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2002 *annual report*



Matáv Group Financial Highlights

	2001	2002	Change
	HUF million	HUF million	%
Total revenues	547,735	590,585	7.8
EBITDA*	236,022	244,981	3.8
Operating profit	119,400	122,240	2.4
Net income	82,560	68,128	(17.5)
No. of shares (millions)	1,037	1,038	0.1
Basic earnings per share (HUF)	79.6	65.7	(17.5)
Total assets	1,104,196	1,077,451	(2.4)
Long term debt	419,763	145,667	(65.3)
Net debt	442,926	364,709	(17.7)
Total shareholders' equity	460,300	516,144	12.1
Net debt to total capital	46.6%	38.8%	n.a.
Capital expenditures	127,747	109,988	(13.9)
EBITDA margin	43.1%	41.5%	n.a.
Operating margin	21.8%	20.7%	n.a.
Net income margin	15.1%	11.5%	n.a.
ROA	8.0%	6.2%	n.a.
HUF/EUR (year end)	246.3	235.9	(4.2)
HUF/EUR (average)	256.7	243.0	(5.3)
HUF/USD (year end)	279.0	225.2	(19.3)
HUF/USD (average)	286.5	258.0	(9.9)

* EBITDA – Earnings Before Interests, Taxes, Depreciation and Amortization

Key Shareholders as of December 31, 2002

The Hungarian State	Holder of the Golden Share
MagyarCom (owned by Deutsche Telekom AG)	59.21%
Publicly held	40.32%
Treasury shares	0.47%

Matáv Group Summary of Operating Statistics

	Dec. 31, 2001	Dec. 31, 2002	Change %
<i>No. of fixed lines:</i>			
<i>residential</i>	2,151,346	2,055,338	(4.5)
<i>business</i>	299,267	282,406	(5.6)
<i>public</i>	37,432	33,316	(11.0)
<i>No. of ISDN channels ("B")</i>	448,396	511,326	14.0
<i>Total fixed lines</i>	2,936,441	2,882,386	(1.8)
<i>No. of fixed lines incl. ISDN, Emitel</i>	80,899	79,460	(1.8)
<i>No. of fixed lines incl. ISDN, MakTel</i>	549,988	594,213	8.0
<i>Network digitalization with ISDN</i>	85.4%	87.1%	n.a.
<i>Fixed line penetration</i> <i>(Matáv service area, per 100 inhabitants)</i>	39.1	38.4	n.a.
<i>No. of Group employees (closing)</i>	16,633	16,114	(3.1)
<i>No. of fixed line employees (closing)</i>	9,615	9,462	(1.6)
<i>No. of fixed lines per employee</i>	314	313	(0.3)
<i>No. of mobile subscribers, Westel</i>	2,493,485	3,402,788	36.5
<i>No. of mobile subscribers, Westel 0660</i>	44,308	23,345	(47.3)
<i>Total mobile subscribers</i>	2,537,793	3,426,133	35.0
<i>No. of mobile subscribers, MakTel</i>	221,336	366,348	65.5
<i>Mobile penetration (Hungary, per 100 inhabitants)</i>	48.7%	67.8%	n.a.
<i>No. of Internet subscribers</i>	133,171	149,962	12.6
<i>No. of Internet subscribers, MakTel</i>	21,674	34,222	57.9
<i>No. of cable television customers</i>	300,857	338,625	12.6
<i>No. of managed leased lines (Flex-Com)</i>	11,386	12,716	11.7
<i>Domestic traffic ('000 minutes)</i>	10,088,137	8,820,201	(12.6)
<i>International outgoing traffic ('000 minutes)</i>	166,649	150,999	(9.4)
<i>Domestic traffic, Emitel ('000 minutes)</i>	91,567	179,670	n.a.
<i>International outgoing traffic, Emitel ('000 minutes)</i>	1,370	2,545	n.a.
<i>MOU (Minutes of Usage per User/Month), Westel</i>	146	118	(19.2)
<i>ARPU (Average Traffic Revenue per User/Month), Westel (HUF)</i>	6,946	5,732	(17.5)

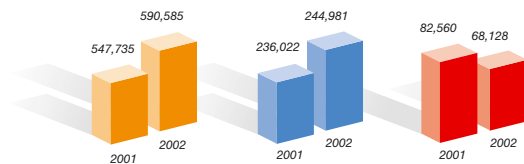
Business Successes – in Full Competition

MATÁV GROUP: REVENUE GROWTH CONTINUED

REVENUES
(HUF million)
7.8%

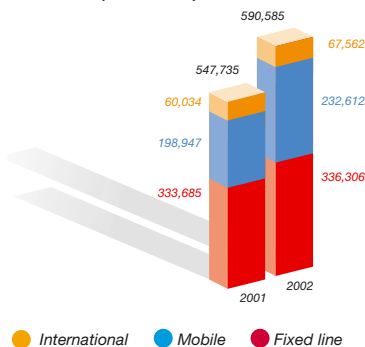
EBITDA
(HUF million)
3.8%

NET INCOME
(HUF million)
(17.5%)



CONTRIBUTION OF BUSINESS SEGMENTS TO 2002 RESULTS

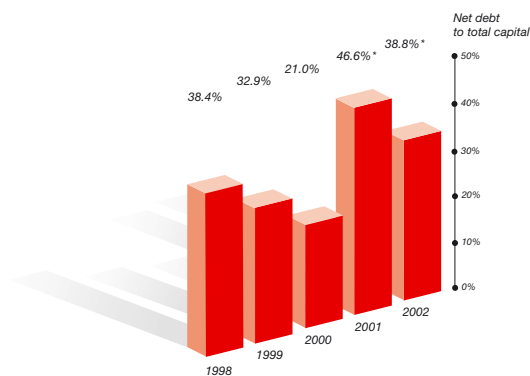
REVENUES (HUF million)



GROWTH OF BUSINESS SEGMENTS IN 2002

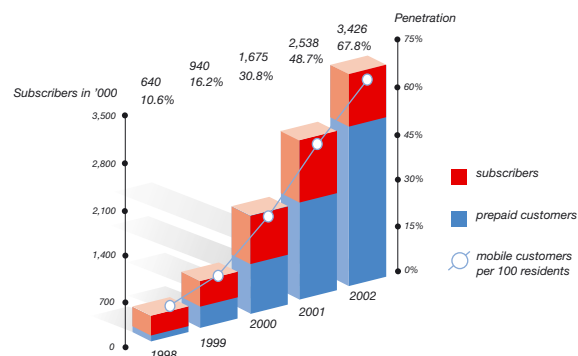
	REVENUE GROWTH	EBITDA MARGIN
Total revenues	7.8%	41.5%
International	12.5%	54.5%
Mobile	16.9%	37.8%
Fixed line	0.8%	35.8%

MATÁV GROUP: SOLID FINANCIAL POSITION

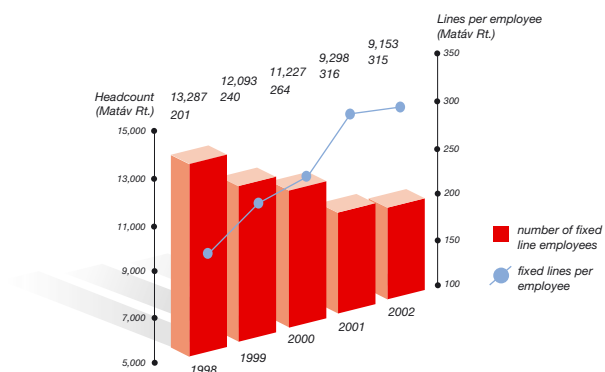


* MakTel and Westel acquisition were financed from debt

MOBILE SEGMENT: THE GROWTH DRIVER



FIXED LINE SEGMENT: STABILIZED POSITIONS



2002: The Year of the Matáv Group

MATÁV GROUP LINES OF BUSINESS

BUSINESS SOLUTIONS



*Market leadership
in business communications*

Market share: 60%

- Data communications: leased lines (Flex-Com), network integration (MultiLAN), IP products
- Unique product portfolio, full range infocommunication services
- e-Business solutions: e-Work Start, e-Signature, e-Wall
- More than 60% of tendered contracts awarded to Matáv
- Quality customer care: key account management, VIPpont call center

RESIDENTIAL SERVICES



*Market leadership
in fixed line telephony*

Market share: 81%

- Nearly 3 million fixed lines, including 18% ISDN
- Rapid increase of broadband capacity: 34,000 ADSL, 339,000 cable TV customers
- Innovative pricing: nearly 1 million customers chose tariff packages
- Innovative services: fixed line SMS, Audiofix, multimedia payphones
- Innovative customer care and sales: e-Pont, Internet call center

INTERNET



*Market leadership
in Internet*

Market share: 43%

- 150,000 subscribers, more than 1 million Freemail users
- Hungary's only full range Internet service provider
- Competitive access rates (15, 40 hours' and night tariffs)
- [origo] is the leading portal site: record of 6 million page impressions a day
- e-Business solutions: WebEDI, Marketline.hu, FókuszOnline

MOBILE



*Market leadership
in GSM mobile*

Market share: 49.6%

- More than 3.4 million customers, 36% increase
- Widest product and package offering, most innovations
- Mobile multimedia: MMS, infoMMS, video streaming
- Mobile Internet: GPRS, WAP, WLAN services
- Value added mobile services: Mobile Office, Mobilbank, m-commerce



Our Mission


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It is Matáv's mission to be a key player in the information society and the new economy, retaining its leading position in Central and Eastern Europe.

We commit to make telecommunications and IT achievements available to the widest scope of clients. We provide solutions to support our clients in creating a more meaningful, more effective and more humane future. Building on our unique experience accumulated on the domestic telecommunications market and our significant achievements we work on attaining our goals, satisfying the needs of our customers and fulfilling the expectations of our investors. The key to our development is our well-educated and committed professionals whom we esteem as an outstanding value of our Company.

Matáv is the principal provider of telecom services in Hungary. Matáv provides a broad range of services including telephony, data transmission, value-added services, and through its subsidiaries is Hungary's largest mobile carrier and leading internet service provider. Matáv also holds a majority stake in Stonebridge Communications AD controlling MakTel, the sole fixed line and the leading mobile operator in Macedonia.

Matáv Hungarian Telecommunications Co. Ltd. was incorporated in 1991 and privatized in 1993. Its majority owner (59.21%) is MagyarCom, fully owned by Deutsche Telekom AG. Matáv's shares were introduced to national and international stock exchanges dealing both in Budapest and New York in 1997. With its steady and dynamic growth Matáv has created significant value for millions of customers and for shareholders.



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Letter to Our Shareholders

DEAR SHAREHOLDERS,

I am glad to report that in 2002 Matáv had another very successful year. We have met all the targets which we have set for ourselves and continued our outstanding record in cash generation. This has been achieved in a rapidly changing environment. As the rest of this Annual Report will show, we made great steps in pursuing efficiency gains and in maintaining unchallenged leadership positions in our main businesses. Among the many marks of recognition, I would single out the achievement of Group level ISO certification. The efficiency of the lines of our business grew and Matáv management also renewed itself.

In meeting or exceeding our targets, revenue grew by nearly 8%, EBITDA margin reached 41.5%. We reduced our gross additions to tangible and intangible assets to 98 billion forints enabling us to channel the savings from the mature fixed line business towards the mobile and international segments. In respect of 2003, we have set new financial targets. Revenue growth will be at a low single digit rate and our aim is to keep EBITDA margin at around 40%. Gross additions to tangible and intangible assets will continue to reflect reduced spending, and will amount to approximately 90 billion forints. Growth areas however will not be affected.

Due to our thorough and complete preparation, we continued to operate successfully in the first year of the fully liberalized fixed voice telephony market. Until now, a major part of the regulatory changes in Hungary has been in harmony with EU telecommunications policies. In certain cases these are even stricter than the EU norms, for example Matáv was obliged to enable local loop unbundling and carrier pre-selection from the start of market opening in Hungary, compared to 2-3 years after market opening in some West-European countries. The regulator approved our reference offers for unbundling and for interconnections. Competition started in call by call services and carrier pre-selection in domestic and international long distance calls in both Matáv and other service provider areas. In 2003, long run incremental cost based fees will replace the fully allocated cost methodology applied in 2002. The regulator has defined the annual price caps until the end of 2004 and has also established a tariff framework that will enable fixed voice market participants including Matáv to operate in a predictable and transparent environment.

The key challenge for the fixed business was to retain our customer base and provide better and more efficient services. We introduced a wide range of customized tariff packages, which best serve our business and residential customer needs. As a successful result of our efforts, nearly 1 million customers selected one of these packages, representing around one third of the total number of lines. Innovation is important in the fixed line segment: we introduced new services such as fixed line SMS allowing customers to send and receive short text messages (SMS) on their fixed line telephone.

The fixed line segment remained a strong cash generator but we nevertheless continued to focus on cost-cutting possibilities to grow fixed line productivity further. As a result, we have decided to further reduce headcount in 2003 and 2004, mainly at the parent company. The lines per employees ratio at Matáv Rt. was 315 at the end of last year. This ratio will likely increase further in 2003 as a combined result of our efforts to mitigate fixed line erosion and to maximize headcount efficiency.

The revenue from the data business grew by around 14% in the fixed line segment mainly due to Internet and ADSL. Matáv's Internet subsidiary, Axelero, maintained its leading position in the dial-up market with an estimated 43% market share. Its total customer base reached almost 150,000. We successfully managed to increase the number of ADSL lines to almost 34,000 and we hope that this number will be multiplied by the end of 2003. The government intention to develop the information society is largely in line with our strategy. Within this, the Internet business plays an important role as the engine of future value creation in the fixed line

segment. Our objective is to spread mass use of the Internet in Hungary through the introduction of new packages and the promotion of broadband technology. From 2003 there are new tax benefits to promote PC and Internet penetration that encourage both customers and service providers to use opportunities provided by the new information policy. We trust that Internet usage will further improve in 2003. Tariffs are becoming cheaper and broadband access is spreading.

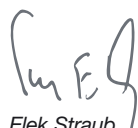
In a very tight competitive environment in the mobile business, Westel maintained its leading position and at the same time produced strong financial results, demonstrating balanced emphasis on profits and market share. Hungarian mobile penetration increased by more than 19 percentage points last year, reaching almost 68% at the end of 2002. This growth at a relatively high penetration rate is expected to slow down this year. The importance of a stable customer base and the expansion of non-voice services is therefore increasing. Churn rates in both prepaid and post-paid segments were relatively low as a result of our successful customer retention program.

Westel was the first GSM service provider in the world to launch a full-fledged commercial Multimedia Messaging Service (MMS). The revenues per user from enhanced services increased by 36% in 2002. Approximately 10% of customers used WAP. Increasing sales of GPRS and MMS enabled handsets create the possibility to extend non-voice revenues significantly. Building upon current technology, video streaming is also available, well before the introduction of the third generation system. Cooperation with the Deutsche Telekom mobile operation creates synergies, thus ensuring a lower cost base for service developments as well as more favorable procurement of network elements and handsets. Westel will continue to benefit from its efficient distribution network and its strong brand, supported by enhanced innovations and gains from economies of scale.

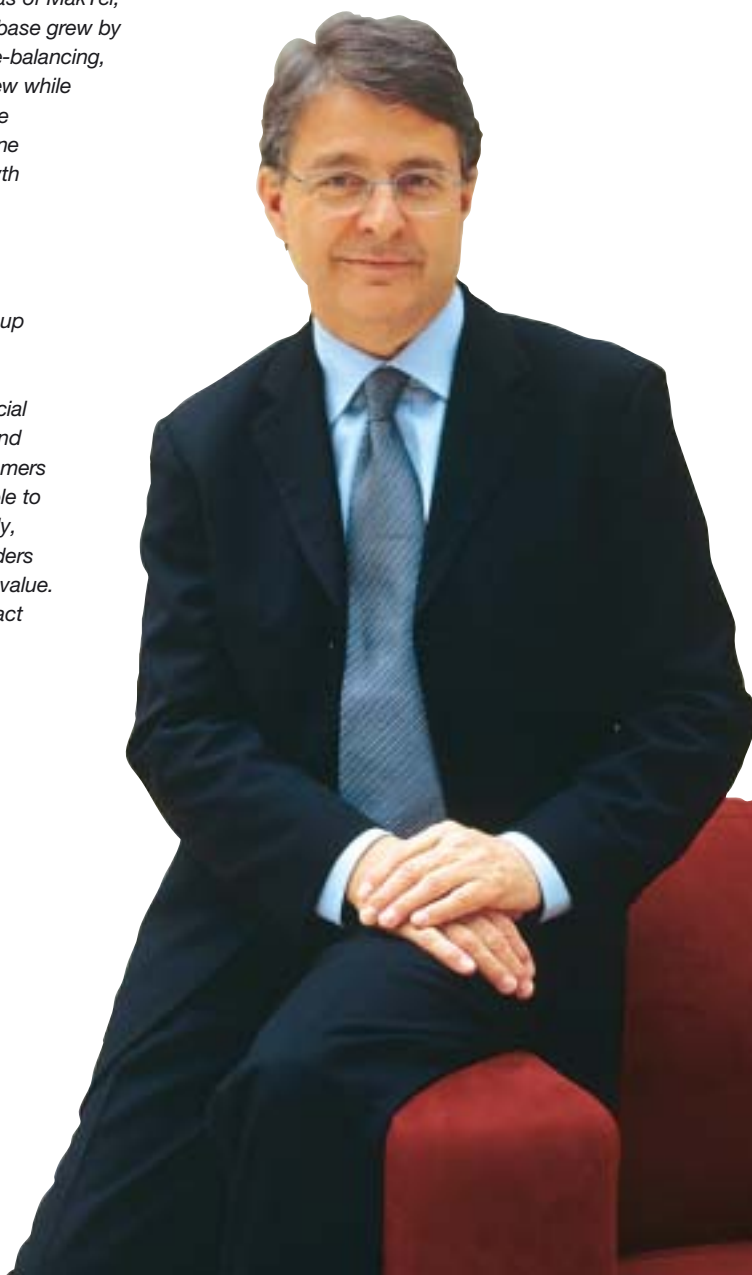
Our international acquisition proved to be a success for the second consecutive year. MakTel's strong results were driven by both an increasing customer base and a continued tariff re-balancing process.

Penetration was growing across all business areas of MakTel, including the mobile sector where the customer base grew by 66% in the last twelve months. As part of tariff re-balancing, subscription fees and domestic tariff charges grew while international calls became cheaper. We anticipate a prolonged tariff re-balancing in Macedonia in line with industry norms and further penetration growth in fixed, mobile and Internet businesses. MakTel will be an important source of value creation for the Group in the longer term. Our goals for MakTel are unchanged: we expect that it will remain a key source of growth for the Matáv Group in 2003.

On behalf of the Board, I would like to say a special thanks to all our employees for their hard work and commitment. I would like also to thank our customers and business partners for what we have been able to achieve together during a challenging year. Finally, but not least, I would like to assure our shareholders that our key objective is to enhance shareholder value. Our strength in 2002 was demonstrated by the fact that we delivered on the targets we had set.



Elek Straub
Chairman and Chief Executive Officer



Senior Management of the Matáv Group
(from left to right, standing):

LÁSZLÓ DRAJKÓ

Chief Executive Officer,
Axelero Internet

LÁSZLÓ BODNÁR

Chief Services and Logistics Officer

ZOLTÁN TANKÓ

Chief Officer Business Solutions

CHRISTOPHER MATTHEISEN

Chief Officer Residential Services

(from left to right, sitting):

ANDRÁS SUGÁR

Chief Executive Officer,
Westel Mobile

ELEK STRAUB

Chairman and Chief Executive Officer,
Chairman of the Management
Committee

MANFRED OHL

Chief Technical Officer,
Chief Officer Network Systems

DR. KLAUS HARTMANN

Chief Financial Officer,
Deputy Chairman of the Management
Committee

DR. TAMÁS PÁSZTORY

Chief Human Resources and
Legal Officer

HORST HERMANN

Chief Strategy and
International Officer



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Matáv Annual Report 2002

Senior Management of the Matáv Group

ELEK STRAUB CHAIRMAN AND CHIEF EXECUTIVE OFFICER,
CHAIRMAN OF THE MANAGEMENT COMMITTEE

(58) He graduated in electrical engineering and business administration at the Budapest Technical University. He worked as Head of IT Department at the Ministry of Labor in 1970–1980. From 1980, he served as Head of IT Division, later Vice President at the Central Statistical Office, and Government Advisor, heading the IT Development Committee of Hungarian Government. In 1990, he became Country General Manager of IBM Hungary. He was appointed CEO of Matáv as of July 17, 1995. He has been member of Matáv's Board of Directors since June 7, 1995, and Chairman of the Board since January 31, 1996. Chairman of the Management Committee since November 14, 2000.

DR. KLAUS HARTMANN CHIEF FINANCIAL OFFICER, DEPUTY
CHAIRMAN OF THE MANAGEMENT COMMITTEE

(41) He graduated in Economics and holds a PhD and an MBA. He worked for Arthur Andersen in Germany, and as treasurer and operational controller for a subsidiary of the BICC Group. He joined Deutsche Telekom in 1995 as

Manager International Capital Markets, and became Corporate Treasurer of Global One, a joint venture of DT, France Telecom and Sprint, in 1997. He returned to DT's Headquarters in Bonn, acting as Senior Advisor to the CFO, in 2000. He was elected member of Matáv's Board of Directors on October 27, 2000 and appointed Matáv's CFO as of November 1, 2000. Deputy Chairman of the Management Committee since November 14, 2000.

HORST HERMANN CHIEF STRATEGY AND INTERNATIONAL OFFICER

(47) He joined Deutsche Telekom as an operations manager in 1978. In 1990 he joined Deutsche Telekom Headquarters, Corporate Strategy and Regulatory Policy. From 1994 he was Assistant Managing Director for Business Development and Finance in DT's regional Headquarters in Singapore. From 1996 he was responsible for Strategic Planning in the Bonn Headquarters again. In 1998 he joined Matáv in charge of Strategy and Business Development. On January 1, 2002 he was promoted to Chief Strategy and International Officer, being also responsible for Portfolio Management and Matáv's Group policy on content and media.

DR. TAMÁS PÁSZTORY CHIEF HUMAN RESOURCES AND LEGAL
OFFICER

(51) A graduate in law and organization engineering, he joined the Hungarian Post in 1969 and since 1980 worked in various positions in the human resources area. From 1990 he was Matáv's Director of Human Resources Development and has been responsible for Matáv's HR and organizational development activities ever since. He was appointed Matáv's Deputy Chief Officer in July 1995 and has been Chief Human Resources and Legal Officer since February 1, 1996.


