Magyar Telekom

We combined our knowledge to make communication an experience

Annual Report 2005

An integrated, full scale, leading telecommunications service provider

Magyar Telekom

Group Center

Lines of Business

T-Com	T-Mobile	T-Systems
Wireline Services	**Mobile Services**	**Corporate Services**
Market leadership in fixed line telephony and internet: 3.5 million fixed lines,* 358,000 broadband connections	Market leadership in mobile: 5.3 million customers*	Market leadership in business communi-cations: 3,000 key business partners
Successful introduction of T-Com, T-Online, T-Kábel brands	3G third generation mobile service launch	Successful introduction of the T-Systems brand
Innovative packages and services: Favorit, T-DSL Favorit Plusz, Szuperszerviz	EDGE fast mobile internet expansion	Uniquely wide product portfolio, international background
Innovative voice products: internet-based and cable telephoning	M-commerce innovations	Managed services, ICT outsourcing, Electronic bill
New offers and new customers in the competitors' areas	Innovative business solutions: push e-mail, Push to Talk	Advanced, NGN-based product development
Online successes: 2 million [origo] PIs daily, 2.5 million [freemail] users	Building a nationwide radio communications system	Strengthening footprint in South-East Europe

* At Group level (in Hungary, Macedonia and Montenegro)

ISO 9001:2000
Certified System

Our vision

As the leading services company in the telecommunications and information technology industry, we network society for a better future. With top quality, efficiency and innovation, to the benefit of our customers. In every respect.

Magyar Telekom (www.magyartelekom.hu) is the principal provider of telecom services in Hungary. It provides a broad range of fixed line services including telephony, data transmission, value added services, and it is Hungary's largest mobile carrier and leading internet service provider.

Magyar Telekom is the majority owner of MakTel, the sole fixed line operator and its subsidiary MobiMak, the leading mobile operator in Macedonia. Magyar Telekom also has a majority stake in Telekom Montenegro, Montenegro's largest telecom operator which provides fixed line, mobile and internet services.

Magyar Telekom was incorporated in 1991 (under the name Matáv) and privatized in 1993. Magyar Telekom shares were introduced to national and international stock exchange dealing both in Budapest and New York in 1997. Magyar Telekom's majority shareholder (59.21%) is MagyarCom Holding GmbH, fully owned by Deutsche Telekom AG, while 40.79% of the shares are publicly traded.

From March 1, 2006 Magyar Telekom's registered company name is Magyar Telekom Telecommunications Public Limited Company, the abbreviated name is Magyar Telekom Plc.

Awards and recognition

- **January 2005:** Magyar Telekom received the Recognised for Excellence award from the European Foundation for Quality Management (EFQM) for its outstanding results achieved in quality management and excellence of activities and operations of the entire organization.

- **February 2005:** Magyar Telekom received T-Com's Churn Management Best Performance award for the most successful churn management activities within the Deutsche Telekom Group.

- **March 2005:** Performing artist Klári Katona, spokesperson of the T-Com Donation Line, received the Pro Caritate award for her exemplary charitable activities.

- **April 2005:** Euromoney business magazine selected Magyar Telekom the Best Fixed Line Telecom of the year in Eastern Europe. Magyar Telekom was ranked second among the Most Transparent Companies, and the companies giving the Best Treatment to Minority Shareholders.

- **April 2005:** Magyar Telekom's Training and Knowledge Management Directorate received an Accredited Adult Education Institution certificate at the decision of the Adult Education Accreditation Board.

- **September 2005:** T-Com's Tudakozó Plusz (Directory Assistance Plus) obtained the Best European Directory Service Award in the International Directory Enquiries Awards competition.

- **October 2005:** T-Com won two grand prizes of Hungarian marketing communication, the Platinum and the Golden Effies, with its Birds campaign promoting wireline services.

- **October 2005:** Award for Budapest Economy established by the Budapest Chamber of Commerce and Industry went to Magyar Telekom, a founding member of the Chamber.

- **November 2005:** Magyar Telekom's Procurement Directorate won the year's Logistics Award for Excellence.

- **November 2005:** Magyar Telekom was placed first in the Deutsche Telekom Group EVA (Economic Value Added) Award competition with its ADSL roll-out project.

- **December 2005:** Magyar Telekom won second rank in the Green Frog Award competition for the best sustainability report.

- **December 2005:** Magyar Telekom won a Special Award in the Hospitable Employer competition invited as part of the Hospitable Budapest program.

Contents

The Management Committee of Magyar Telekom

Elek Straub, Chairman and Chief Executive Officer, Chairman of the Management Committee

Born in 1944. 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 Magyar Telekom as of July 17, 1995. He has been member of Magyar Telekom'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

Born in 1961. 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 of 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 Magyar Telekom's Board of Directors on October 27, 2000 and appointed Magyar Telekom's CFO as of November 1, 2000. Deputy Chairman of the Management Committee since November 14, 2000.

Christopher Mattheisen, Chief Operating Officer Wireline Services

Born in 1961. 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 Manager of US West International and later as T-Mobile Hungary's (formerly: Westel Mobile) 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 has been Magyar Telekom's Chief Officer Residential Services and Member of the Management Committee, and from January 1, 2005 Chief Operating Officer Wireline Services.

János Winkler, Chief Operating Officer Mobile Services

Born in 1954. He earned an economics diploma at the Budapest University of Economic Sciences, and in 2000 an MBA degree at Purdue University (USA). He started his career as trade manager with Nikex Foreign Trade Company, then from 1986 to 1991 he served in Beijing at the Commercial Section of the Republic of Hungary as commercial secretary, later deputy counselor. From 1992 he was National Sales Manager, later Deputy Marketing Director at Westel Rádiótelefon, and in 1994 he was appointed Deputy CEO. From February 1996 he has been Chief Marketing and Sales Officer of T-Mobile Hungary (formerly: Westel Mobile). As of January 20, 2006 he was appointed T-Mobile Hungary's CEO and became member of the Management Committee. From March 1, 2006 he is Chief Operating Officer of Magyar Telekom's Mobile Services.

Senior Management of the Magyar Telekom (left to right):
Christopher Mattheisen Chief Operating Officer Wireline Services Dr. Klaus Hartmann Chief Financial Officer, Deputy Chairman of the Management Committee János Winkler Chief Operating Officer Mobile Services Elek Straub Chairman and Chief Executive Officer, Chairman of the Management Committee Zoltán Tankó Chief Operating Officer Corporate Services Dr. Tamás Pásztory Chief Human Resources and Legal Officer

Dr. Tamás Pásztory, Chief Human Resources and Legal Officer

Born in 1951. He graduated in law and orgainzation engineering. He joined the Hungarian Post in 1969 and worked at its Budapest regional directorate in various positions. In 1980 he became head of labor department and later head of labor economics division at the Post's headquarters. He actively participated in founding and launching the operations of the Post's successor companies including Magyar Telekom. From 1990 he was Magyar Telekom's Director of Human Resources Development. He has been responsible for Magyar Telekom's HR and legal activities as Deputy Chief Officer from July 1995 and as Chief Human Resources and Legal Officer since February 1, 1996. Member of the Management Committee since November 14, 2000.

Zoltán Tankó, Chief Operating Officer Corporate Services

Born in 1957. 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 Gyógyszerárugyár. 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 Magyar Telekom in 1996 as Director of Business Communications and was promoted to Chief Sales Officer of the company as of January 1, 2000. Member of the Management Committee since November 14, 2000. From January 1, 2002 he has been Chief Officer Business Solutions and from January 1, 2005 Chief Operating Officer Corporate Services.

Magyar Telekom's Board of Directors and Supervisory Board

Members of Magyar Telekom's Board of Directors until May 31, 2007 or the date of the General Meeting that will close business year 2006

Elek Straub

Born in 1944. 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 has been Chief Executive Officer of Magyar Telekom since July 1995 and Chairman of its Management Committee since November 2000. Magyar Telekom's Director since June 7, 1995, Chairman of the Board of Directors since January 31, 1996.

Dr. István Földesi

Born in 1949. He spent 20 years in diplomatic service in London, Madrid and Washington as Attaché, then Counsellor. Up to 1988, he was Assistant Under-Secretary Science and Technology at Hungary's Ministry of Foreign Affairs, then to 1990 Advisor to the Prime Minister. Until 1992 he was Deputy Assistant Under-Secretary International Relations at the Ministry of Foreign Affairs. Since 1992 he has been as international business consultant. From 1993 to 1995 he was Vice-Chairman, Central Europe, then East Coast, of IMPAC Integrated Control Systems, a US management consulting firm. Currently he is President of EuroAccess, a business consulting firm. He was Magyar Telekom's Director from December 13, 1994 to April 28, 1999 and Chairman of the Board in 1994–96. Magyar Telekom's Director again since April 25, 2003.

Michael Günther

Born in 1944. 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 responsible for controlling, finance and accounting as well as IT. 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 Member of the Board of Management responsible for Joint Venture Management. Magyar Telekom's Director since April 26, 2002.

Dr. Klaus Hartmann

Born in 1961. 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 of 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 Magyar Telekom's CFO and Deputy Chairman of its Management Committee in November 2000. Magyar Telekom's Director since October 27, 2000.

Horst Hermann

Born in 1955. He joined Deutsche Telekom as operations manager in 1978. In 1990 he joined DT 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 Magyar Telekom in charge of Strategy and Business Development. In 2002 he became Chief Strategy and International Officer, also responsible for Portfolio Management and Magyar Telekom's policy on content and media. In 2003 he was appointed T-Com's Senior Executive Vice President responsible for International Business. Magyar Telekom's Director since April 25, 2003.

Gerhard Viktor Mischke

Born in 1959. He studied business management at Justus-Liebig-University in Gießen, where he obtained his degree in 1984. From 1985 he worked at the Finance Department of Franz Haniel & Cie GmbH in Duisburg. From 1990 he worked at the Finance Department of Scrivner Inc. (Oklahoma City, USA) and concurrently studied as a correspondence student at Cornell University. From 1991 he was Head of Financing and M&A at GEHE AG, Stuttgart, and from 1998 Group Finance Director of GEHE UK, Coventry. He joined Deutsche Telekom in 2000 as Senior Executive Vice President Finance and Treasurer. Since 2004 he has been Senior Executive Vice President, Treasury and International Investment. Magyar Telekom's Director since April 27, 2005.

Dr. Mihály Patai

Born in 1953. He graduated from the Budapest University of Economics, and earned a doctorate in 1979. 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 and later Deputy Head of International Finance Department. 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 in charge of international and foreign exchange operations. From 1996 to 2006 he was Chairman and CEO of Allianz Hungária Insurance Co. Magyar Telekom's Director since April 28, 1998.

Dr. Ralph Rentschler

Born in 1960. After studying economics and gaining a doctorate he worked from 1988 for Robert Bosch GmbH as an expert advisor on business principles and methods. He was head of Group Controlling and the Planning and Reporting Departments, also responsible for strategic planning, at Carl Zeiss from 1992. From 1997 he was Commercial Manager of the Brand Optics Division at Carl Zeiss where he managed Accounting, Controlling, Data Processing and Purchasing. In 2001 he became head of Group Controlling. From 2002 he is Member of the Management Board of T-Com responsible for finance. In 2002–2003 he was Magyar Telekom's Supervisory Board Member. Magyar Telekom's Director since April 25, 2003.

Dr. György Surányi

Born in 1954. After graduating from the Budapest University of Economics, he obtained a PhD in 1986. He is professor of the Budapest University of Economics and the Central European University. From 1977 he was employee then department head at the Financial Research Institute and from 1986 consultant to the World Bank. From 1988 he was advisor to the prime minister's first deputy and an alternate governor at the World Bank. In 1989 he became vice-president of the National Planning Office, then in 1990–1991 president of the National Bank of Hungary and a governor on the IMF's Board of Governors. From 1992 he was CEO of CIB Bank. From 1995 again president of the National Bank of Hungary. From 2001 he is Head of CEE region of Banca Intesa Group, and Chairman of the Board of CIB Bank. Magyar Telekom's Director since April 28, 2004.

Members of Magyar Telekom's Supervisory Board until May 31, 2007 or the date of the General Meeting that will close business year 2006

Dr. László Pap, Chairman
Wolfgang Hauptmann, Deputy Chairman
Géza Böhm
Attila Csizmadia
Dr. Ádám Farkas
Arne Freund
Gellért Kadlót
Wolfgang Kniese
Dr. Thomas Knoll
Dr. Klaus Nitschke
György Varju
Péter Vermes

Members of the Remuneration Committee:

Horst Hermann
Dr. Mihály Patai
Dr. Ralph Rentschler

Members of the Audit Committee:

Dr. Ádám Farkas
Dr. László Pap
Péter Vermes

New opportunities

New certainty, new connections and new opportunities for our customers, both in Hungary and internationally.

Rebranding

- The “T” brand: dynamizing and integrating power
- Successful communication, national awareness
- Perceivable advantages for the customers
- Improving competitiveness with international background
- Creating new value with the T-brand introduction

Rebranding: recognition and closer cooperation

On January 20, 2005 the Board of Directors adopted a decision on changing the Matáv name to Magyar Telekom and full introduction of the “T” brand in Hungary. On February 22, 2005 the extraordinary General Meeting approved the Board’s decision. On May 6, 2005 the company’s name was changed to Magyar Telekom. Since May 2005 the Magyar Telekom Group’s brand structure follows the Deutsche Telekom Group’s brand structure. The years-long close cooperation between the two groups was further deepened with the introduction of the “T” brand in Hungary. The possibility of adopting the international “T” brand was also a recognition of our performance. In addition to the new company name we also introduced new brands to the market: T-Com, T-Systems, T-Online and T-Kábel were added to T-Mobile brand launched in 2004. Our nationwide shop network is called T-Pont. The new brands inherited the strengths built earlier by the Magyar Telekom lines of business and develop them further to create new values.

Successful communication, national brand awareness

In early May 2005 Hungary’s largest rebranding to date was implemented. The objective of the national media campaign was to ensure introduction of the “T” brand to market and its awareness. The key message was “T” itself, i.e. that the “T” brand ensures a guarantee for quality for the consumer groups. It is not our objective for the different brands to have a standardized image since they use different technologies, have different target groups and their products are in different phases of their life-cycle. Unity is ensured by common visual identity elements and basic brand values – reliable, leading, attractive. The results of the rebranding campaign exceeded expectations. T-Com reached 64-65% brand awareness already by the end of July and by the end of the year 82.4% supported awareness among the adult population. T-Online, the other fixed line brand serving the consumer segment, reached its predecessor’s awareness level in six months.

We combined our knowledge to make communication an experience

Customers can be best served in the area of telecommunications by an operator which is present in all areas. In the Magyar Telekom Group T-Com, T-Mobile, T-Online, T-Systems and T-Kábel joined their forces to ensure that customers can use the possibilities of communications in a more convenient and simple way. We recognized that we can offer our customers the full scope of services if we establish closer cooperation and join our professional skills. T-Com, T-Mobile, T-Online, T-Systems and T-Kábel are members of a team that always offers customers the solution which best suits their needs.

“T” is a brand of excellence

The Magyar Telekom Group intends to be a successful representative of the international “T” brand. The ever intensifying partnership with the Deutsche Telekom Group, and the adoption of the worldwide successful “T” brand greatly contribute to the achievement of our objectives. The “T” brand is among the decisive and most successful telecommunications players of the world. The “T” stands for quality, efficiency and innovation, and represents the spirit and commitment of our team worldwide. The strength of the brand lies in the close relations of the parent and the member companies, as well as in the synergies of our Group as a leading force of the telecommunications industry. The “T” brand stands for cutting edge telecommunications technology and top quality services in all those markets where the Group companies are present.

Market leading positions with international background

Magyar Telekom’s objective is to maintain its market leading position in all business segments. For this reason rebranding was an indispensable strategic step in a fully liberalized competitive environment that complies with the EU rules. In the intensive market competition the new brand, the “T” strengthens our positions in face of our competitors. Magyar Telekom as a member of the international Deutsche Telekom Group continues to be Hungary’s leading telecommunications service provider, its objective is to satisfy the needs of its domestic customers. However, the rebranding made clearly visible our close connection with an internationally known and recognized leading group and brand and we also indicated that the benefits offered by a global brand and international background would be directly accessible for the Hungarian customers when using our services.

New impetus and dynamism

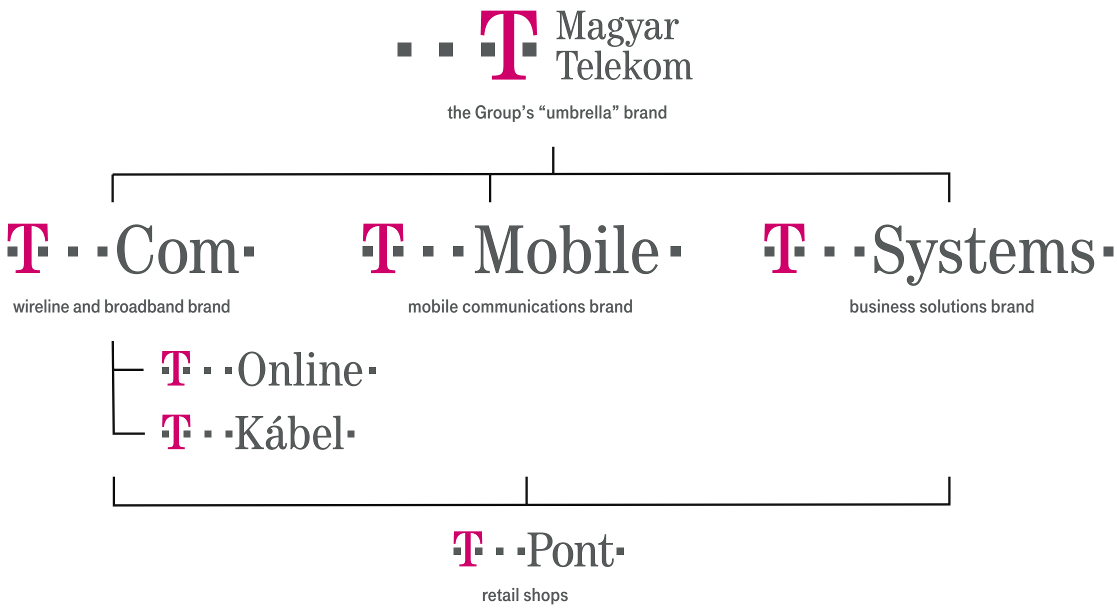
Successful introduction of the international "T" brand opened a new chapter which has given new impetus to all our activities and with which we established a new, fresh, dynamic image. We participate in building one of the world's most successful and dynamically growing telecommunications brands. Our objective is to be able to provide to our customers even more up-to-date high quality services with better price/value ratio. Rebranding gives new impetus to the Magyar Telekom Group in both services to customers and product development. Additionally, rebranding can make the fixed line business more dynamic. With standardized quality and good service provision to customers it will be easier to retain old customers and acquire new customers.

Benefits for customers

The introduction of new brands brought perceptible advantages and positive changes also for our customers. They could get to know the reliable, standard quality represented by the "T" brand. As it can be seen from this Annual Report, since May 2005 we have appeared in the market with new innovative products and services and integrated offerings which can be used by our customers in a convenient way, from a single operator and are competitive also in terms of price. The standard of customer care has improved. The rebranding brought new certainty, new connections and new opportunities for our customers both in Hungary and abroad.

Increasing value, improving competitiveness

The close partnership with the worldwide Deutsche Telekom Group and full introduction of the "T" brand have increased the value of our company and improved our competitiveness. Magyar Telekom's position as an integrated telecommunications operator within the Deutsche Telekom Group enables our company to reduce costs, capture new revenues and improve its competitive positions by leveraging synergies. Under the "T", an internationally recognized brand of excellence, we can more intensively use the advantages resulting from the Group and its international background, primarily in the areas of product development, marketing, sales, innovation and procurement.



Integrated service provider

There is no telecommunications service in Hungary the Magyar Telekom Group cannot provide.
As an integrated service provider we are offering the full product portfolio.

Our strategy

- New management structure: heading for integration
- Dynamism in the wireline segment: broadband and internet
- Efficiency increasing measures
- Closer cooperation within the Group
- Strengthening international presence

Integrated, full scale telecommunications service provider

The Magyar Telekom Group is an integrated group offering the full scale of telecommunications services to customers. Uniquely in Hungary's telecommunications market we represent the entire service portfolio as there is no telecommunications service in Hungary the Magyar Telekom Group cannot provide. We are laying the foundations of our long-term competitive edge with continuous innovation in every business line. Our medium-term value-accretive strategy focuses on efficiency increases so as to enable us to strengthen our competitive abilities and offer more attractive products to our customers, and thus maintain the growth of the Magyar Telekom Group. The Group is also being dynamized by the new management structure based on integration. From 2005, the Group's activities rest on three lines of business: Wireline Services, Mobile Services and Corporate Services. Each business unit pursues its business activities independently, adapting to its own market, on the basis of strategic targets and guidance of the Group Center. Within the business lines, several special or regional activities are carried out by the Magyar Telekom Group's independent member companies through efficiently exploiting the synergies.

Capturing growth opportunities in the wireline segment

In line with our strategy we are seeking to capture growth opportunities in the wireline business both in our own service area and in the areas of the other operators. Our goal is to retain the number of lines and to dynamize the business through the rollout of broadband accesses and the implementation of new, competitive products. We are addressing the problem of line decrease in the framework of our churn management efforts, supplemented by intensive line sales promotion activities. In 2005 we launched innovative internet-based (VoIP) and cable television network-based voice services. We also introduced to market new products and acquired new customers in the local telecom operators' areas. We also expect substantial market growth in the wireline segment through the purchase of Dataplex, operating in the IT services market, by an agreement signed in December 2005. The acquisition provides organic growth and service portfolio expansion opportunities for the Magyar Telekom Group.

Increasing broadband internet penetration

It is primarily the intense rollout of broadband and the internet that can dynamize the wireline segment. The growth of broadband internet penetration and a content-driven value-added product portfolio play a key role in the stabilization of fixed lines. At the end of 2005 Magyar Telekom had nearly 358,000 broadband connections, and we intend to increase this number to 600,000 by the end of 2006. After the first such effort in November 2004, we gradually increased the maximum speed of ADSL accesses in May 2005 and again in February 2006, increasing also by this move the value of the services provided to customers demanding large bandwidth. Other plans include the launch of new business services, increasing the geographic coverage and speed of the existing broadband (ADSL) services, as well as developing the nationwide optical backbone and subscriber networks.

Successful measures to increase efficiency

The continuing outsourcing of our non-core activities is aimed at improving business efficiency as it results in further cost savings. From February 2005 DeTeImmobilien-Hungary, a subsidiary of Deutsche Telekom, has been providing real estate management services for Magyar Telekom. The real estate outsourcing agreement further strengthens the relations with the Deutsche Telekom Group and helps exploit Group synergies. Office administration activities were outsourced in March. From July we outsourced the operation of our Call Center, from November transportation activities, from December the maintenance of the public payphone stations and from January 2006 part of the IT activities. The outsourcing of the fleet management of over 2,000 vehicles was the single biggest move in the country in this line to date. Headcount optimization is one of the measures aimed at increasing efficiency and reducing costs. We are making good progress in increasing our workforce efficiency, the ultimate goal of which is that the number of lines per fixed line employee should exceed 500 at the parent company by the end of 2006. We reached 489 at the end of 2005.

T-Mobile integration: favorable effects

In order to maintain Magyar Telekom's leading position and competitiveness in the mobile market, we improve customer care, increase the ratio of postpaid customers and extend our portfolio with value-added non-voice products. In October 2005 the Board of Directors made a proposal for the merger of Magyar Telekom and T-Mobile Hungary. The proposal was approved by the extraordinary general meetings of both companies in November and December 2005. Following court registration, from March 2006 Magyar Telekom Nyrt. has become the general legal successor of T-Mobile Hungary Rt. T-Mobile continues to operate as an independent brand and line of business within the Magyar Telekom Group and continues to provide services for customers in an unchanged form. The merger helps exploit the Group synergies efficiently. The integration of the shop networks and the market introduction of integrated offers will be implemented in 2006. By taking full advantage of the opportunities inherent in the integration, we will offer better service and favorable integrated products to customers.

Synergies within the Deutsche Telekom Group

The cooperation agreements signed with T-Com and T-Mobile International for the operative support of Magyar Telekom's wireline and mobile activities entered into force from January 2005. The cooperation enables Magyar Telekom to acquire further international experience in the field of wireline and mobile services, for example in developing domestic and international market strategy, in marketing and sales activities, in product development and in the professional training of the employees.

Group-level shared services center

Driven by cost reduction and operation efficiency considerations, in May 2005 the Magyar Telekom Group integrated its financial and accounting activities into a company. Since that time the financial and accounting tasks for all the member companies of the Group have been carried out by EurAccount Kft., a wholly-owned subsidiary of Magyar Telekom. With this the Shared Services Center of the Magyar Telekom Group was established. The Center has set the objective of providing high-level services for its internal customers, improving the efficiency of operations and cutting the costs of non-core activities.

Successful acquisition in Montenegro

Magyar Telekom is looking for attractive value-accretive investment opportunities in the growth markets of the South-East European region. The privatization of Telekom Montenegro (TCG) providing wireline, mobile and internet services, has proved to be an international acquisition offering good growth opportunities. We signed the agreement in March 2005 with the Montenegrin government on the purchase of 51.12% of TCG and – with the purchase of additional minority shares – we acquired 76.53% majority stake in the company by the time the transaction was closed in May 2005. TCG became a fully consolidated member of the Magyar Telekom Group in the second quarter of 2005.

Strengthening our footprint in the international markets

In the coming years Magyar Telekom intends to become the major alternative wireline service provider in several countries of South-East Europe. Our points of presence set up from 2004 in Romania, Bulgaria and Ukraine provide a good basis for our efforts to continuously strengthen our positions in the telecommunications markets of these countries. In November 2005 we signed an agreement on the purchase of 100% stake of Orbitel, Bulgaria's biggest alternative wireline telecom and internet service provider. In February 2006 we appeared as an alternative service provider in yet another market of the South-East European region. In Romania we are offering cheap telephony to residential and business customers through our EUfonika call-by-call service, launched by our Romanian subsidiary Combridge, and taking advantage of the opportunities offered by the liberalized Romanian telecommunications market. It owes its favorable prices to the IP-based next generation network (NGN) technology and an innovative business model.

> By taking full advantage of the opportunities inherent in T-Mobile integration, we offer better service and favorable integrated products to customers.

Commitment

Excellent quality and dedicated work, reflecting the mutual respect and commitment of company and employees.

Human resources

- Committed and qualified employees
- Provident human resources policy
- Improving efficiency and data security
- Hospitable and discrimination-free employer
- Support and recognition for innovation

Excellent quality and commitment

In 2005 the approximately 12,000 employees of Magyar Telekom contributed excellent quality and dedicated work to the successful business operation and growth of the Group, providing a wide range of telecommunications services for millions of customers in Hungary and abroad. The average age of the employees is 39 years, which shows that we are a "youthful" company. It is an indication of the mutual respect and commitment of company and employees that on average our employees work 13 years for us. The over 20 years' experience of 1,500 colleagues at the parent company that has 5,500 employees represents a major asset. There is no exaggeration in the claim that the Magyar Telekom Group boasts a significant amount of Hungary's telecommunications knowledge. As a result of efforts to keep abreast of market demand, efficient employee selection and continuous training, over 40% of the employees have tertiary qualifications and more than 30% speak at least one foreign language.

