

ANNUAL REPORT

OF MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2017



STANDALONE FINANCIAL STATEMENTS AND MANAGEMENT REPORT

OF MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2017



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STANDALONE FINANCIAL STATEMENTS

OF MAGYAR TELEKOM TELECOMMUNICATIONS PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2017

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



INDEPENDENT AUDITOR'S REPORT

To the shareholders of Magyar Telekom Telecommunication Public Limited Company Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Magyar Telekom Telecommunication Public Limited Company. (the "Company") which comprise the statements of financial position as of 31 December 2017 (in which the total of statement of financial position is MHUF 1 038 673), the statements of profit or loss and other comprehensive income (in which the total comprehensive income for the year is a profit of MHUF 41 857), the statements of changes in equity, the statements of cash flows for the year then ended and the notes to the financial statements including a summary of the significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and they have been prepared, in all material respects, in accordance with the supplementary requirements of Act C of 2000 on Accounting ("Accounting Act") relevant for the annual financial statements prepared in accordance with IFRS as adopted by the EU.

Our opinion is consistent with our additional report to the audit committee.

Basis for opinion

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

We are independent of the Company in accordance with the applicable laws of Hungary, with the Hungarian Chamber of Auditors' Rules on ethics and professional conduct of auditors and on disciplinary process and, for matters not regulated in the Rules, with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board (IESBA Code of Ethics) and we also comply with further ethical requirements set out in these.

The non-audit services that we have provided to the Company, in the period from 1 January 2017 to 31 December 2017, are disclosed in note 21 to the financial statements.



To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Company are in accordance with the applicable laws and regulations in Hungary and that we have not provided non-audit services that are prohibited under Article 5 of Regulation of the European Parliament and Committee No 537/2014 and Subsection (1) and (2) of Section 67/A of Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors.

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

Our audit approach

Overview

<i>Overall materiality</i>	Overall materiality applied was MHUF 3 900, which is 2,5% of EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization)
<i>Key Audit Matter</i>	Accuracy of revenue recognition due to complex billing systems

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

<i>Materiality</i>	MHUF 3 900 (2016: MHUF 3 400)
<i>Determination</i>	2,5% of the EBITDA (Earnings before Interest, Taxes, Depreciation and Amortisation)
<i>Rationale for the materiality benchmark applied</i>	We chose EBITDA as the benchmark because, in our view, it is the benchmark against which the performance of the Company is most commonly measured by users, and is a generally accepted benchmark in the telecommunication industry. We chose 2,5%, which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector. This is consistent with the basis for our materiality calculation in the previous year.

Key audit matters

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

<i>Key audit matter</i>	<i>How our audit addressed the key audit matter</i>
<p>Accuracy of revenue recognition due to complex billing systems</p> <p>The accuracy of revenues recorded is an inherent industry risk. This is because telecommunication billing systems are complex and process large volumes of data with a combination of different products sold and price changes during the year, through a number of different systems.</p> <p>Total revenue of the Company was MHUF 471 532. Detailed disclosures and related accounting policies are in notes 2.1.2. and 18 of the financial statements.</p>	<p>We evaluated the relevant IT systems and the design of controls, and tested the operating effectiveness of controls over the:</p> <ul style="list-style-type: none"> • Capturing and recording of revenue transactions; • Authorization of price changes and the input of those to the billing systems; and • Calculation of amounts billed to the customers. <p>We also tested a sample of items from the customer billing systems to the invoices raised and checked these to the cash received from the customers. Our testing included customer bills for both consumers and corporate customers.</p> <p>We have not identified any material misstatements as a result of our procedures.</p>



Other information: the business report

Other information comprises the business report of the Company. Management is responsible for the preparation of the consolidated business report in accordance with the provisions of the Accounting Act and other relevant regulations. Our opinion on the financial statements expressed in the “Opinion” section of our independent auditor’s report does not cover the business report.

In connection with our audit of the financial statements, our responsibility is to read the business report and, in doing so, consider whether the business report is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If based on our work performed we conclude that the business report is materially misstated we are required to report this fact and the nature of the misstatement.

Based on the Accounting Act, it is also our responsibility when reading the business report to consider whether the business report has been prepared in accordance with the provisions of the Accounting Act and other relevant regulations, if any, and to express an opinion on this and on whether the business report is consistent with the financial statements.

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

As the Company is a public interest entity and the conditions in Paragraph a) and b) of Subsection (1) of Section 95/C of the Accounting Act are met at the balance sheet date, the Company shall publish a non-financial statement required by 95/C in its business report. In this respect, we shall state whether the business report includes the non-financial statement required by Section 95/C of the Accounting Act.

In our opinion, the business report of the Company, also including the information prepared under Paragraphs e) and f) of Subsection (2) of Section 95/B of the Accounting Act, is consistent with the financial statements in all material respects, and the business report has been prepared in accordance with the provisions of the Accounting Act. As there is no other regulation prescribing further requirements for the business report, we do not express an opinion in this respect.

We are not aware of any other material inconsistency or material misstatement in the business report, therefore we have nothing to report in this respect.

We state that the information referred to in Paragraphs a)-d), g) and h) of Subsection (2) of Section 95/B of the Accounting Act has been provided. The business report includes the non-financial statement required by Subsection (1) of Section 95/C of the Accounting Act.



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

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and to prepare the financial statements in accordance with the supplementary requirements of the Accounting Act relevant for the annual financial statements prepared in accordance with IFRS as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.



- Conclude on the appropriateness of management's use of the going concern basis of accounting in the financial statements and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that gives a true and fair view.

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

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

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




Report on other legal and regulatory requirements

We were first appointed as auditors of the Company on 31 December 1991. Our appointment has been renewed annually by shareholder resolutions representing a total period of uninterrupted engagement appointment of 26 years.

The engagement partner on the audit resulting in this independent auditor's report is Árpád Balázs

Budapest, 28 February 2018

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



Árpád Balázs
Statutory auditor
Licence number: 006931

Note:

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



STATEMENTS OF FINANCIAL POSITION

	Note	01.01.2016	12.31.2016	12.31.2017
ASSETS				
Current assets				
Cash and cash equivalents	4, 5	846	1,260	948
Trade and other receivables	4, 5, 12	104,942	101,521	110,694
Other current financial assets	4, 5, 17	13,336	18,941	11,173
Current income tax receivable	6	925	1,867	189
Inventories.....	7	8,689	10,683	13,743
		<u>128,738</u>	<u>134,272</u>	<u>136,747</u>
Assets held for sale.....	8	5,760	1,540	161
Total current assets		134,498	135,812	136,908
Non current assets				
Property, plant and equipment	9	377,736	374,751	371,732
Intangible assets	10	401,732	392,069	378,630
Investments	11	173,305	168,900	131,500
Deferred tax assets	6	-	-	-
Non current financial assets	4, 5, 17	16,357	12,530	19,775
Other non current assets	12	218	161	128
		<u>969,348</u>	<u>948,411</u>	<u>901,765</u>
Total non current assets		969,348	948,411	901,765
Total assets		1,103,846	1,084,223	1,038,673
LIABILITIES				
Current liabilities				
Financial liabilities to related parties	4	141,875	77,768	39,336
Other financial liabilities	4, 17	23,794	18,870	5,621
Trade payables	4	100,299	103,180	111,033
Current income tax payable.....	6	-	-	16
Provisions	13	4,924	3,170	2,312
Other current liabilities	14	23,617	27,738	28,783
		<u>294,509</u>	<u>230,726</u>	<u>187,101</u>
Liabilities associated with assets held for sale	8	-	-	-
Total current liabilities		294,509	230,726	187,101
Non current liabilities				
Financial liabilities to related parties	4	220,088	247,178	231,647
Other financial liabilities	4, 17	52,526	48,416	44,783
Deferred tax liabilities	6	25,039	7,985	12,358
Provisions	13	9,301	8,915	8,674
Other non current liabilities	15	905	957	286
		<u>307,859</u>	<u>313,451</u>	<u>297,748</u>
Total non current liabilities		307,859	313,451	297,748
Total liabilities		602,368	544,177	484,849
EQUITY				
Common stock	16	104,274	104,274	104,274
Capital reserves	16	27,412	27,119	25,078
Treasury stock	16	(306)	(55)	(27)
Retained earnings	16	370,098	408,708	424,499
		<u>501,478</u>	<u>540,046</u>	<u>553,824</u>
Total equity		501,478	540,046	553,824
Total liabilities and equity		1,103,846	1,084,223	1,038,673

Budapest, February 20, 2018


 Christopher Mattheisen
 Chief Executive Officer, Board Member


 János Szabó
 Chief Financial Officer

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



STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

		HUF millions (except per share amounts)	
	Note	2016	2017
Revenue	18	447,173	471,532
Direct costs	19	(155,123)	(174,583)
Employee related expenses	20	(54,519)	(56,613)
Depreciation and amortization	9, 10	(89,944)	(87,847)
Other operating expenses	21	(92,994)	(93,302)
Operating expenses		(392,580)	(412,345)
Other operating income	22	7,675	5,957
Operating profit		62,268	65,144
Interest income	23	414	421
Interest expense	24	(18,395)	(13,342)
Other financial expense - net	25	(8,380)	(7,939)
Net financial result		(26,361)	(20,860)
Results from investments.....	26	9,881	10,717
Profit before income tax		45,788	55,001
Income tax.....	6	8,457	(13,144)
Profit for the year		54,245	41,857
Other comprehensive income for the year, net of tax.....		-	-
Total comprehensive income for the year		54,245	41,857
Earnings per share (EPS) information:			
Profit attributable to the owners of the Company		54,279	46,727
Weighted average number of common stock outstanding (thousands) used for basic EPS		1,041,799	1,040,073
Average number of dilutive share options..... (thousands.....)		767	4,585
Weighted average number of common stock outstanding (thousands) used for diluted EPS		1,042,566	1,044,658
Basic earnings per share (HUF)	27	52.10	44.93
Diluted earnings per share (HUF)	27	52.06	44.93

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



STATEMENTS OF CASH FLOWS

	Note	2016	HUF millions 2017
Cash flows from operating activities			
Profit for the year		54,245	41,857
Depreciation and amortization		89,944	87,847
Income tax expense		(8,457)	13,144
Net finance costs.....		16,479	10,239
Results from associated and joint venture companies.....		-	(97)
Change in current assets		5,081	(20,239)
Change in provisions		(2,286)	(1,405)
Change in liabilities carried as working capital		6,751	20,632
Income tax paid		(9,539)	(7,821)
Dividend received		9,433	7,753
Interest and other financial charges paid		(23,844)	(19,492)
Interest received		598	549
Other non-cash items		(3,675)	(1,675)
Net cash generated from operating activities		134,730	131,292
Cash flows from investing activities			
Purchase of property plant and equipment (PPE) and intangible assets ...	28	(82,020)	(75,097)
Purchase of subsidiaries	29	(2,939)	(1,789)
Sale of other financial assets.....		2,889	5,639
Purchase of other financial assets.....		(2,840)	(3,984)
Proceeds from disposal of subsidiaries and other investments.....	26	3,637	35,924
Proceeds from disposal of PPE and intangible assets		9,481	2,288
Net cash used in investing activities		(71,792)	(37,019)
Cash flows from financing activities			
Dividends paid		(15,634)	(26,081)
Proceeds from loans and other borrowings	5	142,980	106,841
Repayment of loans and other borrowings	5	(182,316)	(169,310)
Repayment of other financial liabilities	5	(7,003)	(5,285)
Treasury share purchase.....		(551)	(750)
Net cash used in financing activities		(62,524)	(94,585)
Exchange differences on cash and cash equivalents		-	-
Change in cash and cash equivalents		414	(312)
Cash and cash equivalents, beginning of year		846	1,260
Cash and cash equivalents, end of year	5	<u>1,260</u>	<u>948</u>

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



STATEMENTS OF CHANGES IN EQUITY

	pieces	HUF millions					
	Shares of common stock (a)	Common stock (a)	Capital reserves	Treasury stock (d)	Retained earnings (e)	Total Equity	
			Additional paid in capital (b)	Reserve for equity settled share based transactions (c)			
Balance at January 1, 2016	1,042,742,543	104,274	27,379	33	(306)	370,098	501,478
Dividend (f).....	-	-	-	-	-	(15,635)	(15,635)
Equity settled share based transactions (c)	-	-	-	(293)	32	-	(261)
Treasury share purchase (g)	-	-	-	-	219	-	219
Transactions with owners in their capacity as owners	-	-	-	(293)	251	(15,635)	(15,677)
Profit or loss	-	-	-	-	-	54,245	54,245
Total comprehensive income	-	-	-	-	-	54,245	54,245
Balance at December 31, 2016	1,042,742,543	104,274	27,379	(260)	(55)	408,708	540,046
Dividend (f).....	-	-	-	-	-	(26,067)	(26,067)
Equity settled share based transactions (c)	-	-	-	(2,041)	777	-	(1,264)
Treasury share purchase (g)	-	-	-	-	(749)	-	(749)
Transactions with owners in their capacity as owners	-	-	-	(2,041)	28	(26,067)	(28,080)
Profit or loss	-	-	-	-	-	41,857	41,857
Total comprehensive income	-	-	-	-	-	41,857	41,857
Balance at December 31, 2017	1,042,742,543	104,274	27,379	(2,301)	(27)	424,499	553,824
Of which treasury stock						(40,625)	
Shares of common stock outstanding at December 31, 2017	1,042,701,918						

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

NOTES TO THE STANDALONE STATEMENTS OF CHANGES IN EQUITY

- (a) The total amount of issued shares of common stock is 1,042,742,543 (each with a nominal value of HUF 100) as of December 31, 2017. The number of authorized ordinary shares on December 31, 2017 is 1,042,742,543.

Voting Rights and Voting

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

Transfer of Shares

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

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

- (b) Additional paid in capital represents the amount above the nominal value of the shares that was received by the Company during capital increases.
- (c) Reserve for equity settled share based transactions includes the share-based payment expenses accrued in this reserve related to share settled compensation programs. The December 31, 2017 and 2016 balances of this reserve represent the amount reserved for the Share Matching Plans (Note 20.1.2.).
- (d) Treasury stock represents the cost of the Company's own shares repurchased. When the Company purchases its equity shares, the consideration transferred including any attributable incremental external costs are deducted from the Equity of the owners of the parent as Treasury stock until they are re-sold or cancelled. When such shares are subsequently sold, the treasury share balance decreases by the original cost of the shares, thereby increasing equity, while any gains or losses are also recognized in equity (Retained earnings). Treasury stock transactions are recorded on the transaction date.
- (e) Retained earnings include the accumulated and undistributed profit of the Company. The distributable reserves of the Company at December 31, 2017 amounted to approximately HUF 424 billion (HUF 262 billion at December 31, 2016 which amount was established prior to transition to IFRS). Untied retained earnings is available for the payment of dividends which contains retained earnings from the last financial year (Note 16.1).
- (f) Dividends payable to the Company's shareholders are recognised as a liability and debited against Retained earnings in the period in which the dividends are approved by the shareholders.
- (g) In July 2017 Magyar Telekom Plc. purchased 4,534,758 ordinary shares for the purpose of the Employee Share Ownership Program (ESOP). In 2016 the Company purchased 1,252,616 ordinary shares, of which the ESOP sold 25,764 shares due to the revision of the number of the participants in the program. These share transactions were carried out on the Budapest Stock Exchange through UniCredit Bank Hungary Zrt., as investment service provider (see more details in Note 20.1.2.5.).

Together with the approval of these financial statements for issue, the Board of Directors of the Company proposes a dividend distribution in total HUF 26,069 million to be approved by the Annual General Meeting of the Company in April 2018. In 2017 Magyar Telekom Plc. paid HUF 26,067 million dividend.

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



NOTES TO THE STANDALONE FINANCIAL STATEMENTS

1 GENERAL INFORMATION

Magyar Telekom Telecommunications Public Limited Company (the Company or Magyar Telekom) is the principal provider of telecommunications services in Hungary. These services are subject to various telecommunications regulations.

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

Magyar Telekom is listed on the Budapest Stock Exchange and its shares are traded on the Budapest Stock Exchange. Magyar Telekom's American Depositary Shares (ADSs) each representing five ordinary shares were also traded on the New York Stock Exchange until November 12, 2010, when the ADSs were delisted. Magyar Telekom terminated the registration of its shares and ADSs in the US in February 2012. The Company maintains its American Depositary Receipt program on a Level I basis.

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

The consolidated financial statements of DT AG are available at DT AG's website (www.telekom.com/en).

The Company's Board of Directors (the Board) accepted the submission of these standalone financial statements of the Company on February 20, 2018 to the Annual General Meeting (AGM) of the owners, which is authorized to approve these financial statements, but also has the right to require amendments before approval. As the controlling shareholders are represented in the Board of the Company that accepted the submission of these financial statements, the probability of any potential change required by the AGM is extremely remote, and has never happened in the past.

Persons authorized to sign the annual report:

Christopher Mattheisen - Chief Executive Officer, member of the Board (residence: Budapest)

János Szabó - Chief Financial Officer (residence: Budapest)

In Magyar Telekom Plc., the accounting services are coordinated by Katalin Tari-Szőke (certificate number: 009754. Area of speciality: IFRS entrepreneurial activity. Status: registered. Residence: Budapest).

The Company is subject to compulsory audit. The Company's auditor is PricewaterhouseCoopers Könyvvizsgáló Kft. (its register number is 01-09-063022, its taxation number is 10256161-2-44), the responsible person for carrying out the audit is Árpád Balázs (membership number at Chamber of Hungarian Auditors: 006931).

The standalone financial statement of Magyar Telekom Plc. and the consolidated financial statement of Magyar Telekom Group are available at the Company's registered office and on its corporate website.

Magyar Telekom's corporate website is: www.telekom.hu

2 BASIS OF PREPARATION

The standalone financial statements of Magyar Telekom have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU). All standards and interpretations endorsed by the EU effective as at December 31, 2017 and applicable to Magyar Telekom had been adopted. These standalone financial statements also comply with the Hungarian Accounting Act on standalone financial statements, which refers to the IFRS as endorsed by the EU.

The Company as parent company also prepared consolidated financial statements in accordance with IFRS as endorsed by the EU which were approved by the Company's Board of Directors on February 20, 2018.

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 Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the standalone financial statement, are disclosed in Note 3.

2.1. Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates, that is the Hungarian forint (HUF), which is the functional currency of the Company.

The standalone financial statements are prepared and presented in millions of HUF, unless stated otherwise, as the Company's presentation currency is the Hungarian Forint.

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

2.2 First-time adoption of IFRS as endorsed by the EU

The Company had been preparing and disclose its standalone financial statements according to Act C of 2000 on Accounting, ("Hungarian Accounting Regulations" or "HAR") since its establishment. For the year ending December 31, 2016 the Company disclosed its standalone financial statements according to HAR. For the year ending December 31, 2017 the Company is a first time adopter of IFRS as endorsed by the EU (EU IFRS) for its standalone financial statements as required by the Act C of 2000 on Accounting.

In preparing these financial statements, the Company's opening statement of financial position was prepared as at January 1, 2016, being the date of transition to EU IFRS. This note explains the principal effects of the transition to EU IFRS from HAR to the separate statement of financial position.

Since the Company prepared and issued consolidated financial statements prior to adopting EU IFRS for its separate financial statements, the exemption under the D17 of IFRS 1 had to be applied that opening values of assets and liabilities (as of January 1, 2016) shall be measured at the same amount as in its consolidated statement of financial position (as of January 1, 2016), except for consolidation adjustments. The Company applied the exemption related to investments, see further information in (a) Investments in subsidiaries, joint ventures and associates under the Notes to the reconciliation of the financial statements and to the comprehensive income.

The estimates at January 1, 2016 and at December 31, 2016 are consistent with those made for the same dates for the purposes of the Company's financial statements prepared earlier according to Act C of 2000 on Accounting.

Reconciliations between the Hungarian Accounting Regulations (Act C of 2000 on Accounting - HAR) and EU IFRS
Reconciliation of equity

		01.01.2016	12.31.2016
Equity according to HAR	Notes	412,657	425,558
Investments in subsidiaries, joint ventures and associates (including goodwill)	a)	112,225	123,181
Derivative financial asset, liability	b)	6,552	5,222
Asset retirement obligations	c)	3,189	2,967
Lease classification	d)	521	(497)
Borrowing cost capitalisation	e)	555	1,002
Business combinations	f)	98	(480)
Repurchased treasury shares, business shares	g)	(306)	(55)
Taking into account the time value of liabilities related to frequency rights	h)	(1,927)	(2,834)
Government grants	i)	(7,564)	(8,952)
Deferred tax	j)	(25,039)	(7,985)
Other		517	2,919
Equity according to IFRS		501,478	540,046

Reconciliation of comprehensive income

		2016
Profit for the year according to HAR	Notes	28,536
Deferred tax	j)	17,129
Investments in subsidiaries, joint ventures and associates (including goodwill)	a)	10,956
Government grants	i)	1,388
Lease classification	d)	1,018
Borrowing cost capitalisation	e)	447
Asset retirement obligations	c)	(222)
Taking into account the time value of liabilities related to frequency rights	h)	(907)
Derivative financial asset, liability	b)	(1,330)
Other		(2,770)
Profit for the year according to IFRS		54,245
Comprehensive income according to IFRS		54,245

Notes to the reconciliation of the financial statements above as at January 1, 2016 and December 31, 2016 and to the comprehensive income related to 2016, respectively:

a) Investments in subsidiaries, joint ventures and associates (including goodwill)

In the opening statement of financial position prepared in accordance with EU IFRS at January 1, 2016 investments in subsidiaries, joint ventures and associates were recorded either at cost in accordance with IAS 27 Standalone Financial Statements (retrospectively) measured at January 1, 2016 or at deemed cost being the HAR carrying amount at January 1, 2016. Defining the basis of carrying amounts was taken account of tax considerations. The Company did not apply the fair value option, so none of the investments in subsidiaries, joint ventures and associates were recorded at deemed cost as the fair value at January 1, 2016.

	Carrying amount	Recognition of investments in opening separate statement of financial position in accordance with EU IFRS at 01.01.2016	
		IAS 27	HAR
Stonebridge A.D.	77,999		X
GTS Hungary Kft.	14,269		X
Combridge S.R.L.	2,544	X	
TCG A.D.	35,925	X	
T-Systems Magyarország Zrt.	32,451		X
Novatel E.O.O.D.	1,999	X	
Investel Zrt.	1,658		X
E2 Hungary Zrt.	1,000		X
Other.....	5,460		X
Total	173,305		
of which:			
according to IAS 27 retrospectively....	40,468		
according to HAR at deemed cost.....	132,837		

The amount of investments increased with HUF 18,513 million as of January 1, 2016 and decreased with HUF 3,587 million as of December 31, 2016 due to the transition to IFRS.

The Company recognized impairment on goodwill according to HAR but according to IFRS impairment shall not be recognized (see Note 10.1.). Goodwill was HUF 79,860 million as of December 31, 2015 according to HAR, it increased with HUF 93,712 million due to the transition to IFRS so HUF 173,572 million goodwill was recognized as of January 1, 2016 (see Note 10.4). The transition difference was HUF 126,768 million as of December 31, 2016.

In 2016, the Company recognized HUF 9,724 million impairment of goodwill and HUF 824 million revaluation of investments in foreign currency according to HAR which resulted an increase in the Profit of the year in consequence of the transition to IFRS due to that the settlement of these items shall not be permitted under IFRS.

b) Derivative financial asset, liability

The Company did not present earlier unrealized profit (positive fair value) related to its foreign currency forward and swap transactions in accordance with the Hungarian accounting regulations. Based on IFRS, derivative financial instruments shall be recognised at fair value and measured thereafter at fair value through profit or loss. Accordingly in the Company's separate IFRS statement of financial position financial assets and equity (retained earnings) is greater than those in the balance sheet prepared in accordance with the Hungarian accounting regulations due to forward and swap transactions with positive fair value.

The Company presented provisions related to its foreign currency swap liabilities in accordance with Hungarian accounting regulations. In complying with the rules of IFRS the Company reclassified the provisions to derivative financial liabilities. The effect of derivatives on the balance sheet is the following:

	01.01.2016	12.31.2016
Non current financial assets.....	6,277	3,763
Current financial assets	275	1,505
Provisions.....	855	3,406
Financial liabilities.....	(855)	(3,452)
Equity difference	6,552	5,222

c) Asset retirement obligations

In accordance with IAS 37 the Company recognised asset retirement obligations in case of the telecommunications structures constructed on third parties' properties and the initial estimate adjusts the costs of these assets. Based on the two different regulations the amount of the provision is similar, the difference is due to the fact that based on Hungarian Accounting Regulations the provision is recognized against other expense however based on EU IFRS the provision is recognized against the cost of the asset as an increase. The Company provided provision for this obligation as asset retirement and environmental obligation. The carrying amount of PPE increased with HUF 3,189 million as of January 1, 2016 and with HUF 2,967 million as of December 31, 2016 due to the adjustment. In addition, the adjustment relates to the carrying amount of provisions, amortization and other expenditures.

d) Lease classification

Under the Hungarian accounting regulations certain leases were classified as operating leases in contrast under IFRS those leases are classified as finance leases and the related assets recognised in the statement of financial position. The effects are to increase property, plant and equipment, lease obligations, depreciation charge, interest expense, and to decrease operating lease expense in the statement of profit or loss.

The effect of different treatment of financial leases on comprehensive income is as follows:

	12.31.2016
Rental fees.....	(2,147)
Interest expense.....	1,112
Depreciation charge.....	<u>17</u>
Equity difference.....	<u><u>(1,018)</u></u>

e) Borrowing cost capitalisation

Under IFRS borrowing costs are calculated based on the effective interest method are capitalised in respect of qualifying assets. Based on the Hungarian Accounting Regulations only the nominal interest of the investment loans are capitalized. As a result of the IFRS transition the carrying amount of the PPE has been increased by the interest of general borrowings capitalised to the qualifying assets, and consequently depreciation has been also increased effecting a difference between the two accounting regulations.

f) Business combinations

The Company had acquired other companies in the past few years and measured their assets and liabilities in its consolidated financial statements in accordance with the requirements of acquisition accounting at those past acquisition dates. Later (before the cut-off date of the opening separate IFRS statement of financial position), these companies merged into the Company. As the Company became an IFRS adopter later in its separate financial statements than in its consolidated financial statements, in accordance with the rules of IFRS 1 the assets and liabilities of the merged companies were recognised at the transition date in the Company's separate IFRS statement of financial position at the amounts presented in the Company's consolidated statement of financial positions as at that date. This altogether resulted in an increase of equity compared to local GAAP equity.

g) Repurchased treasury shares, business shares

In the Hungarian financial statements the repurchase value of repurchased treasury shares, business shares has to be recognised under current assets as securities, while under IFRS this amount reduces equity.

h) Taking into account the time value of liabilities related to frequency rights

The present value of the future annual payments for the use of the frequencies are recognised as part of the carrying amount of the licenses as intangible assets and as current and non-current liabilities. In contrast to the provisions of the Hungarian regulation, under IFRS the present value of expenses expected to incur to settle the liability has to be taken into account as the amount of liability, if the impact of the time value of money is significant. The effects are to decrease the carrying amount of the intangible assets and the corresponding liability (see the table below) as well as the amortisation with HUF 1,959 million and increase the finance cost with HUF 2,866 million. The effect of time value of liabilities related to frequency rights on the balance sheet is the following:

	01.01.2016	12.31.2016
Intangible assets.....	(27,666)	(25,631)
Other current financial liabilities.....	2,974	2,747
Other non current financial liabilities.....	<u>22,765</u>	<u>20,050</u>
Equity difference.....	<u>(1,927)</u>	<u>(2,834)</u>

i) Government grants

In contrast to the Hungarian regulations based on IFRS government grants relating to the purchase of assets are deducted from the original cost of the assets and the grants are recognized in the Profit for the year over the useful lives of the related assets through the reduced amount of depreciation or amortisation. According to HAR the amount of any financially settled non-repayable grant received for development purposes without further obligation recognized as other income shall be presented as deferred income.

The IFRS transition effects are to decrease property, plant and equipment and intangible assets, the other current liabilities and depreciation and amortization charge.

j) Deferred tax

Concept of deferred taxation is not embedded in Hungarian accounting regulations. Therefore deductible and taxable temporary differences had to be recognized in the opening statement of financial position. The effect of deferred tax on the balance sheet is the following:

	01.01.2016	12.31.2016
Deferred tax assets.....	-	13,615
Deferred tax liabilities.....	<u>(25,039)</u>	<u>(21,600)</u>
Equity difference.....	<u>(25,039)</u>	<u>(7,985)</u>

2.3 Standards, amendments and interpretations that are not yet effective as at December 31, 2017 and have not been early adopted by the Company

Certain new accounting standards, interpretations and their amendments have been published that are not mandatory for December 31, 2017 reporting periods and have not been early adopted by the Company. Magyar Telekom's assessment of the impact of these new standards and interpretations is set out below.