LÁSZLÓ BODNÁR CHIEF SERVICES AND LOGISTICS OFFICER

(54) He started his career with Elektromechanikai Vállalat in Budapest, then joined the Hungarian Post where he managed regional telecommunications development. From 1989 to 1990 he was Director of Hungarian Post in Sopron. From 1990 to 1999 he was Director of Matáv's Sopron Directorate. In addition he managed Matáv's organizational restructuring project in 1998–1999. In January 1999 he became Director of the West Hungary Technical Directorate and as of March 16, 1999 he was appointed Matáv's Chief Logistics Officer. From January 1, 2002 he has been Chief Services and Logistics Officer and he was Acting Chief Officer Residential Services until August 31, 2002.

MANFRED OHL CHIEF TECHNICAL OFFICER, CHIEF OFFICER NETWORK SYSTEMS

(55) He managed Operation and Maintenance of international terrestrial and satellite transmission systems at Deutsche Telekom until 1984. Afterwards he was regional director for planning construction, operation and maintenance of networks. After 1989 he was responsible for network reconstruction in Eastern Germany as well as investments of the technical division. From 1995 he was Head of the Technical Directorate of Deutsche Telekom. He joined Matáv on January 1, 1999 as Chief Technical Officer. From January 1, 2002 he is also Chief Officer Network Systems.

ZOLTÁN TANKÓ CHIEF OFFICER BUSINESS SOLUTIONS

(45) A Budapest Technical University graduate in electrical engineering, he worked from 1980 as computer development engineer in Budapesti Rádiótechnikai Gyár, and from 1982 in Kőbányai Gyógyszerárnyagár. From 1984 he held various positions at Műszertechnika and was promoted to Vice President in 1987 and Chief Officer in charge of telecommunications in 1990. He joined Matáv in 1996 as Director of Business Communications and was promoted to Chief Sales Officer of the company as of January 1, 2000. From January 1, 2002 he is Chief Officer Business Solutions.

CHRISTOPHER MATTHEISEN CHIEF OFFICER RESIDENTIAL SERVICES

(41) He graduated in economics and finance at Indiana University, Bloomington and Columbia University, New York. He came to Hungary in 1990 to found a consulting company for business analysis and strategic planning. From 1993 he worked as Marketing Officer of US West International and later as Westel Mobile's Marketing and Sales Director. From 1997 he headed in London the commercial and marketing activities of MediaOne's mobile subsidiaries and later worked for BT Cellnet as Business, Trading and Marketing Director. From September 1, 2002 he is Matáv's Chief Officer Residential Services.

LÁSZLÓ DRAJKÓ CHIEF EXECUTIVE OFFICER, AXELERO INTERNET

(35) He graduated in electrical engineering at the Budapest Technical University in 1991. He started his career as network engineer at KFKI research institute for physics. In 1992 he joined Novell Europe in Düsseldorf as product manager, later channel manager for Central and Eastern Europe and from 1994 as Managing Director of Novell Hungary. In 1996, he became general manager of Compaq Computer Hungary, later General Manager Market Development of Compaq Computer BDG in Munich, Germany. From 2000 he has been CEO of Matávnet Rt. reshaped in 2001 under a new brand Axelero Internet.

ANDRÁS SUGÁR CHIEF EXECUTIVE OFFICER, WESTEL MOBILE

(56) He graduated in electrical engineering at the Budapest Technical University. He started his career as development engineer at Elektromechanikai Vállalat. From 1974 he served at Hungary's Ministry of Foreign Trade. In 1980 he became Deputy Commercial Counsellor at the Commercial Section of Hungary's Embassy in New York. In 1985 he became Deputy General Director of Intercooperation Rt. From 1988 he was Deputy General Manager of Transelektro Rt. In 1991 he became General Manager of Westel Rádiótelefon Kft. He has been CEO of Westel Mobile Rt. from 1993.

Matáv's Board of Directors



ELEK STRAUB

(58) A graduate in electrical engineering and business administration, he served as Head of IT Department at the Ministry of Labor in 1970–1980. From 1980, he was Head of IT Division, later Vice President at the Central Statistical Office and Government Advisor, heading the IT Development Committee of the Hungarian Government. In 1990, he became Country General Manager of IBM Hungary. He is Chief Executive Officer of Matáv since July 1995 and Chairman of its Management Committee since November 2000. Matáv's Director since June 7, 1995, Chairman of the Board of Directors since January 31, 1996.



HANS ALBERT AUKES

(53) He was responsible for telecommunications policy at Germany's Federal Ministry of Posts and Telecommunications from 1979 until 1989. From 1990 he managed Deutsche Telekom's Supervisory Board office and was personal assistant to the Board's Chairman. In 1994 he became head of commercial relations at T-Mobile and later the head of strategic Group management at Deutsche Telekom. In 1999 he was appointed senior executive vice president, network communications. At T-Com first he was Chief Operating Officer and currently is head of International Business and acting head of National Business. Matáv's Director since April 26, 2002.



DR. SÁNDOR CSÁNYI

(49) He graduated in finance and accounting in 1974 and holds a university degree since 1980 and a PhD in economics since 1986. He is financial economist, certified price analyst and chartered accountant. He started his career at the Ministry of Finance and later served at the Ministry of Agriculture from 1983 as Head of Section. From 1986 he was Head of Department at Magyar Hitelbank and in 1989 he became Deputy CEO of the K&H Bank. He is Chairman and CEO of the OTP Bank since 1992. Matáv's Director since April 27, 2000.



GYULA GANSPERGER

(39) He graduated in finance at the Budapest University of Economics in 1986. After having served as chief accountant in several firms from 1987, he became owner and managing director of Taxorg Tax Consultants and Accounting Ltd. in 1990. He served as Member of the Supervisory Board of ÁPV Rt., Hungary's State Privatization and Asset Management Company, from 1995. He was appointed Chairman and CEO of ÁPV Rt. in 1998. In 2001–2002 he was Chairman and CEO of Budapest Airport Rt. Matáv's Director since October 27, 2000.



JAN GELDMACHER

(41) After his graduation at the University of Cologne in business administration he worked for NCR/AT&T in various sales executive positions and later at AT&T in San Diego, USA. From 1996 he held various executive positions at Meganet, Vebacom and o.tel.o. From 1999 he was responsible for Network Operations & International Support at debis Systemhaus. In 2000 he took over the International Networks and Portfolio area of Deutsche Telekom. Since 2001 he is Director of Telecommunications Services at T-Systems International. Matáv's Director since April 26, 2002.

STATEMENT OF THE BOARD OF DIRECTORS

"The role of the Board of Directors is to act on behalf of the shareholders in insuring that Matáv operates in a manner that safeguards the interests of shareholders all over the world. Our conduct as Matáv's governing body will be continuously consistent with performing our fiduciary responsibility and the following values:

- *accountability to our shareholders,*
- *openness to scrutiny,*
- *transparency of all decisions taken,*
- *deliberation that will be fair and open but also efficient, timely and orderly.*

By accepting to serve on Matáv's Board we have committed ourselves not to spare neither time nor effort in order to earn the trust of those who have invested in the future of this Company."

Budapest, February 20, 2003



FRIDBERT GERLACH

(45) After his graduation in telecommunications at Aachen University in 1983, he stayed there to work as an electrical engineer and, during that time, completed his studies in business administration. From 1987 he held several management positions within the international division of Alcatel SEL AG in Stuttgart, Germany. He worked as director for international joint ventures at T-Mobile from 1997. He joined Deutsche Telekom in 1999 as Vice President Regional Build-up and Integration in the Region Central and Eastern Europe and Middle East. Matáv's Director since April 27, 2001.



MICHAEL GÜNTHER

(58) He studied business administration at the universities of Berlin and Hamburg. From 1971 he was commercial executive at Philips. From 1987 to 1993 he was Board member of Philips Kommunikations Industrie. In 1994 he joined DeTeSystems, a Deutsche Telekom subsidiary, as commercial director. In 1996 he became head of financial and controlling division at Deutsche Telekom responsible for business customers. From 1997 he was financial and controlling director of T-Mobile. He became Chief Financial Officer of T-Mobile International in 2000 and since 2001 he is Chief Officer responsible for Joint Venture Management. Matáv's Director since April 26, 2002.



DR. KLAUS HARTMANN

(41) He graduated in economics and holds a PhD and an MBA. He worked for Arthur Andersen in Germany, and later for the BICC Group as treasurer and operational controller. He joined Deutsche Telekom in 1995 as Manager International Capital Markets, and became Corporate Treasurer of Global One in 1997. In 2000 he returned to Deutsche Telekom as Senior Advisor to the CFO. He was appointed Matáv's CFO and Deputy Chairman of its Management Committee in November 2000. Matáv's Director since October 27, 2000.



DR. MIHÁLY PATAI

(49) He joined the National Bank of Hungary in 1976, and the Financial Research Institute in 1978. From 1982 he served at the Ministry of Finance as Division Chief. In 1986, he became Chairman of the Board at General Banking and Trust Co. From 1988 he worked for the World Bank and IFC, and from 1993 for K&H Bank as Executive Director. He became Chairman and Chief Executive Officer of Budapest Investment International and later of Allianz Hungária Insurance Co. in 1996. Matáv's Director since April 28, 1998.

MATÁV'S SUPERVISORY BOARD

DR. LÁSZLÓ PAP CHAIRMAN
GÉZA BÖHM
DR. ÁRPÁD HERBST

GELLÉRT KADLÓT
JOACHIM KREGEL
DR. ERBIL KURT

DR. KLAUS NITSCHKE
DR. RALPH RENTSCHLER
PÉTER VERMES

Milestones 2002

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Matáv Annual Report 2002



SUCCESSFUL RESPONSE TO COMPETITIVE CHALLENGES

Matáv successfully met the challenge of competition in 2002, following the liberalization of the telecom market, showing that the preparations made over several years have been effective. Matáv responded to market liberalization by reshaping itself as a Group: starting from 2002, the business lines and subsidiaries reinforce each other, operating as Matáv Group members. The Matáv Group has been able to protect its position as market leader in all the business lines: residential services, business solutions, Internet and mobile. We have been successful in stabilizing the number of access lines in the fixed line market, and launched new programs to increase efficiency. Nearly one million subscribers, or over one third of all Matáv customers, chose tariff packages that suit their phone usage habits. Thanks to our successful activities in the liberalized market, 2002 became the "Year of the Matáv Group".

Matáv Kick-off Meeting 2003: a successful year in competition

MASS SUCCESS ON BROADBAND

Demand for broadband data communications services increased dramatically in 2002. Hungary's Internet market is now characterized by qualitative development. The most significant signs of this are the dynamic growth of customers opting for broadband connection and the increase of the time spent on the Internet. Matáv is making efforts to spread broadband Internet usage. As a result of intensive network development Matáv's high speed ADSL service has become available in 49 cities, offering several times higher bit rate on fixed lines than the dial-up Internet access, without call charge. The number of ADSL channels is expected to increase from 34,000 at the end of 2002 to approach 100,000 by the end of 2003.

MOBILE MULTIMEDIA WORLD PREMIERE

In April 2002 Westel was the first GSM service provider in the world to launch its mobile Multimedia Messaging Service, or MMS. Over 3.4 million customers of Hungary's market leading mobile carrier can now send even color photos or voice video records to mobile or e-mail, using a suitable mobile phone. The world premiere of MMS service is the most impressive milestone to date of 21st century telecommunications in Hungary. Mobile multimedia opens up the window for subscribers to a new world where life is more colorful, cheerful and communicative. Westel is leading the way in innovation and new services. Thanks to the introduction of services unique in Europe, Westel has added a number of novelties providing more convenience for users to its range of services: MMS, Mobilbank, Mobilroda (Mobile Office), WebShop and other value added products.

NEW INTERNET MARKET MODEL

Matáv's new Internet access packages subsidized by the state have been available since August 2002. They offer 15 or 40 hours of discount rate access; in addition Matáv has also launched a new night discount Internet tariff. At the same time Matáv phased out its earlier flat-rate schemes to facilitate market competition and the mass spread of Internet usage and to support home Internet usage, routing Internet usage to a new path and ensuring a long term, dynamic development.

CERTIFIED QUALITY

With the certification of the Group Center, a 3-year program to establish the quality management system of Matáv Group was closed successfully in December 2002. Following the subsidiaries, the quality management system of Matáv Group was certified by ISO 9001:2000 standard at the end of 2002. The successful audit of a quality management system of this volume is a unique achievement in Hungary, and there are few examples even at international level. Matáv has demonstrated in this way too that all its organizations are committed to a quality-oriented corporate culture.

CONFIDENCE-BUILDING AWARDS

In May 2002 Matáv was selected from among hundreds of applicants as a Top 3 winner of the Wharton Infosys Business Transformation Award. The restructuring of business processes, the ability for innovation, the application of new principles and paradigms were taken into consideration in the judging. In June 2002 the business magazine Euromoney awarded Matáv the Award for Good Corporate Governance. This prize put Matáv on the international list of companies with excellent corporate management at a time when the telecommunications market was marked by negative trends.

New tariff packages:
a revitalization of the
Internet market

ISO-audit:
service quality is
a basic value



Market Competition

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Competition in
all segments: strong
positions for Matáv

Fixed line market:
competitive product
offering

Matáv Group lines of business:
coordinated activities

MATÁV IN FULL MARKET COMPETITION

In January 2002 the last segment of Matáv's service portfolio was opened to competition. The Hungarian telecom market became fully liberalized. As the closing phase of market liberalization, the local access market became liberalized from November 2002 also in the service areas of the local telecom operators. The start of market competition did not bring a significant restructuring of the market, as Matáv was well prepared to meet new challenges and it made enormous efforts to be successful in facing the competition. Matáv benefited from the experience of Deutsche Telekom in preparation for market liberalization. At the same time the number of new competitors in the market was lower than expected due to the difficulties experienced in international telecommunications.

STABLE POSITION IN THE FIXED LINE MARKET

The only area where market liberalization brought substantive changes to the Matáv Group was fixed line telephony. Competition has started in the market of long distance and international calls, and is becoming fierce among the fixed line and mobile carriers. Within the Group the number of fixed lines reached its peak already in 2000, and it has been stagnating around 3 million. Due to a number of our marketing campaigns and discount rate tariff packages, only a small number of our customers opted for another fixed line operator.

MATÁV IS THE LEADING ENTERPRISE

According to analyses and company top lists published in 2002 Matáv continues to be Hungary's leading and most profitable enterprise. Matáv is the country's leading company based on its contribution to the GDP. According to the Top 200 list of companies Matáv had the largest before-tax and operating income. Matáv heads the list of companies in terms of shareholder's equity as well, and it achieved the largest growth of after-tax profit. During the past years the financial performance of Matáv has been constantly strong, and it continues to be considered the leading company of the Central and East European telecom market.

A SUCCESSFUL FIRST YEAR OF FULL COMPETITION

During the first year following the market liberalization the Matáv Group proved to be the key and stable factor of Hungary's telecommunications industry. Fixed line voice services remained the Group's main revenue source. In the business solutions market there is a growing demand for broadband that increasingly turns data services into a mass product. The Internet is in the growth phase of its life cycle. Due to their dynamic development mobile services have become the engine of our growth.

CATCHING UP WITH THE EUROPEAN UNION

At the end of 2002 the enlargement negotiations of the European Union were closed successfully, and Hungary is expected to become a member of the EU in May 2004. In 2002 the GDP showed an increase of 3.3%, so it has once again exceeded double the EU average, which together with the unemployment rate below 6% continues to reinforce the process of catching up in the area of the economy. The successful privatization programs and international capital investments contribute to the growth of Hungary's competitiveness after the EU accession and enable the economy to retain its attractiveness for international investors.



STRATEGY IN THE LIBERALIZED MARKET

Matáv as the biggest player of the Hungarian telecom market has to respond quickly and efficiently to market liberalization and the changing telecom market. Matáv is continuing its growth strategy in a new environment, and maintaining its leadership position: it is developing the business lines with the largest revenue potential and keeping its costs under strict control.

MATÁV GROUP CENTER AND THE LINES OF BUSINESS

To meet the requirements of the liberalized market and the challenges of the technological development, a new management structure was introduced at the Matáv Group from January 1, 2002 covering four business lines through the coordinated activities of Matáv and its subsidiaries: services provided to residential and business customers, Internet and mobile services. Accordingly, the Group has four lines of business (Residential Services, Business Solutions, Internet and Mobile) that are strategic business units with business activities of their own based on the strategic guidelines of the Group Center.

EFFICIENT COOPERATION

The new management structure enables the lines of business to respond flexibly to market changes, and focus on the promising areas of high growth potential, by benefiting from the substantial advantages of Group integration. The strategy of Matáv Group combines the strategies of the different lines of business to achieve the best market position for each business activity, while contributing to efficiency improvements at Group level. Matáv's Group strategy focuses on the following goals:

- Maximize shareholder value by the growth of lines of business and by increasing their competitiveness.
- Respond to product development challenges by coordinating with Deutsche Telekom Group's service portfolio.
- Develop an integrated market offering based on efficiency and cost advantages.
- Set up a unique service portfolio by using Group synergies.
- Extend sales opportunities by Group level coordination of sales activities.

FOR MATÁV GROUP'S FUTURE SUCCESS

The future success of the Group depends on how we are able to use our resources and the market leader positions of our business lines. The most important is to retain the market positions and revenue potentials of our core businesses. Matáv continues to explore further business opportunities in other segments of the communications market such as content or entertainment services where our infrastructure, skills and competence, developed in our core activities, can be utilized. International business development continues to be a part of our strategy. Our investment in Macedonia significantly increased the revenue growth potential of the Group.

T-SYSTEMS REGIONAL INNOVATION CENTER

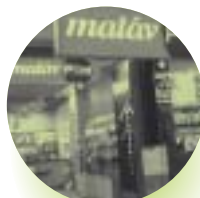
The Regional Innovation Center of T-Systems was opened in Budapest in September 2002. The majority shareholder is T-Systems International, a subsidiary of Deutsche Telekom while the minority shareholder is Matáv. Deutsche Telekom decided to establish the Center in Hungary as it recognized the country's key position in the region and its future development potential. In addition to its research and development task, T-Systems RIC will serve as a source of new technological solutions and also supports the activities of Deutsche Telekom Group subsidiaries in the region by coordinating their IT background.

OPERATIONAL EXCELLENCE FOR CUSTOMERS

To reinforce our market leadership and competitiveness, the core objectives are: the constant improvement of services for customers, quick response to customer demand and wishes, achieving the excellence of all operations. This can be attained only with the support of Matáv Group employees. To meet successfully the challenges of the competitive environment it is essential to:

- devote maximum attention to customer relations,
- develop commitment to quality in all areas,
- ensure profit orientation.

Customer care:
a commitment to quality



Future Matáv successes:
promising areas of growth

A man with dark hair, wearing a brown jacket over a red shirt, stands behind a red sofa. A woman with blonde hair, wearing a red and white striped shirt and blue jeans, sits on the sofa. She is holding a large blue donkey puppet. The background is a solid pink color. A green rounded rectangle is in the top right corner, containing the text 'Our Strategy' and a circle of green dots.

Our Strategy

***Business
Solutions***



Business Solutions:
concerted network and
system integration



Antarctic, King George Island:
Comtr@ck accompanied
polar researchers

INTEGRATED CUSTOMER FOCUSED ORGANIZATION

Matáv's Business Solutions provides one-stop, tailored, complex telecom and IT services for key business customers. The product portfolio of Matáv's Business Solutions is unique in Hungary's telecom market: company management systems, satellite vehicle tracking systems, hosting solutions, video communication services and PABX systems are offered simultaneously with Matáv's full-scale telecom service portfolio (voice and data products, international and system integration services). Matáv's Business Solutions as a system integrator is ready to supply service and application packages complete with management from designing to operation and maintenance.

CUSTOMER-FRIENDLY SOLUTIONS

As a supplementary service to our key account management system, we have set up the VIPpoint call center available to all key accounts to meet the most sophisticated customer demands. This freephone number provides information on our current offers, allows our partners to initiate orders, and calls relating to our services are answered by Matáv's Key Customers Center round the clock. We maintain relations with customers through our key account managers, ensuring a quality, quick and efficient customer care. Through our account managers who maintain close relations with the key customers we learn and understand the expectations of our partners so that we can offer them tailor-made, unique solutions.

LEADING POSITION IN DATA COMMUNICATIONS

In traditional leased line services we continue to maintain strong positions in the data communications market. Extensive growth has ended in this market segment and the engine of our growth is now the increase of bandwidth. In data communications we successfully maintained our leadership position through the development of network integration products such as MultiLAN, in addition to our traditional services. Our IP products developed into a product family are a key element of retaining our leading position in the data communications market. In March 2002 we connected the first business customer to Matáv's 3.5 GHz point-multipoint radio system, able to carry all kinds of telephony, data and broadband services.

MATÁV COMTR@CK AT THE ANTARCTIC

Matáv has sponsored the first Hungarian expedition to the Antarctic in December 2002 by the provision of a crucial service. The vehicle tracking application of Matáv's ComTr@ck infocommunications service provided the route tracking of the polar expedition regardless of the weather conditions and the period of the day. As part of the service Matáv made available to the research team equipment suitable for forwarding the position of the user, based on a satellite positioning system (GPS).

E-BUSINESS: E-WORK, E-SIGNATURE, E-WALL

e-Work embodies all the advantages of teleworking, while the users have access to the infocommunications background of a company environment. The basic product of Matáv's e-Work service package is e-Work Start that provides an ISDN solution for home office work. Our e-Signature (electronic signature) service is designed for all market segments so that in the near future all customers will be able to make secure banking and financial transactions via the Internet. Matáv's e-Wall managed firewall services offer solutions for protection against attacks from the Internet.

Residential Services

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ISDN AND ADSL: HIGH QUALITY FIXED LINE ACCESS

In 2002 the Matáv Group stabilized the number of fixed subscriber lines at around 3 million, simultaneously with the increasing penetration of mobile telephony and in a liberalized market environment. An increasing number of customers select our ISDN service that allows the maximum utilization of the advantages of the fixed line network. The number of ISDN channels exceeded 511,000 by the end of the year, representing 17.7% of all fixed lines. Due to its rapid roll-out, the broadband ADSL service providing fast Internet access was available in 48 cities in addition to Budapest, over 1.4 million fixed lines by the end of 2002. In 2002 the number of ADSL connections increased more than five-fold to 34,000.

EXTENDING TARIFF PACKAGE PORTFOLIO

In 2002 we extended the portfolio of tariff packages to enable our customers to find the offer that best fits their usage habits. By year-end 42% of our residential customers, nearly 1 million subscribers have ordered one of our tariff packages. Those who make the right choice for their phone usage habits can achieve substantial savings on phone calls. An outstanding success of the year was our Csevegő package: in 2002 over 300,000 customers could feel free to chat over the phone because the longer the phone call, the more the discount is. With our Sokatmondó tariff package customers can use various call management services in addition to the discount rate minute fees. Users of our 15-hour (KezdőNet) and 40-hour (HaladóNet) packages can significantly reduce their Internet access rates.