Efficient headcount management

The headcount reduction and organization transformation decided as part of the medium-term strategy of the Magyar Telekom Group continued in 2005. The outsourcing of the non-core activities serves efficiency improvement and further cost saving. From February 2005 DeTeImmobilien-Hungary, a subsidiary of Deutsche Telekom, has been providing real estate management services for Magyar Telekom. Office administration activities were outsourced in March. From July we outsourced the operation of our Call Center, from November the transportation activities and vehicle fleet management, from December the maintenance of the public payphone stations and finally in January 2006 part of the IT activities. As a result of the efforts aimed at efficiency increase, the number of fixed lines per employee reached 489 at the parent company, which matches the European level.

A hospitable employer

Although we are not increasing the headcount of the Magyar Telekom Group, last year over 450 people joined our community from the labor market. In December 2005 we won a special prize at the Hospitable Employer competition invited as part of the Hospitable Budapest program. Magyar Telekom earned the recognition with its exemplary discrimination-free selection and recruitment practices, broad offering of social benefits, the innovative forms of employment aimed at managing the headcount reduction (part-time employment, reserve base), and with the Chance program that successfully helps the employees leaving the company find a new job.

Provident human resources policy

Under the Chance program Magyar Telekom has for years been offering outplacement support for employees affected by the headcount reduction measures. In 2005, 79% of the employees dismissed registered with the Chance offices. 40% of the program participants requested employment counseling, 25% enrolled in the 2-day labor market training, and 21% registered for training. By the end of 2005, 437 people found new employment with the assistance of the program staff. The Chance program operates 10 offices in Budapest and the large cities of the country. Staffed by experienced labor market experts, the offices offer personal and labor market counseling, actively search for jobs and accept applications for group labor market training programs. A detailed information package has been produced on the program for the employees leaving the company.

Electronic administration for the employees

We further developed the complex electronic administration system of human resources which is available on the corporate intranet network. From 2005 a more flexible IT system supports the personnel evaluation system enabling the development of a large amount of questionnaires and their completion online, which makes processing much easier. In 2005 employees could also request discount mobile telephones and view their fixed and mobile telephone bills at a secure intranet site.

Employee data security

Complying with Hungarian and international regulations, in 2005 we reviewed the system of managing the personal profiles of the employees, inventoried all the relevant data carriers and provided for the protection of personal data in an internal regulation. In compliance with the relevant regulations, Magyar Telekom protects the personal data of its employees (including also the former employees, people employed on contract or in the framework of other legal relationship as well as the job applicants). For efficient enforcement of the regulations, Magyar Telekom has created the Employee Data Protection and Data Security Rules which entered into force from 2006.

"Making tomorrow happen with innovative ideas"

Magyar Telekom Group employees submitted 53 applications in the spring of 2005 to the innovation competition invited by Deutsche Telekom. The results were announced in June, bringing great recognition for our colleagues and acknowledging their outstanding creative talents: they won the 1st and the 3rd prizes, and 4 additional Magyar Telekom applications were listed among the top 10. In all, some 1,400 ideas were received from all Deutsche Telekom Group member companies. Magyar Telekom recognized the importance of the idea management for the success of the company, and offers an intranet forum for all employees to make the first step towards realization of their innovative ideas.

High-level adult education

In April 2005, Magyar Telekom's Training and Knowledge Management Directorate received an Accredited Adult Education Institution certificate at the decision of the Adult Education Accreditation Board. This accreditation shows that the education practice of Magyar Telekom complies with the statutory, professional and qualitative requirements of adult education, and makes our company eligible for the adult education grants and resources of both the Hungarian government and the European Union. One of the programs launched by the Training and Knowledge Management Directorate in 2005 offers help in managing the everyday problems of employees through interactive processing of the various problems in groups. The Family and Job program uses research findings and practical experience to address problems that affect everyone, like family and workplace roles and conflicts, intergenerational relations at the workplace and problems of child-raising versus job.

> Our key success factor is our committed, active and dynamic expert staff. The high-level qualifications and valuable experience of its employees are the guarantee of Magyar Telekom's operational excellence.

Present and future

Our support for the present and for the future.

For culture and for knowledge.

For medical treatment and for the needy.

For our environment and our health.

Corporate social responsibility

- T-Com: new brand in sponsorship in Hungary
- "Magyar Telekom Gives Back"
- Support to the nation's culture
- Donations by viewers' decision
- Sustainability principles

T-Com: successful premiere in sponsorship

In May and June 2005 the traditional city run programs with a new name T-Com Vivicittá attracted thousands of participants in Budapest and large regional cities. One of the most successful classical music events of the last years, the concert series called The Piano, continued in the fall of 2005 as part of the rebranded T-Com Music Evenings: in the new season 10 world famous artists gave solo concerts. At a special concert in the T-Com Music Evenings series in October the Grammy Award winner saxophonist Branford Marsalis gave a joint concert with the Magyar Telekom Symphony Orchestra which was renewed and renamed as a result of rebranding. On summer weekends about 160,000 visitors enjoyed the rich offerings of the T-Com Children's Island. Outstanding events in the summer cultural program offerings were held with the sponsorship of T-Com, among others T-Com Kaláka Folk Festival and the Valley of Arts festival.

Support to national cultural institutions

Magyar Telekom has been a committed sponsor of Hungarian culture and classical music for a decade. We do much to enable the prominent institutions of Hungarian culture to focus on their own mission. At a celebration held in June to close Magyar Telekom's rebranding, Chairman&CEO Elek Straub presented a valuable relic, an original manuscript of a poem by Sándor Petőfi, to the Petőfi Literary Museum of Budapest. Since June Magyar Telekom is the main sponsor of the classical music radio station Bartók Radio, continuing an already 9-year old successful cooperation. In September Magyar Telekom provided a 10 million HUF donation to the Budapest Academy of Music. Magyar Telekom has been the gold sponsor of the scientific-educational exhibition called House of the Future opened in December 2005 in Budapest.

"Magyar Telekom Gives Back"

In 2005 the "Magyar Telekom Gives Back" program donated a total of 110 million HUF countrywide towards the solution of the most acute social and health problems, with emphasis on screening and treatment of cancer and cardiovascular diseases, management of children's health and social problems and sports activities of the disadvantaged. For example we donated 3 million HUF to the National Oncology Institute for the purchase of a radio frequency pain-relieving device. The National Institute of Neurosurgery, Europe's third largest neurosurgery center, obtained 3.9 million HUF in aid. We helped the Debrecen University's Children's Clinic with a 2.2 million HUF donation to buy a modern digital EEG device. Our 2 million HUF donation enabled the Szombathely County Hospital to buy a gynecological diagnosis and therapy device and we contributed 3 million HUF that enabled the Balassagyarmat Hospital to buy a digital X-ray device. To support environment and nature protection we constructed 3 bird-watch towers in cooperation with the WWF Hungary Foundation and donated them to national parks.

T-Com Donation Line

By calling the 1788 Donation Line, 100 HUF can be donated for a charitable purpose announced every two months. T-Com offers this service free of charge and transfers the total amount donated while covering the costs involved. We are proud that with the help of the Donation Line that had been operating since May 2002 donations of more than 150 million HUF could be collected up to end of 2005 for 22 non-profit organizations. In recognition of the natural demand that T-Com Donation Line be accessible also for mobile customers, from 2006 the line can be called also from T-Mobile's network.

T-Com Help Line

In January 2005 at Magyar Telekom's initiative 200 HUF could be donated by calling the 1749 Help Line or sending an SMS to help the victims of the South-East Asia earthquake and tsunami. In one month T-Com customers donated more than 60 million HUF on the Help Line. In April-May the victims of the Mátra region flood received 5 million HUF aid from customers calling the Help Line. On both occasions, these amounts were delivered to the needy with the involvement of the Hungarian Red Cross. In September another 5 million HUF was collected through the Help Line for the victims of the flood in Transylvania which was delivered by the Hungarian Ecumenical Aid organization.

Open to the public

Magyar Telekom's corporate social responsibility attracts the attention of the public and the media in addition to the organizations needing aid. To satisfy this to the greatest possible extent, the Corporate Social Responsibility page on the www.magyartelekom.hu website, where information connected with our programs and available support is continuously available, was renewed simultaneously with rebranding. Also available there is the "Gives Back" program's similarly renewed quarterly Newsletter which is delivered to the press, non-governmental organizations and professional partners directly in both electronic and printed form. Thanks to the sponsorship agreement concluded in March 2005 with the Kurt Lewin Foundation, a social issues discussion program called Egál was launched on Radio Café with the objective of calling attention to negative social phenomena such as exclusion, aggression and unemployment, and exploring their causes and impacts with the help of invited experts and radio listeners.

"The Cause – Everyday Heroes": donations by viewers' decision

At Christmas 2005 Magyar Telekom distributed a total of 16 million HUF worth of donations among 4 organizations whose work was presented to TV viewers by films produced at the initiative and with the financing of Magyar Telekom and broadcast on Viasat3 channel. The documentary series called "The Cause – Everyday Heroes" showed four real stories to viewers who could vote by phone on the organizations presented and this way decide on the donations offered by Magyar Telekom. As a result of voting, the Heves County Authority's institute for the handicapped received a donation of 10 million HUF, and three other organizations received 2 million HUF each. Additionally, each call generated a 200 HUF donation, so – on top of the 16 million HUF donation – the viewers' donations also helped the supported organizations. We believe that the "documentary-reality show" as a genre can open new ways both in television and donation culture in Hungary.

Knowledge – value and experience

In March 2005 the University of All Knowledge, the largest recent undertaking in Hungarian popular scientific education launched in the fall of 2002 as a joint project of the Magyar Telekom Group and the Hungarian Academy of Sciences, reached its 100th lecture. In the spring of 2006 the series of programs is to start its 8th semester. With an average of 280,000 television viewers, 60,000 radio listeners, about 1 million newspaper readers and 16,000–20,000 daily visitors to the www.mindentudas.hu website, the series reaches more than 1.5 million people every week. The audience also learns about other communication channels connected with the series, so the University of All Knowledge is supporting education also with the launch of an e-learning program. In April the University started a nationwide competition series for secondary school students with the support of Magyar Telekom. The tasks were based on the program's lectures. The semifinals and the final held in December were broadcast by Hungarian Television.

Sustainability principles

Sustainability and positive action in the relations of environment–society–economy are long-term strategic principles for the Magyar Telekom Group. Accordingly, the Magyar Telekom Group's sustainability approach was elaborated, based on three closely connected fundamental principles.

1) The Magyar Telekom Group as an integrated communications service provider achieved a leading position in environment protection and aims at a leading position also in the area of sustainability.

2) Since simultaneously with the growing use of information and communications technology its negative social and environmental impact may also increase, the Group aims at reducing such negative impacts.

3) We are making efforts to manage infocommunication products and services in terms of sustainability and support the widest possible use of their inherent sustainability features.

> "For those who think so that they know what to do.
> For those who talk so that others also know what they can do.
> For those who have understood and already act."
> Klári Katona, spokesperson of T-Com Donation Line

Convenience and experience

Introducing our customers to the world of unlimited and convenient fixed line telephone calls and broadband services.

Wireline Services

- 3.5 million fixed lines at Group level
- Successful introduction of T-Com, T-Online and T-Kábel brands
- Accelerated growth of broadband connections
- Innovative tariff packages and services
- New offers also in competitors' areas

Expanding broadband, improving efficiency, stronger competition

The successful rebranding in 2005 also entailed the expansion of our product offering and the improvement of our customer services. The widest possible utilization of the wireline network infrastructure and the satisfaction of customer demand continue to be our priorities. The chief role in these efforts belongs to broadband technology. At the end of 2005 we had nearly 358,000 broadband connections in Hungary (primarily ADSL and Kábelnet), and we targeted as an achievable objective 600,000 connections by the end of 2006.
The Montenegrin acquisition further increased the number of fixed lines of the Magyar Telekom Group so that – in Hungary, Macedonia and Montenegro together – it exceeded 3.5 million by the end of 2005. Competition has intensified in Hungary's wireline segment, as customers have never had such a wide choice of services. Primarily as a result of mobile substitution, our fixed lines decreased in Hungary (by 5.1% at annual level). One of the key objectives of T-Com is to retain fixed lines and halt customer churn. We wish to prevent churn with a proactive approach, for example by making customized offers and targeted visits to our customers, while we are also making our line sales activity more intensive.

Dynamically growing ADSL customers

In 2005, we achieved bigger than ever growth in ADSL connections that enable broadband internet access: compared to 206,000 subscribers in 2004, by the end of 2005 we had over 329,000 ADSL subscribers. As a result of our dynamic growth efforts, at the end of 2005 the ADSL service was available in 812 localities in the service area of Magyar Telekom which, projected to population figures, means 87% coverage. T-Com also lays much emphasis on continuous improvement of the quality of internet connection. In May, simultaneously with the rebranding, we increased the speed of the ADSL access for all our customers free of charge. In our turn-key T-DSL package we offer quality internet access in a package with a state-of-the-art desktop or laptop computer. Our wireless broadband HotSpot internet service was available in over 200 public locations of the country in 2005.

Innovative residential tariff packages

It was an outstanding success of 2005 that we managed to halt and reverse the decrease of local minute traffic in our residential business. This was brought about primarily by our innovative tariff packages which introduced our customers to the world of unlimited telephone calls. By the end of 2005 about 66% of Magyar Telekom Nyrt. lines had some kind of discount package, which means nearly 1.8 million lines. In February, we launched the new Teleperc tariff package which offers the best minute rates among T-Com residential packages. After the rebranding, in June T-Com introduced new flat-rate packages called Favorit and Favorit Plusz. Uniquely in the Hungarian market, the Favorit packages offer free telephone calls in the extended off-peak period. Besides, the packages hold several other benefits (free Open Internet access, discount set purchase). The Favorit packages trebled our flat-rate customers in half a year, bringing the number to more than 324,000 by the end of 2005.

New offers and new customers in the competitors' areas

The services of T-Com are available in the entire territory of the country as we are also offering them in the areas of the local telecom operators. In 2005 we expanded the choice of our tariff packages, available with carrier preselection, in the areas of the wireline competitors. We offer Teleperc Partner to our residential customers and Ritmus Business and the V8 Partner tariff packages to business customers, which all include cheap minutes. We also offer call-by-call carrier selection T-Com services in the competitors' areas. The most successful is the Teleperc tariff package, chosen by 106,000 customers by the end of 2005 outside Magyar Telekom's service area. In June 2005 Magyar Telekom acquired the first customer through local loop unbundling in Invitel's service area, and in September in Hungarotel's service area. In this way we are increasing the number of our customers and offering services to subscribers in the competitors' areas with more attractive offerings, without the need to construct our own network.

Internet-based voice service through broadband

The convergence of networks and services, due to which part of wireline calls is channeled to the internet (IP network), is a key trend of the telecommunications market. Having recognized the challenge, from October 2005 Magyar Telekom has been offering internet-based voice service (VoIP) via broadband access: the Klip service that offers free internet calls is a joint product of T-Com and T-Online. The service, available without geographic or service provider constraints, had over 26,000 registered users at the end of 2005. With the Klip software, users can initiate and receive calls on the internet free of charge. From January 2006 new features were added to Klip: users can make calls not only through the internet, but also in wireline and mobile directions, and they can also be called from T-Com's wireline network. The Klip service is an important milestone of our efforts to continuously expand broadband internet access with value-added services.

New benefits and loyalty programs

We launched the PoP benefit program in October 2005. Customers who join this joint loyalty program of T-Com and T-Online can collect points with their telephone and internet bills and with purchases in the T-Pont shops, and later convert them into T-Com usage discount or payment in the T-Pont shops and for T-Online broadband products. For key business customers we have designed the PoP Mega loyalty package which gives them benefits that grow with the size of their bill. In July T-Com launched the new World Line prefix service, which gives users very favorable international minute rates in our service area on calls made with the 1414 prefix.

IT services for our customers

Since broadband internet usage is growing and there are many people unfamiliar with computers and the internet world, there is great demand for IT support and advice. One possible answer is the Szuperszerviz which customers can call on the toll-free 1722 telephone line. The Szuperszerviz team will respond to T-Com residential and business customer calls anywhere in the country to solve computer, network and internet problems, offer remote help desk service through the phone or internet or help with local troubleshooting on appointment with the customer. By way of an additional IT service T-Com as an official partner offers its customers the latest Microsoft software and operation systems for payment in instalments.

Innovation in customer service and sales

Following the brand change in May, our retail shops were transformed into modern T-Pont outlets where not only T-Com but also T-Mobile, T-Online and – depending on coverage –T-Kábel services can be ordered. The shops offer new features and opportunities: our customers can learn the use of our products and services with the help of interactive applications. The www.t-com.hu website offers simple and easy ways of ordering our products and services online. In 2005 we simplified the recorded messages of the T-Com Call Center available night and day seven days a week, to enable our customers to get the information or help they need more quickly and easily. The SMS Directory Assistance was launched in July. In September 2005 T-Com's Directory Assistance service won the Best European Directory Service award for its high quality services, spectacular improvement and the ability to constantly renew.

T-Com business services

In the months following the 2005 rebranding we approached the entire small and medium-size business customer base of T-Com with customized offers. For higher-usage customers we designed the Ritmus Business tariff package that gives volume-based discount. The Grátisz500 business tariff package contains 500 minutes of free calls within T-Com's network. The T-DSL Profi V8 and Ritmus packages launched in 2005 offer business customers very favorable peak-time minutes and broadband internet access in the same package. The PoP benefit program also has a business version: for small businesses we recommend the collection of PoP points, and to higher end business users the PoP Mega loyalty package.

T-Com's services are available country-wide, also in the areas of fixed line competitors.


György Simó, CEO
T-Online Hungary

Upgraded fixed line network and equipment

The rebranding also brought changes in T-Com's phone set portfolio. We introduced the modern Sinus sets in an effort to offer our customers more comfort in making telephone calls. As a new feature, Sinus sets have a magenta-color "T" button which is a short-cut key to the Directory Assistance and Call Center numbers. The new cordless sets also offer services characteristic of mobile phones, such as sending and receiving SMS messages. T-Com's new public payphones – the first of which were installed at Budapest airport in November 2005 – accept Euro coins as well. Depending on their reception T-Com will roll out these payphones to other areas most visited by tourists. In December 2005 the last analog exchange of Magyar Telekom's network was switched off for good. This move completed the replacement of the electro-mechanical exchanges with digital exchanges, making our network 100% digital.

Internet Education Program

Magyar Telekom and T-Online have, for years, been supporting initiatives designed to promote the development of the information society. As part of our free Internet Education Program, we held training sessions for beginner and advanced internet users also in 2005. Participating in this program were the winners of our competition for local governments, church and non-profit organizations. We also organized courses and lectures for disadvantaged people, in cooperation with Roma communities, organizations of the deaf and hearing impaired and the disabled. These programs are supplemented by the free online internet course available on our website. The Open Internet service, providing dial-up internet access since 2003, has been offering heavily reduced telephone rates and no monthly and connection charges from April 2005 to encourage people to use the internet.

T-Online: new broadband packages

At the end of 2005 T-Online – Hungary's leading internet service provider – had nearly 329,000 subscribers which represents 23.5% annual growth. T-Online provides access to almost half of the residential users in Hungary: it holds about 42% share of the switched line market and leads with a significant edge all three key segments of the internet market (residential services, content service, business solutions). Simultaneously with its rebranding in May, T-Online renewed its broadband (DSL and Kábelnet) product offerings in response to a survey of customer needs. It introduced for residential customers the T-Online DSL Start package that enables simple establishment of a new ADSL connection at the customer's home. The new Start package with low monthly fee is designed for beginner and cost-sensitive internet users. The Security package was supplemented with an antivirus service. With the Axer Browser in the Family package children can also use the internet without any risk. The Multimedia package addresses users who want fast downloading and large bandwidth. The users of the WLAN package with wireless broadband access can access the Net from any point of their home. We offer the Eco package for starting micro and small enterprises. The Kábelnet service – available in a substantial part of T-Kábel's network – continuously expanded in 2005 and reached more than 26,000 subscribers by the end of the year.

Innovative online content and service offerings

Simultaneously with the rebranding in May, the new t-online.hu portal site was presented to internet users. The site offers services to customers and displays T-Online's internet product offerings, additionally with its simple and user-friendly interface and innovative services (Music Store, Téka) it offers useful leisure programs and entertainment for beginner and advanced internet users. With the unique Website Wizard started in February, individual and corporate users can produce their own websites with ease. Using this service that offers dedicated templates for the residential and business segments, a new website can be prepared in as little as 30 minutes. In November the Music Store's offerings were increased to more than 180,000 tracks; the site is visited by more than 35,000 users a week. A new t-online.hu service introduced at the end of 2005 was G-Portal where young users can create their own sites and browse contents designed for them.

[origo]: new records and new services

At the end of November 2005 Hungary's leading portal site exceeded 2 million page impressions a day for the first time in its history, then in early December another new record was set up with 800,000 visitors a day. [origo] widened its scope of services during the year. [origo]apró with 350,000 small ads on the average and [origo]állás

András Piller, CEO
T-Kábel Hungary

helping job search were started in September. A new information section of the portal is Health whose content is compiled by doctors and health professionals who also answer the questions asked. The portal also launched a translation service with online administration that already offered 21 languages at the end of 2005. From November vizsla24 users can browse in news and Hungary's national library. Since July 2005 Hungary's leading internet mail system [freemail], connected with this portal, offers new supplementary services. The space available with a mailbox was quintupled to 25 MB and the maximum mail size was also increased. The [freemail] extra service offers uniquely convenient e-mail usage with 1 GB space and giant mails. In February 2006 the number of [freemail] mailboxes opened by users was nearly 2.5 million. In December 2005 T-Online and Erste Bank Hungary launched an internet bank called [origo] klikkbank. Online banking services offered to residential and SME customers – current account, bank card, saving and loans – are accessible through the [origo] portal.

T-Kábel: dynamic growth and innovation

At the end of 2005 the Magyar Telekom Group had nearly 404,000 cable television subscribers in Budapest and in several cities across the country. T-Kábel, which offers high-quality leisure and entertainment services, has kept its position as Hungary's second biggest program distribution company. The T-Kábel brand introduced in May dynamized its activities: the most significant innovative services of the year (cable telephone, digital television) are connected with the new brand. In 2005 the customers of T-Kábel were the first in Hungary's telecommunications market to be offered the choice of four cable services: analog cable television, digital program packages, internet service and cable telephone. As a result they have the opportunity to avail themselves of all the telecommunications services offered by broadband technology – on a single cable.

Kábelnet, cable telephone and digital cable television

Besides cable television service, the broadband Kábelnet internet service provided by T-Online is also available on substantial part of T-Kábel's network. The area covered grew continuously in 2005 too, so now about half of T-Kábel subscribers are connected to a network suitable for internet service. In June 2005 we launched cable telephone service in some parts of the T-Kábel network suitable for internet access. T-Kábel entered the telephone market in the area of a Magyar Telekom competitor. Customers can make calls cheaply, retaining their telephone number, and calls inside the cable network are free of charge. By the end of 2005 we were providing cable telephone service to about 13,000 subscribers. T-Kábel launched a digital cable television service in December 2005, initially in supplement to analog subscriptions, in Budapest and its area. Customers can choose from several thematic program packages. The digital channels also offer language selection option and electronic program listings.

International wireline services

The legal conditions for the liberalization of wireline telecommunications market emerged in Macedonia in February 2005. MakTel, the principal service provider of the country, majority owned by Magyar Telekom, had 559,000 fixed lines at the end of the year. Thanks to efficiency improvements, the number of fixed lines per employee increased to 315. With more than 36% increase, the number of internet subscribers reached 92,000, with 8,000 of them using broadband access. The broadband offering was expanded by several new tariff packages to meet the demands of various customer segments (StartADSL, MaxADSL, OfficeADSL, ProfiADSL). The growth of internet penetration is promoted by MakTel's Schools Online program, under which the company established ADSL connections for 350 education institutions from February 2005.

Telekom Montenegro (TCG) joined the Magyar Telekom Group in April 2005. At the end of the year, as the only wireline operator of the country it had 194,000 telephone lines. The principal goals of the new management include the increase of efficiency, strengthening the company's market leading position and making TCG an efficient integrated telecommunications provider. The product portfolio has been extended significantly. The broadband ADSL service was launched in April. The first tariff packages and the first loyalty program were also launched for residential and business customers. The integration program of the TCG group started in November: as a result a new structure resting on the wireline and the mobile businesses will emerge in 2006, bundled offers will be developed and the shop network will also be integrated.

Freedom

Offering the freedom of choice and of boundless communication by fast implementation of the most state-of-the-art solutions.


No.95

Mobile Services

- 5.3 million customers at Group level
- 3G – broadband mobile internet
- Mobile commerce innovations
- New business applications: push e-mail, Push to Talk
- National and international HotSpot roaming

T-Mobile: leader in the market and in innovation

At the end of 2005 T-Mobile had nearly 4.2 million customers and 45% market share. Despite intense competition, it managed to securely retain its leading position in the three-player Hungarian market. It is an indication of the level of development of the market that mobile subscriptions per 100 citizens reached 92.4 in Hungary by the end of 2005. Together with the nearly 1.1 million customers of the international mobile operations (Macedonia and Montenegro), at the end of 2005 the Magyar Telekom Group was providing mobile communications services for almost 5.3 million customers. 2005 was the first full year of the T-Mobile brand in Hungary.

T-Mobile has been pioneering the introduction of GPRS, EDGE, WLAN, WLAN roaming and 3G services. Its principal goal in the fast implementation of the most state-of-the-art solutions is to offer its customers the freedom of choice and the freedom of communication by providing them with customized services. T-Mobile's success represents an outstanding contribution to strengthening the leading position of Magyar Telekom as an integrated telecommunications service provider both in Hungary and in the region.

Innovative tariff packages

From May 2005 T-Mobile customers were given the opportunity to subscribe to the T-Percek (T-Minutes) package the monthly fee version of which offers 2,500 minutes of call time for 2,500 HUF. In November T-Mobile introduced a new tariff package called MobilOtthon, whose users can call domestic wireline numbers from the entire territory of the country at the same minute rates all day without a monthly fee. With this package too, T-Mobile intends to increase mobility and offer boundless communications to its customers. In December, the company launched partner card versions of the popular Relax tariff packages. One of the principal advantages of these is that they give favorable minute rates even for customers who buy only a small amount of minutes monthly. For example, the Relax 50 minutes package offers the cheapest monthly rate among the similar packages in Hungary's mobile market at present. The new packages can be freely combined with the earlier Relax offers.

Innovative Domino offerings

From August T-Mobile has been offering a new prepaid package to its regular mobile users: the Domino Aktív package gives users particularly advantageous minute rates for a 30-day period fee when calling over 7.5 million Hungarian T-Mobile and wireline customers. Besides call rates Domino Aktív users can also reduce the fees of the SMS messages. In August T-Mobile also introduced the Híváskérő (Call Request) service for its prepaid customers. This means that if they only have credit left for less than 1 minute and cannot initiate a call, T-Mobile offers them the opportunity of a call-back request within its own network. By pressing a single button, the caller can send an automatically generated SMS to the called party's phone containing the caller's mobile number and a call-back request text.

