

## Management Report of Magyar Telekom for the business year 2006

Magyar Telekom Plc. is a limited liability stock corporation, organized under the Act IV of 2006 on Business Associations and registered with the Court of Registration in Budapest under the entry number 01-10-041928. The purpose of the Company is identified in paragraph 1.6 of the Articles of Association as follows: the Company is authorized to provide public telephone services within the entire territory of the Republic of Hungary, along with certain closely related auxiliary services.

### Corporate Governance

Magyar Telekom as public limited company has four separate bodies that play significant role: the general meeting of shareholders, the Board of Directors, the Supervisory Board and the Audit Committee. Their roles are defined by law and by the Company's Articles of Association and may be described generally as follows:

#### *General Meeting of the Shareholders*

The supreme decision making body of the Company is the general meeting of shareholders. A general meeting is convened as frequently as set forth in the Articles of Association, but no less than once a year. The Board of Directors must call an annual general meeting to approve the audited statutory financial statements for the prior year. At the Annual General Meeting the shareholders approve the Management Report and also elect their representatives to the Supervisory Board, the Audit Committee and the Board of Directors, resolve the appropriation of distributable balance sheet profit, and if necessary approve the rules of procedure of Supervisory Board. In addition, the corporation's external auditor is appointed by a shareholders' resolution based on a proposal of the Audit Committee.

If required, extraordinary general meetings may be held at any time. Shareholders holding at least five percent of the outstanding shares may require the Board of Directors to hold an extraordinary general meeting. Under certain circumstances the Board of Directors, the Supervisory Board and the Court of Registry also have the right to call an extraordinary general meeting.

The Board of Directors must call a general meeting within eight days to take necessary measures when:

- due to losses, the equity of the company has decreased to less than two-thirds of the share capital;
- the equity of the Company has decreased to less than HUF 20 million;
- the Company has stopped servicing its debts and its assets are not sufficient to repay its debts;
- the number of members of the Board of Directors falls below six;
- the number of members of the Supervisory Board falls below six;
- the number of members of the Audit Committee falls below three;
- the auditor and the Board of Directors fail to conclude the assignment contract regarding the auditing activities within 90 days upon the date of the GM that elects the auditor or

- upon the request of holder of the Series “B” Share.

Typically, the Board of Directors calls general meetings. To call a general meeting, the Board of Directors must publish a notice of the meeting and an agenda at least 30 days before the scheduled date of the meeting in the official journal of the Budapest Stock Exchange and on the website of the BSE and of the Company. The Company must notify each director, the Supervisory Board and the auditor that a general meeting has been called within eight days following publication of such notice.

A general meeting meets a quorum if shareholders representing more than half of the voting shares are present in person or by proxy. If an agenda item requires an affirmative vote of a holder of the Series “B” Share, for a quorum, the holder of the Series “B” Share must also be present at the meeting in person or by proxy.

If the general meeting does not have a quorum, it will be reconvened on the same day. A reconvened general meeting will have a quorum for those matters on the original agenda, regardless of the number of shareholders present, except for matters requiring the holder of the Series “B” Share to be present.

The general meeting of the shareholders has the sole right to:

1. approve and amend the Articles of Association unless otherwise provided by law;
2. increase (except for the cases falling into the scope of authority of the Board of Directors) or decrease the Company’s registered capital unless otherwise provided by law;
3. amend the rights attached to a series of shares or change their class;
4. merge, consolidate, separate, terminate, dissolve, liquidate or transform the Company into another form of association;
5. decide on the approval of a public offer on own shares;
6. decide on issuing convertible or subscription right bonds unless otherwise provided by law;
7. to elect, remove and determine the remuneration of the members of the Supervisory Board, the Audit Committee and the Board of Directors;
8. elect, remove and determine the remuneration of the Auditor of the Company and to define the contents of the essential elements of the contract to be concluded with the auditor;
9. approve the financial statements, the management report and to decide on the utilization of after tax earnings;
10. approve changes in the Company’s registered scope of activities;
11. designate persons entitled to subscribe for new shares in a closed subscription;
12. alter the number or nominal value of the Series “B” Share and the rights attached to the Series

“B” Share;