FIXED LINE SMS

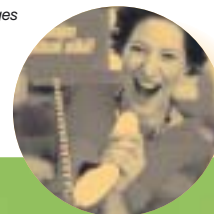
Matáv was the first of Hungary's fixed line service providers to enter the market with a short messaging system or SMS service. Starting from September 2002 customers with a suitable fixed line phone set can forward text messages. For customers who do not have a terminal equipment suitable for receiving SMS, we provided a new solution: text messages are converted into voice messages and forwarded to these customers. Matáv's fixed line SMS system was developed by T-Systems, a member of the Deutsche Telekom Group.

NEW CALL MANAGEMENT AND VALUE ADDED SERVICES

One of the novelties of 2002 was the introduction of the Audiofix service enabling customers to access various entertainment contents. With Audiofix the telephone costs can be budgeted, as set prices are applied with no minute charges.



Fixed line SMS:
text and voice messages
over the phone



Our Televoting service enables customers to join in various media programs and prize games through their fixed line telephones. The scope of services available through Directory Assistance Plus has increased: food and flowers can also be ordered by dialing 197. Our Összhang package offering five call management services at a favorable rate also benefits fixed line customers.

INNOVATIVE CARD SERVICES

In 2002 Matáv's first multimedia payphones started operation, bringing new features to public telephony. These multi-purpose card phones can be used for Internet access and sending e-mails, in addition to phone calls. We continued to extend our range of cards. In addition to the discount rate Barangoló card, calling cards are offered with Sokatmondó and Ritmus tariff packages as well. During the year we installed nationwide more than 9,000 special "Hospital-Hostel" payphones operated with the Barangoló card, making life easier in hospitals and student hostels.

RETAIL NETWORK AND CUSTOMER CARE

Matáv's retail network was extended further in 2002: 24 Matáv Pont shops and 52 Official Partner retail units now serve our customers nationwide. Matáv's call center, keeping pace with increasing customer demand, extended operations in October 2002 and has been available to customers 134 hours out of the 168 hours a week. The number of users dialing the 1212 freephone number increased to over 2.5 million in 2002, and the number of inbound calls exceeded 10 million. To assist our small and medium business customers we have launched a business customer service freephone line.

ONLINE CUSTOMER RELATIONS

The online novelty of the year was the launch of our Internet call center accessible from the summer of 2002 at Matáv's Internet website round the clock. In e-Pont, our Internet store, practically all our services can be ordered online. The e-Pont offerings increased substantially in 2002: in addition to the terminal equipment, phone cards, services and tariff packages, current electronic billing information are available. Matáv's Online directory assistance service, upgraded in 2002, allows searching by the name, phone number, postal code or locality of subscribers.

WIRELESS INTERNET ACCESS

In December 2002 Matáv launched a broadband wireless Internet access solution on a trial basis. The EasyNet service, using WLAN (Wireless Local Area Network) technology, offers wireless, high-speed temporary Internet connection. EasyNet users access the Internet in public places such as conference centers, exhibition halls, airports or hotels by inserting a WLAN card in their laptops.

CABLE TV SERVICES

MatávkábelTV has become the second largest player of Hungary's cable television market. As a result of our marketing campaigns the number of customers increased by 12.6% to nearly 339,000 in 2002. Following major network modernization we can now access 90% of our subscribers through advanced star-point networks. As a result of a successful cooperation with Axelero Internet to spread the Kábelnet service offering Internet access over cable TV network, the number of subscribers more than doubled to 42,000.



Internet



Business Internet market:
broadband e-business
solutions

AXELERO IS THE MARKET LEADER

Axelero, the Internet line of business of the Matáv Group, is Hungary's only full range Internet service provider. In 2002 Axelero continued to reinforce its leading position in all three key segments of the Internet market – residential, business and content services. At the end of 2002 Axelero had over 128,000 dial-up subscribers, representing a 43% market leading share.

NEW TARIFF PACKAGES

Based on an agreement between the government and the telecom service providers two new phone tariff packages allowing discount rate Internet access for 15 and 40 hours per month have been offered from August 2002 for Internet users. Axelero has also renewed its Internet products by aligning them with the new packages. The 15-hour discount package is supplemented with Origo, while the 40-hour tariff package with Otthon Internet package, while customers requiring unlimited and fast Internet access are offered the Profi package. Our most successful traditional product has been NetQuick offering prepaid dial-up Internet access with nearly 21,000 customers representing 13.9% of all Axelero subscriptions.

ADSL AND KÁBELNET

ADSL offering broadband access became Axelero's most successful product of 2002. Axelero also contributes to the growth of the Internet market with the fast roll-out of broadband services for customers. At the end of 2002 Axelero ADSL could be accessed from 48 cities nationwide, in addition to Budapest. The number of ADSL users reached 36,000 by the end of the year, and the market share of Axelero increased to 50%. Another significant business line of Axelero is the offering of new web contents that can convince potential customers about the benefits of using the Internet while in the case of the existing Internet users it can contribute to the increase of time spent on the web. The success of Kábelnet, offering Internet access over the cable TV network, and ADSL far exceeded expectations. The number of broadband





Kábelnet subscribers increased dynamically to reach 4,368. The number of ADSL Otthon subscribers increased to 16,545. In addition to the business packages (ADSL Profi and BDSL), the sales of server capacity and value added e-business services (webEDI) also increased substantially.

[ORIGO] EXCEEDS SIX MILLION PER DAY

In 2002 the average daily visits to [origo], Hungary's leading Internet portal site exceeded 620,000 per day. In October 2002 [origo] reached a new peak of visits: 6.1 million page impressions were registered in 767,000 visits. Since 1999 [origo] occupies first place among Hungarian websites both in terms of visits and page impressions, and in 2002, 4–5 million pages were downloaded in 600,000–700,000 visits on an average weekday. In November 2002 Business Quarter, the business site of [origo] was renewed both in design and content. In addition to the upgrading of its most successful services such as Insurance Calculator or Career Center, the site was supplemented with new content products such as Credit and Shopping.

[FREEMAIL] RECORDS

The [freemail] service offered by [origo] portal site reached the record-breaking figure of one million in November 2002: on November 12, 1,047,000 page impressions were registered during 341,272 visits. On the following day page impressions exceeded one million again, while the system processed 2.2 million e-mail messages. The popularity of [freemail], a free mailing system that can be accessed easily from any location by using web browser programs, has been increasing dynamically for years.

ONLINE MARKETS AND STORES

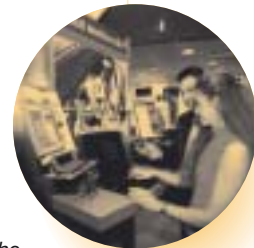
Marketline, majority owned by Axelero, became the leader of the B2B e-market in Hungary. Last year it serviced 850 companies, and managed 330 auctions at its electronic marketplace. Marketline's business partners achieved an average 15% saving on their procurements by using the electronic marketplace in 2002. Customers can select from more than 20,000 products and services in the central catalog. The FókuszOnline Internet bookstore developed dynamically in 2002 as well: during the first half of the year it acquired a market leading position in the area of the Internet book trade. The travel services portal site, Travelport.hu has retained its market leading position and in 2002 it boasted continuous growth in terms of visitors, hotel reservations, air tickets and travel sales.



Axelero: growth in customer numbers, increase in traffic

NETÉPÍTŐ: INTERNET SOLUTION FOR SMALL BUSINESSES

Netépítő is the joint Internet service package of Matáv, Cisco Systems and Axelero offering firewall solutions, IP phone calls, network management and fast Internet access over leased lines or ADSL. It is offered primarily to small and medium-size enterprises, creating new opportunities for the development of advanced IT networks by using solutions affordable earlier only for large companies. Netépítő is expected to boost Internet usage among small and medium-size businesses.



MARKET LEADING MOBILE CARRIER

In 2002 again, the greatest number of new mobile subscribers in Hungary chose the market leader Westel, Matáv Group's Mobile line of business, which increased the number of its customers by more than 900,000. The number of Westel customers exceeded 3.4 million by the end of 2002, representing a 49.6% share of the GSM market. The 36% growth is mostly due to prepaid card customers. In 2002 Westel launched the most new products among Hungary's mobile carriers, and with some of these services (MMS, Mobilbank) they were the first in the world or in Europe.

EVERYTHING FOR THE CUSTOMER AND QUALITY

Westel maintained customer confidence and loyalty primarily by offering competitive prices, unique services and service quality. Thanks to the attractive conditions, Westel customers sent nearly 600 million SMS messages in 2002. Among Hungary's mobile carriers Westel offers the most tariff packages to subscribers and its portfolio was further extended in 2002 by launching Társalgó and Aranytárskártya Társalgó packages. By using Zenefutár, the latest interactive service, customers can send musical voice greetings or ringer tones. Westel customers can make phone calls over 226 networks of 100 countries on 5 continents.



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MMS: WORLD'S FIRST MOBILE MULTIMEDIA

Perhaps the biggest success of 2002 was that in April Westel was the world's first carrier to introduce the Multimedia Messaging Service or MMS able to transmit text, image and voice. The InfoMMS solution launched in October is expected to speed up the dissemination of mobile multimedia as it allows several hundred thousand customers to receive MMS. The video streaming service launched in November assists the development of the information society.

M-LEARNING: MOBILE EDUCATION

A book of studies on mobile communications published in German jointly by Westel and the Hungarian Academy of Sciences was introduced in October 2002 at the Frankfurt Book Fair. The Hungarian version of the book mapping the changes in society associated with mobile phone usage came out in November. Westel and the Academy's Institute of Philosophy launched a joint scientific research program in 2001 called "The communications of the 21st century" and involving renowned Hungarian and international experts. M-learning, i.e. mobile learning and mobile education, is an exciting opportunity of the emerging new period of mobile communications.



INNOVATIVE MOBILE INTERNET SERVICES

Westel's GPRS fast mobile access service launched in 2001 became available from July 2002 for Westel's GPRS and MMS users also on T-Mobile Deutschland's network. Another new feature has been Westel's daily rate GPRS tariff allowing both WAP and mobile Internet usage. As a further innovation of the online service portfolio, from August 2002 customers can pay their telephone bills also through the Internet. In November Westel was the first in Hungary to introduce wireless local access network or WLAN service for business customers, available first at the Budapest airport.

FIRST IN EUROPE: WESTEL MOBILBANK

Westel was the first in Europe when it introduced in October 2002 its SMS-based service called Westel Mobilbank for banking transactions in cooperation with OTP Bank. The new service developed jointly by the two companies enables customers to initiate financial transactions such as bank account queries, bank transfers and blocking deposits directly from their mobile phones 24 hours of the day.




Mobile

M-COMMERCE SOLUTIONS

From November 2002 Westel customers are among the first in Europe who can purchase operator logos and ringer tones through WAP phones and make payment on their monthly bill or by their phone card. Mobile payment will become widely used in the future, as nearly 1.5 million Westel customers have telephone sets suitable for WAP access.

WESTEL MOBILE OFFICE: THE THIRD IN EUROPE

After T-Mobile Deutschland and Orange, Westel was the third in Europe to implement the Mobile Office service for business customers. Since October 2002 their company mailing and office systems, including the calendar, the mailing list and the "to do" list can be accessed from anywhere 24 hours of the day. As a supplementary service an SMS is sent on request about specified transactions to the customer. For users a number of services, accessible earlier only at a computer, are now available through a WAP mobile phone as well.



Westel: a chance to exploit interactive and multimedia communications

MakTel: a significant
contribution to 2002
Matáv Group results



EXPANDING MARKET IN ALL SEGMENTS

The Macedonian telecom operator MakTel, the international subsidiary of the Matáv Group, continued to expand its market in all business segments in 2002. At the end of the year MakTel had 594,000 fixed lines. The number of ISDN channels increased substantially, by 43.6% to 22,350. The mobile business line MobiMak had 366,000 subscribers. The number of mobile subscribers increased sharply, by 66% in 2002. The number of Internet subscribers reached 34,000 by the end of 2002.

MARKET ORIENTED RESTRUCTURING

In 2002 we continued the restructuring of MakTel into an efficient and customer focused company. The development of an advanced call center system has been started to provide quality services for customers, by setting up call centers in the country's three cities. As part of the modernization process the implementation of MakTel's new Business Support System (BSS) was started in 2002. One of its key elements is an advanced billing system supporting telephone, Internet and interconnection services.

TARIFF PACKAGES AND CAMPAIGNS

In the frame of their intensive marketing efforts MakTel's business lines launched new tariff packages and sales campaigns in 2002. The terminal equipment and line sales campaign of MTline, the residential business unit, targeted the extension and upgrading of the fixed line network. The PABX sales campaign of the business communications division, MTcom, offered free line installation and Internet access connection. MTnet, the Internet business line offered new discount tariffs and packages for customers as well as a game with prizes. The mobile carrier MobiMak launched the WAP service in 2002 and offered a number of tariff packages, in addition to Mobi+, a prepaid card service.

STATE-OF-THE-ART RETAIL NETWORK

In 2002 MakTel launched the restructuring of its customer service offices to create a state-of-the-art retail network which by year-end consisted of 38 shops. All fixed line, mobile and Internet services can be ordered on a one-stop basis in the retail units, where terminal equipment and other accessories can also be purchased. In December 2002 MakTel opened its newest shop, selling the products of the four business lines, in a shopping mall of Skopje.

INTENSIVE NETWORK DEVELOPMENT

The country's last electro-mechanical switch was replaced in Skopje in October 2002, which was a milestone of Macedonia's telecommunications network development. The digitalization rate of the fixed line network reached 96% in 2002, meaning that an advanced telecom network has been developed allowing fast and easy access to services. During the year the capacity of the mobile network increased substantially resulting in residential service availability of more than 98%.

SOCIAL RESPONSIBILITY

MakTel's sponsorship and donation activities have a substantial role in Macedonia's social and cultural life. The company's social responsibility includes primarily the sponsoring of cultural and sports events, reconstruction of historical monuments and support for children suffering social and health problems. Since 2002 MakTel has been supporting the reconstruction of the Samoil fortress located in Ohrid, one of the most significant historical monuments of Macedonia.

Shared strategic goals:
successful integration
and restructuring



*International
Segment*



BUSINESS SUCCESS AND TRAINED STAFF

Committed and motivated professional employees represent a key factor for the business success of the Matáv Group. Matáv's human resource management activities contribute to successful increase of shareholder value by providing for sufficient, high quality human resources in accordance with international best practices. High level professional training of the employees, preparation of managers and employees for the challenges of new technologies and market competition are crucial factors for the operation of the Matáv Group. A number of surveys show that Matáv is considered as one of the most attractive employers among young graduates, and economists starting their professional career would also favor Westel as an employer.

PERFORMANCE INCENTIVES

In 2002 a performance incentive commission system was introduced for the employees of the Matáv Pont retail outlet network to stimulate sales. The revenues increased by an average of 20% among the staff concerned, as a result of the performance incentives. Matáv has also launched a new group-level management incentive program based on share options.

Human Resources

*Matáv Group Olympics:
challenging the competition*

*Matáv Children's Day:
high quality human
resources*



ONLINE INTERNAL SERVICES

In September 2002 Matáv was the first in Hungary to introduce an electronic payroll service called e-Payroll that allows employees to get online information on the intranet simultaneously with the bank transfer of wages, while the e-Holiday online service allows employees to check their annual holidays, both the leave days used and remaining. The human resource services supporting system is connected to Matáv's corporate website so that from 2002, with the introduction of a new recruitment system, applications for vacant positions can be submitted through the Internet, on Matáv's website as well.

IDEAS AND CAREER MANAGEMENT

In 2002 a corporate ideas management system was launched under the name of ÖtletNET (IdeasNET) to allow Matáv Group employees to compete by submitting their ideas for corporate process improvement and revenue growth. Iránytű (Compass) is an orientation package designed for new entrants to the company. The program for new employees allows participants to learn about corporate strategy, structure and products. New executives are supported by a customized, "on the job"-type introductory program. In May 2002 a senior management support program was launched for Matáv Group executives, a key part of which was competition training.

INTERNSHIP PROGRAM

The internship program is designed for young and talented engineering and economics graduates and undergraduates committed to telecommunications, to support their career building within the Matáv Group. In 2002, nearly 500 people submitted applications for 30 intern positions. We maintain continuous relations with the academic institutions, and have supported them by development contributions again in 2002. Matáv continues to provide professional training opportunities for university and college students.

AGREEMENT WITH THE EMPLOYEES' REPRESENTATIVES

Under the provisions of the Collective Agreement, since 1994 Matáv conducts negotiations each year with the workers' representatives. In September 2002 an agreement was reached between Matáv and the employees' representatives on headcount changes in 2003 and 2004 and on benefits. To increase efficiency, in 2003 there will be a 9% and in 2004 a 3% Group-level headcount reduction. At the same time Matáv launched a "Chance Program" to support the employment of those leaving the company.

E-AKADEMI@ AND INTERNET ACADEMY

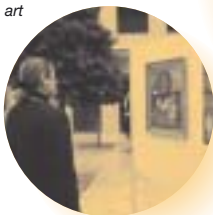
Matáv has launched the country's first infocommunication (telecom-IT) training program under the brand name e-Akademi@ to provide training in the professions of info-structure manager and telecom technician. To cover the lack of IT knowledge – the "digital gap" – and to enhance the emergence of an information society, Matáv and Axelero set up an Internet Academy designed to disseminate mass information on the basics of Internet usage.

MEDIA TRAINING AND RESEARCH CENTER

In cooperation between Matáv and the Budapest Technical and Economics University a Media Training and Research Center was established in September 2002 to respond to social changes and challenges of the 21st century. In this framework an online training course for media engineers was launched in autumn 2002 on a trial basis.



Matáv Gallery: a meeting opportunity with art



University of All Knowledge: education disseminated with Matáv's support



MATÁV – SPONSOR, PATRON, DONOR

Matáv has been a pioneer in Hungary as a responsible corporate citizen, substantially contributing to the development of a professional donation culture. Its corporate social responsibility is aimed at various forms of supporting, with several hundred million forints, Hungarian culture, first of all classical music, quality popular music, contemporary art, theater and mass sports events. In the course of its donation activity Matáv has been involved in supporting a number of health and social care organizations. In 2002 Matáv's Donations Committee awarded funds of more than HUF 70 million to non-profit organizations for charity, social and health purposes.

Corporate Social Responsibility

MATÁV DONATION LINE

In 2002 the company proved its social sensitivity with a new initiative, the Matáv Donation Line established in May, allowing the collection of donations through the phone. The Donation Line has introduced a new method of charity in Hungary. Applications are invited from non-profit organizations, associations and foundations for the possibility of collecting donations to achieve their objectives. Those intending to help can donate HUF 100 by dialing 1788, and a total of HUF 20 million was donated this way in 2002. The greatest amount of donations went to the Hungarian Red Cross, the Hungarian Clowns for Patients Foundation and the League Against Cancer.

FLOOD HELP LINE

In August 2002 the customers of Hungary's major telecom companies including Matáv and Westel could contribute HUF 100 per call by dialing 1749 to help the victims of the Danube flood. In the frame of the campaign tens of thousands of people chose this simple way of assistance, and over HUF 32 million was collected through the flood help line. The Hungarian Red Cross was asked to manage the distribution of the funds.

CLASSICAL MUSIC LIGHTLY...

Matáv was the leading sponsor of music and outstanding music events in Hungary again in 2002. Since 1992 we have been the only sponsor of a key ensemble of classical music, the Matáv Hungarian Symphony Orchestra. Matáv has been traditionally the main sponsor of the classical music channel Bartók Rádió, contributing to the creation of a great number of quality music programs. In February 2002 the Berlin Philharmonic Orchestra and Nigel Kennedy delighted the lovers of classical music. Our Matáv Exclusive Season Ticket presented the Budapest performances of two famous baroque ensembles, Il Giardino Armonico and the Amsterdam Baroque Orchestra and Chorus.

POPULAR MUSIC SERIOUSLY...

In 2002 Matáv concluded an exclusive agreement with a special group of Hungary's music. Audiences could enjoy the world music of Ghymes group stemming from the folk music of Central and Eastern Europe during a concert tour with nearly 60 events. The Christmas concert of Ghymes with the Matáv Hungarian Symphony Orchestra was a special musical treat.



MATÁV GALLERY

Since the summer of 2000 regular exhibitions are organized in the lobby of Matáv Headquarters. Matáv's employees, guests and business partners are offered the exhibitions of contemporary artists covering a broad spectrum of applied and fine arts from photography to tapestry. The exhibition program has a dual benefit: it provides an opportunity for young and talented artists and offers a meeting environment for the employees. Matáv regularly purchases some of the exhibited artworks, supporting Hungarian art in this way, too.

UNIVERSITY OF ALL KNOWLEDGE

In September 2002, Matáv and Axelero launched the University of All Knowledge in close cooperation with the Hungarian Academy of Sciences. Prominent Hungarian scientists are giving lectures each week on various scientific issues of public interest and discuss them with the audience. The lecture recordings are available on TV and radio, in the press and on the Internet as well. In 2002 more than 487,000 visitors and 2.8 million page impressions were registered at the event's home page. As an outstanding success, a total of 13,000 visited the lectures and 200,000 people watched the lectures regularly on TV.

DONATIONS FROM MATÁV EMPLOYEES

Nearly 3,000 kilograms of clothing were collected at the Matáv Group in 2002 as a result of a successful campaign. The charitable Christmas donations of the Matáv employees have been distributed by the Hungarian Red Cross primarily for mothers and children as well as in shelters for homeless people.



ENVIRONMENT-FRIENDLY OPERATIONS

Matáv as a telecom service provider imposes only a small burden on the environment. Nevertheless, even minor pollution can be eliminated by including environmental analysis and survey in our product development process, as we did in 2002. As a result we can inform customers that our telecom services such as ISDN videoconferencing can substitute activities such as car traffic that burden the environment substantially. In 2002 Matáv became the first operator in Europe to put into operation a renewable energy source on a trial basis – a wind-electric generator providing energy supply to a telecommunications facility. This has been our first step in the direction of a future-focused, sustainable development.

Musical events in Hungary: Matáv is the leading sponsor

Frequently Asked Questions

Answered by Elek Straub, Chairman and CEO

IN THE FIRST YEAR OF LIBERALISATION MATÁV SUFFERED LIMITED TRAFFIC LOSS. CAN WE SAY THAT THE TRANSITION INTO A FULLY LIBERALIZED TELECOMMUNICATION MARKET IN HUNGARY WAS SMOOTH AND PAINLESS FOR MATÁV?

First of all the transition that we are talking about is still a continuing process, so it is too early to evaluate it as a whole. What we can say applies only to the initial phase of the liberalization.

Nevertheless, I would not say that transition in the telecommunication market has been painless.