Title of standard	Nature of change	Impact on the Company's financial statements	Application date and EU endorsement
IFRS 9 Financial Instruments	<p>IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting.</p> <p>In December 2011, in November 2013 and in July 2014, the IASB amended the standard in order to make further changes to the classification and measurement rules and also introduced a new impairment model. These latest amendments now complete the new financial instruments standard.</p>	<p>The adoption of the new standard and its amendments will not result in material changes in the financial statements of the Company.</p> <ul style="list-style-type: none"> ▪ The new provisions on the classification of financial assets will give rise to changes in measurement and presentation of certain debt instruments failing to meet the „solely payments of principal and interest” (SPPI) criterion. ▪ The new provisions on the accounting of impairment losses will lead to expected losses having to be expensed earlier in some cases. <p>Application of the simplified approach also for financial assets with a significant financing component will lead to a minor increase in impairment losses (HUF 0.6 billion). The impairment losses on contract assets to be recognized for the first time as of January 1, 2018 in accordance with IFRS 15 is disclosed with the effects of IFRS 15.</p>	<p>The application of the new standard and its amendments is required for annual periods beginning on or after January 1, 2018. Earlier application is permitted.</p> <p>The European Union has endorsed the standard and its amendments.</p>

Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 15 Revenue from Contracts with Customers	<p>The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and</p>	<p>The adoption of the new standard will result in significant changes in the financial statements of the Company, primarily in respect of the timing of revenue recognition and in respect of capitalization of costs of obtaining a contract with a customer and contract fulfilment costs.</p> <ul style="list-style-type: none"> ▪ In the case of multiple-element arrangements (e.g., mobile contract plus handset) with subsidized products delivered in advance, a larger portion of the total remuneration is attributable to the component delivered in advance (mobile handset), requiring earlier recognition of revenue in future. This leads to the recognition of what is known as a contract asset – a receivable arising from the customer contract that has not yet legally come 	<p>The application of the new standard is required for annual periods beginning on or after January 1, 2018. Earlier application is permitted.</p> <p>The European Union has endorsed this standard.</p>

	<p>new guidance for multiple-element arrangements.</p>	<p>into existence – in the statement of financial position.</p> <ul style="list-style-type: none"> ▪ At the same time, it results in higher revenue from the sale of goods and merchandise and to lower revenue from the provision of services. ▪ In the future, expenses for sales commissions (customer acquisition costs) must be capitalized and recognized over the estimated customer retention period. ▪ On first-time application of the standard, both total assets and shareholders' equity will increase due to the capitalization of contract assets and customer acquisition costs. ▪ Deferral, i.e., later recognition of revenue in cases where “material rights” are granted, such as offering additional discounts for future purchases of further products. ▪ Contract liabilities (which, as deferred revenue, were already recognized as liabilities in the past) must be netted against the contract assets for each customer contract. ▪ For the purposes of determining whether Magyar Telekom sells products for its own account (principal = gross revenue) or for the account of others (agent = net revenue), it is unlikely that there will be any material change. ▪ Magyar Telekom will utilize the option for simplified initial application, i.e., contracts that are not completed by January 1, 2018 will be accounted for as if they had been recognized in accordance with IFRS 15 from the very beginning. The cumulative effect arising from the transition will be recognized as an adjustment to the opening balance of equity in the year of initial application. Prior-year comparatives will not be adjusted; however an explanation of the reasons for the changes in items in the statement of financial position and the income statement for the current period will be provided as a result of applying IFRS 15 for the first time. The effects were analyzed in a Group-wide project on implementation of the new standard. Based on management's current estimate, the changeover to the new standard is expected to result in a cumulative increase in retained 	
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		<p>earnings of HUF 17 billion before taxes. As a consequence, HUF 1.9 billion income tax expense will arise. This effect will be mainly attributable to the first-time recognition of</p> <ul style="list-style-type: none"> ▪ Contract assets (HUF 12 billion) that, under IFRS 15, would have led to the earlier recognition of revenue from the sale of goods and merchandise, and ▪ Deferred customer acquisition costs (HUF 5 billion) that, under IFRS 15, would have resulted in the later recognition of selling expenses. ▪ As regards the new standard's impact on the consolidated income statement, Magyar Telekom expects the overall share of revenue from the provision of services to decrease, and the overall share of revenue from the sale of goods and merchandise to increase by between 1 and 3 percentage points with respect to total revenue. As described, IFRS 15 means revenue will be recognized earlier and expenses will be recognized later for contracts not yet concluded by January 1, 2018. However, as the accounting effects of the changeover to the new standard will be recognized directly in equity, the only effects on profit or loss in 2018 will be related to changes in the point in time at which revenue and expenses are realized. On the assumption that business development remains unchanged, this will mean the following for a mass market characterized by a large number of customer contracts that are being concluded at different points in time: <ul style="list-style-type: none"> ▪ For existing contracts, lower service revenues and higher selling expenses from the amortization of capitalized contract assets and customer acquisition costs will be largely compensated for by ▪ higher revenue, on the conclusion of new contracts, from the sale of goods and lower selling expenses from the capitalization of contract assets and customer acquisition costs. Compared with the current accounting method, major effects on earnings can thus arise only if business development changes, for example, if volumes or prices change or if there are changes to business models or products offered. 	
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Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 16 Leases	<p>IFRS 16 requires entities when they are a lessee, to</p> <ul style="list-style-type: none"> ▪ recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments on the statement of financial position, initially measured at the present value of non-cancellable lease payments (including inflation-linked payments); ▪ recognize amortization of right-of-use assets and interest on lease liabilities over the lease term; and ▪ separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities). 	<p>The most significant effect of IFRS 16 will be an increase in right-of-use assets and lease liabilities, the extent of which will have to be determined after thorough analysis. The Company mainly leases cell sites, rooftops, office buildings and retail shops, line and access networks, space on masts or towers and cars that will be affected by the new standard. Details of the Company's leases (including lease commitments) are disclosed in Note 17. On the lessor (sell) side, we will mainly have to analyze the extent of which multiple element arrangements with embedded leases may be affected by the revised definition of leases. Other than that, we do not expect a considerable impact on the financial statements of the Company at this time, as lessor accounting itself is not changing significantly through the introduction of IFRS 16.</p>	<p>An entity is required to apply IFRS 16 for annual periods beginning on or after January 1, 2019 and permits to apply the new Leases Standard earlier, if the entity also applies IFRS 15 Revenue from Contracts with Customers at or before the date of early application.</p> <p>The European Union has not yet endorsed this standard.</p>

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

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

3.1 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. Management believes that this is a critical accounting estimate since it involves assumptions about technological development in an innovative industry and heavily dependent on the investment plans of the Company. Further, due to the significant weight of depreciable assets in our total assets, the impact of any changes in these assumptions can be material to the financial position of the Company, and results of operations. See Notes 9 and 10 for the changes made to useful lives in 2017.

The Company constantly introduces a number of new services or platforms including, but not limited to, the 3G and 4G based broadband services in the mobile communications and the fiber-to-the-home rollout in the fixed line operations. In case of the introduction of such new services, the Company conducts a revision of useful lives of the already existing platforms, but in the vast majority of the cases these new services or assets are designed to co-exist with the existing platforms, resulting in no change-over to the new technology. Consequently, the useful lives of the existing platforms usually do not require shortening.

3.2 Estimated impairment of goodwill

Goodwill is not amortized, but tested for impairment annually or more frequently. On Magyar Telekom Group ("Group") level the Company has a considerable part in assets and liabilities presented in MT-Hungary segment besides it contributes with a significant proportion to the result of MT-Hungary segment. The Group's segments are reported in a manner consistent with the internal reporting provided to the chief operating decision makers, the members of the Management Committee (MC) of Magyar Telekom Plc. The goodwill presented in the Company was tested as the considerable part of this segment when MT-Hungary segment was examined.

Since the Company as a whole is the non-separable part of MT-Hungary segment therefore the impairment test presented hereinafter is in reference to MT-Hungary segment of Magyar Telekom Group. The recoverable amounts of the operating segments are calculated based on fair value less cost to sell determined by the discounted projected cash flows of the operating segments over the next 10 years with a terminal value. This is highly judgmental, which carries the inherent risk of arriving at materially different recoverable amounts if estimates used in the calculations proved to be inappropriate. The Company has an implemented policy to make the impairment test based on a 10-year cash flow projection on reasonable and supportable assumptions that present the management's best estimate on market participants' assumptions and expectations. The MT-Hungary segment uses 10 year cash flow projections as the payback period of our investments in the telecommunications operations often exceeds 5 years.

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

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

The FVLCS of MT-Hungary segment far exceeds its carrying amount and Magyar Telekom Plc. represents a non-separable but significant part of MT-Hungary segment therefore impairment of goodwill did not need to be recognized neither in 2017 nor in 2016. See Note 10.4 for details of carrying amount of goodwill allocated to segments.

The tables below show the WACCs and PGRs used in the fair value calculations of the Group's operating segments for the goodwill impairment test conducted in 2017 and 2016. The tables below also include sensitivity analyses that show how much impairment would have been recognized as at December 31, 2017 or 2016 for the goodwill allocated to the operating segments if we changed the sensitive parameters in the calculations.

In 2017 we disclose what impact a 4 percentage point increase of the WACC would have on the goodwill compared to that applied in calculation. In case of the PGRs we disclose what impact an 8 percentage point decrease of the PGR would have on the goodwill compared to that applied in calculation. In case of the cash flow projections we disclose what impact a 20% or a 40% lower than projected cash flow stream would have on the goodwill.

In 2016 we disclosed what impact a 2 percentage point increase of the WACC would have on the goodwill compared to that applied in calculation. In case of the PGRs we disclose what impact a 5 percentage point decrease of the PGR would have on the goodwill. In case of the cash flow projections we disclose what impact a 10% or a 25% lower than projected cash flow stream would have on the goodwill.

	2016	2017
	MT-Hungary	
<u>WACC</u>		
Used in the calculation	6.68%	6.39%
If changed to	8.68%	10.39%
Potential impairment (HUF million)	-	-
<u>PGR</u>		
Used in the calculation	1.00%	1.00%
If changed to	-4.00%	-7.00%
Potential impairment (HUF million)	-	-
<u>Cash-flow</u>		
If changed by	-10%	-20%
Potential impairment (HUF million)	-	-
If changed by	-25%	-40%
Potential impairment (HUF million)	-	-

Magyar Telekom's management believes that preparing the value in use (VIU) calculation was unnecessary, since it would have resulted in a lower value than the FVLCS. The VIU method is assuming a model without future investments, meaning that additional capex and related revenues and gains to be recognized in the future cannot be considered in the calculations. Assuring the revenue on long term in a telecom business very much depends on future investments. In Magyar Telekom on average only approximately 20% of the capex spent in a year is related to maintenance. Others are new investments, also related to providing new connections to the network. It is obvious, that without this the revenue generation would start to decline sharply on a long term. Consequently, we did not prepare the value in use calculations.

3.3 Estimated impairment of trade and other receivables

We calculate impairment for doubtful accounts receivable based on estimated losses resulting from the inability of our customers to make required payments. For the largest customers and other telecommunications service providers, impairment is calculated on an individual basis, while for other customers it is estimated on a portfolio basis, for which we base our estimate on the aging of our accounts receivable balance and our historical write-off experience, customer credit-worthiness and recent and expected changes in our customer payment terms. These factors are reviewed annually, and changes are made to the calculations when necessary. In addition, we consider also the nature of the business (residential, business, fixed line, mobile, internet, cable TV, etc.) and the environment in which the Company's entities operate in the various markets. If the financial condition of our customers were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the impairment losses recognized so far. See also Note 4.

3.4 Subscriber acquisition and retention costs

Subscriber acquisition and retention costs primarily include the loss on the equipment sales (revenue and costs presented separately) and fees paid to subcontractors that act as agents to acquire new customers or retain the existing subscribers. The Company's agents also spend a portion of their agent fees for marketing the Company's products, while a certain part of the Company's marketing costs could also be considered as part of the subscriber acquisition and retention costs. The up-front fees collected from customers for activation or connection are marginal compared to the incremental acquisition and retention costs. These revenue and costs are recognized when the customer is connected to the Company's fixed or mobile networks. No such costs or revenue are capitalized as an asset or deferred. These acquisition and retention costs (losses) are recognized immediately as they are not accurately separable from other marketing costs. Among these, net losses on equipment sales of the Company amounted to HUF 15.3 billion in 2017 (2016: HUF 15.3 billion). In addition, agent fees amounted to HUF 5.5 billion in 2017 (2016: HUF 6 billion), while the Company's marketing costs amounted to HUF 8.5 billion in 2017 (2016: HUF 9.6 billion).

3.5 Annual fees of mobile licenses

Magyar Telekom's primary activities are the fixed line and mobile operations in Hungary. These services are in most cases regulated by the Hungarian laws or other legislations. These services in most cases require the acquisition of a license or concession, which usually requires a one-off fee and annual payments. It is judgmental whether the management considers the annual fees to be reliably estimable or not. If the management considers that these annual fees can be reliably estimated, the present value of those are capitalized as part of the cost of the license, otherwise these are recognized as costs in the period they relate to.

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

4 FINANCIAL INSTRUMENTS

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

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

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

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

4.1 Financial assets – accounting policies

The Company classifies its financial assets in the following categories:

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

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

Standard purchases and sales of financial assets are recognized on the trade-date, the date on which the Company commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the Profit for the year.

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Any gains or losses on derecognition are recognized in Profit for the year and are calculated as the difference between (a) the sum of the consideration received and any cumulative gain or loss that had been recognised in other comprehensive income and (b) the carrying amount derecognized.

4.1.1 Impairment of financial assets

The Company assesses at each financial statement date whether there is objective evidence of impairment of financial assets classified as at fair value through profit or loss, including an interest in an equity-accounted investee.

For an investment in an equity security, objective evidence of impairment includes a significant or prolonged decline in its fair value below its cost. The Company considers a decline of 20% to be significant and a period of six months to be prolonged or the average daily stock market price of the securities in the past twelve months was more than 10% below the carrying amount.

(a) Financial assets measured at amortised cost

The Company 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, it is assessed collectively 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. Collective assessment is carried out by grouping together assets with similar risk characteristics.

Individual assessment of impairment is carried out for debtors under litigation; bankruptcy proceedings and for the total receivables of customers with more than 1 year overdue receivables. Individual assessment is also performed in special circumstances, if there is an overdue receivable from any designated customer with different credit risk attributes. The carrying amount of loans and receivables, which would otherwise be past due, whose terms have been renegotiated is not impaired if the collectability of the renegotiated cash flows are considered ensured.

In assessing collective impairment, the Company uses historical information on the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than suggested by historical trends. The Company's benchmark policy for collective assessment of impairment of trade receivables is based on the aging of the receivables due to the large number of relatively similar type of customers.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the loss is recognized in the Profit for the year.

Impairment loss on cash and cash equivalents and bank deposits with original maturities over 3 months and its reversal are recognized in the Profit for the year (Other finance expense – net). Impairment loss on trade and other receivables and its reversal are recognized in Direct costs in the Profit for the year (Bad debt expense). Impairment losses on Employee loans and any reversal is recognized in the Profit for the year (Employee related expenses).

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

When the Company considers that there are no realistic prospects of recovery of the asset (i.e. uncollectible), the relevant amounts are written off. The amounts written off and subsequent recoveries of amounts previously written off are recognised in the same line item of the Statement of profit or loss as the impairment losses.

(b) Available-for-sale financial assets

Impairment losses on available-for-sale financial assets are recognised by reclassifying the losses accumulated in the Revaluation reserve for AFS financial assets to the Profit for the year (Other finance expense – net). The amount reclassified is the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in the Profit for the year. If the fair value of an impaired available-for-sale debt security subsequently increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through the Profit for the year (Other finance expense – net).

Impairment losses recognised in Profit for the year for an investment in an equity instrument classified as available-for-sale are not reversed through the Profit for the year.

4.1.2 Financial assets at fair value through profit or loss

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

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

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

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

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

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

4.1.3 Loans and receivables

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

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

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

Loans and receivables are initially measured at fair value plus any directly attributable transaction costs and subsequently measured at amortized cost using the effective interest method, less any impairment losses.

(a) Cash and cash equivalents

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

(b) Bank deposits with original maturities over 3 months

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

(c) Trade receivables

Trade receivables include the receivables for the services rendered from the customers of the Company.

(d) Employee loans

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

The difference between the nominal value of the loan granted and the initial fair value of the employee loan is recognized as prepaid employee benefits (Other non current assets). Interest income on the loan granted calculated by using the effective interest method is recognized as Interest income, while the prepaid employee benefits are amortized to Employee related expenses on a straight line basis over the term of the loan.

4.1.4 Available-for-sale (AFS) financial assets

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

The AFS measurement category includes equity instruments that entails insignificant voting rights (i.e. below 20%) and debt instruments.

AFS financial assets are initially and subsequently measured at fair value. Changes in fair value of securities among AFS are recognised in Other comprehensive income and accumulated in the Revaluation reserve for AFS financial assets.

Interest on AFS debt securities calculated using the effective interest method is recognized in the Profit for the year (Interest income). Dividends on AFS equity instruments are recognized in the Profit for the year (Interest income) when the Company's right to receive payments is established.

4.2 Financial assets in the statement of financial position
4.2.1 Cash and cash equivalents

Cash and cash equivalents include cash on hand and in banks, and all highly liquid deposits and securities with original maturities of three months or less, and exclude all overdrafts. These financial assets are exposed to credit risks, for which see more details in Note 5.1.2. No impairment had to be recognized for any of these balances in the reported years.

Title	<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Cash on hand	160	63	81
Cash in bank (demand deposits).....	<u>686</u>	<u>1,197</u>	<u>867</u>
	<u>846</u>	<u>1,260</u>	<u>948</u>

Average interest rates	Data in percent		
	01.01.2016	12.31.2016	12.31.2017
Cash on hand	0.00	0.00	0.00
Cash in bank (demand deposits)	0.01	0.00	0.06
Average interest rate	0.00	0.00	0.06

Cash and cash equivalents by currency	01.01.2016	12.31.2016	12.31.2017
EUR	43	34	42
HUF	745	1,204	863
USD	58	22	43
	846	1,260	948

4.2.2 Trade receivables

Carrying amount of trade receivables are as follows:

	01.01.2016	12.31.2016	12.31.2017
Trade receivables from unrelated parties	91,703	86,883	92,298
Trade receivables from subsidiaries	2,370	2,785	4,894
Trade receivables from joint ventures	2	75	314
Trade receivables from other related parties	3,995	5,617	6,012
Total trade receivables	98,070	95,360	103,518

The Company has no collaterals related to its trade receivables.

The following tables show the age profile of the Company's trade receivables by days outstanding (past due). The carrying amounts of receivables are shown net of impairment losses charged as of the financial statement dates.

	01.01.2016	12.31.2016	12.31.2017
Not past due	84,356	81,270	90,118
Past due by			
less than 30 days	9,756	9,344	8,860
30–60 days	1,445	1,556	1,689
61–90 days	426	482	525
91–180 days	759	833	659
181–360 days	769	753	509
over 360 days	559	1,123	1,158
Carrying amount	98,070	95,360	103,518

The vast majority of trade receivables is impaired on a portfolio basis. The vast majority of past due trade receivables is partly or fully impaired depending on the period of delay of payments. In determining whether to recognize impairment on past due trade receivables from certain business and governmental customers past experience of payment behavior of these customers are also taken into account. As these amounts are not significant, these are not disclosed separately.

Non past due receivables (except installment receivables from mobile equipment sales) are not assessed collectively for impairment, but in the case of bankruptcy of the customer or defaults on installment payments non past due receivables may have to be partly or



fully impaired. The non past due trade receivables represent approximately 2.3 months of revenue (2016: 2.2 months of revenue). The annual bad debt expense of the Company is approximately 1.1 percent of the annual revenue, therefore, it can be estimated that approximately this percentage of the non past due portion of trade receivables will not be collected, i.e. will have to be impaired in future periods, but are not impaired at the end of the reporting period. In case of installment receivables from mobile equipmentsales 13% or 16% impairment is recognized on receivables not due yet. In case of non-overdue receivables 6% or 8.5% impairment were recognized.

The Company uses the following rates for impairment

Overdue	Rate of impairment ¹
Not due yet	0%-16%
1-30 days	0%-16%
31-60 days	0%-65%
61-90 days	0%-80%
91-180 days	0%-90%
181-360 days	0%-95%
361-720 days	50%-100%
more than 720 days	50%-100%
Customers in state of bankruptcy	100%

¹ The Company uses different impairment rates for different groups of customers within overdue terms based on the previous year's payment experiments. Considering the basis of impairment the installment receivables from equipmentsales is treated as a separate group of customers and the used rates of impairment are generally in the higher sections of the indicated intervals.

The table below shows the impairment losses and changes for trade receivables therein for 2016 and 2017.

	2016	2017
Impairment loss, beginning of period	19,260	19,694
Charged to expense – net (included in Direct costs).....	7,515	4,962
FX difference	-	-
Utilized.....	(7,081)	(6,004)
Impairment loss, end of period	19,694	18,652

See also Note 5.1.2 for further analysis of credit risks related to Trade receivables.

4.2.3 Other financial assets

Other financial assets include receivables due within 12 months (current) and due after 12 months (non current) from the financial statement date. These financial assets are exposed to credit risks, for which see more details in Note 5.1.2. The recognized impairment and its reversal on Other current and non current financial assets are not significant.

4.2.3.1 Other current financial assets

		<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Finance lease receivable from unrelated parties	(a)	4	4	4
Loans and receivables from employees	(b)	306	210	180
Derivative financial instruments contracted with related parties	(c)	276	1,505	2,978
Derivative financial instruments contracted with unrelated parties	(d)	79	-	-
Loans and receivables from related parties		11,505	16,391	7,302
Other		1,166	831	709
		<u>13,336</u>	<u>18,941</u>	<u>11,173</u>

4.2.3.2 Non current financial assets

		<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Borrowings from related parties		-	-	2,800
Finance lease receivable from unrelated parties	(a)	73	69	64
Loans and receivables from employees	(b)	1,850	1,506	1,186
Trade receivables over one year	(e)	7,428	6,622	15,221
Derivative financial instruments contracted with related parties	(c)	6,277	3,763	-
Other		729	570	504
		<u>16,357</u>	<u>12,530</u>	<u>19,775</u>

(a) See Note 17.2 for more information on Finance lease receivable.

(b) Loans and receivables from employees primarily represent the housing loans provided to the employees of the Company.

(c) Derivative financial instruments contracted with related parties include the fair value of open currency forwards and cross-currency interest rate swaps (see more details in Note 5.1.1.1).

(d) Derivative financial instruments contracted with unrelated parties include the fair value of open currency forwards, cross-currency interest rate swaps and commodity hedge transactions (see more details in Note 5.1.1.1).

(e) Trade receivables over one year mainly includes receivables from customers paying over 1-2 years in installments for telecommunications equipment sold. The impairment on trade receivables over one year was HUF 1,358 million as of December 31, 2017 (HUF 741 million in 2016).

4.3 Financial liabilities – accounting policies

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

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

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

4.3.1 Financial liabilities carried at amortized cost

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

(a) Loans and other financial liabilities

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

(b) Trade and other payables

Trade and other payables (including accruals) are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

4.3.2 Financial liabilities at fair value through profit or loss

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

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

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and their fair values are re-measured at subsequent financial statement dates. All gains and losses are recognized in the Profit for the year (Other finance expense – net).

4.4 Financial liabilities in the statement of financial position**4.4.1 Financial liabilities to related parties**

Financial liabilities to related parties include HUF and EUR denominated loans taken from DTIF, DT AG and the Company's subsidiaries, cashpool liabilities and liabilities related to the ESOP incentive program (see Note 20.1.2.5.). For the whole nominal amount and interest payment of loans denominated in EUR granted by DTIF we have cross-currency interest rate swap agreements in place (with DT AG) so that Magyar Telekom's exposure in fact remains in HUF. The loans and the related swap agreements are accounted for and disclosed on a gross basis.



The tables below show the details of the financial liabilities towards related parties as at December 31, 2017 and 2016.

12.31.2016

	<u>Carrying amount</u>	<u>Lender</u>	<u>Currency</u>	<u>Effective interest rate</u>	<u>Fixed / floating</u>	<u>Maturity</u>	<u>Original Term</u>
	15,000	DT AG	HUF	2.86%	fixed	Apr 2017	2 years
	7,192	DTIF	EUR	3.71%	fixed	May 2017	6 years
	2,400	GTS Kft.	HUF	1.19%	floating	Feb 2017	1 year
	216	Combridge	EUR	1.09%	floating	Mar 2017	1 year
	38,866	DT AG	HUF	0.70%	floating	Cashpool	n/a
	3,736	DT AG	EUR	0.28%	floating	Cashpool	n/a
	1,698	DT AG	USD	0.72%	floating	Cashpool	n/a
	445	Investel Zrt.	HUF	0.90%	floating	Cashpool	n/a
	<u>2,111</u>	Other	HUF				
Due within 1 year	71,664						
Accrued interest.....	6,104						
Derivatives.....	-						
Total current	<u>77,768</u>						
	15,651	DTIF	EUR	4.08%	fixed	Nov 2018	7 years
	35,000	DT AG	HUF	5.89%	fixed	Mar 2019	5 years
	20,000	DT AG	HUF	4.98%	fixed	Jun 2019	5 years
	50,000	DT AG	HUF	4.33%	fixed	Oct 2019	5 years
	35,000	DT AG	HUF	3.83%	fixed	Jun 2020	5 years
	40,838	DTIF	EUR	1.99%	fixed	Jan 2021	6 years
	<u>47,237</u>	DTIF	EUR	1.60%	fixed	Jul 2021	5 years
Non current	243,726						
Derivatives.....	3,452						
Total non current.....	<u>247,178</u>						



12.31.2017

	<u>Carrying amount</u>	<u>Lender</u>	<u>Currency</u>	<u>Effective interest rate</u>	<u>Fixed/ floating</u>	<u>Maturity</u>	<u>Original Term</u>
	15,555	DTIF	EUR	4.08%	fixed	Nov 2018	7 years
	12,982	DT AG	HUF	0.30%	floating	Cashpool	n/a
	468	DT AG	USD	1.48%	floating	Cashpool	n/a
	(97)	DT AG	EUR	0.00%	floating	Cashpool	n/a
	1,835	Investel Zrt.	HUF	0.65%	floating	Cashpool	n/a
	253	Other					
Due within 1 year	30,996						
Accrued interest.....	5,973						
Derivatives.....	249						
ESOP	2,118						
Total current	<u>39,336</u>						
	35,000	DT AG	HUF	5.89%	fixed	Mar 2019	5 years
	20,000	DT AG	HUF	4.98%	fixed	Jun 2019	5 years
	50,000	DT AG	HUF	4.33%	fixed	Oct 2019	5 years
	35,000	DT AG	HUF	3.83%	fixed	Jun 2020	5 years
	40,626	DTIF	EUR	1.99%	fixed	Jan 2021	6 years
	45,657	DTIF	EUR	1.60%	fixed	Jul 2021	5 years
Non current	226,283						
Derivatives.....	5,364						
Total non current.....	<u>231,647</u>						

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

	12.31.2016		12.31.2017	
	<u>Book Value</u>	<u>Fair Value</u>	<u>Book Value</u>	<u>Fair Value</u>
<u>HUF denominated loans</u>				
At fixed rate	155,000	173,972	140,000	154,475
At floating rate	43,821	43,821	15,070	15,070
	198,821	217,793	155,070	169,545
<u>EUR denominated loans</u>				
At fixed rate	110,919	120,669	101,838	109,122
At floating rate	3,952	3,952	(97)	(97)
	114,871	124,621	101,741	109,025
<u>USD denominated loans</u>				
At fixed rate	-	-	-	-
At floating rate	1,698	1,698	468	468
	1,698	1,698	468	468
Accrued interest	6,104	6,104	5,973	5,973
Derivatives.....	3,452	3,452	5,613	5,613
ESOP	-	-	2,118	2,118
	9,556	9,556	13,704	13,704
Total related party financial liabilities.....	<u>324,946</u>	<u>353,668</u>	<u>270,983</u>	<u>292,742</u>

The weighted average interest rate on related party loans was 3.61% in 2017 (4.19% in 2016). The fixed interest rate loans are exposed to fair value risk as it can be seen in the table above. Any decrease of market interest rates will result in an increase of the fair value of the fixed interest rate liabilities.

Borrowings subject to floating interest rates are exposed to cash flow risks. If interest rates rise, it will result in higher cash outflows through interest payments.

The aggregate balance of the cashpool is a liability which includes in 2017 cashpool receivables as well as at the reporting date.

Derivatives contracted with related parties include cross-currency interest rate swaps and FX forwards concluded with DT AG to change the Company's exposure to HUF in case of the EUR denominated loans and to cover FX needs of expected future foreign currency outflows.

There were no defaults or breaches in connection with the financial liabilities to related parties.

4.4.2 Other financial liabilities

4.4.2.1 Other financial liabilities - Balances

The tables below show the current and non current balances of Other financial liabilities.

		<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Bank loans.....	(a)	13,069	11,501	-
Annual frequency fee payable.....	(b)	3,064	3,275	3,492
Finance lease payable.....	(c)	3,792	2,277	552
Debtor overpayment.....		1,329	1,144	1,110
Other		<u>2,540</u>	<u>673</u>	<u>467</u>
Total other financial liabilities – current.....		<u><u>23,794</u></u>	<u><u>18,870</u></u>	<u><u>5,621</u></u>

		<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Annual frequency fee payable.....	(b)	48,314	45,215	41,723
Finance lease payable.....	(c)	4,199	3,201	3,060
Other		<u>13</u>	<u>-</u>	<u>-</u>
Total other financial liabilities – non current.....		<u><u>52,526</u></u>	<u><u>48,416</u></u>	<u><u>44,783</u></u>

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

(a) Bank loans

	<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Due within 1 year.....	<u>13,069</u>	<u>11,501</u>	<u>-</u>
Total bank loans.....	<u><u>13,069</u></u>	<u><u>11,501</u></u>	<u><u>-</u></u>

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

	12.31.2016		12.31.2017	
	Carrying amount	Fair value	Carrying amount	Fair value
<u>HUF denominated bank loans</u>				
At fixed rate	-	-	-	-
At floating rate	11,500	11,500	-	-
Accrued interest	1	1	-	-
Total bank loans	11,501	11,501	-	-

Floating interest rate loans are subject to interests calculated based on mostly BUBOR (Budapest Inter-Bank Offered Rate) and EURIBOR (Euro Inter-Bank Offered Rate) plus a margin interest formula.

The majority of the Company's third party loans and borrowings are subject to floating interest rates, which are exposed to cash flow risks. If interest rates rise, it will result in higher cash outflows through interest payments.

(b) Annual frequency fee payable

On October 15, 2014 Magyar Telekom and the NMAH signed the Authority Contract for the use of the 800 MHz, 900 MHz and 1800 MHz frequency bands that came into force on that day. Frequency usage rights and wireless licence for the new brands were released on October 17, 2014. Magyar Telekom acquired the frequency usage rights in the above listed spectrums till June 15, 2034. See Note 34.2 for more details of the agreement. This agreement provides sufficient basis for a reliable estimate of the future annual fees payable related to these Hungarian frequency licenses, as a result of which the present value of the annual fees payable (HUF 39,038 million) was recognized as part of the carrying amount of the licenses as intangible assets, with corresponding current and non current financial liabilities falling due from 2015 to 2034.

On September 6, 2013 Magyar Telekom and the NMAH signed the modification of the Authority Contract for the use of the 900 MHz and 1800 MHz frequency bands. See Note 34.2 for more details of the agreement. This agreement provides sufficient basis for a reliable estimate of the future annual fees payable related to these Hungarian frequency licenses, as a result of which the present value of the annual fees payable (HUF 17,332 million) was recognized as part of the carrying amount of the licenses as intangible assets, with corresponding current and non current financial liabilities falling due from 2014 to 2022.

(c) Finance lease payable

See Note 17.2 for the details of finance leases.

4.4.2.2 Proceeds/repayments of loans and other borrowings

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

4.4.2.3 Repayment of other financial liabilities

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

	<u>12.31.2016</u>	<u>12.31.2017</u>
Finance lease payable.....	3,944	2,096
Annual frequency fee payable	2,989	3,188
Other.....	<u>71</u>	<u>1</u>
Repayment of other financial liabilities	<u><u>7,004</u></u>	<u><u>5,285</u></u>

4.4.2.4 Additional disclosure about changes in liabilities arising from financing activities

As a result of the 2016 January amendment of IAS 7, the below additional disclosures are provided in order to enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments is required to be applied for annual periods beginning on or after January 1, 2017 and it was endorsed by the EU in November 2017.

The following table includes changes in net debt reconciled with their effects on the Consolidated statement of cash flows.



	Opening Balance at January 1, 2017	Changes in cash and cash equivalents	<u>Changes that effect the cash flows from operating activities</u>	Addition to financial liabilities without cash movement	<u>Changes that effect the cash flows from investing activities</u>	<u>Changes that effect the cash flows from financing activities</u>			Closing Balance at December 31, 2017	
						Proceeds from loans and borrowings	Repayment of financial liabilities	Repayment of other financial liabilities	Other	
Related party loans	321,494		4,273	(403)	(1,293)	95,315	(154,016)			265,370
Derivatives from related parties.....	3,452				(3,351)					101
Bank loans.....	11,501		(1)			3,794	(15,294)			-
Frequency fee payable.....	48,490		(87)					(3,188)		45,215
Finance lease liabilities.....	5,478			229				(2,095)		3,612
Debtors overpayment.....	1,144		(34)							1,110
Other financial liabilities	673		(205)					(1)		467
-Less cash and cash equivalents	(1,260)	312								(948)
-Less other current financial assets	(18,941)		(487)		4,398	7,730				(7,300)
Net debt	372,031	312	3,459	(174)	(246)	106,839	(169,310)	(5,284)		307,627
Treasury share purchase.....									(750)	
Dividend paid.....									(26,081)	
Net cash used in financing activities									(94,585)	

4.4.3 Trade payables

	<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Payable to subsidiaries.....	12,660	17,888	11,268
Payable to associated companies and joint ventures	-	1,714	2
Payable to other related parties	9,882	11,956	10,215
Payable to non-related parties	<u>77,757</u>	<u>71,622</u>	<u>89,548</u>
Total	<u>100,299</u>	<u>103,180</u>	<u>111,033</u>

4.5 Additional disclosures on financial instruments
4.5.1 Financial assets and liabilities

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1)
- inputs other than quoted prices included within Level 1 observable for the asset or liability, either directly or indirectly (Level 2)
- inputs for the asset or liability that are not based on observable market data (Level 3)

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The significance of an input is assessed against the fair value measurement in its entirety.

