | -                       | 293                            |
| Provisions for liabilities and charges ...  | 1,205                          | 222                           | -                       | 1,427                          | 2,079                         | -                       | 3,506                          |
| Total net deferred tax asset / (liability) ..   | 11,777                         | (9,268)                       | 1,419                   | 3,928                          | (9,105)                       | 3,749                   | (1,428)                        |
| Of which deferred tax liability<br>after netting .....  | (3,189)                        |                               |                         | (5,647)                        |                               |                         | (2,714)                        |
| Of which deferred tax asset<br>after netting .....  | 14,966                         |                               |                         | 9,575                          |                               |                         | 1,286                          |
| <u>Items included in other movements</u>  |                                |                               |                         |                                |                               |                         |                                |
| Investment tax credit<br>recognized against cost of PPE .....   |                                |                               | 3,109                   |                                |                               | 3,561                   |                                |
| Utilization of investment tax credit .....  |                                |                               | (321)                   |                                |                               | -                       |                                |
| AFS financial assets – valuation<br>differences recognized in equity .....                              |                                |                               | 19                      |                                |                               | (23)                    |                                |
| Currency translation adjustment<br>arising on consolidation .....                                       |                                |                               | (29)                    |                                |                               | 211                     |                                |
| Arising on business combinations .....  |                                |                               | (1,359)                 |                                |                               | -                       |                                |
|   |                                |                               | 1,419                   |                                |                               | 3,749                   |                                |

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Deferred tax assets and liabilities are determined by the legal entities of the Group and disclosed as assets or liabilities accordingly in the balance sheet.

The Group's net deferred tax liability balance is HUF 1,428 million which includes a high amount of individual deferred tax asset and liability items (see in the above table). Of these items, approximately HUF 13,738 million deferred tax asset is expected to reverse in 2008, while a deferred tax liability of approximately HUF 4,607 million is expected to reverse in 2008. The above items exclude deferred tax items expected to arise in 2008.

Deferred tax arising on investment tax credits are recognized against the cost of the related investment.

Deferred tax arising on the revaluation of available-for-sale financial assets recognized directly in equity is also recognized directly in equity.

Temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognized amounts to HUF 13,295 million at December 31, 2007 (2006: HUF 4,602 million).

If the Group's Macedonian subsidiaries distributed all their distributable reserves in the form of a dividend, the Group would have to pay HUF 3,045 million withholding tax, and deferred tax liability with the same amount is recognized as at December 31, 2007. If the Group's Montenegrin subsidiaries distributed all their distributable reserves in the form of a dividend, the Group would have to pay HUF 1,219 million withholding tax in addition to the amount for which a deferred tax liability is recognized as at December 31, 2007 (HUF 595 million). As the Group can control the timing and the form of the dividends, deferred tax liabilities have only been recognized to the extent of the planned dividend distributions of the subsidiaries' retained earnings (undistributed results of 2005, 2006 and 2007) in the foreseeable future.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. Tax losses for which a deferred tax asset has been recognized amounting to HUF 496 million will expire in 2008, while the remaining balance of tax losses of 2,889 million is not subject to statutory limitations. For tax losses in an amount of HUF 4,883 million no deferred tax asset was recognized as at December 31, 2007. Most of these can be utilized without time limitation.

#### **9.5 Investment tax credits**

In order to increase broadband internet penetration in Hungary, companies investing over HUF 100 million in a year in broadband assets (e.g. DSL lines, UMTS assets) from 2003 can apply for a corporate tax reduction. The potential reduction of the corporate tax charge is defined as a percentage of the companies' capital investment in broadband assets. As these investment tax credits are of a governmental grant nature, Magyar Telekom recognized the deferred tax asset against the cost of the related investment. If the tax credits are not utilized in the year when earned, the amount of tax credits carried forward can be utilized at a higher amount as outstanding amounts can be accreted. This accretion is recognized as an increase in the deferred tax asset against a reduction in the deferred tax expense.

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

| Earned in year | Amount of broadband investment | Amount of tax credit earned | Tax credit utilized | Accretion recognized in tax expense to date | Tax credit carried forward at December 31, 2007 |
|----------------|--------------------------------|-----------------------------|---------------------|---|---|
| 2003 .....     | 6,208                          | 2,633                       | (3,763)             | 1,130                                       | -   |
| 2004 .....     | 6,913                          | 3,067                       | (1,759)             | 823   | 2,131   |
| 2005 .....     | 14,606                         | 5,739                       | (2,161)             | 748   | 4,327   |
| 2006 .....     | 15,564                         | 4,272                       | (154)               | 353   | 4,471   |
| 2007 .....     | 12,362                         | 3,014                       | (355)               | -   | 2,659   |
| .....          |                                |                             |                     |   |   |
| Total .....    | <u>55,653</u>                  | <u>18,725</u>               | <u>(8,192)</u>      | <u>3,054</u>                                | <u>13,588</u>                                   |
|                |                                |                             | Expires in          |   |   |
|                |                                |                             |                     | 2015 .....                                  | 6,458   |
|                |                                |                             |                     | 2016 .....                                  | 4,471   |
|                |                                |                             |                     | 2017 .....                                  | 2,659   |
|                |                                |                             |                     |   | <u>13,588</u>                                   |

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. Management believes that the Group has complied and will be able to comply with the requirements to recognize these as deferred tax assets.

#### 9.6 Tax reviews

The tax authorities may at any time inspect the books and records within five years from the end of the year when tax declarations were submitted and may impose additional tax assessments with penalties and penalty interest. Management is not aware of any circumstances which may give rise to a potential material liability in this respect.

#### 10 Inventories

|  | At December 31,   |               |
|--|-------------------|---------------|
|  | 2006              | 2007          |
|  | (in HUF millions) |               |
| Cables, wires and other materials, work-in-progress and advances ..... | 3,745             | 3,125         |
| Inventory for resale .....   | 7,904             | 8,454         |
| Subtotal .....   | 11,649            | 11,579        |
| Less allowances for obsolete inventory .....                           | (1,189)           | (927)         |
|  | <u>10,460</u>     | <u>10,652</u> |

#### 11 Non current assets held for sale

Non current assets held for sale include land and buildings identified for sale, which is expected within 12 months, as a result of the continuing improvement of utilization of properties and headcount reductions.

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**12 Property, plant and equipment - net**

|   | <u>Land and<br/>related<br/>rights</u> | <u>Buildings</u> | <u>Telecom.<br/>equipment</u> | <u>Other<br/>equipment</u> | <u>Total</u>     |
|---|--|------------------|-------------------------------|----------------------------|------------------|
| <b>in HUF millions</b>                    |  |                  |                               |                            |                  |
| <b><u>At January 1, 2006</u></b>          |  |                  |                               |                            |                  |
| Cost .....                                | 6,743                                  | 124,636          | 931,111                       | 143,832                    | 1,206,322        |
| Accumulated depreciation .....            | <u>(1,808)</u>                         | <u>(23,467)</u>  | <u>(493,159)</u>              | <u>(104,850)</u>           | <u>(623,284)</u> |
| Carrying amount .....                     | 4,935                                  | 101,169          | 437,952                       | 38,982                     | 583,038          |
| Of which held for sale .....              |  |                  |                               |                            | <u>(2,302)</u>   |
|   |  |                  |                               |                            | <u>580,736</u>   |
| Carrying amount - January 1, 2006 .....   | 4,935                                  | 101,169          | 437,952                       | 38,982                     | 583,038          |
| Exchange differences .....                | 2                                      | (14)             | 194                           | 37                         | 219              |
| Acquisitions .....                        | -                                      | 134              | 518                           | 1,321                      | 1,973            |
| Additions .....                           | 123                                    | 4 217            | 57,070                        | 13,005                     | 74,415           |
| Disposals .....                           | (187)                                  | (3,254)          | (701)                         | (394)                      | (4,536)          |
| Impairment charge .....                   | (85)                                   | (174)            | (1,404)                       | (64)                       | (1,727)          |
| Depreciation charge .....                 | <u>(172)</u>                           | <u>(3,400)</u>   | <u>(78,151)</u>               | <u>(13,934)</u>            | <u>(95,657)</u>  |
| Carrying amount - December 31, 2006 ..... | 4,616                                  | 98,678           | 415,478                       | 38,953                     | 557,725          |
| <b><u>At December 31, 2006</u></b>        |  |                  |                               |                            |                  |
| Cost .....                                | 6,654                                  | 124,145          | 972,654                       | 154,113                    | 1,257,566        |
| Accumulated depreciation .....            | <u>(2,038)</u>                         | <u>(25,467)</u>  | <u>(557,176)</u>              | <u>(115,160)</u>           | <u>(699,841)</u> |
| Carrying amount .....                     | 4,616                                  | 98,678           | 415,478                       | 38,953                     | 557,725          |
| Of which held for sale .....              |  |                  |                               |                            | <u>(6,825)</u>   |
|   |  |                  |                               |                            | <u>550,900</u>   |
| Carrying amount - January 1, 2007 .....   | 4,616                                  | 98,678           | 415,478                       | 38,953                     | 557,725          |
| Exchange differences .....                | 4                                      | 74               | 180                           | 750                        | 1,008            |
| Acquisitions .....                        | -                                      | 2                | 366                           | 123                        | 491              |
| Additions .....                           | 24                                     | 13,560           | 51,380                        | 10,944                     | 75,908           |
| Disposals .....                           | -                                      | (3,229)          | (454)                         | (1,705)                    | (5,388)          |
| Impairment charge .....                   | -                                      | (94)             | (32)                          | -                          | (126)            |
| Depreciation charge .....                 | (143)                                  | (2,286)          | (79,147)                      | (8,918)                    | (90,494)         |
| Reclassifications .....                   | <u>267</u>                             | <u>(7,680)</u>   | <u>25,741</u>                 | <u>(18,328)</u>            | <u>-</u>         |
| Carrying amount - December 31, 2007 ..... | 4,768                                  | 99,025           | 413,512                       | 21,819                     | 539,124          |
| <b><u>At December 31, 2007</u></b>        |  |                  |                               |                            |                  |
| Cost .....                                | 6,687                                  | 127,522          | 1,057,554                     | 98,645                     | 1,290,408        |
| Accumulated depreciation .....            | <u>(1,919)</u>                         | <u>(28,497)</u>  | <u>(644,042)</u>              | <u>(76,826)</u>            | <u>(751,284)</u> |
| Carrying amount .....                     | 4,768                                  | 99,025           | 413,512                       | 21,819                     | 539,124          |
| Of which held for sale .....              |  |                  |                               |                            | <u>(4,393)</u>   |
|   |  |                  |                               |                            | <u>534,731</u>   |

The closing balance of Property, plant and equipment includes assets in the course of construction in an amount of HUF 27,633 million as at December 31, 2007 (2006: HUF 19,232 million). In the table above the assets in course of construction are shown in the categories where the capitalization is expected.

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Acquisitions include the fair value of the assets of the companies that were acquired by Magyar Telekom in the reported years.

Additions to property, plant and equipment are shown net of the investment tax credit related to broadband investments of HUF 3,561 million in 2007 (2006: HUF 3,109 million). For more details, see Note 9.5.

Impairment losses charged in 2007 relate to the WLAN assets deployed in rural areas of Hungary. It was established that the recoverable amount of these assets based on the value in use calculations was lower than the carrying amount. Value in use was determined using discounted cashflow analyses. The discount rates used were 11.6% to 12.0%.

Impairment losses charged in 2006 relate to various assets, the recoverable amounts of which were defined based on the respective assets' values in use as these were found higher than their fair value less cost to sell. Value in use was determined using discounted cashflow analyses. The discount rates used were in the range of 11.49-11.86% in 2006.

Reclassifications between PPE categories are the result of the unification of disclosure of PPE of the fixed line and mobile business from January 1, 2007, after the merger of the Company and T-Mobile HU. A large number of various assets were reclassified to ensure consistent disclosures between the business units.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2007 the gross book value of the leased back assets is HUF 2,460 million (2006: HUF 1,134 million) and the net book value is HUF 1,407 million (2006: HUF 903 million).

Included mainly in buildings and telecom equipment are assets leased under finance lease conditions (other than sale and lease back). At December 31, 2007 the gross book value of the leased assets is HUF 2,593 million (2006: HUF 1,142) and the net book value is HUF 1,828 million (2006: HUF 1,057 million).

Included in telecommunications equipment at December 31, 2007 are assets leased under operating lease contracts to customers with a gross book value of HUF 7,029 million (2006: HUF 7,744 million) and net book value of HUF 2,514 million (2006: HUF 2,125 million). Depreciation for the year of these assets amounted to HUF 808 million (2006: HUF 876 million). The future minimum lease payments receivable under these contracts are disclosed in Note 32.4.