If I take the example of our headcount reduction plan for 2003 and 2004, which is groupwide but especially in the fixed line business, it is anything but painless. This was the necessary consequence of the continuous competitive pressure on our prices.

It was clearly stated by the authorities that full EU regulatory compliance has to be implemented. The Hungarian regulator opted for a systematic, transparent and step-by-step transition process. On the one hand local loop unbundling and carrier preselection were introduced immediately after market opening. On the other hand in 2002 a fully allocated costing methodology was applied for the 2 reference offers (on unbundling and interconnection), leaving some time for the incumbent operators to adapt to the new requirements. This phased approach also helps customers to thoroughly evaluate and test the opportunities.

In 2003 the shift to long run incremental costing will most likely result in a decrease in the recognised interconnection cost level. However I strongly believe that the decisive factor in attracting new entrants to the market will not be the regulatory environment alone, but rather will be driven by pricing and customer demand factors.

At Matáv we have been working for years to develop a comprehensive range of services and packages fulfilling all kinds of customer demand. What is more, in terms of certain state-of-the-art IP related products we were pretty much ahead of the market. Our prices are very competitive across the whole range of services. Based on these factors and the regulatory framework supporting infrastructure based competition I think that the Hungarian telecommunications marketplace offers opportunities only for those who are willing to build the market further rather than pursuing short term interests.

All in all, so far Matáv experienced limited traffic loss and very importantly some market share gain in the territory of other telecom operators and the company is well prepared to face competitive challenges in the future.

THE MACEDONIAN SUBSIDIARY, MAKTEL, HAS DELIVERED AN EXCELLENT EBITDA MARGIN, 54.5% FOR THE FULL YEAR OF 2002. HOW LONG DO YOU THINK THIS WILL BE SUSTAINABLE?

As the transition of MakTel into an efficient, market oriented company has started not so long ago, I think there are many synergies still to be exploited between Matáv and MakTel.

So far this outstanding performance has been helped by organic growth in the market, most spectacularly in mobile and Internet subscriber growth, but the fixed line business is also still in a growth phase. However, for the future we have to take into account the potential start-up of competition in mobile and later in the fixed line business as well.



The other key element of our success in Macedonia is that Hungarian professionals could find a way of working harmoniously with our Macedonian colleagues and successfully imported know-how coming from our past experiences.

As many measures are still being implemented and the positive market trends are continuing, I am confident that there is still significant scope for efficiency improvement and our goal for MakTel in respect of 2003 is the same: it should remain one of the key drivers for the growth of the Matáv Group.

HUNGARIAN MOBILE PENETRATION REACHED 68% AT THE END OF 2002. IT SEEMS THAT THE GROWTH IN THE SUBSCRIBER BASE IS TAKING PLACE AT A MUCH SLOWER RATE THAN BEFORE. HOW MUCH DO YOU THINK IT WILL AFFECT YOUR BUSINESS CONSIDERING THAT RECENTLY MOBILE HAS BEEN YOUR MOST POWERFUL REVENUE DRIVER?

Excluding regulatory effects in the mobile business in a slowing market the growth in EBITDA may continue for some time after subscriber growth slows down, assuming that competition does not change significantly. This comes mainly from the nature of the mobile market: the profitability of recently acquired customers improves as they become accustomed to the convenience of the various services, so their average monthly revenue per user (ARPU) and usage continuously improves, meaning that while the subscriber growth rate is falling, the overall ARPU dilution effect of the new customers decreases at the same time.

Let me emphasize that Westel already provides a wide range of content, data and multimedia services in an always accessible way and we rightly refer to them as value added services. Value added services represented 9.6% of ARPU in 2002 and are considered to be our fastest revenue driver in the future.

If we accept that subscriber growth will decelerate, we also have to assume that handset subsidies and agency fees relating to sales activities will mean a reduced burden on our costs and margins. This can be partly offset by the increased number of our customers in our loyalty programs.

Very importantly, our competitors have so far mostly focused on handset prices. Westel was very successful in finding the right balance between profitability and market share. The formula was relatively simple; if we changed the entry barrier, depending on its direction either we improved profitability and decreased market share or vice versa. The basic difference between the two scenarios was whether to follow short term or longer term profitability, of course accompanied by excellent service quality and innovative image. For the year 2003 the question is where the market will find competitive differentiation in the mix of quality and innovation, handset prices and tariffs. Westel will continue to strive for high profitability, but at the same time it is also dedicated to preserving its clear market leadership.

MATÁV HAS RECENTLY ANNOUNCED PUBLIC TARGETS FOR 2003. LOW SINGLE DIGIT REVENUE GROWTH AND AN EBITDA MARGIN IN THE REGION OF 40% APPEAR TO BE RATHER CONSERVATIVE.

Certainly Matáv delivered very impressively on its public targets set for the year 2002. In 2003 we anticipate that beside the continuous general improvement of our business, revenue growth will be negatively influenced by several factors, reducing the pace of growth to low single digits.

The change in interconnection fees will most probably result in lower origination and termination fees. As a result of competition, Matáv forecasts some loss of market share predominantly in domestic and international long distance calls. In addition, competition for business customers in data transmission may make discounting necessary, thus hindering revenue growth. Furthermore, the regulation of Westel interconnection fees will probably have a negative influence on revenues.

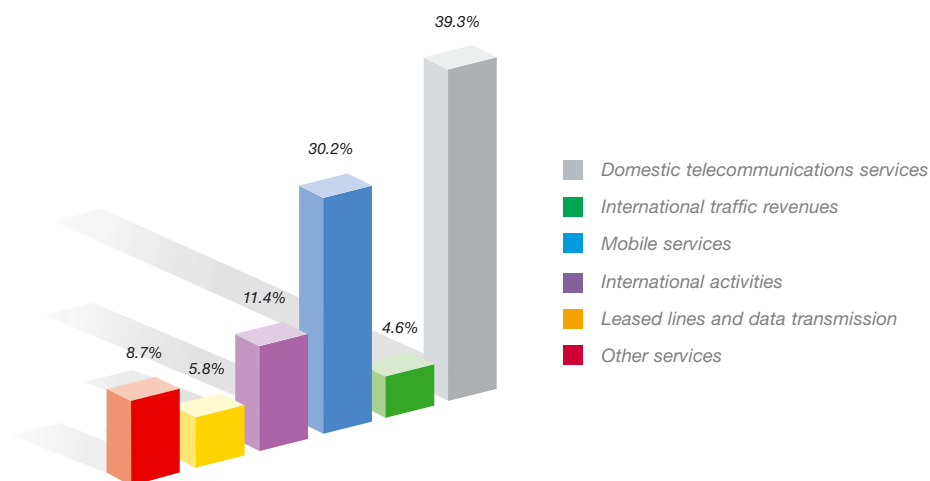
As our costs are more inflexible than revenues, we cannot guarantee that EBITDA margin will reach the previous year's figure of 41.5% in 2003.

Our approach for setting public targets may be on the conservative side, but we believe the figures are realistic and achievable. Of course we shall make every effort to deliver on our public targets for 2003 as impressively as we did for 2002.

Management Report for the Financial Year 2002

HIGHLIGHTS

- Total revenues grew by 7.8% (13.9% in EUR terms) to HUF 590.6 bn (EUR 2.4 bn), primarily due to the strong growth of the mobile business.
- EBITDA amounted to HUF 245 bn. Excluding the HUF 8.6 bn severance provision for the headcount reductions in 2003 and 2004, EBITDA margin would have been 42.9% due to the efficiency of the businesses and further justifying the MakTel acquisition.
- Fixed line segment revenues grew by 0.8%. The decline in the international traffic revenues was almost completely offset by the increase in leased line and data revenues, reflecting the success of ADSL and the increase in Internet subscriptions. Reported EBITDA margin was 35.8% as severance provision primarily hit this segment.
- Mobile segment revenues increased by 16.9%, reaching HUF 232.6 bn for the year before inter-segment elimination. EBITDA margin reached 37.8%. Westel's subscriber base was 3.4 million at the end of 2002, outperforming its competitors in terms of net customer additions, while market share declined slightly as a result of stricter prepaid entry barrier.
- Revenues of the International segment (MakTel) increased to HUF 67.6 bn in 2002. EBITDA margin reached an outstanding 54.5% due to continued development in the fixed and mobile businesses.



REGULATORY ENVIRONMENT OVERVIEW

Full liberalization of the marketplace creates a stable environment. At the end of 2001, the Hungarian telecommunication market became fully liberalized except for 23 local concession areas where concession rights expired only in May and November 2002. Competitors may enter Matáv Group's fixed line service areas and vice versa offering residential and business customers international and domestic long distance telephony services if they meet certain regulatory requirements.

Operators have to agree on interconnection or unbundling arrangements to be able to offer their services in regions served by other local fixed line operators. In the case of an operator identified as an operator with significant market power (SMP), the reference interconnection and unbundling offers provide guidelines for these contracts. Reference offers were administered by the Regulator (Communication Arbitration Committee) during 2002. Matáv Group has significant market power in the telephony, mobile telecommunication, leased lines and interconnection markets. The reference offers of the Matáv parent company for unbundling (MARUO) and for interconnection (MARIO) were accepted on February 28, 2002 and July 18, 2002 respectively. Calculations are based on fully distributed costs being replaced by long run incremental cost (LRIC) from 2003. Interconnection fees also depend on the level of connection (three tiers: local, regional, national). Third party billing for voice telephony is not obligatory. However, part of the Internet related revenues are shared with Internet service providers.

FULL LIBERALIZATION OF THE MARKETPLACE CREATES A STABLE ENVIRONMENT

The Universal Telecommunications Support Fund provides compensation for mandatory uneconomical universal services under the low user package from February 1, 2002. The Fund pays the difference between the subscription fee of an ordinary and the low user package up to a certain limit for all universal service providers. In line with practice in most European countries, a price cap system is in place. This system regulates only the overall level of price increase, with specific price caps for subscription fees and local calls. The overall price cap was 4% in 2002, is 2% in 2003 and will be CPI minus 3% in 2004.



Matáv offers service packages to all residents and businesses operating in Hungary including clients of other local operators. In 2002, most competitors focused on Matáv's business customers, with Vivendi also introducing residential call-by-call packages.

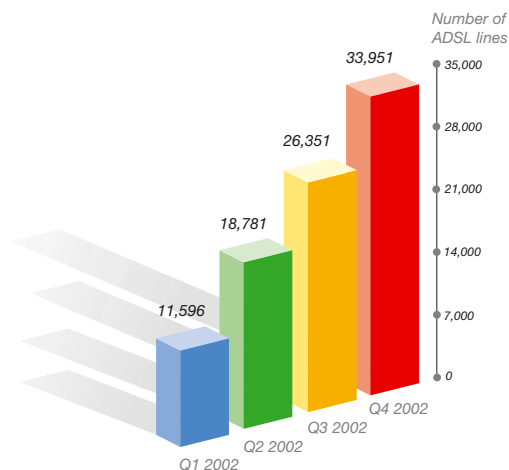
Matáv believes that the existing regulatory framework will provide the basis for long-term stability in the Hungarian telecom sector and that it will be able to maintain its position of market leadership through offering its customers a competitive and high quality service.

FIXED LINE SEGMENT: CONTROLLING COSTS, GROWING NEW SERVICES

Reported EBITDA margin of the segment was 35.8%, adversely impacted by the severance provision created for future headcount rationalization. Within the segment, generating significant cash flow, managed leased lines and Internet were the growth elements.

WITHIN THE FIXED LINE SEGMENT, MANAGED LEASED LINES AND INTERNET WERE THE GROWTH ELEMENTS

The revenues of this segment were stable, increasing by 0.8% with changes in its composition. The total number of lines decreased by 1.8% primarily driven by mobile substitution. By the end of 2002, fixed line penetration thus decreased to 38.4% from 39.1% a year earlier. These trends confirm that the company's policy of cost control has been the right response to market conditions. Matáv Group has decided on a 9% headcount reduction in 2003 and a further 3% in 2004, primarily in the fixed line segment.



Number of installed ADSL lines

On the other hand, Matáv has made use of the growth opportunities of the Internet and data transmission that can compensate for declining voice revenue. The number of managed leased lines increased by 11.7%, the growth of ISDN channels stands at 14% and the rollout of the ADSL was also a success. At the end of 2002, Matáv had approximately 50% ADSL coverage and the number of installed lines increased to nearly 34,000 from 6,200 a year ago.

FIXED LINE VOICE OPERATIONS: FULLY COMPETITIVE ENVIRONMENT

Total number of lines with ISDN channels decreased by 1.8% to 2,882,386, representing a 0.7 percentage points decrease in fixed line penetration to 38.4%. This churn-rate was apparently driven by mobile substitution of the residential customers, as well as the disconnection of low traffic payphones.

Consolidated revenues from subscriptions, connections and other charges increased by 0.6% to HUF 98.1 bn as a combined effect of decreased connections and higher subscription revenues. Subscription fees were increased in February and September, however the number of customers using the low-user package (Minimál) increased to approximately 25% of total residential lines by the end of the year.

The subscription fee for the low-user package is significantly lower compared to the ordinary packages. Total domestic traffic revenues were HUF 118.8 bn. In the effort to minimize fixed line churn, customized tariff packages offer certain discounts to encourage retention of the customer base, as it is very difficult and costly to re-acquire customers who have switched to other operators. At the same time, some packages encourage increased Minutes of Use to partially compensate for the discounts. Matáv also offers packages for clients of other local fixed line operators, covering revenue fallout due to competitors taking domestic long distance and international calls.

The abolition of the flat rate package for dial-up internet users and local calls resulted in diminishing domestic traffic minutes in the second half of 2002. Nevertheless, its revenue impact is minor and declining traffic revenue is a result of slightly diminished average domestic usage and lower international tariffs and minutes. Both outgoing and incoming international minutes decreased and settlement was impacted by the strength of the Hungarian Forint, which lowered Forint based revenues and costs. The decline of other usage is explained by the continued trend for mobile-to-international traffic to bypass Matáv's network and lower fees paid to Matáv by other domestic operators.



Matáv completed the implementation of strict cost control measures to protect cash generation and efficiency from shrinkage. Lines per fixed line employee at Matáv and its subsidiary Emitel were 313. At the same time, severance provision was created for further headcount reductions in 2003 and 2004, which hit reported segment EBITDA margin.

DATA, INTERNET AND CABLE TV: SOURCES OF GROWTH

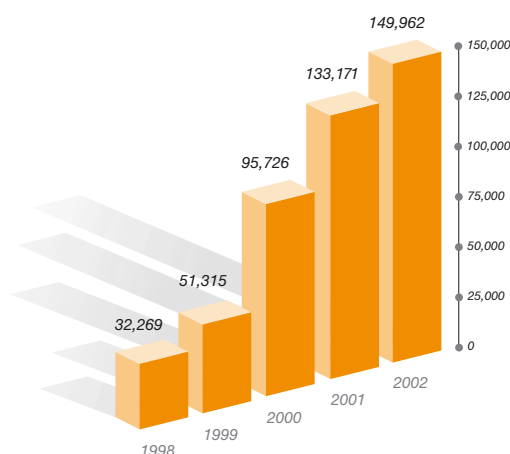
In 2002, Internet, leased lines, data transmission and cable television continued to grow, providing support for the fixed line segment. The volume of managed leased lines, Internet and cable TV subscribers expanded further.

Consolidated revenues from leased lines and data transmission amounted to HUF 34.1 bn in 2002, a 10.2% increase compared to 2001. The number of managed leased lines increased by 11.7% to 12,716, as a result of successful pricing policy in a competitive market. The rollout of wholesale ADSL services was successful, increasing the number of installed lines to almost 34,000 by the end of 2002, up from around 6,200 a year ago. The average number of Internet subscribers increased by almost 24%, with a significant increase of broadband users. Axelero holds an

IN 2002, INTERNET, LEASED LINES, DATA TRANSMISSION
AND CABLE TELEVISION CONTINUED TO GROW,
PROVIDING SUPPORT FOR THE FIXED LINE SEGMENT

estimated 43% share of the dial-up market in Hungary and is the market leader in both the residential and business segments. The Hungarian Government intends to promote the expansion of Internet use and discounted retail packages with a limited subsidy were introduced in the second half of 2002 to replace the flat rate package that was discontinued in the middle of the year. Broadband is supported by tax benefits from January 1, 2003.

Consolidated revenues from other services were up by 11.7% to HUF 51.7 bn. The main drivers of the increase were reimbursement from the Universal Telecommunications Support Fund to compensate for the low user packages for the 11 months ending December 2002, and the increase of cable television revenues.



Number of Internet subscribers

The number of cable television subscribers increased by 12.6%, reaching 338,625 at the end of 2002. Gross contribution to the Universal Telecommunications Support Fund is reported under other operating expenses.

MOBILE SEGMENT: ACTIVELY RETAINING LEADERSHIP WITH BALANCED GROWTH

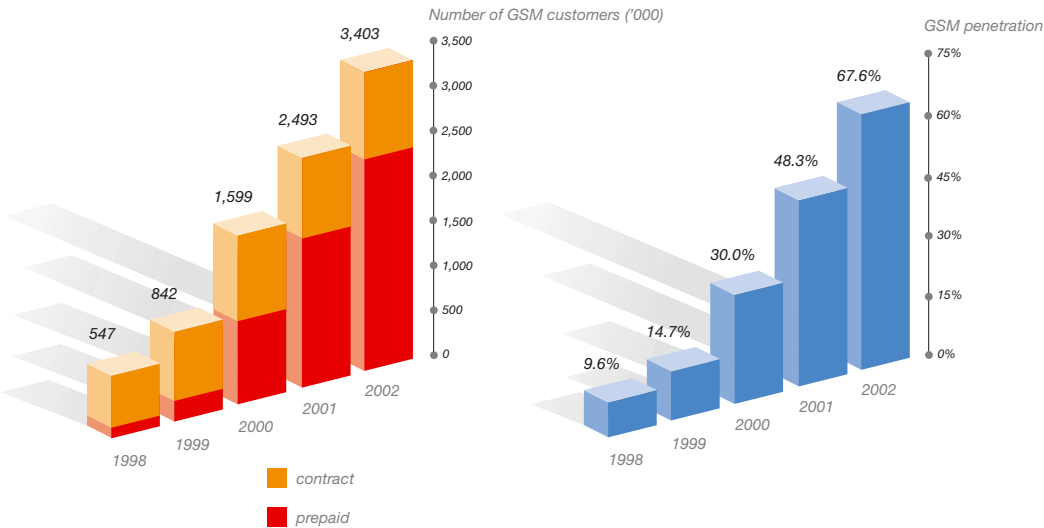
The major growth driver of the Group was the mobile segment, with 15.4% EBITDA growth and a reported 37.8% EBITDA margin. Westel's strategy in 2002 was a balanced focus on both profitability and market share. Westel actively maintained its leading position with a 49.6% GSM market share at the end of the year.

Domestic mobile penetration increased by more than 19 percentage points in 2002, reaching almost 68% at the end of 2002. Westel acquired around 47% of the net

THE MAJOR GROWTH DRIVER OF THE GROUP WAS THE MOBILE SEGMENT

increase in the number of mobile customers, thus maintaining its clear market leadership. Westel benefits from its efficient distribution network and its strong brand supported by enhanced innovations and gains from economies of scale. The leading position is reinforced by the introduction of new services, such as active mobile banking and the world's first fully-fledged commercial multimedia messaging service (MMS). MMS can also be sent to the subscribers of the second largest mobile operator, Pannon GSM, and as of March 2003 to the network of the third digital mobile operator, Vodafone. Building upon current technologies, such as general

The number of Westel customers and Hungary's GSM mobile penetration



packet radio service (GPRS), video streaming is available, well before the introduction of the third generation system. Approximately 10% of customers used WAP.

In 2002, mobile revenues before inter-segment elimination increased by 16.9%, reaching HUF 232.6 bn, and the segment has delivered 15.4% EBITDA growth. The weighted average number of Westel's GSM-subscribers increased by 45.8%. At the end of 2002, Westel had 3.4 million revenue-producing customers with prepaid customers representing approximately 75% of the total customer base, up from 67% a year ago. This trend reflects the growth of the lower income customer segment, which increases the importance of customer retention. Therefore, Westel's balanced focus on market share and profit is gradually moving towards profitability and customer loyalty. In 2002, churn rate was relatively low at 14.7%.

The increasing proportion of prepaid customers and the dilutive impact of their handset upgrade implies a downturn of the monthly minutes of use (MOU), as well as the average revenue per user (ARPU). The average minutes per subscriber decreased by 19.2% to 118 minutes, while the average revenue per subscriber declined by 17.5% to HUF 5,732 (EUR 23.6 using the 2002 average 242.97 HUF/EUR exchange rate). Partially compensating for the reduction of ARPU, the revenues from enhanced services per user increased by 35.6% to HUF 549 in 2002, representing 9.6% of the average revenue per subscriber. SMS is a very popular service that has also benefited from voting in commercial television reality shows. The other favorable trend supporting ratios is the decreased churn rate at the postpaid segment and the success of the new packages.

Efficiency requires not only cost control but also the realisation of synergies. Cooperation within the Deutsche Telekom Group supports service development as well as more favorable procurement of network elements and handsets. Average acquisition cost per subscriber (connection fee less the SIM card cost, equipment subsidy and agent fee) fell by 28.0% to HUF 13,490 as a result of keeping the entry barrier relatively high at the prepaid segment.

INTERNATIONAL SEGMENT: CONTINUING SUCCESS OF ACQUISITION STRATEGY IN MACEDONIA

Matáv's international acquisition is a real success for the second consecutive year with 12.5% revenue growth and EBITDA margin of 54.5% in 2002.

Matáv concluded its first cross-border transaction in January 2001, acquiring a controlling stake in MakTel, the Macedonian fixed line incumbent and mobile operator. MakTel has a similar organizational structure to Matáv (fixed, mobile, Internet and business solutions) and provides full-range telecommunications services for a market of 2.1 million potential customers.

