

*meeting  
tomorrow*

• • • • •

**2004** *annual report*

# Leading Positions Maintained



## THE MATÁV GROUP'S LINES OF BUSINESS

### BUSINESS SERVICES



Market leadership in  
business communications

Share: 62%<sup>(a)</sup>

- New sales strategy: solutions supplied for key business partners, long-term contracts
- Key supplier of the national public service network (service, installation, operation)
- Market expansion: outsourcing, data communications, IT (BCN, Integris)
- Strategic partnerships within the Deutsche Telekom Group (T-Systems International, T-Systems Hungary)
- Offers in the competitors' areas (voice and data services, carrier preselection)

### RESIDENTIAL SERVICES



Market leadership in fixed  
line telephony

Share: 81%<sup>(b)</sup>

- 2.9 million fixed lines, erosion stopped (increase in 4th quarter)
- Broadband mass products: 204,000 ADSL, 384,000 cable TV customers
- Innovative pricing: 1.7 million residential customers use tariff packages (58%)
- Innovative offers for small and medium businesses: Üzleti Felező, Flotta ADSL, Háttértár
- Offers in the competitors' areas (Csevegő Partner, 1515 Előhívó, Ritmus Partner, Ritmus Előhívó)

### INTERNET



Market leadership in Internet

Share: 42%<sup>(c)</sup>

- 266,000 subscribers, 58% with broadband connection
- Multimedia content services: [origo>play], music store, [origo] téka
- New Internet packages: ADSL Play, Internet voucher
- [origo] is the leading portal site: average of 1 million visits a day, 1.9 million [freemail] users
- Offers in the competitors' areas (Kombi packages)

### MOBILE



Market leadership in mobile

Share: 46.2%

- More than 4 million customers
- Successful rebranding: nearly 100% brand awareness in 6 months
- New tariff packages and loyalty programs: Relax, K.A.P., GPRS 300
- Mobile Internet and multimedia: EDGE and HotSpot services, t-zones portal
- UMTS third generation mobile services licence

(a) In the business communication market revenues.

(b) Combined share of Matáv and Emitel in fixed lines.

(c) Among ISPs in the dial-up market.

# The Matáv Group: Financial Highlights

	2003 HUF million	2004 HUF million	Change %
Total revenues	607,252	601,438	(1.0)
EBITDA*	250,398	222,930	(11.0)
Operating profit	122,064	85,264	(30.1)
Net income	57,475	34,641	(39.7)
No. of shares outstanding (millions)	1,038	1,038	0.0
Basic earnings per share (HUF)	55.4	33.4	(39.7)
Total assets	1,058,837	1,029,558	(2.8)
Long term debt	121,344	226,070	86.3
Net debt	291,654	283,153	(2.9)
Total shareholders' equity	560,110	516,567	(7.8)
Net debt to total capital	31.6%	32.9%	n.a.
Gross additions to tangible and intangible fixed assets	90,788	91,748	1.1
EBITDA margin	41.2%	37.1%	n.a.
Operating margin	20.1%	14.2%	n.a.
Net income margin	9.5%	5.8%	n.a.
ROA	5.4%	3.3%	n.a.
HUF/EUR (year end)	262.23	245.93	(6.2)
HUF/EUR (average)	253.42	251.68	(0.7)
HUF/USD (year end)	207.92	180.29	(13.3)
HUF/USD (average)	224.55	202.63	(9.8)

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

## KEY SHAREHOLDERS AS OF DECEMBER 31, 2004

The Hungarian State	Holder of the Golden Share
MagyarCom Holding GmbH (owned by Deutsche Telekom AG)	59.49%
Publicly held	40.51%

# The Matáv Group:

## Summary of Operating Statistics

	Dec. 31, 2003	Dec. 31, 2004	Change %
<i>No. of fixed lines:</i>			
<i>residential</i>	2,012,672	2,015,934	0.2
<i>business</i>	261,642	256,321	(2.0)
<i>public</i>	28,799	27,059	(6.0)
<i>No. of ISDN channels ("B")</i>	527,728	525,346	(0.5)
<i>Total fixed lines</i>	2,830,841	2,824,660	(0.2)
<i>No. of fixed lines incl. ISDN, Eritel</i>	78,638	77,705	(1.2)
<i>No. of fixed lines incl. ISDN, MakTel</i>	619,236	625,858	1.1
<i>Network digitalization with ISDN</i>	89.9%	92.9%	n.a.
<i>Fixed line penetration* (Matáv service area, per 100 inhabitants)</i>	37.5	37.5	n.a.
<i>No. of Group employees (closing)</i>	14,710	13,724	(6.7)
<i>No. of fixed line employees (closing, Matáv Rt.)</i>	8,071	7,740	(4.1)
<i>No. of fixed lines per employee (Matáv Rt.)</i>	350.7	364.9	4.0
<i>No. of mobile subscribers, T-Mobile Hungary</i>	3,766,274	4,032,045	7.1
<i>No. of mobile subscribers, MakTel</i>	523,664	752,462	43.7
<i>Mobile penetration (Hungary, per 100 inhabitants)</i>	78.5	86.4	n.a.
<i>No. of Internet subscribers</i>	210,680	266,020	26.3
<i>No. of Internet subscribers, MakTel (inc. prepaid from Jan 1, 2004)</i>	49,040	64,944	32.4
<i>No. of cable television customers</i>	362,366	383,904	5.9
<i>No. of managed leased lines (Flex-Com)</i>	11,480	10,467	(8.8)
<i>Domestic outgoing traffic ('000 minutes)</i>	7,958,292	7,670,611	(3.6)
<i>International outgoing traffic ('000 minutes)</i>	138,485	131,516	(5.0)
<i>Domestic outgoing traffic, Eritel ('000 minutes)</i>	152,614	139,846	(8.4)
<i>International outgoing traffic, Eritel ('000 minutes)</i>	2,253	2,257	0.2
<i>MOU (Minutes of Usage per User/Month), T-Mobile Hungary</i>	114	115	0.9
<i>ARPU (Average Traffic Revenue per User/Month), T-Mobile Hungary</i>	5,261	4,945	(6.0)

\* For 2003 penetration is different from the rate published earlier as the number of population in Matáv Rt. service area was modified in accordance with the latest figure released by the Central Statistical Office ("KSH").

# Our Mission

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

*We commit to make telecommunications and IT achievements available to the widest scope of clients. We provide solutions to support our clients in creating a more meaningful, more effective and more humane future.*

*Building on our unique experience accumulated on the domestic telecommunications market and our significant achievements we work on attaining our goals, satisfying the needs of our customers and fulfilling the expectations of our investors. The key to our development is our well-educated and committed professionals whom we esteem as an outstanding value of our Company.*

*Matáv ([www.matav.hu](http://www.matav.hu)) is the principal provider of telecom services in Hungary. Matáv provides a broad range of services including telephony, data transmission, value-added services, and through its subsidiaries is Hungary's largest mobile telecom and leading Internet service provider. Matáv also holds 100% stake in Stonebridge Communications AD which is the majority owner of MakTel, the sole fixed line and the leading mobile operator in Macedonia.*

*Matáv Hungarian Telecommunications Co. Ltd. was incorporated in 1991 and privatized in 1993. Its majority owner (59.49%) is MagyarCom Holding GmbH, fully owned by Deutsche Telekom AG. The remainder, 40.51% is publicly traded. Matáv shares were introduced to national and international stock exchange dealing both in Budapest and New York in 1997. With its steady and dynamic growth Matáv has created significant value for millions of customers and for shareholders.*



*Matáv's Board of Directors has made a decision on January 20, 2005 on the renaming of Matáv to Magyar Telekom. On February 22, 2005 Matáv's Extraordinary General Meeting approved the decision of the Board. As a result of this decision the T-brand portfolio will be fully introduced in Hungary. The Matáv Group's brand structure is to follow the brand structure of the Deutsche Telekom Group.*

*The close partnership with the global Deutsche Telekom Group and the overall introduction of the T-brand will contribute to our company's value and competitiveness. Our customers will be able to experience the trust and the invariable quality that this international brand stands for.*