There was no transfer between Level 1 and Level 2 financial instruments.

The fair value of traded financial instruments is determined by reference to their market prices at the end of the reporting period. This typically applies to available-for-sale (AFS) financial instruments. Loans and receivables and most of the financial liabilities are measured at amortized cost, but fair value information is also provided for these. The fair values of these assets and liabilities were determined using level 3 type information. The fair value of financial instruments that are not traded in an active market (including derivative financial instruments) is determined by using valuation techniques, mainly by applying the discounted cash flow method. The cash flow estimations are based on the relevant underlying contracts and the discount rates are calculated based on the market based interest rate benchmarks applicable for the relevant maturities and currencies (BUBOR, BIRS, EURIBOR, EUR swap yields) using interpolation technique. The fair value of forward foreign exchange contracts is determined using quoted spot exchange rates and appropriate interest rates at the end of the reporting period. Foreign exchange conversion is made based on central bank FX fixings (preferably that of the Central Bank of Hungary). There are no assets or liabilities carried at fair value where the fair value was determined using level 3 type information. The carrying amount of floating-rate financial liabilities or those expiring within one year approximate the fair values at the end of the reporting period.

Assumptions applied in the fair value calculations are subject to uncertainties. Changes in the assumptions applied in the calculations would have an impact on the carrying amounts, the fair values and/or the cash flows originating from the financial instruments. Sensitivity analyses related to the Company's financial instruments are provided in Note 5.1.1.1.

The tables below include the carrying amounts and fair values of the Company's financial assets and liabilities as at December 31, 2017 and 2016.

4.5.1.1 Financial assets – Carrying amounts and fair values

Carrying amounts, fair values and fair value hierarchy of financial assets are the following:

31.12.2016						
Carrying amount						
Loans and receivables (Level 3)	Held-to-maturity	Available-for-sale (Level 1)	FTPL (Level 2)	Total	Fair value	
Cash and cash equivalents	1,260	-	-	-	1,260	1,260
Clearing receivables from related parties .	12,746	-	-	-	12,746	12,746
Trade receivables within one year.....	95,360	-	-	-	95,360	95,360
Trade receivables over one year.....	6,622	-	-	-	6,622	7,245
Loans and receivables from employees ...	1,717	-	-	-	1,717	1,875
Derivative financial instruments contracted with related parties.....	-	-	-	5,267	5,267	5,267
Loans given to related parties.....	3,645	-	-	-	3,645	3,645
Finance lease receivable.....	72	-	-	-	72	85
Other current receivables.....	831	-	-	-	831	831
Other non current receivables.....	570	-	-	-	570	866
Total	122,823	-	-	5,267	128,090	129,180

31.12.2017						
Carrying amount						
Loans and receivables (Level 3)	Held-to-maturity	Available-for-sale (Level 1)	FTPL (Level 2)	Total	Fair value	
Cash and cash equivalents	948	-	-	-	948	948
Clearing receivables from related parties .	5,014	-	-	-	5,014	5,014
Trade receivables within one year.....	103,518	-	-	-	103,518	103,518
Trade receivables over one year.....	15,221	-	-	-	15,221	16,376
Loans and receivables from employees ...	1,366	-	-	-	1,366	1,505
Derivative financial instruments contracted with related parties.....	-	-	-	2,978	2,978	2,978
Loans given to related parties.....	5,089	-	-	-	5,089	5,089
Finance lease receivable.....	68	-	-	-	68	80
Other current receivables.....	708	-	-	-	708	708
Other non current receivables.....	503	-	-	-	503	734
Total	132,435	-	-	2,978	135,413	136,950

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

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

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

4.5.1.2 Financial liabilities

Carrying amounts, fair values and fair value hierarchy of financial liabilities are the following:

	31.12.2016				Fair value
	Carrying amount				
	Measured at amortized cost (Level 3)	FVTPL (Level 2)	FVTPL (Level 1)	Total	
Financial liabilities to related parties	321,494	3,452	-	324,946	353,667
Bank loans	11,501	-	-	11,501	11,501
Trade payables	103,180	-	-	103,180	103,180
Frequency fee payable	48,490	-	-	48,490	53,051
Finance lease liabilities	5,478	-	-	5,478	9,027
Debtors' overpayment	1,144	-	-	1,144	1,144
Other current liabilities	673	-	-	673	673
Total	491,960	3,452	-	495,412	532,244

	31.12.2017				Fair value
	Carrying amount				
	Measured at amortized cost (Level 3)	FVTPL (Level 2)	FVTPL (Level 1)	Total	
Financial liabilities to related parties	263,253	5,612	2,118	270,983	292,724
Bank loans	-	-	-	-	-
Trade payables	111,033	-	-	111,033	111,033
Frequency fee payable	45,215	-	-	45,215	55,131
Finance lease liabilities	3,612	-	-	3,612	7,825
Debtors' overpayment	1,110	-	-	1,110	1,110
Other current liabilities	467	-	-	467	467
Total	424,690	5,612	2,118	432,420	468,290

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

Additional fair value information on financial liabilities is provided in Notes 4.4.1. and 4.4.2.

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

FVTPL liabilities include derivative financial instruments, the fair values of which are calculated the same way as FVTPL assets disclosed in Note 4.5.1.1.

4.5.2 Items of income, expense, gains and losses arising on financial instruments

The tables below include gains and losses arising on financial instruments in 2016 and 2017.

2016

	Interest	From subsequent measurement			From derecognition	From fee expense	Total net gain / (loss)
		Change in fair value	Currency translation	Impairment loss			
FVTPL financial instruments (Level 2)	-	(3,961)	-	-	(127)	-	(4,088)
Loans and receivables	381	-	(539)	(7,515)	-	(4,366)	(12,039)
Financial liabilities measured at amortized cost	(18,394)	-	651	-	-	(28)	(17,771)
Net gain/(loss) on financial instruments	(18,013)	(3,961)	112	(7,515)	(127)	(4,394)	(33,898)

2017

	Interest	From subsequent measurement			From derecognition	From fee expense	Total net gain / (loss)
		Change in fair value	Currency translation	Impairment loss			
FVTPL financial instruments (Level 2)	-	(4,511)	-	-	(325)	-	(4,836)
Loans and receivables	340	-	202	(4,962)	-	(4,320)	(8,740)
Financial liabilities measured at amortized cost	(13,220)	-	1,037	-	-	(28)	(12,211)
Net gain/(loss) on financial instruments	(12,880)	(4,511)	1,239	(4,962)	(325)	(4,348)	(25,787)

The tables above include the amounts before capitalization of borrowing costs (See Note 24).

Impairment losses on Loans and receivables includes all expenses incurred or expected to be incurred in relation to the default of our customers. Before writing off or factoring, we impair the receivables to their recoverable amounts through the use of an impairment provision account, as a result of which the actual write-off or factoring of these receivables results in no derecognition gains or losses.

4.5.3 Offsetting financial assets and financial liabilities

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

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

	12.31.2016		12.31.2017	
	Trade and other receivables	Trade payables	Trade and other receivables	Trade payables
Gross amounts of recognized financial instruments	102,848	104,507	111,984	112,323
Gross amounts of financial instruments set off.....	<u>(1,327)</u>	<u>(1,327)</u>	<u>(1,290)</u>	<u>(1,290)</u>
Net amounts of recognized financial instruments presented in the statement of financial position.....	<u>101,521</u>	<u>103,180</u>	<u>110,694</u>	<u>111,033</u>

4.5.4 Other disclosures about financial instruments

Magyar Telekom is also exposed to risks that arise from the possible drawdown of guarantees in a nominal amount of HUF 10.8 billion as at December 31, 2017 (2016: HUF 10.1 billion). These guarantees were issued by banks on behalf of Magyar Telekom as collateral to secure the fulfillment of the Company's certain contractual obligations. The Company has been delivering on its contractual obligations and expects to continue doing so in the future, therefore no significant drawdown of the guarantees happened in 2017 or 2016, and is not expected to happen in the future.

There were no financial assets or liabilities, which were reclassified into another financial instrument category.

No financial assets were transferred in such a way that part or all of the financial assets did not qualify for derecognition.

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

5 FINANCIAL RISK MANAGEMENT

5.1 Financial risk factors

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

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

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

tax impacts and significant changes in the tax legislations. The potential impacts disclosed (less tax) would be the same on the Company's Equity.

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

5.1.1 Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk:

- foreign currency risk
- interest rate risk
- price risk.

The fundamentals of Magyar Telekom's financing strategy are established each year by the Board of Directors. The Company's policy is to borrow centrally using a balanced combination of medium term and short term loans, and fixed and floating interest rates on those loans. The Board of Directors has approved two debt protection ratio KPIs at MT Group level, and monitors their fulfillment annually. At the end of 2017 Magyar Telekom Group fulfilled both criteria; Total Debt to EBITDA ratio of 1.74 in 2017 (2016: 1.99), the allowed maximum of which would be 2.8 and EBITDA to Interest Expense ratio of 8.58 in 2017, (2016: 7.34), the allowed minimum of which would be 3.0. The Company's Treasury is responsible for implementing the finance policy and for ongoing risk management. The details of foreign exchange, liquidity and counterparty risk management guidelines are determined and monitored by the Company's Treasury.

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

For the presentation of market risks, sensitivity analyses is also provided that show the effects of hypothetical changes of relevant risk variables on Profit before tax and Equity. These hypothetical changes were modeled to present a reasonably possible change in the relevant risk variables. The periodic effects are determined by relating the hypothetical changes in the risk variables to the balance of financial instruments at the end of the latest reporting period (2017) and the preceding reporting period (2016). The balances at the end of the reporting period are usually representative for the year as a whole; therefore the impacts are calculated using the year end balances. The methods and assumptions used in the sensitivity calculations did not change significantly compared to the previous period. As a result of the still rather volatile international capital and securities markets, higher fluctuations of the FX and interest rates are also possible.

5.1.1.1 Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in FX rates. Currency risks arise on financial instruments denominated in currencies other than the functional currency of the Company. Relevant risk variables are generally all non-functional currencies in which Magyar Telekom has financial instruments.

In order to mitigate FX risk in case of FX denominated financial instruments, Magyar Telekom minimized its foreign currency borrowings in the past years, or covered them with derivative instruments to substantially reduce FX risk.

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

Several related party loans taken to finance general corporate needs from the financing vehicle of Deutsche Telekom, Deutsche Telekom International Finance B.V. (DTIF) are denominated in EUR, while, at the same time, cross-currency interest rate swaps are concluded with Deutsche Telekom AG (DT AG) to fix the actual cash flows of Magyar Telekom in HUF for the whole nominal amount and interest payments of these loans. Even though the Company does not apply hedge accounting, the change in the HUF/EUR exchange rate has limited (net) impact on profit or loss and equity related to the hedged loans and the swaps together.

Sensitivity analysis

A reasonably possible strengthening or weakening of the EUR in the table below against HUF as at 31 December would have affected the measurement of financial instruments denominated in a foreign currency and increased (+)/ decreased (-) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant and ignores any impact of forecast sales and purchases. As the profit or loss effect would be the same as the equity effect, only the former is disclosed.

	Profit or loss	
	Strengthening	Weakening
12.31.2016		
EUR/HUF (5% movement)		
Loan.....	(5,546)	5,546
Swap agreements.....	<u>6,041</u>	<u>(6,041)</u>
Net effect.....	495	(495)
12.31.2017		
EUR/HUF (5% movement)		
Loan.....	(5,092)	5,092
Swap agreements.....	<u>5,462</u>	<u>(5,462)</u>
Net effect.....	370	(370)

(b) Other FX exposure

The remaining FX exposure of the Company is mostly related to (i) holding foreign currency cash balances by the Company, and (ii) operating activities through revenue from, and payments to, international telecommunications operators as well as (iii) capital expenditure contracted with vendors in foreign currency. In line with currency hedging policy, the Company holds sufficient amounts of foreign currencies on its bank accounts, the amounts of which are determined considering the balance of short term FX denominated trade and leases payables and trade receivables in order to hedge the currency risk arising in connection with those assets and liabilities. The Company's foreign currency (EUR and USD) denominated liabilities (other than the above described loans) exceed the Company's foreign currency (EUR and USD) denominated assets, therefore changes of the functional currencies' exchange rates would have impact on the profit of the Company.

In order to reduce the above exposure, Magyar Telekom occasionally enters into derivative contracts. The positive fair value of the open short term forward positions was HUF 0.2 billion (asset) as of December 31, 2017 (2016: HUF 0.1 billion liability). These positions were opened to hedge the FX risks of future FX payments exceeding FX income.

Sensitivity analysis

A reasonably possible strengthening or weakening of the currencies in the table below against HUF as at 31 December would have affected the measurement of financial instruments denominated in a foreign currency and increased (+)/ decreased (-) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant and ignores any impact of forecast sales and purchases. As the profit or loss effect would be the same as the equity effect, only the former is disclosed.



	Profit or loss	
	Strengthening	Weakening
12.31.2016		
EUR/HUF (5% movement)		
Net balance of f/x trade payables, trade receivables and bank deposits.....	(686)	686
Connected forward deals.....	467	(467)
Net effect.....	(219)	219
USD/HUF (20% movement)		
Net balance of f/x trade payables, trade receivables and bank deposits.....	(648)	648
Connected forward deals.....	399	(399)
Net effect.....	(249)	249
12.31.2017		
EUR/HUF (5% movement)		
Net balance of f/x trade payables, trade receivables and bank deposits.....	(995)	995
Connected forward deals.....	996	(996)
Net effect.....	1	(1)
USD/HUF (20% movement)		
Net balance of f/x trade payables, trade receivables and bank deposits.....	(461)	461
Connected forward deals.....	574	(574)
Net effect.....	113	(113)

As a result of the volatile international capital and securities markets, even a more than 5% fluctuation of the functional currency HUF against EUR, a more than 20% fluctuation of the functional currency HUF against USD is possible as extraordinary market conditions may cause extreme volatility on FX markets.

5.1.1.2 Interest rate risk

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

Changes in the market interest rates of non-derivative financial instruments with fixed interest rates does not affect Profit for the year because none of them are measured at fair value through profit or loss. On the other hand, all financial instruments with fixed interest rates (which are carried at amortized cost) are not subject to cash flow interest rate risk.

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

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

(a) Financial assets

Excess cash of the Company's Hungarian operations is primarily used to repay loans so it has no significant bank deposits.

(b) Financial liabilities

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

As the vast majority of debt portfolio is denominated in HUF, or swap agreements are in place so that the loans payable are exposed to changes in HUF interest rates, the Company is mostly exposed to the HUF interest rate fluctuations for its financial liabilities. To control this interest rate risk, a combination of fixed and floating rate debt is used. Fixed interest-bearing debts (including loans swapped to fixed interest and excluding loans swapped to floating interest) made up 88% of the Company's total debt as of December 31, 2017 (2016: 75%).

Cash-flow sensitivity analysis for variable rate instruments

Floating interest-bearing debts (including loans swapped to floating interest and excluding loans swapped to fixed interest) made up 12% of the Company's total debt as of December 31, 2017 (2016: 25%).

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

	Profit or loss	
	100 bp increase	100 bp decrease
12.31.2016		
Floating rate instrument.....	(610)	610
Discount rate swap.....	(222)	222
Cash-flow sensitivity (net).....	(832)	832
12.31.2017		
Floating rate instrument.....	(154)	154
Discount rate swap.....	(156)	156
Cash-flow sensitivity (net).....	(310)	310

5.1.1.3 Price risk

As Magyar Telekom transferred its business energy operations to E2 Hungary Zrt. in 2016, for the purpose of these financial statements no relevant risk remained in this field and no sensitivity information for price risk is disclosed.

5.1.2 Credit risk

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

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

The vast majority of credit risks may arise in respect of Cash and cash equivalents, Bank deposits with original maturities over 3 months and Trade receivables, most of which have short term maturities.

In line with the Company's risk management policy Magyar Telekom deposits the vast majority of excess cash in banks rated at least BBB+ (or equivalent), or make efforts to get guarantees for these fixed term deposits from banks rated at least BBB+. We, however, also have current accounts in banks with lower rating than this. Moreover, Magyar Telekom prefers to deposit in banks which grants loans to Magyar Telekom to make the compensation of deposits and loans possible in case of the default of the bank.

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

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

No financial assets other than trade and other receivables had to be impaired, as they are neither past due nor are there any indication of impairment. For details of impairment of trade and other receivables please refer to Note 4.2.2.

The annual bad debt expense of the Company in 2017 was 1.1% (2016: 1.7%) of the revenues. Adverse changes in customer payment behavior in the future, however, may result in higher impairment losses. Each additional 1 percentage point of uncollectible revenue would result in additional impairment charges of HUF 4.7 billion in 2017 (2016: HUF 4.4 billion).

There are varying credit checking practices applied as described below.

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

Dunning procedures are run automatically by the billing systems and include various reminder tools like SMS, reminder message via Telekom APP, telephone calls, reminder letters, restricted service, termination letters and disconnections. In case of medium and large enterprises dunning process starts manually (first reminder letter). After the first step, this process is also automated. Based on the effective laws and regulations and over a minimum overdue amount the Company applies varying and customized reminder procedures with specific deadlines to the different customer groups. After the termination of the contract and depending on the expected success of the process, we combine the different collection steps of involving external partners, selling the outstanding debt or initiating legal proceedings. All parts of the process are regulated by internal directives.

5.1.3 Liquidity risk

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

Prudent liquidity risk management implies maintaining sufficient Cash and cash equivalents and Bank deposits as well as available funding through adequate amount of committed credit lines. The Company's Treasury management aims at maintaining flexibility in funding by keeping committed credit lines available. The undrawn bank credit lines amounted to HUF 41.0 billion as at December 31, 2017 (2016: HUF 29.7 billion). In addition to the above, Deutsche Telekom confirmed its readiness to finance Magyar Telekom Company's budgeted financing needs until June 30, 2019.

The following two tables summarize the maturity structure of Magyar Telekom's financial liabilities including the interest payable on those liabilities (undiscounted amounts) as of December 31, 2017 and 2016. As the majority of the financial liabilities are paid from the cash generated from the ongoing operations, the maturity analysis of the financial assets as at the end of the reporting periods (in comparison with the financial liabilities) would not be useful, therefore, is not included in the following tables.

12.31.2016

	Total	within 1 year	1 to 5 years	after 5 years
Trade payables.....	103,180	103,180	-	-
Financial liabilities to related parties.....	331,380	59,621	271,759	-
Bank loans.....	11,534	11,534	-	-
Finance lease liabilities.....	12,023	3,384	5,002	3,637
Other financial liabilities.....	50,306	5,092	13,890	31,324
Total other financial liabilities.....	73,863	20,010	18,892	34,961
Total cash flows.....	508,423	182,811	290,651	34,961
<u>Open swap positions' cash flows</u>				
Gross cash inflow in EUR million.....	389	36	353	-
Gross cash inflow in HUF million (at spot rate).....	120,987	11,197	109,790	-
Gross cash outflow in HUF million.....	124,137	10,655	113,482	-
Net cash inflow in HUF million.....	(3,150)	542	(3,692)	-
<u>Open forward positions' cash flows</u>				
Gross cash inflow in EUR million.....	30	30	-	-
Gross cash inflow in USD million.....	7	7	-	-
Gross cash inflow in HUF million (at spot rate).....	11,386	11,386	-	-
Gross cash outflow in HUF million.....	11,230	11,230	-	-
Net cash inflow in HUF million.....	156	156	-	-



12.31.2017				
	Total	within 1 year	1 to 5 years	after 5 years
Trade payables.....	111,033	111,033	-	-
Financial liabilities to related parties.....	213,633	5,094	208,539	-
Bank loans	-	-	-	-
Finance lease liabilities.....	10,243	1,736	4,933	3,574
Other financial liabilities.....	47,125	5,403	13,703	28,019
Total other financial liabilities.....	57,368	7,139	18,636	31,593
Total cash flows.....	382,034	123,266	227,175	31,593
<u>Open swap positions' cash flows</u>				
Gross cash inflow in EUR million.....	352	62	290	-
Gross cash inflow in HUF million (at spot rate).....	109,170	19,229	89,941	-
Gross cash outflow in HUF million.....	113,396	18,106	95,290	-
Net cash inflow in HUF million.....	(4,226)	1,123	(5,349)	-
<u>Open forward positions' cash flows</u>				
Gross cash inflow in EUR million.....	64	64	-	-
Gross cash inflow in USD million.....	11	11	-	-
Total gross cash inflow in HUF million (at spot rate).....	22,696	22,696	-	-
Gross cash outflow in HUF million.....	23,037	23,037	-	-
Net cash inflow in HUF million.....	(341)	(341)	-	-

The average maturity of Magyar Telekom's debt portfolio was 2.18 years as at December 31, 2017 (2016: 2.60 years). The floating interest payments arising from the financial instruments were calculated using the last interest rates fixed before December 31, 2017 and 2016. Actual cash flows may be different if the floating interest rate changes in future periods.

5.2 Capital management

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

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

This ratio is calculated as Net debt divided by the sum of Equity (including Non-controlling interest) and Net debt. Net debt is calculated as follows:

- Current and non current financial liabilities to related parties – Note 4.4.1
- plus Other current and non current financial liabilities – Note 4.4.2
- less Cash and cash equivalents – Note 4.2.1
- less Other current financial assets – Note 4.2.3.1

During 2016 and 2017, the Company's mid and long term target as approved by the Board was to maintain a gearing ratio within 30% to 40% at MT Group level. The gearing ratio at December 31, 2017 was 39.1% (2016: 39.3%). In 2017, Magyar Telekom paid HUF 26,067 million dividend. The Company's Annual General Meeting in April 2018 approved a proposal to pay HUF 26,069 million for the year 2017.

In addition to the above, according to the Hungarian Civil Code (2013. V.), Magyar Telekom has to ensure that the Company's Equity in the standalone financial statements does not fall below two thirds of its Common stock, i.e. the total of the reserves should not be negative. The Company is in compliance with this regulation.

The equity capital, which the Company manages, amounted to HUF 554 billion on December 31, 2017 (2016: HUF 540 billion).

6 INCOME TAXES

6.1 Income taxes – accounting policies

Income tax expense comprises current and deferred tax. It is recognised in Profit or loss except to the extent that it relates to a business combination, or items recognised directly in equity or in other comprehensive income.

6.1.1 Current taxes

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable in respect of previous years. The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received that reflects uncertainty related to income taxes, if any. It is measured using tax rates enacted or substantively enacted at the reporting date. Current tax also includes any tax arising from dividends. Current tax assets and liabilities are offset only if certain criteria are met.

Income taxes comprises of corporate income taxes and other income taxes.

6.1.1.1 Corporate income taxes

Corporate income taxes are payable to the central tax authorities. The basis of the tax is the taxable entities' accounting profit adjusted for non-deductible and non-taxable items. The withholding tax relating to the dividend received is also reported in corporate income taxes. By the end of 2016 the corporate tax rate in Hungary was 10% for the first HUF 500 million tax base (on an annual basis) of the legal entities, above which the general rate of 19% applied. In the tax rate reconciliation the 19% tax rate was applied for 2016, as it approaches the average tax rate for the Company. From January 1, 2017 a flat corporate income tax rate of 9% has been enacted.

As Magyar Telekom Plc. is listed on the Budapest Stock Exchange, it was obliged to adopt IFRSs in its statutory financial statements from 2017 in accordance with the Act C of 2000 on Accounting. In the first and in the second year following the IFRS transition, taxpayers, who chose to adopt IFRS in their statutory financial statements, are obliged to pay the total sum of their current taxes (i.e. corporate income tax and local business tax) calculated for the tax year preceding the year of the IFRS transition, if in these two years their current tax liabilities are lower than in the tax year preceding the IFRS transition (minimum tax). Magyar Telekom Plc. does not have this minimum tax payment obligation in 2017. If the calculated tax does not reach the amount of the minimum tax, the difference will be accounted for as Other operating expenses in 2018.

6.1.1.2 Other income taxes

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

6.1.2 Deferred taxes

Deferred tax is recognized applying the liability method, on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for taxation purposes.

Deferred tax is not recognized for

- if it arises from the 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,
- if it arises from the initial recognition of goodwill.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit (or reversing deferred tax liabilities) will be available against which the temporary differences can be utilized. Deferred tax assets, which are not recognized, should be re-evaluated as of the financial statement date and recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred tax assets are recognized for temporary differences relating to the subsidiaries and investments to the extent that it is probable that the temporary difference will reverse in the near future, and a future taxable profit will be available against which the temporary difference can be utilized.

Deferred tax liabilities are recognized for all taxable temporary differences relating to the subsidiaries and investment, except for the case that the Company controls the timing of the reverse of these temporary differences, and it is likely that the relevant temporary differences will not reverse in the near future.

Deferred tax is measured at the tax rates that are expected to apply to temporary differences when they reverse using income tax rates enacted or substantially enacted at the reporting date.

In the Company's statement of financial position deferred tax assets and liabilities are offset and disclosed as deferred tax asset or deferred tax liability based on their net balance.

6.2 Income taxes in the Statement of profit or loss

The table below shows the income tax expenses charged in the Profit for the year.

	<u>12.31.2016</u>	<u>12.31.2017</u>
Corporate income tax*	921	984
Other income taxes*	<u>7,751</u>	<u>7,841</u>
Total current income tax expense	8,672	8,825
Deferred tax expense	<u>(17,129)</u>	<u>4,319</u>
Total income tax expense	<u><u>(8,457)</u></u>	<u><u>13,144</u></u>

* The amount of corporate income tax according to IFRS contains HUF 100 million sponsorship of prominent team sports which was disclosed as other expenditure in the Annual Report as of 2016 prepared in accordance with HAR and does not contain the amount of energy suppliers' tax (HUF 41 million) which is presented on other income taxes line. Consequently, the corporate income tax expense differs (IFRS compared to HAR) with these amounts.

6.2.1 Tax expense reconciliation

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

	<u>12.31.2016</u>	<u>12.31.2017</u>
Profit before income tax	45,788	55,001
Calculated amount of tax 19% (2016)/ 9% (2017).....	(8,700)	(4,950)
Changes in tax rates..... (a)	20,949	-
Tax shield of items not subject to income tax..... (b)	3,914	793
Tax impact of non deductible items (c)	(1,803)	(1,918)
Other income taxes (excl. energy suppliers' income tax)..... (d)	(7,750)	(7,841)
Impact of tax deductibility of other income taxes 19% (2016)/ 9% (2017)..... (e)	1,473	706
Energy suppliers' income tax..... (f)	(82)	(180)
Investment tax credit accretion (g)	456	246
Income tax expense	<u>8,457</u>	<u>(13,144)</u>
Effective tax rate	<u>-18.47%</u>	<u>23.90%</u>

(a) Changes in tax rates

This line item of the reconciliation represents the tax impact of changes in tax rates and that the actual average tax rate applicable to the Company is different from the tax rate of 19% applied in the reconciliation. Since January 1, 2017 the corporate income tax rate reduced to 9% from the earlier used 10%/19% progressive tax rate. The lower tax rate was used for calculating the deferred tax as of December 31, 2016 and the reconciliation contains the effect of this.

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

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

(c) Tax impact of non deductible items

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

(d) Other income taxes

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

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

The Hungarian local business tax and innovation fee are deductible expenses for corporate tax purposes, the positive tax impact of which is included in this line of the reconciliation.

(f) Energy suppliers' income tax

This line of reconciliation includes the Energy suppliers' income tax levied on energy supplier companies' profits in Hungary in addition to the corporate income tax. The taxable profit is the revenue from energy supply adjusted by certain items that increase or decrease the taxable profit. Magyar Telekom is also considered as an energy supplier company subject to the energy suppliers' income tax, in proportion to its energy revenues. As tax credit can be utilized for the energy supplier's tax to the extent that the tax liability can be decreased by a half, this effect is also included in this line of the reconciliation.

(g) Investment tax credit accretion

Investment tax credit accretion includes the increase of the net present value of the investment tax credit deriving from the utilization of the tax credits in periods subsequent to the year of recognition. See also Note 6.3.2.1.

6.3 Income taxes in the Statement of financial position
6.3.1 Current taxes in the Statement of financial position

Current tax assets and liabilities in the Statements of financial position represent the amount of corporate and other income taxes receivable from, and payable to the Hungarian tax authorities.

6.3.2 Deferred taxes in the Statement of financial position

Magyar Telekom's deferred tax balances are as follows:

	Balance at 01.01.2016	Effect on profit	Other move- ments	Balance at 12.31.2016	Effect on profit	Other move- ments	Balance at 12.31.2017
Deferred tax assets and (liabilities)							
Investment tax credits.....	12,413	(1,543)	-	10,870	(3,132)	-	7,738
Other financial assets.....	(145)	145	-	-	-	-	-
Impairment of receivables and inventory....	3,388	(1,927)	-	1,461	(69)	-	1,392
PPE and intangible assets.....	(17,478)	9,127	(75)	(8,426)	208	(54)	(8,272)
Goodwill.....	(22,238)	11,108	-	(11,130)	(1,713)	-	(12,843)
Trade and other payables.....	755	(2,799)	-	(2,044)	2,044	-	-
Deferred tax effect of IFRS transition.....	-	-	-	-	(1,362)	-	(1,362)
Loans and other borrowings.....	(4,498)	4,498	-	-	-	-	-
Provisions for liabilities and charges.....	2,764	(1,480)	-	1,284	(295)	-	989
Total net deferred tax.....	(25,039)	17,129	(75)	(7,985)	(4,319)	(54)	(12,358)
Of which deferred tax liabilities.....	(25,039)			(21,600)			(22,477)
Of which deferred tax assets.....	-			13,615			10,119

Items included in the Other movements column in 2017 indicate the investment tax credit decrease (HUF 54 million) which was adjusted against the P&L in deferred taxes. The line of IFRS transition includes the deferred tax effect of IFRS transition accounted in 2017 (Note 6.4).

The Company's net deferred tax liability balance as at December 31, 2017 was HUF 12,358 million which includes a high amount of individual deferred tax asset and liability items (see in the table above).

The Company's net deferred tax liability balance as at December 31, 2016 was HUF 7,985 million which includes a high amount of individual deferred tax asset and liability items (see in the table above).

Deferred tax assets arising on investment tax credits are recognized in note 6.3.2.1.

Temporary differences associated with investments in subsidiaries for which deferred tax liabilities or assets have not been recognized amounted to a net liability of HUF 20,798 million at December 31, 2017 (same HUF 20,798 million was the temporary difference not recognized at December 31, 2016).