13. approve listing of the Company's shares on a stock exchange;
14. approve delisting of the Company's shares from a stock exchange subject to any group of shareholders agreeing to make a public tender to purchase the shares of those shareholders who do not vote in favor of delisting;
15. decision on the acquisition of the Company's own shares;
16. approve an issue that is within its competence pursuant to law or the Company's Articles of Association;
17. transfer or encumber a valuable right held by the Company that enables it to continue a specific activity of the Company;
18. transfer all or substantial part of the Company's assets;
19. generally approve acquisition of shares which would result in a person or persons acting in concert holding ten percent or more of the outstanding voting shares of the Company;
20. approve payment of a dividend advance determined on the basis of interim accounting unless otherwise provided by law;
21. decision on the exclusion of subscription preference right; and
22. to evaluate the work of the members of the Board of Directors in the previous business year, decision on granting relief to the members.

### *The Board of Directors*

The Board of Directors is the executive body of the Company and represents the Company in dealings with third parties, courts of law and other authorities. The Board of Directors exercises its rights and performs its duties as an independent body.

The Board of Directors comprises a minimum of six and a maximum of eleven members. The members of the Board of Directors are elected for a term of three years from the date of the annual general meeting until May 31 of the third year subsequent to the date of the said general meeting, with the exception that if the general meeting in the third year is held prior to May 31 than their assignment lasts until the date of such general meeting. Members of the Board of Directors may be removed or re-elected by the general meeting at any time. The Board of Directors carries out its activity in accordance with rules of procedure established by the Board of Directors and subject to the provisions of applicable law and the Articles of Association.

The member of the Board of Directors must act with the due care that can be generally expected from persons in such a position and shall be held liable, in accordance with provisions of general rules of civil law, for damages to the Company caused by their failure to carry out their tasks in the best interest of the Company. If the damage was caused by the resolution of the management as a body, those members are exempted from such liabilities who did not participate in the voting or voted against the resolution in

question. The members of the Board of Directors shall bear unlimited, joint and several liability for all and any damage resulting from untruthfulness of any data, right or fact entered into the share register or any damage resulting from a late or non-existing entry.

The Board of Directors of Magyar Telekom however, is not a management body. In other words, it does not conduct the daily operations of the Company. It has the authority to deal with all matters not reserved for the general meeting. Amongst other things, it approves the Company's strategy and business plan, organizational restructuring actions of major impact, as well as the conclusion of major transactions, employs and dismisses the CEO and other Chief Officers, defines their remuneration, sets the targets for top management and evaluates their performance.

### *The Supervisory Board*

The Supervisory Board oversees management of the Company. It may request information from executive officers or managerial employees of the Company and may inspect books and documents of the Company. Supervisory Board members shall bear unlimited, joint and several liability for damages caused to the Company due to violation of their supervisory obligations.

The Supervisory Board comprises a minimum of three and a maximum of 15 members. It acts as an independent body, elects a chairman from among its members, and passes its resolutions by simple majority. At present Magyar Telekom's Supervisory Board consists of twelve members. Its members shall be elected by the general meeting of shareholders for a period of three years. It may assign certain supervisory tasks to any of its members or may delegate supervisory tasks among its members on a permanent basis. The members must act in person, not through a representative. No members of the Supervisory Board may receive any instruction from his or her employer or from shareholders as to fulfillment of their duty and obligations as Supervisory Board members. The Supervisory Board carries out its activities in accordance with rules of procedure established by the Supervisory Board, which are approved by the general meeting of shareholders.

According to the legal regulations the Supervisory Board of Magyar Telekom is subject to the principle of employee participation in the supervisory of the Company's operation. Under the Companies Act, the Supervisory Board may include representatives of the shareholders and representatives of the employees as well as independent members. The employees have the right under the Companies Act to elect one-third of the Supervisory Board members.