*The T stands for quality, efficiency and innovation. It embodies the spirit and the commitment of our team, worldwide. The strength of our brand is based on a strong network between holding company and affiliates and the synergies within our Group, which is a leading force in telecommunications. In those markets in which companies of the T-Group are active, our brand shows the way to state-of-the-art telecommunications services and top quality.*

*The T-brand as an internationally recognized quality brand also means that Magyar Telekom can more intensively capitalize on the strengths offered by a Group with an international background.*

*With the introduction of the complete T-brand portfolio, Magyar Telekom will become the representative in Hungary of one of the largest and strongest international brands that permeates people's everyday life.*

*In 2005, together with our shareholders and customers, we are meeting tomorrow.*





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# Letter to Our Shareholders

## DEAR SHAREHOLDERS,

I am pleased to report that in 2004 Matáv continued to deliver a performance in line and in some cases above the full year financial and operational targets. Revenues corresponded to the guidance of around 600 billion forints, while the reported EBITDA margin was 37.1% but EBITDA margin before restructuring charges stood at 40.4%, meeting the around 40% targeted level. The target for gross additions to tangible and intangible assets without UMTS spending was around 90 billion forints. The actual number was somewhat lower at 85 billion forints. As for our operational results, we were able to minimise the erosion of the domestic fixed lines, as planned. A main driver behind this success was the fast ADSL rollout: Matáv surpassed the planned 200 thousand ADSL lines at the end of last year.

Regarding the regulatory environment, the new Electronic Communications Act, containing new service obligations, came into force last January. Fixed line geographic number portability was introduced at the same time, while mobile number portability has been available since May. Our competitors used the opportunities offered by carrier selection and number portability, which led to increased pressure in both the residential and the business segment. The interconnection fees were reduced further and are now close to the relevant average Western-European level. A further Telecommunications Authority resolution stipulated T-Mobile Hungary's fixed-to-mobile termination fees to be reduced by an average of nearly 9% from the middle of 2004.

The Hungarian fixed line business witnessed intensifying competition, partly as a result of last year's regulatory changes. However, Matáv took an active role in shaping the competitive landscape. In preparation for increasing competition and in order to reverse fixed line erosion, we introduced residential packages allowing unlimited local and domestic long distance calls in certain periods. These packages not only helped us to retain and even regain customers but also stimulated the usage of the fixed lines. As a combined result of our initiatives, customised tariff packages represented around 58% of the total number of lines at the end of the year. In line with our stated target for the fixed segment, the total number of lines was broadly stabilised. Moreover, after many years of decline, the closing number of residential lines grew slightly compared to 2003 reflecting the success of our efforts in line preservation. The lines per employee ratio reached 365 at parent company level. In conjunction with our efforts to enhance our position in other markets, we also launched new services outside Matáv

areas through carrier preselection and call-by-call carrier selection.

In our Hungarian broadband business, the number of ADSL lines almost doubled during 2004, and as a result, we outperformed our year-end target. In Matáv's service area, every third Internet subscriber is estimated to be accessing the web via an ADSL line and a rising share of new residential customers select ADSL as their first Internet access line. This positive trend has been supported by the free of charge upgrade of the ADSL access rates as well as the introduction of new broadband content services.

The Macedonian macroeconomic situation remained difficult, with limited signs of recovery so far. The level of foreign direct investments remains low, GDP growth is limited and the unemployment rate is still very high. As a result, MakTel continued to suffer from limited revenue growth potential. Fixed line voice revenues decreased but on the positive side, demand for Internet services increased with Internet penetration in Macedonia approaching 5%. MakTel has a strong leading position in the dial-up market, and remains the only ADSL service provider in Macedonia.

T-Mobile Hungary continued to preserve its strong leading position in a highly saturated market. The Hungarian mobile business reported healthy financials despite very intense competition. As the market approached saturation, the focus shifted from customer acquisition to retention. The rapid acceptance of T-Mobile Hungary's flat rate postpaid packages, Relax, contributed to the positive change in our customer mix resulting in an increase in the proportion of postpaid customers. The postpaid churn rate remained favourable despite competing tariff offers, the high market saturation and the introduction of mobile number portability in May last year. Tariff reductions and the growing flat rate package customer base increased the usage but this growth could not counterbalance the fact that the migration to the postpaid flat rate Relax packages caused a lower average tariff level, putting downward pressure on the margins. An important milestone in 2004 was the decision to rebrand Westel to T-Mobile Hungary, which had a positive effect on sales and customer retention. To support the campaign, T-Mobile Hungary introduced several new offers and handsets to its customers, and the brand awareness improved rapidly. At the end of 2004, T-Mobile Hungary was awarded a UMTS licence. With the rollout of the third generation network, T-Mobile Hungary will offer much wider range of data content





than at present, enabling the fast transmission of high quality multimedia materials.

The Macedonian mobile market continues to gain ground. The penetration reached 49% at the end of 2004. MobiMak's subscriber base grew significantly and the company managed to preserve a strong leading position and solid financials.

In August 2004, Matáv announced its mid-term Value Creation Program, based on three pillars: organic performance improvement, exploitation of Group synergies and acquisition-driven growth. In line with this new strategy, at the end of 2004 we decided to participate in the privatization of Telekom Crne Gore in Montenegro. Matáv decided on a major headcount rationalisation at both parent company and the subsidiaries to boost efficiency. As a result, the fixed lines per employee ratio at the parent company is targeted to reach 500 by end-2006. Our aim is to create additional value by taking advantage of synergies to reduce costs, capture new revenues and improve our competitive position. In the broadband business, we aim to grow the ADSL customer base to over 400 thousands by the end of 2006. The cumulative impact of these steps is expected to deliver low single digit revenue growth in 2005 and 2006 before potential acquisitions. Group EBITDA margin

is expected to exceed 40% before restructuring charges and potential acquisitions in both 2005 and 2006.

We faced several challenges in 2004 and took a proactive approach to preserve our competitiveness. Despite the difficult environment, as a Group, we were able to preserve the market leading positions in our key businesses and as a result reported solid financials in 2004.

Elek Straub  
Chairman and Chief Executive Officer



## Senior Management of the Matáv Group

In December 2004, Matáv's Board of Directors made a decision to modify the Group's structure as of January 1, 2005 as part of the efficiency improvement program. As a result of the modification the Matáv Group's organizational structure will be simplified and its operation will become more efficient. Through the coordinated activities of its member companies, the Matáv Group covers three business areas: services for business customers, wireline services and mobile telephony. Under the new management structure, the Wireline Services Line of Business was created to integrate the activities of Residential Services Division, Internet Services Division and Networks Division. The position of Chief Services and Logistics Officer will be eliminated with the activities of this area transformed and assigned to other areas. The Board of Directors had earlier eliminated the position of Chief Strategy and International Officer as of May 31, 2004. The Management Committee that is responsible for the Group's operative management will consist of 6 chief officers. Members of the Management Committee from January 1, 2005: Elek Straub, dr. Klaus Hartmann, Christopher Mattheisen, dr. Tamás Pásztor, András Sugár, Zoltán Tankó.

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

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

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

(43) He graduated in Economics and holds a PhD and an MBA. He worked for Arthur Andersen in Germany, and as treasurer and operational controller for a subsidiary

of the BICC Group. He joined Deutsche Telekom in 1995 as Manager International Capital Markets, and became Corporate Treasurer of Global One, a joint venture of DT, France Telecom and Sprint, in 1997. He returned to DT's Headquarters in Bonn, acting as Senior Advisor to the CFO, in 2000. He was elected member of Matáv's Board of Directors on October 27, 2000 and appointed Matáv's CFO as of November 1, 2000. Deputy Chairman of the Management Committee since November 14, 2000.

### **DR. TAMÁS PÁSZTOR** CHIEF HUMAN RESOURCES AND LEGAL OFFICER

(53) A graduate in law and organization engineering, he joined the Hungarian Post in 1969 and served in various positions at its Budapest regional directorate. In 1980 he moved on to the Post's headquarters as head of labor issues and later of workforce management department. He was an active participant of the Post's division and of founding and starting its successor companies' operations including Matáv. From 1990 he was Matáv's Director of Human Resources Development and has been



## Senior Management of the Matáv Group

(from left to right)

**ANDRÁS SUGÁR** Chief Executive Officer, T-Mobile Hungary **DR. TAMÁS**

**PÁSZTORY** Chief Human Resources and Legal Officer **ELEK STRAUB**

Chairman and Chief Executive Officer, Chairman of the Management Committee

**DR. KLAUS HARTMANN** Chief Financial Officer, Deputy Chairman of the

Management Committee **GYÖRGY SIMÓ** Chief Executive Officer, Axelero

Internet **CHRISTOPHER MATTHEISEN** Chief Officer Wireline Services

**ZOLTÁN TANKÓ** Chief Officer Business Services **PETER JANECK** Chief

Officer Network Division **LÁSZLÓ BODNÁR** Chief Services and Logistics

Officer

responsible for Matáv's HR and organizational development activities ever since.