Deferred tax liability on goodwill is related to the goodwill arising on the acquisition of subsidiaries (Emitel Zrt. and T-Mobile) in the Company's standalone financial statements, which had merged into Magyar Telekom. The amortization of goodwill is a tax deductible expense in corporate income tax, while under IFRSs there is no amortization accounted in the books. The difference deriving from the two types of accounting is represented by the deferred tax liability

6.3.2.1 Investment tax credits

In order to increase broadband internet penetration in Hungary, companies investing over HUF 100 million in a year in broadband assets (e.g. DSL lines, UMTS assets) from 2003 could apply for a corporate tax reduction. Magyar Telekom accomplished such tax credit programs between 2003 and 2008. The tax credit programs commenced in 2012 and 2013 are "large investment" programs, which enable companies to invest not only in broadband related assets, if the investment value exceeds HUF 3 billion and certain special criteria (i.e. headcount increase) are met. In case of both types of tax credit programs, the potential reduction of the corporate tax charge is defined as a percentage of the companies' capital investment in qualifying assets. As both of these investment tax credits are of a government grant nature, Magyar Telekom recognized the deferred tax asset against the cost of the related investment. 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 plus interests are accreted. This accretion is recognized as an increase in the investment tax credit balance against a reduction in the current year deferred tax expense.

The following table shows the details of the tax credits:

Earned in year	Amount of qualifying investment	Amount of tax credit earned	Accretion recognized in tax expense to date	Tax credit utilized	Tax credit carried forward 12.31.2017	Tax credit carried forward 12.31.2016	Expires in year
2007	10,681	2,827	2,888	(5,715)	-	1,687	2017
2012	11,451	3,518	516	(1,470)	2,564	4,028	2021
2013	14,604	4,580	426	(2)	5,004	4,986	2023
2014	490	161	9	-	170	169	2023
Total	37,226	11,086	3,839	(7,187)	7,738	10,870	

In order to utilize the tax credits and certain tax deductibility opportunities earned by the Company, they have to comply with strict requirements as set out in the relevant tax regulations. The most important requirement for all investment tax credits is that the relevant assets have to be operated for at least 5 years. However, for those earned in 2012 and in 2013 certain increase in headcount and/or salary has to be maintained for at least 4 subsequent years following the first year of tax credit utilization. The headcount of the Company has to be increased by 150 and maintained in the subsequent 4 years from the first utilization of the investment tax credit (which is 2012 and 2014).

The 2013 tax credit program was finished in January 2014, so the first utilization of 2013 tax credit is in 2014. The base year for both programs is 2011. Management believes that the headcount criterion is not a substantive requirement. There was a significant headcount increase in 2012 due to insourcing of certain activities carried out by subcontractors before and there are further insourcing plans in place. Based on the above, management believes that the Company has complied and will be able to comply with the requirements to recognize these as deferred tax assets.

6.4 Tax effects of IFRS transition

In relation to corporate income tax, Magyar Telekom Plc. has opted for an exemption with regard to the difference between the IFRS and local GAAP value of intangible and tangible assets recorded in the Company's books on December 31, 2016, meaning that the base of taxation for these asset categories is calculated according to local GAAP rules. In relation to the remaining balance sheet items, Magyar Telekom Plc. has calculated an IFRS transition difference of HUF 22.7 billion, which qualifies as a corporate income tax increasing item. The corporate income tax incurred in relation to this transition difference will be paid in 3 equal installments in 2017-2019.

6.5 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.

6.6 Dividends paid by Magyar Telekom

The dividends paid and payable by Magyar Telekom to its owners may be subject to withholding or income taxes of the owners, which do not have any impact on the amount of the dividend declared or on the Company's tax expense as these taxes – if any – are levied on the owners.

7 INVENTORIES

7.1 Inventories – Accounting policies

Inventories are stated at the lower of cost or net realizable value using the historical cost method of accounting, and are valued on a weighted average basis. The cost of inventories comprises all costs of purchase, cost of construction and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

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

Impairment losses on Inventories are recognized in Other operating expenses.

7.2 Inventories in the statement of financial position

	<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Goods sold	8,529	10,342	13,328
Other inventory	<u>170</u>	<u>351</u>	<u>418</u>
Subtotal	8,699	10,693	13,746
Impairment	<u>(10)</u>	<u>(10)</u>	<u>(3)</u>
	<u>8,689</u>	<u>10,683</u>	<u>13,743</u>

The Company has no inventory pledged as security as at December 31, 2016 or December 31, 2017.

Impairment and its reversal are not significant so no impairment movement table are presented.

8 ASSETS AND LIABILITIES HELD FOR SALE

8.1 Assets and liabilities held for sale – Accounting policies

An asset (typically real estate) is classified as held for sale if it is no longer needed for the future operations of the Company, and has been designated for sale, which is highly probable to take place within 12 months, and the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets. These assets are measured at the lower of their carrying amount and fair value less cost to sell. Depreciation is discontinued from the date of designation to the held for sale status. When an item of PPE or intangible assets is designated for sale, and the fair value less cost to sell is determined to be lower than the carrying amount, the difference is recognized in the Profit for the year (Depreciation and amortization) as an impairment loss.

8.2 Assets held for sale in the statement of financial position

The assets and liabilities classified as held for sale are disclosed below.

	<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Property, plant and equipment	1,516	1,516	161
Technical equipment, machinery and vehicles	44	24	-
Investments (Note 26.1.2.).....	<u>4,200</u>	<u>-</u>	<u>-</u>
Total assets held for sale.....	<u>5,760</u>	<u>1,540</u>	<u>161</u>

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

9 PROPERTY, PLANT AND EQUIPMENT (PPE)

9.1 PPE – Accounting policies

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

The cost of an item of PPE comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located is also included in the costs if the obligation incurred is recognized as a provision (see Note 13).

Government grants relating to the purchase of PPE are deducted from the original cost of the items and are recognized in the Profit for the year through the reduced amount of depreciation of the related assets over their useful lives. Investment tax credits relating to qualifying investment projects (Note 6.3.2.1.) are also recognized in this manner.

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

Subsequent expenditure on an asset is capitalized if it is probable that the future economic benefits associated with the expenditure will flow to the Company. Maintenance and repairs are recognized as an expense in the Profit for the year when incurred.

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

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

Depreciation is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. On an annual basis, Magyar Telekom reviews the useful lives and residual values for consistency with current development plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 9.3. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year. The depreciation expense is presented in the depreciation and amortization line of the Statement of profit or loss.



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

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

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

The fair values of the individual items of property, plant and equipment of the Company in most cases cannot be determined as individual assets do not generate cash flows. Therefore the Company determines the impairment of standalone assets on CGU level. For this point of view the whole Company is considered as one CGU. The Company determines fair values at CGU level, primarily by using discounted cash flow analyses. See further information in Note 3.2.

The impairment losses of PPE assets are accounted for in the Depreciation and amortization line of the Statement of profit or loss.

9.2 PPE in the statement of financial position

	<u>Land and equivalent rights</u>	<u>Buildings</u>	<u>Telecom. equipment</u>	<u>Other equipment</u>	<u>Total</u>
01.01.2016					
Gross value.....	7,366	119,330	899,052	69,955	1,095,703
Accumulated depreciation.....	<u>(2,274)</u>	<u>(45,540)</u>	<u>(610,400)</u>	<u>(58,193)</u>	<u>(716,407)</u>
Carrying amount.....	<u>5,092</u>	<u>73,790</u>	<u>288,652</u>	<u>11,762</u>	<u>379,296</u>
Of which held for sale.....					<u>(1,560)</u>
					<u>377,736</u>
Carrying amount - 01.01.2016.....	5,092	73,790	288,652	11,762	379,296
Changes due to acquisition.....	-	13	2,769	5	2,787
Changes due to revisions of asset retirement obligations.....	-	(97)	235	-	138
Investments.....	-	1,411	49,996	4,703	56,110
Disposals.....	(176)	(5,092)	(112)	(181)	(5,561)
Depreciation charge.....	(137)	(3,410)	(47,992)	(4,940)	(56,479)
Reclassifications.....	30	(668)	1,656	(1,018)	-
Carrying amount - 31.12.2016.....	<u>4,809</u>	<u>65,947</u>	<u>295,204</u>	<u>10,331</u>	<u>376,291</u>



31.12.2016

Gross value	7,173	109,714	868,164	70,655	1,055,706
Accumulated depreciation.....	<u>(2,364)</u>	<u>(43,767)</u>	<u>(572,960)</u>	<u>(60,324)</u>	<u>(679,415)</u>
Carrying amount.....	<u>4,809</u>	<u>65,947</u>	<u>295,204</u>	<u>10,331</u>	<u>376,291</u>
Of which held for sale.....					<u>(1,540)</u>
					<u>374,751</u>
Carrying amount -01.01.2017.....	4,809	65,947	295,204	10,331	376,291
Changes due to revisions of asset retirement obligations.....	-	297	(31)	-	266
Investments.....	1	1,796	36,542	8,916	47,255
Addition due to acquisition.....	1	9	224	16	250
Disposals.....	(20)	(959)	(36)	(114)	(1,129)
Depreciation charge.....	(74)	(3,359)	(42,310)	(5,297)	(51,040)
Reclassifications.....	<u>61</u>	<u>582</u>	<u>(5)</u>	<u>(638)</u>	<u>-</u>
Carrying amount -31.12.2017.....	<u>4,778</u>	<u>64,313</u>	<u>289,588</u>	<u>13,214</u>	<u>371,893</u>

31.12.2017

Gross value	7,128	109,694	852,290	73,337	1,042,449
Accumulated depreciation.....	<u>(2,350)</u>	<u>(45,381)</u>	<u>(562,702)</u>	<u>(60,123)</u>	<u>(670,556)</u>
Carrying amount.....	<u>4,778</u>	<u>64,313</u>	<u>289,588</u>	<u>13,214</u>	<u>371,893</u>
Of which held for sale.....					<u>(161)</u>
Carrying amount.....					<u>371,732</u>

The closing balance of Property, plant and equipment (PPE) includes assets in the course of construction in an amount of HUF 44,624 million as at December 31, 2017 (2016: HUF 52,955 million). In the table above the assets in course of construction are shown in the categories where the asset is expected to be classified when placed into service.

Changes due to revisions of asset retirement obligations represent the adjustments of the carrying amounts of the assets against a provision for asset retirement obligation (see also Note 13.2.4).

The amount of reclassifications and its effect on depreciation are not significant.

Investments represent the regular investing activity in PPE assets.

No impairment was identified in 2016 and 2017.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2017 the cost of the assets leased back is HUF 4,048 million (2016: HUF 3,775 million) and their carrying amount (net) is HUF 1,529 million (2016: HUF 1,533 million).

Included mainly in buildings and telecomequipment are also assets leased under finance lease conditions other than sale and lease back. At December 31, 2017 the cost of the finance leased assets is HUF 3,391 million (2016: HUF 7,211 million) and the carrying amount (net) is HUF 849 million (2016: HUF 3,750 million).

The Company has no PPE with restricted titles or pledged as security as at December 31, 2017 or December 31, 2016.

9.3 Review of useful lives

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

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>After 2020</u>
Increase/ (decrease) in depreciation expense	(477)	(64)	832	697	(988)

The reviews of the useful lives (and residual values) of property, plant and equipment during 2017 affected the lives of a large number of assets including primarily leased set-top box assets subsequently reclassified to own use. The revisions resulted in the following change in the original trend of depreciation in the current and future years.

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>After 2021</u>
Increase/ (decrease) in depreciation expense	(2,037)	(317)	1,351	917	86

10 INTANGIBLE ASSETS

10.1 Intangible assets – Accounting policies

Intangible assets (excluded goodwill) are measured at historical cost less accumulated amortization and any accumulated impairment losses.

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

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

Costs associated with the acquisition of long term frequency licenses are recognized as an intangible asset when the Company receives a right to charge users of the service provided under the license. The present value of the future annual payments for the use of the frequencies are also capitalized if these payments can be estimated reliably, or otherwise recognized as Other operating expenses in the year the payment obligation refers to. The useful lives of concessions and licenses are determined based on the underlying agreements and are amortized on a straight line basis over the period from availability of the frequency for commercial use until the end of the initial concession or license term. Renewal periods are considered in the determination of useful life only if the Company estimates that it will be realized without further consideration to be transferred.

Amortization of intangible assets is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. Other than goodwill, the Company has no intangible assets with indefinite useful life. The amortization expense is presented in the depreciation and amortization line of the Statement of profit or loss.

On an annual basis, Magyar Telekom reviews the useful lives for consistency with current development and replacement plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 10.3. The annual revisions are conducted in the second quarter of the year and the resulting changes are applied from the third quarter of the year. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year.

The estimated useful lives of intangible assets other than goodwill are as follows:

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

At the date of transition to IFRS (January 1, 2016) the Company recognized goodwill on those investments that merged into the Company after their acquisition but before the date of transition to IFRS in its separate statement of financial position.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net assets and contingent liabilities of the acquired business at the date of acquisition. Goodwill is carried at cost less any accumulated impairment losses. Impairment testing is carried out on an annual basis for all goodwill in the last quarter of the year based on the carrying values as at September 30 of the year. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill allocated to the entity or business sold. See further information in Note 3.2.

In determining whether an asset that incorporates both intangible and tangible elements should be accounted for as a property, plant and equipment or as an intangible asset, management uses judgment to assess which element is more significant and recognizes the assets accordingly.

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

The fair values of the individual intangible assets of the Company in most cases cannot be determined as individual assets do not generate cash flows. Instead, the Company determines CGUs to which the individual assets are allocated and the fair values can only be determined at CGU level, primarily by using discounted cash flow analyses. See also Note 3.2. Corporate assets which have the distinctive characteristics of not generating cash inflows independently of other assets or groups of assets are allocated to CGUs when conducting impairment tests.

Fair value is determined on the CGU level, primarily by using discounted cash flow analyses.

See also Note 3.2. If the calculated fair value less cost to sell is lower than the carrying amount of the CGU, goodwill is impaired.

The impairment losses of intangible assets including that of goodwill are accounted for in the Depreciation and amortization line of the Statement of profit or loss.

10.2 Intangible assets in the statement of financial position

	<u>Goodwill</u>	<u>Concessions and licenses</u>	<u>Software</u>	<u>Other</u>	<u>Total</u>
01.01.2016					
Gross value.....	173,572	175,642	235,435	3,304	587,953
Accumulated amortization.....	-	(28,394)	(156,392)	(1,435)	(186,221)
Carrying amount.....	<u>173,572</u>	<u>147,248</u>	<u>79,043</u>	<u>1,869</u>	<u>401,732</u>
Carrying amount – 01.01.2016.....	173,572	147,248	79,043	1,869	401,732
Changes due to acquisition.....	-	115	25	-	140
Investments.....	-	181	23,473	8	23,662
Disposals.....	-	-	-	-	-
Amortization charge.....	-	(14,465)	(18,712)	(288)	(33,465)
Reclassifications.....	-	(87)	-	87	-
Carrying amount – 12.31.2016.....	<u>173,572</u>	<u>132,992</u>	<u>83,829</u>	<u>1,676</u>	<u>392,069</u>
12.31.2016					
Gross value.....	173,572	175,695	243,201	3,555	596,023
Accumulated amortization.....	-	(42,703)	(159,372)	(1,879)	(203,954)
Carrying amount.....	<u>173,572</u>	<u>132,992</u>	<u>83,829</u>	<u>1,676</u>	<u>392,069</u>
Carrying amount – 01.01.2017.....	173,572	132,992	83,829	1,676	392,069
Addition due to acquisition.....	-	-	-	4,207	4,207
Investments.....	-	-	19,171	-	19,171
Disposals.....	-	-	(10)	-	(10)
Amortization charge.....	-	(14,481)	(21,724)	(602)	(36,807)
Reclassification.....	-	-	-	-	-
Carrying amount – 31.12.2017.....	<u>173,572</u>	<u>118,511</u>	<u>81,266</u>	<u>5,281</u>	<u>378,630</u>
12.31.2017					
Gross value.....	173,572	175,691	261,322	7,761	618,346
Accumulated amortization.....	-	(57,180)	(180,056)	(2,480)	(239,716)
Carrying amount.....	<u>173,572</u>	<u>118,511</u>	<u>81,266</u>	<u>5,281</u>	<u>378,630</u>
Of which held for sale.....					-
Carrying amount.....					<u><u>378,630</u></u>

Investments represent the regular investing activity in intangible assets.

The amortization expense as well as the impairment losses of intangible assets including also goodwill is accounted for in the Depreciation and amortization line of the Statement of profit or loss. The amount of reclassifications and its effect on depreciation are not significant.

The Company has no intangible assets with restricted title or pledged as security as at December 31, 2017 or December 31, 2016.

10.3 Useful lives

The reviews of the useful lives of intangible assets during 2016 resulted the termination of "Távszámla" (an invoice payment via internet) and the extension of useful lives of assets to be amortized to zero within two years. The reviews of the useful lives of intangible assets during 2017 resulted in the following change in the original trend of amortization in the current and future years.

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>After 2020</u>
Increase/ (decrease) in depreciation expense	28	119	159	(298)	(8)

The reviews of the useful lives (and residual values) of intangible assets during 2017 affected the lives of a large number of assets including primarily software. The reviews of the useful lives of intangible assets during 2017 resulted in the following change in the original trend of amortization in the current and future years.

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>After 2021</u>
Increase/ (decrease) in depreciation expense	(1,640)	(58)	351	343	1,004

10.4 Goodwill

At the date of transition to IFRS (January 1, 2016) the Company recognized goodwill on investments that merged into the Company after their acquisition but before the date of transition to IFRS in its separate statement of financial position.

The Company recognizes goodwill for the following merged investments:

	<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
T-Mobile	161,374	161,374	161,374
KTV/T-Kábel.....	4,408	4,408	4,408
T-Online.....	54	54	54
Emitel Zrt.	6,471	6,471	6,471
Dél-Vonal Kft.	100	100	100
Cable TV acquisitions	462	462	462
Modultechnika Kft.	703	703	703
Total.....	173,572	173,572	173,572

The Company is a considerable part of MT-Hungary segment on Magyar Telekom Group level. The goodwill presented in the Company was tested as the considerable part of this segment.

For the goodwill impairment tests, the total amount of goodwill was allocated to the operating segments of the Group and the recoverable amounts of the operating segments were determined based on fair values less costs of disposal based on Level 3 inputs in the fair value calculations (Note 4.5.1). The recoverable amounts of the segments disclosed in the table below exclude net debts, which are not allocated to the segments. For further information, please also see Note 3.2.

As at December 31,

	2016		2017		Recoverable amount of operating segment
	Carrying amount of goodwill allocated	operating segment (incl. goodwill)	Carrying amount of goodwill allocated	operating segment (incl. goodwill)	
MT-Hungary	191,454	807,989	192,085	791,806	1,703,753

The Group regularly carries out an impairment test on goodwill in the last quarter of the financial years. During the annual impairment test conducted in the last quarter of 2016 and 2017 no goodwill impairment was established for any goodwill.

10.5 Significant individual intangible assets

The Company's most significant individual intangible assets are the mobile licenses. The carrying values and remaining amortization periods of the significant licenses are listed in the table below. For further information on these assets, please see Note 34.2.

	12.31.2016		12.31.2017	
	Carrying amount	Remaining amortization period (years)	Carrying amount	Remaining amortization period (years)
Licenses acquired in 2014	87,174	18	82,192	17
Licenses acquired in 2013	39,180	5	31,717	4
Hungarian 3G license	5,358	3	3,581	2
Other	1,279	-	1,021	-
Total concessions and licenses	132,991		118,511	

11 INVESTMENTS

11.1 Investments – accounting policies

Investments in subsidiaries, associates, joint ventures and joint operations are measured at cost less any accumulated impairment losses. Cost of an investment is the fair value of consideration given, including contingent considerations and transaction costs incurred during the acquisition process. For the measurement of the Company's investments in its first IFRS statement of financial position please refer to Note 2.2.

After transition the investments are carried at cost less accumulated impairment losses occurred until transition.

The Company examines that an investment may or may not be impaired by using internal and external information.

Magyar Telekom implements the requirements of IAS 36 standard as the following:

If the carrying amount of investment exceeds HUF 20 billion then its recoverable amount is always analyzed with DCF model (irrespective of whether there is any indication of impairment or not).

If the carrying amount of investment does not exceed HUF 20 billion then the Company examines considering the followings whether there was any changes related to these investments which requires the preparation of impairment assessment based on DCF model:

- 1) The Company examines the possibility whether there were or expected to be any significant changes with an adverse effect during the period in the investment's technological, market, economic and legal environment or economic downturn can be expected or not.
- 2) The company examines the future development of the forecasted results in its investments.
- 3) If subsidiaries, joint ventures or associates recognize dividend then it has to be examined whether the investments' carrying amount in the Company's standalone financial statements exceeds the carrying amount of the investment's net assets (including goodwill) recognized in the consolidated financial statements. In addition, it has to be examined whether in the period the dividend was declared it exceeds the amount of reserve available for dividend distribution since the acquisition of the control.

If any of the above 3 examination indicates that the market value of the investment declines below its carrying amount then the Company prepares the impairment assessment based on DCF model also for that investment where the carrying amount does not exceed HUF 20 billion.

If the carrying amount of the investment exceeds its recoverable amount, the Company recognizes the necessary impairment loss. If the recoverable amount of the investment exceeds its carrying amount, no impairment is necessary. The previously recorded impairment can be reversed to the extent the carrying amount does not exceed the recoverable amount or if this amount is lower than the carrying amount before the impairments settled earlier.

11.2 Investments

Subsidiaries are entities controlled by the Company. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The existence and effect of potential voting rights that are presently exercisable or presently convertible are also considered when assessing whether the Company controls another entity.

As of January 1, 2016, December 31, 2016 and 2017, the Company's investments in subsidiaries are summarized as follows.

	01.01.2016 Carrying amounts	Changes in 2016	12.31.2016 Carrying amounts	Changes in 2017	12.31.2017 Carrying amounts
Stonebridge A.D.	77,999	-	77,999	-	77,999
T-Systems Magyarország Zrt.	32,451	-	32,451	8,369	40,820
Combridge S.R.L.	2,544	-	2,544	-	2,544
Novatel E.O.O.D.	1,999	-	1,999	-	1,999
Investel Zrt.	1,658	-	1,658	-	1,658
Crnogorski Telekom A.D.	35,925	-	35,925	(35,925)	-
GTS Hungary Kft.	14,269	(4,425)	9,844	(9,844)	-
Other	5,460	20	5,480	-	5,480
Total	172,305	(4,405)	167,900	(37,400)	130,500

The Company examined the indicators mentioned in Note 11.1 and carried out the tests and no impairment occurred so impairment was not recorded in 2017.

The impairment recognized for investment was HUF 2 million accumulated on December 31, 2016 and 2017.

The major activities of GTS Hungary Kft. restructured continuously during the last years as a result of which networks and the clients served were transferred into the Company. GTS Hungary Kft. paid a higher dividend than its profit for the year for the Company which resulted that the value of investment decreased with HUF 4,425 million in 2016 and with HUF 1,475 million in 2017. The remaining



HUF 8,369 million of the investment increased the investment in T-Systems Magyarország Zrt. when GTS Hungary Kft. merged into T-Systems Magyarország Zrt.

In consequence of the sale of Crnogorski Telekom A.D. the investment was removed from the accounts,

ESOP Organization is a special organization of Magyar Telekom which is controlled by the Company without any shares in it. Further information see Note 20.

Short descriptions of companies in which Magyar Telekom Plc. has significant shares:

Stonebridge Communications A.D. Skopje (Stonebridge A.D.)

In December 2000, Magyar Telekom, on behalf of a consortium, reached an agreement with the government of Macedonia to purchase 51 percent of Makedonski Telekom A.D., the leading telecommunication provider of Macedonia. The 51 percent ownership acquired by Magyar Telekom was contributed in 2001 to a newly established Macedonian holding company, Stonebridge A.D. residing in Skopje which is owned by the Magyar Telekom Plc. in 100%.

GTS Hungary Távközlési Kft. (GTS Hungary Kft.)

The Magyar Telekom Plc.'s Board of Directors approved the contract on acquiring the 100% share of GTS Hungary Kft. on February 25, 2015. After the acquisition the transaction was registered at Court of Registry of Budapest Environs Regional Court on April 1, 2015.

GTS Hungary Kft. is a leading alternative infocommunication service provider in Hungary, provides fixed line voice, data, internet and IT services for business and residential customers. In 2017 the Company concluded a merger contract with ServerInfo-Ingatlan Kft. (a subsidiary of GTS Hungary Kft.) and based on this contract ServerInfo-Ingatlan Kft. merged into GTS Hungary Kft.

T-Systems Magyarország Zrt.

In 2006 Magyar Telekom Plc. purchased the 100% ownership in KFKI Zrt. In the course of years the company had several transformations resulted numerous mergers. In 2012, the company changed its name and continues its activities under the name of T-Systems Magyarország Zrt. In 2017 ServerInfo-Ingatlan Kft. (operated as a subsidiary of T-Systems Magyarország Zrt. until the merger) and GTS Hungary Távközlési Kft. merged into T-Systems Magyarország Zrt.

Combridge S.R.L.

The company is an alternative telecommunication service provider of Romania. Its main activities are: international and domestic leased line connection, international internet access, international IPVPN services, roaming services and international VoIP call termination. Magyar Telekom Plc. has a 100% share in Combridge S.R.L.

Novatel E.O.O.D.

The company was established in 2004 with headquarters in Bulgaria. The company's main activities are: international and domestic leased line connection, international internet access and IPVPN services, roaming services, infocommunication business solutions and international call termination. Magyar Telekom Plc. has a 100% share in Novatel E.O.O.D.

Crnogorski Telekom A.D.

In 2004, Magyar Telekom won the tender for the sale of a 51.12 per cent stake in Crnogorski Telekom A.D. issued by the Montenegrin Privatization Agency. Crnogorski Telekom is the leading telecommunication service provider of Montenegro. The share purchase agreement was signed in 2005 in the amount of EUR 114 million. In 2005, Magyar Telekom acquired a further 25.41 per cent share for EUR 27 million based on an agreement with minority shareholders. In January 2017, the Company signed a share purchase agreement with Hrvatski Telekom D.D. for the sale of its 76.53% majority shareholding in Crnogorski Telekom A.D. totalled EUR 123.5 million (HUF 38.5 billion). Magyar Telekom did not present this investment as assets held for sale in 2016 year-end because the sale was decided only in January, 2017.

A joint arrangement is an arrangement whereby two or more parties have joint control.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

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

As of January 1, 2016, December 31, 2016 and 2017, the Company's investments in joint venture are summarized as follows:

	01.01.2016 Carrying amounts	12.31.2016 Carrying amounts	Changes in 2017	12.31.2017 Carrying amounts
E2 Hungary Zrt.	1,000	1,000	-	1,000
Total	1,000	1,000	-	1,000

Magyar Telekom signed an agreement with MET Holding AG, a leading integrated retail energy services trader in the region to establish a joint venture in Hungary, E2 Hungary Zrt. as of July 9, 2015. E2 Hungary provides energy services for business customers from 2016. The company's issued capital is HUF 200 million, and additional HUF 1,800 million was contributed as additional paid-in capital which were fully paid by both parties. The joint venture is set up by the parties on a 50:50 ownership basis with balanced rights in the management structure. The cost and the carrying amount of the investment in E2 Hungary Zrt. amounted to HUF 1,000 million as at December 31, 2017 and 2016.

The Company had no investment in associates at December 31, 2016 and 2017.

The Company had no contingent liabilities or commitments relating to its joint venture at December 31, 2016 and 2017.

11.3 Joint operations

Magyar Telekom and Telenor Hungary agreed in 2015 to jointly operate and develop their 800MHz 4G mobile networks in all parts of Hungary except Budapest. The primary goal of the agreement was to accelerate 4G mobile broadband coverage rollout in the countryside and to offer higher bandwidth to the 4G customers, in line with the coverage obligations of the 800 MHz spectrum contract signed in 2014 with the NMAH. Based on the agreement, Telenor Hungary maintains sites in West Hungary and Magyar Telekom operates sites in the eastern region of the country.

The Company assessed the agreement as joint operation as strategic decisions are made jointly by Magyar Telekom and Telenor, and there is no separate vehicle to control the operation of the arrangement. The Company does not share the obligations for liabilities and any returns or expenses beyond the assets included in the agreement.

Therefore only the assets owned by the Company are recognized while there is no need to present the partner's assets, liabilities, or revenues and expenses. The charges from MT to Telenor and from Telenor to MT are almost equal and settled on a net basis and accounted for in the statement of profit or loss and the effect of this settlement is not significant.

In case any of the parties initiates the termination of this contract, in order to ensure the continuous service for the customers the Company might be exposed to additional capital expenditure. The probability is estimated remote by the Management currently.

12 OTHER ASSETS

Other assets usually include current and non current receivables considered non-financial instruments.

12.1 Other current assets

	01.01.2016	12.31.2016	12.31.2017
Accrued income and prepayments for costs and expenses	2,842	2,582	3,548
Advance payments for joint ventures (Note 32.4.)	3,338	988	-
Other tax receivable.....	463	571	603
Other receivables.....	229	2,020	3,025
Total	6,872	6,161	7,176

12.2 Other non current assets

Other non-current assets mainly include long-term prepaid employee benefits relating to housing loans provided by the Company to employees at lower than market interest rates (see note 4.1.3 (d)).

13 PROVISIONS

13.1 Provisions – Accounting policies

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

Provisions are measured at the best estimate of the economic outflow required to settle the present obligation at the reporting date. The estimate can be calculated as the weighted average of estimated potential outcomes or can also be the single most likely outcome.

Provisions expected to fall due after 12 months are determined by discounting the expected future cash flows at the pre-tax rate that reflects current market assessment of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as Interest expense.

Expenses for provisions are recognized in the line item of the statement of profit or loss where the actual expense is expected to be presented. When a provision is released unused, it is released to the same line item of the statement of profit or loss where it was originally provided for. Provisions made for liabilities expected to be incurred in foreign currency are recognized in the functional currency at the spot FX rate, and any change in the provision in the functional currency as a result of a subsequent change in the FX rate is recognized in Other finance expense – net.

13.2 Provisions in the statement of financial position

	Severance payment	Share- based payments	Other employee related	Total employee related	Legal cases	ARO	Other	Total
01.01.2016	5,011	175	1,117	6,303	551	6,942	429	14,225
Reversed.....	(153)	(2)	(27)	(182)	(61)	(264)	(543)	(1,050)
Additions.....	960	312	288	1,560	694	402	918	3,574
Interest.....	-	1	2	3	(27)	107	-	83
Utilized (incl. interest component).....	(3,979)	-	(447)	(4,426)	(131)	(86)	(104)	(4,747)
31.12.2016.....	1,839	486	933	3,258	1,026	7,101	700	12,085
Of which current.....	1,407	-	510	1,917	601	11	640	3,169
Of which non current.....	432	486	423	1,341	425	7,090	60	8,916
01.01.2017.....	1,839	486	933	3,258	1,026	7,101	700	12,085
Reversed.....	(447)	(32)	(13)	(492)	(121)	(73)	(683)	(1,369)
Additions.....	2,521	364	133	3,018	14	339	432	3,803
Interest.....	-	4	(7)	(3)	(77)	157	-	77
Utilized (incl. interest component).....	(2,376)	(66)	(502)	(2,944)	(622)	(38)	(6)	(3,610)
31.12.2017.....	1,537	756	544	2,837	220	7,486	443	10,986
Of which current.....	1,290	-	529	1,819	78	18	397	2,312
Of which non current.....	247	756	15	1,018	142	7,468	46	8,674

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

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

13.2.1 Severance payment

The majority of the provision for severance as at December 31, 2017 relates to the stand-by-pool and the employee terminations payable in relation to the 2018 efficiency improvement in Magyar Telekom. The stand-by-pool of employees includes people whose legal status is an employee, however, these people do not provide services to the Company any more, but the Company provides a reduced amount of compensation and pays social security expenses for them. This is a way of severance that is not paid in one lump sum but in monthly installments. The majority of the provision for severance as at December 31, 2016 also related to the stand-by-pool and the employee terminations paid in relation to the 2017 efficiency improvement in Magyar Telekom.