Innovative multimedia offerings

The number of sets capable of sending and receiving multimedia messages (MMS) is growing fast and with the development of the service, more and more people come to realize the benefits of the MMS. From January 2005 T-Mobile customers can send MMS at more favorable rates, and tariffs are even more friendly within the network. In an effort to leverage the benefits for businesses of the new service as fully as possible, T-Mobile is offering, as first in the country, Mass MMS service for its corporate customers. With this solution customers can send up to 3,600 MMS per hour from their computer to mobile numbers in Hungary. With the increasing sophistication of phone cameras and the spread of mobile phone photography, there is a growing demand on the side of customers to be able to print the photos they make. To meet this demand halfway, T-Mobile has installed printers in several shops, so it is enough to send the MMS photo you want to have printed to a given mobile number. From that point on processing and printing are automatic and the customer can pick up the photos by giving his/her mobile number.

M-commerce innovations

From 2005 T-Mobile customers can select Mobile Purchase as payment method for a number of new products, and make payment on account of their purchase (m-com) balance or with their monthly bill. From March, the Mobile Lottery service gives T-Mobile customers the opportunity to buy lottery or football pools tickets in an SMS. If they win, they will be notified in an SMS, too. From May, T-Mobile customers can purchase travel insurance quickly and simply via electronic channels. This can be initiated on the home page of the partner insurance company, by giving the mobile number. The steps then required can be taken in SMS messages. In some of Budapest's parking zones (for the time being, in 7 districts) T-Mobile customers have the option to pay the parking fee in an SMS since August 2005. Thanks to the cooperation of T-Mobile and T-Online, from August also the [freemail] extra service fees of the country's most popular internet mail system can be paid with mobile phone.

3G: third generation mobile service

On August 26, 2005 – after several months of tests – T-Mobile was the first in the country to launch its third generation mobile service known as 3G (or UMTS) in Budapest. The new service also offering video telephony, fast data transmission, music download and mobile television was available almost in the entire territory of Budapest and Debrecen by the end of the year. T-Mobile won the 3G license on competition in December 2004. Optimally, the third generation network enables up to 384 kb/s download speed. Before commercial start the service had a live trial on June 26 when the test participants could follow the T-Mobile Connection concert live on their mobile phones. With what is perhaps the most spectacular feature, the mobile television service, subscribers can watch the programs of five Hungarian television channels live on their mobile phones.

In conjunction with the commercial service T-Mobile launched its 3G mobile content enabler t-zones 3G WAP portal, which focuses on multimedia solutions – mobile television, films, live broadcasts. Users of the Mobil Zenegép (Mobile Jukebox) service can select from 300,000 recordings to download. In line with customer demand T-Mobile is continuously expanding its 3G network, which is supplemented by the EDGE network.

Video telephony on the 3G network

In 2003 T-Mobile was the first in Hungary to present video telephony on its own network. In order to enable as many people as possible to try the new service, after the commercial introduction T-Mobile customers with suitable sets were given the opportunity to use the video telephone feature free of charge in Hungary till December 31, 2005. Barely a month after the launch of the Budapest 3G network, thanks to international cooperation T-Mobile customers could make video telephone calls to several foreign networks as well. By the end of 2005 T-Mobile had 16 3G roaming partners.

Superfast 3G mobile internet

Just a few months after the launch of its 3G service, in October 2005 T-Mobile began tests of the even faster HSDPA (High Speed Downlink Packet Access) service, also called 3.5G. The new solution offering broadband mobile data communication is being installed on part of the 3G network. The HSDPA will provide fast internet access and e-mail option with mobile phone, portable computer or other mobile device. By gradually increasing speed, it will be possible to reach up to 10 Mb/s transmission speed later on. With the super fast 3G it takes only 10-20 seconds for users to download an average music track. After the tests have been successfully completed and the appropriate mobile sets are put on the market, T-Mobile will start to install the service on its entire 3G network in 2006. With this move the carrier will make data communication even faster for all its subscribers.

> T-Mobile customers can watch live television, recorded programs and video films with their 3G mobile phones.

Mobile television on 3G network

In Hungary, the 3G service could bring a breakthrough in mobile television. The users of T-Mobile have had the option to watch television videos on their mobile phone since May 2003. At present, the streaming offer of T-Mobile consists of live television, recorded programs and video films. But the launch of the third generation mobile service will bring a lot of novelties in this area, too, and a big jump can be expected in video content and service offer thanks to the development of broadband and quality transmission. T-Mobile customers are able to use their third generation mobile phones to view television broadcasts, programs, video clips and cartoons carried to them on Hungary's first commercial 3G network.

Rapidly expanding EDGE network

In 2003 T-Mobile was the first to launch the EDGE solution enabling fast mobile internet access and data communication, and in 2005 with substantial development it promoted the growth of fast WAP and internet usage. At the end of 2005, T-Mobile already offered EDGE service built on the existing GSM network in 160 cities. This service enables customers to browse the WAP and internet sites, send and receive e-mails on their mobile phone or portable or palmtop computers much faster and more comfortably. With EDGE, it takes much less time to send MMS or video and to download video. With appropriate handsets several times the previously accustomed speed can be reached, up to 220 kb/s. In fact 40% of T-Mobile's discount set offering consists of mobile phones capable of fast data communication. Subscribers can use the EDGE network, similarly to the 3G, with their current tariff package and rates. At the end of 2005 T-Mobile's EDGE fast data communication network coverage reached 60% of the country.

Simpler mobile internet

T-Mobile offers its customers more than a dozen internet-based services, online customer service and purchase opportunities. From December 2005, customers can reach many convenient services on the carrier's home page, from sending SMS, MMS and e-mails to Webshopping by selecting the My T-Mobile option. On the single and user-friendly My T-Mobile surface they can shop online in the Webshop, reach the customer service or view information on the K.A.P. loyalty program.

With internet usage growing, the Webshop is playing an increasing role in the sale of mobile products and services. In February, a new feature was added to T-Mobile's internet store: the opportunity to change discount sets online.

From October 2005 T-Mobile launched new mobile internet packages with which users can access WAP sites and their e-mails. The Net 50, Net 300 and Net 1000 internet packages offer 50, 300 and 1,000 MB data traffic.

HotSpot rollout and roaming

T-Mobile, that has the most extensive wireless internet access network (Wireless LAN or WLAN), further increased the number of HotSpot access points in 2005. There are now 79 HotSpots all over the country, and from August also in the lake Balaton region.

Under an agreement with Poland's Era mobile operator, a substantial stake of which is owned by T-Mobile International, from October the subscribers of the two companies can use both networks with their WLAN access. This means that with their HotSpot subscription, Hungarian customers of T-Mobile can enjoy the benefits of fast wireless access in Poland just like at home. Besides international WLAN roaming, T-Mobile and T-Com provide passage between each other's HotSpots also nationally, giving users the opportunity to access the net at high speed in over 200 locations in Hungary.

In May 2005 T-Mobile Hungary joined the Wireless Broadband Alliance (WBA), an organization grouping the leading providers of mobile broadband and promoting WiFi/WLAN service cooperation worldwide.

Innovative applications

T-Mobile launched a service unique in Hungary in December 2005. With the help of the Dynamic Application Manager, on the service provider's home page users can select and download to their mobile phone SIM card applications that simplify the use of the various services.

In April T-Mobile launched the Company Ringtone service, a version of the popular residential product customized to companies. Its principal new feature is that small or even big international companies can assign to the number offered with their subscription their own sound identifier (e.g. a tune or signal). This gives companies the opportunity to use their established musical identity features on mobile telephone calls, as well. Since May T-Mobile has also been offering in a box, together with the necessary data communications services, the Wayfinder satellite navigation system developed specially for mobile telephones.

Credit cards for T-Mobile customers

In March 2005 T-Mobile and MKB Bank launched a credit card jointly. The MKB–T-Mobile MasterCard Gold card, as part of the K.A.P. loyalty program, offers a credit line and various discount services to T-Mobile's loyal Platinum Card customers. From October, Gold Card customers too can avail themselves of the MKB–T-Mobile MasterCard. In cooperation with Budapest Bank, in August T-Mobile began offering credit cards that can also be used with a mobile phone. This T-Mobile Credit Card is a payment tool that combines the benefits of classical credit card and mobile purchases as the credit line is also available with mobile phone.

Innovative business solutions

In September T-Mobile became the first in Hungary to launch the Push to Talk service, which is based on the operating principle of the classical walkie-talkies but has been designed specially for the mobile network and uses state-of-the-art data communications technology. By pressing a single button on your mobile set, you can speak with several people simultaneously, regardless of their geographical location. This new form of fast communication within a group is expected to be used mainly by corporate customers. In Hungary, the Budapest Waterworks was the first large business customer to buy the Push to Talk service, primarily to satisfy their special communication requirements when implementing damage repair operations. This new service also helps reduce the communication costs of the company. The wireless mobile mail system represents significant business value for companies. Having realized this fact, in March 2005 T-Mobile made available also in Hungary the push e-mail solution of the BlackBerry service (in cooperation with RIM). Now its corporate customers, and through the BlackBerry Instant E-mail also its residential customers, can take advantage of the push e-mail which provides group availability.

Nationwide emergency system

In October 2005 the consortium of Magyar Telekom and T-Mobile won the public procurement tender for the implementation of EDR or Integrated Digital Radio Telecommunications System. In December, the Magyar Telekom Group founded a new company called Pro-M Professzionális Mobilrádió Zrt. Pro-M will establish the Budapest network of the emergency radio-communications system by early April 2006, and the 94% nationwide coverage network by the end of January 2007. The EDR will be implemented with the use of the TETRA (Terrestrial Trunked Radio) technology. The infrastructure of the network is supplied by EADS. The state-of-the-art digital radio communications system will guarantee a high degree of security, make the illegal use of data and information impossible and will provide secure operation also in case of power failure. It will be a particular feature of Hungary's EDR that, compared to the European practice, a greater number of organizations will be able to use it simultaneously, such as the police, border guards, disaster emergency service, customs and excise office, ambulance service, the army, national security and justice administration organizations.

International mobile services

In Macedonia, MakTel's fully-owned subsidiary MobiMak has been successful in retaining its strong leading position in the two-player mobile market where competition has intensified last year in every segment in terms of both customer acquisition and retention. At the end of 2005 MobiMak had over 877,000 customers, which amounts to 69.2% market share, while mobile penetration in Macedonia has reached 61.3 %. MobiMak has improved its perception and market position by offering innovative packages that are attractively priced and good value for money. The new Mobi Hit tariff package proved to be the most successful product of the year, because with it MobiMak pioneered in the local market such innovative solutions as subscription without a monthly fee and the extension of the discount mobile subscription rates also to prepaid customers.

Monet, the 100%-owned mobile subsidiary of Telekom Montenegro (TCG), has been a member of the Magyar Telekom Group since April 2005. Monet launched its service in 2000, 4 years later than its competitor, and with continuous expansion it reached 42.7% coverage of the two-player Montenegrin market achieving 78.6% penetration rate, which means a customer base of 208,000 by the end of 2005. In 2005, Monet hit the market with several innovative offers and services: for example, subscribers of the MO Club package collect points which they can subsequently use for calls or sending SMS, and the EasyNet package gives internet users the option of mobile payment. Monet launched the EDGE fast data communications solution in July 2005.

> In 2005 T-Mobile made available also in Hungary the push e-mail mobile mail system representing significant business value for companies.

Business flexibility

Effective support to our business partners' operations with a uniquely wide scope of integrated solutions.

Corporate Services

- Successful introduction of the T-Systems brand
- Services to 3,000 key business and governmental partners
- Strong international cooperation
- Managed services
- ICT outsourcing services

One brand – one message

Since May 2005 Magyar Telekom's Corporate Services offers its services and solutions to the Group's key business and governmental customers under the T-Systems brand.
T-Systems, in an ever closer cooperation with T-Systems Hungary that is operating in Hungary's IT market, represents and strengthens the international T-Systems brand through coordination of competences and account management.
Within the Magyar Telekom Group, T-Systems primarily focuses on telecommunications, infocommunication and infocommunication outsourcing and network management services, while T-Systems Hungary is responsible for large individual projects requiring IT, system integration and IT outsourcing competences.
The T-Systems brand concentrates major infocommunication service and outsourcing potential, capacities and skills. With its uniquely wide product portfolio and coordinated competences T-Systems is a key infocommunication market player in Hungary.

Market leadership and market expansion strategy

T-Systems' strategic objective is to preserve its leading position achieved in the business communications market in Hungary. We have the largest customer base in the market of business services. The additional advantages achievable through rebranding, such as closer international cooperation within the Deutsche Telekom Group whose benefits we can leverage more intensively under the "T" brand, contribute to strengthening our positions. In addition to preserving its positions, T-Systems is making efforts for further market expansion in accordance with the business sales strategy based on providing solutions. In addition to widening our product portfolio we also play a role as general contractor.

Full competences, international background

T-Systems – as a strategic business unit of the Deutsche Telekom Group – is one of Europe's largest information and communication technology (ICT) solution providers with premises and own companies in more than 20 countries.
As a result of the strong cooperation in Hungary, T-Systems can rely not only on its own resources, but also on the experience and skills of an international ICT service provider. As a result T-Systems has full telecommunications, IT and outsourcing competences to offer complex service to about 3,000 strategic and public administration customers and the key and large corporate customers of the Magyar Telekom Group. We offer customized solutions to ensure that our partners can focus on their business to achieve more successful market operation and improving efficiency, as well as real competitive edge through cost optimization.

Business flexibility

Business flexibility means helping the market flexibility of our business partners. T-Systems' objective is to have a positive impact on its partners' market activities and effectively support their operations. T-Systems offers its business partners the Magyar Telekom Group's full competences.
This common knowledge is used to satisfy our partners' infocommunication needs with a uniquely wide scope of turnkey solutions. In addition to telecommunications, voice and data communication services our product portfolio includes IT, system integration and outsourcing solutions.
We rely on our international professional background, reliability and commitment to quality to offer our partners really comprehensive integrated solutions.

Innovative and individual solutions, exclusive service

T-Systems has a clear objective: to be a reliable partner of its customers. A partner who contributes with its skills and reliable services to making its business partners more competitive and successful on their respective markets. The key elements of widening our product offerings are fast reaction capability, innovation, leveraging the Magyar Telekom Group's synergies and cost-efficiency.
T-Systems knows and understands the goals and demands of the business market so it can elaborate individual tailor-made solutions. T-Systems offers innovative services and solutions in the ICT market which are in harmony with its business partners' individual business operations and ensure efficient solutions and foreseeable costs.
We offer our partners fast and efficient customer relations through our account managers and key customer service function with exclusive service. One-stop service guaran-

tees that we can offer customized ICT solutions in line with the directly explored customer needs.

Managed services

T-Systems, having substantial international experience and support, introduced in 2005 new managed services in the Hungarian ICT market. These complex solutions offered as services with flat monthly rate can be planned with favorable conditions. With their use ICT costs can be significantly reduced. T-Systems guarantees the problem-free operation of information and communications technology services, ensuring that the corporate partners can focus on their core business activity. With the use of these services the companies' market image, efficiency and competitiveness can further improve.
T-Systems' Managed Voice service offers a solution for the elaboration and operation of a turnkey virtual private network solution and voice traffic on the partners' data network infrastructure. Managed LAN is a provisioning and support solution that jointly manages the operator's data line and the connected local networks. The Managed Security service offers local or central supervision to ensure protection of the IT infrastructure.

ICT outsourcing services

Enterprises have a growing need for integrated and optimized solutions which jointly manage voice and data communication, including PABX solutions, LAN (local access network) and IP telephony. For most companies design and implementation of integrated solutions is not part of the core activity. It is always reasonable to examine whether the company wants to manage the operation of its communication and IT infrastructure itself or engage a professional operator to achieve efficiency and cheaper operation.
T-Systems is the first in the Hungarian market to provide centralized integrated ICT outsourcing services which cover the company's whole IT and telecommunications infrastructure. After outsourcing the partner's tasks not included in its core activity, we ensure quality of operation and service continuity, improving the competitiveness and market image of the companies using outsourcing.

Electronic bill presentment and payment

In May 2005 T-Systems introduced Telebill, the first electronic bill presentment and payment service in Hungary. With this service the bill is not delivered to the addressee on paper, but in electronic form via the internet. With the Telebill service the users can view and manage the bills received from service providers in their homes or offices on a single website. The bills issued by the "T" brand service providers – T-Com, T-Mobile, T-Online and T-Kábel – were the first to be made available on Telebill because T-Systems integrated these bill issuers.

NGN – next generation network and services

The next generation network (NGN) technology offers an integrated service provision capability with which the same communication network is used for voice, data and multimedia transmission. T-Systems' key future objectives include the implementation of NGN-based services. Development and usage of NGN capabilities started with the introduction of the IP Complex Plusz integrated voice-data product. NGN encompasses a technical solution that enables the operator's network for the transmission of all kinds of information – voice-data-video, interactive services, videoconferencing, hosted business services, etc. Accordingly the network's transmission links and switching devices are capable of transmission of these various types of information, as well as management of calls terminated in or originated from the fixed and mobile network.

> T-Systems guarantees that its corporate partners can focus on their core business activities.

Strengthening market presence in South-East Europe

In November 2005, after signing an agreement on the acquisition of Orbitel, the largest alternative wireline and internet service provider in Bulgaria, we announced that in the following years Magyar Telekom wants to become the major alternative wireline operator in several countries in the South-East European region. In Romania, Bulgaria and Ukraine we already have points of presence in place which create a good basis for us to continuously strengthen our positions in the telecommunications markets of these countries. Until 2005 T-Systems – using the synergies of the Deutsche Telekom Group as a strategic partner of T-Systems Enterprise Services – was present in the South-East European telecommunications markets only with wholesale products.
Orbitel offers voice and data services to business customers in Bulgaria. In February 2006 we entered the residential and business retail telecommunications market in Romania with our subsidiary Combridge. We are planning the development of further products for corporate customers in this country through organic growth.

Management report for the 2005 financial year

Highlights

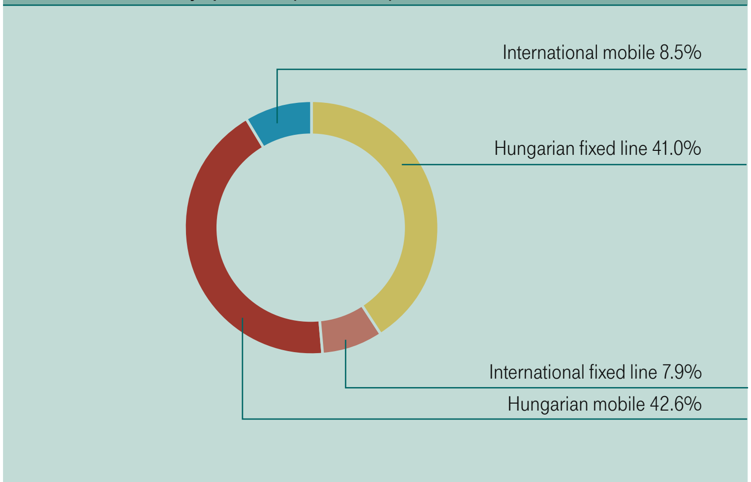
- Total revenues of Magyar Telekom Group increased by 3.2% to HUF 620.7 bn (EUR 2.5 bn using the 2005 average exchange rate of 248.05 HUF/EUR), primarily driven by the impact of the consolidation of Telekom Crne Gore (TCG) Group in April 2005.

- External revenues from fixed line services decreased by 0.9% to HUF 331.1 bn with TCG Group contributing HUF 12.0 bn. Traffic revenues were adversely impacted by the increased competitive pressure in Hungary, declining line numbers, both in Hungary and Macedonia, and the continued mobile substitution. The growth in leased lines and data transmission revenues was driven by higher broadband connections, counterbalancing a significant part of lower traffic revenues. Cable television revenues continued to increase in 2005.

- External revenues from mobile services increased by 8.4%, reaching HUF 289.6 bn, primarily driven by the increase in the customer base, higher usage in Hungary, enhanced services, and the consolidation of Monet. The Montenegrin subsidiary, Monet, contributed HUF 7.9 bn to total revenues.

- Group EBITDA amounted to HUF 248.1 bn with an EBITDA margin of 40.0%. TCG Group contributed HUF 2.3 bn to fixed line and HUF 3.3 bn to mobile EBITDA.

EBITDA breakdown by operations (HUF million)



Overview of the regulatory environment

In 2005, the National Regulatory Authority (NRA) concluded most of its initial market analysis based on the EU recommendation for the 18 product and service markets of the electronic communications sector. As a result, a price cap was introduced on the aggregate increase to access fees of residential and non-residential lines (anticipated CPI). The overall level of the retail price increase for universal services remains regulated (anticipated CPI minus 3%). Furthermore, the prices of the wholesale national bitstream access and wholesale leased line termination became regulated.

NRA identified Vodafone Hungary as an operator with significant market power in the mobile market and its termination fees became regulated in 2005. As a result of the new fees, the asymmetry in mobile termination fees decreased.

In Macedonia, the liberalization of the fixed line services commenced in 2005. The reference interconnection offer was approved in early 2006, with the reference unbundling offer expected to follow shortly. The introduction of number portability is scheduled for 2007.

Fixed line segment: Broadband growth and headcount efficiency improvement

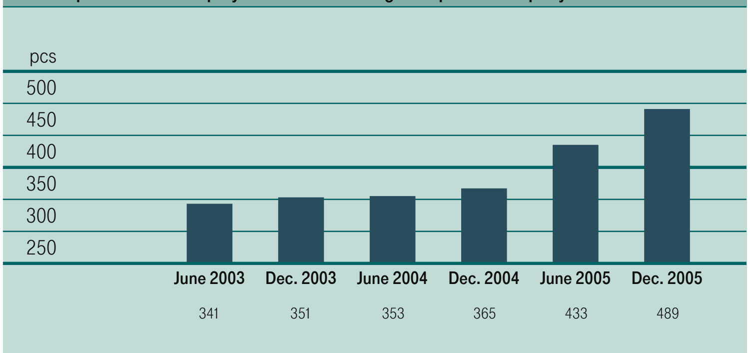
By the end of 2005, the total number of fixed lines decreased by 5.1% to below 2.8 million lines with a 35.6% fixed line penetration in Magyar Telekom's service area. Lines per fixed line employee at parent company level increased to 489. Additionally, T-Kábel, the cable unit of Magyar Telekom, launched voice service and triple-play offers in mid-2005, reaching 13,385 voice-over-cable subscribers at the end of the year. The number of revenue-generating Hungarian broadband internet lines increased to 357,957, from 222,358 a year ago.

The total number of MakTel's lines decreased by 10.7% in 2005, inter alia by mobile substitution, while fixed line penetration declined to 26.0%. Lines per fixed line employee at MakTel increased to 315. The number of broadband internet lines increased to 7,935 from 2,611 a year ago.

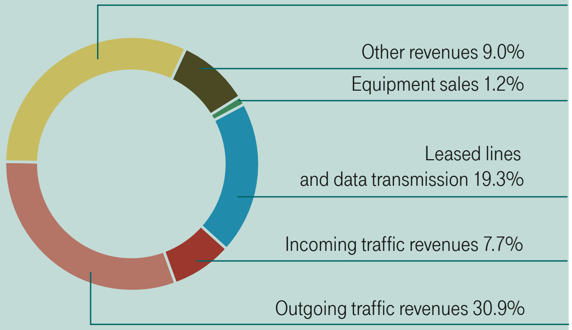
Montenegrin fixed line penetration was 31.2% at the end of 2005 with 193,872 lines. The number of broadband internet lines was 1,202.

Total fixed line revenues decreased by 0.9% despite the consolidation of Telekom Crne Gore from April 2005. The number of total broadband lines increased by 63.2%, but line and traffic erosion continued. EBITDA margin on external revenues for the segment was 36.6%.

Lines per fixed-line-employee ratio at the Hungarian parent company



External revenues from fixed line services



External revenues of the segment declined by 0.9% as a combined result of lower traffic revenues, higher internet related revenues and the consolidation impact of Telekom Crne Gore (TCG). Lower traffic revenues mainly reflect increased fixed line and mobile competition and the lower revenue-generating number of customers.

In the attempt to preserve longer term internal efficiency, Magyar Telekom is implementing a headcount reduction program at the fixed operations. The benefits of the program have already been visible in 2005. Furthermore, declining Hungarian mobile termination fees and lower average charges of international operators support the profitability of the segment.

Fixed line voice operations: repackaging to compete

Consolidated revenues from subscriptions, connections and other charges decreased by 0.5% to HUF 105.7 bn, mainly driven by the lower number of lines, reduced private branch exchange revenues, and lower amortization of deferred revenues. The decline was mitigated mainly by the consolidation of TCG, the increased role of access-type voice packages (e.g. Favorit), and a marginal increase in some subscription fees.

Total outgoing traffic revenues reduced by 18.1% to HUF 102.1 bn. Excluding TCG, the decline would be 22.8%. Outgoing domestic minutes in Hungary decreased by 12.5% and by 14.1% in Macedonia. Outgoing international minutes declined by 15.3% and 11.6%, respectively, mainly due to competitors capturing traffic and the lower number of lines. In respect of tariffs, customized tariff packages offer certain discounts to encourage retention of the customer base. The majority of these discounts reduce outgoing traffic revenues. Furthermore, the lower Hungarian mobile termination fees allowed a reduction in average end-user prices.

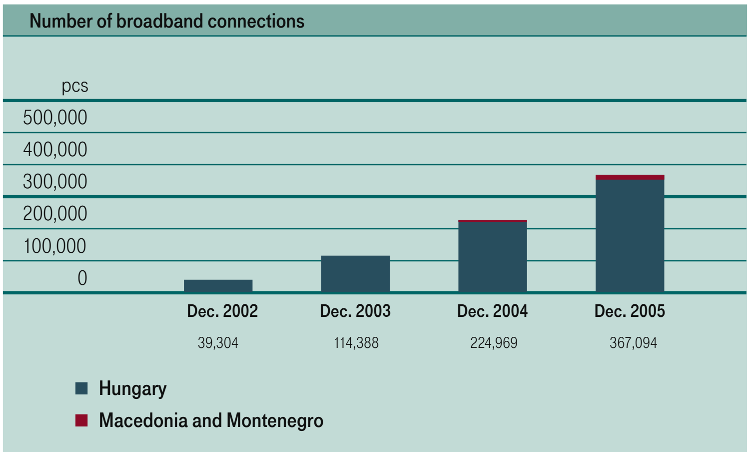
Total incoming traffic revenues increased by 18.3% to HUF 25.6 bn mainly driven by TCG consolidation and higher Hungarian interconnection revenues as call-by-call and pre-select competitors generated more traffic.

The number of Magyar Telekom's cable television subscribers was up by 5.1%, reaching 403,631 at the end of 2005. Revenue growth at the cable operation was the main driver of the increase in other revenues to HUF 29.9 bn.

Data and internet: fixed line momentum

Internet related revenues continue to grow as broadband programs gather momentum.

Consolidated revenues from leased lines and data transmission amounted to HUF 63.7 bn in 2005, a 25.0% increase compared to 2004, primarily driven by the successful rollout of broadband services in Hungary. The number of total broadband internet lines was up by 61.0% in Hungary and by 203.9% in Macedonia. The number of internet subscribers at the Hungarian internet service provider, T-Online, increased by 23.5% to 328,535, with a significant increase in broadband users generating higher revenue. T-Online holds an estimated 42% share of the dial-up and broadband markets in Hungary and is the market leader with a population based internet penetration of around 9%. At MakTel, the number of internet subscribers increased by 36.3% by the end of 2005, with the population based internet penetration estimated at around 6%. TCG Group contributed HUF 1.2 bn to leased lines and data transmission revenues.