As a result of the annual review of the useful life of the Group's assets, the lives of certain assets were changed as of January 1, 2007 due to technical obsolescence. These assets mainly included software, and the change in life resulted in HUF 132 million higher depreciation expense in 2007.

HUF 1,859 million of PPE has restricted titles as at December 31, 2007 (2006: HUF 2,369 million), which serve as pledges for loans or other borrowings (mainly finance leases).

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**13 Intangible assets - net**

|                                      | Goodwill        | Software | Concessions<br>and licenses | Other   | Total     |
|--------------------------------------|-----------------|----------|-----------------------------|---------|-----------|
|                                      | in HUF millions |          |                             |         |           |
| <b>At January 1, 2006</b>            |                 |          |                             |         |           |
| Cost .....                           | 232,157         | 110,038  | 40,139                      | 18,502  | 400,836   |
| Accumulated amortization .....       | -               | (65,893) | (10,361)                    | (4,785) | (81,039)  |
| Carrying amount .....                | 232,157         | 44,145   | 29,778                      | 13,717  | 319,797   |
| Carrying amount - January 1, 2006 .. | 232,157         | 44,145   | 29,778                      | 13,717  | 319,797   |
| Exchange differences .....           | (78)            | 84       | 4                           | 98      | 108       |
| Acquisitions .....                   | 13,070          | 391      | 177                         | 6,726   | 20,364    |
| Additions .....                      | -               | 16,379   | 7                           | 72      | 16,458    |
| Disposals .....                      | -               | (122)    | -                           | -       | (122)     |
| Impairment .....                     | -               | -        | -                           | (1,346) | (1,346)   |
| Amortization charge .....            | -               | (17,659) | (2,741)                     | (3,119) | (23,519)  |
| Carrying amount - December 31, 2006  | 245,149         | 43,218   | 27,225                      | 16,148  | 331,740   |
| <b>At December 31, 2006</b>          |                 |          |                             |         |           |
| Cost .....                           | 245,149         | 121,675  | 40,705                      | 21,917  | 429,446   |
| Accumulated amortization .....       | -               | (78,457) | (13,480)                    | (5,769) | (97,706)  |
| Carrying amount .....                | 245,149         | 43,218   | 27,225                      | 16,148  | 331,740   |
| Carrying amount - January 1, 2007 .. | 245,149         | 43,218   | 27,225                      | 16,148  | 331,740   |
| Exchange differences .....           | 185             | 51       | 1,629                       | (1)     | 1,864     |
| Acquisitions .....                   | 520             | 384      | 1,214                       | 21      | 2,139     |
| Additions .....                      | -               | 15,441   | 11,564                      | 1,005   | 28,010    |
| Disposals .....                      | -               | (216)    | (1,606)                     | (46)    | (1,437)   |
| Impairment .....                     | -               | -        | -                           | -       | -         |
| Amortization charge .....            | -               | (18,583) | (3,020)                     | (3,372) | (24,975)  |
| Reclassifications .....              | 458             | 2,931    | (1)                         | (3,502) | (115)     |
| Carrying amount - December 31, 2007  | 246,312         | 43,657   | 37,005                      | 10,253  | 337,227   |
| <b>At December 31, 2007</b>          |                 |          |                             |         |           |
| Cost .....                           | 246,312         | 139,415  | 54,262                      | 19,818  | 459,807   |
| Accumulated amortization .....       | -               | (95,758) | (17,257)                    | (9,565) | (122,580) |
| Carrying amount .....                | 246,312         | 43,657   | 37,005                      | 10,253  | 337,227   |

Acquisitions include the assets of the companies that were acquired by Magyar Telekom in the reported years and the goodwill arising on these acquisitions.

The amortization expense as well as the impairment losses of intangible assets including goodwill is accounted for in the depreciation and amortization line of the income statement.

Reclassifications between intangible asset categories are mainly the result of the unification of disclosure of Intangible assets of the fixed line and mobile business from January 1, 2007, after the merger of the Company and T-Mobile HU. A large number of various assets were reclassified to ensure consistent disclosures between the business units.

The Group regularly carries out an impairment test on goodwill in the last quarter of the financial years. We established in all cases that the carrying amount of goodwill allocated to the cash generating units did not suffer impairment as the recoverable amounts of the CGUs based on fair values determined using discounted projected cashflows proved to be higher than the carrying values. Consequently, no goodwill impairment was charged in

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any of the reported years. The cashflows attributable to the national CGUs were projected for the coming ten years with terminal values determined.

The most significant amounts of goodwill are allocated to the T-Mobile segment. Beyond the 10-year planning period, the perpetual growth rates applied in the T-Mobile segment calculations were determined from 0.5% to 2.0% depending on the country of operations. The weighted average cost of capital was determined at 12.66% for T-Mobile HU, 11.61% for T-Mobile MK and 11.33% for T-Mobile CG.

The most significant individual intangible assets as of December 31, 2007 are listed in the table below.

| Description                               | Carrying amount<br>in HUF millions | Remaining<br>useful life<br>(years) |
|---|------------------------------------|-------------------------------------|
| Goodwill – T-Mobile segment .....         | 208,275                            | -                                   |
| Goodwill - T-Com segment.....             | 33,174                             | -                                   |
| Goodwill - T-Systems segment.....         | 4,863                              | -                                   |
| T-Mobile HU UMTS licence .....            | 14,272                             | 12                                  |
| T-Mobile HU GSM licence (Note 1.3.4)..... | 10,358                             | 9                                   |
| T-Mobile HU DCS 1800 licence .....        | 6,468                              | 7                                   |
| Other intangible assets .....             | 59,817                             | 7                                   |
|   | <u>337,227</u>                     |                                     |

**14 Investments in associates and joint ventures**

|  | For the year ended<br>December 31, |              |
|--|------------------------------------|--------------|
|  | 2006                               | 2007         |
|  | (in HUF millions)                  |              |
| Opening balance.....                                   | 5,020                              | 5,771        |
| TSH becomes a subsidiary .....                         | -                                  | (1,689)      |
| .....  |                                    |              |
| Capital injection to TSH .....                         | 205                                | -            |
| Share of associates' and joint ventures' profits ..... | 703                                | 934          |
| Dividends .....  | (157)                              | (72)         |
| Sale of T-Systems RIC.....                             | -                                  | (11)         |
| Additions.....   | -                                  | 3            |
| Closing balance .....                                  | <u>5,771</u>                       | <u>4,936</u> |

The following table shows the total assets and liabilities as at December 31, 2007, and revenues and profit for the year ended December 31, 2007 of the major associates and joint ventures of the Group.

|                         | Hunsat            | IKO<br>Telekom<br>Média<br>Holding | Magyar<br>RTL |
|-------------------------|-------------------|------------------------------------|---------------|
|                         | (in HUF millions) |                                    |               |
| Total assets .....      | 1,247             | 6,267                              | 30,198        |
| Total liabilities ..... | 1,333             | 1                                  | 17,361        |
| Revenues .....          | 3,289             | -                                  | 33,086        |



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|                           |     |       |       |
|---------------------------|-----|-------|-------|
| Profit for the year ..... | 177 | 1,497 | 3,888 |
|---------------------------|-----|-------|-------|

**15 Other non current assets**

Other non current assets mainly include long-term prepaid employee benefits.

**16 Financial liabilities to related parties**

Related party loans are taken from Deutsche Telekom International Finance (DTIF), the treasury vehicle of Deutsche Telekom Group, and are denominated in HUF.

The table below shows the details of the loans outstanding as at December 31, 2007 and the related accrued interest.

|                         | <u>Carrying<br/>amount<br/>(HUF millions)</u> | <u>Interest<br/>rate (%)</u> | <u>Fixed /<br/>variable</u> | <u>Repayable</u> |
|-------------------------|---|------------------------------|-----------------------------|------------------|
| Due within 1 year ..... | 20,000  | 8.21                         | fixed                       | May 2008         |
| Accrued interest .....  | 5,210   |                              |                             |                  |
|                         | <u>25,210</u>                                 |                              |                             |                  |
|                         | 9,487   | 7.56                         | variable                    | Jan 2009         |
|                         | 5,000   | 9.68                         | fixed                       | Sep 2009         |
|                         | 25,000  | 9.61                         | fixed                       | Oct 2009         |
|                         | 28,000  | 7.69                         | variable                    | Oct 2009         |
|                         | 20,000  | 7.53                         | fixed                       | Oct 2009         |
|                         | 9,487   | 7.56                         | variable                    | Jan 2010         |
|                         | 30,000  | 7.66                         | fixed                       | Jul 2010         |
|                         | 9,486   | 7.56                         | variable                    | Jan 2011         |
|                         | 34,000  | 7.21                         | fixed                       | Jul 2011         |
|                         | 9,486   | 7.56                         | variable                    | Jan 2012         |
|                         | 40,000  | 8.71                         | fixed                       | May 2012         |
|                         | 9,486   | 7.56                         | variable                    | Jan 2013         |
|                         | <u>25,000</u>                                 | 7.26                         | fixed                       | Oct 2013         |
| Due after 1 year .....  | 254,432                                       |                              |                             |                  |
|                         | <u><u>279,642</u></u>                         |                              |                             |                  |

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

|                        | <u>At December 31,</u>   |                   |                   |                   |
|------------------------|--------------------------|-------------------|-------------------|-------------------|
|                        | <u>2006</u>              |                   | <u>2007</u>       |                   |
|                        | <u>(in HUF millions)</u> |                   |                   |                   |
|                        | <b>Book value</b>        | <b>Fair value</b> | <b>Book value</b> | <b>Fair value</b> |
| At fixed rate .....    | 184,000                  | 188,914           | 199,000           | 206,958           |
| At variable rate ..... | 75,432                   | 75,432            | <u>75,432</u>     | <u>75,432</u>     |

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|                                 |         |         |         |         |
|---------------------------------|---------|---------|---------|---------|
| Total related party loans ..... | 259,432 | 264,346 | 274,432 | 282,390 |
|---------------------------------|---------|---------|---------|---------|

The weighted average interest rate on related party loans was 7.95% in 2007 (8.45% in 2006, 8.45% in 2005).

The majority of the Group's related party loans is subject to fixed interest rates that are exposed to fair value risk as it is stated in the table above. Any decrease of market interest rates will result in an increase of the fair value of the liabilities.

**17 Other financial liabilities**

|  |     | <b>At December 31,</b>   |               |
|--|-----|--------------------------|---------------|
|  |     | <b>2006</b>              | <b>2007</b>   |
|  |     | <b>(in HUF millions)</b> |               |
| Bank loans .....   | (a) | 28,846                   | 40,506        |
| Finance lease payable (Note 32.1) .....                      |     | 412                      | 659           |
| Accrued interest .....                                       |     | 298                      | 1,474         |
| Other .....  |     | 347                      | 2,027         |
| <b>Total other financial liabilities – current</b> .....     |     | <b>29,903</b>            | <b>44,666</b> |
|  |     |                          |               |
| Bank loans .....   | (a) | 18,250                   | 52,204        |
| Finance lease payable (Note 32.1) .....                      |     | 2,324                    | 2,711         |
| Other .....  |     | 123                      | 123           |
| <b>Total other financial liabilities – non current</b> ..... |     | <b>20,697</b>            | <b>55,038</b> |

**(a) Bank loans**

|                               |     | <b>As at December 31,</b> |               |
|-------------------------------|-----|---------------------------|---------------|
|                               |     | <b>2006</b>               | <b>2007</b>   |
|                               |     | <b>(in HUF millions)</b>  |               |
| Current bank loans .....      |     | 28,846                    | 40,506        |
| Non current bank loans .....  |     | 18,250                    | 52,204        |
| <b>Total bank loans</b> ..... | (a) | <b>47,096</b>             | <b>92,710</b> |

Bank loans analyzed by currency are as follows:

|             |  |               |               |
|-------------|--|---------------|---------------|
| HUF .....   |  | 47,096        | 81,130        |
| EUR .....   |  | -             | 11,484        |
| Other ..... |  | -             | 96            |
|             |  | <b>47,096</b> | <b>92,710</b> |

Principal repayments of bank loans fall due:

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| <u>Year</u>         | <b>Maturity<br/>as at December 31,</b> |               |
|---------------------|--|---------------|
|                     | <b>2006</b>                            | <b>2007</b>   |
|                     | <b>(in HUF millions)</b>               |               |
| Within 1 year ..... | 28,846                                 | 40,506        |
| 1-5 years .....     | 18,250                                 | 52,108        |
| After 5 years ..... | -                                      | 96            |
|                     | <u>47,096</u>                          | <u>92,710</u> |

Loans totaling HUF 30,136 million at December 31, 2007 are revolving loans (2006: HUF 17,708 million) which can be prepaid at any time and may be drawn down in one to six month rolling periods.