860 employees left the Company in 2017 (2016: 740), related to which termination payments were made. The balance of provision as at December 31, 2017 relates to 396 employees and former employees in the stand-by-pool (2016: 413).

The total payments made in relation to employee termination in 2017 amounted to HUF 3,094 million (2016: HUF 4,132 million).

13.2.2 Share-based payments

The bases of the provisions for share-based payments are described in Note 20.1.2.

13.2.3 Legal cases

Provisions for legal cases mainly include amounts expected to be paid to regulatory and competition authorities as well as to ex-employees and trading partners as a result of legal disputes. There are numerous legal cases for which provisions were recognized, which are individually not material.

13.2.4 Asset retirement obligations (ARO)

Asset retirement obligations primarily exist in case of the telecommunications structures constructed on third parties' properties. The Company carries out a revision of the necessary provisions every year. The revisions did not result in material changes in 2017 or 2016.

13.2.5 Other provisions

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

14 OTHER CURRENT LIABILITIES

	<u>01.01.2016</u>	<u>12.31.2016</u>	<u>12.31.2017</u>
Deferred revenue and advances received	8,957	9,149	7,990
Other taxes and social security	10,211	9,938	10,335
Salaries and wages.....	4,157	3,257	5,509
Advances received for asset-related grants..... (a)	-	5,104	4,648
Dividend payable to non controlled interest	24	26	11
Other liabilities	<u>268</u>	<u>264</u>	<u>290</u>
Total	<u>23,617</u>	<u>27,738</u>	<u>28,783</u>

(a) Advances received for asset-related grants

In 2016 HUF 12.2 billion of EU funds have been granted to Magyar Telekom. This is a result of the first and second rounds of a tender aimed at developing digital networks nationwide to cover households in Western and Eastern parts of Hungary with a fixed network capable of reaching speed of at least 30 Mbps. From this fund HUF 1.4 billion has been drawn down. See also Note 9 for government grants relating to the purchase of PPE and Note 28 for details of Purchase of PPE and intangible assets.

15 OTHER NON CURRENT LIABILITIES

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

16 EQUITY

16.1 Equity reconciliation table

In accordance with Act C of 2000 on Accounting („HAR”) effective in Hungary, the following equity reconciliation table shows the reconciliation between the components of equity presented in these financial statements (under EU IFRS) and the equity components defined by Section 4 (a) 114/B of HAR. The reconciliation consists of an allocation of equity components under EU IFRS to equity components under HAR and adjustments for differences between the equities determined on different bases.

	12.31.2016	12.31.2017
Equity in accordance with IFRS (Section 4 (a) 114/B)		
Common stock	104,274	104,274
Reserves	381,582	407,420
Treasury stock	(55)	(27)
Profit or loss for the year	54,245	41,857
Total equity	540,046	553,524
Section 4 (a) 114/B Equity		
Equity	540,046	553,524
Supplementary payments received and recognised as a liability in IFRS (+)	-	-
Supplementary payments paid and recognised as an asset in IFRS (-)	-	-
Any cash to be transferred to the capital reserve on the basis of legal provisions, and assets received, recognised as deferred income (+)	-	-
Receivables from owners arising from capital increase that qualifies as an equity instrument (-)	-	-
Total equity	540,046	553,524
Section 4 (b) 114/B Common stock in accordance with IFRS*		
Common stock provided for by the articles of association if that qualified as an equity instrument	104,274	104,274
Nominal value of own shares repurchased (-)	(8)	(4)
Common stock in accordance with IFRS	104,266	104,270
Section 4 (c) 114/B Subscribed but unpaid capital		
Amount has not yet been provided for the owner from the common stock in accordance with IFRS	-	-
Section 4 (d) 114/B Capital reserves		
Sum of all part of equity that does not comply with the definitions of common stock, subscribed but unpaid capital, retained earnings, valuation reserve, profit or loss for the year or restricted reserves in accordance with IFRS	27,119	25,078
Total capital reserves	27,119	25,078
Section 4 (e) 114/B Retained earnings		
Previous years' profit accumulated and not yet distributed for the owners disclosed in the financial statements in accordance with IFRS that may not include other comprehensive income (±)	354,463	382,642
Supplementary payments paid and recognised as an asset in IFRS (-)	-	-
Unused development reserve (-)	-	-
Unused development reserve related deferred tax based on IAS 12 (+)	-	-
Total retained earnings	354,463	382,642

	12.31.2016	12.31.2017
Section 4 (f) 114/B Valuation reserve		
Accumulated amount of other comprehensive income disclosed in the statements of comprehensive income (±)	-	-
Other comprehensive income disclosed in the statements of comprehensive income including other comprehensive income from the current year (±)	-	-
Valuation reserve	-	-
Section 4 (g) 114/B Profit or loss for the year		
Profit or loss for ongoing activities disclosed in statement of performance in its own right within the comprehensive income statement or in the separate profit and loss statement (-)	54,245	41,857
Profit or loss for discontinued activities disclosed in statement of performance in its own right within the comprehensive income statement or in the separate profit and loss statement	-	-
Profit or loss for the year	54,245	41,857
Section 4 (h) 114/B Restricted reserves		
Supplementary payments received and recognised as a liability in IFRS (+)	-	-
Unused development reserve (+)	-	-
Unused development reserve related deferred tax based on IAS 12 (-)	-	-
Total restricted reserves	-	-
Section 5 (a) 114/B Reconciliation of the capital registered by the Court of Registry with the subscribed capital under IFRS*		
Capital registered by the Court of Registry	104,274	104,274
Subscribed capital under IFRS	104,266	104,270
Difference (nominal value of treasury stock repurchased)	8	4
Section 5 (b) 114/B Untied retained earnings available for the payment of dividends		
Retained earnings (contains profit or loss of the last financial year)	408,708	424,499
Cumulative unrealized gains claimed in connection with any increase in the fair value of investment properties as provided in IAS 40 (-)	-	-
Cumulative income tax accounted for under IAS 12 Income Taxes related to cumulative unrealized gains claimed in connection with any increase in the fair value of investment properties as provided in IAS 40 (+)	-	-
Untied retained earnings available for the payment of dividends	408,708	424,499

* The Company discloses the treasury stock repurchased on repurchase value separately in the balance sheet on Treasury stock line. Common stock shows the value of common stock recorded in article of association in the balance sheet, the table above contains the deduction defined in the relevant sections of the Hungarian Act on Accounting.

17 LEASES

17.1. Leases – Accounting policies

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for a period of time set out in the contract. A lease can be either an operating lease or a finance lease.

According to the accounting principle of substance over (legal) form, in practice not only those arrangements can accounting-wise qualify for leases that are denominated as leases.

In the Group's practice, the following can be in particular arrangements that are not legally leases but might contain leases:

- arrangements assigning network capacity rights to others
- outsourcing-type arrangements (i.e. whereby the Group outsources its own resources/assets/some of its activities/certain employees to another company).

An arrangement contains a lease, if the fulfilment of the arrangement is dependent on the use of a specific asset or assets or if the arrangement conveys a right to use the asset(s). The arrangement conveys the right to use the asset(s) when the arrangement conveys the control over the use of the underlying asset(s) for the lessee. If an arrangement contains a lease, then the lease element of the arrangement should be classified and accounted for as either operating or finance lease. The element of the arrangement other than the lease element should be accounted for in accordance with the applicable standards.

For the purpose of applying the classification and accounting rules, payments and other consideration required by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease and those for other elements on the basis of their relative fair values. In doing such separation, a significant degree of estimation might be necessary.

If all the benefits and risks related to the ownership of the leased asset are transferred to the lessee then the lease is classified as finance lease. All lease transactions not classified as finance lease are operating lease. The classification whether a lease is finance or operating lease depends on the actual content of the transaction and not on the form of the contract.

a) Finance lease – Company as lessor

Leases of assets where Magyar Telekom transfers substantially all the benefits and risks of ownership are classified as finance leases. Under finance leases, the Company recognizes revenue and a finance lease receivable at the commencement of the lease. The revenue equals the estimated present value of the minimum lease payments receivable and any unguaranteed residual value accruing to the lessor (net investment in the lease). The cost of the asset sold in a finance lease transaction is recognized in Profit for the period at the commencement of the lease. Each lease receipt is allocated between the receivable and interest income so as to produce a constant rate of return on the net investment in the finance lease. The interest income element of the lease receipt is recognized in Interest income.

Finance leases mainly include equipment provided to business customers as part of our outsourcing contracts where the Company is the service provider.

b) Finance lease – Company 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. The leased assets are measured initially at the fair value of the asset or if lower, at the estimated present value of the minimum lease payments. Each lease payment is apportioned between the reduction of the finance lease liability outstanding and interest expense. The finance lease liability, net of finance charges, is recognized in Other financial liabilities in the Statement of financial position. The interest expense element of the lease payments is charged to profit or loss and recognized in Interest expense over the lease period and is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Subsequent to initial recognition, the leased assets are accounted for in accordance with the accounting policy applicable to that asset, except for that property, plant and equipment acquired under finance lease contracts are depreciated over the shorter of the lease term and the useful life of the asset.

c) Operating lease – Company as lessor

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

d) Operating lease – Company as lessee

Payments made under operating leases are charged to the Profit for the year (Other operating expenses) on a straight-line basis over the lease term.

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

17.2 Finance lease
17.2.1 Finance lease – Company as lessor

Future lease receivables under finance leases at December 31, 2016 and 2017 are as follows:

	01.01.2016			12.31.2016			12.31.2017		
	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt
Within 1 year.....	4	4	7	4	3	7	4	3	7
1–5 years.....	16	13	30	17	11	28	18	11	29
After 5 years.....	57	21	78	51	13	64	46	13	59
Total	77	38	115	72	27	99	68	27	95

The interest component represents the unearned finance income. The present value due within one year is included in Other current financial assets, while the present value after one year is included in Non current financial assets. The finance income accruing to the Company over the lease term is recognized in the Profit for the year (Interest income).

The Company has not recognized impairment loss of financial leases neither on the above mentioned balance sheet dates.

17.2.2 Finance lease – Company as lessee

Finance leases in 2016 and 2017 mainly relate to the sale and lease back of spaces in buildings accommodating telephone exchanges. In most cases the contracts are denominated in EUR, the term of the leases is 5–15 years, and the contracts include renewal options but no purchase options.

Future lease payments under finance leases related to sale and lease back transactions at December 31, 2016 and 2017 are as follows:

	01.01.2016			12.31.2016			12.31.2017		
	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt
Within 1 year.....	200	795	995	98	786	884	134	807	941
1–5 years.....	575	2,627	3,202	582	2,578	3,160	649	2,576	3,225
After 5 years.....	1,170	1,734	2,904	1,256	1,281	2,537	1,200	1,214	2,414
Total	1,945	5,156	7,101	1,936	4,645	6,581	1,983	4,597	6,580

Finance leases other than sale and lease back in 2016 and 2017 mainly relate to IPTV set-top-boxes, vehicles and IT equipment. In most cases the contract term of the leases is 2–5 years partly with renewal and purchase options.



Future lease payments under finance leases other than sale and lease back transactions at December 31, 2016 and 2017 are as follows:

	01.01.2016			12.31.2016			12.31.2017		
	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt
Within 1 year.....	3,592	287	3,879	2,180	320	2,500	418	377	795
1-5 years.....	1,846	815	2,661	657	1,004	1,661	512	1,195	1,707
After 5 years.....	608	555	1,163	706	576	1,282	699	531	1,230
Total	6,046	1,657	7,703	3,543	1,900	5,443	1,629	2,103	3,732

The Company has no contingent rents related to its finance leases. The Company does not sub-lease any of the assets leased in a finance lease contract.

17.3 Operating leases

17.3.1 Operating lease – Company as lessor

The following table includes the future minimum lease payments receivable by the Company for the operating leases of mobile tower sections and PBX (private business exchange) equipment where Magyar Telekom is the lessor.

	01.01.2016	12.31.2016	12.31.2017
Within 1 year.....	1,007	319	372
1-5 years.....	1,799	355	524
After 5 years.....	143	281	513
Total	2,949	955	1,409

17.3.2 Operating lease – Company as lessee

Operating lease commitments are mainly in respect of the rental of mobile cell sites, and to a lesser extent, related to buildings, network and other telecommunications facilities and equipment. The following table includes the future minimum lease payments payable of the Company:

	01.01.2016	12.31.2016	12.31.2017
Within 1 year.....	9,492	9,866	10,464
1-5 years.....	22,648	25,076	23,614
After 5 years.....	8,099	6,800	4,646
Total	40,239	41,742	38,724

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

18 REVENUE

18.1 Revenue – Accounting policies

18.1.1 Sale of goods

Revenue from sale of goods (equipment) is recognised when risks and rewards of ownership have been transferred to the customer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. The timing of the transfer of risks and rewards varies depending on the individual terms of the agreement. Revenue from sale of goods is measured net of returns, trade discounts and volume rebates.

18.1.2 Rendering of services

The Company recognizes revenue from rendering of services in proportion to the stage of completion of the service at the reporting date. The method of assessment of the stage of completion depends on the type of the service.

18.1.3 Loyalty programs

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

The loyalty program of Magyar Telekom Plc. was ceased as of July 1, 2017 which resulted in the reversal of the related deferred income for the unredeemed loyalty awards.

18.1.4 Revenue from operating leases

Revenues from operating leases are recognized as revenue on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease. Operating lease revenue are primarily recognized as System integration and IT revenue.

18.2 Revenues from major service lines

18.2.1 Mobile and Fixed line telecommunications revenue

Revenue is primarily derived from services provided to Magyar Telekom's customer subscribers and other third parties using Magyar Telekom's telecommunications network, and equipment sales.

Customer subscriber arrangements typically include an equipment sale, subscription fee and charge for the actual voice, internet, data or multimedia services used. The 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 using the residual method for each of the elements. These units are identified and separated, since they have value on a standalone basis and are sold not only in a bundle, but separately as well. Therefore the Company recognizes revenue for all of these elements using the residual method, i.e. the amount of consideration allocated to the delivered elements of the arrangements equals the total consideration less the fair value of the undelivered elements. The revenue allocable to a delivered item, however, is limited to the amount that is not contingent upon the delivery of additional items (the non contingent amount). The revenue to be recognized is therefore restricted by the amount received that is not contingent upon undelivered elements of the arrangement.

The Company provides customers with narrow and broadband access to its fixed, mobile and TV distribution networks. Service revenue 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 revenue are recognized in the period they relate to.

Revenue and expenses associated with the sale of telecommunications equipment and accessories are recognized when the products are delivered, provided that there are no unfulfilled obligations that affect the customer's final acceptance of the arrangement. In case the equipment is sold on installments with payment terms exceeding 12 months, the amount of the revenue immediately recognized is the present value of the installments.

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

Revenues from premium rate services are recognized on a gross basis when the delivery of the service over Magyar Telekom's network is the responsibility of the Company, the Company determines the prices of these services and bears substantial risks of these services; otherwise these revenues are presented on a net basis.

Customers may also purchase prepaid mobile, public phone and internet credits (cards) which allow those customers to use Magyar Telekom's telecommunications network for a selected amount of time. Customers must pay for such services at the date when the card is purchased. Revenue from the sale of cards are recognized when used by the customers or when the credits expire with unused traffic.

Third parties using Magyar Telekom's telecommunications network include roaming customers of other service providers and other telecommunications providers which terminate or transit calls on Magyar Telekom's network. These wholesale (incoming) traffic revenue are recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (interconnect) for the use of their networks, where applicable. The revenue and costs of these transit calls are stated gross in the statement of profit or loss as the Company 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.

18.2.2 System integration (SI) and IT revenue

Contracts for network services, which consist of the installation and operation of communication networks for customers, have an average duration of 2-3 years.

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 to determine whether the arrangement contains a lease (in accordance with IFRIC 4), and if they include embedded lease elements, the revenue attributable to the lease element are recognized as described in IAS 17 Leasings, see Note 17.

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

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

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

18.2.3 Energy retail revenues – gas and electricity

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

The annual quantity of the electricity and natural gas consumption is estimated based on the actual customer number and their expected consumption as well as historic weather inputs. These estimates are calculated and continuously updated by customer segment in the energy market: universal residential, universal small business and competitive market clients. These segments are further broken down to sub-groups based on their pricing characteristics so that energy costs and revenues can be estimated with adequate reliability. As time passes during the year, more and more accurate estimates are available for both costs and revenues. Costs and revenues are continuously updated on a year-to-date basis.

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

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

For details of the Company's participation on the energy market see Note 34. 4.

18.3 Revenue in the Statement of profit or loss

	<u>2016</u>	<u>2017</u>
<u>Mobile revenue</u>		
Voice retail	133,008	127,316
Voice wholesale	6,270	6,863
Data	57,556	67,503
SMS	15,711	16,032
Equipment	50,961	59,871
Other mobile revenue	12,516	14,260
Total Mobile revenue	276,022	291,845
<u>Fixed line revenue</u>		
Voice retail	43,555	40,456
Broadband retail	39,399	39,540
TV	35,029	37,627
Equipment	4,551	8,740
Data retail	7,749	9,632
Wholesale	9,921	13,167
Other fixed line revenue	17,905	16,539
Total Fixed line revenue	158,109	165,701
System integration and IT revenue	6,259	9,384
Revenue from energy services	6,783	4,602
Total revenue	447,173	471,532

19 DIRECT COSTS

	<u>2016</u>	<u>2017</u>
Telecom tax.....(a)	24,141	25,023
Interconnect costs.....	12,513	14,216
SI/IT service related costs.....	4,184	8,102
Energy service related costs.....	6,779	4,788
Bad debt expense.....	7,515	4,962
Other direct costs.....(b)	99,991	117,492
Total direct costs	<u>155,123</u>	<u>174,583</u>

(a) Telecom tax

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

(b) Other direct costs

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

20 EMPLOYEE RELATED EXPENSES

20.1 Employee related expenses – Accounting policies

20.1.1 Short term employee benefits

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

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

20.1.2 Share based payments

Magyar Telekom recognizes the costs of services received from its employees in a share based payment transaction when services are received. Magyar Telekom recognizes a corresponding increase in its equity reserves (Reserve for equity settled share based transactions) if the services are received in an equity-settled share based payment transaction. When the share based compensation program is completed, i.e. the shares are transferred to the employees' ownership or the share options have forfeited, the respective reserve is derecognized. If the services are received in a cash-settled share based payment transaction, the Company recognizes the expense against a liability, re-measured to fair value at each financial statement date.

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

20.1.2.1 Share Matching Plan of Magyar Telekom's CEO

In December 2011 the Board of Directors approved the implementation of the revolving Share Matching Plan of Magyar Telekom. The program was implemented for the CEO of Magyar Telekom starting in 2012. An amount of minimum 10% of the gross annual variable bonus of the CEO was to be invested in shares of Magyar Telekom. The CEO had the option of voluntary increase to a maximum of 33.3% of his bonus. These shares are to be held for a period of at least 4 years (lock-up period). After the lock-up period of 4 years has passed, one additional share (matching share) will be granted for every share acquired as part of the aforementioned personal investment. The program was planned to be revolving in 5 consecutive years starting in 2012.

In 2017 HUF 5 million was recognized (2016: HUF 17 million) as expenses for the program.

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

20.1.2.2 Share Matching Plan of Deutsche Telekom

As of July 1, 2015, Magyar Telekom Company implemented Share Matching Plan for all executives (cca. 60). Participation in the program is voluntary.

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

In 2017 HUF 24 million was recognized (2016: HUF 18 million) as expenses for the program.

20.1.2.3 Long-term incentive program (LTI)

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

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

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

In 2017 HUF 320 million was recognized (2016: HUF 311 million) as expenses for the program.

20.1.2.4 Share transfer to ESOP Organization

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

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

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

Magyar Telekom transferred 1,533,636 treasury shares in August 2016 to the established ESOP Organization of which 25,764 shares were sold by the ESOP Organization due to the revision of the number of the participants in the program. As the improvement of the oFCF of MT-Hungary segment was confirmed by the Board of Directors, the ESOP Organization distributed the shares amongst 6,452 employees in April 2017.

In 2017 HUF 138 million was recognized (2016: HUF 402 million) as expenses for the program.

20.1.2.5 Bonus payment via ESOP Organization

By reshaping the current remuneration structure, the Company has launched an incentive program based on the new remuneration policy in 2017, by which the corporate financial targets, approximately half (50%) of the total bonus, will be paid via the ESOP Organization for Magyar Telekom Plc. and T-Systems Magyarország Zrt. eligible employees. Under the new incentive program, the Company purchased 4,534,758 Magyar Telekom shares worth HUF 2,139 million during 2017. The purchased shares were transferred to the ESOP Organization in several installments. The vesting conditions of the new program are (a) that the operating free cash flow for the MT-Hungary segment for the financial year ending December 31, 2017 to exceed that for the previous year ending December 31, 2016 and (b) that the effected employee is employed by Magyar Telekom Plc. or T-Systems Magyarország Zrt. in March 2018 (vesting date). In accordance with the remuneration program those employees of the Company and T-Systems Magyarország Zrt. are rewarded who are under the personal scope of the Remuneration policy approved on February 22, 2017 by the Company's Board of Directors

If the vesting conditions are met the corporate financial target will be paid in cash based on the employees' claims arising from the conversion of the transferred Magyar Telekom ordinary shares into cash expectedly in March 2018 (vesting date) via the ESOP Organization. The Company considers January 1, 2017 as grant date with respect to the initial assumptions of the newly formed share based program because the parties had a common understanding on the relevant terms defined by historical conditions at that date.

Based on the initial information the Company estimated the amount of the bonus to be paid considering the headcount as of January 1, 2017 from which the necessary number of shares were calculated inversely by reference to the expected forward rate of shares relating to March, 2018 prevailing as at January 1, 2017. The estimated number of shares was 4,702,702 on January 1, 2017.

The Company is expected to be able to cover the significant proportion of the bonus payments related to corporate financial target via the ESOP based on the formula in the Remuneration policy and relevant internal regulation. The remaining part of the total bonus will be granted to the employees as supplementary benefit when the exchange rate for converting the shares into cash by the ESOP Organization is already known. The Company is liable to repurchase the shares under the Articles of Association of the ESOP Organization. This liability is recognized at fair value by reference to the share price (see Note 4.4.1.).



Employees who fall out of the scope of the Remuneration policy before the management of the ESOP Organization asserts the fulfillment of the vesting conditions, are not entitled for the benefit via the ESOP Organization, such benefits will be paid off by the Company under the relevant internal regulations.

T-Systems Magyarország Zrt. is liable to the Company to reimburse the consideration of the own shares repurchased for the remuneration of T-Systems Magyarország Zrt.'s employees.

In 2017 HUF 1.4 billion was recognized as the total expenses of the program which presented in the balance sheet among Share-based payment (SBP) reserves.

20.1.3 Termination benefits

Termination benefits are payable whenever an employee's employment is terminated before the nominal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company 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.

20.2 Employee related expenses in the Statement of profit or loss

	<u>2016</u>	<u>2017</u>
Short term benefits.....	58,618	57,775
Termination benefits.....	1,093	2,699
Share settled share based payments.....	35	29
Cash settled share based payments.....	311	320
Employee share ownership program (ESOP).....	402	138
Bonus payment via ESOP.....	-	1,431
Total before capitalization.....	60,459	62,392
Expenses capitalized.....	<u>(5,940)</u>	<u>(5,779)</u>
	<u>54,519</u>	<u>56,613</u>
Total costs expensed in relation to defined contributions (including social security contribution).....	13,459	11,892
Average number of employees (full time equivalent).....	6,184	6,287
Closing number of employees (full time equivalent).....	6,281	6,241

21 OTHER OPERATING EXPENSES

	<u>2016</u>	<u>2017</u>
Utility tax..... (a)	7,260	7,416
Rental and leasing expenses.....	15,477	17,776
Marketing expenses.....	9,591	8,467
Energy costs.....	7,125	6,378
Other purchased services..... (b)	46,835	48,076
Other operating expenses.....	<u>6,706</u>	<u>5,189</u>
	<u>92,994</u>	<u>93,302</u>

Research as well as marketing costs are expensed as incurred. The Company recognized in 2017 HUF 89 million (2016: HUF 46 million) for research and development among other operating expenses.

(a) Utility tax

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

(b) Audit costs included in other purchased services

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

	<u>2016</u>	<u>2017</u>
Audit of the financial statements.....	253	266
Other audit related fees.....	135	29
Other non audit related fees.....	121	-
Total expenses payable to PwC.....	<u>507</u>	<u>295</u>

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

Other audit-related fees are the aggregate fees of PwC for reviews of the second quarterly report (in 2016 all the four quarterly reports) which are normally performed by the external auditor in connection with the auditing of the annual financial statements, e.g. advice on issues of accounting and reporting, which were not classified as audit services.

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

22 OTHER OPERATING INCOME

	<u>2016</u>	<u>2017</u>
Income received for the relocation of our own network	1,111	2,900
Income from support services to related party.....	97	-
Income on the sale of PPE, Intangible assets and assets held for sale	4,007	1,178
Income from insurance compensation.....	220	123
Other operating income.....	<u>2,240</u>	<u>1,672</u>
Total	<u>7,675</u>	<u>5,957</u>

23 INTEREST INCOME

	<u>2016</u>	<u>2017</u>
Interest income on loans and receivables.....	381	339
Finance lease interest income.....	30	79
Unwinding of the interest component of provisions.....	<u>3</u>	<u>3</u>
Total	<u>414</u>	<u>421</u>

24 INTEREST EXPENSE

	<u>2016</u>	<u>2017</u>
Interest expense payable on loans to related parties	13,962	9,132
Interest expense on loans to unrelated parties	3,302	2,977
Finance lease interest expense	1,168	1,195
Accretion / interest on provisions	83	77
Borrowing costs capitalized	<u>(120)</u>	<u>(39)</u>
Total	<u>18,395</u>	<u>13,342</u>

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

Total Interest expense is shown net of borrowing costs capitalized using average borrowing rates of 2.92% - 3.46% in 2017 (2016: 3.77% - 4.33%). When calculating the borrowing rates, Other finance expenses (included in Note 25) are also considered.

25 OTHER FINANCE EXPENSE – NET

	<u>2016</u>	<u>2017</u>
Fee expense	4,394	4,348
Net foreign exchange losses / (gains) on financial instruments	(93)	(1,084)
Other net foreign exchange losses	(10)	(100)
Losses/(gains) on the measurement of derivatives contracted with related parties	3,883	4,450
Losses/(gains) on the measurement of derivatives contracted with unrelated parties	79	-
Losses/(gains) on the derecognition of derivatives contracted with related parties	207	337
Losses/(gains) on the derecognition of derivatives contracted with unrelated parties	(80)	(12)
	<u>8,380</u>	<u>7,939</u>

26 RESULTS OF INVESTMENTS

26.1 Results of investments in subsidiaries

26.1.1 Dividend received

Dividends receivable by the Company are recognized as a receivable and income in the period in which the dividends are approved by the general meeting of the investees.

The following table shows dividends received from the Company's investments related to years 2016 and 2017:

	<u>2016</u>	<u>2017</u>
Stonebridge A.D.	4,764	3,488
GTS Hungary Kft.	575	325
Crnogorski Telekom A.D.	4,620	-
Vidanet Zrt.	-	4,169
Other	487	106
Total	<u>10,446</u>	<u>8,088</u>

26.1.2 Sale of investments

Sale of Crnogorski Telekom A.D.

In January 2017, the Company signed a share purchase agreement with Hrvatski Telekom D.D. for the sale of its 76.53% majority shareholding in Crnogorski Telekom A.D. Podgorica totalled EUR 123.5 million (HUF 38.5 billion). The closing of the transaction took place in January 2017. The net effect of HUF 2,532 million gain of this transaction in the result is disclosed in result of investments.

Sale of Origo Zrt.

In December 2015, the Company signed a share purchase agreement for the sale of the total of its 100% shareholding in Origo Zrt. The closing of the transaction took place in February 5, 2016. The binding offer on cash free debt free basis was EUR 13.2 million (approximately HUF 4.2 billion). The net effect of HUF 563 million loss of this transaction in the result is disclosed in result of investments.

26.2 Results of investments in associated companies and joint ventures

Dividend received from E2 Hungary Zrt. was HUF 97 million in 2017.

27 EARNINGS PER SHARE (EPS)

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

The Company is subject to prepare consolidated annual report so disclosures related to EPS indicator (based on IAS 33) are shown based on consolidated financial statements.

28 PURCHASE OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

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

	<u>12.31.2016</u>	<u>12.31.2017</u>
Investments in property, plant and equipment (Note 8)	56,110	47,255
Investments in intangible assets (Note 9)	23,662	19,171
Total investments in PPE and intangible assets	79,772	66,426
Advances received for asset-related (Note 14)	(a) (5,104)	456
Capitalized annual frequency fee payable	(b) (181)	-
PPE under finance leases	(c) (1,459)	(272)
Change in trade payables relating to capital expenditures	(d) 8,992	8,487
Cash payments for purchases of PPE and intangible assets	82,020	75,097

(a) Advances received for asset-related grants

In 2016 HUF 12.2 billion of EU funds were granted to Magyar Telekom Group as a result of the first and second rounds of a tender aimed at developing digital networks nationwide to cover households in Western and Eastern parts of Hungary with a fixed network capable of reaching speed of at least 30 Mbps. The Company used up HUF 1.4 billion of this advance. See also Note 9 for government grants relating to the purchase of PPE.

(b) Capitalized annual frequency fee payable

The present value of the annual frequency fees is capitalized as part of the intangible asset (Licenses) if the future payments can be reliably estimated, however, these fees are paid in cash in subsequent periods. The cash payments on the discounted liability are included in the Repayment of other financial liabilities line of the Financing cash flow, while the interest payments accruing on the discounted liability are included in the Interest and other financial charges paid line of the Operating cash flow. The significant license acquisitions are described in Note 10.5.

(c) PPE acquired under finance leases

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

(d) Change in trade payables relating to capital expenditures

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

29 PURCHASE OF SUBSIDIARIES

The table below shows the cash payments made in relation to investments in subsidiaries.

	<u>12.31.2016</u>	<u>12.31.2017</u>
GTS Hungary Kft. – telecommunication activities	2,926	1,789
Com.unique Kft. – cable tv activities.....	<u>13</u>	<u>-</u>
	<u>2,939</u>	<u>1,789</u>

Magyar Telekom acquires the assets and the related customer base of GTS Hungary Kft. (owned by the Company) in several instalments since 2015 which contracts are considered as business combinations. The transaction closed during 2017.

The Company recorded the assets of GTS Hungary Kft. acquired during the transaction on their fair value at the time of the acquisition based on the business combination principles. Assets acquired from GTS Hungary Kft. in 2017 were compensated with a loan granted by GTS Hungary Kft. amounting to HUF 3,400 million.