Although it is not permitted to make management decisions, the Supervisory Board has comprehensive monitoring functions, including advising the general meeting on a regular basis in decisions of fundamental importance to the company by virtue of preliminary analysis of core business reports and other submissions on the agenda of the general meeting within the exclusive scope of authority of the general meeting. To ensure that these monitoring functions are carried out properly, the Board of Directors must, among other things, regularly report to the Supervisory Board on the management, the financial status and business policy of the Company. The Supervisory Board may also request special reports from the Board of Directors or any senior employee at any time. The Supervisory Board has a significant role in ensuring the operation and the reporting of the internal audit branch of the Company. The Audit Committee helps the work of the Supervisory Board.

### *The Audit Committee*

The Audit Committee is a permanent committee beside the Supervisory Board.

The GM elects a 3-5 member Audit Committee from the independent members of the SB for the same duration as the membership of the relevant members in the SB according to the Articles of Association. The Audit Committee acts within its scope of authorities provided in the Act on Business Associations and the Articles of Associations as well as the rules of the Budapest Stock Exchange and the New York Stock Exchange and the regulations of the SEC. The Audit Committee among other things oversees the work of the Company's independent auditor, evaluates the operation of the financial reporting system and reviews the efficiency of the internal audit function.

## **Voting Rights and Voting**

Each ordinary share entitles the holder to one vote. Only shareholders or their proxies registered in the shareholders' register six business days prior to a general meeting may cast a vote. The Series "B" Share has special voting rights as described below. The matters listed in clauses 1. to 6. and 11. to 15. above, any decision overriding a resolution of the Board of Directors and preemptive shareholder rights in the event of a capital increase, all require a three-quarter majority of votes cast by the shareholders present or represented at the general meeting. All other matters submitted to a general meeting require only a simple majority vote.

There is no limitation on the rights of non-resident or foreign shareholders to hold or exercise voting rights on the ordinary shares.

### *Series "B" Share*

The Hungarian government owns the Series "B" Share. Only the Minister or his legal successor may exercise rights attached to the Series "B" Share. Except as described below, the Series "B" Share has the same rights as the ordinary shares. The holder of the Series "B" Share is entitled:

1. to nominate one member of the Board of Directors and one member of the Supervisory Board and effectively to elect, remove or replace these members;
2. if the Company's registered capital is increased, a new class of shares is issued or the rights attached to a particular class of shares change, to require the Articles of Association to be amended so that the voting rights of the Series "B" Share will be sufficient to nominate, elect or remove the Series "B" director or Supervisory Board member;
3. to inspect the shareholders' register and the books maintained by a depository of the Company's shares approved by the Company and to request copies of the register or books;
4. if the Company dissolves without a successor company, to purchase all or part of the Company's assets, including shares of subsidiaries or affiliates, for a price equal to the appraised fair market value of such assets;
5. to request from the Board of Directors detailed information about a material fact significantly affecting the Company's financial position; and

6. to request that the Company audit or investigate any issue or prepare reports or provide information on issues within the scope of activities of the Company's auditor or the Supervisory Board pursuant to law or the Articles of Association.

The holder of the Series "B" Share must be present, in person or by proxy, for a quorum, and its approval is required to pass shareholders' resolutions related to any:

1. increase and decrease of the Company's registered capital;
2. change of rights attached to any class of shares, including any amendment to the rights of the Series "B" Share or the creation of a new class of shares with rights superior or equal to the rights or adversely affecting the rights of the Series "B" Share, or any amendment to the rights attached to any existing class of shares that would grant them rights superior or equal to the rights attached to the Series "B" Share;
3. merger into or consolidation with another business entity, de-merger, transformation into another form of business association and termination of the Company without a legal successor;
4. transfer, creation or encumbrance of a valuable right that enables the Company to operate according to the Universal Telecommunications Service Contract;
5. election or removal of the Series "B" director or Supervisory Board member;
6. conversion of a type of shares;
7. transfer of all or a substantial part of the assets of the Company that would render the Company incapable of performing its obligations under the Universal Telecommunications Service Contract;
8. amendment to the Articles of Association which would impair the rights of the holder of the Series "B" Share, including authorizing the Board of Directors to increase the Company's registered capital;
9. issuance of convertible bonds or bonds conferring preemptive rights; and
10. decisions on significant transfers of voting shares.