The following table shows the weighted average interest rates of bank loans as at December 31, 2007.

|  | <b>Maturities</b>                            |               |              |               |             | <b>There-<br/>after</b> | <b>Total</b>  |
|--|--|---------------|--------------|---------------|-------------|-------------------------|---------------|
|  | <b>2008</b>                                  | <b>2009</b>   | <b>2010</b>  | <b>2011</b>   | <b>2012</b> |                         |               |
|  | <b>(in HUF millions, except percentages)</b> |               |              |               |             |                         |               |
| <b>Bank loans (HUF denominated)</b>        |  |               |              |               |             |                         |               |
| At variable rate .....                     | 37,128                                       | 28,014        | 4,565        | 423           | -           | -                       | 70,130        |
| Average interest rate .....                | 7.70   | 7.79          | 7.88         | 8.23          | -           | -                       | 7.75          |
| At fixed rate .....                        | -  | -             | -            | 11,000        | -           | -                       | 11,000        |
| Average interest rate .....                | -  | -             | -            | 7.83          | -           | -                       | 7.83          |
| Total .....                                | <u>37,128</u>                                | <u>28,014</u> | <u>4,565</u> | <u>11,423</u> | -           | -                       | <u>81,130</u> |
| <b>Bank loans (EUR denominated)</b>        |  |               |              |               |             |                         |               |
| At variable rate .....                     | -  | -             | 3,040        | -             | -           | -                       | 3,040         |
| Average interest rate .....                | -  | -             | 4.94         | -             | -           | -                       | 4.94          |
| At fixed rate .....                        | 3,378  | 3,378         | 1,688        | -             | -           | -                       | 8,444         |
| Average interest rate .....                | 4.95   | 4.95          | 4.95         | -             | -           | -                       | 4.95          |
| Total .....                                | <u>3,378</u>                                 | <u>3,378</u>  | <u>4,728</u> | -             | -           | -                       | <u>11,484</u> |
| <b>Bank loans (other currencies - BGN)</b> |  |               |              |               |             |                         |               |
| At variable rate .....                     | -  | -             | -            | -             | -           | -                       | -             |
| Average interest rate .....                | -  | -             | -            | -             | -           | -                       | -             |
| At fixed rate .....                        | -  | -             | -            | -             | -           | 96                      | 96            |
| Average interest rate .....                | -  | -             | -            | -             | -           | 5.52                    | 5.52          |
| Total .....                                | -  | -             | -            | -             | -           | <u>96</u>               | <u>96</u>     |
| Total bank loans                           | <u>40,506</u>                                | <u>31,392</u> | <u>9,293</u> | <u>11,423</u> | -           | <u>96</u>               | <u>92,710</u> |

The weighted average interest rate on bank loans was 7.41% in 2007 (7.86% in 2006, 6.53% in 2005).

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

|  | <b>At December 31,</b>   |                      |                      |                      |
|--|--------------------------|----------------------|----------------------|----------------------|
|  | <b>2006</b>              |                      | <b>2007</b>          |                      |
|  | <b>(in HUF millions)</b> |                      |                      |                      |
|  | <b>Book value</b>        | <b>Fair value</b>    | <b>Book value</b>    | <b>Fair value</b>    |
| <b><u>HUF denominated bank loans</u></b>                       |                          |                      |                      |                      |
| At fixed rate .....  | 3,372                    | 3,372                | 11,000               | 12,067               |
| At variable rate .....   | 43,724                   | 43,724               | 70,130               | 70,130               |
|  | <u>47,096</u>            | <u>47,096</u>        | <u>81,130</u>        | <u>82,197</u>        |
| <b><u>EUR denominated bank loans</u></b>                       |                          |                      |                      |                      |
| At fixed rate .....  | -                        | -                    | 8,444                | 8,617                |
| At variable rate .....   | -                        | -                    | 3,040                | 3,040                |
|  | <u>-</u>                 | <u>-</u>             | <u>11,484</u>        | <u>11,657</u>        |
| <b><u>Bank loans denominated in other currencies (BGN)</u></b> |                          |                      |                      |                      |
| At fixed rate .....  | -                        | -                    | -                    | -                    |
| At variable rate .....   | -                        | -                    | 96                   | 96                   |
|  | <u>-</u>                 | <u>-</u>             | <u>96</u>            | <u>96</u>            |
| <b>Total bank loans</b>  | <u><u>47,096</u></u>     | <u><u>47,096</u></u> | <u><u>92,710</u></u> | <u><u>93,950</u></u> |

Variable 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 variable interest rates, which are exposed to cashflow risks. If interest rates are rising, it results in higher cash outflows through interest payments.

**(b) Credit facilities**

At December 31, 2007, Magyar Telekom had un-drawn committed credit facilities of HUF 48,352 million. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin depending on the currency and institution providing the facilities.

**18 Trade payables**

|  | <b>At December 31,</b>   |               |
|--|--------------------------|---------------|
|  | <b>2006</b>              | <b>2007</b>   |
|  | <b>(in HUF millions)</b> |               |
| Payable to DT Group companies .....            | 6,207                    | 7,524         |
| Payable to associates and joint ventures ..... | 1,287                    | 9             |
| Other trade payables .....                     | 73,898                   | 80,456        |
|  | <u>81,392</u>            | <u>87,989</u> |

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**19 Provision**

| In HUF millions                              | Severance | Customer<br>loyalty<br>programs | Legal<br>cases | MTIP  | Fixed to<br>mobile IC<br>fees | Other   | Total         |
|--|-----------|---------------------------------|----------------|-------|-------------------------------|---------|---------------|
| January 1, 2006 .....                        | 3,629     | 1,907                           | 2,645          | 256   | 2,950                         | 1,777   | 13,164        |
| Acquired through business combinations ..... | -         | -                               | -              | -     | -                             | 154     | 154           |
| Amounts utilized / retired .....             | (2,639)   | (1,837)                         | (2,455)        | (199) | -                             | (1,145) | (8,275)       |
| Additions .....                              | 3,063     | 1,965                           | 2,462          | 132   | 1,640                         | 2,232   | 11,494        |
| December 31, 2006 .....                      | 4,053     | 2,035                           | 2,652          | 189   | 4,590                         | 3,018   | <u>16,537</u> |
| Acquired through business combinations ..... | -         | -                               | -              | -     | -                             | 179     | 179           |
| Amounts utilized / retired .....             | (3,589)   | (645)                           | (542)          | (158) | -                             | (2,328) | (7,262)       |
| Additions .....                              | 14,258    | 1,064                           | 3,542          | 40    | 2,394                         | 2,945   | 24,243        |
| December 31, 2007 .....                      | 14,722    | 2,454                           | 5,652          | 71    | 6,984                         | 3,814   | <u>33,697</u> |
| Of which current .....                       | 13,703    | 751                             | 4,422          | 13    | -                             | 1,922   | 20,811        |
| Of which non current .....                   | 1,019     | 1,703                           | 1,230          | 58    | 6,984                         | 1,892   | 12,886        |

Magyar Telekom does not expect any reimbursement with regards the provisions recognized, therefore, no related assets have been recognized in the financial statements.

**19.1 Severance**

The provision for severance as at December 31, 2007 mostly relates to the major restructuring of Magyar Telekom Plc's operations from January 1, 2008, and impact all functions of the Company. The provision for severance as at December 31, 2006 mostly related to the employee terminations in 2007 in Macedonia and Montenegro.

1,704 employees were dismissed in 2007 (2006: 771), related to which severance payments were made. The balance of provision as at December 31, 2007 relates to 813 employees (2006: 499) working in all functions of the Group.

The total payments made in relation to employee termination in 2007 amounted to HUF 14,652 million (2006: HUF 6,099 million), of which HUF 3,589 million was charged against the provision as at December 31, 2006, while the rest was recognized as employee related expense in 2007. The total payments made in relation to employee termination in 2006 amounted to HUF 6,099 million, of which HUF 2,639 million was charged against the provision as at December 31, 2005, while the rest was recognized as employee related expense in 2006.

**19.2 Customer loyalty**

Provision for customer loyalty programs includes the fair value of discount credits earned by customers that have not been utilized. The provision is recognized against revenues.

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**19.3 Legal cases**

Provisions for legal cases mainly include amounts expected to be paid to tax, regulatory and competition authorities as well as to ex-employees and trading partners as a result of legal disputes. The balance also includes amounts expected to be paid as compensation for loss of value to owners of real estates, allegedly caused by cellular base stations installed on neighboring sites. There are numerous legal cases for which provisions were recognized, of which the significant ones are described below.

**19.3.1 Alleged abuse of dominant market position in Macedonia**

In February 2007, a procedure was initiated against MakTel, by the Commission for protection of competition (CPC), upon request from UNET, a local Internet Service Provider, for abusing dominant position on the market for access to digital leased lines (DLL). In September 2007, the CPC brought a decision determining that MakTel had a dominant position on the leased lines market and that it abuses its dominant position. Executing the decision, MakTel submitted description of the wholesale DLL offer to the CPC, which is still under CPC's scrutiny. No misdemeanor procedure has so far been initiated by the CPC. Given the provisions of the Law for protection of the competition regarding the penalty in case of misdemeanor procedure a provision of HUF 418 million was recognized in 2007.

T-Mobile MK is alleged to have been misusing its dominant market position by the CPC regarding its service Maily (which is the trade name for the voice mail service ("VMS")) and based on its findings, the same authority started a misdemeanor procedure against T-Mobile MK. Management believes that the probability for payment of certain regulatory penalties is rather high and the amount of the penalty is estimated up to the revenue earned from the Maily service for the period of the alleged misdemeanor duration (as of the start of the service until the procedure has been initiated), in an amount of HUF 752 million, which was provided for in 2007.

**19.3.2 Employee termination disputes in Montenegro**

In 2005, CT offered a voluntary lay-off program with beneficial terms for employees accepting the offer. In 2006, CT announced another voluntary redundancy which had even more beneficial terms. After the announcement of the 2006 program, employees laid off in 2005 believe that they had been misled about the conditions of the lay-off. These former employees have announced that unless CT indemnifies them for the difference in the terms between the 2006 and 2005 programs, they would sue for being misled in 2005. In 2007, 236 former employees of CT started misdemeanor procedures against CT in an amount of EUR 3.5 million arguing that CT had misled them while they accepted the voluntary termination program in 2005. Even though management is questioning the amount of the claims, it is more likely than not, that the claimants' approach will be accepted than that it will be rejected. Accordingly, a provision of HUF 887 million was recognized in 2007.

**19.4 MTIP**

For more details on the Mid-term Incentive Plan see Note 24.1.3.

**19.5 Fixed to mobile IC fees**

The amount provided for in this category includes amounts collected from Magyar Telekom Plc's customers, which will probably be repayable to universal customers related to the reduced fixed to mobile termination charges, which has been accounted for as a reduction of revenues. The Company has reassessed the

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classification of the liability as compared to December 31, 2006 considering the uncertainty about the exact timing and amount of the liability, and as a result, the liability in 2007 is disclosed as a provision as opposed to December 31, 2006, when it was disclosed as a Trade and other payables in the financial statements. Comparative amounts have been amended accordingly. The reclassification had no impact on equity, net income or EPS.

Pursuant to a decree, the Company has the obligation to decrease the F2M tariffs of the universal services subscribers by the amount of the decrease in the F2M termination rates. The Company has not fulfilled this obligation so far because the mobile operators - referring to their lawsuits against the NHH resolutions - did not, from a legal point of view, decrease the F2M termination rates, in their interconnection agreements with the Company. It is difficult to predict the final decision of the Court with regard to these cases. Nevertheless, even if the lawsuits are decided in favor of the mobile operators, we believe that the NHH will be required to perform a new procedure to determine the mobile termination prices, which is expected to result in the same or very similar, reduced F2M termination fees.

Even though the lawsuits initiated by the mobile operators have not been concluded, the NHH called upon the Company to repay the difference to its universal customers. There are ongoing negotiations with NHH to determine the form of settlement of the difference with the Company's universal customers, the conclusion of which can have a significant impact on the final amount and timing of the liability. Magyar Telekom has set up a provision based on management's best estimate, considering the early stage of such negotiations.

**19.6 Other provisions**

Other provisions as at December 31, 2007 include asset retirement and guarantee obligations and further other individually small items.