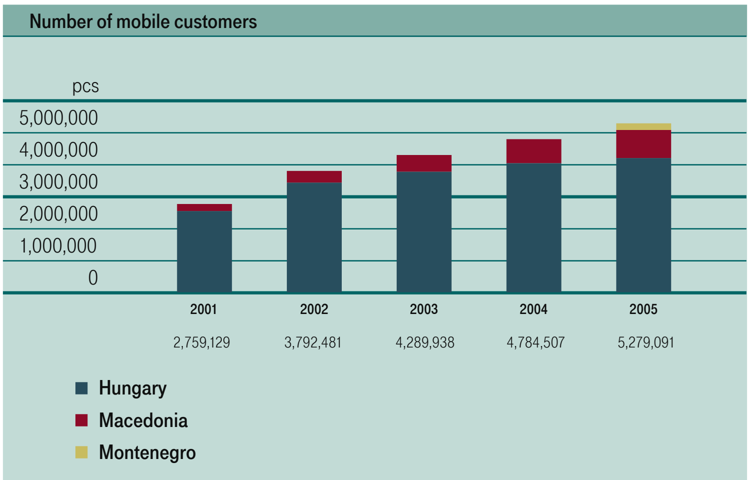


Mobile segment: maintaining the leading role

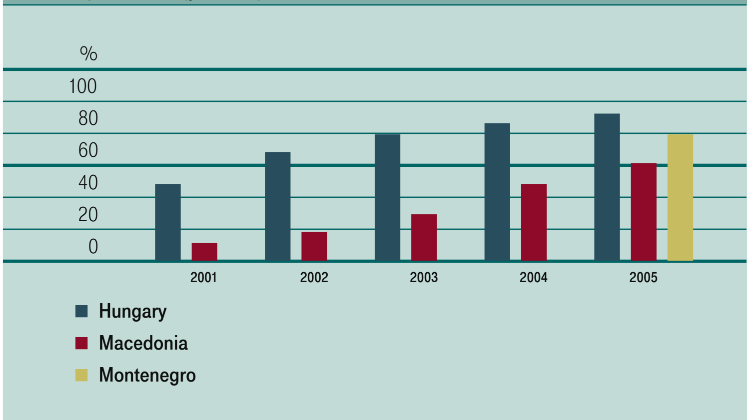
Hungarian mobile penetration increased by 6 percentage points in 2005, reaching 92.4% at the end of the year. Because of the high penetration, the focus is gradually shifting from customer acquisition to retention. The average acquisition cost per subscriber (SIM card cost, sales related equipment subsidy and agent fee less connection fee) decreased further by 31.3% to HUF 7,062 despite the higher ratio of postpaid subscribers at 31.6% at the end of 2005, compared to 28.9% a year ago. T-Mobile Hungary's subscriber base increased by 4.0% to 4.2 million.

Macedonian mobile penetration increased by more than 13 percentage points in 2005, reaching 61.3% at the end of the year. The revenue-generating customer base of the Macedonian mobile arm, MobiMak, increased by 16.6% to 877,142. The proportion of postpaid customers was broadly stable at 15.9% at the end of 2005. In Montenegro, the penetration showed signs of seasonal fluctuation within the year, driven by the summer holiday season. The figure stood at 78.6% at the end of 2005. Monet, the Montenegrin mobile arm, was ranked second with 208,094 subscribers, a 42.7% market share, and a postpaid ratio of 15.0%.

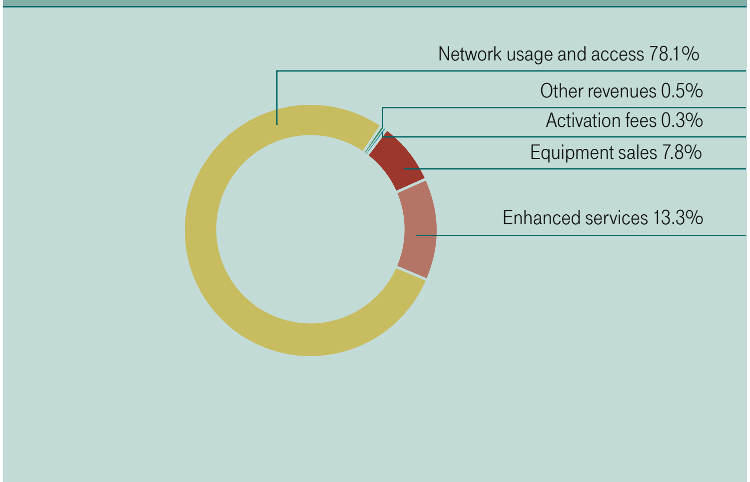
T-Mobile Hungary and MobiMak maintained their clear market leadership with a market share of 45.0% and 69.2%, respectively, at the end of 2005. EBITDA of the segment grew by 4.6% (excluding Monet, EBITDA growth would have been 1.9%). EBITDA margin for the segment on external revenues was 43.8%.



Mobile penetration (year-end)



External revenues from mobile services



Excluding the consolidation impact of Monet, revenues from network usage and access would have increased by 5.4% and revenues from enhanced services by 17.2%, mainly driven by the increasing Hungarian customer base, with broadly stable ARPU also reflecting continued growth in enhanced services. However, lower revenues from equipment sales, mainly driven by a decrease in the average price of handsets sold, somewhat mitigated the increase.

The Hungarian average monthly minutes of use (MOU) increased by 10.4% to 127. However, the average revenue per user (ARPU) declined by 0.6% to HUF 4,917 (or EUR 19.8 using the 2005 average exchange rate of 248.05 HUF/EUR) despite higher revenues from enhanced services, mainly as a result of competition-driven discounts, conscious package selection and lower interconnection revenues. The mobile termination fees of T-Mobile Hungary were further cut in mid-2005 by an estimated average of 10%. T-Mobile Hungary launched commercial UMTS service in August 2005, which had an insignificant impact on full year revenues.

The dilution impact of the increasing subscriber base on usage and tariff pressure from the other mobile operator heavily impacted the corresponding operational figures of MobiMak. The average monthly minutes of use (MOU) decreased by 4.5% to 63 with the average revenue per user (ARPU) declining 19.4% to HUF 3,065 (or EUR 12.4 using the 2005 average exchange rate of 248.05 HUF/EUR). Hence, MobiMak could only marginally contribute to revenue growth, despite of the significant growth in the customer base.

Monet, the Montenegrin mobile arm, has been consolidated from the second quarter of 2005 and reported an average ARPU of HUF 3,745 (or EUR 15.1 using the 2005 average exchange rate of 248.05 HUF/EUR), and MOU of 127.

Analysis of expenses

Employee-related expenses decreased by 15.3% to HUF 92.8 bn despite the consolidation of TCG Group from the second quarter of 2005, primarily explained by the lower headcount and lower restructuring charges. At the end of 2005, total group headcount was 11,919, representing a 13.2% decline compared to 13,724 a year ago. Restructuring charges related to headcount efficiency improvement measures decreased to HUF 5.1 bn, from HUF 20.7 bn in 2004.

Depreciation and amortization amounted to HUF 114.7 bn, compared to HUF 137.7 bn in 2004 (a decrease of 16.7%). Goodwill is not amortized from 2005 (HUF 13.9 bn in 2004, mainly from the acquisition of Westel and the MakTel Group). In 2004, Magyar Telekom booked a HUF 4.4 bn impairment charge on the Westel brand name resulting from the T-Mobile Hungary rebranding and a HUF 5.4 bn impairment mainly related to managed leased line node equipment and operational system.

Payments to other network operators amounted to HUF 89.1 bn, compared to HUF 87.6 bn in 2004. The increase of 1.7% is due to the consolidation impact of TCG Group as a further decrease in Hungarian mobile termination fees, a favorable change in average international roaming charges and lower outgoing fixed line minutes fully offset the higher expenses from increased mobile traffic.

The cost of telecommunications equipment sales decreased by 9.2% to HUF 37.2 bn, driven primarily by lower average mobile handset prices.

Other operating expenses increased by 9.3% to HUF 153.5 bn, mainly driven by the consolidation impact of TCG Group, increased sales activity and operating costs related to, for example, ADSL sales, presence in the service areas of other Hungarian local telecom operators, etc. The rebranding of the Hungarian fixed line operations in 2005 and the Hungarian mobile operation in 2004 did not result in increased net operating expenses because of the compensation received from the parent company (Deutsche Telekom). In 2005, other expenses include HUF 2,059 million paid under four consulting contracts entered into by the Group, as to which the Company has not been able to obtain sufficient evidence that it or its subsidiaries received adequate value.

Net debt to total capital ratio

Net financial expenses decreased by 13.4% to HUF 31.3 bn in 2005 mostly due to the lower Hungarian interest rate levels and favorable foreign exchange impacts. At the end of 2005, loans remained almost exclusively Hungarian Forint-denominated with 24.6% subject to floating interest rates. The net debt to total capital (net debt plus equity plus minority interest) ratio was 33.2% with a net debt of HUF 296.6 bn at the end of 2005, up from HUF 283.2 bn a year ago.

In 2004, the share of associates' results after tax reflected a significant gain on Hunsat's sale of its investment in Eutelsat in the first quarter of 2004. This non-recurring item is the main reason for the decreased contribution of associated companies in 2005.

Income tax expense increased to HUF 13.5 bn in 2005 as a result of higher profit before tax. The decreased effective tax rate in 2005 (down to 13.2% from 15.1% in 2004) was partly due to the compounding of the tax credit carried forward, related to the Hungarian broadband investments, which resulted in tax credits with no impact on profit before tax.

The increase in minority interests to HUF 10.4 bn is driven by higher profit after tax at MakTel and the consolidation impact of TCG Group.

Stable dividend and acquisition of TCG Group.

Cash flow generation

In 2005, net cash flow from operating activities increased by 6.1% to HUF 201.3 bn reflecting strong cash generation, consolidation of TCG Group and lower income tax and interest paid, driven by lower Hungarian interest rate levels and some fluctuation in tax payments. Purchase of tangible and intangible assets amounted to HUF 103.6 bn including the HUF 11.5 bn installments of the UMTS license fee and other UMTS-related investments. In 2005, the purchase of subsidiaries and business units includes the acquisition of TCG Group. Magyar Telekom paid HUF 70 dividend per share on 2004 earnings, the same as in 2004. However, in 2005 dividends paid to shareholders and minority interests increased to HUF 84.6 bn from HUF 78.3 bn as MakTel distributed a significantly higher amount to its shareholders and the amount paid to shareholders other than the Magyar Telekom Group increased this cash flow line.

Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm to the Board of Directors
and Shareholders of Magyar Telekom Plc.

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers Kft.
H-1077 Budapest
Wesselényi u. 16.
H-1438 Budapest, P.O. Box 517
HUNGARY
Telephone: (36-1) 461-9100
Facsimile: (36-1) 461-9101
Internet: www.pwc.com/hu

To the shareholders of Magyar Telekom Nyrt.

Independent Auditors' Report

We have audited the consolidated balance sheet of Magyar Telekom Nyrt. (the "Company") as of 31 December 2005 – in which the balance sheet total is MHUF 1,082,948 the profit attributable to equity holders of the Company is MHUF 78,564 –, the related consolidated statements of income, cash flows and changes in shareholders' equity for the year ended 31 December 2005 and the notes for 2005 which are included in the consolidated financial statements of Magyar Telekom Nyrt. The consolidated financial statements and the business report are the responsibility of the Company's management. The auditor's responsibility is to express an opinion on the consolidated financial statements based on the audit and to assess whether or not the accounting information disclosed in the business report is consistent with that contained in the consolidated financial statements.

We conducted our audit in accordance with Hungarian and International Standards on Auditing and with applicable laws and regulations in force in Hungary. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements and also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. Our work with respect to the business report was limited to checking it within the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. We believe that our audit provides a reasonable basis for our audit opinion.

During our work we have audited the components and disclosures along with the underlying accounting records and supporting documentation in the consolidated financial statements of Magyar Telekom Nyrt. in accordance with Hungarian and International Standards on Auditing and, on the basis of our audit work, we have gained sufficient and appropriate evidence that the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted for use in the European Union. In our opinion, the consolidated financial statements give a true and fair view of the financial position of Magyar Telekom Nyrt. as at 31 December 2005 and of the results of its operations for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union. The business report is consistent with the disclosures in the consolidated financial statements.

Budapest, 20 December 2006

Szilvia Szabados
Statutory Auditor
Licence No.: 005314
Office Address:
16 Wesselényi u, 1077 Budapest

Nick Kós
Partner
PricewaterhouseCoopers Kft.
Licence No.: 001464
Address: 16 Wesselényi u, 1077 Budapest

Consolidated balance sheets

	Notes	2004	2005	2005
		At December 31,		
		(in HUF millions)		(million USD) (unaudited) (note 2)
ASSETS				
Current assets				
Cash and cash equivalents	6	36,879	46,060	216
Other financial assets	7	576	1,817	9
Trade and other receivables	8	83,440	97,183	455
Current income tax receivable		3,549	452	2
Inventories	9	7,669	8,414	39
Assets held for disposal	10	3,063	2,302	11
Total current assets		135,176	156,228	732
Non current assets				
Property, plant and equipment – net	11	571,090	580,736	2,719
Intangible assets – net	12	298,351	319,797	1,497
Associates	14	5,750	5,020	23
Deferred taxes	26	12,527	14,966	70
Other non current assets	15	6,664	6,201	29
Total non current assets		894,382	926,720	4,338
Total assets		**1,029,558**	**1,082,948**	**5,070**
LIABILITIES				
Current liabilities				
Loans from related parties	17	60,000	74,648	350
Loans and other borrowings – third party	17	34,538	43,602	204
Trade and other payables	18	109,921	119,464	559
Current income tax payable		52	1,472	7
Deferred revenue	19	1,502	918	4
Provision for liabilities and charges	20	15,537	6,817	32
Total current liabilities		221,550	246,921	1,156
Non current liabilities				
Loans from related parties	17	177,675	212,000	993
Loans and other borrowings – third party	17	48,395	14,215	67
Deferred revenue	19	1,186	267	1
Deferred taxes	26	1,280	3,189	15
Provision for liabilities and charges	20	2,761	3,141	15
Other non current liabilities	18	47	5,521	26
Total non current liabilities		231,344	238,333	1,117
Total liabilities		452,894	485,254	2,273
EQUITY				
Shareholders' equity				
Common stock		104,281	104,281	488
Additional paid in capital		27,382	27,382	128
Treasury stock		(3,842)	(1,926)	(9)
Cumulative translation adjustment		(3,026)	(420)	(2)
Retained earnings		391,772	398,250	1,864
Total shareholders' equity		516,567	527,567	2,469
Minority interests		60,097	70,127	328
Total equity		576,664	597,694	2,797
Total liabilities and equity		**1,029,558**	**1,082,948**	**5,070**

These consolidated financial statements were authorized for issue by the Board of Directors on December 5, 2006 and signed on their behalf by:

Horst Hermann
Deputy Chairman
of Board of Directors

Dr. Klaus Hartmann
Chief Financial Officer
until September 15, 2006,
Board member

Thilo Kusch
Chief Financial Officer,
Board member

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

Consolidated income statements

	Notes	2003	2004	2005	2005
		For the year ended December 31,			
		(in HUF millions, except per share amounts)			(million USD) (unaudited) (note 2)
Fixed line services	21	358,655	334,174	331,062	1,550
Mobile services	22	248,597	267,264	289,635	1,356
Total revenues		607,252	601,438	620,697	2,906
Employee related expenses	23	(87,920)	(109,497)	(92,783)	(434)
Depreciation and amortization		(128,334)	(137,666)	(114,686)	(537)
Payments to other network operators		(84,449)	(87,580)	(89,097)	(417)
Cost of telecommunications equipment sales		(40,811)	(40,971)	(37,221)	(174)
Other operating expenses – net	24	(143,674)	(140,460)	(153,522)	(720)
Total operating expenses		(485,188)	(516,174)	(487,309)	(2,282)
Operating profit		122,064	85,264	133,388	624
Net financial expenses	25	(40,002)	(36,146)	(31,288)	(146)
Share of associates' profits/losses after tax	14	795	1,896	330	1
Profit before income tax		82,857	51,014	102,430	479
Income tax	26	(13,517)	(7,687)	(13,511)	(63)
Profit for the year		**69,340**	**43,327**	**88,919**	**416**
Attributable to:					
Equity holders of the Company (Net income)		57,475	34,641	78,564	368
Minority interests		11,865	8,686	10,355	48
		69,340	**43,327**	**88,919**	**416**
Earnings per share (EPS) information:					
Profit attributable to the equity holders of the Company		57,475	34,641	78,564	368
Weighted average number of common stock outstanding (thousands) used for basic EPS		1,037,912	1,037,912	1,038,803	
Average number of dilutive share options (thousands)		122	318	417	
Weighted average number of common stock outstanding (thousands) used for diluted EPS		1,038,034	1,038,230	1,039,220	
Basic earnings per share (HUF and USD)		55.38	33.38	75.63	0.35
Diluted earnings per share (HUF and USD)		55.37	33.37	75.60	0.35

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

Consolidated cashflow statements

	Notes	2003	2004	2005	2005
		For the year ended December 31,			
			(in HUF millions)		(million USD) (unaudited) (note 2)
Cashflows from operating activities					
Cash generated from operations	27	240,497	234,681	236,937	1,110
Interest paid		(30,063)	(34,030)	(31,078)	(146)
Income tax paid		(12,318)	(10,900)	(4,523)	(21)
Net cashflows from operating activities		198,116	189,751	201,336	943
Cashflows from investing activities					
Purchase of tangible and intangible assets	13	(90,788)	(91,748)	(103,587)	(485)
Purchase of subsidiaries and business units	5	(7,992)	(17,273)	(35,927)	(168)
Cash acquired through business combinations	5	61	16	1,866	9
Interest received		908	1,452	2,195	10
Dividend received		575	2,633	1,729	8
Proceeds from / (payments for) other financial assets – net		266	43	(371)	(2)
Proceeds from disposal of non current assets		2,269	4,090	2,529	12
Net cashflows from investing activities		(94,701)	(100,787)	(131,566)	(616)
Cashflows from financing activities					
Dividends paid to shareholders and minority interest		(23,507)	(78,294)	(84,551)	(396)
Proceeds from loans and other borrowings		192,057	338,680	263,329	1,233
Repayment of loans and other borrowings		(260,583)	(332,481)	(242,595)	(1,136)
Purchase of treasury stock		(3,842)	-	-	-
Proceeds from sale of treasury stock		3,842	-	1,969	9
Other		(2)	-	-	-
Net cashflows from financing activities		(92,035)	(72,095)	(61,848)	(290)
Effect of foreign exchange rate changes on cash and cash equivalents		1,901	(2,122)	1,259	6
Change in cash and cash equivalents		**13,281**	**14,747**	**9,181**	**43**
Cash and cash equivalents, beginning of year		8,851	22,132	36,879	173
Cash and cash equivalents, end of year	6	22,132	36,879	46,060	216

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

Consolidated statements of changes in equity

	Attributable to the equity holders of the Company						Minority interest	Total equity
	Shares of common stock (a)	Common stock	Additional paid in capital	Treasury stock	Cumulative translation adjustment	Retained earnings (i)		
Balance at December 31, 2002	**1,042,811,600**	**104,281**	**27,382**	**(4,488)**	**(4,348)**	**393,317**	**59,436**	**575,580**
Dividend (g)						(18,682)		(18,682)
Dividend declared to minority interest (h)							(4,796)	(4,796)
Business combinations (b)							(2,424)	(2,424)
Sale of treasury stock (c)				4,488		(646)		3,842
Purchase of treasury stock (c)				(3,842)				(3,842)
Cumulative Translation Adjustment					5,173		6,193	11,366
Profit for the year						57,475	11,865	69,340
Balance at December 31, 2003	**1,042,811,600**	**104,281**	**27,382**	**(3,842)**	**825**	**431,464**	**70,274**	**630,384**
Dividend (g)						(72,654)		(72,654)
Dividend declared to minority interest (h)							(5,651)	(5,651)
Business combinations (b)							(9,109)	(9,109)
Purchase of investment in T-Systems Hungary (d)						(1,679)		(1,679)
Cumulative Translation Adjustment					(3,851)		(4,103)	(7,954)
Profit for the year						34,641	8,686	43,327
Balance at December 31, 2004 as reported	**1,042,811,600**	**104,281**	**27,382**	**(3,842)**	**(3,026)**	**391,772**	**60,097**	**576,664**
Effect of adoption of changes in IAS 39 – net of tax (note 2(e))						(733)		(733)
Balance at December 31, 2004 as restated	**1,042,811,600**	**104,281**	**27,382**	**(3,842)**	**(3,026)**	**391,039**	**60,097**	**575,931**
Dividend (g)						(72,654)		(72,654)
Dividend declared to minority interest (h)							(11,913)	(11,913)
Business combinations (b)							9,447	9,447
Sale of Telit to DeTe Immobilien (d)						495		495
TSI's capital injection in TSH (d)						669		669
Sale of treasury stock (e)				1,916		53		1,969
Effect of fair value of share based payments (f)						84		84
Cumulative Translation Adjustment					2,606		2,141	4,747
Profit for the year						78,564	10,355	88,919
Balance at December 31, 2005	**1,042,811,600**	**104,281**	**27,382**	**(1,926)**	**(420)**	**398,250**	**70,127**	**597,694**
Of which treasury stock	(2,456,659)							
Shares of common stock outstanding at December 31, 2005	**1,040,354,941**							

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

Consolidated statements of changes in 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, 2005. This Series "B" share is held by the Ministry of Informatics and Communications 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. The number of authorized shares on December 31, 2005 is 1,054,911,600.

(b) Business combinations include the change in minority interests due to acquisitions. In case of new acquisitions where Magyar Telekom acquires a less than 100 percent stake, minority interests increase. Minority interests decrease where Magyar Telekom acquires further share of ownership in subsidiaries already consolidated.

(c) Due to statutory requirements the Company sold and repurchased its 4,900,000 shares of common stock in 2003 for HUF 3,842 million, which resulted in a loss of HUF 646 million recognized in retained earnings.

(d) Related party transactions

In 2004 Magyar Telekom acquired a 49% share of ownership in T-Systems Hungary (TSH), since which time TSH is an associate of Magyar Telekom Group. As both Magyar Telekom and TSH belong to the Deutsche Telekom group, the ultimate parent of Magyar Telekom, the transaction is considered as being between entities under common control. As a result, the difference between the carrying value of this investment in T-Systems International's books (HUF 1,751 million) and the purchase price (HUF 3,430 million) was accounted for directly against the retained earnings of the Group.

In 2005 Magyar Telekom sold its investment in Telit Rt., the real estate outsourcing company of Magyar Telekom to DeTe Immobilien, a Deutsche Telekom group member. As the transaction took place between entities under common control, the gain on the sale of the investment was recognized directly in retained earnings.

In 2005 T-Systems International (TSI) forgave a loan given to T-Systems Hungary (TSH) in an amount of HUF 1,366 million of which HUF 669 appears as an increase in Magyar Telekom's share of TSH's net assets on equity consolidation as TSH is an associated company of the Group. As all three parties are part of the Deutsche Telekom group and the transaction took place between entities under common control, the increase in Magyar Telekom's investment in TSH was recognized directly in retained earnings.

(e) In 2005 Magyar Telekom's CEO and other managers exercised some of their share options, and the Company used its treasury shares reserved for the option programs. As a result of these transactions, the Company sold 2,443,341 of its treasury shares to the CEO and other managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 53 million, which was recognized in retained earnings. For more details on the programs see note 28.

(f) In 2005 Magyar Telekom adopted IFRS 2 – Share-based payment, which requires the Company to recognize the cost of the equity-settled share-based payments against retained earnings. In 2005 the Company accounted for HUF 84 million of such expenses. For more details see note 28.

(g) In 2005 Magyar Telekom Plc. declared and paid HUF 70 dividend per share (HUF 70 in 2004, HUF 18 in 2003).

(h) The dividend declared to minority interest almost entirely reflects the dividend declared by MakTel, Magyar Telekom's Macedonian subsidiary to its minority shareholders.

(i) The distributable reserves of the Company under Hungarian law at December 31, 2005 amounted to approximately HUF 282,000 million (HUF 283,000 million at December 31, 2004).

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

Notes to the Consolidated Financial Statements

1 General Information

Magyar Telekom Plc., (the "Company" or "Magyar Telekom Plc.") with its subsidiaries form Magyar Telekom Group ("Magyar Telekom" or "the Group"). Magyar Telekom is the principal supplier of telecommunications services in Hungary, Macedonia and Montenegro. Magyar Telekom is a full-service telecommunications provider.

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

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

Investigation into certain consultancy contracts

On February 13, 2006, the Company announced that it was investigating certain contracts to determine whether they were entered into in violation of Company policy or applicable law or regulation. The investigation, which is being conducted by an independent law firm and supervised by the Audit Committee, is still ongoing. Concerns regarding two consultancy contracts entered into by one of the Company's subsidiaries were initially raised by the Company's auditors. As a result of the investigation, two additional consultancy contracts, which were entered into by the Company, have been called into question. The total amount of the four contracts under investigation is around HUF 2 billion. The investigators have concluded that certain employees impeded the investigation by destroying relevant electronic documents. As a consequence of the investigation, the Company has suspended a number of employees who have since resigned.

Although the investigation has not been finalized, to date the independent investigators have been unable to establish that the Company or its subsidiaries received benefits from these contracts of a value commensurate with the amounts paid on the contracts. Moreover, these contracts were entered into without full compliance with internal company procedures regarding the entry of such contracts. In its 2005 preliminary results announcement, the Company had capitalized the HUF 1.12 billion payment made related to two of these contracts. As a result of the findings of the investigation, the Company has expensed the total amount of the HUF 2 billion paid under these four contracts, and disclosed these expenses under the caption "Other operating expenses – net" (see Note 24). This has resulted in a commensurate effect on, among other items, taxes, minority interest and net income when compared to the corresponding items in the Company's 2005 preliminary results announcement.

The Company has already implemented certain remedial measures designed to enhance its control procedures with respect to the entry into consultancy contracts, including the introduction of a new governance model and replacement of the Board of Directors at Crnogorski Telekom and termination of work contracts with employees initiating data deletions interfering with the investigation.

The Company's Board of Directors also approved on November 8, 2006 a more extensive program of remedial actions, which it expects to implement in the near future. These decisions include structural and procedural changes in relation to mergers and acquisitions and procurement, as well as a new internal control regime. The Company's Board of Directors also decided on December 5, 2006 on certain additional enhancements of internal controls and the implementation thereof.

As a result of the delays in finalizing its 2005 financial statements as a result of the investigation, the Company and some of its subsidiaries have failed and may fail to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. The Company has already been fined HUF 12 million as a consequence of such delays. The Company has notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation and is in contact with these authorities regarding the investigation and has responded to a number of inquiries these authorities have raised.

Magyar Telekom is Hungary's, Macedonia's and Montenegro's largest telecommunications service provider. In addition, Magyar Telekom provides leased lines, data transmission, corporate networks, cable television, internet services and sells and leases telecommunications equipment in Hungary, Macedonia and Montenegro.

On February 22, 2005, the General Meeting approved the renaming of Magyar Távközlési Rt. (Matáv) to Magyar Telekom Plc. and rebranding its products, which was completed by December 2005. As agreed, Deutsche Telekom, the controlling shareholder of the Group, supported the renaming and the product rebranding. The impact of renaming and product rebranding on the consolidated financial statements as of December 31, 2005 included HUF 7,281 million of expenditures accounted for in the operating expenses and a compensation by Deutsche Telekom of HUF 7,281 million disclosed separately in note 24.