Magyar Telekom acquired the ownership of Com.unique Kft.'s cable tv network consequent to the conclusion of the process started in 2014. This acquisition considered business combination of MT-Hungary's operating segment. The full purchase price was paid in cash in 2016.

30 CONTINGENT ASSETS AND LIABILITIES

30.1 Contingent assets

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence of uncertain future events not within the control of the Company. These assets are not recognized in the statement of financial position.

The Company has no contingencies where the inflow of economic benefits would be probable and material.

30.2 Contingent liabilities

No provision is recognized for contingent liabilities. A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events (excluding executory contracts) not wholly within the control of the Company; 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.

The most significant contingent liabilities of the Company are described below. No provisions have been recognized for these cases as management estimates that it is unlikely that these claims originating from past events would result in any material economic outflows or the amount of the obligation cannot be measured with sufficient reliability.

30.2.1 Guarantees

Magyar Telekom Plc. is exposed to risks that arise from the possible drawdown of guarantees for which see more details in Note 4.5.4.

31 PURCHASE COMMITMENTS

31.1 Property, plant and equipment and intangible assets

The table below summarizes Magyar Telekom's contractual purchase commitments for property, plant and equipment and intangible assets with the majority falling due within two years.

	<u>12.31.2016</u>	<u>12.31.2017</u>
Property, plant and equipment.....	2,704	5,054
Intangible assets.....	3,347	1,003
Total	<u>6,051</u>	<u>6,057</u>

31.2 Investments

As at December 31, 2017 and 2016 the Company had no committed business combinations.

32 RELATED PARTY TRANSACTIONS

Related parties of the Company include legal entities and persons that are related to the Company.

A person or a close member of that person's family is related to the Company if that person:

- has control or joint control of the reporting entity;
- has significant influence over the reporting entity; or
- is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

An entity is related to a reporting entity if any of the following conditions applies:

- The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
- One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
- Both entities are joint ventures of the same third party.
- One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- The entity is controlled or jointly controlled by a person related to the entity or such a person holds a key position in the reporting entity.
- The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

The transactions with related parties are priced on arm's lengths basis, if the conditions are met.

32.1 Related party transactions in the Statement of financial position

The tables below summarize the carrying amount of assets and liabilities arising from transactions with related parties as of December 31, 2016 and 2017:

12.31.2016	Trade receivable	Other receivables (advances)	Loans given	Swap - asset	Loans received	Swap - liability	Dividends payable
Parent	3,980	16,664		1,505	(203,381)	(3,452)	(9,262)
Subsidiaries.....	2,745	203	16,391		(5,177)		
Associates and joint ventures.....	75	76					
Other related parties.....	1,678	78			(112,936)		
from this: DTIF.....					(112,741)		
Total.....	8,478	2,021	16,391	1,505	(321,494)	(3,452)	(9,262)

12.31.2017	Trade receivable	Other receivables (advances)	Loans given	Swap - asset	Loans received	Swap - liability	Dividends payable
Parent	3,127	2,582		2,978	(157,349)	(5,612)	(15,436)
Subsidiaries.....	4,929	306	10,103		(2,096)		
Associates and joint ventures.....	314						
Other related parties.....	2,850	55			(103,807)		
from this: DTIF.....					(103,725)		
Total.....	11,220	2,943	10,103	2,978	(263,252)	(5,612)	(15,436)

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

32.2 Related party transactions in the Statement of profit or loss

The tables below summarize the transactions with related parties as of December 31, 2016 and 2017:

12.31.2016	Revenue from services	Cost of services	Income from support services	Interest income	Interest expense	Swap	Dividend paid
Parent.....	2,158	(3,015)	76		(9,441)	(4,090)	(9,262)
Subsidiaries.....	7,349	(12,975)	6	76	(72)		
Associates and joint ventures.....	146	(6,978)					
Other related parties.....	5,700	(5,299)	(12)		(4,449)		
from this: DTIF.....					(4,449)		
Total.....	15,353	(28,267)	70	76	(13,962)	(4,090)	(9,262)



12.31.2017	Revenue from services	Cost of services	Income from support services	Interest income	Interest expense	Swap	Dividend paid
Parent.....	3,434	(4,078)	47		(6,798)	(4,785)	(15,436)
Subsidiaries.....	5,488	(16,181)		88	(37)	(1)	
Associates and joint ventures.....	103	(7,710)					
Other related parties from this: DTIF.....	7,812	(6,902)	(5)	37	(2,297)		
					(2,297)		
Total.....	16,837	(34,871)	42	125	(9,132)	(4,786)	(15,436)

32.3 Transactions with Deutsche Telekom Group and the Federal Republic of Germany

32.3.1 Deutsche Telekom Group

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

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

Deutsche Telekom has pledged its support for Magyar Telekom's budgeted financing needs through to June 30, 2017.

32.3.2 The Federal Republic of Germany

The Federal Republic of Germany is both a direct and an indirect shareholder and holds approximately 32 percent of the share capital of DT AG. Due to the average attendance at the shareholders' meetings, the Federal Republic of Germany represents a solid majority at the shareholders' meetings of DT AG, although it only has a minority shareholding, making DT AG a dependent company of the Federal Republic. Therefore, the Federal Republic and the companies controlled by the Federal Republic or companies over which the Federal Republic can exercise a significant influence are classified as related parties of DT AG, and consequently of Magyar Telekom as well.

DT AG and Magyar Telekom did not execute as part of its normal business activities any transactions that were individually material in the 2017 or 2016 financial year with companies controlled by the Federal Republic or companies over which the Federal Republic can exercise a significant influence.

32.4 Joint ventures

E2 Hungary Zrt. is a joint venture of the Magyar Telekom Company since July 9, 2015. The company was provided energy services for business customers from 2016. In 2017, the only material outstanding amount is an accrued HUF 300 million revenue not yet invoiced to E2 for trademark usage and connecting services.



32.5 Board and Supervisory Board members

	<u>12.31.2016</u>	<u>12.31.2017</u>
Remuneration of the members of the Board of Directors	16	16
Remuneration of the members of the Supervisory Board.....	63	63
Loans granted to the members of the Board of Directors.....	-	-
Loans granted to the members of the Supervisory Board.....	2	2

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

32.6 Key management personnel

Key management has been identified as the members of the Company's Management Committee, which is the chief operating decision making body of Magyar Telekom.

The table below shows in total the compensation expenses (including social security and other payroll related taxes) incurred by the Company in relation to the key management.

	<u>12.31.2016</u>	<u>12.31.2017</u>
Salaries and other short-term employee benefits.....	1,727	1,168
Contractual termination expense	-	-
Share based payments (Note 20).....	33	25
	<u>1,760</u>	<u>1,193</u>
Costs expensed in relation to defined contribution plans (including social security contribution).....	347	295

The Company did not provide loans or guarantees to its key management.

32.7. Guarantees provided by the Company for liabilities of related parties and guarantees provided by related parties for liabilities of the Company

32.7.1 Comfort letter

Comfort letter in relation to Magyar Telekom and its related parties represents a guarantee which contains a guarantee for the payment obligations of the company until a specified date without stating the amount. Such letter is issued by DT AG for Magyar Telekom annually and by Magyar Telekom for its subsidiary Novatel E.O.O.D.

32.7.2 Bank guarantees

Bank guarantees for subsidiaries issued by Magyar Telekom in the name of the subsidiaries and it pays the related fees for the bank. In case of guarantee drawdown the Magyar Telekom's bank account shall be debited with the amount drawdown/paid. Fees paid by Magyar Telekom invoiced within the group.

The following table presents the guarantees provided by the Company for liabilities of related parties:

Type of the guarantee	Sum of Guarantee		
	<u>01.01.2016</u>	<u>31.12.2016</u>	<u>31.12.2017</u>
Bank guarantee	6,584	5,272	5,172

32.7.3 Shareholdings declaration

E2 Hungary Zrt. concluded a trade finance revolving loan contract (maturity over a year and in multi-currency) with OTP Bank Nyrt. in 2016. Magyar Telekom has issued the following shareholdings declaration related to E2 Hungary Zrt. as the borrower for both 2016 and 2017 years:

- decision shall only be made with the creditor's prior written approval by which the common stock of E2 Hungary Zrt. decreased
- dividend or interim dividends (in accordance with HAR) shall only be taken from E2 Hungary Zrt. without the bank's prior written approval thereby E2's equity not to reduce below HUF 1,800 million.

33 REPORTABLE SEGMENTS AND INFORMATION ABOUT GEOGRAPHICAL AREAS

33.1 General information

Magyar Telekom's chief operating decision makers are the members of the Management Committee (MC). The MC is responsible for allocating resources to, and assessing the performance on a monthly basis. The MC assesses the performance of the Company on Group level and makes its decisions at that level. The operating segments of the Company are the MT-Hungary and Macedonia. Since the Company as a whole is part of MT-Hungary segment therefore the segment information related to the Company shall not be disclosed in this annual report.

In accordance with Act LXXXVI of 2007 on Electric Energy and Government Decree 273/2007 (X.19.) on the implementation of provisions thereof, and Act XL of 2008 on Natural Gas Supply and Government Decree 19/2009 (I.30.) on the implementation of provisions thereof, the Company is subject to disclose balance sheet and statement of profit or loss relating to energy services. These disclosures are not the same as the required disclosures of IFRS 8 and are presented in Note 36.

The Company presents disclosures as required based on IFRS 8.

Magyar Telekom operates in Hungary providing mobile and fixed line telecommunications and TV distribution and energy retail services to millions of residential and small businesses customers mainly under the "Telekom" or "T" brand. Magyar Telekom is also responsible for the wholesale mobile and fixed line services in Hungary, and performs strategic and cross-divisional management and support functions including Procurement, Treasury, Real estate, Accounting, Tax, Legal, Internal Audit and similar shared services and other central functions of the Company. For details on revenue please refer to Note 18.

33.2 Information about geographical areas

Considering that Magyar Telekom provides its services within the boundaries of Hungary and the base of geographical classification is the headquarter of the Company, all the realized revenues by the Company are in the category of Hungary. In a similar manner all tangible assets of the Company are classified as Hungary considering geographical areas.

33.3 Information about revenues for group of products and services

Revenues from customers for group of similar products and services are disclosed in Note 18.3.

33.4 Information about revenues from major customers

None of the Company's customers represent a significant source of revenue. Revenues from transactions with a single external customer (or group of entities that – knowingly to us – are under common control of a third party or government) do not exceed 10 per cent of the Company's revenue.

34 PUBLIC SERVICE CONCESSION AND LICENSE ARRANGEMENTS

34.1 Service Concession Arrangements – Accounting policies

The Company applies 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.

A feature of these service arrangements is the public service nature of the obligation undertaken by the operator (business community). The service arrangement contractually obliges the operator to provide the services to the public.

The IFRIC 12 interpretation applies to public-to-private service concession arrangements if the grantor (public sector) controls or regulates what services the operator (business community) must provide with the infrastructure, to whom it must provide them, and at what price; and the grantor (public sector) controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement.

This Interpretation applies to both the infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and the existing infrastructure to which the grantor (public sector) gives the operator (business community) access for the purpose of the service arrangement.

Magyar Telekom's primary activities are the fixed line and mobile operations in Hungary. These services are in most cases regulated by the country's laws or other legislations. These services in most cases require the acquisition of a license or concession, which usually requires a one-off fee and annual payments. These licenses or concessions are recognized as intangible assets.

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

34.2 Mobile

Magyar Telekom Plc. is the market leading mobile service provider in Hungary. The Implementation of the EU New Regulatory Framework (NRF) Review package had been completed by the amendment of the Act C of 2003 on Electronic Communications (hereinafter: Communications Act). The National Media and Infocommunications Authority of Hungary (NMAIAH) is the supreme supervisory body and is responsible for secondary legislation making and the preparation of relevant decrees.

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

On December 7, 2004, the Company obtained the spectrum usage right of certain frequency blocks for the deployment and operation of an IMT2000/UMTS mobile telecommunications system (3G system). The duration of the spectrum license is 15 years (until December 7, 2019) with an option to extend it for another 7.5 years.

The Company won a tender for a spectrum usage right for a 26 GHz block on April 30, 2009. On May 14, 2012 the NMAIAH granted spectrum license to Magyar Telekom for 4 pieces of basic spectrum blocks (2 x 28 MHz each) in the 26 GHz band. Furthermore Telekom acquired GTS Hungary Kft.'s blocks in the 26 GHz band for HUF 114.6 million HUF net, and has a usage right for it from November 1, 2016. Blocks purchased in 2012 are to be prolonged in 2018, conditions are to be renegotiated meanwhile the prolongation procedure.

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

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

- Magyar Telekom's spectrum usage rights in the 1800 MHz frequency band otherwise expiring on October 7, 2014 and in the 900 MHz frequency band otherwise expiring on May 4, 2016 were prolonged and harmonized until April 2022.
- Magyar Telekom will retain spectrum usage right also until April 2022 on the two duplex 1 MHz frequency blocks in the 900 MHz frequency band won in the 900 MHz auction in 2012. Accordingly, Magyar Telekom currently has frequency usage rights of 10 MHz duplex frequency blocks in the 900 MHz frequency bands and of 15 MHz duplex blocks in the 1800 MHz frequency band.

- The initial fee of the prolongation and harmonization of 900 MHz/1800 MHz spectrum licenses was HUF 38 billion. However, Magyar Telekom was required to pay HUF 34 billion out of the aforementioned amount, considering the expiry of the frequency blocks won in 2012 being changed from the original 2027 date to 2022.

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

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

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

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

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

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

Since June 30, 2007, an EU regulation has been regulating international roaming tariffs for wholesale and retail customers on the basis of a price cap system. The first EU roaming regulation prescribed a glide-path that mandated annual reductions of wholesale and retail prices. (EU Roaming Regulation I.)

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

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

The actual EU roaming regulation - “Full Roam Like At Home With Fair Use Policy Possibility” - is applied from June 15, 2017. (EU Roaming Regulation IV.). As a result, European retail roaming price levels for voice, SMS and data are equal to domestic prices since summer 2017. The Commission implementing regulation (EU) 2016/2286 of 15 December 2016 laid down detailed rules on the application of fair use policy and on the methodology for assessing the sustainability of the abolition of retail roaming surcharges and on the application to be submitted by a roaming provider for the purposes of that assessment.

34.3 Fixed line

Universal services are basic communications services (including access to communication services at a fixed location, public payphones, directory and directory enquiry services) that should be available to all customers at an affordable price. The NMAIAH published its request for proposal on the provision of universal services on November 4, 2013. The Company submitted a bid for access on fixed location and for national directory enquiry service. As a result of a tendering procedure MT was designated by the NRA as a universal service provider for public payphones (came into force June 1, 2014); for fixed line access (came into force with the conclusion of the authority contract with NMAIAH on July 1, 2014) and for directory services, phonebook (came into force Aug 1, 2014).

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

Magyar Telekom is Hungary's leading fixed line broadband service provider in the wholesale market and one of the leading ones in the retail market. In accordance with the effective resolution, all retail fixed products shall be 'reproducible' by competitors based on the wholesale service. Consequently, the full retail portfolio shall have a wholesale equivalent. Previous regulation defined a retail minus price setting. The NMIAH published the latest resolutions with regards to markets 3a and 3b on December 15, 2017. Service fee calculation for all relevant regulated services – both markets 3a and 3b - are with a BU-LRIC+ model. The new fees will have to be applied from the next reference unbundling offer's approval (MARUO), assumed to be in end of Q2 2018.

SMP operators are obliged to prepare reference unbundling offer for access to (physical) passive network infrastructure (RUO) and to provide these services when there is a request for them by other telecommunications service providers. The reference offer of each SMP operator must be approved by the NMIAH. The price setting of the next RUO services are based on a hypothetical BU-LRIC+ model, that was built by the advisor of the NMIAH. Magyar Telekom was designated as an SMP in both 3a and 3b markets and is obliged to submit its next MARUO in March 2018 with an assumed approval in end of Q2 2018. As a novelty the resolutions contain geographical segmentation in the access regulation, as a start of a deregulation path, in a limited number of settlements and the virtual unbundling obligation (L2-WAP).

The fourth round of the market analysis procedure of the fix call origination and fix call termination (ex M2 and ex M3) markets was closed in 2013, when conditions were set. The NMIAH published its actual fifth round market analysis procedures' draft resolutions on November 9. The draft resolution's FTR (fix termination rate) proposal - that is based on a pure BU-LRIC model - is 0.26 HUF/min. The new fee – that is to be applied symmetrically - is assumed to have an effect from end of Q2 2018 altogether for 144 operators.

The next MARIO and the call origination and supplementary interconnection service fees come into force in end of Q2 2018.

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

34.4 Energy services in Hungary

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

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

Magyar Telekom decided to exit from the residential segment of the electricity market with effect from November 1, 2017.

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

On December 31, 2017 the Company had no active customers consuming electricity and gas owing to the exit from energy market.

The exit from the residential electricity business has no direct impact on the operation of E2.

35 EVENTS AFTER THE REPORTING PERIOD

Currently we are not aware of any events after the reporting period.

36 UNBUNDLING OF ACTIVITIES

In accordance with Act LXXXVI of 2007 on Electric Energy and Government Decree 273/2007 (X. 19.) on the implementation of provisions thereof, and Act XL of 2008 on Natural Gas Supply and Government Decree 19/2009 (I. 30.) on the implementation of provisions thereof, hereinafter are disclosed the statements of financial position and the statements of profit or loss and other comprehensive income.

36.1 Statements of financial position connected with energy services provided

	12.31.2016			
	Electricity	Gas	Other	Total
ASSETS				
Current assets				
Cash and cash equivalents	1	(1)	1,260	1,260
Trade and other receivables	1,252	219	100,050	101,521
Other current financial assets	39	(12)	18,914	18,941
Current income tax receivable	1	(1)	1,867	1,867
Inventories	-	-	10,683	10,683
	<u>1,293</u>	<u>205</u>	<u>132,774</u>	<u>134,272</u>
Assets held for sale	-	-	1,540	1,540
Total current assets	1,293	205	134,314	135,812
Non current assets				
Property, plant and equipment	58	(57)	374,750	374,751
Intangible assets	421	271	391,377	392,069
Investments	-	-	168,900	168,900
Deferred tax assets	-	-	-	-
Non current financial assets	3	(3)	12,530	12,530
Other non current assets	-	-	161	161
	<u>482</u>	<u>211</u>	<u>947,718</u>	<u>948,411</u>
Total non current assets	482	211	947,718	948,411
Total assets	1,775	416	1,082,032	1,084,223
LIABILITIES				
Current liabilities				
Financial liabilities to related parties	62	(61)	77,767	77,768
Other financial liabilities	(97)	104	18,863	18,870
Trade payables	1,724	(219)	101,675	103,180
Current income tax payable	-	-	-	-
Provisions	-	-	3,170	3,170
Other current liabilities	3	(2)	27,737	27,738
	<u>3</u>	<u>(2)</u>	<u>27,737</u>	<u>27,738</u>
Liabilities associated with assets held for sale	-	-	-	-
Total current liabilities	1,692	(178)	229,212	230,726
Non current liabilities				
Financial liabilities to related parties	197	(194)	247,175	247,178
Other financial liabilities	11	(11)	48,416	48,416
Deferred tax liabilities	6	(6)	7,985	7,985
Provisions	-	-	8,915	8,915
Other non current liabilities	-	-	957	957
	<u>214</u>	<u>(211)</u>	<u>313,448</u>	<u>313,451</u>
Total non current liabilities	214	(211)	313,448	313,451
Total liabilities	1,906	(389)	542,660	544,177



	12.31.2016			
	Electricity	Gas	Other	Total
EQUITY				
Common stock	-	-	104,274	104,274
Capital reserves	-	-	27,119	27,119
Treasury stock	-	-	(55)	(55)
Retained earnings	(4,897)	(5,986)	419,591	408,708
Accumulated other comprehensive income.....	-	-	-	-
Total equity	(4,897)	(5,986)	550,929	540,046
DIFFERENCE BECAUSE OF SEPARATION				
Difference because of separation	4,766	6,791	(11,557)	-
Total difference because of separation	4,766	6,791	(11,557)	-
Total liabilities and equity	1,775	416	1,082,032	1,084,223
	12.31.2017			
	Electricity	Gas	Other	Total
ASSETS				
Current assets				
Cash and cash equivalents.....	-	-	948	948
Trade and other receivables.....	191	(2)	110,505	110,694
Other current financial assets.....	9	-	11,164	11,173
Current income tax receivable.....	-	-	189	189
Inventories.....	-	-	13,743	13,743
	200	(2)	136,549	136,747
Assets held for sale.....	-	-	161	161
Total current assets	200	(2)	136,710	136,908
Non current assets				
Property, plant and equipment.....	(39)	(3)	371,774	371,732
Intangible assets.....	524	-	378,106	378,630
Investments.....	-	-	131,500	131,500
Deferred tax assets.....	-	-	-	-
Non current financial assets.....	-	-	19,775	19,775
Other non current assets.....	-	-	128	128
Total non current assets	485	(3)	901,283	901,765
Total assets.....	685	(5)	1,037,993	1,038,673
LIABILITIES				
Current liabilities				
Financial liabilities to related parties.....	(19)	(2)	39,357	39,336
Other financial liabilities.....	(217)	108	5,730	5,621
Trade payables.....	560	(187)	110,660	111,033
Current income tax payable.....	-	-	16	16
Provisions.....	-	-	2,312	2,312
Other current liabilities.....	(2)	-	28,785	28,783
Liabilities associated with assets held for sale.....	-	-	-	-
Total current liabilities	322	(81)	186,860	187,101
Non current liabilities				
Financial liabilities to related parties.....	(118)	(9)	231,774	231,647
Other financial liabilities.....	(7)	(1)	44,791	44,783
Deferred tax liabilities.....	(6)	(1)	12,365	12,358
Provisions.....	-	-	8,674	8,674
Other non current liabilities.....	-	-	286	286
Total non current liabilities	(131)	(11)	297,890	297,748
Total liabilities	191	(92)	484,750	484,849



	12.31.2017			
	Electricity	Gas	Other	Total
EQUITY				
Common stock.....	-	-	104,274	104,274
Capital reserves.....	-	-	25,078	25,078
Treasury stock.....	-	-	(27)	(27)
Retained earnings.....	(4,981)	(6,007)	435,487	424,499
Accumulated other comprehensive income.....	-	-	-	-
Total equity.....	(4,981)	(6,007)	564,812	553,824
DIFFERENCE BECAUSE OF SEPARATION				
Difference because of separation.....	5,475	6,094	(11,569)	-
Total difference because of separation.....	5,475	6,094	(11,569)	-
Total liabilities and equity.....	685	(5)	1,037,993	1,038,673

36.2 Statements of profit or loss and other comprehensive income connected with energy services provided

	2016			
	Electricity	Gas	Other	Total
Revenue	6,428	374	440,371	447,173
Direct costs	(6,217)	(585)	(148,321)	(155,123)
Employee related expenses	5	(5)	(54,519)	(54,519)
Depreciation and amortization	(180)	(115)	(89,649)	(89,944)
Other operating expenses	(62)	(25)	(92,907)	(92,984)
Operating expenses	(6,454)	(730)	(385,396)	(392,580)
Other operating income	-	-	7,675	7,675
Operating profit	(26)	(356)	62,650	62,268
Interest income	-	-	414	414
Interest expense	(15)	14	(18,394)	(18,395)
Other financial expense - net	(14)	3	(8,369)	(8,380)
Net financial result.....	(29)	17	(26,349)	(26,361)
Results from investments.....	8	(8)	9,881	9,881
Results from associates and joint ventures	-	-	-	-
Profit before income tax	(47)	(347)	46,182	45,788
Income tax.....	(18)	(23)	8,498	8,457
Profit for the year	(65)	(370)	54,680	54,245
Other comprehensive income for the year, net of tax.....	-	-	-	-
Total comprehensive income for the year	(65)	(370)	54,680	54,245

	2017			
	Electricity	Gas	Other	Total
Revenue	4,603	-	466,929	471,532
Direct costs	(4,764)	(18)	(169,801)	(174,583)
Employee related expenses	(3)	-	(56,610)	(56,613)
Depreciation and amortization	232	-	(88,079)	(87,847)
Other operating expenses	(77)	1	(93,226)	(93,302)
Operating expenses	(4,612)	(17)	(407,716)	(412,345)
Other operating income	-	-	5,957	5,957
Operating profit	(9)	(17)	65,170	65,144
Interest income	-	-	421	421
Interest expense	7	1	(13,350)	(13,342)
Other financial expense - net	2	-	(7,941)	(7,939)
Net financial result	9	1	(20,870)	(20,860)
Results from investments.....	(4)	-	10,624	10,620
Results from associates and joint ventures	-	-	97	97
Profit before income tax	-	-	55,021	55,001
Income tax.....	(83)	1	(13,062)	(13,144)
Profit for the year	(87)	(15)	41,959	41,857
Other comprehensive income for the year, net of tax.....	-	-	-	-
Total comprehensive income for the year	(87)	(15)	41,959	41,857

36.3 Main rules applied to the financial data for energy services by activities presented above

General rule applied during allocation is that if a general ledger account contains the settlement of energy activities (directly or indirectly from an allocation process) and there is no any subledger then the separation of the balance between electricity and gas activities are based on the weighted proportion of the point of delivery (POD) numbers for the year concerned. At a significant part of general ledger accounts the allocation is based on proportion of direct margin because of the different profit of telecommunication and energy products. The direct margin is the difference between revenues and direct costs related to it; corrected by the effect of utility costs reduction, the amount of discount related to energy services connected to telecommunication services. Items are separated to energy services and to telecommunication/other services in the proportion of direct margin.

In case of the information are available in subledger then allocated amounts on energy activities are defined by individual items based on data supply. In case of some items the allocation ratio depends on costs. The cost ratio on energy services is equal to the quotient of the material-type expenses for energy services in 100% (electricity and/or gas) and the total material-type expenses of the Company.

36.4 Gas-engine small power plant

Magyar Telekom Plc.'s individual authorized activities also include the operation of gas-engine small power plant. Since the Company uses the gas-engine small power plant for its own purposes the volume of sales is very low and this economic activity is not meaningful. Because of this the comparability of assets and liabilities in the balance sheet cannot be ensured and neither the income statement would contain meaningful economic information. The amounts related to this activity are not significant compared to the figures disclosed in the balance sheet and income statement of the Company so in connection with the accounting separation of gas-engine small power plant only the main indicators are disclosed in the following table.

	2016	2017
Tangible assets.....	184	143
Revenues	2	5
Direct costs	45	43
Employee related expenditures	8	8
Depreciation and amortization.....	41	41
Other operational expenses.....	83	79

Budapest, February 20, 2018

Christopher Mattheisen
Chief Executive Officer, Board member

János Szabó
Chief Financial Officer



EGYÜTT. VELED

MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

BUSINESS REPORT

FOR THE YEAR ENDED DECEMBER 31, 2017



INTRODUCTION

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

- THE COMPANY'S SHARE CAPITAL, VOTING RIGHTS AND TRANSFER OF SHARES
- CORPORATE GOVERNANCE
- SOCIAL COMMITMENTS, LABOUR STANDARDS, HUMAN RIGHTS
- COMPENSATION OF MEMBERS OF THE BOARD OF DIRECTORS, SUPERVISORY BOARD, AND MANAGEMENT COMMITTEE
- RESEARCH AND DEVELOPMENT
- REAL ESTATE, SITES OF OPERATION
- SUSTAINABILITY
- ENVIRONMENT PROTECTION
- CORPORATE COMPLIANCE
- ECONOMIC ENVIRONMENT
- TARGETS AND STRATEGY
- INTERNAL CONTROLS, RISKS AND UNCERTAINTIES
- ANALYSIS OF FINANCIAL RESULTS FOR 2017
- SUBSEQUENT EVENTS BETWEEN THE END OF THE YEAR AND THE RELEASE OF THE REPORT



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

As of December 31, 2017, the share capital of Magyar Telekom Plc. was HUF 104,274,254,300, consisting of 1,042,742,543 Series "A" dematerialized ordinary shares. All Series "A" ordinary shares have a nominal value of HUF 100. Rights and obligations related to Series "A" ordinary shares are described in detail in Section 2 of the Articles of Association (http://www.telekom.hu/about_us/investor_relations/corporate_governance/corporate_governance_documents). Information concerning our ownership structure as of December 31, 2017 is described in the following table:

<u>Shareholder</u>	<u>Number of shares</u>	<u>Percentage of share capital</u>
Deutsche Telekom Europe B.V.....	617,436,759	59.21
Publicly traded.....	425,265,159	40.79
Treasury shares.....	40,625	0.00
	<u>1,042,742,543</u>	<u>100.00</u>

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

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

1.1 Voting Rights and Voting

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

1.2 Transfer of Shares

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

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

2 CORPORATE GOVERNANCE

2.1 Annual General Meeting

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

2.2 Board of Directors

The detailed rules on the scope of authorities and operation of the Board of Directors are detailed in 6.4 of the Articles of Association and in the Rules of Procedure of the Board of Directors (https://www.telekom.hu/about_us/investor_relations/corporate_governance/board_of_directors).



The rules of competence regarding the capital increase and purchase of treasury shares are detailed in Sections 5.2(b) and (p) as well as 6.4. (l) and (m) of the Articles of Association. The General Meeting by its Resolution No. 9/2017 (IV.7.) authorized the Board of Directors to purchase Magyar Telekom ordinary shares for 18 months starting from the date of approval of the resolution. See the detailed description of the authorization on the General Meetings section of our website.

Under Hungarian laws, the Board of Directors is responsible for all matters relating to the Company's management and course of business not otherwise reserved to the General Meeting or to other corporate bodies by the Articles of Association or by the Hungarian laws. The Board of Directors draws up, at the end of each business year, a report for the General Meeting and quarterly to the Supervisory Board on the management of the Company, the assets of the Company, the financial situation of the Company and the business policy of the Company.

Pursuant to the Articles of Association, the Board of Directors consists of a minimum of six and a maximum of eleven members elected by the General Meeting for a term of three years, unless otherwise provided by the General Meeting. On December 31, 2017, there were eight members of the Board of Directors.

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

On December 31, 2017, members of the Board of Directors, their principal occupation and the years of their original election were as follows:

<u>Name</u>	<u>Born</u>	<u>Principal Occupation</u>	<u>Member since</u>
Christopher Mattheisen.....	1961	Chief Executive Officer of Magyar Telekom Plc.	2006
Dr. Mihály Patai.....	1953	Chairman-CEO of Unicredit Bank Hungary Ltd.	2012
György Mosonyi	1949	Chairman of the Supervisory Board of MOL Plc.	2012
Ralf Nejedl.....	1970	Senior Vice President B2B Europe, Deutsche Telekom AG	2016
Frank Odzuck.....	1959	Chief Executive Officer of Zwack Unicum Plc.	2006
Dr. Robert Hauber.....	1971	Senior Vice President Finance & Performance Management Europe, DT AG, Chairman of the Board of Directors of Magyar Telekom Plc.	2017
Guido Menzel.....	1961	Senior Vice President Technology Europe, Deutsche Telekom AG	2017
Mardia Niehaus.....	1963	Senior Vice President International Carrier Sales and Solutions, Deutsche Telekom AG	2017

The members' assignment lasts until May 31, 2019.

2.3 Management Committee

Pursuant to the Rules of Procedure of the Board of Directors, the Board of Directors established a Management Committee in 2000. The Management Committee carries out its activities based on its Rules of Procedure approved by the Board of Directors, which is available on the Company's website:

(http://www.telekom.hu/about_us/investor_relations/corporate_governance/management_committee).