**20 Other current liabilities**

|  | <u>At December 31,</u>   |               |
|--|--------------------------|---------------|
|  | <u>2006</u>              | <u>2007</u>   |
|  | <u>(in HUF millions)</u> |               |
| Deferred revenue and advances received ..... | 11,779                   | 13,939        |
| Other taxes and social security .....        | 13,162                   | 13,327        |
| Salaries and wages .....                     | 7,033                    | 9,500         |
| Dividend payable to MagyarCom GmbH .....     | 45,074                   | -             |
| Dividend payable to others .....             | 31,091                   | 151           |
| Other liabilities .....                      | 2,459                    | 5,060         |
|  | <u>110,598</u>           | <u>41,977</u> |

Dividend payable decreased significantly as the General Meeting of Magyar Telekom Plc. approved the 2005 financial statements only in December 2006, therefore, the dividend was paid in January 2007. The delay in 2006 was a result of the investigation (Note 1.2).



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**21 Other non current liabilities**

|                   | <b>At December 31,</b>   |             |
|-------------------|--------------------------|-------------|
|                   | <b>2006</b>              | <b>2007</b> |
|                   | <b>(in HUF millions)</b> |             |
| EKG payable ..... | 5,117                    | 3,293       |
| Other .....       | 3,613                    | 2,504       |
|                   | 8,730                    | 5,797       |

(a) During 2005 the Company concluded an agreement with the Hungarian government for taking over the operation of the existing Electronic Governmental Backbone Network (EKG) for a period of 50 months. During the term of the agreement the Company committed to significant upgrades of the network and transferring these back to the government at the end of the term free of charge. During the term of the agreement, the Company has exclusivity in providing telecommunication services to the government institutions connected to the network. As the substance of the agreement is of a nature similar to a concession, the Company recognized an intangible asset (right) and a corresponding liability.

**22 Revenue**

|   | <b>For the year ended December 31,</b> |             |             |
|---|--|-------------|-------------|
|   | <b>2005</b>                            | <b>2006</b> | <b>2007</b> |
|   | <b>(in HUF millions)</b>               |             |             |
| <u>Fixed line revenues</u>                    |  |             |             |
| Voice retail .....                            | 197,679                                | 182,280     | 159,772     |
| Voice wholesale .....                         | 25,579                                 | 28,691      | 30,319      |
| Internet .....                                | 39,783                                 | 49,733      | 57,796      |
| Data .....                                    | 26,792                                 | 27,121      | 27,440      |
| Multimedia .....                              | 15,037                                 | 17,506      | 18,102      |
| Equipment .....                               | 5,205                                  | 4,249       | 5,395       |
| Other fixed line revenues .....               | 10,108                                 | 9,607       | 10,509      |
| Total Fixed line revenue .....                | 320,183                                | 319,187     | 309,333     |
| <u>Mobile revenues</u>                        |  |             |             |
| Voice .....                                   | 225,003                                | 240,285     | 248,594     |
| Non voice .....                               | 36,539                                 | 40,258      | 45,068      |
| Equipment and activation .....                | 23,472                                 | 25,280      | 23,121      |
| Other mobile revenues .....                   | 834                                    | 21,507      | 8,984       |
| Total Mobile revenue .....                    | 285,848                                | 327,330     | 325,767     |
| <u>System integration and IT</u>              |  |             |             |
| System integration .....                      | 7,354                                  | 11,494      | 19,715      |
| IT .....                                      | 1,669                                  | 13,185      | 21,846      |
| Total System integration and IT revenue ..... | 9,023                                  | 24,679      | 41,561      |
| Total revenue                                 | 615,054                                | 671,196     | 676,661     |

(a) Other mobile revenues mainly include the revenues of Pro-M. In November 2005 the Company concluded an agreement to build a wireless network (using TETRA technology) for the exclusive use of certain

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organizations (e.g. police, ambulance, etc.). The agreement has a 10 year term and the Company committed to build the network by January 31, 2007 and provide operation and maintenance services throughout the term for a fixed annual fee. The Company founded a subsidiary (Pro-M), which will be responsible for providing the services. During 2006 the Group evaluated the impact of this agreement considering also the requirements of IFRIC 4 and concluded that the agreement included a lease element which was determined to be of a finance lease nature. The service is provided to one buyer, the Hungarian Government, and required the construction of a customer specific asset, the Group accounts separately for the sale type lease (mainly in 2006) and the continuous telecommunications services provided on the network.

**23 Expenses directly related to revenues**

|  | <b>For the year ended December 31,</b> |                |                |
|--|--|----------------|----------------|
|  | <b>2005</b>                            | <b>2006</b>    | <b>2007</b>    |
|  | <b>(in HUF millions)</b>               |                |                |
| Voice, data and internet related payments .....          | 86,794                                 | 91,102         | 86,244         |
| Material cost of telecommunications equipment sold ..... | 37,221                                 | 59,714         | 41,957         |
| Payments to other subcontractors and agents .....        | 21,593                                 | 32,737         | 52,984         |
|  | <u>145,608</u>                         | <u>183,553</u> | <u>181,185</u> |

**24 Employee related expenses**

|   | Note | <b>For the year ended December 31,</b> |                |                |
|---|------|--|----------------|----------------|
|   |      | <b>2005</b>                            | <b>2006</b>    | <b>2007</b>    |
|   |      | <b>(in HUF millions)</b>               |                |                |
| Short term benefits .....   |      | 90,605                                 | 92,638         | 99,459         |
| Share based payments .....  | 24.1 | 270                                    | 281            | (134)          |
| Termination benefits .....  |      | 5,142                                  | 6,523          | 25,332         |
| Total before capitalization .....   |      | <u>96,017</u>                          | <u>99,442</u>  | <u>124,657</u> |
| Expenses capitalized .....  |      | <u>(3,234)</u>                         | <u>(4,189)</u> | <u>(4,481)</u> |
|   |      | <u>92,783</u>                          | <u>95,253</u>  | <u>120,176</u> |
| Total costs expensed in relation to defined contribution plans<br>(including social security) ..... |      | 21,797                                 | 21,737         | 28,791         |
| Closing number of employees   |      | 11,919                                 | 12,341         | 11,723         |

**24.1 Share-based compensation**

**24.1.1 Management share option plan**

On April 26, 2002, the annual Shareholders' Meeting approved the introduction of a new management share option plan and authorized the Company's Board of Directors to purchase 17 million "A" series registered ordinary shares, each having a nominal value of HUF 100 as treasury shares. Consequently, the Company issued 4,900,000 shares on July 1, 2002, which were repurchased immediately as treasury shares.

On July 1, 2002, the Company granted 3,964,600 options to participants of the stock option plan at an exercise price of HUF 933 for the first tranche (exercisable in 2003) and HUF 950 for the second and third

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tranches (exercisable in 2004 and 2005). As the Company's share price as quoted on the Budapest Stock Exchange on the grant date was HUF 833 per share, there was no intrinsic value to the options. The options had a life of five years from the grant date, meaning that the options are forfeited without replacement or compensation on June 30, 2007.

The option with respect to a maximum of one-third of the shares that could be purchased under the first tranche was exercisable from July 1, 2003 until the end of the term. The option with respect to a maximum of a further one-third of the shares that could be purchased under the second tranche was exercisable from July 1, 2004 until the end of the term. The option with respect to the rest of the shares that could be purchased under the third tranche was exercisable from July 1, 2005 until the end of the term.

As the management share option plan did not fall into the scope of IFRS 2 – Share based Payments, the Group did not recognize compensation expense in any of the periods.

The table below shows the movements in the number of management stock options in thousands.

|  | <u>2005</u>  | <u>2006</u>  | <u>2007</u> | <u>Average exercise price (HUF)</u> |
|--|--------------|--------------|-------------|-------------------------------------|
| Opening number of share options .....              | 3,207        | 1,929        | 1,307       | 944                                 |
| Number of share options exercised .....            | (991)        | (539)        | (414)       | 944                                 |
| Forfeited share options .....                      | (287)        | (83)         | (893)       | 944                                 |
| Closing number of share options .....              | <u>1,929</u> | <u>1,307</u> | -           | -                                   |
| Number of exercisable options at end of year ..... | 1,929        | 1,307        | -           | -                                   |

The average share price on the exercise dates in 2007 was HUF 985 (HUF 1,060 in 2006).

**24.1.2 The former CEO's share option plan**

The former CEO of Magyar Telekom was granted share options in 2000, 2001, 2002, 2003 and 2004. The exercise price of the options was determined in US dollars and the options had no intrinsic values on the grant dates in 2000, 2001, 2002 and 2003, while those granted in 2004 had an intrinsic value of HUF 63 million. One third of the options granted vested after one year, another one third vested two years after the grant date, while the last third vested after three years. The options are exercisable for ten years after the grant date. The Group recognized compensation expense in an amount of HUF 36 million in 2006 (2005: HUF 84 million) among employee related expenses against equity (Reserve for equity settled share based transactions).

In 2006, the former CEO resigned and exercised his remaining options from 2003 and 2004. Although the last third of the 2004 grant would not have been exercisable, the resignation agreement concluded between the Company and the CEO allowed the early exercising of these 487 thousand options. Further, the settlement was concluded in cash even though the plan was originally intended as equity settled. The options granted in 2000 remain exercisable with the original conditions. The closing share price on the exercise date was HUF 1,060.

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The table below shows the details of the CEO's share options.

|  | <u>Options granted in year</u> |             |             |             |             | <u>Total</u> |
|--|--------------------------------|-------------|-------------|-------------|-------------|--------------|
|  | <u>2000</u>                    | <u>2001</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> |              |
| Number of options granted (thousand) .....                       | 103                            | 250         | 303         | 619         | 1,462       | 2,737        |
| Exercised (thousand) – in 2005 .....                             | -                              | (250)       | (303)       | (413)       | (487)       | (1,453)      |
| Exercised (thousand) – in 2006 .....                             | -                              | -           | -           | (206)       | (975)       | (1,181)      |
| Outstanding (thousand)   |                                |             |             |             |             |              |
| at December 31, 2007 .....                                       | 103                            | -           | -           | -           | -           | 103          |
| Exercisable (thousand)   |                                |             |             |             |             |              |
| at December 31, 2007 .....                                       | 103                            | -           | -           | -           | -           | 103          |
| Exercise price in USD .....                                      | 7.36                           | 2.93        | 3.48        | 3.62        | 3.87        |              |
| Remaining contractual life<br>at December 31, 2007 (years) ..... | 2.5                            | -           | -           | -           | -           |              |

**24.1.3 Mid-term incentive plan (MTIP)**

In 2004 Magyar Telekom launched a Mid Term Incentive Plan (MTIP) for its top management, whereby the targets to be achieved are based on the performance of the Magyar Telekom share. The MTIP is a cash settled long term incentive instrument which is planned to cover five years, with a new package being launched in each year, and with each tranche lasting for three years.

The first tranche of the program spanned the period between January 1, 2004 and December 31, 2006. The second tranche of the program spanned the period between January 1, 2005 and December 31, 2007, the third tranche of the program spans the period between January 1, 2006 and December 31, 2008, while the fourth tranche of the program spans the period between January 1, 2007 and December 31, 2009. Participants include top and senior managers of the Group.

At the beginning of the plan each participant has an offered bonus. This bonus will be paid out at the end of the plan, depending on the achievement of the two fixed targets, an absolute Magyar Telekom share specific and a relative Index target.

The absolute performance target is achieved when the Magyar Telekom share price, adjusted for dividends paid during the tenure, is more than 35 percent higher at the end of the lock-up period than at the beginning of the plan. The basis of the calculation is the un-weighted average closing price of the Magyar Telekom share at the Budapest Stock Exchange during the last 20 trading days before the beginning and the end of the plan. The share price calculated according to the above was HUF 755 at the grant date of the first tranche, HUF 843 at the grant date of the second tranche, HUF 949 at the grant date of the third tranche and HUF 1,012 at the grant date of the fourth tranche.

The relative performance target is linked to the Total Return of the Magyar Telekom share compared to the performance of the Dow Jones Euro STOXX Total Return Index during the vesting period, each at the last 20 trading days. Measurement is the un-weighted average Magyar Telekom share price plus dividend payments.

These target figures are weighted with the fair value factors of achieving these targets. The fair value factors are calculated using the Monte Carlo technique. The target figures are multiplied by the relevant fair value

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factors and these amounts are then accrued for the given tranche period. This technique aims to determine the fair values of the share options granted and present it in accordance with the accruals concept.

The 2004 program ended on December 31, 2006. The absolute performance target was met, while the relative target was not. The 2005 program ended on December 31, 2007. Neither of the targets was met.

The provision for the payments in relation to the MTIP program and the movements thereof are disclosed in Note 19.4.