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

The regulatory environment under which the Group operates is summarized as follows:

Hungarian Fixed line

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

According to the Act on Electronic Communications, universal services are basic communications services that should be available to all customers at an affordable price. Universal service providers are entitled to compensation for their net avoidable costs, except for the costs incurred from discount pricing plans offered to residential subscribers.

The NCA assigned 18 relevant markets in the area of electronic communications in 2004. In 2004 and 2005 Magyar Telekom was designated as an SMP (an operator with significant market power) in 12 markets. These included all retail and wholesale voice markets, the market of wholesale leased line and termination, the market of minimum set of leased lines and the wholesale broadband market.

Currently in Hungary, beside the universal services, the retail voice tariff regulation is only concerned with the access market for both business and residential customers. This regulation is based on the price-cap method. There is a price-cap for universal service packages and the SMP designation on residential and business access markets has introduced a new price cap for all subscription fees.

Magyar Telekom Plc.'s regulated access prices currently include an access deficit, which should be eliminated according to the Pricing Act and the relating ministerial decrees.

According to the Act on Electronic Communications, designated SMP operators like Magyar Telekom are obliged to prepare reference offers for unbundled local loops (RUO) and bit-stream access and to provide these services when there is a request for them by other telecommunications service providers. The reference offer of each SMP must be approved by the NCA. The price of these services has to be cost based and calculated using Fully Distributed Costs based on a 2003 Ministerial Decree.

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

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

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

Macedonian Fixed line

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

During the exclusivity period MakTel was obliged to provide universal services. It is expected that the Agency for Electronic Communications (Agency) will initiate a public tender proceeding for the purpose of electing one or more universal service providers (USP) in the first half of 2007, after enacting the relevant by-laws.

The regulatory framework for the tariff regulation for MakTel is provided in the currently valid Concession Contract. With the enactment of the ECL, the Agency may regulate retail prices of fixed telephony services. Regulated wholesale services are cost based using fully distributed costs (FDC). Long run incremental costs (LRIC) methodology is to be implemented from March 2007.

The concession contracts will be made compliant with the provisions of the ECL. Under the ECL, MakTel has been designated as an SMP in the market for fixed line voice telephone networks and services, including the market for access to the networks for data transmission and leased lines.

MakTel has neither the obligation nor the technical possibility to provide bit-stream unbundling. MakTel as an SMP operator has the obligation to enable its subscribers to access publicly available telephone services of any interconnected operator with officially signed interconnection contract. The number portability is scheduled to be fully implemented not later than two years after the enactment of the ECL, i.e. by March 5, 2007.

Montenegrin Fixed line

The Group's Montenegrin subsidiary, Crnogorski Telekom (CGT) is the holder of the only license issued for fixed line telecommunications services in Montenegro although the period of exclusivity provided by Telecommunications Law published in 2000 (the "2000 Law") expired at the end of 2003. The license allows CGT to provide domestic and international voice and data services as well as VOIP, leased line, public payphone, value added, etc. services.

The telecommunications sector in Montenegro is regulated by the 2000 Law. The 2000 Law established the Telecommunications Agency with broad authority and instituted a licensing regime whereby all telecommunications activity must be licensed by the Telecommunications Agency. Although a new Competition Law has come into force in 2006, a competition agency has not yet been instituted. To date, there is no consumer protection law or agency in Montenegro.

Prices of CGT must be approved by the Telecommunications Agency. CGT's tariff structure is currently highly unbalanced, monthly access fees and local calls are inexpensive, whereas long-distance and international calls are very expensive, and businesses are charged approximately twice as much as individuals. During the privatization process, a schedule for the cost-based re-alignment of prices for access lines and traffic, rebalancing tied to the timing of market liberalization was agreed with the Montenegrin government.

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

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

There is no obligation for number portability, local loop unbundling, bit stream access or accounting separation in Montenegro.

The State Union of Serbia and Montenegro had been negotiating a Stabilization and Association Agreement with the EU. It was expected that the agreement would be very similar to the agreements signed with Croatia and Macedonia requiring the harmonization of the telecommunications regulations with the regulatory framework of the EU. In the case of Montenegro the expected amendment of the 2000 Law will achieve most of that goal. As Montenegro has become an independent state in 2006, the country will have to restart negotiations about a Stabilization and Association Agreement of its own, however, this will expectedly have no impact on the telecommunications section of the document.

Hungarian Mobile

The Group is the market leader in the Hungarian mobile market through its Mobile operations, T-Mobile Hungary (T-Mobile H).

The initial duration of the concession regarding the GSM 900 public mobile radio telephone service is a period of 15 years calculated from the execution of the concession agreement (November 4, 1993 to November 4, 2008). On October 7, 1999 an amended concession contract was signed between the Ministry of Transport, Communications and Water Management and T-Mobile H extending T-Mobile H's rights and obligations to also provide service in the 1800 MHz band in Hungary. The DCS 1800 public mobile radio telephone service shall be 15 years from the execution of the new concession agreement (October 7, 1999 to October 7, 2014).

The Minister is entitled to extend the concession period for both the GSM 900 and the DCS 1800 public mobile radio telephone services upon their expiration, which with regard to the GSM 900 public mobile radio telephone service is on November 4, 2008, and with regard to the DCS 1800 public mobile radio telephone service is on October 7, 2014. The extension can be for another 7.5 years without the issuance of a tender invitation.

On November 4, 2002 the NCA designated T-Mobile H as having significant market power in the interconnections market.

On December 7, 2004 the NCA awarded T-Mobile H the exclusive right of use of certain frequency blocks for the deployment and operation of an IMT2000/UMTS mobile telecommunications system (3G system). The duration of the frequency usage right is 15 years (until 2019) with an option to extend it for another 7.5 years.

T-Mobile H is obliged by the term of the license decree to start commercial 3G service within 12 months after the acquisition of the license within the inner city of Budapest. It is also obliged to reach a population-wide coverage of 30% within 36 months of license acquisition. As of August 26, 2005 T-Mobile H had started to provide 3G service in compliance with the license conditions.

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

Macedonian Mobile

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

Prices of mobile services may be freely set by operators and providers. However, as a measure against a dominant position, the ECL provides the possibility to the Agency to impose regulated retail tariffs on the mobile market.

If the Agency determines that any of the existing mobile operators has significant market power, it will request the interconnection prices to be transparent and cost-oriented.

Carrier selection may be imposed on T-Mobile MK after the SMP announcement. Number portability is also applicable to the Mobile segment.

Under the Concession Agreement, T-Mobile MK has the exclusive license to use bandwidth 3 in the GSM 900 band and is entitled to operate all radio stations it reasonably requires to provide mobile public telephony services. T-Mobile MK's use of these frequencies is subject to terms and conditions set forth in the Concession Agreement.

Montenegrin Mobile

T-Mobile Crna Gora (T-Mobile CG), Magyar Telekom's subsidiary, is the holder of one of the two GSM licenses issued in Montenegro. T-Mobile CG was launched on July 1, 2000. It arrived as the second mobile telecommunications operator in Montenegro – four years after the first one.

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

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

No obligation for number portability is in force.

A tender for 3G mobile frequencies is currently being contemplated by the Montenegrin telecommunications regulator. The government plans to issue three 3G licenses, two to the incumbent mobile operators and one to a new entrant. In our view the size of the Montenegrin market would not justify the entry of a third operator to the already saturated mobile telecommunications market. We do not expect, however, that the tender would be issued before 2007.

2 Accounting policies

(a) Basis of presentation

The consolidated financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below, and in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. In Magyar Telekom's case these are identical to the IFRS as issued by the IASB and effective for 2005.

According to Hungarian regulation, the Annual General Meeting has the power to approve the consolidated financial statements of the Group.

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 cashflow statement for the year 2005 are also presented in millions of U.S. dollars ("USD") translated at a rate of HUF 213.58 to USD 1 (the official rate of the National Bank of Hungary at December 31, 2005). These translations are supplementary information and 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.

In 2005, the Group adopted the IFRSs below, which are relevant to its operations.

- IAS 1 (revised 2003) Presentation of Financial Statements
- IAS 2 (revised 2003) Inventories
- IAS 8 (revised 2003) Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 (revised 2003) Events after the Balance Sheet Date
- IAS 16 (revised 2003) Property, Plant and Equipment
- IAS 17 (revised 2003) Leases
- IAS 21 (revised 2003) The Effects of Changes in Foreign Exchange Rates
- IAS 24 (revised 2003) Related Party Disclosures
- IAS 27 (revised 2003) Consolidated and Separate Financial Statements
- IAS 28 (revised 2003) Investments in Associates
- IAS 32 (revised 2003) Financial Instruments: Disclosure and Presentation
- IAS 33 (revised 2003) Earnings per Share
- IAS 39 (revised 2003) Financial Instruments: Recognition and Measurement
- IFRS 2 (issued 2004) Share-based Payments
- IFRS 3 (issued 2004) Business Combinations

– IAS 36 (revised 2004) Impairment of Assets
– IAS 38 (revised 2004) Intangible Assets

The adoption of IAS 1, 2, 8, 10, 16, 17, 21, 24, 27, 28, 32 and 33 (all revised 2003) did not result in substantial changes to the Group's accounting policies. In summary:

– IAS 1 (revised 2003) has affected the presentation of minority interest and other disclosures.
– IAS 2, 8, 10, 16, 17, 27, 28, 32 and 33 had no material effect on the Group's policies.
– IAS 21 (revised 2003) had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance of the revised standard. All the Group entities have the same functional currency as their measurement currency.
– IAS 24 (revised 2003) has affected the identification of related parties and some other related-party disclosures.

The adoption of IAS 39 (revised 2003) has resulted in a change in the accounting policy relating to the classification of financial assets at fair value through profit or loss. Further, the change in accounting policy resulted in the de-recognition of certain embedded derivatives [note 2(e)], which was implemented as required by IAS 8 – Accounting Policies.

The adoption of IFRS 2 has resulted in a change in the accounting policy for share-based payments. Until December 31, 2004, the provision of share options to employees did not result in a charge in the income statement. Subsequent to that date, the Group charges the cost of share options to the income statement (note 23).

The adoption of IFRS 3, IAS 36 (revised 2004) and IAS 38 (revised 2004) resulted in a change in the accounting policy for goodwill. Until December 31, 2004, goodwill was amortized on a straight line basis over a period ranging from 10 to 20 years, and assessed for an indication of impairment at each balance sheet date. In accordance with the provisions of IFRS 3:

– The Group ceased amortization of goodwill from January 1, 2005
– Accumulated amortization as at January 1, 2005 has been eliminated with a corresponding decrease in the cost of goodwill
– From the year ended December 31, 2004 onwards, goodwill is tested annually for impairment, as well as when there are indications of impairment.

The Group has reassessed the useful lives of its intangible assets in accordance with the provisions of IAS 38. No adjustment resulted from this reassessment.

All changes in the accounting policies have been made in accordance with the transitional provisions in the respective standards. All standards adopted by the Group require retrospective application other than:

– IAS 16 the exchange of property, plant and equipment is accounted at fair value prospectively
– IAS 21 prospective accounting for goodwill and fair value adjustments as part of foreign operations
– IAS 39 does not require the classification of financial assets as at 'fair value through profit or loss' of previously recognized financial assets
– IFRS 2 retrospective application for all equity instruments granted after November 7, 2002 and not vested at January 1, 2005
– IFRS 3 prospectively after March 31, 2004

– IAS 39 requires simultaneous adoption with IAS 32
– IFRS 3 requires simultaneous adoption with IAS 36 and IAS 38

The adoption of IFRS 2 would have resulted in the following changes to the previously reported years and resulted in the following impact during 2005.

	For the year ended December 31,		
	2003	2004	2005
	(in HUF millions)		
Increase in Employee related expenses (share based payments)	30	82	84
Increase to Retained earnings	30	82	84

(b) Consolidation

(1) Subsidiaries
Subsidiaries (including Special Purpose Entities) in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies, are consolidated.

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

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets and contingent liabilities of the subsidiary acquired is recorded as goodwill.

In case of business combinations where the transaction takes place between companies under common control, the transaction is recorded at cost and any gains or losses on the transaction are directly recognized in retained earnings.

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

Business combinations before April 1, 2004 are accounted for according to the purchase method of accounting prescribed by IAS 22 – Business Combinations. For acquisitions after March 31, 2004, Magyar Telekom has been applying the provisions of IFRS 3 – Business Combinations. Although IFRS 3 continues to require purchase price allocation for new acquisitions, in case of additional shares acquired in subsidiaries already controlled (step acquisition), no purchase price allocation is made. Consequently, the difference between the consideration paid and the share of net assets acquired is accounted for as goodwill.

(2) Associates and joint ventures
Investments in associates and joint ventures are accounted for applying the equity method of accounting. Under this method the company's share of the post-acquisition profits or losses of associates and joint ventures is recognized in the income statement, under the caption "Share of associates' profits/losses after tax". The cumulative post-acquisition movements are adjusted against the cost of the investment.

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or over which the Group has significant influence, but which it does not control. Joint ventures are entities in which Magyar Telekom holds a 50% share of ownership with a third party owner of the other 50% with identical voting rights.

At December 31, 2005 and 2004 the principal operating subsidiaries and associates of the Group, which are incorporated in Hungary, Macedonia and Montenegro, were as follows:

Subsidiaries	**Group interest in capital as at December 31,**		**Activity**
	2004	**2005**	
Incorporated in Hungary:			
T-Mobile Hungary	100%	100%	Cellular telecom service provider
T-Online	100%	100%	Internet service and content provider
T-Kábel	100%	100%	Cable TV operator
BCN Rendszerház	100%	100%	Solutions for business customers
Emitel	100%	100%	Local telecom operator
InvesTel	100%	100%	Cable TV holding

Subsidiaries	Group interest in capital as at December 31,		Activity
	2004	2005	
Incorporated in Macedonia:			
Makedonski Telekomunikacii (MakTel)	51%	51%	Fixed line telecom service provider
T-Mobile Macedonia (T-Mobile MK)	51%	51%	Cellular telecom service provider
Telemacedonia	100%	100%	Management consulting
Stonebridge	100%	100%	Holding company
Incorporated in Montenegro:			
Crnogorski Telekom (CGT)	-	76.53%	Fixed line telecom service provider
T-Mobile Crna Gora (T-Mobile CG)	-	76.53%	Cellular telecom service provider
Internet Crna Gora (ICG)	-	76.53%	Internet service and content provider

Associates	Group interest in capital as at December 31,		Activity
	2004	2005	
Incorporated in Hungary:			
Hunsat	50%	50%	Satellite telecommunications
T-Systems Hungary (TSH)	49%	49%	Systems integration for business customers
Magyar RTL (M-RTL)	25%	25%	Television broadcast company

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

(c) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency of the reporting entities using 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 financial expenses.

For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date are incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at that date. The fair value adjustments resulting from the purchase price allocation and goodwill are accounted for in HUF for acquisitions before March 31, 2004, after which date these adjustments arising on consolidation are accounted for in the functional currency of the subsidiary as required by IFRS 3 – Business Combinations.

As the majority of the revenues and expenses of the Macedonian subsidiaries arise in MKD, the functional currency of these entities is MKD, while the majority of the revenues and expenses of the Montenegrin subsidiaries arise in EUR, the functional currency of these entities is EUR. 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 accounted against the Cumulative translation adjustment in equity.

(d) Cash and cash equivalents

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

(e) Financial assets

The Group classifies its financial assets into the following categories: at fair value through profit or loss, loans and receivables, and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

(1) Financial assets at fair value through profit or loss
This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as financial assets held for trading as Magyar Telekom does not apply hedge accounting. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance sheet date.

(2) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non current assets. Loans and receivables due within 12 months are classified as Trade and other receivables in the balance sheet, while those with a maturity over 12 months are included in Other non current assets.

(3) Available-for-sale financial assets
Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in Other non current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Magyar Telekom has no financial assets that would be classified in this category.

Regular purchases and sales of investments are recognized on trade-date, the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the income statement. Investments are derecognized when the rights to receive cash flows from the investments have expired or have been transferred, and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value.

Loans and receivables are carried at amortized cost using the effective interest method. Gains or losses arising from changes in the fair value of the financial assets at fair value through profit or loss category, including interest and dividend income, are presented in the income statement within Net financial expenses, in the period in which they arise.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If impairment is established, the loss on financial assets through profit or loss is recognized in Other financial expenses, while impairment loss of Trade and other receivables is charged in the Other operating expenses as Bad debt expense. Recoverable amounts of Trade and other receivables, used as a basis for determining whether impairment has become necessary, are estimated taking into account potential delays and defaults on payments.

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

The revised interpretation of IAS 39 – Financial Instruments – Recognition and Measurement does not consider contracts denominated in a currency that is not the functional currency of either of the contracting parties as a separable host contract and an embedded derivative if the contract currency is widely used in that market. As a result of the change in the interpretation, Magyar Telekom has restated its opening retained earnings to eliminate the carrying amounts of these embedded derivatives previously recognized (HUF 873 million) and the related deferred tax liability (HUF 140 million) in the balance sheet as at December 31, 2004.

(f) Inventories

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

(g) Assets held for disposal

Assets held for disposal include real estate that is no longer needed for the future operations of the Group, and have been identified for sale, which is expected to take place within 12 months. These assets are accounted for at the lower of carrying value or fair value less cost to sell. These assets continued to be depreciated until the sale, in accordance with IAS 16 – Property, Plant and Equipment until December 31, 2004. From January 2005 Magyar Telekom applies the regulations of IFRS 5 – Non Current Assets held for Sale and Discontinued Operations, whereby the depreciation is discontinued from the date of designation to the held for sale status.

(h) Property, plant and equipment

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

The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located is also included in the costs if the obligation incurred can be recognized as a provision according to IAS 37 – Provisions, Contingent Liabilities and Contingent Assets.

Government grants relating to the purchase of property, plant and equipment are deducted from the original cost of the items and are recognized in the income statement through the reduced amount of depreciation of the related assets over their useful lives. Investment tax credits relating to qualifying investment projects are also recognized in this manner (note 26).

Cost in the case of the outside plant comprises of 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 income statement in Other operating expenses.
Maintenance and repairs are charged to expense when incurred.

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

The useful lives assigned are as follows:

	Years
Buildings	10–50
Duct, cable and other outside plant	25–38
Other telecommunications equipment	7–15
Other fixed assets	3–12

(i) Intangible assets

Intangible assets are stated at historical cost less accumulated amortization and impairment losses.

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

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

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets and contingent liabilities of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions completed before March 31, 2004 is reported in the balance sheet as an intangible asset and was amortized using the straight-line method over its estimated useful life. Goodwill arising on acquisitions after this date was not amortized in 2004. Following the change in the IFRS regulations, amortization of goodwill arising on acquisition before March 31, 2004 was discontinued from January 1, 2005, and impairment testing is now carried out on an annual basis for all goodwill recognized in the IFRS accounts.

Intangible assets other than goodwill are amortized over their respective economic useful lives.

	Years
Software	3–5
Concessions and licenses	8–25
Brand-name	5–10
Other intangible assets	3–10

Other than goodwill, the Group has no intangible assets with indefinite life.

(j) Impairment of Property, plant and equipment and Intangible assets

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

Goodwill impairment is tested at the cash generating unit level, which is defined one level below the primary reporting segments, i.e. the national activities of the fixed line and the mobile segments (see note 4). The corporate headquarters' assets are allocated to the Hungarian operations of the fixed line segment.

(k) Leases

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

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

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

(3) Sale and leaseback transactions
Sale and leaseback transactions involve the sale of an asset by Magyar Telekom and the leasing of the same asset or part of it back to Magyar Telekom. When sale and leaseback transactions qualify as finance leases any gain on the sale is deferred and recognized in the income statement over the lease term through lower depreciation expense.

(l) Deferred taxes

Deferred tax is recognized, using the liability method, for tax losses and tax credits and 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.

(m) Loans and other borrowings

Borrowings are recognized initially at fair value less transaction costs. In subsequent periods, they are stated at amortized costs. The effective interest 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 was 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 was defined as the ratio of equity to debt financing, where debt excludes short term borrowings and loans related to the financing of acquisitions. As all loans taken for capital expenditure on tangible and intangible assets were repaid by the end of 2003, no interest was capitalized in 2004 and 2005.

Effective borrowing cost (note 17) is calculated using the average amount of loans and other borrowings during the year and the total interest and other financial charges. The weighted average interest rate on borrowings is calculated using the average amount of loans and other borrowings during the year and the interest expense charged.

Fair value information on loans and other borrowings is also presented in the financial statements (note 17). Fair value of loans and other borrowings is calculated using the discounted cashflow method.

(n) 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 are recognized in the income statement upon connection, reflecting the change in related legislation and the advanced development of the network.

(o) Employee benefits

(1) Short term employee benefits

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

(2) Pensions

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

Magyar Telekom does not have defined benefit pension schemes.

(3) Share based compensation

Magyar Telekom adopted IFRS 2 – Share-based Payment as of January 1, 2005. The standard requires the Group to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees. Accordingly, Magyar Telekom recognizes the costs of services received from its employees in a share-based payment transaction when services are received. Magyar Telekom recognizes a corresponding increase in retained earnings if the services are received in an equity-settled share-based payment transaction, or a liability if the services are received in a cash-settled share-based payment transaction.

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

Bonuses tied to the long term performance of the Magyar Telekom share are recognized in the income statement at their time-proportioned fair value (note 28) against an accumulating liability in Trade and other payables.

(4) Termination benefits

Termination benefits are payable whenever an employee's employment is terminated before the nominal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are discounted to present value.

(p) Provisions

Provisions as required by IAS 37 are recognized when Magyar Telekom 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.

(q) Treasury stock

When the Company or its subsidiaries purchase the Company's equity share capital, the consideration paid including any attributable incremental external costs are deducted from the Shareholders' equity as treasury stock until they are cancelled. Where such shares are subsequently sold or reissued, the treasury share balance decreases by the original cost of the particular shares, thereby increasing the equity, while any gains or losses are recognized in retained earnings.

(r) Revenues

Revenue is primarily derived from services provided to Magyar Telekom's customer subscribers and other third parties using Magyar Telekom's telecommunications network, and equipment sales. Revenues for all services and equipment sales (notes 21, 22) are shown net of VAT, discounts and after eliminating sales within the Group, and are recognized when there is persuasive evidence of an arrangement that services have been provided or equipment has been delivered, the price is fixed or determinable and collection is reasonably assured.

Customer subscriber arrangements typically include an activation fee, equipment sale, subscription fee and monthly charge for the actual airtime used. The Company considers the various elements of these arrangements to be separate earnings processes for IFRS purposes and classifies the revenue for each of the deliverables at their invoiced amounts into the categories as disclosed in notes 21 and 22.

Customers may also purchase public phone cards, prepaid mobile and internet cards which allow those customers to use Magyar Telekom's telecommunications network for a selected amount of time. Customers must pay for such services at the date when the card is purchased.

Third parties using Magyar Telekom's telecommunications network include roaming customers of other service providers and other telecommunications providers which terminate or transit calls on Magyar Telekom's network.

Magyar Telekom's IFRS revenue recognition policies for the different groups of services are as follows:

(1) Fixed line connection and mobile activation fees
Revenues earned from connecting subscribers to the fixed or the mobile network are recognized upon service activation. Fixed line connection fees received before October 1997 were deferred and are amortized to revenue over a period of 10 years. See also accounting policy note for deferred revenue.

(2) Subscription fees (fixed line and mobile access)
Monthly subscription fees represent a fixed monthly fee charged to customer subscribers for access to Magyar Telekom's network. Such fees are recognized in the month during which the customer is permitted access to the network. In case of subscriptions when certain amount of free airtime usage is included in the subscription, the total amount due for the month is recognized as subscription fee revenue.

(3) Outgoing traffic revenue (fixed line and mobile network usage)
Outgoing traffic represents customer use of Magyar Telekom's telecommunications network. Customers are charged for outgoing traffic based on their actual use of the network multiplied by a contractually agreed rate. The revenue from usage is recognized in the period in which service is provided to the customers or third parties. A proportion of the revenue received is often paid to other operators (including roaming and interconnect) for the use of their networks, where appropriate. The revenues and costs of these calls are stated gross in these consolidated financial statements.

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

(4) Incoming traffic revenue (fixed line and mobile network usage)
Incoming traffic revenue is recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (interconnect) for the use of their networks, where appropriate. The revenues and costs of these transit calls are stated gross in these consolidated financial statements and recognized in the period of related usage.

(5) Leased lines and data transmission revenues
Leased line services are provided to customers on a monthly rental basis, while data transmission is charged on a unit basis. These revenues are recognized in the period of usage or availability of the service to the customer.

(6) Equipment sales
Revenues and costs from sale of telephone sets are recognized upon delivery.

(7) Value added services (other fixed line charges and enhanced mobile services)
Value added services mostly include SMS, MMS, WAP as well as directory assistance and similar services. To a lesser extent revenues from premium rate services are also included in this category, which are in most cases recognized on a gross basis, when the delivery of the service over Magyar Telekom's network is the responsibility of the Group and the Group also bears substantial risks of these services.

(s) R&D and Marketing expenses

Research and development costs that do not qualify for recognition as an intangible asset as well as marketing costs are expensed as incurred.

(t) Earnings per share

Basic earnings per share is calculated by dividing profit attributable to the equity holders of the company for the period by the weighted average number of common stocks outstanding, while diluted earnings per share is calculated considering the weighted average number of diluting share options in addition to the number of common stocks outstanding.

(u) Dividends

Dividends payable to the Company's shareholders and to minority shareholders of the subsidiaries are recorded as a liability and debited against equity in the Group's financial statements in the period in which they are approved by the shareholders.

(v) Segment reporting

Magyar Telekom determines segments primarily based on products and services that are subject to risks and returns that are different from those of other businesses. The primary segments are based on the business lines (Fixed line and Mobile operations), both of which include Hungarian, Macedonian and Montenegrin activities. Reported segments are consistent with information used by management for internal reporting and monitoring purposes. The Company's secondary format for reporting segment information is the geographical segments.

(w) Comparative information

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

(x) Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The most critical estimates and assumptions are discussed below.

(1) Useful lives of assets
The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technological development and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions. We believe that the accounting estimate related to the determination of the useful lives of assets is a critical accounting estimate since it involves assumptions about technological development in an innovative industry. Further, due to the significant weight of long-lived assets in our total assets, the impact of any changes in these assumptions could be material to our financial position, and results of operations. As an example, if Magyar Telekom was to shorten the average useful life by 10%, this would result in additional annual depreciation and amortization expense of approximately HUF 11.5 billion.

(2) Impairment testing of goodwill
Under IFRS, goodwill is no longer amortized, but tested for impairment annually or more frequently. As all of our subsidiaries are either not listed on stock exchanges or there is no active market for their shares, the fair values of the business units and reportable segments are calculated based on the discounted projected cashflows of these units. This is highly judgmental, which carries the inherent risk of arriving at materially different fair values if estimates used in the calculations would prove to be inappropriate. If Magyar Telekom had used a WACC of 11.2% and a 0 percent perpetual growth rate after the ten year projected period, it would have resulted in an impairment charge. Any further increase in the WACC or a negative growth rate applied would have resulted in further amounts of impairment, initially related to goodwill allocated to the international operations of the Fixed line segment.