### **Controlling stakeholder**

MagyarCom GmbH owns the majority of the registered shares and consequently the voting rights in the Company and the two rights are equal because one registered share represents one vote. The majority owner does not have additional controlling rights, not in comparison to even one shareholder. The Company, as a member of DT Group, concluded cooperation agreements and contracts regarding use of name with German companies, being also the members of DT Group. The preliminary approval of contracts falls into the scope of authority of the Board of Directors of Magyar Telekom.

## **Risk management**

The procedure of risk management includes the identification, measurement and valuation of risks, including the development of necessary action plans, as well as the monitoring of performance and results. An efficient risk management is the result of a conscious risk handling in favor of business success. At Magyar Telekom, risk management is not equal to risk elimination or minimization, but facing risks is rather an essential item of business activity in line with achieving the Company's objectives.

Following the release of the Sarbanes-Oxley Act, Magyar Telekom decided to enhance its previous risk management procedures. As this new regulation requires fast disclosure of all risk items influencing the investors' decisions, Magyar Telekom complemented its quarterly risk reporting system with an ad-hoc reporting procedure. In accordance with that all departments and subsidiaries of Magyar Telekom need to enter any fact, material information or risk that come to their attention on a real time basis in the risk monitoring software. Risk information created in the software is monitored daily by the risk management organization, and the CFO should be notified about a material risk or information emerged.

The risk management system of Magyar Telekom Group is an unique one in Hungary due to its cover for the whole company and its extension to the substantial corporate risks beside financial risks.

## **Final clause**

The attached Declaration in connection with the Corporate Governance Recommendations (dated December 8, 2003) published by the Budapest Stock Exchange Company Limited by Shares regarding corporate governance practices is inseparable part of this Management Report.

# Declaration in connection with the Corporate Governance Recommendations (dated December 8, 2003) published by the Budapest Stock Exchange Company Limited by Shares regarding corporate governance practices

Magyar Telekom Telecommunications Public Limited Company (the "Company") declares as set forth below and provides the following information:

## 1. to Section 1.1.2 of the Recommendations

The mission of the Board of Directors covers matters set forth in this Section.

Yes (Complies) No (Please explain)

The Board of Directors established its Charter.

Yes (Complies) No (Please explain)

## 2. to Section 1.2.2 of the Recommendations

The Supervisory Board established its Charter and work schedule.

Yes (Complies) No (Please explain)

## 3. to Section 1.3.2 of the Recommendations

Minutes have been prepared on meetings of the Board of Directors and the Supervisory Board, respectively, and resolutions had been properly administered.

Yes (Complies) No (Please explain)

## 4. to Section 1.6.1. and Section 2.1.6 of the Recommendations

The Board of Directors has prepared the guidelines regarding the evaluation and remuneration of the management.

Yes (Complies) No (Please explain)

The Board of Directors has published the guidelines regarding the evaluation and remuneration of the management.



Yes (Complies)  
(when, where :<sup>\*</sup>

No (Please explain)

Corporate website  
of Magyar Telekom

<http://www.magyartelekom.hu/english/investorrelations/corporategovernance/compensation.vm>

## **5. to Section 1.7. of the Recommendations**

An independent internal audit department (independent internal control) functions at the Company.

Yes (Complies)

No (Please explain:

Internal Audit Branch is the independent internal auditing organization of the Magyar Telekom Group. From the organizational viewpoint it reports directly to the Chief Executive Officer. The Director of Internal Audit reports directly to the Chief Executive Officer, the Audit Committee and the Supervisory Board. Director of Internal Audit reports regularly to the Chief Executive Officer, the Audit Committee and the Supervisory Board on the audit work performed. The Audit Committee reviews the effectiveness of the Internal Audit function, the report on Internal Audit activities prior to its submission to the Supervisory Board.)

The independent audit department has an auditing plan approved by the Board of Directors or the Supervisory Board.

Yes (Complies)

No (Please explain)

## **6. to Section 1.10. of the Recommendations**

The shareholders' meeting and the Supervisory Board have been informed about the fact that the outside audit firm of the Company received a material assignment in addition to the audit.