He was appointed Matáv's Deputy Chief Officer in July 1995 and has been Chief Human Resources and Legal Officer since February 1, 1996.

### **ZOLTÁN TANKÓ** CHIEF OFFICER BUSINESS SERVICES

(47) A Budapest Technical University graduate in electrical engineering, he worked from 1980 as computer development engineer in Budapesti Rádiótechnikai Gyar, 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 Matáv in 1996 as Director of Business Communications and was promoted to Chief Sales Officer of the company as of January 1, 2000. From January 1, 2002 he has been Chief Officer Business Solutions and from January 1, 2005 Chief Officer Business Services.

### **CHRISTOPHER MATTHEISEN** CHIEF OFFICER

#### WIRELINE SERVICES

(43) He graduated in economics and finance at Indiana University, Bloomington and Columbia University, New York. He came to Hungary in 1990 to found a consulting company for business analysis and strategic planning. From 1993 he worked as Marketing Officer of US West International and later as Westel Mobile's Marketing and Sales Director. From 1997 he headed in London the commercial and marketing activities of MediaOne's mobile subsidiaries and later worked for BT Cellnet as Business, Trading and Marketing Director. From September 1, 2002 he has been Matáv's Chief Officer Residential Services and from January 1, 2005 Chief Officer Wireline Services.

### **ANDRÁS SUGÁR** CHIEF EXECUTIVE OFFICER, T-MOBILE

#### HUNGARY

(58) He graduated in electrical engineering at the Budapest Technical University. He started his career as development engineer at Elektromechanikai Vállalat. From 1974 he served at Hungary's Ministry of Foreign Trade. In 1980 he became Deputy Commercial Counsellor at the Commercial Section of Hungary's Embassy in New York. In 1985 he became Deputy General Director of Intercooperation Rt. From 1988 he was Deputy General Manager of Transelektro Rt. In 1991 he became General Manager of Westel Rádiótelefon Kft. He has been CEO of T-Mobile Hungary Rt. (until 2004, Westel Mobile Rt.) from its incorporation in 1993 while also heading the Matáv Group's Mobile line of business from January 1, 2002 and then Mobile Services from January 1, 2005.

### **LÁSZLÓ BODNÁR** CHIEF SERVICES AND LOGISTICS OFFICER

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

### **PETER JANECK** CHIEF OFFICER NETWORKS DIVISION

(55) He is a graduate in engineering. He started his career at Deutsche Post, and has been working in telecommunications since 1983. He has accumulated considerable international experience in this period, serving, among other roles, as Chief Officer responsible for the fixed line network of Hrvatski Telekom for two years. Beginning March 2002 he was in charge of the technical infrastructure branch of T-Com, Deutsche Telekom's fixed business line. He took the position of Matáv's Chief Technical Officer and Chief Officer Network Systems from July 12, 2004 and he has been Chief Officer Networks Division from January 1, 2005.

### **GYÖRGY SIMÓ** CHIEF EXECUTIVE OFFICER, AXELERO

#### INTERNET

(38) Graduated in 1997 at ELTE Sociology Department. During his studies received a scholarship to the Sociology Department of the New School for Social Research in New York. In 1991 he was a founder and host, later Chairman of the Board of Trustees of Tilos Radio. From 1996 to 1998 Vice-Chairman of AMARC-Europe, the European Association of Community Radio Broadcasters. From 1999 he was Program Director at MatávNet (since 2001 Axelero Internet). In 2000 he became a leader of the project elaborating Matáv's Internet strategy, later promoted to Axelero's Chief Officer and Executive Director, then Senior Chief Officer responsible for media, strategy and communication. Since November 1, 2003 he has been Chief Executive Officer of Axelero Internet and also heading the Matáv Group's Internet line of business and then, from January 1, 2005, its Internet Services Division.



# Matáv's Board of Directors and Supervisory Board

## MEMBERS OF MATÁV'S BOARD OF DIRECTORS

ELECTED AT THE ANNUAL GENERAL MEETING ON APRIL 28, 2004

UNTIL MAY 31, 2007 OR THE DATE OF THE GENERAL MEETING THAT WILL CLOSE BUSINESS YEAR 2006



### ELEK STRAUB

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



### ACHIM BERG

(40) After studying management information systems, he began his professional career with the computer manufacturer and systems integrator Bull. He then held further positions as Sales Director for the PC systems manufacturer Dell Computer, Managing Director, Germany, of Fujitsu Siemens Computers and Chairman of the Board of the software company Guideguide. He became a member of T-Com's Board of Management in May 2002 and has since been responsible for Marketing and Sales in Deutsche Telekom's fixed network division. Matáv's Director since April 28, 2004.



### DR. ISTVÁN FÖLDESI

(56) 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 Matáv's Director from December 13, 1994 to April 28, 1999 and Chairman of the Board in 1994–96. Matáv's Director again since April 25, 2003.



### MICHAEL GÜNTHER

(60) He studied business administration at the universities of Berlin and Hamburg. From 1971 he was commercial executive in various business areas at Philips. From 1987 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-Mobil. He became Chief Financial Officer of T-Mobile International in 2000 and since 2001 he is Chief Officer responsible for Joint Venture Management. Matáv's Director since April 26, 2002.



### DR. KLAUS HARTMANN

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

### **HORST HERMANN**

(49) 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 Matáv in charge of Strategy and Business Development. In 2002 he became Chief Strategy and International Officer, also responsible for Portfolio Management and Matáv's policy on content and media. In 2003 he was appointed T-Com's Senior Executive Vice President responsible for International Business. Matáv's Director since April 25, 2003.



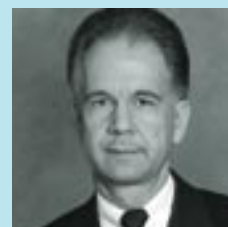
### **DR. MIHÁLY PATAI**

(51) 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. Since 1996 he has been Chairman and CEO of Allianz Hungária Insurance Co. Matáv's Director since April 28, 1998.



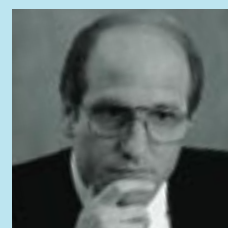
### **DR. RALPH RENTSCHLER**

(44) 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 Matáv's Supervisory Board Member. Matáv's Director since April 25, 2003.



### **DR. GYÖRGY SURÁNYI**

(50) 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 for 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. Matáv's Director since April 28, 2004.



### **MEMBERS OF MATÁV'S SUPERVISORY BOARD**

Elected at the Annual General Meeting on April 28, 2004

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**

**ARNE FREUND**

**GELLÉRT KADLÓT**

**JOACHIM KREGEL \***

**DR. KLAUS NITSCHKE**

**PÉTER VERMES**

### **MEMBERS OF THE REMUNERATION COMMITTEE:**

**HORST HERMANN**

**DR. MIHÁLY PATAI**

**DR. RALPH RENTSCHLER**

### **MEMBERS OF THE AUDIT COMMITTEE:**

**ARNE FREUND\*\***

**WOLFGANG HAUPTMANN**

**JOACHIM KREGEL\***

**DR. LÁSZLÓ PAP**

\* Mr. Joachim Kregel has resigned as of September 30, 2004 from his membership in the Supervisory Board and the Audit Committee.

\*\* The Supervisory Board elected Mr. Arne Freund on October 25, 2004 to be a member of the Audit Committee.