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

(4) Impairment of trade and other receivables
We calculate impairment for doubtful accounts based on estimated losses resulting from the inability of our customers to make required payments. We base our estimate on the aging of our account receivables balance and our historical write-off experience, customer credit-worthiness and changes in our customer payment terms when evaluating the adequacy of the impairment loss for doubtful accounts. These involve assumptions about future customer behavior and the resulting future cash collections. If the financial condition of our customers were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the impairment losses recognized so far.

(5) Provisions
Provisions in general are highly judgmental, especially in the cases of legal disputes. The Group assesses the probability of an adverse event as a result of a past event to happen and if the probability is evaluated to be more than fifty percent, the Group fully provides for the total amount of the liability. The Group is rather prudent in these assessments, but due to the high level of uncertainty, in some cases the evaluation may not prove to be in line with the eventual outcome of the case.

(6) Subscriber acquisition costs
Subscriber acquisition costs primarily include the loss on the equipment sales (revenues and costs disclosed separately) and fees paid to subcontractors that act as agents to acquire new customers. The up-front fees collected from customers for activation or connection are marginal compared to the costs. These revenues, costs and losses are recognized when the customer is connected to the Group's fixed or mobile networks. No such costs or revenues are deferred.

3 Financial risk management

(a) Financial risk factors

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

(1) Foreign exchange risk
The most significant foreign exchange exposure of the Group is related to its foreign direct investments in the Southern and Eastern European region. The Group through its subsidiaries is present in Macedonia, Montenegro, and to a lesser extent in Bulgaria, Romania and Ukraine. Most of these countries are candidates to accession to the European Union, which over time mitigates the currency risk of these countries. The high amount of foreign currency (EUR and USD) denominated cash portfolio of subsidiaries in these countries mitigates the currency risk on Group level.

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 order to mitigate this increased risk, Magyar Telekom minimized its foreign currency borrowings in 2002 and 2003. In 2004 and 2005 Magyar Telekom had insignificant amount of foreign currency denominated debts.

A further foreign exchange exposure of Magyar Telekom is related to holding foreign currency cash balances, and operating activities through revenues from and payments to international telecommunications carriers as well as capital expenditure contracted with vendors in foreign currency. These revenues and payments, however, are almost in full balance, therefore Magyar Telekom very rarely has to buy or sell foreign currency on the market.

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

(2) Interest rate risk

Magyar Telekom is exposed to financial market risk primarily through interest rate fluctuations. This is due to the fact that changing HUF interest rates affect the fair value of fixed rate debts and also affect the cash outflow through the variable rate debts. To control interest rate risk, a combination of fixed and floating rate debt is used within the HUF portfolio. By the end of 2003 Magyar Telekom managed to convert almost all of its remaining foreign exchange debt portfolio to HUF, thereby limiting its exposure to interest rate fluctuations in the HUF environment.

(3) Credit risk

The Group has no significant concentrations of credit risk. 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 Magyar Telekom places its cash with substantial credit institutions. Cash and cash equivalents held by the Macedonian subsidiaries are denominated in Macedonian Denars, EUR and in U.S. dollars, while the Montenegrin subsidiaries possess cash and cash equivalents primarily denominated in EUR.

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

(4) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities as well as available funding through adequate amount of committed credit. The Group Treasury's management aims at maintaining flexibility in funding by keeping committed credit lines available.

(b) Accounting for derivative financial instruments and hedging activities

Magyar Telekom does not apply hedge accounting for its financial instruments, all gains and losses are recognized in the income statement. The fair value of derivative financial instruments is included in Other financial assets or Other non current assets or other current or non current liabilities depending on the maturity of the agreements.

(c) Fair value estimation

The fair value of publicly traded derivative financial instruments and other financial assets is based on quoted market prices at the balance sheet date. 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 derivative financial and other instruments, the Group makes assumptions that are based on market conditions existing at each balance sheet date and estimated discounted future cashflows are used to determine fair value for the remaining financial instruments.

4 Segment information

Magyar Telekom has two primary segments, fixed line and mobile services, which include both Hungarian and international activities.

The Fixed line segment provides local telephony, domestic and international long distance telecommunications services in Hungary, Macedonia and Montenegro. The Hungarian operations include the activities of the points of presence extended to Romania, Bulgaria and Ukraine. Entities in the segment also provide services such as leased lines, data transmission, PBX, corporate network, internet and cable TV services.

The Mobile segment provides digital services in various frequency bandwidths in Hungary, Macedonia and Montenegro.

Inter-segment pricing is on an arms' length basis.

(a) Primary reporting format

The following tables present a summary of operating results of the Group by business segment for the years ended December 31, 2003, 2004 and 2005. The segments presented below are substantially consistent with the format used by the Company's Management Committee.

	For the year ended December 31,		
	2003	2004	2005
		(in HUF millions)	
Revenues			
Hungarian Fixed line	324,552	301,743	288,050
International Fixed line	49,690	45,184	55,850
Total	374,242	346,927	343,900
Less: intra-segment revenue	(1,553)	(907)	(1,006)
Total revenue of Fixed line segment	372,689	346,020	342,894
Less: inter-segment revenue	(14,034)	(11,846)	(11,832)
Fixed line revenue from external customers	358,655	334,174	331,062
Hungarian Mobile	254,141	263,023	270,362
International Mobile	31,575	33,734	42,693
Total	285,716	296,757	313,055
Intra-segment revenue	(20)	(58)	(27)
Total revenue of Mobile segment	285,696	296,699	313,028
Less: inter-segment revenue	(37,099)	(29,435)	(23,393)
Mobile revenue from external customers	248,597	267,264	289,635
Total revenue of the Group	**607,252**	**601,438**	**620,697**

	For the year ended December 31,		
	2003	2004	2005
		(in HUF millions)	
Depreciation and amortization			
Hungarian Fixed line – amortization of goodwill	1,599	1,601	-
Hungarian Fixed line – impairment of tangible and intangible assets	1,344	5,355	316
Hungarian Fixed line – other depreciation and amortization	68,918	65,610	61,074
Hungarian Fixed line	71,861	72,566	61,390
International Fixed line – amortization of goodwill	663	684	-
International Fixed line – other depreciation and amortization	9,081	8,411	10,505
International Fixed line	9,744	9,095	10,505
Fixed line segment	81,605	81,661	71,895
Hungarian Mobile – amortization of goodwill	9,540	9,540	-
Hungarian Mobile – impairment of tangible and intangible assets	-	4,426	-
Hungarian Mobile – other depreciation and amortization	30,355	33,605	33,897
Hungarian Mobile	39,895	47,571	33,897
International Mobile – amortization of goodwill	1,989	2,051	-
International Mobile – impairment of tangible and intangible assets	-	-	75
International Mobile – other depreciation and amortization	4,845	6,383	8,819
International Mobile	6,834	8,434	8,894
Mobile segment	46,729	56,005	42,791
Total depreciation and amortization of the Group	**128,334**	**137,666**	**114,686**
Segment results (Operating profit)			
Hungarian Fixed line	44,090	13,061	40,299
International Fixed line	11,765	7,028	9,067
Fixed line segment	55,855	20,089	49,366
Hungarian Mobile	55,030	56,128	71,717
International Mobile	11,179	9,047	12,305
Mobile segment	66,209	65,175	84,022
Total operating profit of the Group	**122,064**	**85,264**	**133,388**
Share of associates' profits/losses after tax			
Hungarian Fixed line	795	1,896	330

	At December 31,		
	2003	2004	2005
		(in HUF millions)	
Assets			
Assets of Hungarian fixed line	503,091	454,564	444,328
Goodwill allocated to Hungarian fixed line	14,194	13,655	13,655
Associates of Hungarian fixed line	4,827	5,750	5,020
Hungarian fixed line	522,112	473,969	463,003
Assets of International fixed line	97,569	95,872	135,397
Goodwill allocated to International fixed line	11,751	12,972	12,972
International fixed line	109,320	108,844	148,369
Intra-segment elimination	(879)	(369)	(761)
Fixed line segment	630,553	582,444	610,611
Assets of Hungarian mobile	186,720	201,032	206,996
Goodwill allocated to Hungarian mobile	170,914	161,374	161,374
Hungarian mobile	357,634	362,406	368,370
Assets of International mobile	36,384	38,159	53,103
Goodwill allocated to International mobile	35,253	38,918	44,156
International mobile	71,637	77,077	97,259
Intra-segment elimination	(1)	(41)	-
Mobile segment	429,270	439,442	465,629
Inter-segment elimination	(8,025)	(8,404)	(8,710)
Total segment assets	1,051,798	1,013,482	1,067,530
Unallocated assets*	7,039	16,076	15,418
Total assets of the Group	**1,058,837**	**1,029,558**	**1,082,948**
Liabilities			
Hungarian fixed line	69,138	84,801	80,988
International fixed line	5,918	4,039	10,306
Intra-segment elimination	(879)	(369)	(761)
Fixed line segment	74,177	88,471	90,533
Hungarian mobile	43,222	47,535	48,464
International mobile	2,526	3,393	5,841
Intra-segment elimination	(1)	(41)	-
Mobile segment	45,747	50,887	54,305
Inter-segment elimination	(8,025)	(8,404)	(8,710)
Total segment liabilities	111,899	130,954	136,128
Unallocated liabilities*	316,554	321,940	349,126
Total liabilities of the Group	**428,453**	**452,894**	**485,254**

* Unallocated assets include income tax assets (current and deferred), while unallocated liabilities include loans and other borrowings and income tax liabilities (current and deferred).

	2003	2004	2005
		For the year ended December 31,	
		(in HUF millions)	
Purchase of tangible and intangible assets			
Hungarian fixed line	39,662	39,495	42,875
International fixed line	8,227	5,270	5,997
Fixed line segment	47,889	44,765	48,872
Hungarian mobile	37,131	41,440	47,401
International mobile	5,768	5,543	7,314
Mobile segment	42,899	46,983	54,715
Total Group	**90,788**	**91,748**	**103,587**

(b) Secondary reporting format

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

	2003	2004	2005
		For the year ended December 31,	
		(in HUF millions)	
Revenues			
Revenue generated in Hungary	538,702	533,706	532,557
Less: inter-segment revenue	(1,322)	(682)	(1,020)
Revenue from external customers – Hungary	537,380	533,024	531,537
Revenue generated in Macedonia	70,014	68,352	67,549
Less: inter-segment revenue	(250)	(283)	(311)
Revenue from external customers – Macedonia	69,764	68,069	67,238
Revenue generated in Montenegro	-	-	20,522
Less: inter-segment revenue	-	-	(62)
Revenue from external customers – Montenegro	-	-	20,460
Revenue generated in other countries	128	509	2,133
Less: inter-segment revenues	(20)	(164)	(671)
Revenue from external customers – other countries	108	345	1,462
Total revenue of the Group	**607,252**	**601,438**	**620,697**

	2003	2004	2005
		For the year ended December 31,	
		(in HUF millions)	
Purchase of tangible and intangible assets			
Hungary	76,793	80,390	88,996
Macedonia	13,995	10,813	9,623
Montenegro	-	-	3,688
Other countries	-	545	1,280
Total Group	**90,788**	**91,748**	**103,587**

	At December 31,		
	2003	2004	2005
		(in HUF millions)	
Assets			
Hungary	872,955	828,414	821,833
Macedonia	179,553	184,876	187,433
Montenegro	-	-	56,523
Other countries	201	1,187	3,265
Total	1,052,709	1,014,477	1,069,054
Inter-segment elimination	(911)	(995)	(1,524)
Total segment assets	1,051,798	1,013,482	1,067,530
Unallocated assets	7,039	16,076	15,418
Total assets of the Group	**1,058,837**	**1,029,558**	**1,082,948**

5 Acquisitions

(a) Acquisition of a 76.53% share of ownership in Crnogorski Telekom (CGT) in 2005

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

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

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

In HUF millions	**Total**	**Net assets included in the Fixed line segment on first consolidation**	**Net assets included in the Mobile segment on first consolidation**
Total cost of acquisition	35,927		
Less: Cash acquired	(1,866)	1,742	124
Consideration paid	34,061		
Fair value of net assets acquired	28,939		
Goodwill	5,122	-	5,122
Fair value of net assets acquired:			
Receivables	7,678	6,442	1,236
Income tax receivable	339	-	-
Inventory	609	426	183
Property, plant and equipment	28,687	22,495	6,192
Intangible assets	9,958	3,700	6,258
Other non current assets	1,080	1,080	-
Trade and other payables	(3,917)	(3,148)	(769)
Loans and other borrowings	(3,290)	-	-
Provisions	(1,951)	(1,914)	(37)
Net deferred tax liability	(807)	-	-
	38,386	29,081	13,063
Minority interest	(9,447)		
Total	28,939		

The Group's total revenue in 2005 amounted to HUF 620,697 million and profit for the year attributable to the equity holders of the Company amounted to HUF 78,564 million with CGT group consolidated from March 31, 2005. If the acquisition had taken place on January 1, 2005, the Group's total revenue would be HUF 626,019 million and profit for the year attributable to the equity holders of the Company would be HUF 78,198 million.

The acquisition of CGT group resulted in an additional profit for the year attributable to the equity holders of the Company of HUF 1,482 million for Magyar Telekom Group in 2005.

(b) Acquisition of 49% share of ownership in T-Systems Hungary in 2004

As of September 30, 2004, Magyar Telekom acquired a 49% share of ownership in T-Systems Hungary (TSH) from T-Systems International (TSI). The consideration paid amounted to HUF 3,430 million. As the transaction took place between companies of Deutsche Telekom Group, Magyar Telekom applied predecessor accounting. This means that Magyar Telekom took over the carrying value of the investment and the related goodwill from the accounts of TSI and the difference between the consideration paid and the carrying values was recorded in shareholders' equity (note d on page 54). The goodwill taken over from TSI's accounts (HUF 149 million) is included in the value of the associate.

(c) Acquisition of additional shares in Stonebridge (holding company owning 51% of MakTel)

The subscription and shareholders' deed (Deed) agreed between the original owners of Stonebridge provided for a put option which entitled SEEF Holdings, one of the co-owners, to sell its shares to Magyar Telekom at a price formula also set out in the Deed on May 15 of each of 2003, 2004 or 2005 or upon the occurrence of certain events. The formula took 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.

Pursuant to the terms of the Deed, SEEF exercised its put option (in relation to 3.05% holding in Stonebridge) in 2003 and Magyar Telekom paid EUR 21 million (HUF 5,545 million). In 2004, SEEF exercised its put option for the remaining 3.05% share of ownership in Stonebridge. Magyar Telekom paid USD 27.4 million (HUF 5,554 million) for these shares, thereby increasing its share of ownership to 92.6% in Stonebridge. The acquisition in 2003 was accounted for according to IAS 22 – Business combinations, while the 2004 acquisition was accounted for according to IFRS 3 – Business combinations.

CosmoTelco, the other co-owner in Stonebridge, and Magyar Telekom entered into a call option agreement whereby CosmoTelco had the right to acquire additional shares in Stonebridge from Magyar Telekom such that CosmoTelco's holding could have increased its original 7.44 percent stake in Stonebridge to 29 percent. The price was defined as Magyar Telekom's acquisition cost plus holding costs. Before the expiration of CosmoTelco's call option in 2002, Magyar Telekom and CosmoTelco amended the option agreement as a result of which CosmoTelco had to exercise its option for a 10% share in Stonebridge until February, 2003. Magyar Telekom 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 in 2002. In 2003, the parties agreed that CosmoTelco allowed its option to lapse, and Magyar Telekom paid EUR 2.5 million (HUF 658 million) to CosmoTelco.

As of October 26, 2004 Magyar Telekom acquired CosmoTelco's 7.44% share of ownership in Stonebridge, whereby Magyar Telekom became the sole owner of Stonebridge. As a result of this acquisition, Magyar Telekom's effective ownership in MakTel increased to 51%. Total acquisition cost of the transaction amounted to HUF 9,003 million.

Since Magyar Telekom has a 100% ownership in Stonebridge, the holding company structure is no longer necessary. In November 2005 Magyar Telekom commenced the winding-up of Stonebridge in accordance with the relevant Macedonian laws. Once the process is complete, Magyar Telekom will directly own its shares in MakTel, thus simplifying the ownership structure.

(d) Purchase of subsidiaries and business units in the cashflow statement

	For the year ended December 31,		
	2003	2004	2005
	(in HUF millions)		
Telekom Montenegro	-	-	35,927
T-Systems Hungary	-	3,430	-
Stonebridge	5,545	13,355	-
Amounts paid to CosmoTelco for unexercised call option	658	-	-
Other	1,789	488	-
Total purchase of subsidiaries and business units	**7,992**	**17,273**	**35,927**

Other items include the consideration paid for shares of non-principal subsidiaries and business units.

6 Cash and cash equivalents

	At December 31,		
	2004	2005	2005
	(in HUF millions)		Average interest rate
HUF	1,552	1,794	3.22%
MKD	22,110	21,916	6.38%
EUR	7,815	13,527	2.12%
Other	5,402	8,823	3.44%
	36,879	**46,060**	**4.44%**

	At December 31,	
	2004	2005
	(in HUF millions)	
Cash on hand	93	166
Cash in banks and cash equivalents	36,786	45,894
	36,879	**46,060**

7 Other financial assets

Other financial assets include financial assets held for trading including financial instruments with maturities between three to twelve months and other instruments at fair value through profit or loss.

The balance as at December 31, 2004 also included the fair value of certain embedded derivatives (HUF 438 million) that were de-recognized against retained earning as a result of the change in accounting policy for the recognition of embedded derivatives [note 2 (e)].

8 Trade and other receivables

	At December 31, 2004	At December 31, 2005
	(in HUF millions)	
Domestic trade receivables	87,290	100,206
Foreign trade receivables	4,624	7,080
Receivables from associates	555	1,008
Receivables from Deutsche Telekom Group companies	1,200	1,943
Advances paid for current assets	796	2,577
Other taxes receivable	4,259	2,742
Prepayments and accrued income	2,128	3,686
Other receivables	6,864	7,932
	107,716	127,174
Allowance for impairment loss	(24,276)	(29,991)
	83,440	**97,183**

The allowance for impairment loss and changes therein for 2004 and 2005 are as follows:

	At December 31, 2004	At December 31, 2005
	(in HUF millions)	
Impairment loss, beginning of period	(20,960)	(24,276)
Charged to expense (included in other operating expenses)	(6,082)	(6,266)
Impairment losses of acquired companies on acquisition	-	(3,674)
Utilized and translation differences	2,766	4,225
Impairment loss, end of period	**(24,276)**	**(29,991)**

9 Inventories

	At December 31, 2004	At December 31, 2005
	(in HUF millions)	
Cables, wires and other materials	3,933	3,493
Inventory for resale	4,724	6,215
Subtotal	8,657	9,708
Less allowances for obsolete inventory	(988)	(1,294)
	7,669	**8,414**

10 Assets held for disposal

Assets held for disposal include land and buildings identified for sale, which is expected within 12 months, as a result of the continuing improvement of utilization of properties and headcount reductions. All of these assets are included in the Fixed line segment.

11 Property, plant and equipment – net

	Land and equivalent rights	Buildings	Telecom. equipment	Other equipment	Total
			in HUF millions		
At January 1, 2004					
Cost	5,963	110,638	852,404	135,049	1,104,054
Accumulated depreciation	(1,430)	(19,040)	(369,552)	(88,528)	(478,550)
Carrying amount	**4,533**	**91,598**	**482,852**	**46,521**	**625,504**
Carrying amount - January 1, 2004	4,533	91,598	482,852	46,521	625,504
Exchange differences	(2)	(779)	(3,914)	(384)	(5,079)
Reclassifications	-	-	(858)	-	(858)
Acquisitions	-	1	170	145	316
Additions	145	5,066	43,387	12,375	60,973
Disposals	(398)	(1,141)	(642)	(379)	(2,560)
Impairment charge	-	-	(5,355)	-	(5,355)
Depreciation charge	(364)	(3,173)	(75,788)	(19,463)	(98,788)
Carrying amount – December 31, 2004	3,914	91,572	439,852	38,815	574,153
At December 31, 2004					
Cost	5,543	112,328	868,615	135,396	1,121,882
Accumulated depreciation	(1,629)	(20,756)	(428,763)	(96,581)	(547,729)
Carrying amount	**3,914**	**91,572**	**439,852**	**38,815**	**574,153**
Of which held for disposal					(3,063)
					571,090
Carrying amount - January 1, 2005	3,914	91,572	439,852	38,815	574,153
Exchange differences	27	500	2,106	149	2,782
Acquisitions	1,226	6,502	19,116	1,843	28,687
Additions	185	6,625	54,194	14,701	75,705
Disposals	(203)	(818)	(201)	(313)	(1,535)
Impairment charge	-	(75)	(199)	(117)	(391)
Depreciation charge	(214)	(3,137)	(76,916)	(16,096)	(96,363)
Carrying amount – December 31, 2005	4,935	101,169	437,952	38,982	583,038
At December 31, 2005					
Cost	6,743	124,636	931,111	143,832	1,206,322
Accumulated depreciation	(1,808)	(23,467)	(493,159)	(104,850)	(623,284)
Carrying amount	**4,935**	**101,169**	**437,952**	**38,982**	**583,038**
Of which held for disposal					(2,302)
					580,736

The closing balance of Property, plant and equipment includes assets in the course of construction in an amount of HUF 28,069 million as at December 31, 2005 (2004: HUF 16,283 million). This was reported as a separate category until 2004, while in the table above the assets in course of construction are shown in the categories where the capitalization is expected. We have also changed the categorization of the property plant and equipment, and prior year balances and movements are now shown in line with the new disclosure.

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

Additions to property, plant and equipment are shown net of the investment tax credit related to broadband investments of HUF 5,373 million in 2005 (HUF 6,849 million in 2004). For more details, see note 26.

Impairment losses charged in 2005 relate to various assets, the recoverable amounts of which were defined based on the respective assets' fair value less cost to sell as these were found higher than their value in use.

Impairment losses charged in 2004 mainly related to MLLN node equipment and operational system, DTU, FMUX, High Speed Subscriber's Facilities. The recoverable amount for the above mentioned equipment was defined based on the value in use, determined using discounted cashflow analysis. The discount rate used in the discounted cashflow calculations was 9.74% in 2004. All impairment losses charged are included in the Fixed line segment.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2005 the gross book value of the leased back assets is HUF 752 million and the net book value is HUF 645 million.

Included in telecommunications equipment at December 31, 2005 are assets leased under operating lease contracts to customers with a gross book value of HUF 5,657 million (2004: HUF 5,436 million) and net book value of HUF 2,217 million (2004: HUF 2,730 million). Depreciation for the year of these assets amounted to HUF 934 million (2004: HUF 463 million).

As a result of the continuous revision of the useful life of the Group's assets, the lives of certain assets were changed as of January 1, 2005. These assets mainly included ISDN and ADSL equipment, other equipment and vehicles and the change in life resulted in HUF 1,771 million higher depreciation expense in 2005.

12 Intangible assets – net

	Goodwill	Software	Concessions and licenses	Brand name	Other	Total
			in HUF millions			
At January 1, 2004						
Cost	289,183	75,747	19,770	7,706	6,769	399,175
Accumulated amortization	(57,062)	(40,401)	(6,251)	(2,839)	(4,290)	(110,843)
Carrying amount	**232,121**	**35,346**	**13,519**	**4,867**	**2,479**	**288,332**
Carrying amount – January 1, 2004	232,121	35,346	13,519	4,867	2,479	288,332
Exchange differences	-	(227)	(2)	-	(433)	(662)
Reclassifications	-	858	-	-	-	858
Acquisitions	8,675	-	-	365	151	9,191
Additions	-	16,898	17,073	-	206	34,177
Disposals	-	(2)	-	-	(20)	(22)
Impairment	-	-	-	(4,426)	-	(4,426)
Amortization charge	(13,876)	(12,791)	(1,638)	(346)	(446)	(29,097)
Carrying amount – December 31, 2004	226,920	40,082	28,952	460	1,937	298,351
At December 31, 2004						
Cost	297,858	90,101	36,829	525	5,661	430,974
Accumulated amortization	(70,938)	(50,019)	(7,877)	(65)	(3,724)	(132,623)
Carrying amount	**226,920**	**40,082**	**28,952**	**460**	**1,937**	**298,351**
Carrying amount – January 1, 2005	226,920	40,082	28,952	460	1,937	298,351
Exchange differences	115	336	61	35	81	628
Acquisitions	5,122	1,698	2,820	1,740	3,700	15,080
Additions	-	16,705	-	-	6,964	23,669
Amortization charge	-	(14,676)	(2,055)	(319)	(881)	(17,931)
Carrying amount – December 31, 2005	232,157	44,145	29,778	1,916	11,801	319,797
At December 31, 2005						
Cost	232,157	110,038	40,139	2,305	16,197	400,836
Accumulated amortization	-	(65,893)	(10,361)	(389)	(4,396)	(81,039)
Carrying amount	**232,157**	**44,145**	**29,778**	**1,916**	**11,801**	**319,797**

We have changed the categorization of intangible assets, prior year balances and movements are now shown in line with the new disclosure.

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

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

The Group carried out an impairment test on goodwill in the last quarter of 2004 and 2005 and established that the carrying amount goodwill allocated to the cash generating units did not suffer impairment as the recoverable amounts of the segments based on value in use determined using discounted projected cashflows proved to be higher than the carrying values. Consequently, no goodwill impairment was charged in any of the reported years. The cashflows attributable to the national operations of the segments were projected for the coming ten years with terminal values determined.

The most significant amounts of goodwill are allocated to the Hungarian and the International operations of the Mobile segment. Beyond the 10 year planning period, the perpetual growth rates of these Mobile operations were determined at 2.5%. The weighted average cost of capital was determined at 7.43% for the Hungarian Mobile operations, and 9.34% for the International Mobile operations.

In 2004, the Hungarian mobile subsidiary, Westel, was renamed to T-Mobile Hungary. As a result of the change of the brand name, the carrying value of the capitalized Westel brand name was impaired and then de-recognized after the completion of the rebranding.

The most significant individual intangible assets as of December 31, 2005 are listed in the table below.

Description	Carrying amount in HUF millions	Remaining useful life (years)
Goodwill allocated to Hungarian Mobile	161,374	-
Goodwill allocated to International Mobile	44,156	-
Goodwill allocated to Hungarian Fixed line	13,655	-
Goodwill allocated to International Fixed line	12,972	-
T-Mobile H UMTS licence	16,654	14
T-Mobile H DCS 1,800 licence	8,368	9
Other intangible assets	62,618	3–10
	319,797	

13 Purchase of tangible and intangible assets

	For the year ended December 31,		
	2003	2004	2005
		(in HUF millions)	
Additions to property, plant and equipment	70,767	60,973	75,705
Additions to intangible assets	17,506	34,177	23,669
Total additions to tangible and intangible assets	88,273	95,150	99,374
Recognition of investment tax credit (note 26)	-	6,849	5,373
Change in payables relating to capital expenditures	2,515	(10,251)	(1,160)
	90,788	**91,748**	**103,587**

14 Associates

	For the year ended December 31,	
	2004	2005
	(in HUF millions)	
Opening balance of associates	4,827	5,750
Acquisition of TSH	1,602	-
Goodwill arising on TSH's acquisition	149	-
TSI's capital injection to TSH	-	669
Other additions	10	-
Share of associates' profits/losses after tax	1,896	330
Disposal of associates	(101)	-
Dividends	(2,633)	(1,729)
Closing balance of associates	**5,750**	**5,020**

The following table shows the total assets and liabilities as at December 31, 2005, and revenues and profit for the year ended December 31, 2005 of the major associates of the Group.