Revenues from the international segment increased by 12.5% compared to 2001, reaching HUF 67.6 bn before inter-segment elimination. The fixed line customer base



grew by 8.0% to 594,213 at the end of 2002. Fixed line penetration was 28% up from 26.2% a year ago. Tariff rebalancing efforts continued, resulting in an increase in subscription fees, local and domestic long distance charges while international calls became cheaper. The favorable impact was partially offset by lower incoming international minutes and the adverse impact of the strengthening domestic currency. An important source of growth is MobiMak, the mobile subsidiary. The number of

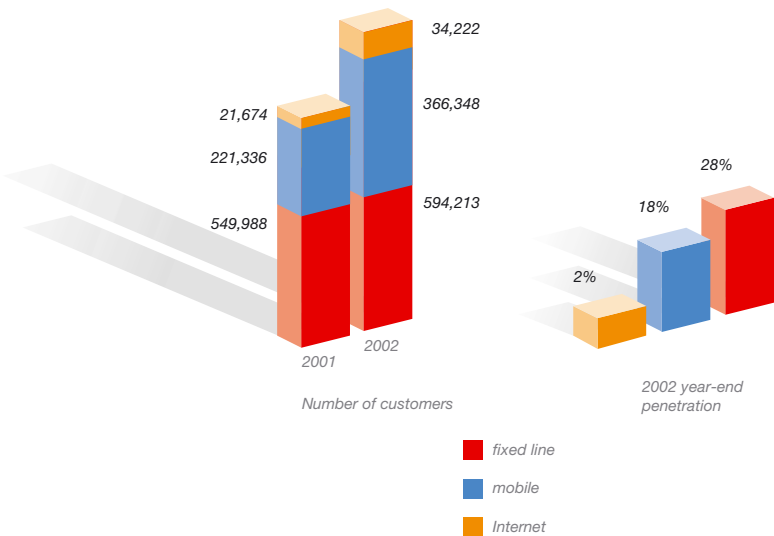
**MATÁV'S INTERNATIONAL ACQUISITION IS A REAL SUCCESS
FOR THE SECOND CONSECUTIVE YEAR**

mobile subscribers was up by 65.5% to 366,348 with penetration increasing to 17.8% at year-end 2002. Another growth driver is the Internet business, where the number of subscribers increased by 57.9% to 34,222.

Closing headcount decreased by 132 to 3,644 at MakTel. Employee related expenses, however, increased to HUF 7.8 bn as a result of higher wages, as well as early retirements. The cost of telecommunication equipment sales, marketing and agent fees increased following mobile penetration growth. EBITDA growth was 8.8% with an impressive EBITDA margin of 54.5%.

Please note that as consolidation of MakTel began at January 15, 2001, consolidation days are slightly higher in 2002. The strength of the Hungarian Forint led to lower amounts when translated into Forint compared to 2001, resulting in a negative impact on segment result.

Growth of MakTel
customer base
and penetration



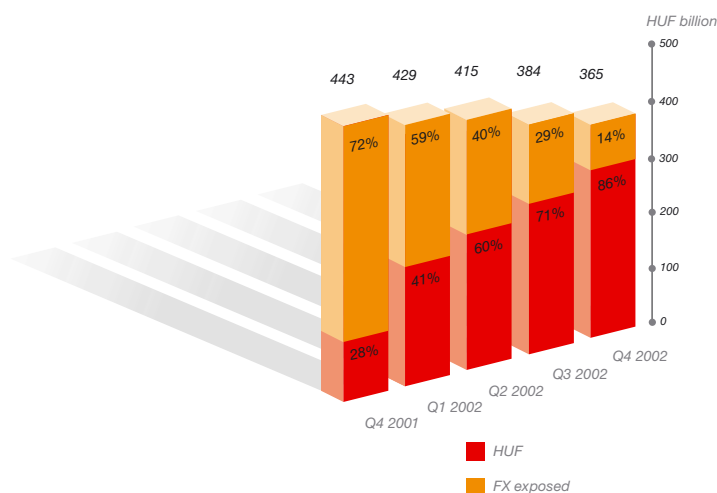
ANALYSIS OF OPERATING EXPENSES

Employee-related expenses increased by 17.5% to HUF 89.3 bn as a result of wage increases (e.g. effective April 1, 2002 at parent company, Matáv Rt.), a 3% decrease in average group headcount, as well as a HUF 8.6 bn severance provision for 2003 and 2004 headcount rationalization plans at the parent company and 2003 headcount reduction at subsidiaries. At the end of 2002, total group headcount amounted to 16,114 representing a 3.1% decrease compared to 16,633 at the end of 2001.

Depreciation and amortization amounted to HUF 122.7 bn, compared to HUF 116.6 bn in 2001 (an increase of 5.2%) due to a higher gross asset base and a HUF 4.3 bn impairment charge. The most significant elements are the impairment losses relating to the assets of the public payphone business and certain assets using 3.5 GHz technology (fixed line segment). In addition, depreciation and amortization also includes the amortization of goodwill arising from the acquisition of MakTel and Westel.

Payments to other network operators amounted to HUF 81.1 bn, compared to HUF 72.6 bn in 2001 (an increase of 11.7%). Payments to foreign service-providers decreased because of lower international traffic and favorable average settlement rates due to the strength of the Hungarian Forint. On the other hand, fixed and mobile traffic to Pannon GSM and Vodafone and international mobile roaming increased due to the higher mobile penetration.

The cost of telecommunications equipment sales was HUF 39.7 bn, compared to HUF 39.1 bn last year, representing an increase of 1.6%. Higher gross additions and upgrades at Westel and MobiMak during the year with the increase in the equipment sales ratio of Westel (the proportion of customers purchasing a handset) were partially offset by the lower average cost of mobile handsets. Lower average cost is attributable to different composition and harmonized procurement with Deutsche Telekom.



Net debt and FX exposure

Other operating expenses were HUF 135.5 bn, compared to HUF 124 bn in 2001 increasing by 9.2%. Gross contribution to the Universal Telecommunications Support Fund due from 2002 accounts for a part of this increase. However, the Matáv Group is a net beneficiary of the Fund as reimbursement due recorded among other service revenues exceeds this contribution. Major expenses increased including materials, maintenance, energy, marketing and consultancy expenses, as well as agency fees with higher than average growth covering commissions paid to agents selling new Internet and Westel subscriptions and prepaid mobile refill vouchers. On the other hand, a significant decrease of provisions for receivables compensated somewhat for the higher expenses.

Beyond operating expenses, the income tax expense increased as Westel lost its 60% tax holiday following Matáv's acquisition of Deutsche Telekom's stake at the end of 2001. Corporate tax rates are 18% and 15% in Hungary and Macedonia respectively. At the end of 2002, deferred tax assets were recognized primarily arising from previously unrecoverable losses of certain Matáv subsidiaries, decreasing reported income tax expense.

FINANCIAL CHARGES

Net interest and other charges were HUF 27.9 bn in 2002 compared to HUF 13.1 bn in 2001. Interest charges increased significantly resulting from the 28.7% higher average loan balance and different foreign exchange composition.

The major element of the average loan balance increase is the EUR 920 million loan from Deutsche Telekom at the end of 2001, for financing the acquisition of Westel's 49% stake. Matáv paid back part of this loan, therefore the net debt to total capital (net debt plus equity plus minority interest) ratio decreased to 38.8% with a net debt of HUF 364.7 bn at the end of 2002, from HUF 442.9 bn at year-end 2001.

At the same time, Matáv significantly decreased the foreign exchange risk relating to the Euro denominated loans, executing EUR/HUF cross currency swaps. Though the interest cost of Forint financing is higher, these transactions could materially reduce the exposure to foreign exchange rate volatility. As a consequence only 14% of loans were exposed to foreign exchange risk, not covered by swap agreements at the end of 2002.

FIRM CASH FLOW GENERATION

Net cash flow from operating activities reached HUF 199 bn increasing by 1.3% compared to 2001, reflecting strong cash generation of the group despite higher interest paid and increased working capital chiefly due to a fall in trade payables. This cash was used for investments and paying down debt.

Purchase of tangible and intangible assets were HUF 110 bn, including a HUF 12 bn change in capex creditors in 2002. This represents a 13.9% decrease over 2001, as a result of the reduced investment need mainly in the mature fixed line business. On the other hand, some of the savings were channeled to growth areas such as the mobile business. The significant decline of cash flows from investing activities is a result of the material financing needs of the Westel and MakTel acquisitions in 2001. This

SOLID CASH FLOW USED

FOR DISCIPLINED INVESTMENTS AND PAYING DOWN DEBT

difference is also reflected in the financing activities. In 2002, Matáv used part of the generated cash to pay back a net amount of HUF 69.4 bn in loans (including realized foreign exchange gains) acquired in 2001 and earlier. The HUF 5.0 bn issue of common stock shown in financing activities includes the capital increase of the parent company related to the new management share option program launched on July 1, 2002 and sale of treasury shares previously held at Investel. Of the newly issued shares HUF 4.5 bn was repurchased as treasury stock for the purposes of the option program. Since Matáv fully acquired Westel at the end of 2001, the total amount of any dividend paid by the mobile company has become internal cash movement that does not appear in the group's cash flow. In 2002, the amount of dividend paid therefore decreased according to the cash flow statement.

Consolidated Financial Statements

Independent Accountant's Report *to the Board of Directors of Magyar Távközlési Rt.*

We have audited the accompanying consolidated balance sheets of Magyar Távközlési Rt. ("Matáv") as of December 31, 2001 and 2002, and the related consolidated statements of income, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of Matáv's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Matáv as of December 31, 2001 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2002 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers

PricewaterhouseCoopers

Budapest

February 10, 2003

Consolidated Balance Sheets

		At December 31,		
	Notes	2001	2002	2002
		(in HUF millions)		(million USD)
				(unaudited), note 2
ASSETS				
Current Assets				
Cash and cash equivalents	4	10,117	8,851	39
Trading investments	5	327	447	2
Trade and other receivables	6	88,079	88,921	395
Inventories	7	13,297	13,063	58
Assets held for disposal		3,725	2,285	10
Total Current Assets		115,545	113,567	504
Non-current Assets				
Property, plant and equipment	8	654,298	645,087	2,865
Intangible assets	9	306,029	295,199	1,311
Associates	11	6,209	4,607	21
Other non-current investments	12	6,990	2,251	10
Deferred tax assets	24	3,816	6,619	29
Other non-current assets	13	11,309	10,121	45
Total Non-current Assets		988,651	963,884	4,281
Total Assets		1,104,196	1,077,451	4,785
LIABILITIES AND SHAREHOLDER'S EQUITY				
Current Liabilities				
Loans and other borrowings – third party	14	33,607	65,569	291
Loans from related parties	14	-	162,771	723
Trade and other payables	16	122,126	101,857	452
Deferred revenue	17	3,430	2,722	12
Provision for liabilities and charges	18	3,320	11,150	50
Total Current Liabilities		162,483	344,069	1,528
Non-current Liabilities				
Loans and other borrowings – third party	14	118,855	71,992	320
Loans from related parties	14	300,908	73,675	327
Deferred revenue	17	7,101	4,456	20
Deferred tax liability	24	1,763	2,646	12
Provision for liabilities and charges	18	-	1,040	4
Other non-current liabilities	19	4,617	3,993	18
Total Non-current Liabilities		433,244	157,802	701
Minority Interests	20	48,169	59,436	264
Shareholders' Equity				
Common stock		103,736	104,281	463
Additional paid in capital		22,955	27,382	121
Treasury stock		(163)	(4,488)	(20)
Cumulative translation adjustment		(2,420)	(4,348)	(19)
Retained earnings		336,192	393,317	1,747
Total Shareholders' Equity		460,300	516,144	2,292
Total Liabilities and Shareholders' Equity		1,104,196	1,077,451	4,785

These consolidated financial statements were accepted for the Board of Directors on February 10, 2003 and signed on their behalf by:

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

Elek Straub
Chairman and Chief Executive Officer

Dr. Klaus Hartmann
Chief Financial Officer

Consolidated Income Statements

	Notes	For the year ended December 31,			
		2000	2001	2002	2002
		(in HUF millions, except per share amounts)			(million USD) (unaudited), note 2
Revenues	21	445,945	547,735	590,585	2,623
Employee-related expenses		(66,024)	(75,962)	(89,264)	(396)
Depreciation and amortization		(94,720)	(116,622)	(122,741)	(545)
Payments to other network operators		(55,617)	(72,606)	(81,078)	(360)
Cost of telecommunications equipments sales		(34,111)	(39,101)	(39,744)	(177)
Other operating expenses	22	(99,382)	(124,044)	(135,518)	(602)
Total Operating Expenses		(349,854)	(428,335)	(468,345)	(2,080)
Operating profit		96,091	119,400	122,240	543
Net interest and other charges	23	(20,992)	(13,104)	(27,919)	(124)
Share of associates' results before income tax		2,174	1,703	691	3
Profit Before Income Tax		77,273	107,999	95,012	422
Income tax expense	24	(7,752)	(11,733)	(13,245)	(59)
Profit After Income Tax		69,521	96,266	81,767	363
Minority Interest	20	(2,869)	(13,706)	(13,639)	(60)
Net Income		66,652	82,560	68,128	303
Basic Earnings Per Share					
Weighted average number of common stock outstanding (millions)		1,037	1,037	1,038	1,038
Net income (HUF millions)		66,652	82,560	68,128	303
Basic earnings per share (HUF)		64.27	79.61	65.66	0.29
Diluted Earnings Per Share					
Weighted average number of common stock outstanding (millions)		1,037	1,037	1,038	1,038
Number of dilutive convertible bonds/share options (millions)		5	-	-	-
Weighted average number of common stock outstanding for diluted earnings per share (millions)		1,042	1,037	1,038	1,038
Net income (HUF millions)		66,652	82,560	68,128	303
Diluted earnings per share (HUF)		63.97	79.61	65.66	0.29

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

Consolidated Cash Flow Statements

		For the year ended December 31,			
Notes		2000	2001	2002	2002
		(in HUF millions)		(million USD)	
				(unaudited), note 2	
Cash Flows from Operating Activities					
Operating profit		96,091	119,400	122,240	543
Depreciation and amortization		94,720	116,622	122,741	545
Change in payables		7,728	13,978	(4,454)	(20)
Change in inventory		(1,634)	(3,450)	552	2
Change in receivables		(12,133)	(5,587)	(1,092)	(5)
Amortization of deferred revenue		(4,652)	(3,499)	(3,353)	(15)
Interest paid		(15,123)	(19,416)	(27,259)	(121)
Commissions and bank charges		(2,042)	(2,420)	(3,296)	(14)
Income tax paid		(8,150)	(13,383)	(13,234)	(59)
Other cash flows from operations		1,644	(5,700)	6,198	28
Net Cash Flows from Operating Activities		156,449	196,545	199,043	884
Cash Flows from Investing Activities					
Purchase of tangible and intangible assets	10	(152,784)	(127,747)	(109,988)	(488)
Purchase of investments		(3,568)	(1,740)	(229)	(1)
Purchase of subsidiaries	2	-	(324,813)	(13,230)	(59)
Cash aquired through business combinations	2	-	6,314	-	-
Interest received		2,067	2,141	660	3
Dividends received		1,009	779	1,437	6
Purchase of trading investments – net		(2,313)	6,417	(120)	(1)
Proceeds from disposal fixed assets		9,784	9,099	1,529	7
Net Cash Flows from Investing Activities		(145,805)	(429,550)	(119,941)	(533)
Cash Flows from Financing Activities					
Dividends paid to shareholders and minority interest		(9,411)	(18,806)	(11,437)	(51)
Proceeds from loans and other borrowings		261,870	522,464	217,429	966
Repayment of loans and other borrowings		(256,955)	(273,300)	(286,787)	(1,274)
Proceeds from issue of common stock		129	-	4,973	22
Purchase of treasury stock		(256)	(36)	(4,488)	(20)
Proceeds from sale of treasury stock		104	-	85	0
Other		587	(125)	171	1
Net Cash Flows from Financing Activities		(3,932)	230,197	(80,054)	(356)
Effect of foreign exchange rate changes on cash and cash equivalents					
		-	(371)	(314)	(1)
Change in Cash and Cash Equivalents		6,712	(3,179)	(1,266)	(6)
Cash and cash equivalents, beginning of year		6,584	13,296	10,117	45
Cash and cash equivalents, end of year		13,296	10,117	8,851	39

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

Consolidated Statements of Changes in Shareholders' Equity

	Shares of common stock	Common stock	Additional paid-in capital	Treasury stock	Cumulative translation adjustment	Retained earnings (k)	Total shareholders' equity
(in HUF millions)							
Balance at December 31, 1999	1,037,281,600	103,728	22,834	-	-	201,017	327,579
Dividend						(9,335)	(9,335)
Stock issuance (b)	77,270	8	121				129
Purchase of treasury stock (c)				(256)			(256)
Sale of treasury stock (c)				129		(25)	104
Net income as previously reported (h)						68,763	68,763
Balance at December 31, 2000	<u>1,037,358,870</u>	<u>103,736</u>	<u>22,955</u>	<u>(127)</u>	<u>-</u>	<u>260,420</u>	<u>386,984</u>
Acquisition of additional 49% interest in Westels							
Equity effect (e)						252,408	252,408
Net income effect (h)						(2,111)	(2,111)
Balance at December 31, 2000 after restatement	<u>1,037,358,870</u>	<u>103,736</u>	<u>22,955</u>	<u>(127)</u>	<u>-</u>	<u>510,717</u>	<u>637,281</u>
Effect of adopting IAS 39 (d)						501	501
Dividend						(10,373)	(10,373)
Purchase of treasury stock (c)				(36)			(36)
Cumulate translation adjustment					(2,420)		(2,420)
Acquisition of additional 49% interest in Westels							
Equity effect (g)						(247,213)	(247,213)
Net income effect (f)						7,354	7,354
Net income before the impacts of the Westel transaction						75,206	75,206
Net income reported in the income statement						82,560	
Balance at December 31, 2001	<u>1,037,358,870</u>	<u>103,736</u>	<u>22,955</u>	<u>(163)</u>	<u>(2,420)</u>	<u>336,192</u>	<u>460,300</u>
Price correction of Westel transaction (i)						485	485
Dividend						(11,410)	(11,410)
Net income						68,128	68,128
Cumulative translation adjustment					(1,928)		(1,928)
Sale of treasury stock (c)				163		(78)	85
Stock issuance (b)	552,730	55	429				484
Stock issuance (j)	4,900,000	490	3,998				4,488
Purchase of treasury stock (j)				(4,488)			(4,488)
Balance at December 31, 2002 (a)	<u>1,042,811,600</u>	<u>104,281</u>	<u>27,382</u>	<u>(4,488)</u>	<u>(4,348)</u>	<u>393,317</u>	<u>516,144</u>
Of which treasury stock	<u>4,900,000</u>						
Shares of common stock outstanding at December 31, 2002	<u>1,037,911,600</u>						

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (NOTES)

- (a) In addition to the 1,042,811,600 issued shares of common stock (nominal value of HUF 100), total shareholders' equity includes one Series "B" preference share at the nominal value of HUF 10,000 at December 31, 2002. This Series "B" share is held by the Prime Minister's Office and bestows certain rights on its owner, including access to information, and the appointment of a Director. This share may only be held by the Government or its nominee.
- (b) In June 2000, 630,000 shares of common stock of the Company were registered which were subscribed by Investel (a consolidated subsidiary of the Group). In 2000 77,270 of these shares were issued outside the Group for HUF 129 million. In 2002 the remaining 552,730 shares were issued outside the Group for HUF 484 million.
- (c) During 2000 the Company purchased 129,591 shares of its common stock and sold 54,827 shares of this common stock. These transactions resulted in a loss of HUF 25 million. During 2001 the Company purchased 21,333 shares of its common stock. In 2002 the Company sold 96,097 shares of common stock. The transaction resulted in a loss of HUF 78 million.
- (d) In 2001 the Company adopted IAS 39 "Financial instruments – Recognition and Measurement" and has recognized the cumulative effect of the change in accounting directly in equity for the derivative asset of HUF 589 million with a related deferred tax liability of HUF 88 million (see note 24).
- (e) In December 2001 the Company acquired 49 percent of the common stock of Westel and Westel 0660 ("the Westels") from Deutsche Telekom ("DT"). The Company was controlled by DT, hence this was a transaction between parties under common control. The financial statements were restated as if the Westels had been wholly owned subsidiaries of Matáv from March 23, 2000, the date when DT acquired 49% of the Westels. The consideration for the Company's acquisition of the Westels was financed by a loan from DT. Terms of the loan agreement are described in Note 14. The loan agreement was completed on December 20, 2001. The book value of the Company's additional share of net assets (including goodwill and other intangibles) of the Westels on March 23, 2000 has been presented as an increase in equity at December 31, 2000 (HUF 252,408 million). See note 2 for more details.
- (f) This reflects the amortization of goodwill and intangible assets of HUF (16,411) million (2000: HUF (16,780) million) relating to the additional 49% shareholding in the Westels, the related deferred tax of HUF 26 million (2000: HUF 456 million) and the reduction in the minority interest in the net profit of the Westels of HUF 23,739 million (2000: HUF 14,213 million).
- (g) The loan agreement with DT was completed on December 20, 2001 and the total consideration payable by the Company for the additional 49% share in the Westels was transferred from equity to liabilities. In addition, the reduction of equity included dividends paid by Westel to DT prior to the transaction.
- (h) The net income in 2000 of HUF 66,652 million as reported in the income statement comprises HUF 68,763 million as previously reported and a net income effect of HUF (2,111) million due to the acquisition of the Westels.
- (i) In March 2002, the final price for the 49% shares of Westel was reduced by HUF 485 million from the estimated amount due to the lower amount of dividend declared by Westel for the year 2001.
- (j) As a result of the new employee stock ownership program launched in 2002, the Company issued 4,900,000 shares of common stock, which were repurchased immediately. See note 25 for more details.
- (k) The distributable reserves of the Company under Hungarian law at December 31, 2001 and 2002 amounted to approximately HUF 248,000 million and HUF 260,000 million, respectively.

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

Notes to the Consolidated Financial Statements

1 Principal activities

Magyar Távközlési Rt. (the "Company" or "Matáv Rt.") with its subsidiaries form the Matáv Group ("Matáv" or "the Group"). Matáv is the principal supplier of telecommunications services in Hungary. Matáv is a full-service telecommunications provider.

The Company had exclusive rights through December 2001 to provide domestic long distance and international public telephony services throughout Hungary. Of the 54 local concession areas, the Company had exclusive rights to provide local public fixed line telephony service in 31 areas until December 23, 2001. Since that date, Matáv Rt. is subject to competition in these areas. Matáv Rt. had exclusive rights in additional five concession areas through May 2002, while its subsidiary, Emitel had exclusive rights in an additional three concession areas through November 2002. In the remaining 15 local concession areas, the concession holders had exclusive rights until December 2002, from which time Matáv can compete in these areas.

Matáv is Hungary's largest mobile telecommunications provider through its subsidiaries, Westel Mobil Távközlési Rt. ("Westel") and Westel Rádiótelefon Kft. ("Westel 0660"). In addition, Matáv provides leased lines, data transmission, corporate network, cable television, internet and sells and leases telecommunications equipment.

Matáv had 16,114 full time equivalent employees at December 31, 2002, while at the end of 2001 the number of employees was 16,633.

2 Basis of presentation

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

The consolidated financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below, and in compliance with International Financial Reporting Standards ("IFRS").