# Corporate Governance

## RESPONSIBILITY AND TRANSPARENCY

*In compliance with the provisions of the Sarbanes-Oxley Act, and as a listed company, also with the regulations of the New York Stock Exchange (NYSE) and the Budapest Stock Exchange (BSE), Matáv has transparent and responsible corporate governance practices and from 2004, it publishes the relevant detailed information on the Matáv website and in its 20F format annual report. The Articles of Association, and the Rules of Procedure of the Board of Directors and the Supervisory Board as well as its Audit Committee, constitute part of Matáv's own responsible corporate governance code. In addition, Matáv has published the information on relations of the Board of Directors and the management with third parties, as well as the guidelines on insider trading and on the evaluation and remuneration of the management.*

## BOARD OF DIRECTORS

*Under Hungarian law, the Board of Directors is responsible for the company's governance and it takes decision in all matters where the shareholders do not have exclusive decision competence. At present, the Board consists of 9 directors. The percentage of the independent members within the overall number of the Board, in compliance with the relevant BSE recommendation is: 77% independent members. The members of the Remuneration Committee are selected from the Board members, and it makes a recommendation to the Board for the employment, evaluation of the work and remuneration of the chief executive officer and the chief officers. The Board also establishes the Management Committee and selects its members.*

## SUPERVISORY BOARD

*The Supervisory Board supervises the management of Matáv and ensures the company's compliance with the Hungarian statutory requirements and its own regulations on corporate governance. The Supervisory Board examines the reports to be submitted to the General Meeting, the proposals of the Board of Directors, the financial reports and the proposal concerning the distribution of the profits. At present, the Supervisory Board consists of 8 members. The percentage of the independent members within the overall number of the Supervisory Board, in compliance with the relevant BSE recommendation is: 66% independent*

*members. The members of the Audit Committee are selected from the members of the Supervisory Board. The Audit Committee supervises and approves every activity of the independent auditor, and reviews Matáv's annual financial report and the reports of the Internal audit.*

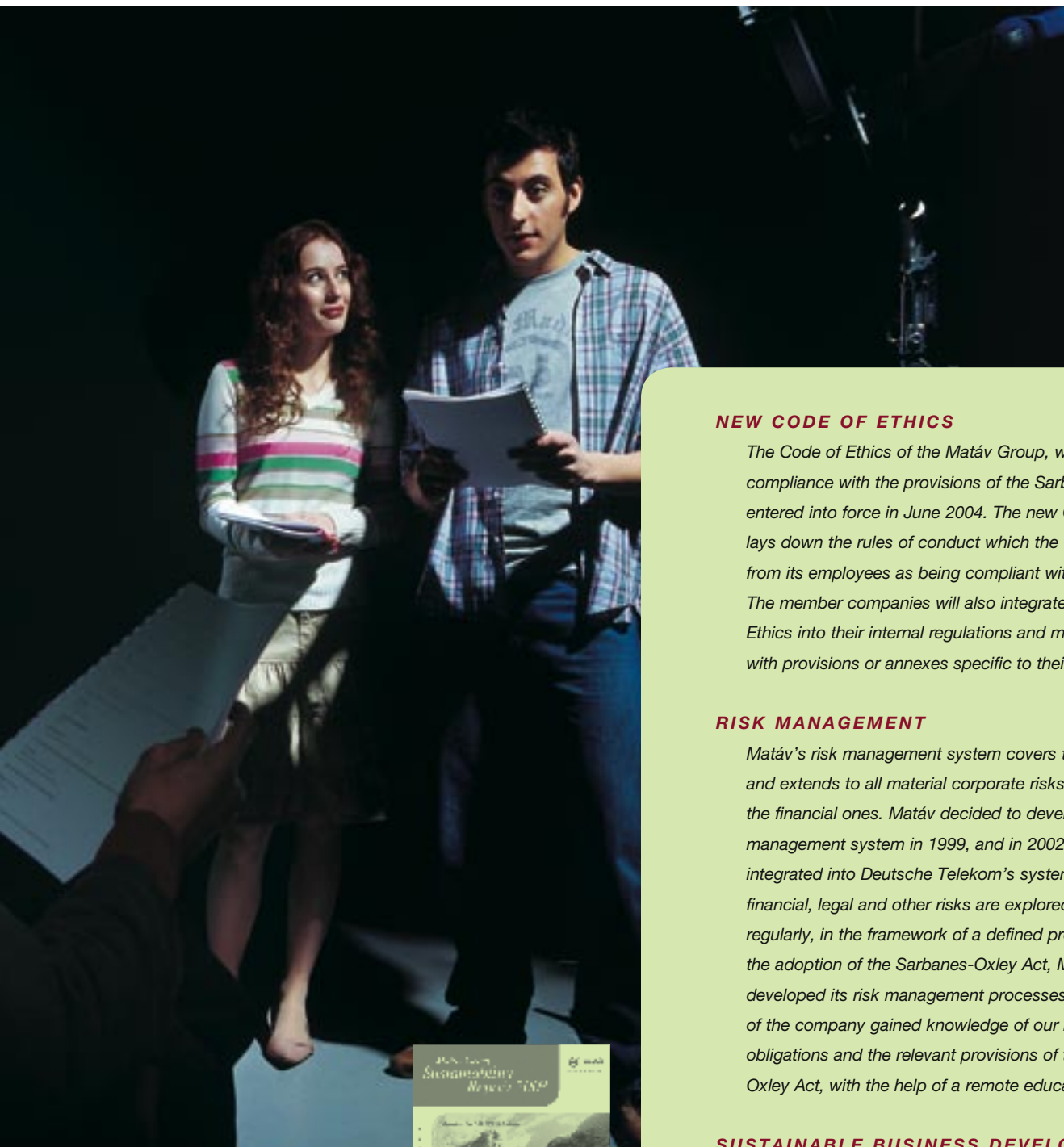
## MANAGEMENT COMMITTEE

*In 2000, the Board of Directors of Matáv established the Management Committee (MC), which it authorized to carry*



*We have transparent and responsible corporate governance practices*





Long-term  
commitment to  
sustainable business  
development

out its activities in compliance with the annual business plan. The Board selects the members of the Management Committee and determines its scope of authority. The MC may not act or take decision in matters which belong to the exclusive competence of the General Meeting or the Board of Directors. With the changed management structure, from January 1, 2005 the Management Committee consists of 6 members.

### NEW CODE OF ETHICS

The Code of Ethics of the Matáv Group, which is also in compliance with the provisions of the Sarbanes-Oxley Act, entered into force in June 2004. The new Code of Ethics lays down the rules of conduct which the Group demands from its employees as being compliant with Group interests. The member companies will also integrate the Code of Ethics into their internal regulations and may supplement it with provisions or annexes specific to their own activities.

### RISK MANAGEMENT

Matáv's risk management system covers the entire Group and extends to all material corporate risks, in addition to the financial ones. Matáv decided to develop its own risk management system in 1999, and in 2002 this system was integrated into Deutsche Telekom's system. The operating, financial, legal and other risks are explored and managed regularly, in the framework of a defined process. Following the adoption of the Sarbanes-Oxley Act, Matáv further developed its risk management processes. Every employee of the company gained knowledge of our risk management obligations and the relevant provisions of the Sarbanes-Oxley Act, with the help of a remote education program.

### SUSTAINABLE BUSINESS DEVELOPMENT

Infocommunications has a defining role and responsibility in sustainable development, which is an important element of the long-term strategy of the European Union. Matáv hosted the first European Telecommunications and Sustainability Conference in Budapest in November 2004. The conference organized by ETNO (European Telecommunications Network Operators Association) underscored the role played by the telecommunications industry and proclaimed the ETNO Sustainability Charter which Matáv also joined. Matáv managed the ETNO project called "Gases causing greenhouse effect and infocommunications" which showed that environmental harms can be mitigated through fuller utilization of the possibilities offered by infocommunications.

# Milestones 2004

## **BROADBAND INTERNET ACCESS MADE A MASS PRODUCT**

In December 2004 Matáv announced attainment of the target set one year earlier: connection of the 200,000th broadband Internet access (ADSL connection) representing almost 100% growth. We plan further growth of 100,000 lines in each of the following years too, so by the end of 2006 we can have 400,000 ADSL connections. As a result of the large-scale investments made to spread broadband Internet access, this year we doubled the number of towns covered by ADSL service: the service is available in 375 localities where 80% of the population live. With this Matáv's ADSL coverage topped 75%. The share of broadband connections within all Internet subscriptions grew to 33%. In November the ADSL access maximum download rate was significantly increased for our customers. In December a volume-based ADSL scheme, better complying with consumer demand, was launched for our Internet service provider partners.