	Hunsat	T-Systems Hungary	Magyar RTL
		(in HUF millions)	
Total assets	1,327	9,420	30,486
Total liabilities	911	6,264	19,537
Revenues	3,324	9,323	30,797
Profit for the year	316	315	2,988

The profit of T-Systems Hungary includes the income from the loan forgiven by its majority owner, T-Systems International in an amount of HUF 1,366 million. See more details in note d on page 54.

15 Other non current assets

	At December 31,	
	2004	2005
	(in HUF millions)	
Employee loans	3,515	4,089
Other loans receivable	326	98
Derivative instruments	435	-
Other	2,388	2,014
	6,664	**6,201**

Derivative instruments as at December 31, 2004 included the fair value of certain embedded derivatives that were de-recognized against retained earnings as a result of the change in accounting policy for the recognition of embedded derivatives [note 2 (e)].

16 Financial instruments

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

For the acquisition of the remaining 49% of T-Mobile Hungary and MakTel Group in 2001, Magyar Telekom received loans from Deutsche Telekom International Finance B.V. (DTIF), the treasury vehicle of Deutsche Telekom. In 2002, Magyar Telekom entered into several swap agreements with Deutsche Telekom AG in order to exchange the cashflows of the EUR loans payable to HUF cashflows. These loans were accounted for in the originally denominated currency (EUR), while the related swap agreements were accounted for as derivative financial instruments. All swap agreements were terminated in 2003 parallel with the refinancing of the underlying loans.

Derivative contracts entered into in 2003, 2004 and 2005 were limited to foreign currency forward contracts.

The net carrying amounts of current financial assets reflect reasonable estimates of their fair values due to the short period to maturity of the instruments.

Non current loans receivable are accounted for at amortized cost.

The fair value of short term liabilities other than loans and other borrowings approximates their carrying values due to their relatively short maturities. For the fair value of loans and other borrowing see note 17. The fair values of other non current liabilities are reflected in their carrying amount as they are discounted to fair value.

17 Loans and other borrowings

	Notes	At December 31, 2004	2005
		(in HUF millions)	
Current loans from related parties		60,000	74,648
Non current loans from related parties		177,675	212,000
Total loans from related parties	(a)	237,675	286,648
Current bank loans		34,161	43,196
Non current bank loans		47,266	13,278
Total bank loans	(b)	81,427	56,474
Current other borrowings		377	406
Non current other borrowings		1,129	937
Total other borrowings		1,506	1,343
Total third party loans and other borrowings		82,933	57,817
Total loans and other borrowings		**320,608**	**344,465**

At December 31, 2005, principal repayments fall due in:

	Maturity At December 31, 2004	2005
Year	(in HUF millions)	
2005	94,538	-
2006	103,538	118,250
2007	25,673	77,342
2008	23,053	23,075
2009	33,063	81,090
2010	-	4,110
Thereafter	40,743	40,598
Total loans and other borrowings	**320,608**	**344,465**

The effective borrowing cost (total interest payable and other charges) for Magyar Telekom's loans and borrowings was 10.1% in 2005 (11.9% in both in 2004 and 2003). The weighted average interest rate on borrowings was 9.4% in 2005 (10.9% in 2004, 7.5% in 2003).

(a) Loans from related parties

Primarily all the related party loans are taken from Deutsche Telekom International Finance (DTIF), the treasury vehicle of Deutsche Telekom Group, and are denominated in HUF. One loan as at December 31, 2005, however, was taken from Deutsche Telekom AG (DTAG). DTAG provided this loan to Magyar Telekom for the financing of the rebranding, the final settlement of which was due in February 2006.

The table below shows the details of the loans outstanding as at December 31, 2005.:

Lender	Amount (HUF millions)	Interest rate (%)	Fixed / variable	Repayable
DTIF	73,675	9.36	fixed	Jan 2006
DTAG	973	6.19	variable	Feb 2006
Total current	74,648			
DTIF	20,000	7.55	fixed	Jan 2007
DTIF	20,000	7.61	fixed	May 2007
DTIF	14,000	10.20	fixed	May 2007
DTIF	20,000	7.45	fixed	Dec 2007
DTIF	20,000	8.21	fixed	May 2008
DTIF	5,000	9.68	fixed	Sep 2009
DTIF	20,000	7.53	fixed	Oct 2009
DTIF	25,000	9.61	fixed	Oct 2009
DTIF	28,000	6.40	variable	Oct 2009
DTIF	40,000	8.73	fixed	May 2012
Total non current	212,000			
	286,648			

(b) Bank loans

Bank loans are denominated in HUF and EUR at December 31, 2005, while in 2004 all bank loans were denominated in HUF.

Loans totaling HUF 3,825 million at December 31, 2005 are revolving loans (HUF 25,581 million in 2004) which can be prepaid at any time and may be drawn down in one to six month rolling periods.

Certain loan agreements contain covenant restrictions that require the maintenance of pre-defined financial ratios. Breach of those covenants would result in HUF 2,000 million (HUF 15,500 million in 2004) being due and payable in 30 days if not remedied. At December 31, 2005 the Company was in compliance with these covenants. One of the covenants allows a debt to EBITDA (earnings before interest, tax, depreciation and amortization) ratio of maximum 3.0. The other covenant requires the maintenance of an EBITDA to interest expense ratio of minimum 2.0.

The following table shows the weighted average interest rates of bank loans as at December 31, 2005.

	Maturities						
	2006	2007	2008	2009	2010	Thereafter	Total
	(in HUF millions, except percentages)						
Bank loans (HUF Denominated)							
Variable rate	41,917	3,125	3,000	3,000	4,000	-	55,042
Average interest rate	6.43%	6.64%	6.43%	6.67%	6.62%	-	6.47%
Bank loans (EUR Denominated)							
Variable rate	458	126	-	-	-	-	584
Average interest rate	6.31%	5.29%					6.09%
Fixed rate	821	27	-	-	-	-	848
Average interest rate	6.05%	5.90%					6.05%
Total	1,279	153	-	-	-	-	1,432
Total bank loans	**43,196**	**3,278**	**3,000**	**3,000**	**4,000**	**-**	**56,474**

(c) Fair values

The following table is a summary of Magyar Telekom's market sensitive debt instruments, including fair value calculated using the discounted cashflow method.

	At December 31,			
	2004		2005	
	(in HUF millions)			
	Book value	Fair value	Book value	Fair value
Bank loans				
Fixed rate	-	-	848	848
Variable rate	81,427	81,427	55,626	55,626
Total bank loans	**81,427**	**81,427**	**56,474**	**56,474**
Related party loans				
Fixed rate	177,675	178,997	257,675	268,599
Variable rate	60,000	60,000	28,973	28,973
Total related party loans	**237,675**	**238,997**	**286,648**	**297,572**

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

The majority of the Group's loans and borrowings are subject to fixed interest rates that are exposed to fair value risk as it is stated in the table above. Any decrease of market interest rates will result in an increase of the fair value of the liabilities. The rest of the Group's loans and borrowings are subject to variable interests, which are exposed to cashflow risks if interest rates are rising, resulting in higher cash outflows through interest payments.

(d) Credit facilities and pledges

At December 31, 2005, Magyar Telekom had un-drawn committed credit facilities of HUF 71,374 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 181 million.

18 Trade and other payables

	At December 31, 2004	At December 31, 2005
	(in HUF millions)	
Domestic trade payables	47,529	58,292
Foreign trade payables	3,885	7,658
UMTS license fee payable	11,500	-
Salaries and wages	10,175	8,794
Other taxes and social security	8,305	12,191
Amounts received in advance	6,380	6,861
Accrued expenses and prepayments	5,457	6,587
Accrued interest to DTIF	5,491	6,198
Accrued interest to third parties	906	461
Amounts owed to DT Group companies	2,321	1,828
Payable to associates	1,621	694
Dividends payable	61	77
Other payables	6,290	9,823
	109,921	**119,464**

Included in other payables as at December 31, 2005 is an amount of HUF 2,950 million (HUF 1,544 million as at December 31, 2004) potentially repayable to universal customers related to the reduced fixed to mobile termination charges (note 30), which was accounted for as a reduction of revenues.

Included in other payables is also HUF 739 million that relates to the acquisition of a service contract in 2005 for the operation of a governmental backbone network. This represents the short term portion of a total amount of HUF 6,095 million payable, while the rest is included in Other non current liabilities, which caused the increase of that line of the balance sheet as at December 31, 2005.

19 Deferred revenue

	At December 31, 2004	At December 31, 2005
	(in HUF millions)	
Beginning of period	4,446	2,688
Amortization	(1,758)	(1,503)
End of period	**2,688**	**1,185**
Amount to be recognized within one year	1,502	918

20 Provision for liabilities and charges

	Severance	Customer loyalty programs	Legal cases	Other	Total
			(in HUF millions)		
January 1, 2004	1,570	1,453	3,061	415	6,499
Amounts utilized / retired	(1,570)	(1,453)	(1,369)	(330)	(4,722)
Additions	13,022	1,785	1,468	246	16,521
December 31, 2004	**13,022**	**1,785**	**3,160**	**331**	**18,298**
January 1, 2005	13,022	1,785	3,160	331	18,298
Acquired through business combinations	-	-	173	1,778	1,951
Amounts utilized / retired	(10,721)	(1,701)	(2,945)	(509)	(15,876)
Additions	1,328	1,823	2,257	177	5,585
December 31, 2005	**3,629**	**1,907**	**2,645**	**1,777**	**9,958**
Less: non current portion	(1,074)	(1,307)	(103)	(657)	(3,141)
Current provision	**2,555**	**600**	**2,542**	**1,120**	**6,817**

The provision for severance as at December 31, 2005 mostly relates to the employee termination in 2006 and in later years in accordance with the agreement made with employee representatives of Magyar Telekom Plc. in 2004. The number of employees impacted by the headcount reduction covered in the agreement is approximately 1,900 and includes mostly network and back office personnel. Of this number, approximately 1,600 lay-offs were completed in 2005, while the remaining 300 are expected in the coming years. In 2005 an additional headcount of 300 was identified for redundancy in 2006 in various entities of the Group, for which an additional provision was recognized.

The total payments made in relation to employee termination in 2005 amounted to HUF 14,535 million (HUF 7,549 million in 2004), of which HUF 10,721 million (HUF 1,570 million in 2004) was charged against the provision for liabilities and charges as at December 31, 2004, while the rest was recognized as employee related expense in 2005.

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

Provisions for legal cases mainly include amounts expectedly payable to tax and regulatory authorities and amounts expected to be paid as compensation for loss of value of real estates of inhabitants allegedly caused by cellular base stations installed on neighboring sites.

21 Revenues – fixed line services

	For the year ended December 31,		
	2003	2004	2005
		(in HUF millions)	
Subscriptions, connections and other charges	109,063	106,224	105,665
Outgoing domestic traffic revenues	131,659	112,381	90,933
Outgoing international traffic revenues	13,096	12,255	11,141
Total outgoing traffic revenues	144,755	124,636	102,074
Incoming domestic traffic revenues	10,797	5,883	9,618
Incoming international traffic revenues	20,024	15,781	16,007
Total incoming traffic revenues	30,821	21,664	25,625
Leased lines and data transmission	41,502	50,976	63,743
Equipment sales	3,249	3,678	4,046
Other revenues	29,265	26,996	29,909
Total fixed line revenues	**358,655**	**334,174**	**331,062**

Included in other revenues in 2003 is HUF 6,032 million of subsidies from the Universal Telecommunications Support Fund to compensate for the maintenance of low usage discount packages provided by the Hungarian fixed line telecommunications service providers of the Group. No such compensation was recognized in 2004 or 2005.

22 Revenues – mobile services

	For the year ended December 31,		
	2003	2004	2005
	(in HUF millions)		
Network usage and access	193,322	208,193	226,176
Enhanced services	28,037	31,945	38,421
Equipment sales	23,109	24,549	22,653
Activation fees	1,534	820	819
Other revenues	2,595	1,757	1,566
Total mobile revenues	**248,597**	**267,264**	**289,635**

Enhanced services include mainly non-voice value added services like SMS, MMS, WAP, GPRS, etc.

23 Employee related expenses

	For the year ended December 31,		
	2003	2004	2005
	(in HUF millions)		
Short term benefits	91,056	92,733	90,605
Share based payments	-	70	270
Termination benefits	1,101	20,180	5,142
Total before capitalization	92,157	112,983	96,017
Expenses capitalized	(4,237)	(3,486)	(3,234)
	87,920	**109,497**	**92,783**
Total amount paid to defined contribution plans (including social security)	21,546	25,876	21,797

24 Other operating expenses – net

	For the year ended December 31,		
	2003	2004	2005
	(in HUF millions)		
Materials, maintenance and service fees	57,992	58,104	60,696
Subcontractors and agent commissions	21,792	22,491	25,994
Marketing	16,902	22,189	24,888
Fees and levies	23,833	20,268	21,821
Consulting	6,102	7,082	7,571
Rental and operating lease	6,338	6,716	7,246
Bad debt expense	4,450	6,082	6,266
Other expenses	6,265	3,448	6,321
Total other operating expenses	143,674	146,380	160,803
Other income	-	(5,920)	(7,281)
	143,674	**140,460**	**153,522**

Other expenses include HUF 2,059 million paid under four consulting contracts entered into by the Group, as to which the Company has not been able to obtain sufficient evidence that it or its subsidiaries received adequate value. This amount also includes the operating tax implications of the payments as well. See Note 1 – Investigation into certain consultancy contracts.

Other income includes compensation received from Deutsche Telekom AG related to the renaming and rebranding of the Group (note 31).

Contributions payable to the Universal Telecommunications Support Fund were accrued as part of Fees and levies in 2003 (HUF 5,098 million). According to the decision of the National Regulatory Authority on the actual amounts payable, HUF 1,353 million in 2004 on the same line where the expenses were originally accrued. As the Fund did not accept the claims of the fixed line telecom operators with respect to 2004 and the same is expected for 2005, no additional amounts payable were accrued in 2004 or 2005.

25 Net financial expenses

	For the year ended December 31,		
	2003	**2004**	**2005**
		(in HUF millions)	
Interest expense:			
HUF	21,315	34,611	31,218
Foreign currency	4,469	120	122
(Gains) / losses on the valuation of derivative financial instruments	972	(647)	-
Net foreign exchange losses / (gains)	8,799	523	(1,014)
Other financial expenses	5,364	3,183	3,157
Total financial expenses	40,919	37,790	33,483
Interest capitalized	(41)	-	-
Interest and other financial income	(876)	(1,644)	(2,195)
	40,002	**36,146**	**31,288**

26 Income tax

	For the year ended December 31,		
	2003	**2004**	**2005**
		(in HUF millions)	
Corporate income tax	12,259	9,352	11,686
Deferred income taxes	1,258	(1,665)	1,825
	13,517	**7,687**	**13,511**

The Company qualified for a reduction in corporate income tax payable for ten years on meeting certain conditions. The last year of tax reduction was in 2003, when the Company's corporate tax payable could be reduced by 60% to 7.2%.

In December 2003 the Hungarian Parliament passed the new tax law in which the corporate tax rate was reduced from 18% to 16% from January 2004. Deferred tax balances of the Hungarian members of the Group were amended accordingly at the end of 2003.

Deferred taxes have been recognized for temporary differences arising on the valuation of investments (mainly currency differences) in subsidiaries and associates in the parent companies' books as required by IAS 12.

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 2,718 million will expire in 2006, HUF 2,435 million in 2007 and HUF 1,517 million in 2008. The remaining balance of the recognized tax losses of HUF 31,755 million is not subject to statutory limitations.

In order to increase broadband internet penetration in Hungary, the Hungarian Government decided that companies investing over HUF 100 million in broadband assets (e.g. DSL lines) from 2003 can apply for a corporate tax reduction. The potential reduction of the corporate tax charge is defined as a percentage of the companies' capital investment in broadband assets.

As the recoverability of these investment tax credits was uncertain in 2003, no deferred tax asset was recognized in 2003. Due to the change of the assessment of the recoverability, Magyar Telekom recognized a deferred tax asset of HUF 6,849 million in 2004 (HUF 3,879 million related to 2004 and HUF 2,970 million related to 2003). As these investment tax credits are of a governmental grant nature, Magyar Telekom recognized the deferred tax asset against the cost of the related investment (see also notes 11, 13). If the tax credits are not utilized in the year when earned, the amount of tax credits carried forward can be utilized at a higher amount as the Government allows the outstanding amounts to be accreted. This accretion is recognized as an increase in the deferred tax asset against a reduction in the income tax expense.

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

Earned in year	Amount of broadband investment	Amount of tax credit earned	Tax credit utilized	Accretion recognized in tax expense to date	Tax credit carried forward at December 31, 2005
2003	6,638	2,872	(146)	464	3,190
2004	7,230	3,214	-	277	3,491
2005	15,285	6,136	(2,161)	-	3,975
Total	**29,153**	**12,222**	**(2,307)**	**741**	**10,656**
			Expires in	2007	3,190
				2014	7,145
				2015	187
				2016	134
					10,656

Magyar Telekom's deferred tax balances are as follows:

	Balance at Dec. 31, 2003	Income statement effect	Other movements	Balance at Dec. 31, 2004	Income statement effect	Other movements	Balance at Dec. 31, 2005
Deferred tax assets and (liabilities)							
Investment tax credits	-	-	6,849	6,849	741	3,066	10,656
Net operating loss carry-forward	2,377	1,344	-	3,721	2,354	1	6,076
Investments in subsidiaries	(500)	(832)	(2)	(1,334)	434	-	(900)
Other financial assets	(36)	(104)	-	(140)	24	140	24
Impairment of receivables, inventory and financial investments	3,142	381	(59)	3,464	264	-	3,728
Property, plant and equipment and intangible assets	(3,725)	(1,050)	(20)	(4,795)	(1,918)	(852)	(7,565)
Goodwill	-	-	-	-	(1,864)	-	(1,864)
Trade and other payables	(61)	144	(2)	81	23	-	104
Loans and other borrowings	221	(16)	-	205	(49)	-	156
Deferred revenue	616	(236)	-	380	(223)	-	157
Provisions for liabilities and charges	782	2,034	-	2,816	(1,611)	-	1,205
Total net deferred tax assets	2,816	1,665	6,766	11,247	(1,825)	2,355	11,777
Add back: deferred tax liability	1,768			1,280			3,189
Deferred tax assets	**4,584**			**12,527**			**14,966**

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

The amounts of other movements in tax credits were booked against the cost of the related investment.

The amount of other movement in deferred taxes on other financial assets represent the deferred tax on embedded derivatives derecognized against the opening retained earnings as a result of the change in accounting policy for the measurement of certain embedded derivatives [note 2 (e)].

Included in other movements are HUF -44 million (2004: HUF -24 million) of currency translation adjustments and HUF -807 million (2004: HUF -59 million) deferred tax arising on business combinations.

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,		
	2003	2004	2005
	(in HUF millions)		
IFRS profit before income tax	82,857	51,014	102,430
Tax at 18%	(14,914)	-	-
Tax at 16%	-	(8,162)	(16,389)
Effect of reduced tax rates in foreign countries	567	191	451
Impact of tax rate change from 18% to 16% enacted for 2004	(296)	-	-
Impact of tax incentives	901	584	897
Tax on items not subject to tax	1,714	1,889	2,623
Tax on non deductible expenses	(2,586)	(2,189)	(1,093)
Temporary differences reversing at different rates	1,097	-	-
Income tax expense	**(13,517)**	**(7,687)**	**(13,511)**

Items not subject to income tax consist primarily of the other income from DTAG (note 31), which is not taxable, as well as the share of associates' profit after income tax as it is included net of tax in the IFRS profit before income tax.

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

27 Cash generated from operations

	For the year ended December 31,		
	2003	2004	2005
	(in HUF millions)		
Profit for the year	69,340	43,327	88,919
Income tax expense	13,517	7,687	13,511
Share of associates' profits/losses after tax	(795)	(1,896)	(330)
Net financial expenses	40,002	36,146	31,288
Depreciation and amortization	128,334	137,666	114,686
Change in payables	2,885	(3,474)	9,662
Change in inventory	4,117	2,825	(303)
Change in receivables	(2,168)	4,500	(8,034)
Amortization of deferred revenue	(2,732)	(1,758)	(1,503)
Other financial expenses paid	(5,364)	(3,183)	(3,157)
Other cashflows from operations	(6,639)	12,841	(7,802)
Cash generated from operations	**240,497**	**234,681**	**236,937**

28 Share-based compensation

(a) Management share option plan

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

On July 1, 2002, the Company granted 3,964,600 options to participants of the stock option plan at an exercise price of HUF 933 for the first tranche (exercisable in 2003) and HUF 950 for the second and third tranches (exercisable in 2004 and 2005). As the Company's share price as quoted on the BÉT (Budapest Stock Exchange) on the grant date was HUF 833 per share, there was no intrinsic value to the options. 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 a maximum of one-third of the shares that can be purchased under the first tranche may be exercised from July 1, 2003 until the end of the term. The option with respect to a maximum of a further one-third of the shares that can be purchased under the 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 third tranche may be exercised from July 1, 2005 until the end of the term.

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

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

	2003	2004	2005	Average exercise price (HUF)
Opening number of share options	3,964	3,655	3,207	944
Number of share options exercised	-	-	(991)	944
Forfeited share options	(309)	(448)	(287)	944
Closing number of share options	3,655	3,207	1,929	944
Number of exercisable options at end of year	1,218	2,138	1,929	944

(b) The CEO's share option plan

The CEO of Magyar Telekom was granted share options in 2000, 2001, 2002, 2003 and 2004. The exercise price of the options is determined in US dollars and the options had no intrinsic values on the grant dates in 2000, 2001, 2002 and 2003, while those granted in 2004 had an intrinsic value of HUF 63 million. One third of the options granted vests after one year, another one third vests two years after the grant date, while the last third vests after three years. The options are exercisable for ten years after the grant date. In 2005 the Group recognized compensation expense in an amount of HUF 84 million among employee related expenses against retained earnings.

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

	Options granted in year					
	2000	2001	2002	2003	2004	Total
Number of options granted (thousand)	103	250	303	619	1,462	2,737
Exercised (thousand) – all in 2005	-	(250)	(303)	(413)	(487)	(1,453)
Outstanding (thousand) at December 31, 2005	103	-	-	206	975	1,284
Exercisable (thousand) at December 31, 2005	103	-	-	-	-	103
Exercise price in USD	7.36	2.93	3.48	3.62	3.87	
Remaining contractual life at December 31, 2005 (years)	4.5	-	-	7.5	8.5	

(c) Mid-term incentive plan (MTIP)

In 2004 Magyar Telekom launched a Mid Term Incentive Plan (MTIP) for its top management, whereby the targets to be achieved are based on the performance of the Magyar Telekom share. The MTIP is a cash settled long term incentive instrument which is planned to cover five years, with a new package being launched in each year, and with each tranche lasting for three years.
The first tranche of the program spans the period between January 1, 2004 and December 31, 2006. The second tranche of the program spans the period between January 1, 2005 and December 31, 2007. Participants are employees of Magyar Telekom who are incumbents of certain top and senior managerial positions.

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

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

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

Total compensation expense accrued for the first two tranches of the program as at December 31, 2005 is HUF 256 million (HUF 186 million expensed in 2005 and HUF 70 million in 2004). The expenses are included in employee related expenses recognized against payables to employees.

29 Commitments

(a) Lease commitments

Finance leases in 2005 relate to the sale and lease back of spaces in buildings accommodating telephone exchanges. Operating lease commitments are mainly in respect of the rental of cell sites, with other leases related to buildings, network and other telecommunications facilities.

Future minimum lease payments under finance and operating leases at December 31, 2004 and 2005 are as follows:

	Finance Leases At December 31,	
	2004	2005
	(in HUF millions)	
Year		
2005	150	-
2006	137	211
2007	137	213
2008	137	214
2009	137	213
2010	137	215
Thereafter	417	739
Total minimum lease payments	1,252	1,805
Less: amounts representing interest	(604)	(944)
Present value of net minimum lease payments	648	861
Less: finance lease obligations included in current other borrowings	(45)	(51)
Long-term finance lease obligations included in non current other borrowings	603	810

	Operating Leases At December 31,	
	2004	2005
	(in HUF millions)	
Year		
2005	5,283	-
2006	4,932	5,410
2007	4,583	4,548
2008	4,157	3,736
2009	3,241	3,031
2010	–	2,588
Thereafter	2,984	10,494
Total minimum lease payments	**25,180**	**29,807**

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

(b) Purchase commitments for tangible assets

As of December 31, 2004, Magyar Telekom had contractual commitments for capital expenditures of HUF 3.2 billion (HUF 6.1 billion in 2004, HUF 3.4 billion in 2003) falling due within 1 year.

In addition to the above, in October 2005 Magyar Telekom won the government tender and signed a contract with the Prime Minister's Office to build and operate the nationwide Unified Digital Radio Network (EDR) system in Hungary. EDR is a 380–400 MHz band nation-wide Professional Mobile Radio (PMR) network used by public safety and security services in Hungary. The main users of EDR will be the Police, Fire Departments and Ambulance Services. The rollout of EDR is planned for 2006 and the contract lasts until end of 2015. Magyar Telekom expects to invest HUF 20-22 billion in 2006 in the assets required to build out the EDR service. In line with its contractual obligations Magyar Telekom Group established a fully owned subsidiary, Pro-M to deliver the EDR services. The company will operate in the Hungarian operations of the Group's Mobile segment.

(c) Future lease revenues

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

Year	Lease revenues (in HUF millions)
2006	2,426
2007–2009	2,438
2010 and thereafter	164
Total minimum lease payments receivable	**5,028**

30 Contingencies

Magyar Telekom's most significant contingency is related to the fixed to mobile termination charges in Hungary.

The Hungarian National Communications Authority (NCA) published several decisions in 2004 and 2005 as to how the termination charges of the fixed to mobile calls should be reduced in the interconnect contracts of the fixed line and mobile telecom operators. All mobile telecom operators appealed against the decisions at court and in most cases did not change their contracts with the fixed line telecom operators.

As the interconnect contracts were not amended to reflect the appealed decisions of the NCA, the fixed line operators did not change their charges to their customers for the fixed to mobile calls. There is a high level of uncertainty as to whether any of these NCA decisions will be found properly established by the Hungarian Court. If so, it is also uncertain as of when these new interconnect rates should be applied and whether retrospectively or prospectively and whether the fixed line telecom operators can be forced to repay the difference to their customers for these calls.

These consolidated financial statements reflect the Group's estimate of the most probable outcome. Thereby the fixed line operators can be forced to repay the difference only to their customers with universal packages, while the interconnect charges between the fixed line and mobile companies are accrued based on the fees required by the NCA decisions, regardless of the actual amounts invoiced, the difference being treated as payables or receivables.

31 Related party transactions

All transactions with related parties are on an arm's length basis.

(a) Deutsche Telekom Group

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

The Company is directly owned by MagyarCom GmbH, which is a holding company of DTAG. Magyar Telekom pays dividends annually to its owners including MagyarCom GmbH. These payments are made during the year resulting in no outstanding payable at the end of the years.

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

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

DTAG entered into cross-currency swap agreements with Magyar Telekom in 2002, which were closed in 2003. The related derivative interest expenses incurred in 2003 were included in the 2003 income statement.

The Company's mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004, while other companies were renamed in 2005. The expenditure incurred in connection with the launch and promotion of the new brands and the loss of value caused by discontinuing the old brands were compensated in value by Deutsche Telekom AG.The compensation received was recognized as other operating income in the "Other operating expenses – net" line of the income statement (note 24).