The consolidated financial statements are shown in millions of Hungarian Forints ("HUF"). For the convenience of the reader, the consolidated balance sheet, income statement and cash flow statement for the year 2002 are also presented in millions of U.S. dollars ("USD") translated at a rate of HUF 225.16 to USD 1.00 (the official rate of the National Bank of Hungary at December 31, 2002). These translations are unaudited.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reported in the financial statements and notes thereto. Actual results could differ from those estimates.

Acquisition of the remaining 49% ownership in Westel Mobil Rt. (Westel) and Westel Rádiótelefon Kft. (Westel 0660)

In March 2000, Deutsche Telekom finalised the purchase of MediaOne's interests in mobile operations in Central and Eastern Europe including MediaOne International B.V. which owned 49% of Westel and 49% of Westel 0660. At the same time the Company was granted an option to purchase the 49% holdings in Westel and Westel 0660 from Deutsche Telekom during the fifteen-month period ending September 2001. On December 21, 2001 the Company became a 100% owner of both Westel and Westel 0660. The final purchase price included HUF 226,750 million (EUR 920 million), paid in December 2001, financed by a loan from DT as described in note 14, plus HUF 11,515 million paid in 2002, equal to 49% of the amount of dividends declared by Westel for the year 2001.

The Company was controlled by DT, hence this was a transaction between parties under common control. The financial statements were restated as if the Westels were wholly owned subsidiaries of the Company from March 23, 2000, the date when DT acquired 49% of the Westels. The consideration for the Company's acquisition of the Westels was financed by a loan from DT. The terms of the loan agreement are described in note 14. The loan agreement was completed on December 20, 2001. The book value of the Company's additional share of net assets (including goodwill and other intangibles) of the Westels on March 23, 2000 were presented as an increase in equity at December 31, 2000 (HUF 252,408 million).

Below is a summary of the impact of the restatement on shareholders' equity and net income.

Equity (excluding the effect of the restatement)
Adjustment in relation to the Westel acquisition
Transfer of consideration payable to liability
As restated

At December 31,	
2000	2001
(in HUF millions)	
386,984	449,862
250,297	257,651
-	(247,213)
637,281	460,300

The increase in equity as of December 31, 2000 reflects the Company's additional share of the assets and liabilities (including goodwill and other intangibles) of Westel and Westel 0660 at March 23, 2000, which was presented as equity because the loan from DT was not completed until December 20, 2001. The decrease in equity in December 2001 reflects the loan agreement with DT, which was completed on December 20, 2001, dividends paid by Westel to DT prior to the transaction and additional consideration payable. The consideration payable by the Company was then transferred from equity to liabilities.

Net income (before the restatement)
Adjustment in relation to the Westel acquisition
As restated

At December 31,	
2000	2001
(in HUF millions)	
68,763	75,206
(2,111)	7,354
66,652	82,560

The adjustments above reflect the additional amortization of goodwill and intangible assets of HUF (16,411) million (2000: HUF (16,780) million), the related deferred tax of HUF 26 million (2000: HUF 456 million) and the reduction in the minority interest of HUF 23,738 million (2000 HUF: 14,213 million). The minority interest in Westel and Westel 0660 was eliminated and considered as part of the Group's net income both for 2000 and 2001.

The minority interest in the net income of the two companies between March 31, 2000 and December 21, 2001 was as follows:

Westel
Westel 0660

At December 31,	
2000	2001
(in HUF millions)	
13,987	23,542
226	196

Acquisition of Makedonski Telekomunikacii AD (MakTel)

In December 2000, the Company, on behalf of a consortium, reached agreement with the government of Macedonia to purchase 51 percent of MakTel on its privatization. The closing of the transaction took place on January 15, 2001 whereby the Company paid EUR 343.3 million on behalf of the consortium in accordance with the relevant agreement. The 51 percent ownership acquired by the Company was contributed on January 16, 2001 to a newly established Macedonian holding company, Stonebridge Communications AD ("Stonebridge").

In accordance with a subscription and shareholders' deed ("Deed") between the Company, SEEF Holdings Ltd. ("SEEF") and CosmoTelco Added Value Services S.A. ("CosmoTelco"), the latter two acquired a 6.1 percent and a 7.4 percent ownership respectively in Stonebridge reducing Matáv's investment in Stonebridge to EUR 301.5 million. Matáv, consequently, has an 86.5 percent stake in Stonebridge, which owns 51 percent of MakTel, thereby Matáv has an effective ownership percent in MakTel of approximately 44 percent. The total acquisition cost of the 44% effective ownership amounted to HUF 83,380 million.

The Deed provides for a put option which entitles SEEF to sell its shares to Matáv on May 15 of each of 2003, 2004 or 2005 or upon the occurrence of certain events at a price formula also set out in the Deed. The formula takes into account the purchase price paid by the consortium for the shares, the current earnings before interest, tax, depreciation and amortization (EBITDA) and the net debt of MakTel.

CosmoTelco and the Company entered into a call option agreement whereby CosmoTelco had the right to acquire additional shares in Stonebridge from Matáv such that CosmoTelco's holding could have been increased to 29 percent of the issued share capital of Stonebridge. The price for each share is based on Matáv's acquisition cost plus holding costs. Before the expiration of CosmoTelco's call option on February 8, 2002 Matáv and CosmoTelco amended the option agreement as a result of which CosmoTelco has until February 2003 to exercise its option for a 10% share in Stonebridge. Matáv paid a fee of EUR 7 million (HUF 1,715 million) in return for CosmoTelco letting the option for the remaining 11.55% share expire unexercised on February 8, 2002.

Matáv's ownership interest of 86.5% in Stonebridge equals its share of voting rights. Stonebridge's ownership interest of 51% in MakTel equals its share of voting rights.

MakTel has been a consolidated subsidiary of the Group from January 15, 2001 on the basis that Matáv controls Stonebridge through its 86.5% share of ownership and Stonebridge controls MakTel through its 51% share of ownership.

Acquisition of the remaining 50% ownership in Emitel Rt.

Matáv Rt. had been a 50% owner of Emitel since its establishment and accounted for Emitel as an associated company in its consolidated financial statements. On December 31, 2000, the Company agreed with Aphrodite BV, the owner of the other 50% stake that it would purchase the remaining shares. The change of ownership was conditional on the approval of the Minister responsible for telecommunications in Hungary as well as on the approval of the Hungarian Competition Office, which Matáv received in June 2001. The price of HUF 13,930 million was determined on the closing of the transaction on July 2, 2001, from which date Emitel has been a consolidated subsidiary of the Group.

The assets and liabilities of subsidiaries acquired in 2001 are summarized in the table below:

	Westel and Westel 0660	MakTel	Emitel
	(in HUF millions)		
Total purchase consideration	239,018	83,380	13,930
Fair value of net assets acquired	51,223	32,027	5,847
Goodwill	187,795	51,353	8,083
Fair Value of Net Assets Acquired			
Cash and cash equivalents		5,488	826
Trading investments		699	
Receivables		10,096	742
Inventory		785	96
Property, plant and equipment		74,023	10,270
Intangible assets	6,246	171	311
Associates			(3,234)
Trade and other payables	2,192	(5,768)	(1,018)
Deferred revenue			(391)
Loans and other borrowings		(19,661)	(1,265)
Net deferred tax assets	(1,124)	2,157	(490)
Minority interests	54,832	(35,963)	
Equity adjustment	(10,923)		
	<u>51,223</u>	<u>32,027</u>	<u>5,847</u>

The purchase of subsidiaries in the cash flow statement for the year ended December 31, 2002 includes the additional purchase price paid for the Westels in the amount of HUF 11,515 million, and HUF 1,715 million paid to CosmoTelco to let its option for 11.55% share in Stonebridge expire unexercised.

3 Statement of accounting policies

(a) Principles of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries over which the Company has control. Inter-company balances and transactions have been eliminated in the consolidation.

Associated companies (companies for which Matáv has significant influence but not control) and joint ventures (companies where the activity is subject to joint control based on a contractual arrangement) are accounted for in the consolidated financial statements using the equity method of accounting.

Business combinations are accounted for according to the purchase method of accounting prescribed by IAS 22 – Business combinations.

(b) Cash and cash equivalents

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

(c) Financial investments

Financial investments include securities issued by the government, the maturities of which are between three months and one year. The purchases of these investments are accounted for at the trade date.

At January 1, 2001 the Group adopted IAS 39 and classified its investments into the following categories: trading, held-to-maturity and available-for-sale. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets. Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non current assets.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale. These are included in non current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Trading and available-for-sale investments are subsequently carried at fair value, while held-to-maturity investments are carried at amortized cost. Any changes in the carrying values are accounted for in the income statement.

During the period Matáv did not hold any available-for-sale or held-to-maturity types of investments.

(d) Receivables

Receivables are stated at their recoverable amount, after accounting for any impairment losses included in other operating expenses. Recoverable amounts are estimated taking into account potential delays and defaults on payments.

Amounts due and receivable from other network operators are shown net where a right of set-off exists and the amounts are settled on a net basis.

(e) Inventories

Inventories are stated at the lower of cost or net realizable value using the historical cost method of accounting, and are valued on a weighted average basis. 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 as the normal resale value of the phone sets approximates cost.

(f) Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation, except for certain assets, which were revalued at incorporation. Cost in the case of the outside plant, comprises all expenditures including the cabling within customers' premises and interest on related loans. When assets are retired or disposed of, the cost and accumulated depreciation are removed from the accounts and any related gain or loss is recognized in the consolidated income statement. Maintenance and repairs are charged to expense when incurred.

Depreciation is calculated on a straight-line basis from the time the assets are deployed over their remaining useful lives. Matáv regularly reviews these lives for consistency with current development plans and advances in technology.

The useful lives assigned are as follows:

Buildings	10–50 years
Duct, cable and other outside plant	25–38 years
Telephone exchanges	7–15 years
Other fixed assets	3–12 years

(g) Intangible assets

Costs associated with developing internal computer software that has a probable benefit exceeding the cost beyond one year are recognized as intangible assets. Expenditures which enhance and extend the benefits of computer software programs beyond their original specifications and lives are recognized as a capital improvement and added to the original cost of the software.

Costs associated with the maintenance of existing computer software programs are expensed as incurred.

Costs associated with the acquisition of long term licenses are capitalized including any related borrowing costs. Matáv starts amortizing the acquired cellular licenses as bandwidths are made available for usage.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary/associated undertaking at the date of acquisition. Goodwill on acquisitions is reported in the balance sheet as an intangible asset and is amortized using the straight-line method over its estimated useful life.

Intangible assets are amortized over their respective economic lives. The useful lives of concessions and licenses were determined based on the terms of the underlying agreements. Such assets are stated at cost less amortization on a straight-line basis over the following periods:

Concessions and licenses	8–25 years
Software	3–5 years
Leasehold interests	6 years
Customer base and brand-name	2–10 years
Goodwill on purchase of subsidiaries	10–20 years

(h) Impairment of non current assets

Matáv regularly reviews its non current assets, including property, plant and equipment, intangible assets and associates and other long-term investments for impairment. Impairment losses are recognized as an expense for assets whose carrying value exceeds their recoverable amount. Impairment losses of tangible and intangible assets are included in the depreciation and amortization line of the income statement, while impairment losses of other non current assets are included in net interest and other charges.

(i) Leased assets**Lessor**

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

Lessee

Leases of property, plant and equipment where Matáv assumes substantially all the benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the fair value of the asset or if lower, at the estimated present value of the future minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in loans and other borrowings. The interest element of the finance charge is charged to the income statement over the lease period. The property, plant and equipment acquired under finance lease contracts are depreciated over the lease term or the useful life of the asset.

Costs in respect of operating leases are charged to the consolidated income statement on a straight-line basis over the lease term, included in other operating expenses.

(j) Financial Instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, trade creditors, leases and borrowings and other non current liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

Matáv adopted International Accounting Standards No. 39 (IAS 39), "Financial Instruments: Recognition and Measurement" on January 1, 2001. IAS 39 requires that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or a liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized in earnings unless specific hedge accounting criteria are met.

The cumulative effect of adopting IAS 39 was recognized against the retained earnings on January 1, 2001.

Matáv does not apply hedge accounting for its financial instruments, all gains and losses are recognized in the income statement. The fair value of derivative instruments is included in other non current assets and other non current liabilities in the consolidated balance sheet.

The fair value of publicly traded derivatives and trading and available-for-sale securities is based on quoted market prices at the balance sheet date. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined based on forward exchange market rates at the balance sheet date.

In assessing the fair value of non-traded derivatives and other financial instruments, the Group makes assumptions that are based on market conditions existing at each balance sheet date and estimated discounted value of future cash flows are used to determine fair value for the remaining financial instruments.

(k) Deferred revenue

A portion of fees charged to customers in Hungary upon connection to the fixed line network prior to October 15, 1997 represented contributions to the cost of network construction. The capital contribution element of such fees was deferred and is amortized to revenue over the life of the related assets. Legislation was enacted effective October 15, 1997 eliminating refunds of such fees and signaling the removal of any capital contribution element of future customer fees. Since October 1997, these connection fees and related costs are recognized in the income statement upon connection, reflecting the change in related legislation and the advanced development of the network.

(l) Revenues

Revenues for all services (note 21), shown net of VAT and discounts and after eliminated sales within the Group, are recognized when products and services are provided.

A proportion of the revenue received is paid to other operators for the use of their networks, where appropriate. These revenues and costs are stated gross in these consolidated financial statements.

Revenues earned from connecting subscribers to the mobile network are recognized upon service activation. Revenue and costs from sale of telephone sets is recognized upon delivery.

Revenues from sale of public phone cards, prepaid mobile cards and prepaid Internet cards are recognized when used by the customers or when expire with unused units.

(m) Operating expenses

Research and development as well as marketing costs are expensed as incurred.

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

(n) Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into the local currency (HUF or MKD) at the exchange rates at the balance sheet date and any unrealized exchange gains and losses are recognized immediately. Gains and losses that arise on foreign currency transactions and financing activities are included under net interest and other charges.

For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date were incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at that date. The fair value adjustments resulting from the purchase price allocation and goodwill is accounted for in HUF.

As the majority of the revenues and expenses of the Macedonian subsidiaries arise in MKD, the measurement currency of these entities is MKD. At year-end the assets and liabilities of the foreign subsidiaries are translated into HUF using the exchange rates prevailing on the balance sheet date. The income statements of the foreign subsidiaries are translated into HUF using the average rate of exchange during the year. The translation difference arising on consolidation is booked against the cumulative translation adjustment in shareholders' equity.

(o) Loans and other borrowings

Borrowings are recognized initially at the proceeds received, net of transaction costs. In subsequent periods they are stated at amortized costs. Any difference between the proceeds and the redemption value is recognized in the income statement over the period of the borrowings.

Borrowing costs are recognized as an expense as incurred net of amounts capitalized. Interest on general borrowings is capitalized as part of the cost of the relevant fixed asset, up to the date of commissioning and is then amortized over the period the asset is depreciated. The rate used to determine the amount of borrowing costs eligible for capitalization is defined as the ratio of equity to debt financing, where debt excludes short term borrowings and loans related to financing of acquisitions.

(p) Income tax

Deferred tax is recognized, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used to determine deferred income tax.

The principal temporary differences arise from depreciation on property, plant and equipment, intangible assets, deferred revenue, impairment of receivables and inventory, provisions for liabilities and charges, government loans and tax losses carried forward.

(q) Pensions and other post-retirement benefits

Matáv had provided post-retirement meal and other benefits to their retirees. Under IAS 19 the expected costs of these benefits were accrued over the period of employment using a single actuarial method not tied to the funding of the plan. The valuation of these obligations had been carried out using the projected unit cost method. During 2000 Matáv terminated the provision of such benefits to its former employees, which resulted in the reversal of the accumulated provision to employee related expenses.

Payments to defined contribution pension plans are recognized as expense in the period in which they become due. Payments amounted to HUF 1,850 million, HUF 2,082 million and HUF 2,218 million for the years ended December 31, 2000, 2001 and 2002, respectively.

(r) **Equity compensation plans**

These financial statements do not include any compensation expenses related to equity compensation plans.

(s) **Earnings per share**

Basic earnings per share is calculated by dividing income for the period by the weighted average number of common stocks outstanding, while diluted earnings per share is calculated considering the weighted average number of dilutive convertible bonds and share options in addition to the number of common stocks outstanding.

(t) **Comparative information**

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

4 Cash and cash equivalents

Cash and cash equivalents held by the Hungarian members of the Group are primarily denominated in Hungarian Forint and concentrations of credit risk are limited as Matáv places its cash with substantial credit institutions. Cash and cash equivalents held by the Macedonian subsidiaries are denominated in Macedonian Denars, Euros and in U.S. dollars.

5 Trading investments

Financial investments consist of treasury instruments with maturities of three to twelve months, held for trading purposes.

6 Receivables

	At December 31,	
	2001	2002
	(in HUF millions)	
Domestic trade receivables	74,936	68,181
Foreign trade receivables	22,330	21,254
Receivables from related parties	644	1,731
Advances paid for current assets	480	444
Receivables from associates	668	420
Taxes receivable	6,277	3,945
Other receivables	3,429	4,759
Other prepayments and accrued income	1,960	8,686
	<u>110,724</u>	<u>109,420</u>
Less impairment loss	<u>(22,645)</u>	<u>(20,499)</u>
	<u>88,079</u>	<u>88,921</u>

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

The allowance for impairment loss and changes therein for 2001 and 2002 are as follows:

Impairment loss, beginning of period
Change in the composition of the Group
Charged to expense
Utilized
Impairment loss, end of period

At December 31,	
2001	2002
(in HUF millions)	
(18,469)	(22,645)
(3,338)	-
(6,462)	(4,972)
5,624	7,118
<u>(22,645)</u>	<u>(20,499)</u>

7 Inventories

Cables, wires and other inventory
Inventory for resale
Subtotal
Less allowances for obsolete inventory

At December 31,	
2001	2002
(in HUF millions)	
5,573	5,917
10,483	9,682
16,056	15,599
(2,759)	(2,536)
<u>13,297</u>	<u>13,063</u>

8 Property, plant and equipment

Land	Buildings	Duct, cable and other outside plant	Telephone-exchanges	Other	Capital work in progress	Total
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Cost

(in HUF millions)						
January 1, 2002	4,112	105,506	255,077	494,231	111,801	999,107
Change in the composition of the Group	3	18	1,972	3	582	2,718
Additions	381	5,663	11,590	59,404	15,430	84,906
Disposals			(3,125)	(15,767)	(5,788)	(24,955)
Translation adjustment	(1)	(637)	(1,456)	(2,362)	(577)	(5,185)
Reclassifications from assets held for disposal		812				812
Other reclassifications				7,016	(7,016)	0
December 31, 2002	<u>4,495</u>	<u>111,362</u>	<u>264,058</u>	<u>542,525</u>	<u>114,432</u>	<u>1,057,403</u>

Depreciation

January 1, 2002		16,969	62,873	200,867	64,100	344,809
Change in the composition of the Group		1	326		129	456
Charge for the year		3,138	10,804	59,255	17,323	90,520
Impairment losses		503		2,347		2,850
Disposals			(3,104)	(15,737)	(5,773)	(24,614)
Translation adjustment		(146)	(514)	(760)	(285)	(1,705)
Reclassifications				3,687	(3,687)	0
December 31, 2002		<u>20,465</u>	<u>70,385</u>	<u>249,659</u>	<u>71,807</u>	<u>412,316</u>

Net book value

December 31, 2002	<u>4,495</u>	<u>90,897</u>	<u>193,673</u>	<u>292,866</u>	<u>42,625</u>	<u>645,087</u>
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Net book value

December 31, 2001	<u>4,112</u>	<u>88,537</u>	<u>192,204</u>	<u>293,364</u>	<u>47,701</u>	<u>654,298</u>
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Change in the composition of the Group includes the assets of the companies that became consolidated subsidiaries at January 1, 2002. See note 11 for more details.

Additions to capital work in progress are shown net of transfers to assets in service.

Impairment losses charged in 2002 relate to the public payphone assets and certain assets using 3.5 GHz technology (fixed line segment), accounted for due to changes in market conditions. The recoverable amount, determined at the cash generating unit level, represents the value in use determined using discounted cash flow analysis.

Impairment losses charged in 2001 in an amount of HUF 1,843 million mostly related to analog cellular (mobile segment) and security monitoring equipment (fixed line segment).

Included in telephone exchanges at 31 December 2002 are assets subject to finance leases with a gross book value of HUF 1,476 million and net book value of HUF 365 million.

Included in telephone exchanges at 31 December 2002 are assets leased under operating lease contracts to customers with a gross book value of HUF 11,183 million and net book value of HUF 6,561 million. Depreciation for the year of these assets amounted to HUF 1,237 million.

As of January 1, 2002, the Company revised and changed the useful lives of certain tangible fixed assets considering their technical obsolescence (eg. network, servers, routers). This change resulted in additional planned depreciation in an amount of HUF 4,202 million.

9 Intangible assets	Concession costs and licenses	Software	Leasehold interest	Brand name	Goodwill	Total
(in HUF millions)						
Cost						
January 1, 2002	21,450	51,989	6,669	7,546	280,804	368,458
Change in the composition of the Group		17	422		4,941	5,380
Additions	(1,212)	13,631	614			13,033
Disposals		(2,833)	(652)			(3,485)
Translation adjustment	(28)	(284)				(312)
December 31, 2002	20,210	62,520	7,053	7,546	285,745	383,074
Amortization						
January 1, 2002	3,983	24,779	3,423	1,321	28,923	62,429
Change in the composition of the Group		9	36			45
Charge for the year	1,060	11,510	762	755	13,428	27,515
Impairment losses	520				916	1,436
Disposals		(2,831)	(653)			(3,484)
Translation adjustment	(10)	(56)				(66)
December 31, 2002	5,553	33,411	3,568	2,076	43,267	87,875
Net book value						
December 31, 2002	14,657	29,109	3,485	5,470	242,478	295,199
Net book value						
December 31, 2001	17,467	27,210	3,246	6,225	251,881	306,029

Change in the composition of the Group includes the assets of the companies that became consolidated subsidiaries at January 1, 2002. See note 11 for more details.

The negative addition in the Concession costs and licenses represent the reversal of the unrealized portion of borrowing costs capitalized in prior years related to license fees payable in foreign currency.

The amortization expense of intangible assets including goodwill is accounted for in the Depreciation and amortization line of the Income statement.

Impairment losses charged in 2002 relate to the 3.5 GHz license (fixed line segment), accounted for due to changes in market conditions. The recoverable amount represents the value in use determined using discounted cash flow analysis. The impairment losses on goodwill relate to investments in various subsidiaries of the fixed line segment (HUF 491 million in 2001).

Impairment losses charged in 2001 for software in an amount of HUF 468 million related to the analog cellular activity.