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

On December 31, 2017, the members of the Management Committee and the years of their original election were as follows:

<u>Name</u>	<u>Born</u>	<u>Current position</u>	<u>Member since</u>
Christopher Mattheisen	1961	Chief Executive Officer of Magyar Telekom Plc.	2006
János Szabó.....	1961	Chief Financial Officer	2013
Dr. Balázs Máthé.....	1968	Chief Legal and Corporate Affairs Officer	2010
Tibor Rékasi.....	1973	Chief Commercial Officer Residential	2013
Zsuzsanna Friedl.....	1977	Chief Human Resources Officer	2017
Dr. Kim Kylesbech Larsen.....	1965	Chief Technology and IT Officer	2017
Zoltán Kaszás.....	1968	Chief Commercial Officer Enterprise, Chief Executive Officer of T-systems Hungary Ltd.	2017

2.4 Supervisory Board

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

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

On December 31, 2017, the members of the Supervisory Board, their principal occupation and the years of their original election were as follows:

<u>Name</u>	<u>Born</u>	<u>Principal Occupation</u>	<u>Member since</u>
Dr. László Pap.....	1943	Budapest University of Technology and Economics, Professor	1997
Dr. János Bitó.....	1936	Chairman of the Thesis and Final Examination Board at Pázmány Péter Catholic University, Information Technology Faculty	2010
Sándor Hartai.....	1966	Expert of TU Wholesale Directorate, Magyar Telekom	2016
Dr. János Illéssy.....	1962	Managing Director, Lebona Kft.	2006
Dr. Sándor Kerekes.....	1948	Director of Institute of Environmental Sciences, Corvinus University Budapest	2006
Konrad Kreuzer.....	1948	Managing Director of EUTOP Vienna, Budapest and Prague	2006



Tamás Lichnovszky.....	1962	Chairman of the Central Workers' Council, Magyar Telekom	2010
Martin Meffert.....	1960	Responsible for Corporate Governance issues of Magyar Telekom, Makedonski Telekom and Slovak Telekom at the Group Headquarters of Deutsche Telekom AG.	2009
Éva Őz.....	1957	Controlling Manager of Controlling Directorate, Chairwoman of the Workers' Council of Central Functions, Magyar Telekom	2012
Dr. Károly Salamon.....	1954	Managing Director, MIS Kft.	2010
Zsoltné Varga.....	1969	Quality Manager, Magyar Telekom	2008
Dr. Konrad Wetzker.....	1950	Chairman, School of Management of Corvinus University of Budapest	2011

The members' assignment lasts until May 31, 2019.

2.5 Audit Committee

The Audit Committee executes its duties pursuant to the Articles of Association Section 7.8, and its own Rules of Procedure (https://www.telekom.hu/about_us/investor_relations/corporate_governance/audit_committee). The members of the Audit Committee have been elected by the General Meeting from the independent members of the Supervisory Board for the same period as their membership in the Supervisory Board.

On December 31, 2017, the members of the Audit Committee were as follows:

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

2.6 Remuneration and Nomination Committee

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

The Remuneration and Nomination Committee is established by the Board of Directors of the Company to function as supporting body of the Board of Directors of the Company regarding the remuneration and certain nomination related issues of the members of the corporate bodies and the top executives of the Company in accordance with its Rules of Procedure. (https://www.telekom.hu/about_us/investor_relations/corporate_governance/compensation).

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

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

On December 31, 2017, the members of the Remuneration and Nomination Committee were as follows:

- Frank Odzuck
- Dr. Robert Hauber
- Ralf Nejedl

2.7 Corporate Governance and Management Report

Magyar Telekom Plc. is a public limited company listed on the Budapest Stock Exchange. In 2004, the Budapest Stock Exchange issued its Corporate Governance Recommendations (the Recommendations) containing recommendations related to the corporate governance practice of companies listed on the Budapest Stock Exchange, taking account of the most commonly used international principles, of experiences gathered in Hungary, and of the characteristics of the Hungarian market as well as the Companies Act. The Recommendations were updated in 2007, 2008 and in 2012. The Recommendations effective from time to time is available at the website of the Budapest Stock Exchange: <https://www.bse.hu/Products-And-Services/Rules-and-Regulations/BSE-Rules>

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

http://www.telekom.hu/about_us/investor_relations/corporate_governance/corporate_governance_documents

Companies listed on the stock exchange are required to express their views on their corporate governance practices in two ways. In the first part of the report they have to give account of the corporate governance practices applied by their company in the given business year, including their corporate governance policy, and a description of any unusual circumstances. In the second part of the report, in accordance with the "comply or explain" principle, they have to indicate their compliance with those recommendations included in specified sections of the CGR ("R" - recommendation) and whether they apply the different suggestions formulated in the CGR ("S" - suggestion). In the case of suggestions, companies shall only indicate whether they apply the given guideline or not; there is no need for a specific explanation.

The Corporate Governance Declaration on the Compliance with the Corporate Governance Recommendations, and regarding certain questions the possible alterations and their explanations are included in the report. Sections 1 to 5 of the above report include the description and operation of the Board of Directors, the Supervisory Board, the relevant committees and executive management. Section 6 of the report includes a description of the internal controls and risk management procedures, while Section 8 of the report describes the disclosure policies and insider trading guidelines. In Sections 9 to 10 the method of exercising shareholders' right and the rules on conducting the General Meeting is summarized, while Section 11 contains the Remuneration Statement. The Company complies with the vast majority of the 150 recommendations and suggestions, however in the business year of 2017 in case of 10 recommendations and 6 suggestions it has not or not completely complied with due to the ownership and organizational structure or processes of the Company.

The Board of Directors, through the internal audit area, carried out an evaluation of the Company's disclosure processes in 2017 again. Based on the evaluation, the disclosure controls and procedures of the Company were effective and designed to ensure a proper basis for the timely and accurate disclosures to the market participants required under the respective accounting, capital markets and company law regulations

3 SOCIAL COMMITMENTS, LABOUR STANDARDS, HUMAN RIGHTS

Some of the key challenges of the sustainability strategy come from the area of human resources management. This is why human resources management has a crucial part in the achievement of our sustainability targets. Our vision is to operate in a corporate environment that is livable, likeable and successful. This set of values strengthens the commitment and satisfaction of our employees and is also attractive on the job market.

3.1.1. People strategy from the perspective of the company

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



In 2016-2017, we build our People Strategy around 4 pillars:

- brand and recruitment,
- training-development,
- remuneration and
- well-being.

3.1.2. People strategy from the perspective of our employees

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

People strategy pillars in 2016-2017:

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

3.1.3. Headcount

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

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Magyar Telekom Plc.....	6,670	6,281	6,241

3.2. 1. Policies and agreements

Code of Conduct: <https://www.telekom.hu/static-tr/sw/file/mt-code-of-conduct.pdf>

The Code of Conduct provides the framework of orientation for all employees of Deutsche Telekom Group and Magyar Telekom. Additionally, it applies to people to who are viewed as equivalent to employees in functional terms, e.g. to temporary agency employees. It combines the joint requirement of compliance with legal obligations and acting with integrity and thus ensures that Deutsche Telekom and Magyar Telekom remain transparent and traceable enterprises for everybody. Deutsche Telekom and Magyar Telekom expect their suppliers and consultants to comply with the rules of behavior manifested in this Code of Conduct and to endeavor them to ensure that they are also obliged to abide to its regulation by contract.

Code of Human Rights and Social Principles: <https://www.telekom.hu/static-tr/sw/file/code-of-human-rights-social-principles-eng.pdf>

Equal Opportunities Plan: https://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_Eselyegyenlosegi_Terv_2016_2020_en.pdf

The Code of Human Rights and Social Principles and the [Equal Opportunities Plan](#) of Magyar Telekom set the general human rights principles of the group and guidance to their group-wide implementation. Magyar Telekom recognizes and respects the fact that the cultural, social and legal diversity of its employees provide the foundations of operations based on equal opportunities. It is also a competitive advantage that leads to business success.

Diversity Policy - https://www.telekom.hu/static-tr/sw/file/Diversity_Policy.pdf

The Diversity Policy of Magyar Telekom underscores our commitment to consistently identify and utilize potential for improvement.

Suppliers' Compliance: Magyar Telekom is committed to respect and protect human rights and it expects its suppliers to comply with these rules of behavior. Prior to becoming authorized suppliers of Magyar Telekom and T-Systems our suppliers must register their enterprises at our vendors' registration site.

https://beszerzes.telekom.hu/beszerzes/portal_en?appid=beszerzes&page=english/registration_vendor.vm

As an obligatory part of the registration process vendors are obliged to understand and accept our Suppliers Code of Conduct that among other policies, entails our Code of Conduct, Social Charter and Diversity Policy. Our suppliers must understand and accept these policies and obligatory frameworks for their behaviors as well.

Equal Opportunities Plan:

Anti-discrimination and the safeguarding of equal opportunities is a key priority to Magyar Telekom. According to the act CXXV of 2003 on Equal Treatment and Promotion of Equal Opportunities, and the corporate protocol in place since 2010 Magyar Telekom has accepted its 4th Equal Opportunities Plan in order to secure the practices of equal treatment, the advancement of equal opportunities and the monitoring an improvement of the labor positions of particular disadvantaged employee groups. The Equal Opportunities plan currently in force is valid between 2016 and 2020 and has been developed in close cooperation with the employee representative bodies.

The Diversity Charter of the European Union – Hungary has joined the Diversity Charter of the European Union in 2016 and, among 50 signatory companies Magyar Telekom has also underscored its dedication to safeguard diversity as a fundamental value. Magyar Telekom has been among the signatory companies in 2017 too.

UN Guiding Principles on Business and Human Rights – According to the dedication of Magyar Telekom to safeguard and protect human rights along its operations as stated in the UN Guiding Principles of Business and Human Rights, the company considers the rights and guidelines stated in the Universal Declaration of Human Rights and in the ILO's Declaration on Fundamental Principles and Rights at Work to be mandatory in its own practices.

UN Human Rights Treaties ratified by Hungary – Magyar Telekom as a corporation legally registered in Hungary is carrying out its entire operations and business practices in full accordance with the nationally ratified UN Human Rights Treaties.

http://tbinternet.ohchr.org/_layouts/TreatyBodyExternal/Treaty.aspx?CountryID=77&Lang=EN

3.2.2. Monitoring and auditing practices

The group-level coordination of corporate sustainability operations that also incorporate labor standards, social issues and the protection of human rights is being coordinated by the Group Sustainability Coordination Council (GSCC). The levels of development and management of the corporate sustainability strategy are separated from the operative implementation level within the operation of the GSCC, thus the process of implementing sustainability activities is divided to the level of strategy development and management, and the level of operative implementation.

According to the relevant group directive the strategic tasks are allocated to the respective Chief Officers. 50% of the bonuses of Chief Officers depend on the performance of collective objectives. More detailed information about the actual operation of the GSCC and its reporting obligations towards the Management Committee could be found in the Sustainability chapter of this document and in the annual Sustainability Report.

Magyar Telekom's Code of Conduct covers the requirements of corporate compliance and states our collective set of values, and thus stands as an affirmation of Magyar Telekom's strong reputation, solid position and future success. The Code of Conduct applies to all

board members of Magyar Telekom from employees to managing directors, executives and board members. Furthermore, Magyar Telekom expects its suppliers and consultants to comply with the rules of behavior manifested in this Code of Conduct and to endeavor them to ensure that they are also obliged to abide to its regulation by contract.

Magyar Telekom's Corporate Compliance Program has been elaborated with the aim to ensure that Magyar Telekom conducts its business with maximum consciousness and commitment, in accordance with relevant laws and regulations, in harmony with the strictest possible business ethics standards. The Compliance Program involves the Group Compliance Manager and compliance representatives of particular functional areas of operation, who are working together as members of the Group Compliance Committee. The Compliance Program has been designed to ensure that the Company conducts its business to the highest standards of awareness, transparency, accountability, commitment, and adherence to applicable laws and regulations.

External audits could be conducted as part of the control process carried out by the Hungarian Labor Inspectorate. The Inspectorate has the right to issue such an auditing process in case of public complaints or issued requests. The Inspectorate also provides counseling to the corporations in support of legal compliance.

3.3. Results of Policies

3.3.1. Diversity and Equal Opportunities

As one of the largest employers in the Hungarian ICT sector we believe that diversity contributes to the success of businesses and all kinds of organizations to a large extent. This value is also at the core when it comes to the increase of creativity and innovation, to the involvement of new partners, experts and clients, to the quick adaptation to changes and most of all, to the compliance with the legal obligations of non-discrimination in all corporate operations.

The corporate Equal Opportunities Plan of 2016-2020 addresses actions and procedures to improve the labor conditions and career perspectives of particular disadvantaged employee target groups such as women, employees with families, employees on child-care leave, employees living with disabilities, recent graduates and 50+ employees. In order to maintain this focus Magyar Telekom has developed and accepted Equal Opportunities plans since 2008 in close cooperation with the employee representative bodies. The current is the 4th Equal Opportunities Plan of the company, the guidelines, policies and actions of which cover the 2016-2020 period.

The principles of justice and equal treatment of Magyar Telekom are being defined by our Code of Conduct. Ways of non-typical employment such as Telework, flexible working hours, part-time work, employment of people living with disabilities allow the company to realize the principle of equal treatment in practice. These measures are further assisted by several measures implemented in corporate day-to-day operations, such as our large offices (FutureWork, FutureLab) that are designed to support Teleworking.

In accordance with Hungarian labor legislations we provide our employees with extra days off after their children, and after blood donation. In case of more than 40% health damage we provide our employees with extra five days off annually for rehabilitation. On top of these we also credit the voluntary work of our employees by providing days off, the proportion of which is strictly regulated in internal directives.

One of the targets of our 2016-2020 Sustainability strategy was to measure and improve the diversity culture of Magyar Telekom. We measure the state of corporate diversity culture through an internal survey between December 2017 and January 2018. After the evaluation of the results we are going to define the strategic steps, targets and result indicators of the effective improvement of our corporate diversity and equal opportunities culture that is going to be advanced through the complex implementation of operative measures.

3.3.2. Anti-discrimination and labor-market integration actions

As an employer, Magyar Telekom has issued the following actions in 2017 to improve the conditions of the employee groups marked in the 2016-2020 Equal Opportunities plan.

The company has continued to support the Romaster program of Hungarian Business Leaders Forum (HBLF) that is designated to support young roma talents to proceed with their education.

In order to secure the equal opportunities of our current and future colleagues living with disabilities, we are using a special module on our online job-application site (<http://www.telekom.hu/rolunk/karrier>) since 2010, where our applicants are encouraged to state any accessibility requests they might have in order to attend the selection process.

Apart from the hiring process Magyar Telekom is dedicated to advance involvement and inclusion in the office days too. Just as we did in the past few years, in 2017 Magyar Telekom has organized its "Have You ever tried to...?" office events involving external organizations and NGO's. We have also provided several opportunities along its Year Kick-Off event, the 'Mozdulj Telekom!' ('Get Movin' Telekom!') Family Sports Day and during the Autumn Health program series, where employees could get personal experiences about the daily challenges of people living with sensory and impairments and/or physical disabilities. Employees also valued the opportunity to be inspired by the strength, stamina and competitive spirit of our Paralympic champions at the Kick-Off 2017 where our athletes and Paralympic champions got together to inspire our employees.

3.3.3. Respect of Human Rights, actions against child labor and all kinds of forced labor

As disclosed in the Social Charter of Magyar Telekom the Company rejects child labor and all kinds of forced or compulsory labor and fights against all kinds of human trafficking and modern day slavery by all means at its disposal. As the parent company of Magyar Telekom Deutsche Telekom Group is responsible for supply chain compliance auditing and management on a global level. More detailed information about the methodology and results of the global supply chain management at <https://www.telekom.com/en/corporate-responsibility/assume-responsibility/assume-responsibility/supply-chain-management-355304>

New employees of Magyar Telekom as part of their orientation process in their first two months receive compulsory education about the company principles, guidelines and practices concerning social issues, labor standards and human rights. All employees must understand and accept these guidelines as the fundamentals of their own professional behavior and operations. Nevertheless, the company is aware of the fact that there could be situations in which it is harder to tell appropriate from inappropriate. In order to assist employees in making the right choices in these situations, the company offers secure internal whistleblower channels, operated by the Corporate Compliance Department. "Kérdezz!" ("Ask me!") advice portal has been set up to help resolve uncertainties as far as compliance-relevant behavior is concerned. Serious misconduct must be announced for prevention purposes and for appropriate sanctions. For this reason, the "Tell me!" whistleblower portal has been established. The main principles and the detailed description of the internal inspection process is detailed in employee directives available on all employees on the shared intranet platform. Throughout the inspection process the whistleblowers' anonymity, personal and data privacy are guaranteed and handled with utmost discretion.

3.3.4. Relationship of management and employees

At present two unions and workers' council operate at Magyar Telekom, communication with them runs on two levels. Central decisions concerning the whole Company, when the employee representation bodies need to be consulted, are deliberated with the Central Workers Council and the representatives delegated by the trade unions, either in the frame of joint consultation (Interest Reconciliation Council), or separately, depending on the nature of the matter discussed. Central communication is managed both verbally (negotiation) and in writing. The Chief HR Officer and the HR Strategic Director are responsible for central level communication with the employee representation bodies. Interest enforcement issues concerning a given governance area are also discussed locally with the representatives of the trade unions and the local workers' council. The HR Business Partners of the governance area are responsible for communication with the local employee representation bodies.

Trade union and the workers' council (Central Workers Council) must be consulted and their opinion solicited on significant decisions resulting in organizational changes or changes affecting a large group of employees. In organization restructuring decisions the collective bargaining bodies have 7 days to submit their comments, in other cases 15 days. The measure in question may not be implemented during this 15-day period. Trade unions and workers' councils (Central Workers Council) must be consulted with regard to draft resolutions, aiming at organizational changes without regard to the number of employees concerned.

Under the Act V of 2013 on the Civil Code one third of the Supervisory Board shall consist of employee representatives. The employee representatives in the Supervisory Board are nominated by the Central Workers' Council considering the opinion of the trade unions operating at the Company. Persons nominated by the Central Workers' Council shall be elected by the General Meeting to the member of the Supervisory Board, except if disqualifications exist in respect of the nominated persons. On December 31, 2017, four members of the Supervisory Board were employee representatives. These members were Tamás Lichnovszky, Zsoltné Varga, Éva Óz and Sándor Hartai.

3.3.5. Freedom of organization and collective bargaining

Magyar Telekom acknowledges the basic rights to freedom of organization and collective agreement in its Social Charter. In line with an openness and trust that relies on a constructive social dialogue, Magyar Telekom declares its support to cooperation with the legitimate representatives of the employees in order to establish a balance of interests.

The Social Charter together with the long history of mutual respect and cooperation of the management and employee representative councils are the guarantees that these rights are being fully and thoroughly respected. 100% of the employment contracts of Magyar Telekom employees operating in Hungary fall under collective bargaining agreements developed with the Hungarian Telecommunications Trade Unions (Távközlési Szakszervezet, TÁVSZAK and Magyar Távközlési Ágazati Szakszervezet, MATÁSZ). The agreement, which can be terminated by either party with three months' notice, applies to all Magyar Telekom Plc. employees except the CEO, regardless of their union membership status. Wage terms in the collective bargaining agreement must be renegotiated annually. If the employment is terminated due to reasons related to the employer's operation, employees are entitled to a specific amount of severance pay surplus, which depends on the tenure of the employee.

In addition to the collective bargaining agreement, employees of our Hungarian operations are generally covered by the Act I of 2012 on the Labor Code, which imposes various restrictions on the involuntary termination of employment. The Labor Code protects employee interests through two different labor organizations: the Trade Union and the Workers' Council.

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

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

3.3.6. Workforce Reduction and Redeployment

Magyar Telekom – in order to ensure the resources related to the Company's strategic objectives - has reached an agreement with the trade unions on headcount reduction and wage increase measures for 2018.

According to the terms of the agreement, the Company plans to make ca. 350 parent company employees redundant. In addition, around a further 160 employees are expected to leave the Company as a result of a number of discontinued corporate projects. The majority of the employees to be made redundant are expected to have left the Company by the end of 2017. The company shall provide active job search, labor market training and one-on-one counselling to the colleagues laid off, in the framework of Program Chance, which has proven its success in the past years, and trusts that the above support these highly-trained employees of up-to-date professional expertise in finding employment elsewhere as soon as possible.

It is planned to reinvest a significant proportion of the expected employee cost savings in resources related to the Company's strategic objectives.

As from January 1, 2018, employee salaries at the Company will rise by an average of 5%.

3.3.7. Pensions and Benefit Programs

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

We provide employees with telecommunication allowances, subsidized meals, interest-free housing loans (such loans are not offered or extended to the Company's Board of Directors), discount holiday facilities and other fringe benefits. In addition to our statutory contributions to governmental health, retirement and unemployment schemes, we contribute to the employees' pension, health and self-aid savings, provided he is member of the voluntary fund, which provides private pension and health insurance as well as social



benefits supplementing government pension and health benefits. We do not, however, guarantee payment by the fund to its members. In December 31, 2017, approximately 59% of employees of Magyar Telekom Plc. participated in the pension-, 36% in the self-aid-, and 65% in the health fund.

3.4. Risk management

3.4.1. Providing educational and professional background

The educational pillar of Magyar Telekom's Sustainability Strategy aims to improve the digital competencies of the clients and the wider public. It also aims to contribute to the development of industrial succession knowing that a potential throwback in the amount of available highly qualified professionals in the industry could mean a serious risk to maintaining, improvement and development of the quality of our services. In order to secure the highest quality service to our clients we need work with the best professionals. To be able to have them a competitive industrial educational background is necessary.

Upon the initiative and by funding of T-Labs (Telekom Innovation Laboratories, Berlin) the faculty Data Science and Engineering began to operate at Eötvös Loránd University from September 2016 as the first pillar of the EU Labs researcher network.

Magyar Telekom also provides practice opportunities for secondary school pupils from the relevant technological industries. In 2017 100 students have spent their obligatory practices at our company.

We supported the work of the Environment Protection Committee of the Hungarian Academy of Sciences as well as the scientific work of the National Adaptation Center. Our colleagues are in close relationship with several higher education institutes and we help the universities with consultancy for writing theses, expert education and giving lectures.

3.4.2. Employee expectations and equal opportunities

The pillars of our People Strategy are based on the aim to meet the needs of our employees, and to live up to the challenges of maintaining our company status as a highly competitive and future oriented employer. Our employees require security, stability, opportunities for advancement and competitive compensations. Magyar Telekom, as a company committed to provide equal opportunities to its employees, finds it especially important to harmonize wages and to terminate unjust wage gaps. Our tiered wage system, built on the Hay methodology, serves the above purpose. Our remuneration system is fully transparent thus our base wage tables and the relevant policies are available for all employees

As an employer dedicated to diversity as a core value, Magyar Telekom finds it important to raise the amount of women in leadership positions. As a member of Deutsche Telekom Group the objective in 2010 was to increase the proportion of female managers to 30% by 2020. Along the aim to contribute to reaching the defined target, the company strives to utilize the actual business benefits inherent to the advancement of corporate diversity culture.

Magyar Telekom considers stress, overload and burnout related risk-reduction as its priority duty in relation to its employees. In order to take charge of these risks by securing an empowering environment to develop and maintain a healthy lifestyle, employees are also provided with coaching and training opportunities that help in the advancement of their task management skills. Efficient work-life balance of employees with families is further supported by our child-friendly offices and the available, tax-free nursery and/or kindergarten support that could be selected from our cafeteria benefit scheme, thus contributing to the reduction of expenses. Taking notice of the special conditions of employees (ex. illness or the longer term domestic care of a relative) a longer period of unpaid leave is also available.

3.5 Performance indicators

Education results of the 2016-2020 Sustainability Strategy:

- 33 918 smarter brains since 2016 with the help of digital inclusion programs eg. Digital Bridge, LTI

Non-typical employment at Magyar Telekom Group

- No. of Part-time employees in 2017: 145
- No. of Flexi-time employees in 2017: 726
- No. of Teleworking employees in 2017: 2752

More women in leadership positions at Magyar Telekom Plc.

- Percentage of women in overall workforce: 41%
- Percentage of women in senior management: 22%
- Percentage of women in executive board: 13%

**Volunteer work benefits at Magyar Telekom Group**

- No. of volunteer working hours: 14 261
- No. of supported people by the projects: 27 400

3.6 ESOP organization

By reshaping the current remuneration structure, the Company has launched an incentive program based on the new remuneration policy in 2017, by which the corporate financial targets, approximately half (50%) of the total bonus, will be paid via the ESOP Organization for Magyar Telekom Plc. and T-Systems Magyarország Zrt. eligible employees. Under the new incentive program, the Company purchased 4,534,758 Magyar Telekom shares worth HUF 2,139 million during 2017. The purchased shares were transferred to the ESOP Organization in several installments. The vesting condition of the new program is the operating free cash flow for the MT-Hungary segment for the financial year ending December 31, 2017 to exceed that for the previous year ending December 31, 2016. In accordance with the remuneration program those employees of the Company and T-Systems Magyarország Zrt. are rewarded who are under the personal scope of the Remuneration policy approved on February 22, 2017 by the Company's Board of Directors. For further information see Note 20.1.2.5 of the Financial Statements.

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

The aggregate compensation of the members of the Board of Directors in their capacity as Board members was HUF 16 million in 2017.

The aggregate compensation of the members of the Supervisory Board in their capacity as Supervisory Board members was HUF 63 million in 2017.

The total compensation expenses (including social security and other payroll-related taxes as well as contractual termination expenses) of the members of the Management Committee (MC) was HUF 1,463 million in 2017.

On December 31, 2017, three of the seven MC members have an employment contract with fixed duration. Pursuant to Hungarian legislation, if an employment contract is terminated before the end of its term, the absence fee received for the remaining period is up to 12 months. The notice period is two months for three of the five indefinite contracts, and six months for the remaining two contracts. For two contracts the severance payment is in accordance with the Labour Code and the Collective Agreement, for the rest of the contracts the severance payment is between 3 and 16 months.

In addition to the above, the affected persons are bound by the non-compete clause, under which the employee is barred from entering into employment with any Hungarian or international competitor of Magyar Telekom and is required to refrain from providing 114 direct or indirect services or activities of any kind to such companies for a definite period (not longer than one year) upon termination of his/her employment. Furthermore, such employee is barred from any action aimed to recruit employees of Magyar Telekom for any other company. This limitation entails certain compensation which is proportional with the above obligation. If the employee is in breach of the agreement, he/she will reimburse the net amount of compensation to the employer. In addition, the employee will be liable for a payment of compensation to the employer.

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

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

For information about the Share Based Compensation programs, see Note 20.1.2 of the Financial Statements.

5 RESEARCH AND DEVELOPMENT

In 2017, within the scope of tender obligations, the research and development activities of Magyar Telekom were comprised of maintaining the R&D tender project funded and awarded by the National Research, Development, and Innovation Fund.

During 2017, in addition to the tender obligation, we have continued the development of several project related products and services that were based on the R&D activities of 2016, such as the TV application that can be used on the TVGO mobile and web platforms and is related to the topic of TV/Entertainment.

In addition to the above, we have also launched new key R&D projects in 2017 in the fields of IoT TV/Entertainment and Big Data. Amongst others, we have examined voice and gesture based remote IPTV control, the feasibility of a cloud based TV service, and also created the prototype of the TVGO application in a general Windows 10 development environment. Within the scope of the intelligent parking project, we examined the business opportunities provided by new mobile solutions, such as NB-IoT. In addition, we have done research on artificial intelligence (AI) and machine learning (ML) supported face recognition and related services. Within the same topic of AI/ML, we have created a chatbot that may later provide aid in the work done by customer service staff by leveraging the opportunities offered by online interfaces. Regarding the topic of Big Data, we have investigated the opportunities of forecasting traffic events using mobile data.

In addition to innovative domestic SMEs, the research and development tasks are performed by the internal researchers as well as the product and services development staff of Magyar Telekom. In addition, the Company leverages the synergistic effect of an internal and external knowledge base, and strives for partnership with well-known innovation centers and institutes of higher education. Our main partners are renowned Hungarian universities and research institutes, such as the Budapest University of Technology and Economics, the Eötvös Loránd University, the Budapest Corvinus University, the Óbuda University, and the Hungarian Academy of Sciences.

Within the framework of cooperation launched during the past year, we have continued our work with the Technische Universität Berlin, the Department of Data Science and Data Technology operating at the Faculty of Informatics at the Eötvös Loránd University, the research and development department of Magyar Telekom and Deutsche Telekom, and the Telekom Innovation Laboratories (T-Labs) in Berlin.

From amongst the topics of the previous year, the Telekom Open Services project was also completed in 2017.

As the partner of EIT Digital, Magyar Telekom promotes and supports even closer cooperation between higher education institutions and their industrial partners. Within this framework, the Budapest University of Technology and Economics and the Eötvös Loránd University provides professional support to students within the EIT Digital post graduate training system.

In 2017, we have launched an internal idea incubation initiative the Mission Telekom Program. All the applicants were from the employees of the Magyar Telekom group. 150 applications were received and after several rounds of selection, the teams the best five ideas were realized to prototype level. This will be followed by the go-live and business utilization of stand-alone prototypes.

In addition to the above, Magyar Telekom also believes it important to support R&D type knowledge transfer projects. As a result, it has been an active participant of the EIT ICT Labs knowledge transfer program as a professional cooperating partner since 2012, and cooperates several international R&D tender initiatives.

6 REAL ESTATE, SITES OF OPERATION

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

6.1 The registered office of the Company:

- 1013 Budapest, Krisztinakrt. 55.

6.2 Sites of the Company:

- 1117 Budapest, Magyar tudósok krt. 9.
- 1073 Budapest, Dob u. 76-78.
- 1117 Budapest, Budafoki u. 103-107.
- 1107 Budapest, Száva u. 3-5.
- 1117 Budapest, Szerémi út 4.
- 1117 Budapest, Budafoki út 56.
- 1106 Budapest, Örs vezér tere 25. 1. em.
- 1138 Budapest, Váci út 178.
- 1195 Budapest, Üllői út 201.
- 1191 Budapest, Vak Bottyán u. 75. a-c.
- 1024 Budapest, Lövházu. 2-6. 2. em.
- 1123 Budapest, Alkotás út 53.
- 1152 Budapest, Szentmihályi út 131.
- 1062 Budapest, Váci út 1-3.
- 1117 Budapest, Október huszonharmadika utca 8-10.
- 1119 Budapest, Fehérvári út 79.
- 1033 Budapest, Huszti út 32.
- 1082 Budapest, József utca 19-23.
- 1095 Budapest, Soroksári út 166/A.
- 1098 Budapest, Távíró utca 3-5.
- 1156 Budapest, Száraznád utca 1-3.

Out of the number of 1,728 buildings that take place on the 1,496 sites of Magyar Telekom Plc, 55% is owned by the company, 5% is jointly owned and the rest 40% is leased. These figures do not contain the technology sites, from these type of sites we have 6,075.

The total area of properties used by Magyar Telekom Plc. as of December 31, 2017 was 553,691 m². The majority of sites used in our operations are smaller than 100 m². The largest site is our headquarters building located at Krisztina krt. 55 in Budapest, with floor space of over 30,000 m²

7 SUSTAINABILITY

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

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

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

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

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

Charters and initiatives of cooperation accepted and signed by Magyar Telekom

Besides professional challenges, the Company also seeks cooperation opportunities for the solution of social and environmental problems.