**25 Other operating expenses**

|   | <b>For the year ended December 31,</b> |                |                |
|---|--|----------------|----------------|
|   | <b>2005</b>                            | <b>2006</b>    | <b>2007</b>    |
|   | <b>(in HUF millions)</b>               |                |                |
| Materials, maintenance and service fees ..... | 60,696                                 | 71,586         | 69,034         |
| Marketing .....                               | 24,888                                 | 21,868         | 20,152         |
| Fees and levies .....                         | 13,455                                 | 14,919         | 15,640         |
| Consulting .....                              | 7,571                                  | 11,301         | 12,818         |
| Rental and operating lease .....              | 9,039                                  | 9,977          | 9,304          |
| Bad debt expense .....                        | 6,266                                  | 5,066          | 5,136          |
| Other expenses .....                          | 6,317                                  | 2,608          | 3,310          |
|   | <u>128,232</u>                         | <u>137,325</u> | <u>135,394</u> |

Other expenses in 2005 include HUF 2,059 million paid under four consulting contracts entered into by the Group, as to which the Company has not been able to obtain sufficient evidence that Company or its subsidiaries received adequate value. See Note 1.2 for more details.

**26 Other operating income**

|  | <b>For the year ended December 31,</b> |              |              |
|--|--|--------------|--------------|
|  | <b>2005</b>                            | <b>2006</b>  | <b>2007</b>  |
|  | <b>(in HUF millions)</b>               |              |              |
| Compensation for rebranding (Note 33.1) .....                          | 7,281                                  | 1,435        | 229          |
| Gain on sale of PP&E, Intangible assets and assets held for sale ..... | 728                                    | 2,140        | 3,203        |
| Other operating income .....   | -                                      | -            | 569          |
|  | <u>8,009</u>                           | <u>3,575</u> | <u>4,001</u> |

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**27 Finance expenses**

|                                  | <b>For the year ended December 31,</b> |               |               |
|----------------------------------|--|---------------|---------------|
|                                  | <b>2005</b>                            | <b>2006</b>   | <b>2007</b>   |
|                                  | <b>(in HUF millions)</b>               |               |               |
| Interest expense .....           | 31,340                                 | 27,325        | 31,147        |
| Other finance expenses .....     | 3,157                                  | 2,831         | 4,039         |
| Less: Interest capitalized ..... | -                                      | (54)          | -             |
|                                  | <u>34,497</u>                          | <u>30,102</u> | <u>35,186</u> |

Other finance expenses mainly include bank charges.

The capitalization rate used in 2006 to determine the amount of borrowing costs eligible for capitalization is 3 month BUBOR + 0.17525%.

**28 Finance income**

|   | <b>For the year ended December 31,</b> |              |              |
|---|--|--------------|--------------|
|   | <b>2005</b>                            | <b>2006</b>  | <b>2007</b>  |
|   | <b>(in HUF millions)</b>               |              |              |
| Gain on sale of financial instruments .....                                 | -                                      | 1,190        | 828          |
| Gains / (losses) on the valuation of derivative financial instruments ..... | -                                      | 377          | (139)        |
| Net foreign exchange gains / (losses) .....                                 | 1,014                                  | (659)        | (1,481)      |
| Finance lease interest income .....   | -                                      | 480          | 1,675        |
| Interest and other finance income .....                                     | 1,982                                  | 3,304        | 4,334        |
|   | <u>2,996</u>                           | <u>4,692</u> | <u>5,217</u> |

**29 Purchase of property, plant and equipment and intangible assets**

|   | <b>For the year ended December 31,</b> |               |                |
|---|--|---------------|----------------|
|   | <b>2005</b>                            | <b>2006</b>   | <b>2007</b>    |
|   | <b>(in HUF millions)</b>               |               |                |
| Additions to property, plant and equipment .....          | 75,705                                 | 74,415        | 75,908         |
| Additions to intangible assets .....                      | 23,669                                 | 16,458        | 28,010         |
| Total additions to tangible and intangible assets .....   | <u>99,374</u>                          | <u>90,873</u> | <u>103,918</u> |
| Recognition of investment tax credit (Note 9.4) .....     | 5,373                                  | 3,109         | 3,561          |
| Change in payables relating to capital expenditures ..... | <u>(1,160)</u>                         | <u>2,808</u>  | <u>(4,382)</u> |
|   | <u>103,587</u>                         | <u>96,790</u> | <u>103,097</u> |

The Group had no significant non cash transactions in any of the reported years.

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**30 Purchase of subsidiaries and business units**

|   | <b>For the year ended December 31,</b> |               |             |
|---|--|---------------|-------------|
|   | <b>2005</b>                            | <b>2006</b>   | <b>2007</b> |
|   | <b>(in HUF millions)</b>               |               |             |
| KFKI .....  | -                                      | 9,840         | -           |
| Dataplex .....  | -                                      | 5,148         | -           |
| Orbitel .....   | -                                      | 1,982         | -           |
| CT .....  | 35,927                                 | -             | -           |
| T-Systems Hungary .....                                 | -                                      | -             | 60          |
| Stonebridge / MakTel .....                              | -                                      | 16,579        | -           |
| Other .....   | -                                      | 1,778         | 650         |
| Total purchase of subsidiaries and business units ..... | <u>35,927</u>                          | <u>35,327</u> | <u>710</u>  |

Other items include the consideration paid for smaller business combinations and for additional shares of ownership in subsidiaries already consolidated.

**31 Segment information**

In 2007, Magyar Telekom has changed its management structure, whereby instead of the past two operating segments (Fixed line and Mobile) the Group is now managed along four segments. This practically means the further split of the old Fixed line segment into three segments (T-Com, T-Systems and Group headquarters and Shared services). The comparative information has been restated accordingly. The mobile segment's new name is T-Mobile.

The T-Com segment is the primary fixed line telecommunications service provider in Hungary, Macedonia and Montenegro. To a lesser extent, T-Com is also present in Romania, Bulgaria and Ukraine, providing alternative telecommunications services.

The T-Mobile segment provides digital services in various frequency bandwidths in Hungary, Macedonia and Montenegro and also includes the professional mobile services provided by Pro-M in Hungary.

The T-Systems segment provides fixed line telecommunications services in Hungary to the largest 3,200 customers of Magyar Telekom Plc. Further, T-Systems also provides system integration and information technology related services and products to business clients in Hungary.

The Group headquarters and Shared services (GHS) segment includes the activities of the Magyar Telekom headquarters, including the Procurement, Treasury, Real estate, Accounting, Tax, Legal, Internal audit and similar shared services and other central functions of the Group's management. GHS is disclosed voluntarily as a segment regardless of its size and activities.

The segments' revenues include revenues from external clients as well as the internal revenues generated from other segments for telecommunications as well as support services.

The segments' depreciation, amortization and impairment expenses include the aforementioned expenses related to the intangible assets and PPE allocated to the segments.

The segments' results are monitored to Operating profit. The financial results, the share of associates' and joint ventures' profits and tax expenses as well as the minority interests are not allocated to the segments, as these items are managed at Group level.

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Assets allocated to the segments exclude Cash and cash equivalents, Other current financial assets and Non current financial assets and Current and Deferred tax assets, which are managed at Group level. All other assets are allocated to the segments.

Liabilities allocated to the segments exclude Financial liabilities and Current and Deferred tax liabilities, which are managed at Group level. All other liabilities are allocated to the segments.

**31.1 Primary reporting format**

The following tables present a summary of operating results of the Group by business segment. The segments presented below are substantially consistent with the format used by the Company's Management Committee.

|  | <b>For the year ended December 31,</b> |                       |                       |
|--|--|-----------------------|-----------------------|
|  | <b>2005</b>                            | <b>2006</b>           | <b>2007</b>           |
|  | <b>(in HUF millions)</b>               |                       |                       |
| <b>Revenues</b>                                  |  |                       |                       |
| T-Com revenues from external customers .....     | 275,016                                | 272,822               | 273,275               |
| T-Com revenues from other segments .....         | 30,340                                 | 42,421                | 34,426                |
| Total revenues of T-Com .....                    | <u>305,356</u>                         | <u>315,243</u>        | <u>307,701</u>        |
| .....  |  |                       |                       |
| T-Mobile revenues from external customers .....  | 285,848                                | 327,330               | 325,724               |
| T-Mobile revenues from other segments .....      | 23,035                                 | 22,236                | 21,146                |
| Total revenues of T-Mobile .....                 | <u>308,883</u>                         | <u>349,566</u>        | <u>346,870</u>        |
| .....  |  |                       |                       |
| T-Systems revenues from external customers ..... | 50,803                                 | 63,423                | 75,034                |
| T-Systems revenues from other segments .....     | 6,198                                  | 1,946                 | 3,898                 |
| Total revenues of T-Systems .....                | <u>57,001</u>                          | <u>65,369</u>         | <u>78,932</u>         |
| .....  |  |                       |                       |
| GHS revenues from external customers .....       | 3,387                                  | 7,621                 | 2,628                 |
| GHS revenues from other segments .....           | 18,628                                 | 18,776                | 21,109                |
| Total revenues of GHS.....                       | <u>22,015</u>                          | <u>26,397</u>         | <u>23,737</u>         |
| .....  |  |                       |                       |
| Less: Inter-segment revenue .....                | (78,201)                               | (85,379)              | (80,579)              |
| Total revenue of the Group .....                 | <u><u>615,054</u></u>                  | <u><u>671,196</u></u> | <u><u>676,661</u></u> |



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|   | <b>For the year ended December 31,</b> |                 |                 |
|---|--|-----------------|-----------------|
|   | <b>2005</b>                            | <b>2006</b>     | <b>2007</b>     |
|   | <b>(in HUF millions)</b>               |                 |                 |
| <b>Depreciation and amortization</b>                          |  |                 |                 |
| Impairment of tangible and intangible assets .....            | 316                                    | 2,457           | -               |
| Other depreciation and amortization .....                     | 58,684                                 | 65,004          | 57,473          |
| <b>T-Com .....</b>  | <b>59,000</b>                          | <b>67,461</b>   | <b>57,473</b>   |
| Impairment of tangible and intangible assets .....            | 75                                     | 616             | 126             |
| Other depreciation and amortization .....                     | 42,716                                 | 46,559          | 47,323          |
| <b>T-Mobile .....</b>   | <b>42,791</b>                          | <b>47,175</b>   | <b>47,449</b>   |
| Impairment of tangible and intangible assets .....            | -                                      | -               | -               |
| Other depreciation and amortization .....                     | 1,962                                  | 3,611           | 5,867           |
| <b>T-Systems .....</b>  | <b>1,962</b>                           | <b>3,611</b>    | <b>5,867</b>    |
| Impairment of tangible and intangible assets .....            | -                                      | -               | -               |
| Other depreciation and amortization .....                     | 10,933                                 | 4,002           | 4,806           |
| <b>GHS .....</b>  | <b>10,933</b>                          | <b>4,002</b>    | <b>4,806</b>    |
| <b>Total depreciation and amortization of the Group .....</b> | <b>114,686</b>                         | <b>122,249</b>  | <b>115,595</b>  |
| <b>Segment results (Operating profit)</b>                     |  |                 |                 |
| <b>T-Com .....</b>  | <b>66,162</b>                          | <b>56,300</b>   | <b>54,096</b>   |
| <b>T-Mobile .....</b>   | <b>87,524</b>                          | <b>92,772</b>   | <b>101,855</b>  |
| <b>T-Systems .....</b>  | <b>20,823</b>                          | <b>12,134</b>   | <b>5,966</b>    |
| <b>GHS .....</b>  | <b>(32,755)</b>                        | <b>(24,815)</b> | <b>(33,605)</b> |
| <b>Total operating profit of the Group .....</b>              | <b>141,754</b>                         | <b>136,391</b>  | <b>128,312</b>  |
| <b>Additions to PPE and Intangible assets</b>                 |  |                 |                 |
| Additions to Goodwill .....                                   | -                                      | 6,317           | -               |
| Other additions due to business combinations .....            | 26,195                                 | 3,090           | 50              |
| Purchases of tangible and intangible assets .....             | 43,158                                 | 38,574          | 39,433          |
| <b>T-Com .....</b>  | <b>69,353</b>                          | <b>47,981</b>   | <b>39,483</b>   |
| Additions to Goodwill .....                                   | 5,122                                  | 2,285           | 507             |
| Other additions due to business combinations .....            | 12,450                                 | -               | -               |
| Purchases of tangible and intangible assets .....             | 46,322                                 | 40,236          | 55,903          |
| <b>T-Mobile .....</b>   | <b>63,894</b>                          | <b>42,521</b>   | <b>56,410</b>   |
| Additions to Goodwill .....                                   | -                                      | 4,468           | 13              |
| Other additions due to business combinations .....            | -                                      | 6,177           | 2,060           |
| Purchases of tangible and intangible assets .....             | 5,078                                  | 5,853           | 3,316           |
| <b>T-Systems .....</b>  | <b>5,078</b>                           | <b>16,498</b>   | <b>5,389</b>    |
| Purchases of tangible and intangible assets.....              | 4,816                                  | 6,210           | 5,266           |
| <b>GHS .....</b>  | <b>4,816</b>                           | <b>6,210</b>    | <b>5,266</b>    |
| <b>Total Group .....</b>                                      | <b>143,141</b>                         | <b>113,210</b>  | <b>106,548</b>  |