## **FIXED LINE EROSION STOPPED**

By the end of 2004 we were able to stop the drop in fixed lines – after three years of gradual erosion – and stabilized the number of connections at the 2003 level. With this we achieved an earlier strategic target: to maintain the number of analog and ISDN lines. In fixed line segment, churn was reduced to a minimum by the end of the year and the number of residential PSTN lines even rose to a slight extent. Fixed lines were connected in about 100,000 new households so at the end of 2004 there were 1,500 more households with Matáv line than at the start of the year. The success of discount tariff packages greatly contributed to stabilization of the number of fixed lines: customers decided for one of our tariff packages with 58% of all lines that makes up for 1.7 million subscribers. As the driving engine of the information society, we generated additional growth in the Internet market too. Year-on-year, the Matáv Group's Internet subscriber based grew by 26.3% to 266,000.

## **MOBILE: SUCCESSFUL REBRANDING – 4 MILLION CUSTOMERS – UMTS**

In March 2004 Matáv's Board made a decision to rebrand Westel, our mobile business, to join a leading international mobile brand, T-Mobile. Since May 2004

the company's official name is T-Mobile Hungary, while it remains a fully-owned member company of the Matáv Group. Rebranding contributed to maintaining strong market leadership with over 46% share and to outstanding profitability. In December 2004 T-Mobile Hungary, that now has more than 4 million customers, obtained a 3G (UMTS) mobile service license for a period of 15 years. The company will launch 3G services at the end of 2005 on the new frequency.

## **YEAR OF STRATEGY CREATION**

In August 2004 the Matáv Group announced its medium-term value enhancing strategy. The strategic program for the next two-year period gave a response to the greatest challenges mounting in 2004: intensifying competition, saturation of the fixed line and mobile markets and new market regulation conforming to EU rules. The new strategy identifies the key targets to be attained by the end of 2006 and ensures further growth opportunities for the Group through efficiency improvement, synergies within the DT Group and further acquisitions. As part of the efficiency improvement program, in December 2004 the Board made a decision on restructuring of the Group's management from January 1, 2005. As a result of the modification, the Matáv Group organizational structure will be simplified and its operation will become more efficient. The Group's operations are based on three LoBs: Wireline Services, Business Services, Mobile Services.

## **2005: RENAMING AND REBRANDING PREPARATIONS**

On January 20 Matáv's Board made a decision on changing Matáv's name. The company's official name will be Hungarian Telekom Co. Ltd. and the Matáv Group brand structure is expected to follow the Deutsche Telekom Group brand structure. The final decision on rebranding was adopted by the Extraordinary General Meeting on February 22, 2005. The Shareholders' Meeting also made a decision on full introduction of the T-brand in Hungary. After the successful introduction of the T-Mobile brand in May 2004 now leading brands known worldwide such as T-Com, T-Systems and T-Online can also come to Hungary. Renaming and rebranding as additional steps towards integrating the Matáv Group's services into the Deutsche Telekom Group are expected to increase the company's corporate value and competitiveness.

## **A STRING OF AWARDS AND RECOGNITION IN 2004**

- Corporate Donor of the Year (for the 2nd time)
- MTA (Hungarian Academy of Sciences) Mór Wahrmann Medal for promotion of social awareness of science



We have almost doubled the number of broadband connections in 2004



Matáv remains the driving engine of information society

- Superbrand qualification in the international Superbrands program (Matáv and T-Mobile Hungary)
- Best Corporate Social Responsibility Special Award from Superbrands Hungary
- Golden EFFIE Award for the XL tariff package launch campaign
- Figyelő Top 200: Hungarian company with the best operating profit
- Figyelő Top 200: Hungarian company with the highest own capital
- Figyelő Top 200: Largest Hungarian telecommunications company
- Investor Relations Magazine: Grand Prix – Best Investor Relations in the region (for the 3rd time)
- Investor Relations Magazine: Best Investor Relations in Hungary (for the 3rd time)
- Investor Relations Magazine: Best Investor Relations Website (for the 2nd time)
- Investor Relations Magazine: Best Corporate Management

- Investor Relations Magazine: Best Corporate Social Responsibility (shared with MOL)
- Kreatív: 1st place for “corporate website Press Room quality”
- Sűveg Award for University of All Knowledge
- Prima Primissima Award for University of All Knowledge
- Figyelő–Hewitt Inside Consulting: Best Employer Award (T-Mobile Hungary)
- Reader's Digest: T-Mobile Hungary is the Most Popular Mobile Carrier
- DT Group “Living Diversity” Award (2nd rank)
- Central European Environmental Reporting Award 2nd Rank for Matáv's 2003 Sustainability Report
- Order of Merit of Germany, 1st Class, for Elek Straub
- Order of Merit of the Republic of Hungary, Officer's Cross, for Elek Straub
- Order of Merit of the Republic of Hungary, Commander's Cross, for András Sugár





# Our Strategy

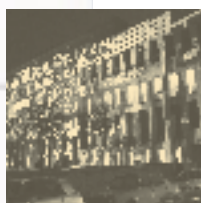
## **VALUE CREATION PROGRAM: OUR MEDIUM-TERM STRATEGY FOR 2005–2006**

Since becoming a listed company in 1997 Matáv has maintained its leading position in the domestic fixed line and mobile telecommunications market, even in the intensively competitive environment that followed full liberalization. The company's successful domestic and international acquisitions contributed to Matáv's solid financial results. In August 2004 the medium-term strategy program was finalized on the basis of detailed analyses and its implementation was started. Matáv's medium-term strategy focuses on improvement of efficiency to further strengthen competitiveness and offer even more attractive products to customers in order to maintain Group growth. The three key components of our Value Creation Program are improving internal efficiency, exploiting Group synergies and capturing acquisition-driven growth opportunities.

## **ORGANIC DEVELOPMENT AND PERFORMANCE IMPROVEMENT**

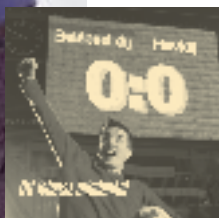
The Value Creation Program covers improvement of the performance of all core businesses. In the fixed line business

– after having stopped erosion of the customer base – our goal is to maintain the number of fixed lines and to boost this business with the launch of new competitive products and tariff packages. Matáv brings attractive offers to market not only in its own service area but also in that of its competitors. Increasing Internet penetration through fast spread of broadband access and ADSL plays a key role in maintaining the number of fixed lines. Matáv is planning to continue dynamic growth after nearly 204,000 customers reached in 2004 so that the number of the company's ADSL customers is expected to top 400,000 in 2006. The Matáv Group's mobile business, T-Mobile Hungary has the strategic objective to maintain its strong market leadership position. The tools to reach this are clear pricing strategy, unique customer value management system and



Raypainting 2004:  
strengthening  
competitiveness with more  
attractive products

Broadband Internet  
access plays a key  
role in maintaining  
fixed lines



a high percentage of postpaid customers with higher traffic, T-Mobile's international product portfolio and the additional benefits that have become accessible with rebranding. A key element of our strategy is the Matáv Group's internal efficiency improvement and significant reduction of costs. This includes headcount rationalization and workforce efficiency improvement to raise Matáv Rt.'s fixed lines / employee ratio above 500 by the end of 2006.

#### **INTEGRATION AND SYNERGIES WITHIN THE DEUTSCHE TELEKOM GROUP**

Matáv's position as an integrated telecom company within the Deutsche Telekom Group will allow the company to reduce costs, capture additional revenues and improve its

competitive positions by taking advantage of the synergies. A good example of this is the partnership agreement between Matáv and T-Systems International concluded in March 2004, followed in July 2004 by the establishment of their joint venture T-Systems Hungary. Cooperation between Matáv and T-Systems Hungary creates added value through expansion on the outsourcing and system integration markets and additional growth in international carrier traffic. Strategic agreements were reached in October 2004 between Matáv and T-Com, Matáv and T-Mobile International to exploit synergies within the DT Group. A Shared Service Center (SSC) is operational in the financial area since January 2005 that integrates the financial and accounting processes of the Matáv Group's member companies. This new business solution can be successfully used to merge parallel activities in various units.