Yes (Complies)

No (Please explain:

In view of the fact that Magyar Telekom is also listed on the New York Stock Exchange, in compliance with the extremely strict provisions of the Sarbanes-Oxley Act, the Audit Committee is responsible for the oversight of the work of the independent external auditor of the Company. All audit-relevant and non-audit-relevant services to be performed by the independent external auditor for the Company and their fees are subject to the Audit Committee's pre-approval in order to ensure that the independent external auditor does not impair his independence from the Company. For this activity the "Rules of Procedure and pre-approval policy of Magyar Telekom Plc.'s Audit Committee of the Supervisory Board" approved by the Supervisory Board on December 13, 2005 were applicable, since December 11, 2006 the "Pre-approval policy of Magyar Telekom Plc.'s Audit Committee" approved by the Supervisory Board is applicable. All Supervisory Board members receive the minutes of the Audit Committee meetings and of fax votes, and the Audit Committee also reports on its activities at the Supervisory Board meetings.)

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<sup>\*</sup> The relevant documents and information can be found on the company's website since June 12, 2005 and are updated if required.

### **7. to Section 2.1.1. of the Recommendations**

The guidelines for disclosures have been prepared by the Company.

Yes (Complies)

No (Please explain)

### **8. to Section 2.1.4. of the Recommendations**

The Board of Directors published its actual business strategy.

Yes (Complies)

No (Please explain)

(when, where\*:

Corporate website  
of Magyar Telekom

<http://www.magyartelekom.hu/english/investorrelations/corporategovernance/strategy.vm> )

### **9. to Section 2.1.6. of the Recommendations**

The Company published in accordance with Section 2.1.6 of the Recommendations the information relating to the career of the members of the Board of Directors, the Supervisory Board and executive management.

Yes (Complies)

No (Please explain)

(when, where\*:

Corporate website  
of Magyar Telekom

<http://www.magyartelekom.hu/english/investorrelations/corporategovernance/boardofdirectors/members.vm>

Corporate website  
of Magyar Telekom

<http://www.magyartelekom.hu/english/investorrelations/corporategovernance/supervisoryboard/members.vm>

Corporate website  
of Magyar Telekom

<http://www.magyartelekom.hu/english/investorrelations/corporategovernance/managementcommittee/members.vm>)

### **10. to Section 2.1.7. of the Recommendations**

The Company published in accordance with Section 2.1.7 of the Recommendations its risk management guidelines.

Yes (Complies)

No (Please explain)

(when, where\*:

Corporate website  
of Magyar Telekom

[http://www.magyartelekom.hu/english/doc/kockazatkezeles\\_en.pdf](http://www.magyartelekom.hu/english/doc/kockazatkezeles_en.pdf))

## 11. to Section 2.1.9 of the Recommendations

The Company published its guidelines on insider dealings.

Yes (Complies)  
(when, where\*:

No (Please explain)

Corporate website of Magyar Telekom [http://www.magyartelekom.hu/english/doc/bennfentes\\_en.pdf](http://www.magyartelekom.hu/english/doc/bennfentes_en.pdf)

## 12. to Section 2.1.10. of the Recommendations

The Board of Directors published in accordance with Section 2.1.10 of the Recommendations information regarding the relationships of the directors and members of the management with third parties.

Yes (Complies)  
(when, where\*:

No (Please explain)

Corporate website of Magyar Telekom <http://www.magyartelekom.hu/english/investorrelations/corporategovernance/boardofdirectors/members.vm>

Corporate website of Magyar Telekom <http://www.magyartelekom.hu/english/investorrelations/corporategovernance/supervisoryboard/members.vm>

Corporate website of Magyar Telekom <http://www.magyartelekom.hu/english/investorrelations/corporategovernance/managementcommittee/members.vm>

## Information and other notes

### 1. to Section 1.3.1. of the Recommendations

The Board of Directors held with 87 % average participation ratio 16 meetings in the business year of 2006. The Supervisory Board held with 93 % average participation ratio 11 meetings in the business year of 2006.

### 2. to Section 1.5.2. of the Recommendations

The ratio of the independent directors qualifying as independent according to the recommendation of the Budapest Stock Exchange compared to the total number of directors:

- until May 23, 2006: 77 % independent;
- from May 23, 2006: 75 % independent with regard to resignation from office of 1 member of the Board of Directors (Board);
- from September 15, 2006: 87 % independent since the Chief Financial Officer of the Company left the Company but remained Board member;
- from October 9, 2006: 85 % independent with regard to resignation from office of 1 Board member.