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|   | <b>As at December 31,</b> |                  |
|---|---------------------------|------------------|
|   | <b>2006</b>               | <b>2007</b>      |
|   | <b>(in HUF millions)</b>  |                  |
| <b>Assets</b>                               |                           |                  |
| Goodwill .....                              | 32,710                    | 33,174           |
| Associates and joint ventures.....          | 4,071                     | 4,933            |
| Assets held for sale .....                  | 1,878                     | 636              |
| Other assets .....                          | 413,041                   | 390,481          |
| <b>T-Com .....</b>                          | <b>451,700</b>            | <b>429,224</b>   |
| Goodwill .....                              | 207,738                   | 208,275          |
| Assets held for sale .....                  | 888                       | -                |
| Other assets .....                          | 248,328                   | 260,796          |
| <b>T-Mobile .....</b>                       | <b>456,954</b>            | <b>469,071</b>   |
| Goodwill .....                              | 4,701                     | 4,863            |
| Associates and joint ventures .....         | 1,700                     | -                |
| Assets held for sale .....                  | 739                       | 739              |
| Other assets .....                          | 31,512                    | 32,550           |
| <b>T-Systems .....</b>                      | <b>38,652</b>             | <b>38,152</b>    |
| Assets held for sale .....                  | 3,320                     | 3,018            |
| Other assets .....                          | 62,487                    | 62,418           |
| <b>GHS .....</b>                            | <b>65,807</b>             | <b>65,436</b>    |
| Inter-segment elimination .....             | (17,911)                  | (5,987)          |
| <b>Total segment assets .....</b>           | <b>995,202</b>            | <b>995,896</b>   |
| Unallocated assets .....                    | 136,393                   | 139,682          |
| <b>Total assets of the Group .....</b>      | <b>1,131,595</b>          | <b>1,135,578</b> |
| <b>Liabilities</b>                          |                           |                  |
| T-Com .....                                 | 54,595                    | 65,274           |
| T-Mobile .....                              | 49,153                    | 58,348           |
| T-Systems .....                             | 9,307                     | 20,127           |
| GHS .....                                   | 104,437                   | 34,829           |
| Inter-segment elimination .....             | (17,911)                  | (5,987)          |
| <b>Total segment liabilities .....</b>      | <b>199,581</b>            | <b>172,591</b>   |
| Unallocated liabilities .....               | 338,847                   | 381,294          |
| <b>Total liabilities of the Group .....</b> | <b>538,428</b>            | <b>553,885</b>   |

**31.2 Secondary reporting format**

Magyar Telekom's segments primarily operate in Hungary, Macedonia and Montenegro. The Group also has Fixed line operations in Romania, Bulgaria and Ukraine, which are shown in one amount in the table below. The geographical segment reporting information is included in the tables below.

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|   | <b>For the year ended December 31,</b> |                       |                       |
|---|--|-----------------------|-----------------------|
|   | <b>2005</b>                            | <b>2006</b>           | <b>2007</b>           |
|   | <b>(in HUF millions)</b>               |                       |                       |
| <b>Revenues</b>   |  |                       |                       |
| Revenue generated in Hungary .....                      | 526,947                                | 565,770               | 565,750               |
| Less: inter-segment revenue .....                       | (1,020)                                | (2,254)               | (3,474)               |
| Revenue from external customers – Hungary .....         | <u>525,927</u>                         | <u>563,516</u>        | <u>562,276</u>        |
| Revenue generated in Macedonia .....                    | 67,547                                 | 74,056                | 74,332                |
| Less: inter-segment revenue .....                       | (311)                                  | (760)                 | (525)                 |
| Revenue from external customers – Macedonia .....       | <u>67,236</u>                          | <u>73,296</u>         | <u>73,807</u>         |
| Revenue generated in Montenegro .....                   | 20,521                                 | 30,683                | 35,747                |
| Less: inter-segment revenue .....                       | (62)                                   | (229)                 | (491)                 |
| Revenue from external customers – Montenegro .....      | <u>20,459</u>                          | <u>30,454</u>         | <u>35,256</u>         |
| Revenue generated in other countries .....              | 2,133                                  | 4,784                 | 6,489                 |
| Less: inter-segment revenues .....                      | (701)                                  | (854)                 | (1,167)               |
| Revenue from external customers – other countries ..... | <u>1,432</u>                           | <u>3,930</u>          | <u>5,322</u>          |
| Total revenue of the Group .....                        | <u><u>615,054</u></u>                  | <u><u>671,196</u></u> | <u><u>676,661</u></u> |
| <b>Additions to PPE and Intangible assets</b>           |  |                       |                       |
| Additions to Goodwill .....                             | -                                      | 10,377                | 520                   |
| Other additions due to business combinations .....      | -                                      | 9,138                 | 2,110                 |
| Purchases of tangible and intangible assets.....        | 84,764                                 | 77,875                | 83,538                |
| Hungary .....   | <u>84,764</u>                          | <u>97,390</u>         | <u>86,168</u>         |
| Additions to Goodwill .....                             | -                                      | 1,724                 | -                     |
| Other additions due to business combinations .....      | -                                      | -                     | -                     |
| Purchases of tangible and intangible assets.....        | 9,052                                  | 7,340                 | 9,880                 |
| Macedonia .....   | <u>9,052</u>                           | <u>9,064</u>          | <u>9,880</u>          |
| Additions to Goodwill .....                             | 5,122                                  | -                     | -                     |
| Other additions due to business combinations .....      | 38,645                                 | -                     | -                     |
| Purchases of tangible and intangible assets.....        | 4,278                                  | 3,541                 | 6,974                 |
| Montenegro .....  | <u>48,045</u>                          | <u>3,541</u>          | <u>6,974</u>          |
| Additions to Goodwill .....                             | -                                      | 969                   | -                     |
| Other additions due to business combinations .....      | -                                      | 129                   | -                     |
| Purchases of tangible and intangible assets.....        | 1,280                                  | 2,117                 | 3,526                 |
| Other countries .....                                   | <u>1,280</u>                           | <u>3,215</u>          | <u>3,526</u>          |
| Total Group .....                                       | <u><u>143,141</u></u>                  | <u><u>113,210</u></u> | <u><u>106,548</u></u> |

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|                                 | As at December 31,      |                         |
|---------------------------------|-------------------------|-------------------------|
|                                 | 2006                    | 2007                    |
| (in HUF millions)               |                         |                         |
| <b>Assets</b>                   |                         |                         |
| Hungary .....                   | 803,422                 | 812,311                 |
| Macedonia .....                 | 138,879                 | 135,623                 |
| Montenegro .....                | 47,558                  | 49,909                  |
| Other countries .....           | 6,690                   | 8,352                   |
| Total .....                     | <u>996,549</u>          | <u>1,006,195</u>        |
| Inter-segment elimination ..... | (1,347)                 | (10,299)                |
| Total segment assets .....      | <u>995,202</u>          | <u>995,896</u>          |
| Unallocated assets .....        | 136,393                 | 139,682                 |
| Total assets of the Group ..... | <u><u>1,131,595</u></u> | <u><u>1,135,578</u></u> |

**32 Commitments**

**32.1 Finance lease –Group as lessee**

Finance leases in 2006 and 2007 relate to the sale and lease back of spaces in buildings accommodating telephone exchanges. The average contract term of these leases is 10 years, and the contracts include renewal options but no purchase options.

Future lease payments under finance leases related to sale and lease back transactions at December 31, 2006 and 2007 are as follows:

| Amounts in HUF millions | 2006          |                    |                       | 2007          |                    |                       |
|-------------------------|---------------|--------------------|-----------------------|---------------|--------------------|-----------------------|
|                         | Present value | Interest component | Minimum lease payment | Present value | Interest component | Minimum lease payment |
| Within 1 year .....     | 124           | 274                | 398                   | 222           | 324                | 546                   |
| 1-5 years .....         | 668           | 794                | 1,462                 | 872           | 866                | 1,738                 |
| After 5 years .....     | 585           | 280                | 865                   | 561           | 247                | 808                   |
| Total .....             | <u>1,377</u>  | <u>1,348</u>       | <u>2,725</u>          | <u>1,655</u>  | <u>1,437</u>       | <u>3,092</u>          |

Finance leases other than sale and lease back in 2007 mainly relate to vehicles and IT equipment. The average contract term of the leases is 3-5 years.

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Future lease payments under finance leases other than sale and lease back transactions at December 31, 2006 and 2007 are as follows:

| Amounts in HUF millions | At December 31, 2006 |                    |                       | At December 31, 2007 |                    |                       |
|-------------------------|----------------------|--------------------|-----------------------|----------------------|--------------------|-----------------------|
|                         | Present value        | Interest component | Minimum lease payment | Present value        | Interest component | Minimum lease payment |
| Within 1 year .....     | 288                  | 99                 | 387                   | 437                  | 163                | 600                   |
| 1-5 years .....         | 1,071                | 129                | 1,200                 | 1,131                | 280                | 1,411                 |
| After 5 years .....     | -                    | -                  | -                     | 147                  | 19                 | 166                   |
| Total .....             | 1,359                | 228                | 1,587                 | 1,715                | 462                | 2,177                 |

**32.2 Operating lease –Group as lessee**

Operating lease commitments are mainly in respect of the rental of cell sites, and to a lesser extent, related to buildings, network and other telecommunications facilities.

| Amounts in HUF millions | At December 31, |        |
|-------------------------|-----------------|--------|
|                         | 2006            | 2007   |
| Within 1 year .....     | 6,869           | 7,360  |
| 1-5 years .....         | 18,813          | 19,801 |
| After 5 years .....     | 17,667          | 15,668 |
| Total .....             | 43,349          | 42,829 |

The lease commitments represent a high amount of individually immaterial lease agreements, the terms of which vary on a wide range, spanning from 3 to 20 years with renewal options in most cases.

**32.3 Finance lease –Group as lessor**

Future lease receivables under finance leases at December 31, 2006 and 2007 are as follows:

| Amounts in HUF millions | At December 31, 2006 |                    |                       | At December 31, 2007 |                    |                       |
|-------------------------|----------------------|--------------------|-----------------------|----------------------|--------------------|-----------------------|
|                         | Present value        | Interest component | Minimum lease receipt | Present value        | Interest component | Minimum lease receipt |
| Within 1 year .....     | 1,856                | 1,330              | 3,186                 | 4,011                | 1,617              | 5,628                 |
| 1-5 years .....         | 8,907                | 4,690              | 13,597                | 9,742                | 3,928              | 13,668                |
| After 5 years .....     | 7,256                | 902                | 8,158                 | 7,816                | 5,971              | 8,787                 |
| Total .....             | 18,019               | 6,922              | 24,941                | 21,569               | 6,514              | 28,083                |

The interest component represents the unearned finance income. The present value due within one year is included in Other current financial assets, while the present value after one year is included in Other non current financial assets. The finance income accruing to the Group over the lease term is recognized in the income statement (Finance income).

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**32.4 Operating lease – Group as lessor**

The following table sets forth the future minimum lease payments receivable by the Group for the operating leases of PBX equipment where Magyar Telekom is the lessor.

| <b>Amounts in HUF millions</b> | <b>At December 31,<br/>2007</b>  |
|--------------------------------|----------------------------------|
|                                | <b>Minimum lease<br/>receipt</b> |
| Within 1 year .....            | 2,738                            |
| 1-5 years .....                | 2,446                            |
| After 5 years .....            | 12                               |
| <b>Total .....</b>             | <b>5,196</b>                     |

**32.5 Purchase commitments for tangible assets**

As of December 31, 2007, Magyar Telekom had contractual commitments for capital expenditures of HUF 12,6 billion (HUF 6.3 billion in 2006, HUF 3.2 billion in 2005) with the majority falling due within one year.

**32.6 Commitments related to the extended GSM license of T-Mobile HU**

The Company renewed its mobile concession contract for use of the 900 MHz frequency band that expires on November 4, 2008 for an additional term of seven and a half years, as agreed with the Hungarian Government. At the same time, the Company agreed to carry out large-scale investment projects to further increase mobile broadband coverage. In addition to the payment of the HUF 10 billion concession fee, Magyar Telekom agreed with the Government to spend at least HUF 20 billion in the following two years (2008 and 2009) on further increasing mobile broadband coverage in Hungary.