#### **ACQUISITION-DRIVEN GROWTH**

Growth through further value-enhancing acquisitions remains Matáv's priority in the future too. With our successful acquisition we have become an international group and we are seeking further acquisition targets that increase shareholder value. Matáv is looking for attractive value-creating investment opportunities in the expanding markets of South-Eastern Europe. Our presence in the region and track record in restructuring monopoly companies to market oriented carriers create a good basis for Matáv to repeat the success story of Macedonia in other countries. The privatization of Telekom Cme Gore AD (TCG) seems to be an international acquisition that will offer growth opportunity. Matáv made a successful bid in 2004, then as the first ranked in the tender it has acquired a 73% majority stake in TCG in March 2005.

#### **INCREASING MATÁV PRESENCE IN THE INTERNATIONAL MARKETS**

In 2004 Matáv's international market presence continued to grow through establishment of additional network interconnection points. With these steps we want to raise our market share in the South-East European region in the sale of international wholesale telecommunications services. Matáv signed an agreement with T-Systems International in July 2004 to provide joint international network and carrier services through establishing network interconnection points in the South-East European countries. Matáv as a strategic partner of T-Systems Hungary is enabled to improve its international reach and portfolio also by serving internationally active companies in Hungary. The timing of the cooperation coincides with major growth in the Hungarian market resulting from its entry into the European Union.

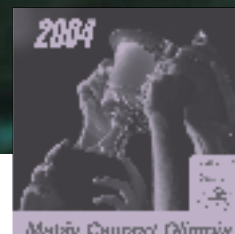
# Competitive Market Positions

## **STRONG FIXED LINE MARKET COMPETITION**

Liberalization of the Hungarian telecommunications market was completed in 2004. The competitive environment created by the Electronic Communications Act made the Hungarian telecommunications market attractive, so new investors and service providers entered the fixed line residential market too. Competition intensified among service providers within each segment, while fixed line and mobile service providers are also competing with each other. In September 2004 competition in fixed line telecommunications received a new impetus with the roll-out of carrier preselection and opening the market of local calls. In 2004 the Matáv Group offered various new products and solutions in both the residential and business markets with which we were able to keep our customers and stable market leader position in spite of the strong competition in all our key business areas – residential, business, mobile and Internet services. With this we attained one of our key 2004 targets.

## **MARKET BOOSTING REGULATORY ENVIRONMENT**

The primary objective of the Electronic Communications Act which entered into force in January 2004 is to stimulate the market, promote competition and create a customer-focused regulatory environment, as well as to implement the new EU regulatory package. The regulation positioned Matáv as a service provider with significant market power, operating in the market as a universal service provider, too. The universal service providers are obliged to sign customer contracts and to ensure anywhere the possibility of making phone calls and accessing the Internet through the telephone network. The regulator declared one of Matáv's most popular tariff packages, Felező to be the universal package. The universal service tariffs remains regulated by a government decree. The government encourages expansion of the broadband network with preferential taxation regulations, such as allowing deduction of 35-50% of such investments from the tax. Development of the mobile market and competition will be rearranged by the UMTS tender closed in November 2004 where a Matáv Group member company, T-Mobile Hungary also obtained a license for 3G services.



In spite of strong competition, we maintained our stable market leader positions





## WITH BROADBAND FOR THE INFORMATION SOCIETY

The Matáv Group also played a key role in 2004 in the development of the information society. Our key objective was to increase Internet penetration and improve the quality of Internet access with the spread of broadband connections. The success story in 2004 was a significant increase in broadband Internet access numbers. Numerous campaigns were launched and new solutions were introduced with which not only ADSL coverage was extended, but the quality of service provided to the customers was also improved. From November we increased significantly and free of charge the ADSL access download rate. In December 2004 Matáv announced a new wholesale structure whereby its Internet service provider partners can offer volume-based ADSL access package for customers.

## MATÁV OFFERS IN THE AREA OF DOMESTIC FIXED LINE COMPETITORS

A good example of opportunities that promote stronger competition is carrier preselection enabling customers to select a service provider offering the best conditions for them. Matáv widened its offerings in the areas of competitors, too. Since September 2004 Invitel, Monortel and Hungarotel customers can use Matáv's services not only for long-distance, but also for local and regional calls and Internet access. All Matáv tariff packages include this possibility. The Csevegő Partner tariff package, Ritmus package family, 1515 Előhívó and Ritmus100 Előhívó services are offered to competitors' customers in most cases with lower tariffs than those of the local carrier.

## NUMBER PORTABILITY ROLLED OUT

Number portability also contributed to boosting the telecommunications market and ensuring full competition for the customers. In 2004 customers were enabled in various steps to keep their existing telephone numbers when migrating to another telephone service provider. According to the new regulation – with the investment subsidy of the Ministry of IT and Communications – Matáv ensures number portability from January 2004 when the customer migrates to another service provider while staying at the same geographic location. In May number portability was introduced in addition to mobile telephone numbers also for non-geographic (blue, green, premium rate) numbers. In July 2004 Matáv launched its relocation with unchanged telephone number commercial service with which customers can keep their Matáv telephone number also when moving to another address within the same primary area.



Matáv product promotion  
in the competitors' areas

# Business Services

## UNCHANGED POSITION IN A CHANGING MARKET

The fast development of IP technology in the market of Matáv's largest business customers, the data communication market, brought new challenges. Our approximately 5,400 large and medium-sized corporate customers require complex infocommunication solutions with the highest security and service levels 24 hours a day, 7 days a week. In our operations we make efforts to get to know our partners' business processes and offer individual solutions to their individual requirements to make them more efficient. For this purpose we offer them the most up-to-date integrated IT and telecommunications tools based on our experience and our commitment to quality performance. As a result of our efforts we were able to maintain our stable leading position – notwithstanding the regulatory and competitive environment impacts – with 62% market share in the business communication market.

## LONG-TERM PARTNERSHIP RELATIONS

The communication networks of the key customers are being increasingly standardized in line with market changes. Standardization can be successful if the existing telecommunications and data communication infrastructure is appropriately optimized. The optimal operation of communication connections is designed with profitability calculations and a network simulation model. It is not by chance that we are entering into long-term agreements with a rising number of our business customers to maintain the existing partnership relation. Matáv is prepared for fulfilling these tasks at high standard: we can provide a wide range of both telecommunications and IT solutions. The cooperation agreements concluded in 2003 and 2004 with partners such as IBM, Microsoft, Hewlett-Packard, Albacomp and T-Systems International ensure a solid background.

## BUSINESS MARKET EXPANSION WITH NEW SALES STRATEGY

2004 was the year of market expansion in accordance with our new business sales strategy based on provision of solutions. With the combination of telecommunications and IT, instead of products we offer complex solutions with higher added value to meet market demand. Provision



Our business sales strategy is based on supplying solutions



We perform product development tailored to business market segment

of solutions includes business consulting, situation analysis, elaboration of solution possibilities, performance of the required job and in most cases continuous operation too. The six business solution packages created at the end of 2003 were upgraded with the addition of new telecommunications and system integration components and their reliability was improved. Our bid at Hungary's biggest infocommunication tender so far in January 2004 was successful. As part of the Public Net program Matáv will provide telecommunications service at 5,100 access points and will install and operate local network facilities at 7,300 access points. To enable offering the widest scope of services to our customers we are stepping up our presence outside Matáv's service areas where we offer customers the possibility of carrier selection and we enter numerous towns with voice and data services accessible on our own infrastructure.