The Company is a member of several working groups of the Hungarian Business Leaders Forum (HBLF):

- Partnership and Volunteering Working Group
- HBLF for DiversityHR Working Group
- Equal Opportunities Working Group
- Health Working Group
- Environmental Protection and Sustainability Working Group
- Community Programs Working Group
- Business Ethics and Transparency Working Group

HBLF-ROMASTER – Magyar Telekom is a member of the program together with other major players of the business sphere. This is the first initiative aiming to join forces, without any state involvement, in order to address the urgent and sensitive social issue of roma people's integration and working closely together in improving or solving the situation.

The Company has been an active member of ETNO's (European Telecommunications Network Operators Association) Sustainability Workgroup for years. The members work closely towards solving all kinds of sustainability-related programs. In addition to the three meetings held each year, an internet portal also helps our joint work and contributes to the sharing of best practices.

In respect of the hello holnap! fee package we held various forums with the involved organizations of people living with disabilities (AOSZ, ÉFOÉSZ, MEOSZ, MVGYOSZ). Our cooperation with these bodies is continuous, active and based on the proposals we continuously improve our relationship with disabled people and develop our relevant services. In 2016 we implement the latest version of the fee package that provides several services at the cheap price for disabled people. Our most important new initiative is that each entitled member can use two hello holnap! subscriptions to involve a family member or an attendant. In 2017 we increase further this number, thus one living with disability customer can have all together three subscriptions on their own name.

We supported the work of the Environment Protection Committee of the Hungarian Academy of Sciences as well as the scientific work of the National Adaptation Center. Our colleagues are in close relationship with several higher education institutes and we help the universities with consultancy for writing theses, expert education and giving lectures.

OECD-Guidelines – Magyar Telekom has been the first among the Hungarian companies to accept OECD Guidelines for Multinational Enterprises and set them up as mandatory guidelines for its operations.

European Union's Diversity Charter – has been signed by the company and considered as a mandatory guideline inherent in the corporate Human strategy.

UN Global Compact has been signed by the company and the current report also stands to report our achievements in the 10 principles

UN Sustainable Development Goals – Magyar Telekom has acknowledged the SDG and through incorporating them as guidelines in its 2016-2020 the company finds the contribution to the goals a mandatory element of its operations.

Carbon Disclosure Project (CDP) – Magyar Telekom has signed the global initiative and fulfills its annual reporting obligations

https://www.telekom.hu/about_us/society_and_environment/cooperation

Quality guarantees in the Magyar Telekom can be found:

https://www.telekom.hu/about_us/about_magyar_telekom/principles/quality_guarantees

7.1 Sustainability strategy

In 2016, Magyar Telekom started its new five-year sustainability strategic cycle, 2016-2020.

In addition to the results of our Sustainability Strategy 2011-2015, the goals and tasks defined for the period through the end of 2020 have been determined by the goals and directions applied internationally in terms of sustainable development (SDG, CDP, GeSI SMARTer2030, EU2020 climate package), which we, as a Company, adhere to. When identifying our priorities, we have focused on the expectations of the responsible investors monitoring our company and the current corporate trends. Of course, local market conditions, as well as consumer behavior and demand have also been taken into account, so that we be able to proactively meet our customers' needs.

When identifying our strategic goals, we kept in mind that our sustainable operation has a significant impact on the society, the economy and the environment. In addition to being responsible for the livable future of our several million customers and more than 10 000 employees, as a market leader ICT provider and a large enterprise of regional proportions, we are aware that our business and operational decisions influence the economy and the society of the future, too. It is our firm belief that we, as a company, are responsible for all the groups of people whom we can enable by ICT solutions, and that we have to make social, economic and environmental responsibility a part of our corporate genetic code to thus promote sustainable development and opportunities for future generations.

The main objective set forth by the fourth Sustainability strategy covering the period through the end of 2020 is to make sustainability part of Magyar Telekom's business. This can be ensured, if considering all three pillars of sustainability, we are comprehensive, credible and innovative.

Until 2020, climate protection, education and awareness, and digitally enabled sustainability are the major foci of the strategy.

Climate protection

Our goal is to make our customers climate-conscious, too, and to be an authentic and responsible company that helps them along that journey. It is our ambitious objective to generate revenue from our climate protection activities, as the ICT world offers especially great potential for that, at the same time to push Magyar Telekom Group's actual CO₂ emission below 100,000 tons. In order to achieve the above, in addition to the emission decreasing initiatives, we also need to work on elaborating "green" services specifically.

KPI: push Magyar Telekom Group's actual CO₂ emission below 100,000 tons

KPI: generate revenue from climate protection

Education

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

KPI: 100,000 digitally educated people in Hungary

Digitally enabled sustainability

Being a sustainable digital company, it is our clear expectation that our customers should also use sustainable digital services. To that end, we strive to pursue responsible marketing and activities that enable and inspire others, as well as are based on sharing. In this context, our goal is that awareness about Magyar Telekom, as a sustainable company should reach 50%.

KPI: awareness about Magyar Telekom, as a sustainable company should reach 50%

Awards and recognitions achieved in 2017:

- Oekom – B Prime category
- FTSE4GOOD Index membership
- CEERIUS sustainability index membership
- Disability-friendly Workplace
- Best Sustainability report Hungary 2017 - Green Frog Award

7.2 Initiatives concerning stakeholders

In order to successfully operate the company it is essential to have strong relations with stakeholders.

Below you will find a list of our key activities with our stakeholders the details of which are elaborated in the respective chapters of the Sustainability Report:

- Investors – Investor (and responsible investor) assessment
- Customers – Sustainable products and services, hello holnap! mobile app
- Employees – community solar pilot, diversity culture survey, hello holnap! points

- Regulators – conformity, regulatory relations
- Local communities – Digital Bridge, 2nd Telekom Voluntary Day Autistic Art Strategic Partnership (donations, voluntary, tablets, awareness videos)
- Non-profit organizations – Sustainability Roundtable Discussion, 10th Sustainability Day
- Suppliers – sustainable supplier chain, TOP3 sustainable supplier of Magyar Telekom
- Media – Sustainability Media Club, Press Award on the Sustainability Day
- Future generations – Become an IT expert! sustainable innovation, sustainable innovations

At the end of Y2017 we started the community solar program pilot. Most of the electricity consumption of the educational building in Kékvirág street is given by solar panels located on the roof of the building. During the program employees have the opportunity to adopt a solar panel and get extra benefit in exchange.

In 2017, we organized the Sustainability Roundtable Discussion for the 18th time, the objective of which is to have an open dialogue with our stakeholders for the sake of understanding the demands towards Magyar Telekom, discussing the arising problems, and to provide a suitable background for thinking together and co-operating in building a sustainable future.

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

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

A jury of experts decides which submitted project should receive the award. The ninth award ceremony took place on June 10, 2016, as part of the Sustainability Roundtable. In 2017, we recognized organizations and businesses promoting sustainable, innovative solutions and sustainability education and awareness raising.

The tenth Sustainability Day event took place on September 30, 2017. The topic of the day was flow. Record number, nine thousand visitors attended the event where they participated in panel discussions on the three pillars of sustainability and examined pieces of works submitted to the creative design exhibition as well as exhibitors.

The event presented an opportunity to hand over the Sustainability Media Award for the seventh time by the members of the Sustainability Media Club - established by Magyar Telekom. Awards were distributed in three categories: tv/radio/video content, written newspaper (print, online); blog, vlog., The award amounted to HUF 300 000 for each category.

In 2017, we continued to sensitize our employees to social issues by organizing volunteer work events. The strategic target of the corporate volunteering is 50,000 hours of voluntary work by Magyar Telekom employees. To achieve that they had the possibility to grow the amount of the theoretical contribution to society by educational (Digital Bridge, Be an IT expert!, Mobile scientists) and charity (eg. It is good to give! cookie campaign) voluntary events and the Telekom Voluntary Day. The philanthropic voluntary programs are very popular among our employees eg. the seasonal blood donation or helping in caring homes operated by associations for youth living with disabilities.

In 2017, we organized the Telekom Volunteer Day for the second time. During the year 1219 colleagues worked 13,641 hours of volunteer work, by means of which a theoretical amount of HUF 58.7 million was thus donated to the society.

In 2017, we continued the “hello holnap!” employee point collection. In the fourth year of the initiative 7,023 points were collected by 2,546 colleagues. The first three employees who collected the most points were given a Csepel bike voucher and an electric car use voucher.

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

http://www.telekom.hu/about_us/society_and_environment/society/protection_of_our_children.

As a part of the strategic partnership with Autistic Art, in 2017 Magyar Telekom cooperated with BOOK Kids and the Sustainability Media Club. During the campaign the Huawei Fairy Tale Tablet was the part of the Magyar Telekom portfolio. The objective was that

after each of the sold fairy tale tablet Magyar Telekom donated the same tablet for those who live in homes for autistic youth operated by the Autistic Art Foundation. Thanks to the campaign 176 devices can be used by the nursing professionals for the complex and personalized development of competences of the youth living with autism.

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

We launched the "hello holnap!" mobile app on September 27, 2014, by which we drew attention to Telekom's sustainability efforts in particular and sustainable lifestyles in general. By using the app, users can collect "hello holnap!" points and donate them, converted into real money by Telekom, to non-governmental organizations of their choice. The success of the mobile application in 2017 is best represented by the fact that it has more than 11,000 downloads and it is one of the most popular Telekom applications.

One pillar of atypical staffing is telework, which is one of the most important sustainability aspects of the Future Work project. Working from home in the framework of the project launched in July 2014 enabled the Company's employees to save time and mileage. Thus, drivers can relieve the environment of as much as 4 million kilometers and twenty years of travel in 2017.

7.3 Annual Sustainability Report

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

The 2014 and 2015 Sustainability Report was compiled along the Fourth-Generation Principles set forth by the Global Reporting Initiative (GRI G4), while the 2016 Sustainability report was compiled along the newest requirement, the GRI Standard. It was applied on comprehensive level and includes more information about the Company's sustainability performance. The independent assurance and certification of compliance with the GRI Standard criteria was conducted by PricewaterhouseCoopers along the ISAE 3000 international standard.

Further details on the sustainability performance of the Company can be found in the annual reports available on:
https://www.telekom.hu/about_us/society_and_environment/sustainability_reports

The 2017 Sustainability Report is going to be published in 2018 spring.

8 ENVIRONMENT PROTECTION

Policies

Magyar Telekom upholds its commitment to sustainable development and the environment protection in the environmental policy. The policy contains obligations for the members of the Magyar Telekom both individually and as a Company:
https://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_environmental_policy.pdf

The Group-level coordination is continued to be implemented under the auspices of the Group Sustainability Coordination Council (GSCC). The levels of development and management of the corporate sustainability strategy are separated from the operative implementation level within the operation of the GSCC, thus the process of implementing sustainability activities is divided to the following levels:

1. Strategy development and strategy management level operating under the auspices of the GSCC: development of strategic concepts, implementation of the strategy, relevant communication with national and international organizations
2. Operative implementation level managed by relevant organisations of the governance areas and business units, actual operative activities, task management, data provision etc.

The GSCC's operation is regulated by a group level directive: on the regulation of Magyar Telekom Group's sustainability operation and the responsibilities and competence of stakeholders.

The top management of Magyar Telekom, the Management Committee receives at least once a year a report on the implementation of the tasks of the Company's Sustainability Strategy and other ongoing significant sustainability activities, results, potential exposures and opportunities.

The MC is informed on the latest sustainability trends and may respond to the feedback from stakeholders through the annual report and based on the report may decide on the amendment of the strategy. The MC keeps contact with the stakeholders (e.g. General Meeting) through the GSCC. Incoming inquiries are received by the respective professional areas and critical comments regarding sustainability are transferred to the responsible staff members by the GSCC members. According to the relevant group directive the strategic tasks are allocated to the respective Chief Officers. 50% of the bonuses of Chief Officers depend on the performance of collective objectives.

Results of the policies

As a leading provider of info-communications services in the region, Magyar Telekom's commitment to sustainable development with a focus on preserving the environment lies in the centre of its mission. In our new Sustainability Strategy 2016-2020 we set the ambitious goal to reduce the level of our carbon dioxide emission below 100 000 tons.

In 2017 we continued our carbon offset project. We spent half of the income of our company car policy regulated bonus-malus system to carbon offset. Our aim was to become carbon neutral again in 2017 too. We have reached our goal by using 100% renewable energy for our electricity and we offset the rest of our emissions, by purchasing and retiring 25,000 CER (Certified Emission Reduction) units. The reduction came from a Chinese project. In 2017 Magyar Telekom Plc. has purchased 180.8 GWh of renewable energy that is equal with 100% of the total amount of electricity used by the Company. Furthermore, in 2017 we purchased 6,672 CER units to offset our Magenta1 customers for Y2018.

Our highlighted environmental and operational ecoefficiency goals are:

- Reducing our CO₂ emissions (target set below 100 000 tons of CO₂ by 2020)
- Energy consumption: saving energy (reduce consumption), increase of energy efficiency levels, using green energy
- Increase the energy efficiency of our buildings
- Decrease our fleet consumption, promotion travel replacement solutions, and dematerialization solutions
- Introduction of sustainable and climate friendly products and services
- Waste management: reduction of waste (increased recycling-rate)
- Measure the climate footprint of our customers and suppliers

Risks

Based on the Business Continuity Management System (BCM) we have identified the critical climate risks (floods, heat waves) that might affect our operations and we have prepared action plans for possible risk management. According to our annual assessment the rate of climate damage in the network did not reach the level of intervention (HUF 50 million damage/ month). In 2017 we have identified 659 climate related cases (storm damage) with the costs of 65,3 million HUF. In 2017 during the heatwave we allowed our colleagues to work remotely in order to reduce the energy consumption of our offices, and we increased the core temperature of our datacenters and base stations

Performance indicators

Cumulated CO₂ emission – 97,110 tons CO₂

Group CO₂ emission by categories – Scope 1: 21.543 tons CO₂, Scope 2: 74.702 tons CO₂

Energy efficiency – bits transmitted / energy consumption – 95.62 Gbit/kWh

The average CO₂ emission of the fleet – 119.6 g/km CO₂

Group revenue related energy consumption 1,264 GJ/million HUF

9 CORPORATE COMPLIANCE

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

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

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

In the year 2010 an external independent party audited the implementation of the Compliance program, and we were awarded a certificate of compliance with the external expectations and of the implementation of the system. The program was revised in 2013, including other related areas as well – such as procurement, internal audit, HR, sales. The audit was not aimed only at the implementation and control of the system in the different areas, but it measured the operational efficiency of the control system. We met the expectations and were awarded by a certificate issued by Ernst&Young as independent external party. In 2017 again an external auditor (KPMG) evaluated the effectiveness of the compliance management system of Magyar Telekom, and issued a certification that the program complies with the requirements of the new anti-corruption ISO standard.

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

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

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

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

Fight against bribery and corruption

Policies

Magyar Telekom does not tolerate any attempts of corruption, so numerous procedures and policies were introduced to prevent and fight corruption. Magyar Telekom complies with the anti-corruption rules the Group, and expects its business partners not engage in unlawful activities (including breaching the anti-corruption laws) such as utilize any money or other services provided by Magyar Telekom for unlawful purposes. This also includes direct or indirect payments to individual(s) to improve the perception of Magyar Telekom (or any parties acting for Magyar Telekom) or to influence any business decision. Magyar Telekom strictly prohibits any form of corruption including (but not only), receiving personal advantages or monetary gains, accepting or providing bribes or promising facilitating payments. The Company also prohibits employees to make beneficial decisions towards family, friends or close or distant acquaintances. It is not allowed to provide any gift or invitation to an event to third parties if it could potentially influence any business

transaction. Magyar Telekom does not support morally or financially any political parties, organizations or representatives of these. Magyar Telekom will not start business relations with third parties that violate the anti-corruption clauses of the Compliance Program or the basic principles of the Code of Conduct.

Due Diligence procedures: There are no fixed procedures on how thorough due diligence should be to avoid legal responsibility or any investigation as per the anti-corruption laws. The aim of these procedures is to identify high-risk areas, and to provide indication when further due diligence or review is required.

Result of the policies

During the year we have verified the plausibility of any complaints we have received about unethical behaviour and initiated internal investigations if necessary. If we have identified any misconduct we initiated the necessary measures and actions. Any complaints regarding breaches of internal or external rules can be sent to the Tell Me! portal of Magyar Telekom. Any questions regarding corporate compliance can be asked on the Ask Me! intranet portal.

Risk

The basis and prerequisite of the efficient defense against breaches of laws and policies is the register and analysis of compliance risks and identified other compliance relevant cases at Magyar Telekom. The yearly Compliance Risk Assessment (CRA) handles active and passive corruption separately. The risk assessment always includes Magyar Telekom, T-Systems and Makedonski Telekom. Other subsidiaries can be included on a case-by-case basis, based on information originating from internal investigations. The CRA fully covers the abovementioned companies. The Compliance Officer informs the Audit Committee, the Board of Directors, and the management about the result of the risk assessment and gives an update about the status of the measures in every quarter.

10 ECONOMIC ENVIRONMENTS

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

Traditional telco markets are shrinking on midterm. Market for voice services (both mobile and fixed) is saturated resulting in decreasing pricing and revenues. There is an increasing demand for data services driven by content consumption but strong competition puts pressure on prices. The fixed voice market as a major revenue and profit source is declining, mobile has started to follow this trend with stagnant customer base and lower prices. The fixed market is characterized by fixed-mobile integrated bundles, with broadband becoming a core element of service offerings. We expect continued consolidation in the fixed arena with network developments and growing competition. An increasing technology platform-based competition is fueled by the government's Digital Hungary program. The extensive development program aims to cover every household in Hungary with high-speed internet (HSI > 30 Mbit/s) access until the end of 2018. In the meantime, the competition of the service providers is pushing the market to the 100Mbps+ bandwidth and fiber technologies. Mobile market characterised by great quality and coverage from network perspective. Meanwhile the mobile voice market is characterized by increasing ratio of flat rate packages; the appearance of new market players is expected with strong impact on the market in mid-term. There is a fierce competition in broadband and content services and the battle for customer contracts has shifted from prices to quality in communication, especially focusing on network coverage and speed. The mobile broadband uptake still fuels the overall mobile market. However, the increasing regulation, in particular the abolishment of roaming fees and the decrease in mobile termination rates, is putting further pressure on market players. 2018 is the year of preparation for 5G networks as well. 5G networks is no longer the network with residential segment focus, but rather the industrial usage.

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

11 TARGETS AND STRATEGY

11.1 Outlook

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

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

Each of our business segments is affected by their own unique business environment, and we are subject to circumstances and events that are unforeseen or are beyond our control. The global economy recovered from the crisis and passed the first shock of Brexit and the uncertainty of Trump's appearance. Our business environment largely depends on the monetary policy of the FED, the growth of the Chinese and European economy and the movements of EU funds. The last 2 years have brought significant prosperity in the world economy and that pulled the Hungarian economy too.

The biggest challenge for Magyar Telekom is probably Digi's mobile market entry, the acquisition of Invitel Távközlési Zrt. and the fixed market competition which is focusing on technology and network developments. We think that we can keep the leading position on our key markets with the continuously growing number of customers with Magenta 1 offers which connect the mobile and fixed services, and with the improvement & utilization of the HSI (high speed internet) network. In addition, the SI/IT market is expected to grow further, underpinned by higher EU fund inflows; our intention is to increase our market share through a greater focus on high margin system integration projects. On midterm there is a focus on increasing the income of service based solutions for the business segment.

11.2 Strategy

As a result of our focused strategic efforts, Magyar Telekom maintained its leading position in its Hungarian fixed voice, broadband, pay TV, mobile and ICT businesses in 2017, we successfully improved customer retention and delivered strong volume figures. We built a world class 4G mobile network and massively improved our fixed line HSI coverage in the past 3 years

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

While anticipating new competencies required by the changing customer behaviour, technological advances, and new business models, we aim to exploit our abilities to become a leader in all digital services around the home for both customers and third parties.

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

12 INTERNAL CONTROLS, RISKS AND UNCERTAINTIES

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

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

For the business year 2017 we accomplished control documentation and evaluation in the IT supported ICSⁱ system. Transaction Level Controls describe the controls built into our business processes that have been designed and operated to ensure that material misstatements in each significant financial account and disclosure within the financial statements are prevented or detected in a timely manner.

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

In line with the criteria of the adopted internal control framework, management evaluates the effectiveness of internal control system within each financial year. Management's assessment for 2017 is still in progress, but based on the already available information, we believe that internal control system has been operating effectively to prevent potential material misstatements in the financial statements, and minimize operating and compliance risks.

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

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

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

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

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

It is our policy that all disclosures made by us to our security holders and the investment community, are accurate and complete, and fairly present our financial condition and results of operations in all material respects. Such disclosures should be made on a timely basis as required by applicable laws, rules and regulations. To achieve these objectives we developed and have continuously enhanced our risk management policies.

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

In 1999, we established a formal risk management system. This system has been operating in an integrated way with the risk management system of Deutsche Telekom since 2002.

All risks related to material internal and external operations, financial and legal compliance and certain other risks are evaluated and managed by a well-defined internal mechanism. A risk management handbook and an internal regulation on risk management were issued. A risk management course was developed for employees responsible for risk management in all organizational areas. Risk items affecting our operations are reviewed quarterly throughout the Company. All of our subsidiaries, business units, divisions and entities are obliged to identify and report their operational risks on a quarterly basis. After the evaluation of these risks, results are reported to our management, to the Board of Directors and to the Audit Committee.

For the sake of prompt disclosure of all risk items influencing investors' decisions, we enhanced our risk management procedures by adding a new element. We complemented our quarterly risk reporting system with a continuous reporting procedure which requires all of our departments and subsidiaries to report on a real-time basis any new material fact, information or risk that comes to their knowledge. Information thus submitted is monitored and evaluated by the risk management area and the CFO is notified when a new

ⁱ Internal Control System

material risk or information is identified.

An internal regulation has been issued to define responsibilities of each employee in risk monitoring and management.

12.3 Risk factors

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

- Our operations are subject to substantial government regulations, further restrictions related to consumer protection were published; the change of the price setting methodology of already regulated wholesale products and new type of regulated access services are probable, which can result in adverse consequences for our business and results of operations;
- Net neutrality regulation has no defined framework in Hungary yet. Case-by-case decisions of the Regulatory Authority may hinder innovation;
- We are subject to more intense competition in the fixed business due to meeting our competitors on more and more area as a result of the network roll-outs;
- DIGI bought retail and small business subscribers of Invitel in July 2017. The transaction is expected to be closed in Q1-2018. The deal still requires GVH (Hungarian Competition Authority) approval. As a consequence of the above transaction we may be subject of more intense competition in the fixed business;
- Beyond current market players in Hungary, DIGI also acquired 2x5 MHz spectrum block in the 1800 MHz band and 1x20 MHz spectrum block in the 3400-3600 MHz band, and will most probably enter the mobile market as a new player in 2018;
- As of October 2017, telco service providers are allowed to sell services only with 1-year loyalty period in Hungary except device was also sold at a discounted price. Further change that mobile service providers must carry out the network unlocking of devices free of charge which were sold at a discounted price with fixed term contracts –i.e. loyalty periods– and which have expired subscriber agreements. This allows customers to choose mobile service providers more freely in the future.
- The future of our current operational model is subject to currently unforeseeable changes in the future business environment;
- Developments in the technology and telecommunications sectors may result in impairment of the carrying value of certain of our assets;
- Our business may be adversely affected by actual or perceived health risks associated with mobile communication technologies;
- System failures could result in reduced user traffic and revenue and could harm our reputation;
- Loss of key personnel could weaken our business;
- Our share price may be volatile, and the ability to sell our shares may be adversely affected due to the relatively illiquid market for our shares and ADSs;
- The value of our investments, results of operations and financial condition could be adversely affected by economic developments in Hungary and other countries;
- Unpredictable changes in the Hungarian tax regulations may have an adverse effect on our results;
- Fluctuations in the currency exchange rate could have an adverse effect on our results of operations;
- Disputes and litigation with regulators, competitors and other parties could have an adverse effect on our results of operations.
- The number of cyber attacks have been evolving at an exponential rate recently worldwide. Although Magyar Telekom provides services with highest security-standards and constantly tests and updates its cyber security countermeasures, it cannot be fully excluded that the Company will be subject of a cyber attack.

12.4 Financial risk management

The classification of the Company's financial instruments is described in detail in Note 4 and the financial risk management of the Company is described in detail in Note 5 of the Financial Statements.

13 ANALYSIS OF FINANCIAL RESULTS FOR 2017

13.1 Revenues

Total revenues increased to HUF 471.5 billion in 2017, from HUF 447.2 billion in 2016, driven by the significant growth in equipment and mobile data revenues.

Mobile revenues increased by 5.7% to HUF 291.8 billion in 2017, compared to HUF 276.0 billion in 2016. Lower mobile voice revenues were more than offset by higher mobile data and equipment revenues.

- **Voice retail** revenues decreased by 4.3% to HUF 127.3 billion in 2017. The positive effects of the expanding postpaid customer base were offset by competitive pressures, which led to price erosion and lower roaming revenues as a result of EU regulation.
- **Voice wholesale** revenues declined by 9.5% to HUF 6.8 billion in 2017. The higher voice wholesale revenues reflect increased traffic driven by a growing portion of flat rate packages.
- **Data** revenues grew by 17.3% to HUF 67.5 billion in 2017 as a result of higher subscriber numbers and increased data usage.
- **SMS** revenues increased by 2.0% to HUF 16.0 billion in 2017 as the growth in mass messaging revenues compensated for the lower residential usage.
- **Mobile equipment** revenues increased by 17.5% to HUF 59.9 billion in 2017. Higher accessories and third-party export sales, coupled with increased average handset prices, contributed to the increase.

Fixed line revenues increased to HUF 165.7 billion in 2017, up from HUF 158.1 billion in the previous year. The continued decline of voice revenues was fully offset by improvements in TV, data and equipment revenues.

- **Voice retail** revenues decreased by 7.1% to HUF 40.5 billion in 2017, primarily due to the compounded impact of the customer base erosion, along with a reduction in average tariff levels.
- **Broadband retail** revenues remained stable at HUF 39.5 billion in 2017. The expansion of the customer base compensated for the competition driven tariff erosion.
- **TV** revenues increased by 7.4% to HUF 37.6 billion in 2017, thanks to an enlarged customer base and improving ARPU.
- **Fixed equipment** revenues rose to HUF 8.7 billion in 2017, from HUF 4.5 billion in 2016, due to a significant increase in sales of TV sets, tablets and laptops to retail customers.
- **Data retail** revenues increased by 24.3% to HUF 9.6 billion in 2017. This was primarily due to higher revenues driven by a major project related to the 2017 Swimming World Championship (FINA).
- **Wholesale** revenues increased by 32.7% to HUF 13.2 billion in 2017, largely as a result of higher revenues from international leased lines and data revenues.

Energy Service revenues decreased to HUF 4.6 billion in 2017 compared to HUF 6.8 billion in 2016, representing a 32.2% decline that reflects the expiry of the last remaining gas universal contracts and the exit from the residential segment of the electricity market which came into effect on November 1, 2017.

13.2 Direct costs

Direct costs increased by 12.5% year-on-year to HUF 174.6 billion in 2017, from HUF 155.1 billion in 2016, mainly due to a sharp increase in other direct costs.

- **Interconnect costs** improved by 13.6% to HUF 14.2 billion in 2017, driven by higher mobile traffic led to increased payments to domestic mobile operators.
- **Energy service related costs** decreased by 29.4% to HUF 4.8 billion in 2017, as a result of the expiry of the last remaining gas universal contracts coupled with the exit from the residential segment of the electricity market effective November 1, 2017.
- **Bad debt expenses** were lower by 34.0% at HUF 5.0 billion in 2017, owing to lower impairment rates in the mobile segment thanks to the improved collection efficiency.

- **Telecom tax** increased by 3.7% to HUF 25.0 billion in 2017, driven by higher mobile voice traffic in both residential and business segments in light of the growing share of flat rate packages.
- **Other direct costs** increased by 17.5% to HUF 117.5 billion in 2017 primarily due to higher cost of mobile equipment, accessories and other equipment sales, in line with higher sales volume. TV and other content related costs (mainly attributable to the new content fee) and roaming outpayments also increased.

13.3 Gross profit

Gross profit improved to HUF 297.0 billion in 2017, from HUF 292.0 billion in 2016, thanks to the strong increase in revenues.

13.4 Employee-related expenses

Employee-related expenses increased by 3.8% year-on-year to HUF 56.6 billion, owing to higher severance-related expenses.

13.5 Other operating expenses

Other operating expenses remained broadly stable at HUF 93.3 billion in 2017. Cost saving measures implemented during the year resulted in lower advisory, HR-related, material and marketing costs. However, these were offset by increased rental fees and maintenance costs and the higher utility tax. Utility tax increased by 2.1% in 2017 reflecting network acquisitions and an increased length of taxable network resulting from the refinement of the cable network records.

13.6 Other operating income

Other operating income declined by 22.4% year-on-year to HUF 6.0 billion, primarily attributable to the absence of one-off profits realized on the sales of Infopark and Origo in 2016. That was partly counterbalanced by higher brand fee income from the E2 energy joint venture.

13.7 EBITDA

EBITDA was higher by 0.5% at HUF 153.0 billion, as the improvements in gross profit of operation were counterbalanced by higher severance expenses and a decline in other operating income.

13.8 Depreciation and amortization

Depreciation and amortization (D&A) expenses declined by 2.3% to HUF 87.8 billion in 2017. The lower D&A expense was driven by useful life extensions of some assets with a remaining useful life of less than 2 years as well as the scrapping of radio technical equipment.

13.9 Operating profit

Operating profit increased from HUF 62.3 billion in 2016 to HUF 65.1 billion in 2017 thanks to lower D&A and the slight EBITDA increase.

13.10 Net financial result

Net financial loss narrowed from HUF 26.4 billion in 2016 to HUF 20.9 billion in 2017 due to a lower interest expense resulting from a lower average debt level and a decline in the average interest rates on loans.

13.11 Income tax

Income tax increased from an income of HUF 8.5 billion in 2016 to an expense of HUF 13.1 billion in 2017. The primary reason for this change was the reduction in the corporate income tax rate from 19% to a flat rate of 9% as of 1 January, 2017, which was reflected in the Q4 2016 deferred tax position. Furthermore, the one-off impact of the change in the tax calculation methodology relating to the transition from local GAAP to standalone IFRS has increased income tax expense in 2017.

14 SUBSEQUENT EVENTS BETWEEN THE END OF THE YEAR AND THE RELEASE OF THE REPORT

There were no significant events between the end of the business year and the release of the report.

Budapest, February 20, 2018



Christopher Mattheisen
Chief Executive Officer, Board member



János Szabó
Chief Financial Officer

Declaration

We the undersigned declare that

- the attached annual financial statements which have been prepared in accordance with the applicable set of accounting standards and to the best of our knowledge, gives a true and fair view of the assets, liabilities, financial position and profit or loss of Magyar Telekom Plc. and
- the business report gives a fair view of the position, development and performance of Magyar Telekom Plc., together with a description of the principal risks and uncertainties of its business.

Budapest, April 10, 2018



Christopher Mattheisen
Chief Executive Officer,
Member of the Board



János Szabó
Chief Financial Officer