10 Purchase of tangible and intangible assets

Additions to property, plant and equipment
Additions to intangible assets
Total capital expenditure
Change in payables relating to capital expenditures

For the year ended December 31,		
2000	2001	2002
(in HUF millions)		
132,385	101,725	84,906
26,598	15,817	13,033
158,983	117,542	97,939
(6,199)	10,205	12,049
152,784	127,747	109,988

11 Associates

Opening balance of associates
Additions to associates
Share of associates' profit before tax
Share of associates' corporate tax
Dividend payments
Disposals
Associates becoming subsidiaries
Closing balance of associates

For the year ended December 31,	
2001	2002
(in HUF million)	
8,438	6,209
300	80
1,703	691
(51)	(136)
(779)	(1,437)
(168)	-
(3,234)	(800)
6,209	4,607

Certain companies included in the opening balance of associates are consolidated subsidiaries in 2002 as they fall under the scope of SIC 33 – Consolidation and Equity Method – Potential Voting Rights and Allocation of Ownership Interests (effective January 1, 2002).

12 Other non current investments

Other non current investments

At December 31,	
2001	2002
(in HUF millions)	
6,990	2,251

Other non current investments at December 31, 2002 include loans given to third parties classified as originated loans under IAS 39, while the balance at December 31, 2001 included loans receivable from both third parties and associates.

Other non current investments decreased as a result of change in the consolidation method described in note 11 as loans receivable from the affected associated companies are eliminated on consolidation in 2002.

13 Other non current assets

Derivatives
Prepayments falling due after 1 year
Other non current assets

At December 31,	
2001	2002
(in HUF millions)	
2,671	1,001
4,978	6,103
3,660	3,017
11,309	10,121

Derivatives include the fair value of the cross-currency interest rate swaps related to the USD loans disclosed in note 15.

14 Loans and other borrowings

	Notes	At December 31,	
		2001	2002
		(in HUF millions)	
Bank loans	(a)	127,063	112,798
Bonds	(b)	23,217	23,207
Finance leases		888	552
Other		1,294	1,004
Loans and other borrowings – third party		152,462	137,561
Loans from related parties	(c)	300,908	236,446
Total loans and other borrowings		453,370	374,007

At December 31, 2002, principal repayments fall due in:

Year	Maturity at December 31,	
	2001	2002
	(in HUF millions)	
2002	33,607	-
2003	279,612	228,340
2004	40,451	40,660
2005	10,264	15,733
2006	77,858	76,576
2007	3,003	5,225
Thereafter	8,575	7,473
Total loans and other borrowings	453,370	374,007

The effective borrowing costs (total interest payable and other charges) for Matáv's loans and borrowings were 12.7%, 7.5% and 6.96% for the years ended 2000, 2001 and 2002, respectively. The weighted average interest rate on borrowings (denominated in Hungarian Forints and foreign currencies) was 6.88% in 2000, 9.61% in 2001 and 5.39% in 2002.

(a) Bank loans

Bank loans analyzed by currency are as follows:

	At December 31,	
	2001	2002
	(in HUF millions)	
HUF	88,155	94,966
EUR	17,888	9,726
USD	21,020	8,106
	127,063	112,798

Bank loans denominated in HUF in an amount of HUF 76,166 million at December 31, 2002 were subject to variable interest rates. Variable rate loans raised in Hungarian Forint are subject to interest rates between 8.36% and 10.25% and are based on various rates, including BUBOR (Budapest Inter-bank Offered Rate), yield of treasury bills. Bank loans of HUF 18,800 million are subject to fixed interest rates ranging from 9.15% to 11.75%.

All foreign currency bank loans are subject to fixed interest rates, ranging between 5.99% and 7.65%.

The bank loans have maturities ranging from 2003 to 2011.

Included in bank loans are loans from the European Investment Bank totaling HUF 38,489 million and HUF 30,332 million at December 31, 2001 and 2002, respectively. The majority of these loans are taken in foreign currency, which are subject to interest rates of between 5.99 % and 7.65%. These loans are amortizing loans with repayments falling due every year through 2011.

Included in bank loans is a USD denominated loan amounting to HUF 3,984 million that is subject to interest based on a fixed rate of 7.05%. This loan is subject to a cross-currency interest rate swap arrangement, which is described in note 15.

Included in bank loans is a USD denominated loan amounting to HUF 4,122 million that is subject to interest based on a fixed rate of 6.56%.

This loan is subject to a cross currency swap agreement, which is described in note 15.

Loans totaling HUF 27,550 million and HUF 31,791 million at December 31, 2001 and 2002 are roll-over loans which can be prepaid at any time and may be drawn down in one to six month rolling periods. However, the facility under which the loans are provided has final repayment dates falling due after one year and are, therefore, classified as long-term.

Certain loan agreements contain covenant restrictions that require the maintenance of pre-defined financial ratios. Breach of those covenants would make HUF 54,882 million due and payable in 30 days if not remedied. At December 31, 2002 the Company was in compliance with these covenants. One of the covenants allows a debt to EBITD (earnings before interest, tax and depreciation) ratio of maximum 2.5 and 3.0 (in the different agreements), while the actual ratio was 1.53. The other covenant requires the maintenance of an EBITD to interest expense ratio of minimum 2.0, while the actual ratio was 8.8.

(b) Bonds

On March 24, 1998, the Company issued five-year bonds with a total amount of HUF 10 billion with interest payable semi-annually at an interest rate of 50 basis points over the average yield of the last three auctions of 6-month Hungarian Treasury Bills.

On June 22, 2000 Matáv launched a HUF 45 billion bond program. This program allows Matáv to issue fixed, floating or zero coupon bonds with maturities of between 1 and 10 years. On July 12, 2000, Matáv issued a three-year, fixed rate tranche in the nominal amount of HUF 10 billion. The bonds were sold at an average price 51 basis points over the 3-year Hungarian Treasury Bills. On March 21, 2001 Matáv issued 2.5-year fixed rate 9.25% bonds in the nominal amount of HUF 3 billion. The bonds were sold at an average price 74 basis points over the 3-year Hungarian Treasury Bills.

(c) Loans from related parties

Included in loans from related parties is a HUF denominated loan in an amount of HUF 73,675 million received from Deutsche Telekom Finance B.V. The loan is subject to fixed 9.36% interest rate, repayable in one amount on January 31, 2006. Interest payments are due semi-annually.

Included in loans from related parties is a EUR denominated loan in an amount of HUF 162,771 million (EUR 690 million) received from Deutsche Telekom Finance B.V. The loan is based on a variable rate of EURIBOR+50 basis points and repayable in one amount on August 14, 2003. Interest payments are due quarterly. EUR 525 million of the loan is subject to various cross-currency interest rate swap agreements (note 15).

(d) Credit facilities and pledges

At December 31, 2002, Matáv had undrawn committed credit facilities of HUF 14,227 million. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin depending on the currency and institution providing the facilities. There are pledges on receivables for loans totaling HUF 1,004 million.

15 Quantitative and Qualitative Information about Financial Instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, trade payables, leases and borrowings. Matáv is also a party to financial instruments that reduce exposure to fluctuations in foreign currency exchange.

Matáv is exposed to interest and foreign exchange rate risk associated with its debt and anticipated transactions. Matáv has no significant concentrations of credit risk. As the vast majority of the revenues and expenses of the Hungarian entities arise in Hungarian Forints, the measurement currency of Matáv is HUF, therefore Matáv's objective is to minimize the level of its financial risk in HUF terms.

Matáv is exposed to financial market risk through interest rate fluctuations. This is due to the fact that changing EUR and HUF interest rates affect the fair value of fixed rate debts and also affect the cash outflow through the variable rate debts. To control interest rate risk, a combination of fixed and floating rate debt is used within the foreign currency and HUF portfolios. Since in 2002 the majority of the debt portfolio was transformed or swapped to HUF, the interest targets are mainly related to the HUF debt portfolio. Before 2002 the floating rate elements dominated in the HUF portfolio due to decreasing HUF interest rates.

Matáv is exposed to foreign exchange risk related to foreign currency debt and foreign exchange payments (ie. international third party telecommunications carriers and capital expenditure). To reduce foreign exchange risk, Matáv targeted to increase the proportion of its borrowings in Hungarian Forint. Matáv's foreign exchange debt portfolio is denominated in, or swapped to, Euro after MakTel prepaid its USD denominated debt in 2002. The National Bank of Hungary lifted the devaluation of the Hungarian Forint against the Euro in October 2001 after widening the intervention band from +/-2.25% to +/-15% as of May 4, 2001. The introduction of this new foreign exchange regulation increased the foreign exchange risk of the Group significantly.

In 2000 and 2001 and 2002 Matáv occasionally entered into derivative contracts for risk reduction purposes. These foreign currency forward contracts and swap arrangements were taken to reduce the exchange rate risk related to the debt portfolio and/or the foreign exchange denominated payment obligations.

Derivative instruments are limited to foreign currency forward contracts and swap agreements that are recognized at cost in the financial statements on inception. As of December 31, 2002, Matáv had no open foreign currency forward positions.

Included in bank loans is a USD denominated loan amounting to HUF 3,984 million that is subject to interest based on a fixed rate of 7.05%. This loan is subject to a cross currency interest rate swap arrangement which entitles Matáv to receive USD interest and principal payments at fixed rates, and obliges it to pay EUR interest and principal repayments at floating rates of the EURIBOR rate plus a margin of 0.66%. The EUR principal payments are fixed at a rate of 1 EUR = 1.0777 USD. The timing and amount of the USD payments to be received exactly match the underlying payment obligations on the USD loan. This is an amortizing loan with semi-annual repayments with a final maturity in 2011. In 2000 Matáv accounted for interest and foreign exchange movements on these loans at the EUR rate.

Included in bank loans is a USD denominated loan amounting to HUF 4,122 million that is subject to interest based on a fixed rate of 6.56%. This loan is subject to a cross currency swap agreement. This swap agreement entitles Matáv to receive USD interest and principal payments at fixed rates, and obliges it to pay EUR interest and principal payments at fixed rates of 5.17%. EUR principal payments are determined according to the EUR equivalent of the USD principal payments at a rate of 1.0277 USD/EUR. The timing and amount of the USD payments received exactly match the underlying payment obligations of the USD loans. This is an amortizing loan with semi-annual repayments with a final maturity in 2011. In 2000 Matáv accounted for interest and foreign exchange movements on these loans at the EUR rate.

From 2001 the two loans described above are accounted for as USD loans, while the fair value of the swap agreements is accounted for separately as derivative assets and is disclosed in other non current assets.

For the acquisition of a 44% stake in MakTel, Matáv received a loan of EUR 301.5 million (HUF 79,985 million) from Deutsche Telekom Finance B.V. on January 15, 2001. The loan was based on a variable rate of EURIBOR+30 basis points and repayable in one amount on January 31, 2006. Interest payments are due semi-annually.

Matáv has entered into a swap agreement on February 4, 2002 in order to exchange the cash flows of the EUR 301.5 million loan to HUF cash flows. The counter-party in the transaction was Deutsche Telekom AG. The cross currency swap agreement entitles Matáv to receive EUR interest and principal payments and pay HUF interest and principal payments. The EUR loan was subject to floating rate interest based on 6 month EURIBOR plus a margin of 30 basis points, while under the swap Matáv was obliged to pay an interest based on 6 month BUBOR plus a margin of 34 basis points. The HUF principal payment was fixed at a rate of 1 EUR to 244.36 HUF (HUF 73,675 million). The timing and the amount of the EUR payments to be received under the swap were matched with the underlying payment obligations on the EUR loan.

As of November 4, 2002, the loan and the swap agreement were replaced with a new fixed 9.36% interest HUF loan of HUF 73,675 million, leaving the repayment terms unchanged.

For the acquisition of the remaining 49% stake in Westel, Matáv received a loan of EUR 920 million (HUF 226,750 million) from Deutsche Telekom Finance B.V. on December 20, 2001. The loan is based on a variable rate of EURIBOR+50 basis points and repayable in one amount on August 14, 2003. Interest payments are due quarterly.

In 2002 Matáv concluded four swap agreements in order to exchange some of the cash flows related to the above mentioned EUR loan to HUF cash flows. The counter-party in the transaction is Deutsche Telekom AG. The cross currency swap agreement entitles Matáv to receive EUR interest subject to 3 month EURIBOR plus a margin of 50 basis points and EUR 525 million principal amount, while Matáv has the obligation to pay HUF interest subject to 3 month BUBOR plus a margin of 50-57 basis points and HUF 126,644 million principal amount. The timing of the EUR payments to be received under the swaps are matched with the timing of the EUR payment obligations relating to the original EUR loan.

In 2002 EUR 230 million was repaid of the portion of the loan for which no swap agreements were in place. As a result of the early repayments, the balance of the loan as of December 31, 2002 is EUR 690 million (HUF 162,771 million), of which EUR 165 million is not covered with swap agreements.

The loan described above is accounted for as a EUR loan, while the fair value of the swap agreements is accounted for separately as a derivative liability and is disclosed in other non current liabilities.

The financial asset portfolio is relatively small compared to the debt portfolio of Matáv and mainly includes bank deposits.

As of December 31, 2002, Matáv's cash and cash equivalent's balance included HUF denominated cash equivalent instruments in an amount of HUF 1,761 million at an average interest rate of 1.97%, MKD denominated cash balance in an amount of HUF 6,689 at an average interest rate of 5.82% and other foreign exchange denominated instruments at an amount of HUF 401 million with an average interest rate of 1.43%.

The net carrying amounts of financial assets including cash, investments, receivables and payables and finance lease obligations reflect reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

The following table is a summary of Matáv's market sensitive debt instruments, including fair value calculated using the discounted cash flow method. Average rates disclosed represent the weighted average rates of fixed rate and variable rate portfolios at period end. The book values of variable rate loans and borrowings approximate their fair values as shown below at December 31, 2002.

	Maturities							
	2003	2004	2005	2006	2007	after 2007	Total	Fair value
	(in HUF millions, except percentages)							
Bank loans (HUF denominated)								
Fixed rate	6,300	12,500	-	-	-	-	18,800	19,437
Average interest rate	9.31%	11.75%					10.93%	
Variable rate	33,408	25,634	13,375	625	3,124	-	76,166	76,166
Average interest rate	9.18%	9.25%	9.46%	10.25%	9.88%		9.29%	
Total	39,708	38,134	13,375	625	3,124	0	94,966	95,603
Bank loans (foreign currency denominated)								
Fixed rate	2,098	2,098	2,098	2,098	2,098	7,342	17,832	19,963
Average interest rate	6.92%	6.92%	6.92%	6.92%	6.92%	6.92%	6.92%	
Total	2,098	2,098	2,098	2,098	2,098	7,342	17,832	19,963
Total bank loans	41,806	40,232	15,473	2,723	5,222	7,342	112,798	115,566
Bonds (HUF denominated)								
Fixed rate	13,076	-	-	-	-	131	13,207	13,246
Average interest rate	9.20%					0.00%	9.11%	
Variable rate	10,000	-	-	-	-	-	10,000	10,000
Average interest rate	10.28%						10.28%	
Total	23,076	0	0	0	0	131	23,207	23,246

16 Trade and other payables

	At December 31,	
	2001	2002
(in HUF millions)		
Domestic trade payables	47,832	38,285
Foreign trade payables	11,409	8,854
Amounts owed to related parties	12,859	1,406
Taxation and social security	12,661	8,384
Accrued expenses and prepayments	19,830	21,947
Amounts received in advance	1,460	7,000
Salaries and wages	9,462	7,378
Payables to associates	87	230
Dividends payable to minority interest holders	63	8
Other payables	6,463	8,365
	122,126	101,857

Amounts owed to related parties at December 31, 2001 included an expected amount of HUF 12,000 million as additional purchase price payable to MediaOne for the acquisition of the Westels (note 2). The final amount paid in 2002 was HUF 11,515 million, while the remaining HUF 485 million was released to equity.

17 Deferred revenue

	At December 31,	
	2001	2002
	(in HUF millions)	
Beginning of period	13,639	10,531
Change in the composition of the Group	391	-
Amortization	(3,499)	(3,353)
End of period	<u>10,531</u>	<u>7,178</u>
Amount to be recognized within one year	<u>3,430</u>	<u>2,722</u>

18 Provision for liabilities and charges

	Severance	Customer loyalty programs	Other	Total
	(in HUF millions)			
January 1, 2002	540	2,293	487	3,320
Amounts used	(540)	(2,090)	(487)	(3,117)
Additions	<u>8,623</u>	<u>2,333</u>	<u>1,031</u>	<u>11,987</u>
December 31, 2002	<u>8,623</u>	<u>2,536</u>	<u>1,031</u>	<u>12,190</u>

The provision for severance relates to the employee termination benefit payable in 2003 and 2004 in accordance with the agreement made with employee representatives. The amount of HUF 1,040 million payable in 2004 is included in provisions for liabilities and charges under non current liabilities.

Provision for customer loyalty programs includes the fair value of discount credits earned by customers that have not been utilized.

Other provisions include liabilities deriving mainly from legal cases and guarantee obligations.

19 Other non current liabilities

	At December 31,	
	2001	2002
	(in HUF millions)	
Long term concession payable	4,428	-
Derivatives	-	3,993
Other	<u>189</u>	<u>-</u>
	<u>4,617</u>	<u>3,993</u>

Derivatives include the fair value of the swap agreements concluded with Deutsche Telekom AG related to the loans received from Deutsche Telekom Finance B.V. See note 15 for more details.

20 Minority interests

In cases where subsidiaries are not wholly owned by the Group, the consolidated balance sheets and income statements reflect the share of investment and results held by third parties.

	For the year ended December 31,		
	2000	2001	2002
	(in HUF millions)		
Beginning of period	23,012	1,228	48,169
Acquisition of minority interest in Westel and Westel 0660	(25,290)	-	-
Acquisition of Maktel	-	35,963	-
Share of results for the year	2,869	13,706	13,639
Dividends paid/payable to minority shareholders	(143)	(58)	(56)
Other movement in capital contributed by minority interest	780	396	128
Cumulative translation adjustment	-	(3,066)	(2,444)
End of period	<u>1,228</u>	<u>48,169</u>	<u>59,436</u>

The balance of minority interest at December 31, 2002 includes an amount of HUF 1,275 million (2001: HUF 2,100 million) in relation to the call option of CosmoTelco representing the loss to Matáv had CosmoTelco exercised its option for the 10% interest in Stonebridge at December 31, 2002 (see note 2).

21 Revenues

Domestic fixed line telecommunications services:

Subscriptions, connections and other charges	
Domestic traffic revenue	
Other usage	

International traffic revenues

Mobile telecommunications services

Revenue from international activities

Leased lines and data transmission

Other services

For the year ended December 31,		
2000	2001	2002
(in HUF millions)		
83,691	97,487	98,050
129,517	123,366	118,812
19,136	17,254	15,024
39,008	32,212	27,076
108,885	140,234	178,492
-	59,977	67,330
26,111	30,977	34,142
39,597	46,228	51,659
<u>445,945</u>	<u>547,735</u>	<u>590,585</u>

Revenue from international activities includes the total consolidated revenues of MakTel.

Included in other services is HUF 6,061 million of subsidies from the Universal Telecommunication Support Fund that is meant to compensate for the maintenance of low usage discount packages provided by the fixed line telecom service providers of the Group. Contributions payable to the Fund are shown as part of fees and levies in other operating expenses (see below), in an amount of HUF 5,064 million.

22 Other operating expenses

Materials, maintenance and service fees

Subcontractors and agent commissions

Fees and levies

Marketing

Consulting

Rental fees

Other expenses

For the year ended December 31,		
2000	2001	2002
(in HUF millions)		
38,946	53,946	57,538
12,277	11,514	18,098
11,901	15,921	24,014
10,348	13,360	13,514
6,775	6,736	7,483
4,192	5,667	6,348
14,943	16,900	8,523
<u>99,382</u>	<u>124,044</u>	<u>135,518</u>

The remuneration of the Company's Directors amounted to 7 million in 2002 (HUF 7 million in 2001, HUF 13 million in 2000). The remuneration of the members of the Company's Supervisory Board amounted to HUF 7 million in 2002 (HUF 7 million in 2001, HUF 7 million in 2000).

23 Net interest and other charges

Interest expense:

Hungarian Forint

Foreign currency

(Gains)/losses on swap agreements

Net foreign exchange losses/(gains)

Bank charges and other financial expenses

Total interest expense and other charges

Interest capitalized

Interest and other financial income

For the year ended December 31,		
2000	2001	2002
(in HUF millions)		
11,490	11,592	14,173
5,318	9,149	12,459
-	(582)	9,435
4,835	(6,930)	(10,948)
2,042	2,420	3,686
<u>23,685</u>	<u>15,649</u>	<u>28,805</u>
(626)	(404)	(226)
<u>(2,067)</u>	<u>(2,141)</u>	<u>(660)</u>
<u>20,992</u>	<u>13,104</u>	<u>27,919</u>

24 Income tax

Income tax charge on the profit for the year
Deferred income taxes
Income tax on the Group's share of the results of associates
Income tax expense

For the year ended December 31,		
2000	2001	2002
(in HUF millions)		
(8,625)	(9,464)	(15,113)
1,102	(2,218)	2,004
(229)	(51)	(136)
<u>(7,752)</u>	<u>(11,733)</u>	<u>(13,245)</u>

The Company and the Westels qualified for a reduction in income tax payable on meeting certain conditions. The reduction in the tax payable amounted to a 100% allowance for five years from the date of qualification, and a 60% allowance for a further five years. Through 1998, Matáv Rt. and Westel qualified for the 100% allowance. Through 1995, Westel 0660 utilized the 100% allowance. From January 1, 1999, Matáv Rt. has been utilizing the reduced allowance of 60%, for a maximum possible five years (effective tax rate of 7.2%). Westel 0660 utilized the reduced allowance of 60% until December 31, 1999.

Management believes that the conditions underlying the reduction in income tax will continue to be met by Matáv Rt. As result of Matáv's acquisition of the remaining 49% of Westel, foreign ownership fell below 30%, hence Westel lost its 60% reduction in income tax as of December 21, 2001. This resulted in a deferred tax credit of approximately HUF 1,600 million in 2001. All other Hungarian subsidiaries were subject to income tax of 18%, while the Macedonian companies are subject to income tax of 15%.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. Recognized tax losses of HUF 1,615 million will expire in 2003, HUF 100 million will expire in 2005, HUF 5,842 million will expire in 2006 and HUF 5,112 million will expire in 2007. Of the recognized tax losses, HUF 4,949 million is not subject to statutory limitations.

Matáv's deferred tax balances are as follows.