#### **SERVICE PROVISION TO CUSTOMERS ACCORDING TO MARKET DEMAND**

*Provision of high standard services to the Matáv Group's key partners is ensured by personal account managers and key customer service. Our operation is characterized by fast reaction capability, innovation, use of Group synergies and the need for cost efficiency. With these features in mind Integris System House seated in Győr, since September 2004 as a regional outsourcing company provides the full scope of IT, human administration and financial accounting services to the small and medium business sector in Western Hungary. The competence and expertise of the company acquired in 2003 strengthened the Matáv Group's position on the outsourcing market. Another new member of the Matáv Group is BCN System House established through the merger of Matávcom and BCN which provides since December complete solutions to the business partners' individual data communication and IT needs.*

#### **DOMESTIC AND INTERNATIONAL STRATEGIC PARTNERSHIP WITH T-SYSTEMS**

*In July 2004 Matáv and T-Systems International signed an agreement for cooperation in international carrier services. Taking advantage of the Deutsche Telekom Group synergies, Matáv operates as the partner of T-Systems International in the telecom markets of the South-Eastern Europe region to market the international carrier services of T-Systems and its own products. An agreement on strategic partnership between T-Systems international's subsidiary T-Systems Hungary and Matáv was also concluded. As strategic partners, the two companies will jointly offer telecommunications and IT system integration and outsourcing solutions to the top 200 domestic enterprises. T-Systems Hungary's expertise drawn from its international background and its internationally recognized knowledge base is a huge competitive advantage in the domestic market. Matáv obtained 49% ownership share in T-Systems Hungary.*



# Residential Services

## NEW PROSPECTS IN FIXED LINE TELEPHONY

Matáv is committed to show and make existing and would-be customers aware of the numerous opportunities offered by fixed line telephony. Long and important calls can be made with high quality and convenience on fixed telephone line, and high quality Internet opens a new horizon for fixed line telephony. One of the major achievements in 2004 was that we were able to stop the fall in the number of fixed lines in the residential customers

segment. Additionally, residential traffic in minutes carried by fixed telephone lines started to grow in 2004. Primarily two factors contributed to these successes. Our offers including telephone set and free minutes were very popular with our customers in 2004 too. Another important factor was that newly introduced tariff packages made customers feel the experience of unlimited phoning.

## UNLIMITED PHONING WITH MATÁV TARIFF PACKAGES

We continued to widen the scope of our tariff packages in 2004. The XL supplementary tariff package introduced at the end of 2003 offers unlimited local calls in off-peak period. One of the novelties in 2004 was the XXL package based on the XL package with which all Matáv numbers in Hungary can be called without switching fee and usage charge in off-peak period. At the end of 2004 the number of XL customers topped 100,000 and almost 38,000 people used XXL.



We show our customers the opportunities offered by fixed line telephony



In addition to broadband packages we offer a number of innovative Internet services

Figures show that our customers revealed again the possibilities offered by fixed line telephony since the traffic in minutes generated by XL and XXL package users significantly increased. Since December the Free Day offer is automatically available to the majority of our residential customers, so they can make free local calls one evening a week.

#### **NEW OFFERS IN THE COMPETITORS' AREAS**

In 2004 we continued to extend the range of product offerings in Invitel's area and made our services accessible also for the subscribers of Hungarotel and Monortel. Since the liberalization of the telecommunications market customers can decide which service provider to use for carrying their telephone calls. We offer residential customers choosing carrier preselection (who can preselect Matáv for carrying their calls) the Csevegő Partner tariff package with which the discount increases proportionally with the call duration. We offer the 1515 Előhívó (Prefix) service to residential customers choosing the carrier selection on a call-by-call basis (before making a call they dial Matáv's 1515 prefix) to apply Matáv's tariffs for the call. We offer business customers the Ritmus Partner and Ritmus100 Előhívó packages with low peak period tariffs. In 2004 almost 12,000 residential and business customers of competitor carriers selected Matáv's attractive tariffs.

#### **DYNAMIC MARKET GROWTH IN BROADBAND**

Our greatest success in 2004 in the fixed line segment was to reach a customer base of 200,000 ADSL subscribers which means that Matáv almost doubled its broadband connections and every third Matáv Internet user can access the web on ADSL. As a result of major investments and fast developments, in 2004 the number of towns covered by ADSL service doubled so broadband Internet is accessible in more than 350 towns, i.e. in 75% of Matáv's service area. Increasing the coverage and improving the quality of Internet usage are also among our key targets. In 2004 we enabled customers still not having computers to use broadband Internet access with our Turnkey ADSL package that includes a modern computer with bringing into operation and remote help desk. In November the maximum download rate of ADSL connections was increased free of charge to ensure higher service quality.

#### **INNOVATIVE INTERNET PRODUCT OFFERINGS**

Matáv has been committed for years to increasing Internet penetration. In 2004 we offered, in addition to broadband ADSL packages, a number of additional innovative Internet services.

**Open Internet:** All customers can access the Internet with minute-rate tariffs (i.e. without connection fee and monthly fee) with our Open Internet service. This service became increasingly popular over the last two years; at the end of 2004 over 90,000 customers used Open Internet.

**Wireless Internet:** Matáv's wireless Internet service, EasyNet Plus is accessible nationwide at more than 50 public points with the wi-fi (wireless fidelity) technology. In October 2004 Matáv and T-Mobile Hungary enabled their customers to freely use wireless Internet in both networks (wi-fi roaming).

**Getting to know the web:** Matáv promotes Internet usage expansion also by presenting the use of the web. In 2004 free training was offered to the disadvantaged and disabled, and regular Internet training was also held at the University of All Knowledge. A free Internet course is offered to all users on Matáv's homepage at a website created for Internet beginners.

**NetPáncél package:** To stop fraudulent dialing programs Matáv introduced its NetPáncél service that enhances Internet security with which customers with modem-based access can disable or enable international and premium rate calls.

#### **BUSINESS OFFERS FOR THE SME SEGMENT**

In 2004 we introduced new offers tailored to the requirements and telephone usage patterns of small and medium enterprises. **Üzleti Felező** is a business tariff package with which half of the monthly fee can be used for free calls, no switching fee is charged and lower minute tariffs are applied. The V8 enterprise tariff package was designed primarily for the phoning patterns of small enterprises without switching and monthly fee with very attractive minute tariffs. The Flotta ADSL offer enables employers to give home ADSL Internet access to their employees as a cost-saving supplementary benefit without additional tax and contribution payment. The users of the Hátértár intelligent data backup service can regularly back up important files on a Matáv server and access them at any time or recover them in case of loss.

With the introduction of the new 1235 business customer service number a call center point was created where fast and convenient service is provided to the full SME segment. The free 1235 service also offers consulting to partners and this way helps enterprises select the most suitable business solutions.

# Internet

## THE FUTURE FOR FIXED LINE SERVICES: BROADBAND AND CONTENT

According to Axelero, Matáv Group's Internet service provider, in the future fixed line telephone connection will become the major channel for electronic entertainment that enables communication, Internet access and transmission of entertainment contents. Today the Internet has become a public utility that accommodates various forms of exchange of knowledge, information and goods, comfort services and entertainment. With the spread of broadband Internet access Internet usage patterns are also changing: customers use the Net longer, more frequently and to access more varied contents. The rise in the number of customers with broadband Internet access and the change in Internet usage patterns required the appearance of new online contents that the content providers add to their offerings. At the end of 2004 Axelero, that retained its leadership position with 42% market share, reached 266,000 customers (26.3% year-on-year growth) of which 58%, more than 153,000 users had broadband connection. Last year, the number of customers of broadband Kábelnet service grew dynamically by nearly 56%: at the end of 2004 it topped 14,000.

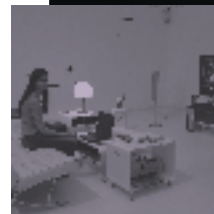
## [ORIGO] PLAY: MULTIMEDIA CONTENT SERVICES

In April 2004 Axelero launched its [origo>play] portal providing broadband content service that is the first of its kind in Hungary. The more than 70,000 users visiting on an average week the new multimedia portal can choose from free and charged structured online contents by topic (video, photo, music and game). With this new service Axelero offers attractive and valuable contents on the Internet that can make access to the web attractive for the users. In May an online music download service was launched in Hungary's first Internet-based music shop, the [origo>play] Music Store.

## ONLINE VIDEO SERVICE

In December a new offer was added to our entertainment contents with the launch of [origo] téka video-on-demand service, providing online movie streaming to customers through ADSL access. The videos selected from the catalog can be viewed on the computer several times within 24 hours of renting. The initial offerings included 80 films,

Axelero living room:  
advanced entertainment  
and communication  
through wireline  
connection



Visitors of our  
multimedia  
portal site  
can choose  
from attractive  
contents



and the choice is being further widened with the involvement of domestic and international content providers.