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

	2003	2004	2005
		(in HUF millions)	
Revenues from telecom services provided to DT Group	8,682	6,921	5,155
Costs of telecommunications services provided by DT Group	(4,955)	(6,289)	(6,158)
Consulting expenses to MagyarCom Services Kft.	(1,287)	(1,488)	(1,140)
Other income from DTAG	-	5,920	7,281
Interest expense to DTIF	(15,009)	(23,271)	(24,518)
Derivative interest paid to DTAG	(3,219)	-	-
Dividends paid to MagyarCom GmbH	(11,114)	(43,222)	(43,222)
Accounts receivable from DT Group	2,692	1,200	1,943
Accounts payable to MagyarCom Services Kft.	(456)	(410)	(313)
Accounts payable to other DT Group companies	(1,105)	(1,911)	(1,515)
Accrued interests payable to DTIF	(4,674)	(5,491)	(6,198)
Loans payable to DTIF and DTAG	(200,319)	(237,675)	(286,648)

Deutsche Telekom has pledged its support for Magyar Telekom's financing needs through to June 30, 2008.

(b) Governments

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

(c) Associates

Hunsat is an enterprise founded by the Company (50%) and Antenna Hungária Rt. (50%). The revenues of Hunsat include commissions received from Hungarian telecommunications companies for the use of services of international satellite agencies. The operational transactions and balances with Hunsat are insignificant. Dividends received from Hunsat amounted to HUF 1,376 million in 2005 (HUF 2,133 million in 2004 and HUF 75 million in 2003).

M-RTL is a Hungarian television broadcast company, in which Magyar Telekom has a 25% effective share of ownership through a holding company, IKO-Telekom Média Holding Rt. M-RTL sells airtime through media agencies to Magyar Telekom, and Magyar Telekom provides telecom services to M-RTL mainly through an interactive service provider. Consequently, the direct operating transactions between M-RTL and the Group are insignificant. M-RTL declared dividends to Magyar Telekom directly and indirectly in an amount of HUF 550 million in 2005 (HUF 500 million in 2004 and HUF 500 million in 2003).

T-Systems Hungary (TSH) is an associated company of Magyar Telekom, in which the Company acquired a 49% share of ownership in September 2004. The acquisition took place through share purchase from T-Systems International, a Deutsche Telekom Group company, and a capital increase in TSH. The inter-company transactions and balances with TSH are not significant. All inter-company transactions and balances with TSH are included in the amounts shown in the table earlier in this note for the Deutsche Telekom Group relations.

(d) Board and supervisory board members

The remuneration of the members of the Company's Board of Directors amounted to HUF 10 million in 2005 (HUF 9 million in 2004 and in 2003). The remuneration of the members of the Company's Supervisory Board amounted to HUF 14 million in 2005 (HUF 10 million in 2004, HUF 9 million in 2003).

(e) Key management

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

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

	At December 31,		
	2003	2004	2005
	(in HUF millions)		
Salaries and other short-term employee benefits	801	800	670
Contractual termination expense	-	-	350
Share based compensation (note 28)	30	101	130
	831	**901**	**1,150**

The Group does not provide loans to its key management.

32 Subsequent events

On January 12, 2006 Magyar Telekom signed a project financing loan agreement in an amount of HUF 47.4 billion. The loan was granted by the European Investment Bank through Deutsche Telekom International Finance BV to finance the broadband investments of Magyar Telekom. The loan matures in January 2013, and will be repaid in five equal installments with two years grace period. The loan bears a variable interest rate based on the 3-month BUBOR.

In June, 2006 MakTel acquired 10% of its own shares at a public auction held by the Macedonian Government, the minority owner for EUR 60.9 million. Following the share purchase transaction, Magyar Telekom's voting rights in MakTel increased from 51% to 56.7%, while the Macedonian Government's share of ownership fell to 36.81%, with the rest of the shares owned by smaller minority shareholders.

In June 2006 Magyar Telekom and Deutsche Telekom decided to change the Group's Macedonian mobile operator, Mobimak's name to T-Mobile Macedonia (T-Mobile MK), and to introduce the "T" brands in Montenegro as well for both the Fixed line and the Mobile operations.

At the end of 2004, the Group had receivables amounting to HUF 1,468 million and liabilities in the amount of HUF 1,131 million related to the Universal Telecommunication Support Fund. During 2005, HUF 619 million of the receivables was recovered. Due to a Court decision as of September 15, 2005, which annulled the Group's liability toward the above Fund, the remaining receivable and the outstanding liability were written off. With its review decision of April 25, 2006 the Supreme Court upheld the resolution that the Group was still liable with the previously recognized amount of HUF 1,131 million, which indicated that the Group would be able to partly recover the previously written-off receivable. This event has been identified as an adjusting post-balance sheet event and accounted for as such, consequently both a receivable and a liability in relation to the above Fund have been reinstated in the financial statements of 2005.

Purchase of subsidiaries and business units after the balance sheet date

On November 29, 2005 Magyar Telekom concluded an agreement to acquire a 100% stake in Orbitel for EUR 8 million. Orbitel is an alternative Bulgarian telecommunications and internet service provider offering countrywide voice and data services to the business community utilizing IP technology. In 2005, the company generated revenues of EUR 11.5 million.

The financial closing of the deal took place on February 3, 2006.

On December 12, 2005 Magyar Telekom agreed to acquire a 100% stake in Dataplex Kft. for HUF 5.1 billion, based on the net debt position of the company at the time of the agreement. Dataplex is an operator in the Hungarian IT outsourcing market with revenues of around HUF 1.3 billion in 2005 (unaudited). The financial closing of the transaction took place following the approval by the Hungarian Competition Authority, on April 5, 2006.

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

In May 2006 Magyar Telekom acquired the 100% ownership of Adnetwork Kft., the leading Hungarian online advertisement network for a purchase price of HUF 0.2 billion. Adnetwork was established in 2005 and generated revenues of HUF 28 million in 2005.

In June 2006 Magyar Telekom signed a share purchase agreement to acquire the 100% ownership of KFKI-LNX, one of the leading Hungarian IT companies for a purchase price HUF 8.2 billion plus an optional earn-out payment of HUF 1.5 billion dependent on the 2006 financial performance. The acquisition was closed on September 15, 2006, from which date KFKI Group will become consolidated in the Group. In 2005, KFKI Group's revenues amounted to approximately HUF 17 billion. KFKI-LNX has two 100% owned subsidiaries, ICON and IQSYS.

All of the above business combinations effected in 2006 will be included in the Fixed line segment of the Group.

By the time of the approval of the financial statements the Company has only finalized the purchase price allocation for the Orbitel acquisition. The result of the remaining purchase price allocations will be available by the closing of 2006 and therefore will be included in 2006 financial statements of the Group.

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

	Fair values	**Carrying values**
	In HUF millions	
Purchase price of ownership acquired	2,014	
Additional costs directly attributable to the business combination	38	
Consideration paid	2,052	
Net assets acquired	1,015	
Goodwill	1,037	
Net assets acquired:		
Cash	22	22
Other financial assets	6	6
Receivables	378	378
Income tax receivable	8	8
Inventory	12	12
Property, plant and equipment	512	370
Intangible assets	802	211
Other non current assets	4	4
Trade and other payables	(396)	(396)
Loans and other borrowings	(199)	(199)
Net deferred tax liability	(134)	(24)
Total	1,015	392

The carrying values of the net assets of the companies (KFKI Group, iWiW and Adnetwork) acquired in individually immaterial business combinations are disclosed in their aggregate amounts in the table below.

	Carrying values
	In HUF millions
Purchase price of ownership acquired	10,968
Additional costs directly attributable to the business combination	161
Consideration paid	11,129
Net assets acquired	1,339
Goodwill	9,790
Net assets acquired:	
Cash	350
Receivables	2,886
Income tax receivable	32
Inventory	656
Property, plant and equipment	633
Intangible assets	238
Net deferred tax asset	23
Trade and other payables	(2,737)
Loans and other borrowings	(588)
Provisions	(154)
Total	1,339

Dataplex did not have IFRS accounts at the date of the acquisition, which makes the book value disclosure on Dataplex's balance sheet as at the acquisition date impracticable.

33 Recent accounting pronouncements

The Group has reviewed the new standards, amendments and interpretations to existing standards that have been published that are mandatory for the Group's accounting periods after January 1, 2006 and found the following changes relevant.

IFRIC 4 – Determining whether an Arrangement contrains a Lease requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfillment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. As Magyar Telekom often provides complex services to its business clients that require the deployment of certain technological assets as well, revenues that have so far been reported as service revenues may have to be split and some reported as lease revenues. In case lease components are identified and the lease qualifies as a finance lease according to IAS 17, the applicable part of the service revenues that would have been recognized evenly over the service period will be recognized upfront as revenue from sale of assets. Consequently, the depreciation that would have arisen over the useful life of the applicable assets will be recognized as cost of equipment sold at the deployment of the asset. In the relevant cases, finance income will also accrue on the finance lease receivables. This will result in changes in the relevant income statement and balance sheet lines, but the expected change to the net income or the equity of the Group is not expected to be significant. One of the examples that is impacted by the adoption of this interpretation is the Tetra services commenced in 2006. See more details on the Tetra services in note 29 (b).

IAS 39 (Amendment), The Fair Value Option (effective from January 1, 2006). This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Group believes that this amendment should not have a significant impact on the classification of financial instruments, as the Group should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit and loss. The Group will apply this amendment from annual periods beginning January 1, 2006.

IFRS 7 Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from January 1, 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. The Group will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning January 1, 2007.

Reconciliation to U.S. GAAP (unaudited)

Magyar Telekom's consolidated financial statements are prepared in accordance with International Financial Reporting Standards, which in certain respects differ from U.S. GAAP, the generally accepted accounting principles in the USA. The principal differences between IFRS and U.S. GAAP are presented below, together with explanations of the adjustments that affect consolidated profit for each of the three years in the period ended December 31, 2005 and total shareholders' equity as of December 31, 2004 and 2005.

	Notes	For the year ended December 31,		
		2003	2004	2005
		(in HUF millions)		
Profit attributable to the equity holders of the Company (Net income) under IFRS		57,475	34,641	78,564
Profit attributable to minority interests under IFRS		11,865	8,686	10,355
Profit for the year under IFRS		69,340	43,327	88,919
Adjustments for U.S. GAAP:				
Revenue recognition	(a)	3,712	4,749	4,237
Asset retirement obligation	(b)	(136)	(871)	(402)
Employee expenses	(c)	-	950	(1,110)
Interest capitalized	(d)	359	420	472
Derivatives	(e)	-	-	(227)
Other income (rebranding)	(f)	-	(5,920)	(7,281)
Purchase price allocation (business combinations)	(g)	(6,720)	(6,977)	(4,775)
Goodwill	(h)	13,795	13,876	-
Profit before tax		11,010	6,227	(9,086)
Tax	(i)	(711)	(1,503)	610
Profit after tax		10,299	4,724	(8,476)
Minority interest	(j)	(1,370)	319	(828)
Total U.S. GAAP adjustments on Net income		**8,929**	**5,043**	**(9,304)**
Profit attributable to the equity holders of the Company (Net income) under U.S. GAAP		66,404	39,684	69,260
Profit attributable to minority interests under U.S. GAAP		13,235	8,367	11,183
		79,639	48,051	80,443

The amounts in the table above show by topic how much more or less income or expense was recognized in the U.S. GAAP accounts in comparison to the IFRS accounts.

	Notes	At December 31, 2004	2005
		(in HUF millions)	
Total Shareholders' equity under IFRS – as reported		516,567	527,567
Restatement for IAS 39		(733)	-
Total Shareholders' equity under IFRS – as restated		515,834	527,567
Minority interests under IFRS		60,097	70,127
Total equity under IFRS – as restated		575,931	597,694
Adjustments for U.S. GAAP:			
Revenue recognition	(a)	(13,705)	(9,468)
Asset retirement obligation	(b)	(1,007)	(1,409)
Employee expenses	(c)	960	(213)
Interest capitalized	(d)	4,993	5,465
Derivatives	(e)	873	646
Purchase price allocation (business combinations)	(g)	13,881	8,132
Goodwill	(h)	16,693	14,237
Tax	(i)	(5,747)	(5,049)
Minority interest	(j)	2,132	2,190
Total U.S. GAAP adjustments on Shareholders' equity		**19,073**	**14,531**
U.S. GAAP adjustment on Minority interest	(j)	(2,132)	(2,190)
Total U.S. GAAP adjustments on Equity		16,941	12,341
Total Shareholders' equity under U.S. GAAP		534,907	542,098
Minority interests under U.S. GAAP		57,965	67,937
		592,872	610,035

In previous years the Group's equity reconciliation was presented on the basis of the cumulative income statement impact of the reconciling adjustments between U.S. GAAP and IFRS. The amounts included in the table above show the cumulative adjustments on the net assets by reconciling item. The format of the disclosure has been changed on the basis the revised format is more informative.

(a) Revenue recognition

In Magyar Telekom's IFRS accounts fixed line connection fees collected after October 1997 are recognized immediately together with the directly related expenses. Mobile activation fees are also recognized when customers' subscriptions are activated. In the U.S. GAAP accounts, however, fixed line connection fees and mobile activation fees until December 31, 2003 were deferred and recognized as revenue over the expected customer relationship period as regulated by SAB 101. Directly related expenses of the connections and activations were also deferred up to the amount of the revenues.

As of January 1, 2004 Magyar Telekom adopted EITF 00-21 and SAB 104 in its U.S. GAAP accounts, according to which bundled customer packages are analyzed by the elements of the bundle. Revenues from the individual elements of multiple deliverable packages are recognized in proportion of the relative fair values of the elements. Connections in all cases are bundled with other deliverables such as equipment and/or prepaid usage. As connections and activations are no longer considered separate earnings events, the fair value of this element is considered zero. Accordingly, amounts collected for connections and activations are allocated to the other elements of the packages and recognized according to revenue recognition policies applied to those services (such as equipment sales, prepaid airtime, etc.).

In the U.S. GAAP accounts there is a higher amount of deferred revenues and there are deferred expenses as well related to the direct costs of the activations and connections, due to the amounts deferred until 2003, not yet fully amortized to revenue and expense respectively.

(b) Asset retirement obligation

On January 1, 2003 Magyar Telekom adopted SFAS 143, "Accounting for Asset Retirement Obligations". SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of the fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. As opposed to the U.S. GAAP accounts, Magyar Telekom does not recognize a provision for asset retirement obligations in its IFRS accounts when the criteria to recognize a provision according to IAS 37 are not met.

In the U.S. GAAP accounts these assets have a higher gross book value which implies higher amount of depreciation, and there is a higher amount of provisions, which are acrreted until utilized.

(c) Employee expenses

Certain severance related expenses recognized as a provision in 2004 in the IFRS accounts related to redundancies in 2005 did not meet the criteria to be recognized as a liability in U.S. GAAP. These expenses were recognized in the U.S. GAAP accounts in 2005.

In addition, different amount of expense was recognized in the IFRS accounts for share based payments according to IFRS 2 than in the U.S. GAAP accounts according to APB 25.

(d) Interest capitalized

In the IFRS accounts Magyar Telekom capitalized a gradually decreasing amount of interest in prior years, and did not capitalize any interest in 2004 and 2005. This was the case as all loans taken for capital investment projects in prior years had been gradually repaid by the end of 2003.

In accordance with U.S. GAAP, Magyar Telekom does not differentiate the loans based on the purpose for which they were taken, all are considered for interest capitalization. As a result, a higher amount of interest is capitalized in the U.S. GAAP accounts, which results in a higher balance of property, plant and equipment and consequently a higher amount of depreciation.

(e) Derivatives

The revised interpretation of IAS 39 – Financial Instruments – Recognition and Measurement does not consider contracts denominated in a currency that is not the functional currency of either of the contracting parties as a separable host contract and an embedded derivative if the contract currency is widely used in that market. As a result of the change in the interpretation, Magyar Telekom has restated its opening IFRS retained earnings to eliminate the carrying amounts of these embedded derivatives (HUF 873 million) and the related deferred tax liability (HUF 140 million) as at December 31, 2004.

The change in the IFRS interpretation does not have an impact on the U.S. GAAP accounts, in which these embedded derivatives remain to be recognized and re-measured to fair value.

(f) Other income (rebranding)

The Company's mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004, while other companies of the Group were renamed in 2005 (note 31). The compensation received from DTAG is shown as other income in the IFRS income statement.

Under U.S. GAAP, Magyar Telekom recognizes the compensation received as a contribution of capital by the majority shareholder. This results in a lower net income in the U.S. GAAP accounts, but the Shareholders' equity is no different in this respect.

(g) Purchase price allocation (business combinations)

Due to the different intangible asset recognition rules of IFRS and U.S. GAAP in earlier years, the fair value of the net assets of T-Mobile H, MakTel and Emitel on the 2001 acquisition was different. In the U.S. GAAP accounts, in general, a higher amount of intangible assets was recognized in those years. Consequently, the amortization expense of these intangibles is higher than in the IFRS accounts.

In addition, from March 31, 2004 in the IFRS accounts the total amount of fair value adjustments on the net assets of the acquired companies are recognized on consolidation, while in the U.S. GAAP accounts the fair value adjustments are only recognized in proportion to the share of ownership acquired, as was the policy in the IFRS accounts before the above mentioned date. This results in a lower amount of depreciation and amortization expense in the U.S. GAAP accounts for intangible and tangible asset adjustments arising on business combinations since March 31, 2004.

(h) Goodwill

Due to the different asset and liability recognition rules of IFRS and U.S. GAAP in earlier years, the fair value of the net assets of T-Mobile H, MakTel and Emitel on the 2001 acquisition was different. In the U.S. GAAP accounts, in general, a higher amount of intangible assets was recognized in those years on business combinations. Consequently, the goodwill recognized in the U.S. GAAP accounts was lower than in the IFRS accounts.

Further, according to SFAS 141 and 142, goodwill is not amortized under U.S. GAAP in the 3-year period presented, which resulted in significant differences between the IFRS and U.S. GAAP accounts in 2003 and 2004. From January 1, 2005 goodwill is also not amortized in IFRS, consequently no additional differences arise in this respect.

Goodwill is recorded in the currency of the acquired company under U.S. GAAP, while in earlier years goodwill was recognized in HUF under IFRS. This results in currency translation adjustments in the Shareholders' equity when compared to IFRS, the impact of which is included in the Goodwill line of the reconciliation.

(i) Tax

Most of the above described U.S. GAAP adjustments result in temporary differences for which deferred tax is recognized.

(j) Minority interest

Some of the above described adjustments are related to subsidiaries in which Magyar Telekom's share of ownership is less than 100 percent. In these cases the minority interests take their share of the adjustments.

Further, the Company had several call options for the remaining shares of certain consolidated subsidiaries. Co-owners of subsidiaries also had call and put options for shares held by Magyar Telekom in certain consolidated subsidiaries. The recognition and measurement of these options differed in certain cases under IFRS and U.S. GAAP. The differences between the recognition and measurement of these options resulted in U.S. GAAP adjustments in 2003 and 2004, which were accounted for in the minority interest lines of the reconciliation.

Financial Calendar 2006

February 13, 2006	Release of 2005 full year results
May 11, 2006	Release of 2006 1st quarter results
August 10, 2006	Release of 2006 1st half results
October 9, 2006	Extraordinary General Meeting
November 6, 2006	Continued Extraordinary General Meeting, suspended on October 9
November 9, 2006	Release of 2006 1st nine months results
November 15, 2006	Extraordinary General Meeting
December 21, 2006	Extraordinary General Meeting

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, 2005 filed with the U.S. Securities and Exchange Commission.

Magyar Telekom
Telecommunications Public Limited Company

Magyar Telekom Group Center: Krisztina krt. 55., 1013 Budapest
Mailing address: 1541 Budapest, Hungary
Phone: (+36 1) 458 0000, 458 7000, 457 4000
Telefax: (+36 1) 458 7176, 458 7177
Internet: www.magyartelekom.hu

Investor information

Magyar Telekom Group Investor Relations
Mailing address: 1541 Budapest, Hungary
Phone: (+36 1) 458 0437, 458 0424
Fax: (+36 1) 458 0443
E-mail: investor.relations@telekom.hu

Magyar Telekom stock ticker symbol

Budapest Stock Exchange (BSE): MTELEKOM HB (Bloomberg); MTEL.BU (Reuters)
New York Stock Exchange (NYSE): MTA.US (Bloomberg); MTA.N (Reuters)

Stock registration

Keler Zrt.
Address: Asbóth u. 9–11., 1075 Budapest, Hungary
Phone: (+36 1) 483 6100
Fax: (+36 1) 342 3539

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

Published by:
© Magyar Telekom Plc.
Group Communications
Budapest, 2007

Creative concepts and layout design:
© H-ArtDirectors

Image pictures:
© Tamás Dobos

Printed by:
Present Kft.

Magyar Telekom 8113/2006

Magyar Telekom Group: financial highlights

	2004 (HUF million)	2005 (HUF million)	Change (%)
Total revenues	601,438	620,697	3.2
EBITDA*	222,930	248,074	11.3
Operating profit	85,264	133,388	56.4
Net income	34,641	78,564	126.8
Total assets	1,029,558	1,082,948	5.2
Long term debt	226,070	226,215	0.1
Net debt	283,153	296,588	4.7
Total shareholders' equity	516,567	527,567	2.1
Net debt to total capital	32.9%	33.2%	n.a.
Purchase of tangible and intangible assets	91,748	103,587	12.9
Number of employees (closing) **	13,724	11,919	(13.2)
No. of shares (millions)	1,038	1,040	0.2
Basic earnings per share (HUF)	33.4	77.1	130.8
EBITDA margin	37.1%	40.0%	n.a.
Operating margin	14.2%	21.5%	n.a.
Net income margin	5.8%	12.7%	n.a.
ROA	3.3%	7.4%	n.a.

HUF/EUR (per 1 unit, year end)	245.93	252.73	2.8
HUF/EUR (per 1 unit, average)	251.68	248.05	(1.4)
HUF/USD (per 1 unit, year end)	180.29	213.58	18.5
HUF/USD (per 1 unit, average)	202.63	199.66	(1.5)

* EBITDA – Earnings before net financial expenses, taxes, depreciation and amortization
** Includes employees at Telekom Montenegro (TCG) from March 31, 2005

Key Shareholders as of December 31, 2005

The Hungarian State	Holder of the Golden Share
MagyarCom Holding GmbH (owned by Deutsche Telekom AG)	59.21%
Publicly held	40.79%

Magyar Telekom Group: summary of operating statistics

Hungarian fixed line operations	Dec. 31, 2004	Dec. 31, 2005	Change (%)
Fixed line penetration (Magyar Telekom Nyrt. service area, per 100 inhabitants)	37.5%	35.6%	n.a.
Digitalization of exchanges with ISDN	92.9%	100.0%	n.a.
Number of closing lines [1]			
Residential	2,080,408	1,981,876	(4.7)
Business	263,889	248,955	(5.7)
Payphone	27,818	22,112	(20.5)
ISDN channels	530,250	500,696	(5.6)
Total lines	2,902,365	2,753,639	(5.1)
Data products			
ADSL lines	205,886	329,314	59.9
Number of internet subscribers			
Dial-up	111,638	80,938	(27.5)
Leased line	907	751	(17.2)
DSL	137,910	218,954	58.8
W-LAN	1,153	1,467	27.2
CATV	14,412	26,425	83.4
Total internet subscribers	266,020	328,535	23.5
Managed leased lines (Flex-Com) [1]	10,939	10,289	(5.9)
Cable television customers	383,904	403,631	5.1
Total broadband internet access [2]	222,358	357,957	61.0
Employees			
Fixed line employees (closing) [1]	8,009	5,684	(29.0)
Lines per fixed line employees [1]	362.4	484.4	33.7
Fixed line employees (Magyar Telekom Nyrt., closing)	7,740	5,478	(29.2)
Lines per fixed line employees (Magyar Telekom Nyrt.)	364.9	489.0	34.0

Hungarian mobile operations	Dec. 31, 2004	Dec. 31, 2005	Change (%)
Mobile penetration	86.4%	92.4%	n.a.
Market share of T-Mobile Hungary	46.2%	45.0%	n.a.
Number of customers	4,032,045	4,193,855	4.0
Postpaid share in the customer base	28.9%	31.6%	n.a.
MOU (Minutes of Usage per User/Month)	115	127	10.4
ARPU (Average Traffic Revenue per User/Month)	4,945	4,917	(0.6)
Postpaid ARPU	11,828	11,007	(6.9)
Prepaid ARPU	2,380	2,287	(3.9)
Enhanced services within ARPU	612	706	15.4
Average acquisition cost (SAC) per customer	10,275	7,062	(31.3)

International fixed line operations	Dec. 31, 2004	Dec. 31, 2005	Change (%)
Macedonian fixed line penetration	29.0%	26.0%	n.a.
Number of closing lines			
Residential	524,722	467,559	(10.9)
Business	56,329	48,252	(14.3)
Payphone	2,725	2,063	(24.3)
ISDN channels	42,082	41,262	(1.9)
Total Macedonian lines	625,858	559,136	(10.7)
Data products (Macedonia)			
ADSL lines	2,447	7,798	218.7
Number of internet subscribers			
Dial-up	64,780	83,930	29.6
Leased line	164	137	(16.5)
DSL	2,447	7,798	218.7
Total internet subscribers	67,391	91,865	36.3
Macedonian employees			
Fixed line employees (closing)	2,382	1,776	(25.4)
Lines per fixed line employees	262.7	314.9	19.9
Montenegrin fixed line penetration	n.a.	31.2%	n.a.
Number of closing lines			
PSTN lines	n.a.	175,122	n.a.
ISDN channels	n.a.	18,750	n.a.
Total Montenegrin lines	n.a.	193,872	n.a.
Data products (Montenegro)			
ADSL lines	n.a.	1,085	n.a.
Number of internet subscribers			
Prepaid	n.a.	25,594	n.a.
Leased line	n.a.	117	n.a.
DSL	n.a.	1,085	n.a.
Total internet subscribers [3]	n.a.	26,796	n.a.
Montenegrin employees			
Fixed line employees (closing)	n.a.	975	n.a.
Lines per fixed line employees	n.a.	198.8	n.a.

International mobile operations	Dec. 31, 2004	Dec. 31, 2005	Change (%)
Macedonian mobile penetration	48.1%	61.3%	n.a.
Market share of MobiMak	76.3%	69.2%	n.a.
Number of customers	752,462	877,142	16.6
Postpaid share in the customer base	15.8%	15.9%	n.a.
MOU	66	63	(4.5)
ARPU	3,804	3,065	(19.4)
Montenegrin mobile penetration	n.a.	78.6%	n.a.
Market share of Monet	n.a.	42.7%	n.a.
Number of customers	n.a.	208,094	n.a.
Postpaid share in the customer base	n.a.	15.0%	n.a.
MOU	n.a.	127	n.a.
ARPU	n.a.	3,745	n.a.

[1] Magyar Telekom Nyrt. and Emitel Zrt.
[2] Includes ADSL lines operated by Magyar Telekom Nyrt. and Emitel Zrt. plus T-Online Hungary's broadband customers (other than the ADSL purchased from Magyar Telekom Nyrt.).
[3] Internet RPC figures in Montenegro are not consistent yet with the Magyar Telekom Group standard.

Magyar Telekom Group: international presence

■ Incumbent service providers
■ Alternative service providers
* Point of presence