	Balance at December 31, 2001	Cumulative translation adjustment	Income statement effect	Balance at December 31, 2002
Deferred tax assets and (liabilities)				
Net operating loss carry-forward	52		3,117	3,169
Investments in subsidiaries	(1,055)		(1,016)	(2,071)
Impairment of receivables, inventory and financial investments	3,884	(39)	(440)	3,405
Property, plant and equipment and intangible assets	(1,909)	(23)	(209)	(2,141)
Derivative assets	(184)		(225)	(409)
Trade and other payables	45	(22)	(248)	(225)
Loans and other borrowings	(54)		204	150
Deferred revenue	929		(121)	808
Provisions for liabilities and charges	345		942	1,287
Total net deferred tax assets	<u>2,053</u>	<u>(84)</u>	<u>2,004</u>	<u>3,973</u>
Add back: deferred tax liability	<u>1,763</u>			<u>2,646</u>
Deferred tax assets	<u><u>3,816</u></u>			<u><u>6,619</u></u>

Deferred tax assets and liabilities are determined by the legal entities of the Group.

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

	For the year ended December 31,		
	2000	2001	2002
	(in HUF millions)		
IFRS profit before income tax	77,273	107,999	95,012
Tax at 18%	(13,910)	(19,440)	(17,102)
Effect of reduced tax rates	8,510	11,259	2,686
Tax on items not subject to tax	981	1,368	2,027
Tax effect of recognition/(non-recognition) of tax losses	(352)	(1,151)	1,925
Tax on non deductible expenses	(2,511)	(4,459)	(2,837)
Temporary differences reversing at different rates	(241)	741	192
Income tax expense (before associates' tax)	(7,523)	(11,682)	(13,109)
Share of associates tax expense	(229)	(51)	(136)
Income tax expense	(7,752)	(11,733)	(13,245)

Items not subject to income tax consist primarily of amortization of investment contribution fees and connection fees to revenue as well as the share of associates' profit before income tax as the results of the associates are not included in the reconciliation.

25 Management Incentive Plans

(a) Convertible bonds

From June 29, 1998 to July 1, 1998, Matáv Rt. issued 7 million convertible bearer bonds, known as the "Management Incentive Program Bond" each with a face value of HUF 1. The holder of a bond could convert it into one newly issued Matáv A series registered common stock with a face value of HUF 100, in accordance with the allocation and conversion rules. On July 1, 1998, 4,231 thousand bonds were allocated to management. In 1999, 402 thousand bonds were forfeited. In 2000 additional 876 thousand bonds were allocated to management and 283 thousand bonds were forfeited. In 2001, 242 thousand bonds were forfeited.

The Bonds could be converted into newly issued Matáv A series registered common stock over a three year period with one third vesting each year beginning July 1, 1999. Bonds could not be converted after the end of the bond's term, June 2002. None of the bonds were converted into shares and so all outstanding bonds were forfeited in 2002.

The conversion price of the bonds was the Hungarian Forint equivalent of USD 5.75 per bond, calculated based on the USD/HUF exchange rate quoted by the Hungarian National Bank on the day of conversion, less the face value of the bond, but not less than the initial public offering price of HUF 730 per share.

Compensation cost was not recognized in these financial statements for the fair value or the intrinsic value of the bonds granted.

(b) Share options

On April 26, 2002, the annual Shareholders' Meeting approved the introduction of a new management share option plan and authorized the Company's Board of Directors to purchase 17 million "A" series registered ordinary shares, each having a nominal value of HUF 100 as treasury shares.

On July 1, 2002, the Company granted 3,964,600 options to participants of the stock option plan at an exercise price of HUF 933 for the first tranche (exercisable in 2003) and HUF 950 for the second and third tranches (exercisable in 2004 and 2005). The Company's share price as quoted on the BET (Budapest Stock Exchange) on the grant date was HUF 833 per share. The options have a life of five years from the grant date, meaning that the options are forfeited without replacement or compensation on June 30, 2007.

The option with respect to the maximum of one-third of the shares that can be purchased under the relevant option (first tranche) may be exercised from July 1, 2003 until the end of the term.

The option with respect to the maximum of a further one-third of the shares that can be purchased under the option (second tranche) may be exercised from July 1, 2004 until the end of the term.

The option with respect to the rest of the shares that can be purchased under the option (the third tranche) may be exercised from July 1, 2005 until the end of the term.

Compensation cost was not recognized in these financial statements for the fair value of the options granted.

26 Commitments

(a) Lease commitments

Operating lease commitments were mainly in respect of the lease of buildings, network and other telecommunications facilities. Finance leases relate to the sale and lease back of PBX and other telecommunications equipment. Future minimum lease payments under finance and operating leases at December 31, 2001 and 2002 are as follows:

Year	Finance Leases At December 31,	
	2001	2002
	(in HUF millions)	
2002	410	-
2003	462	455
2004	139	155
2005 and thereafter	-	-
Total minimum lease payments	1,011	610
Less: amounts representing interest	(123)	(58)
Present value of net minimum lease payments	888	552
Less: finance lease obligations included in short-term debt	331	406
Long-term finance lease obligations	557	146

Year	Operating Leases At December 31,	
	2001	2002
	(in HUF millions)	
2002	3,245	-
2003	2,502	2,065
2004	2,082	1,579
2005	1,388	1,324
2006	966	1,348
2007	778	1,415
Thereafter	-	1,533
Total minimum lease payments	10,961	9,264

(b) Purchase commitments

As of December 31, 2000, 2001 and 2002 capital expenditures amounting to HUF 18.2 billion, HUF 11.2 billion and HUF 7.5 billion, respectively, principally relating to the telecommunications network, had been committed to under contractual arrangements, with the majority of payments due within one year.

(c) M-RTL

Matáv Rt. acquired a 25% share in M-RTL, a television broadcasting company in 1997. Matáv Rt. committed to provide M-RTL with equity and debt financing if M-RTL needs that. At December 31, 2002 Matáv Rt. has outstanding commitments of approximately DEM 4 million (in proportion to its ownership) to provide further funds to M-RTL. In 2002 M-RTL repaid all its loans to its founders and also paid dividends of HUF 1.6 billion, which makes Matáv believe that this commitment will not have to be delivered upon.

(d) Contingencies

In November 2002 Westel and the other significant Hungarian mobile company were designated by the National Telecom Regulatory Authority ("HiF") as having Significant Market Power ("SMP") in the interconnection market. Westel filed its cost calculation methodology and relevant cost/tariff data based on the mandatory Long Range Incremental Cost ("LRIC"), meeting the provisions of law. The other company appealed against the decision. This was accepted by the court but is being appealed by HiF and is now subject to review by the Supreme Court. In order to avoid a competitive disadvantage and to ensure non-discriminatory treatment, Westel filed an official request with HiF, asking for the delay of execution of any decision regarding implementation of its SMP obligations until final settlement of the judicial review.

There is an on-going investigation by the Competition Office into accusations of monopolistic behavior in the Hungarian mobile market, the current status of which is a recommendation to the Competition Council to levy a penalty of HUF 1.9 billion on Westel. Matáv believes that the basis for the Competition Office's findings is not well founded and that the amount of a potential liability is not material to the financial statements as of December 31, 2002.

27 Lease revenues

Operating lease revenues relate primarily to the leasing of PBX equipment where Matáv is the lessor.

Year

2003

2004 – 2006

2007 and thereafter

Total minimum lease payments receivable

Operating Leases

(in HUF millions)

5,346

8,977

1,207

15,530

28 Related party transactions

MagyarCom GmbH

The Company is majority owned by MagyarCom GmbH (59.21%), which is owned by Deutsche Telekom AG. In 2002 Matáv paid dividends of HUF 6,792 million to MagyarCom GmbH, while the amount in 2001 amounted to HUF 6,174 million.

Matáv had no revenues or expenses incurred in the three-year period ended December 31, 2002 or receivables and payables at the end of 2001 or 2002.

MagyarCom Services Kft.

MagyarCom Services Kft., a Hungarian company owned by Deutsche Telekom, provides Matáv with management and consultancy services. The total service fees charged in 2000, 2001 and 2002 amounted to HUF 2,478 million and HUF 1,563 million and HUF 2,028 million, respectively. Matáv had outstanding payable to MagyarCom Services Kft. of HUF 573 million at December 31, 2002 (HUF 515 million at December 31, 2001). Matáv had no amounts receivable from MagyarCom Services Kft. as of the same dates.

Deutsche Telekom Group

Matáv had telecommunications revenues amounting to HUF 7,589 million (HUF 5,992 million in 2001, HUF 5,168 million in 2000) from other Deutsche Telekom Group members. Operating expenses to Deutsche Telekom Group members amounted to HUF 4,852 million in 2002 (HUF 5,900 million in 2001, HUF 4,658 million in 2000).

Matáv had outstanding payable to other Deutsche Telekom Group members of HUF 833 million at December 31, 2002 (HUF 344 million at December 31, 2001). Matáv had amounts receivable from other DT Group members amounting to HUF 1,731 million in 2002 (HUF 644 million in 2001).

Related to the swap agreements concluded with Deutsche Telekom AG (note 15), Matáv had interest expense of HUF 5,040 million in 2002 included in the gains and losses on swap agreements. Accrued interest at December 31, 2002 amounted to HUF 1,041 million included in the fair value of the swap agreements in other non current liabilities.

Related to the loan agreement concluded with Deutsche Telekom Finance B.V. Matáv had interest expense of HUF 13,654 million in 2002, and HUF 3,846 million in 2001. For the loan balances refer to note 14 and 15. Accrued interest at December 31, 2002 amounted to HUF 4,298 million (HUF 1,918 million in 2001), included in accrued expenses.

Deutsche Telekom has pledged its support for Matáv's financing needs through to June 30, 2004.

Governments

Matáv provides services to Government departments and businesses in Hungary and Macedonia on arm's length basis, however, individually none of these customers represent a significant source of revenue.

Associates

Hunsat is a joint venture founded by the Company (50%) and Antenna Hungária Rt. The revenues of Hunsat include membership fees paid by the establishing owners and subsidies received from an international space communications organization. Costs incurred by Matáv including payment of these membership fees amounted to HUF 160 million in 2002, HUF 269 million in 2001 and HUF 324 million in 2000. Any profits made by Hunsat are repaid to the joint venture partners.

As M-RTL, the Hungarian television broadcast company, in which Matáv has a 25% share of ownership, operates mostly through production agencies, the transactions between M-RTL and Matáv Group are insignificant.

29 Principal investees

At December 31, 2002 the principal operating associates and subsidiaries of the Group, which are incorporated in Hungary and Macedonia, were as follows:

Associates	Group interest in capital	Activity
Hunsat Magyar Úrtávközlési Koordinációs Egyesülés	50.00%	VSAT Satellite communications
Magyar RTL Televízió Rt.	25.00%	Television broadcast company

Subsidiaries	Group interest in capital	Activity
Axelero Rt.	100.00%	Internet service and content provider
Emitel Távközlési Rt.	100.00%	Local telecommunications operator
InvesTel Rt.	100.00%	Cable TV holding
Makedonski Telekomunikacii AD (MakTel)	44.11%	Macedonian telecommunications company
MatávCom Kft.	100.00%	Solutions for business customers
MatávkábelTV Kft.	100.00%	Cable television operator
Stonebridge AD	86.46%	Macedonian holding company
Westel Rádiótelefon Kft.	100.00%	Cellular telephone services
Westel Mobil Távközlési Rt.	100.00%	GSM digital cellular telephone services

The Group's interest in the capital of subsidiaries and associates equals the voting rights therein, with the exception of MakTel, where the Company holds 51% of the voting rights due to its voting power exercised through its ownership in Stonebridge.

MakTel and Stonebridge are incorporated in the Republic of Macedonia, while the rest of the subsidiaries and associates are incorporated in the Republic of Hungary.

30 Segment information

Matáv has three operating segments, fixed line telecommunications, mobile telecommunications and international activities.

The Fixed line telecommunications segment provides local telephony in Matáv's 39 local primary areas, domestic and international long distance services on a nationwide basis as well as related services such as leased lines, data transmission, PBX, corporate networks cable TV services and internet.

The Mobile segment consists of services provided by Westel and Westel 0660. Westel provides digital services in the 900 and 1,800 MHz frequency bandwidth, while Westel 0660 provides analog services in the 450 MHz frequency bandwidth. Services provided between the Company, Westel and Westel 0660 are made on an arms-length basis. Westel and Westel 0660 each provide distribution for the other's products. Both Westel and Westel 0660 lease space at base stations to each other and from the Company on a contract basis.

The International segment includes the four Macedonian companies: Stonebridge (the holding company through which Matáv controls MakTel), MakTel (Macedonia's exclusive fixed line telecommunications company), MobiMak (MakTel's subsidiary, a cellular telecommunications service provider in Macedonia) and Telemacedonia AD (through which Matáv provides management and consultancy services to MakTel, MobiMak AD and Stonebridge).

Of the 2002 total revenue of the International segment HUF 23,616 million is generated by the mobile activities. Of the total assets of the International segment HUF 29,297 is related to the mobile activities, before the allocation of any goodwill thereto.

Of the total net book value of goodwill as at December 31, 2002, HUF 15,706 million is allocated to the Fixed line segment, HUF 180,454 million to the Mobile segment and HUF 46,318 million to the International segment.

The following table presents a summary of operating results of the Group by segment for the years ended December 31, 2000, 2001 and 2002. The segments presented below are substantially consistent with the format used by the Company's Management Committee.

Revenues

Total revenue of Fixed line segment
Fixed line revenue from other segments
Fixed line revenue from external customers
Total revenue of Mobile segment
Mobile revenue from other segments
Mobile revenue from external customers
Total revenue of International segment
International revenue from other segments
International revenue from external customers
Total revenue of the Group

Depreciation and amortization

Fixed line
Mobile
International
Total

Operating profit

Fixed line
Mobile
International
Total

Share of associates' results before income tax

Fixed line
Total

Assets

Fixed line
Mobile
International
Inter-segment elimination
Total segment assets
Unallocated assets
Total assets

Capital expenditures on tangible and intangible assets

Fixed line
Mobile
International
Total

Liabilities

Fixed line
Mobile
International
Inter-segment elimination
Total segment liabilities
Unallocated liabilities
Total liabilities

For the year ended December 31,

2000	2001	2002
(in HUF millions)		
326,280	333,685	336,306
(9,491)	(11,221)	(11,620)
316,789	322,464	324,686
159,345	198,947	232,612
(30,189)	(33,653)	(34,043)
129,156	165,294	198,569
-	60,034	67,562
-	(57)	(232)
-	59,977	67,330
445,945	547,735	590,585
60,932	65,948	76,664
33,788	40,282	35,423
-	10,392	10,654
94,720	116,622	122,741
70,837	60,143	43,664
25,254	35,793	52,390
-	23,464	26,186
96,091	119,400	122,240
2,174	1,703	691
2,174	1,703	691
584,937	601,290	563,917
374,953	359,614	361,535
-	148,438	157,894
(8,813)	(12,989)	(14,979)
951,077	1,096,353	1,068,367
3,347	7,843	9,084
954,424	1,104,196	1,077,451
111,134	75,050	49,245
41,650	36,494	41,532
-	16,203	19,211
152,784	127,747	109,988
94,191	102,048	88,073
40,549	43,766	40,503
-	7,511	11,046
(8,813)	(12,989)	(14,979)
125,927	140,336	124,643
189,988	455,391	377,228
315,915	595,727	501,871

Unallocated assets include tax assets, while unallocated liabilities include loans and other borrowings and tax liabilities.

Inter-segment pricing is on arms' length basis.

Geographic Information: Matáv's fixed line and mobile segments operate exclusively in Hungary, while the international segment operates in Macedonia. Matáv does not analyze results on a more detailed level based on geographic areas within Hungary or Macedonia.

31 Subsequent event

On February 7, 2003 Matáv and CosmoTelco amended the option agreement described in note 2. The parties agreed to extend the exercise date of the option for the 10% share in Stonebridge until September 30, 2003, leaving all other conditions of the agreement unchanged.

Reconciliation to U.S. GAAP (Unaudited)

Matáv's consolidated financial statements are prepared in accordance with International Financial Reporting Standards, which differ in certain respects from U.S. GAAP. The principal differences between IFRS and U.S. GAAP are presented below, together with explanations of the adjustments that affect consolidated net income for each of the three years in the period ended December 31, 2002 and total shareholders' equity as of December 31, 2001 and 2002.

		For the year ended December 31,		
	Notes	2000	2001	2002
		(in HUF millions, except per share amounts)		
Net income under IFRS		66,652	82,560	68,128
Adjustments for U.S. GAAP:				
Cumulative effect of adopting SAB 101	(a)	(22,167)	-	-
Deferred revenue	(a)	15,197	2,947	2,918
Post-retirement benefits	(b)	(621)	-	-
Management Incentive Plan Bonds	(c)	(134)	(37)	-
Amortization of intangible assets	(d)	2,534	(2,546)	7,889
Cumulative effect of adopting SFAS 133				
net of deferred tax	(e)	-	501	-
CosmoTelco option	(f)	-	-	(155)
Cumulative income tax effect of adopting SAB 101		3,042	-	-
Deferred income tax on U.S. GAAP adjustments		5	(1,194)	(627)
Net income under U.S. GAAP		<u>64,508</u>	<u>82,231</u>	<u>78,153</u>
Basic earnings per share under U.S. GAAP		62.20	79.30	75.32
Diluted earnings per share under U.S. GAAP		61.91	79.30	75.32

		At December 31,	
	Notes	2001	2002
		(in HUF millions)	
Shareholders' equity under IFRS		460,300	516,144
Adjustments for U.S. GAAP:			
Deferred revenue	(a)	(16,344)	(13,426)
Intangible assets	(d)	(11)	7,878
CosmoTelco option	(f)	-	(155)
Deferred income tax on U.S. GAAP adjustments		1,222	595
Shareholders' equity under U.S. GAAP		445,167	511,036

(a) Deferred revenue

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101), which provides additional guidance in applying generally accepted accounting principles. In certain cases, SAB 101 requires up-front fees to be deferred and recognized over the expected period of customer relationship.

Under U.S. GAAP Matáv applied the guidance of SAB 101 as follows:

For fixed line customers a relationship period of 10 years was assessed and up-front fees are deferred over that term. Incremental direct costs are also deferred to the extent of the revenues. For mobile subscribers activation fees are deferred over a 4 year customer relationship period together with incremental direct costs up to the amount of revenue deferred.

(b) Post-retirement benefits

During 2000 Matáv terminated the provision of post-retirement benefits, therefore, the difference in equity was eliminated. The difference in net income in 2000 reflects the release of the difference between the provisions in IFRS and U.S. GAAP, accumulated in prior years.

(c) Convertible bonds — The Management Incentive Program

Compensation expense is calculated on convertible bonds granted under the "Management Incentive Plan" and disclosed in the U.S. GAAP income statement adjustments in accordance with APB 25. Total compensation expense is based on the difference between the exercise price and the market price on the grant date. Total compensation expense of HUF 143 million was going to be recognized over the three-year vesting period starting July 1, 1998. The amount amortized in 1999 took into account the impact of the forfeit of 402 thousand bonds by managers. In 2000, 283 thousand bonds were forfeited and additional 876 thousand bonds were allocated to management. Compensation expense of HUF 117 million was calculated in relation to the new grants. In total, HUF 134 million compensation expense was recognized in 2000, while the remaining HUF 37 million was recognized in 2001.

The new incentive program (note 25) required no U.S. GAAP adjustment as the share price on the grant date was higher than the exercise price.

(d) Amortization of intangible assets

Due to the different revenue and intangible asset recognition rules of IFRS and U.S. GAAP, the shareholders' equity of Westel, MakTel and Emitel on acquisition was different, consequently the goodwill and the value of customer base on acquisition and their amortization are different.

As a result of the new accounting announcements (SFAS 141 and 142) goodwill on the acquisition of Emitel (as of July 2, 2001) is not amortized under U.S. GAAP as the transaction was concluded after July 1, 2001.

The amortization of goodwill related to other acquisitions was stopped at January 1, 2002.

(e) Adoption of SFAS 133

IAS 39 is substantially similar to SFAS 133, however the cumulative effect of adopting the new standard was recognized against the retained earnings under IFRS, while the same effect was recognized in the income statement under U.S. GAAP.

(f) CosmoTelco option

The balance of minority interest in the IFRS financial statements at December 31, 2002 (note 20) includes an amount of HUF 1,275 million in relation to the call option of CosmoTelco. This amount equals the book value of the loss to Matáv, had CosmoTelco exercised its option for the 10% interest in Stonebridge at December 31, 2002. Based on the agreement concluded with CosmoTelco to let 11.55% of the option expire unexercised, an amount of HUF 1,430 million (including the U.S. GAAP adjustment) would cover for the payment Matáv would make to CosmoTelco for letting the remaining 10% of the option expire unexercised.

FINANCIAL CALENDAR 2003

FEBRUARY 14, 2003	<i>Release of 2002 full year results</i>
APRIL 25, 2003	<i>Annual General Meeting of shareholders</i>
MAY 15, 2003	<i>Release of 2003 1st quarter results</i>
AUGUST 14, 2003	<i>Release of 2003 1st half results</i>
NOVEMBER 14, 2003	<i>Release of 2003 1st nine months results</i>

FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. These statements are based on current plans, estimates and projections, and therefore you should not place undue reliance on them. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of them in light of new information or future events.

Forward-looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Such factors are described in, among other things, our Annual Report on Form 20-F for the year ended December 31, 2001 filed with the U.S. Securities and Exchange Commission.



MATÁV

HUNGARIAN TELECOMMUNICATIONS COMPANY LIMITED

MATÁV GROUP CENTER: KRISZTINA KRT. 55., BUDAPEST

Mailing address: 1541 Budapest, Hungary

Phone: (+36 1) 458 0000, 458 7000, 457 4000

Telefax: (+36 1) 458 7176, 458 7177

Internet: www.matav.hu

INVESTOR INFORMATION

MATÁV GROUP INVESTOR RELATIONS

Mailing address: 1541 Budapest, Hungary

Phone: (+36 1) 458 0424, 458 0437

Fax: (+36 1) 458 0443

E-mail: investor.relations@ln.matav.hu

MATÁV STOCK TICKER SYMBOL

BUDAPEST STOCK EXCHANGE (BÉT): MTAV.BU

NEW YORK STOCK EXCHANGE (NYSE): MTA.N

STOCK REGISTRATION

KELER RT.

Address: Asbóth u. 9–11., 1075 Budapest, Hungary

Phone: (+36 1) 269 6550 ext. 300, 301

Fax: (+36 1) 327 8378

STOCK TRADING INFORMATION

BUDAPEST STOCK EXCHANGE, INFORMATION CENTER

Address: Deák Ferenc u. 5., 1052 Budapest, Hungary

Phone: (+36 1) 429 6636, 429 6637

Fax: (+36 1) 429 6654

Internet: www.bse.hu

ADR TRADING INFORMATION

JP MORGAN, MORGAN GUARANTY TRUST COMPANY

Address: 60 Wall Street, New York, NY 10260-0060, USA

Phone: (+1 212) 483 2323

Fax: (+1 212) 648 5105

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