**33 Related party transactions**

**33.1 Deutsche Telekom Group**

Deutsche Telekom AG is the ultimate controlling owner of Magyar Telekom Plc. holding 59.21% of the issued shares. Deutsche Telekom (DT) Group has a number of fixed line and mobile telecom service provider subsidiaries worldwide, with whom Magyar Telekom Group has regular transactions.

The Company is directly owned by MagyarCom GmbH, which is a holding company of DTAG. Magyar Telekom pays dividends annually to its owners including MagyarCom GmbH.

MagyarCom Services Kft., a Hungarian company owned by Deutsche Telekom, provides Magyar Telekom with management and consulting services.

Deutsche Telekom International Finance (DTIF) is the treasury vehicle of DT Group, which provides loan financing across the DT Group including Magyar Telekom.

The Company's Hungarian mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004, while other Hungarian companies were renamed in 2005. The renaming continued in 2006 in Macedonia and Montenegro. The expenditures incurred in connection with the launch and promotion of the new brands and the

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loss of value caused by discontinuing the old brands were compensated in value by Deutsche Telekom AG. The compensation received was recognized in the income statement (Other operating income).

The table below summarizes the above related party transactions with DT group.

|   | <u>2005</u>       | <u>2006</u> | <u>2007</u> |
|---|-------------------|-------------|-------------|
|   | (in HUF millions) |             |             |
| Revenues from telecom services provided to DT Group ..... | 8,056             | 7,127       | 6,729       |
| Costs of services provided by DT Group .....              | (11,303)          | (13,016)    | (11,881)    |
| Other income from DTAG .....                              | 7,281             | 1,435       | 229         |
| Interest expense to DTIF .....                            | (24,518)          | (21,389)    | (23,301)    |
| Dividend paid to MagyarCom GmbH .....                     | (43,222)          | -           | (88,296)    |
| Dividend payable to MagyarCom GmbH .....                  | -                 | (45,074)    | -           |
| Accounts receivable from DT Group .....                   | 3,711             | 7,991       | 6,878       |
| Accounts payable to MagyarCom Services Kft .....          | (313)             | (163)       | (268)       |
| Accounts payable to other DT Group companies .....        | (3,254)           | (6,044)     | (7,256)     |
| Accrued interests payable to DTIF .....                   | (6,198)           | (3,756)     | (5,210)     |
| Loans payable to DTIF.....                                | (286,648)         | (259,432)   | (274,432)   |

Deutsche Telekom has pledged its support for Magyar Telekom's financing needs through to June 30, 2009.

### 33.2 Governments

Magyar Telekom provides services to Government departments and businesses in Hungary, Macedonia and Montenegro, but individually none of these customers represent a significant source of revenue.

### 33.3 Associates and joint ventures

Hunsat is a joint venture founded by the Company (50%) and Antenna Hungária Rt. (50%). The revenues of Hunsat include commissions received from Hungarian telecommunications companies for the use of services of international satellite agencies. The operational transactions and balances with Hunsat are insignificant. Dividends received from Hunsat amounted to HUF 72 million in 2007 (2006: HUF 157 million, 2005: HUF 1,376 million).

IKO-Telekom Média Holding (ITMH) is a joint venture holding company of Magyar Telekom and IKO Production Kft., with a 50-50% ownership. The transactions between the Group and ITMH are insignificant.

M-RTL is an associate of Magyar Telekom. M-RTL is a television broadcast company that sells airtime through media agencies to Magyar Telekom, and Magyar Telekom provides telecom services to M-RTL mainly through an interactive service provider. Consequently, the direct operating transactions between M-RTL and the Group were insignificant. M-RTL declared dividends to Magyar Telekom directly and indirectly in an amount of

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HUF 750 million in 2007 (2006: HUF 605 million, 2005: HUF 550 million).

**33.4 Board and supervisory board members**

The remuneration of the members of the Company's Board of Directors amounted to HUF 11 million in 2007 (2006: HUF 8 million, 2005: HUF 10 million). The remuneration of the members of the Company's Supervisory Board amounted to HUF 42 million in 2007 (2006: HUF 17 million, 2005: HUF 14 million).

**33.5 Key management**

Key management has been identified as the members of the Group's Management Committee, which is the main operational decision making body of Magyar Telekom.

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.

|   | <b>At December 31,</b>   |              |              |
|---|--------------------------|--------------|--------------|
|   | <b>2005</b>              | <b>2006</b>  | <b>2007</b>  |
|   | <b>(in HUF millions)</b> |              |              |
| Salaries and other short-term employee benefits ..... | 670                      | 647          | 978          |
| Contractual termination expense .....                 | 350                      | 432          | 1,129        |
| Share based compensation (Note 24.1) .....            | 130                      | 112          | (123)        |
|   | <b>1,150</b>             | <b>1,191</b> | <b>1,984</b> |

The Group does not provide loans to its key management.

In 2001, DT's shareholders approved the introduction of the 2001 Stock Option Plan, resulting in the granting of stock options in 2001 and 2002. 50 percent of the options granted to each beneficiary may only be exercised following the end of a vesting period of two years. The remaining 50 percent of the options granted to each beneficiary may be exercised at the end of a vesting period of three years. All options are vested as December 31, 2007. The exercise price of the 2001 option is EUR 30.00, the term of the options runs until August 12, 2011. The exercise price of the 2002 option is EUR 12.36, the term of the options runs until July 14, 2012. At the time they were granted, the options of the 2001 and 2002 tranches had no intrinsic value, but a fair value of EUR 4.87 and EUR 3.79 respectively. The Company's Chief Financial Officer (CFO), who was a senior manager of DT at the time of the stock option, is a participant of the 2002 tranche, having 6,510 share options. Magyar Telekom does not have any potential obligation deriving from the CFO's share options.

Further, the Company's CFO is also a participant of the 2004, 2005 and 2006 MTIP programs of DT, which are very similar to those of Magyar Telekom as described in Note 24.1.3, the difference being that the targets of the programs are tied to the performance of the DT shares. Magyar Telekom does not have any potential obligation deriving from the CFO's participation in DT's MTIP program.

In 2001 and 2002, Deutsche Telekom granted stock appreciation rights (SARs) to employees in countries where it was not legally possible to issue stock options. Magyar Telekom employees only participated in the 2001 program. Each individual SAR entitles the plan participant to receive an amount in cash subject to these terms and conditions. Magyar Telekom does not have any potential obligation deriving from that contract, since Deutsche Telekom will pay the compensation, if any, to the participants, and further, the fair value of the SARs



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as at December 31, 20007 is estimated to be zero. No member of the current key management is a participant of the SAR program, but former members of the key management were participants of the 2001 SAR program.

**34. Disclosures on financial instruments**

**34.1 Categories of financial assets and liabilities**

**34.1.1 Financial assets**

The table below shows the categorization of financial assets as at December 31, 2006.

| Assets<br>in HUF millions                                     | Financial assets         |                      |                        |                     | Carrying<br>amount<br>2006 | Fair<br>value<br>2006 |
|---|--------------------------|----------------------|------------------------|---------------------|----------------------------|-----------------------|
|   | Loans and<br>receivables | Held-to-<br>maturity | Available-<br>for-sale | Held for<br>trading |                            |                       |
| Cash and cash equivalents .....                               | 60,207                   | -                    | -                      | -                   | 60,207                     | 60,207                |
| Bank deposits with original<br>maturities over 3 months ..... | 17,633                   | -                    | -                      | -                   | 17,633                     | 17,633                |
| Trade receivables .....                                       | 89,149                   | -                    | -                      | -                   | 89,149                     | 89,149                |
| Trade receivables over one year .....                         | 586                      | -                    | -                      | -                   | 586                        | 567                   |
| Employee loans<br>.....                                       | 5,014                    | -                    | -                      | -                   | 5,014                      | 4,940                 |
| Derivative financial instruments<br>.....                     | -                        | -                    | -                      | 378                 | 378                        | 378                   |
| Other current financial assets .....                          | 482                      | -                    | -                      | -                   | 482                        | 482                   |
| Financial assets available for sale<br>....                   | -                        | -                    | 458                    | -                   | 458                        | 458                   |
| Other non current financial asset .....                       | 2,280                    | -                    | -                      | -                   | 2,280                      | 2,269                 |
| <b>Total .....</b>  | <b>175,351</b>           | <b>-</b>             | <b>458</b>             | <b>378</b>          | <b>176,187</b>             | <b>176,083</b>        |

The table below shows the categorization of financial assets as at December 31, 2007.

| Assets<br>in HUF millions                                     | Financial assets         |                      |                        |                     | Carrying<br>amount<br>2007 | Fair<br>value<br>2007 |
|---|--------------------------|----------------------|------------------------|---------------------|----------------------------|-----------------------|
|   | Loans and<br>receivables | Held-to-<br>maturity | Available-<br>for-sale | Held for<br>trading |                            |                       |
| Cash and cash equivalents .....                               | 47,666                   | -                    | -                      | -                   | 47,666                     | 47,666                |
| Bank deposits with original<br>maturities over 3 months ..... | 58,053                   | -                    | -                      | -                   | 58,053                     | 58,053                |
| Trade receivables .....                                       | 95,478                   | -                    | -                      | -                   | 95,478                     | 95,478                |
| Trade receivables over one year .....                         | 619                      | -                    | -                      | -                   | 619                        | 595                   |
| Employee loans .....  | 4,610                    | -                    | -                      | -                   | 4,610                      | 4,879                 |
| Derivative financial instruments<br>.....                     | -                        | -                    | -                      | 57                  | 57                         | 57                    |
| Loans to third parties .....                                  | 1,334                    | -                    | -                      | -                   | 1,334                      | 1,334                 |
| Other current financial assets .....                          | 636                      | -                    | -                      | -                   | 636                        | 636                   |
| Financial assets available for sale ...                       | -                        | -                    | 690                    | -                   | 690                        | 690                   |
| Other non current financial asset .....                       | 841                      | -                    | -                      | -                   | 841                        | 897                   |
| <b>Total .....</b>  | <b>209,237</b>           | <b>-</b>             | <b>690</b>             | <b>57</b>           | <b>209,984</b>             | <b>210,285</b>        |

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All financial instruments are recognized initially at fair value. More details are provided on subsequent measurement of financial instruments in Note 2.4.

Cash and cash equivalents, trade receivables, other current financial assets and loans to third parties mainly have short times to maturity. For this reason, their carrying amounts at the reporting date approximate the fair values.

The fair value of employee loans, trade receivables over one year and other non-current financial assets are determined by using discounted cash-flow valuation technique. The quarterly cash inflows from the employees are discounted by market based interest rates interpolated from the official Budapest and EUR Interest Rate Swap.

The fair value of financial instruments that are not traded in an active market (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 balance sheet date.

Financial assets available for sale include investment in equity instruments that are measured at fair value.

Finance lease receivables (2007: HUF 21,568 million, 2006: HUF 18,019 million) meet the criteria of a financial instrument, but these are recognized and measured according to IAS 17 – Leases.

### 34.1.2 Financial liabilities

The table below shows the categorization of financial liabilities as at December 31, 2006.

| Liabilities<br>in HUF millions             | Financial liabilities         |                  | Carrying<br>amount<br>2006 | Fair value<br>2006 |
|--|-------------------------------|------------------|----------------------------|--------------------|
|  | Measured at amortized<br>cost | Held for trading |                            |                    |
| Financial liabilities                      |                               |                  |                            |                    |
| to related parties .....                   | 263,188                       | -                | 263,188                    | 268,102            |
| Bank loans .....                           | 47,394                        | -                | 47,394                     | 47,394             |
| Trade payables .....                       | 81,392                        | -                | 81,392                     | 81,392             |
| Dividend payable .....                     | 76,165                        | -                | 76,165                     | 76,165             |
| Nonconvertible bonds and debentures .      | 194                           | -                | 194                        | 142                |
| Other current financial liabilities        |                               |                  |                            |                    |
| .....                                      | 1,776                         | -                | 1,776                      | 1,776              |
| Other non current financial liabilities .. | 6,405                         | -                | 6,405                      | 5,978              |
| Total .....                                | 476,514                       | -                | 476,514                    | 480,949            |

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The table below shows the categorization of financial liabilities as at December 31, 2007.

| Liabilities<br>in HUF millions             | Financial liabilities         |                  | Carrying<br>amount<br>2007 | Fair value<br>2007 |
|--|-------------------------------|------------------|----------------------------|--------------------|
|  | Measured at amortized<br>cost | Held for trading |                            |                    |
| Financial liabilities                      |                               |                  |                            |                    |
| to related parties .....                   | 279,642                       | -                | 279,642                    | 287,600            |
| Bank loans .....                           | 94,184                        | -                | 94,184                     | 95,424             |
| Trade payables .....                       | 87,989                        | -                | 87,989                     | 87,989             |
| Dividend payable .....                     | 151                           | -                | 151                        | 151                |
| Nonconvertible bonds and debentures .      | 194                           | -                | 194                        | 146                |
| Other current financial liabilities .....  | 1,532                         | -                | 1,532                      | 1,532              |
| Other non current financial liabilities .. | 3,827                         | -                | 3,827                      | 3,566              |
| Total .....                                | 467,519                       | -                | 467,519                    | 476,408            |

The fair value of long term fixed-rate financial liabilities of a monetary nature (Financial liabilities to related parties, Bank loans and Nonconvertible bonds and debentures) is determined by using discounted cash-flow valuation technique. The cash flows of the liabilities are discounted by interest rates, which is reasonable to the Group for similar financial instruments. The carrying amount of floating-rate financial liabilities of monetary nature or expiring within one year, approximate the fair values at the reporting date, therefore these are not revalued.