On November 6, 2006 the General Meeting elected 3 new Board members, so from that date the ratio of directors qualifying as independent according to the recommendation of the Budapest Stock Exchange compared to the total number of directors changed to 80 %.

On December 5, 2006 the Chairman of the Board resigned from his office, so from that date the ratio of directors qualifying as independent according to recommendation of the Budapest Stock Exchange compared to the total number of directors changed to 88 %.

On December 21, 2006 the General Meeting elected 1 new Board member, so from that date the ratio of directors qualifying as independent according to the recommendation of the Budapest Stock Exchange compared to the total number of directors changed to 80%.

### **3. to Section 1.5.5. of the Recommendations**

The ratio of the independent Supervisory Board members qualifying as independent according to the recommendation of the Budapest Stock Exchange compared to the total number of Supervisory Board members was 66 % independent until November 6, 2006.

On November 6, 2006 – with regard to Act IV of 2006 on Business Associations providing that the majority of the Supervisory Board members shall be independent, the Audit Committee members shall be elected by the General Meeting from the independent Supervisory Board members, and laying down also the criteria for independence – 4 Supervisory Board members resigned from office and the General Meeting elected 4 new members to the Supervisory Board. Since the mandate of 1 newly elected Supervisory Board member starts on March 1, 2007, from November 6, 2006 the ratio of the independent Supervisory Board members qualifying as independent according to the recommendation of the Budapest Stock Exchange compared to the total number of Supervisory Board members changed to 63%, while the ratio of Supervisory Board members qualifying as independent according to Act IV of 2006 on Business Associations compared to the total number of Supervisory Board members: 54 % independent.

(When the ratio of the independent Supervisory Board members is determined the employee representatives participating in the Supervisory Board are not qualified as independent by the Company in line with the recommendation of the Budapest Stock Exchange.)

### **4. to Section 1.8. of the Recommendations**

At the Company the below board committees held the below number of meetings per committee in the business year of 2006:

- Remuneration Committee: 4 meetings
- Audit Committee: 12 meetings

### **5. to Section 3.1.4. of the Recommendations**

In preparing and holding the shareholders' meeting at the Company the relevant recommendations on preparation and holding of shareholders' meeting had been taken into account in the business year of 2006.

Yes

No

## 6. The Company established a Corporate Governance Code.

Yes

No

(available at

Corporate website  
of Magyar Telekom

[http://www.magyartelekom.hu/english/doc/alapszabaly\\_en.pdf](http://www.magyartelekom.hu/english/doc/alapszabaly_en.pdf)

[http://www.magyartelekom.hu/english/doc/igazgatosag\\_ugyrendje\\_en.pdf](http://www.magyartelekom.hu/english/doc/igazgatosag_ugyrendje_en.pdf)

[http://www.magyartelekom.hu/english/doc/FEB\\_ugyrendje\\_en.pdf](http://www.magyartelekom.hu/english/doc/FEB_ugyrendje_en.pdf)

[http://www.magyartelekom.hu/english/doc/Audit\\_Bizottsag\\_Ugyrendje\\_en.pdf](http://www.magyartelekom.hu/english/doc/Audit_Bizottsag_Ugyrendje_en.pdf)

[http://www.magyartelekom.hu/english/doc/Audit\\_Biz\\_Jovahagyasi\\_en.pdf](http://www.magyartelekom.hu/english/doc/Audit_Biz_Jovahagyasi_en.pdf) )

## 7. The Company established a Code of Ethics.

Yes

No

(available at

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of Magyar Telekom

[http://www.magyartelekom.hu/english/doc/etikaikodex\\_en.pdf](http://www.magyartelekom.hu/english/doc/etikaikodex_en.pdf) )

## 8. The function of the Chief Executive Officer and the Chairman of the Board of Directors is fulfilled by the same person.

Yes

No

### Enclosure

Present declaration was accepted by the General Meeting of Magyar Telekom Plc. with its General Meeting Resolution No. 6/2007 (IV.26.).