Fair value information on the financial liabilities is provided Notes 16 and 17.

Trade payables and other current financial liabilities generally have short times to maturity, therefore the values reported approximate the fair values. As dividend payable is also a short-term liability, the carrying amount is a reasonable approximation of fair value.

There is an item in other non current financial liabilities, the carrying amount of which is a reasonable approximation of fair value at December 31, 2006, as the liability was recognized in September 2006 and there were no significant changes in market interest rates in Q3 2006. The fair value of other items in other non current liabilities is determined by using discounted cash-flow valuation technique.

Finance lease liabilities (2007: HUF 3,370 million, 2006: HUF 2,736 million) meet the criteria of a financial instrument, but these are recognized and measured according to IAS 17 – Leases.

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**34.2 Net gain/loss by financial instrument category**

The table below shows the net gains and losses by financial instruments in 2006.

| in HUF millions   | From interest | From subsequent measurement |                      |                 | From derecognition | From fee expense | Net gain / loss 2006 |
|---|---------------|-----------------------------|----------------------|-----------------|--------------------|------------------|----------------------|
|   |               | At fair value               | Currency translation | Impairment loss |                    |                  |                      |
| Loans and receivables .....   | 3,304         | -                           | (2,457)              | (5,066)         | -                  | (2,726)          | (6,945)              |
| Held-to-maturity investments  | -             | -                           | -                    | -               | -                  | -                | 0                    |
| Available-for-sale financial assets .....                             | -             | -                           | -                    | -               | 1,190              | -                | 1,190                |
| Financial instruments held for trading .....                          | -             | 377                         | -                    | -               | -                  | -                | 377                  |
| Financial liabilities measured at amortized cost ...                  | (26,979)      | -                           | 1,798                | -               | -                  | (105)            | (25,286)             |
| Net gain/loss of financial instruments under the scope of IAS 39 .... | (23,675)      | 377                         | (659)                | (5,066)         | 1,190              | (2,831)          | (30,664)             |
| Finance lease net interest income (out of scope of IAS39).....        | 188           | -                           | -                    | -               | -                  | -                | 188                  |

The table below shows the net gains and losses by financial instruments in 2007.

| in HUF millions   | From interest | From subsequent measurement |                      |                 | From derecognition | From fee expense | Net gain / loss 2007 |
|---|---------------|-----------------------------|----------------------|-----------------|--------------------|------------------|----------------------|
|   |               | At fair value               | Currency translation | Impairment loss |                    |                  |                      |
| Loans and receivables .....   | 4,334         | -                           | (799)                | (3,193)         | -                  | (3,120)          | (2,804)              |
| Held-to-maturity investments  | -             | -                           | -                    | -               | -                  | -                | -                    |
| Available-for-sale financial assets .....                             | -             | 233                         | -                    | -               | -                  | -                | 233                  |
| Financial instruments held for trading .....                          | -             | (321)                       | -                    | -               | 828                | -                | 507                  |
| Financial liabilities measured at amortized cost ...                  | (31,147)      | -                           | (457)                | -               | -                  | (427)            | (32,005)             |
| Net gain/loss of financial instruments under the scope of IAS 39 .... | (26,813)      | (88)                        | (1,256)              | (3,193)         | 828                | (3,514)          | (34,069)             |
| Finance lease net interest income (out of scope of IAS 39) .....      | 1,183         | -                           | -                    | -               | -                  | -                | 1,183                |

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 de-recognition.

The Group has pledged no financial assets as collateral for liabilities or contingent liabilities.

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The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated is not material therefore no separate disclosure is provided on those.

The amount of receivables that are individually determined to be impaired is not material, therefore, these are not disclosed separately.

The Group does not have compound financial instruments with multiple embedded derivatives.

There were no defaults and breaches in connection with loans payable.

### **35. Contingent liabilities**

The most significant contingent liabilities of Group are described below. No provisions have been recognized for any of these cases as the management estimates that it is unlikely that these would result in economic outflows from the Group.

#### **35.1 Compensation for unjustified termination of a contract by T-Mobile MK**

In January 2002, T-Mobile MK and Newsphone signed an agreement, including a 3-month trial period, for the collection of T-Mobile MK's overdue receivables. After the expiration of the 3-months trial period, T-Mobile MK terminated this contract in April 2002 due to breaches of the contractual obligations by Newsphone. Newsphone initiated a lawsuit in April 2003 requesting damage compensation for foregone profit and compensation for services already rendered. Expertise ordered by the court to review the figures and results of the cooperation between the parties during the trial period concluded on their review mostly in favor of T-Mobile MK. Management estimates it unlikely that Newsphone would win the court case against T-Mobile MK. The potential loss from the claim is approximately HUF 1,200 million. The first instance decision will be made by a primary court of Macedonia, the timing of which is uncertain.

#### **35.2 Alleged abuse of dominant position by Maktel on wholesale ADSL market**

In September 2007, the CPC stated that Maktel had been abusing its dominant position as it did not offer wholesale ADSL service for its competitors, while it started its own ADSL service and it also did not make 3rd party billing possible for other providers. Management estimates it unlikely that the CPC would win the court case against Maktel. The potential loss from the claim is approximately HUF 600 million. The final decision will be made by the Administrative Court of Macedonia, the timing of which is uncertain.

Maktel's competitors have sued Maktel for damage compensation based on the above decision of the CPC. Management estimates it unlikely that the competitors would win the court cases against Maktel. The potential loss from the claim is approximately HUF 1,100 million. The first instance decisions will be made by a primary court of Macedonia, the timing of which is uncertain.

#### **35.3 Alleged abuse of dominant position by Maktel by charging administrative fee**

In February 2006, the CPC initiated procedure against MakTel for abusing dominant position by charging an administrative fee to the customers in an amount of 2% of the subscribers' bill. Starting from June, 2006 MakTel stopped charging 2% administrative fee and implemented a fixed charge for covering the costs for preparation of the bill in fixed amount. In January 2007, the CPC established that MakTel abused its dominant position by

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charging the fixed fee and officially prohibited MakTel from charging the fixed amount or any additional amount for covering of the expenses for preparation of the bills. MakTel stopped charging the administrative fee from March 2007 showing the intention to comply with the CPC decisions. In June 2007, the CPC imposed a fine of approximately HUF 600 million for the misdemeanor MakTel had committed before discontinuing charging these fees. MakTel appealed against the above CPC resolutions, which will be decided by the Administrative Court of Macedonia. Management estimates it unlikely that the CPC would win these court cases against MakTel. The final decision will be made by the Administrative Court of Macedonia, the timing of which is uncertain.

#### **35.4 Dispute around MakTel's Reference Interconnection Offer (MATERIO)**

In December 2006 the Macedonian Commission of Agency for Electronic Communications (the Agency) brought a decision requesting MakTel to change its MATERIO fees. MakTel appealed against the decision, which was rejected by the Agency. Subsequent to the rejection, MakTel submitted its adjusted MATERIO fees (calculated in accordance with the existing regulation for interconnections fees determination) to the Agency for final approval, which the Agency refused. The Agency initiated a misdemeanor procedure at a Macedonian primary court accusing MakTel of committing misdemeanor by not adjusting its MATERIO prices as per their request. Management believes that MakTel's action can not be prescribed as misdemeanor at the time, and no misdemeanor sanction can be applied according to the general legal clauses that one cannot be convicted of misdemeanor if its action is not prescribed as misdemeanor by the law, and consequently there is no sanction prescribed for the action by law. Therefore, management estimates it unlikely that the Agency would win the court case against MakTel. The potential loss from the claim is approximately HUF 4.4 billion, as a theoretical maximum of 10% of MakTel's annual revenue. The first instance decisions will be made by the primary court of Macedonia, the timing of which is uncertain.

#### **35.5 MakTel's dispute on fixed-to-mobile termination fees**

In 2005, MakTel changed the retail prices for the traffic from fixed to mobile network. According to the interconnection agreements with mobile operators the change in retail prices automatically decreased interconnection fees for termination in the mobile networks. In February 2006, one of the Macedonian mobile operators, Cosmofon, submitted to the Commission of Agency for Electronic Communications (Agency) a request for dispute resolution with reference to the termination prices. The Agency rejected the requests of Cosmofon as "ungrounded". This decision of the Agency was appealed by Cosmofon by filing a law suit at the Administrative Court of Macedonia. The potential loss from the claim is approximately HUF 370 million, but the management estimates it unlikely that this would result in any loss. The final decision will be made by the Administrative Court of Macedonia, the timing of which is uncertain.

### **36 Events after the balance sheet date**

#### **36.1 Privatization tender for Telekom Slovenia**

Following the completion of due diligence Magyar Telekom filed a binding bid in the public tender of the Republic of Slovenia for the sale of an equity participation in Telekom Slovenije d.d. on January 4, 2007. Later in January it was announced that the Company had not been selected to proceed to the next stage in the public tender process.

#### **36.2 Termination of a significant T-Systems contract**

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Pursuant to the decree of the Metropolitan Court in October 2007, a liquidation procedure was ordered to start against T-Systems Hungary (TSH) due to its debts (HUF 19 million) towards a creditor. The date of the publication in the Companies Gazette and the starting date of the insolvency / liquidation process was January 3, 2008.

TSH merged into IQSYS, which had been registered by the Court of Registry on December 31, 2007. At the same time TSH was deleted from the Companies Registry on December 31, 2007. The debt was paid to the creditor by the legal successor company (IQSYS). Consequently, the Metropolitan Court dated January 15, 2008 withdrew its decree which stated the insolvency of and ordered the insolvency / liquidation proceeding against TSH, and terminated the insolvency / liquidation proceeding. According to this decree, as of the starting date of the insolvency / liquidation proceeding (i.e. on January 3, 2008), T-Systems Hungary Kft. did not exist, because it had been deleted from the Companies Registry by the Metropolitan Court acting as Court of Registry dated December 31, 2007.

On January 18, 2008, a large T-Systems customer sent a termination letter with immediate effect regarding the long term contract entered into in September 2001, as the customer considered that the Court ordered the liquidation in 2007 was a cause for termination with immediate effect under a provision of the said contract. The customer also found injurious that TSH did not duly fulfill its obligation to provide information on the liquidation process. On January 21, 2008 IQSYS indicated in its response that it does not accept the termination with immediate effect, taking into consideration that the company is not insolvent, and the Metropolitan Court has terminated the insolvency / liquidation proceeding and has withdrawn its decree on ordering the insolvency / liquidation proceeding.

The agreement guaranteed the right for the customer to terminate the contract with immediate effect, because the underlying cause had occurred. However, the starting date of the insolvency / liquidation proceeding is January 3, 2008, and on this date TSH did not exist. On the date of the termination letter with immediate effect (January 18, 2008) the service provider (IQSYS, the legal successor of TSH) was not insolvent. The parties are in negotiations in connection with the above. The value of the dispute is not more than HUF 2.5 billion. Should the negotiations end unsuccessfully, a lawsuit could possibly be initiated due to the termination with immediate effect. We have recognized an impairment loss of HUF 1,500 million of the finance lease receivable from the customer as at December 31, 2007.

The Company is currently investigating the deficiencies in internal controls which led to the legal situation, triggering the early termination of the contract.

### **36.3 Sale of a subsidiary**

MakTel signed an agreement in February 2008 to sell its subsidiary, Montmak for a consideration of EUR 5 million. Montmak owns and operates a beach hotel facility on Montenegro's Adriatic coast. The Group will realize a gain of approximately HUF 1 billion on the sale, which will be recognized in 2008.