## [ORIGO]: 1 MILLION VISITS DAILY

The number one Internet success story is still the origo.hu news portal. On an average day 1 million users visit the most popular news portal. Axelero can reach via [origo] almost three quarters (73%) of the domestic Internet users. [origo]'s pages covering the Athens Olympics generated a traffic that surpassed all expectations. On several days more than 600,000 pages were downloaded, on the most successful day of Hungarian sport this figure approached 800,000. In September [origo] started new auto and motorcycle pages and expects to achieve in 2005 market leader position in the competition among auto portals. In the weeks before Christmas 2004 the online shops of the [origo] shopping center were visited by almost 10,000 customers each day, twice as many as in the same period in 2003. The number of shops rose steadily during the year so today customers can select from the product offerings of more than 150 companies on the Internet.





#### **RENEWED WEBSITE, ONLINE CUSTOMER CARE SERVICE AND FREEMAIL**

Since July 2004 the new Internet customer care service is accessible on Axelero's renewed website. Customers can make changes in their subscription, place orders, query their account balance and pay their bill. Simpler, faster and more convenient administration is supported by an individual account identification system. In November new comfort functions were added to the market leader mail system [freemail] to make navigation between folders and messages simpler. Users with higher traffic can set display of up to 500 mails per page. Freemail users numbered more than 1.9 million by the end of 2004.

#### **INNOVATIVE PRODUCTS: FAVORABLE TARIFFS, INCREASED BANDWIDTH**

In July a new flat-rate tariff regime entered into force for the Kombi 15, Kombi 40 and Kombi 100 modem-based Internet packages that includes the Internet usage related telephone charges. With the new packages coverage

was also raised since they are accessible in the service areas of Matáv, Invitel, as well as Monortel and Emitel. In June Axelero launched a new broadband service called ADSL Play offering 786 kbps download rate also for home Internet users that has been doubled later in November. The name of the new products refers to the [origo>play] portal that offers broadband contents. In December 2004 Axelero started a new service called Sodexho Pass Internet voucher with which companies can give their employees home Internet access as a benefit not subject to tax and contribution payment. Employees can use the vouchers for the use of Axelero's residential ADSL, Kábelnet, Kombi and Mindenkinet services anywhere in Hungary.

*For the purpose of customer retention we extended our loyalty program*



# Mobile



*With the successful new brand we brought new colors and images to people's lives*



## **SUCCESSFUL REBRANDING**

According to a decision of the Matáv Board on March 22, 2004 Westel continued its operations from May 3, 2004 under the name T-Mobile Hungary Telecommunications Co. Ltd. Under the T-Mobile brand name the over 4 million customers of Hungary's largest mobile carrier, controlling 46.2% of the market at the end of 2004, can get new innovative products and access T-Mobile's international services. The T-Mobile brand was introduced in just over one and a half months and the intense efforts gave new impetus to the whole mobile market. With the successful change the company acquired a youthful look and brought new colors and images to people's lives. Surveys show that by November, just six months after the rebranding, the T-Mobile brand awareness approached 100%.

## **NEW TARIFF PACKAGES WITH THE NEW BRAND**

An attractive offer given with the rebranding is T-Mobile Hungary's new Relax tariff packages offered since June without monthly fee. The appearance of Relax packages had a significant impact on the whole domestic mobile market. The minutes included in the package are prepaid by the customer and all minutes paid can be used. Relax is transparent with its standard tariffs in all charging periods and to all networks in Hungary both for calls and SMS sending and with the international version, mobile and fixed line numbers in 29 countries can be called for national tariffs. In 2004 T-Mobile introduced a new tariff regime for its business customers with simpler and lower tariffs. In mobile data transmission, costs were significantly reduced in March

for minute-based WAP usage, in addition to that of the GPRS packages launched in February. Since December the new GPRS 300 package is offered to customers regularly using mobile Internet.

## **LOYALTY PROGRAM FOR ALL CUSTOMERS**

Mobile carriers lay ever greater emphasis on retention of customers. For this purpose in September 2004 T-Mobile Hungary added various new features to its loyalty program, the Connection Golden Card Program. Benefits are applicable also to Domino prepaid card customers. Domino continues to be the market's leading prepaid mobile service as 71% of the 4 million T-Mobile customers use Domino cards. Since September customers receive Connection points in addition to the monthly mobile usage also for calls received and the period since the conclusion of contract, and points can be redeemed for purchase of phone, services, gifts and Domino recharge cards.

## **UMTS: THIRD MOBILE GENERATION STARTS**

In December 2004 T-Mobile Hungary obtained a UMTS, e.g. third generation mobile service license for 15 years. In the fall of 2003 we were the first to present video telephony on our UMTS test network in Hungary to show that we are prepared for construction of the network and introduction of the services. Due to the unified global standards the 3G mobile network supports high quality multimedia applications and fast Internet access. Its value is further enhanced by T-Mobile Hungary with the combination of its existing (GSM, GPRS, EDGE, WLAN) and new technologies. Since December 2004 customers with an appropriately enabled phone can use



UMTS in various European countries and the service will be accessible to domestic customers from the end of 2005.

#### **MULTIMEDIA AND WAP**

T-Mobile Hungary's significantly extended WAP portal t-zones offers the widest scope of mobile content services in Hungary. On an average day 40,000 visitors download about 150,000 pages from the portal. The role of multimedia is confirmed by the fact that at the end of 2004 more than 900,000 T-Mobile customers had MMS enabled phones. Video and textual information is accessible on the t-zones WAP portal on numerous subjects on the basis of infoMMS lists. T-zones VideoMMS was the first service offered by a domestic mobile carrier with weather forecast and movie preview sent to customers. T-Mobile offers its business customers the Tömeges (Mass) MMS service with which up to 3,600 multimedia messages per hour can be sent from a computer.

#### **M-COMMERCE NOVELTIES**

With the cooperation of T-Mobile Hungary and other partner providers a mobile payment solution was implemented for the first time in Europe that is accessible to all banks and public utilities in Hungary and their customers. Customers can pay their electricity bill or parking fee with a mobile phone. Additionally T-Mobile customers can use the Mobile Buying service to order flowers, recharge their Axelero Internet access account, subscribe to a newspaper and buy gifts on the t-zones WAP portal. Since December T-Mobile customers can use their mobile phone to post and pay classified advertisements, buy cinema tickets, DVD or video cassettes and travel insurance.

#### **MOBILE INTERNET**

T-Mobile Hungary played a pioneering role in spreading mobile Internet access also in 2004. The company was the first domestic mobile carrier to introduce the EDGE service that was accessible in December already almost everywhere in Budapest. With EDGE and an appropriately equipped phone the Internet can be accessed with a transmission rate similar to that of ISDN. T-Mobile was the only mobile carrier in 2004 to offer commercial WLAN (wireless fast Internet) service under the name HotSpot. The scope of users was further widened in October when Matáv and T-Mobile customers could use the WLAN service free of charge in both networks on a trial basis. T-Mobile's 28 HotSpots and Matáv's 53 WLAN points were included in WLAN roaming.

#### **INNOVATION AND PORTABLE NUMBERS**

The market leader T-Mobile Hungary offered numerous novelties also in 2004. With the Dallamcsengő service that T-Mobile was the first to offer its customers in Hungary from September, the calling party can listen to the music selected by the called party while the phone rings. This solution is a modern personalized mobile version of the well-known music during call waiting. SMS-based customer care service was started in December: many of the T-Mobile services can be activated also by SMS in addition to call center, Internet- and WAP-based customer care service. A determining novelty was the introduction of number portability in May with which customers can keep their telephone number indefinitely.



# International Activities

## MARKET EXPANSION AND OUTSTANDING SERVICE QUALITY

Matáv Group's Macedonian subsidiary MakTel had 626,000 fixed lines at the end of 2004. The sale of ADSL services started in 2004 and nearly 2,500 lines were connected during the year. MakTel's mobile business Mobimak continued to dynamically grow its customer base and at the end of 2004 it exceeded 752,000 which meant 44% annual growth. Mobimak maintained its strong market leader position with 76% market share while mobile penetration grew to over 48%. The number of dial-up Internet customers grew by more than 32% to 65,000 in 2004. The company's Internet business MTnet operates the most popular newsportal of the country called Idividi. Although the service quality target figures laid down in MakTel's concession contracts are raised year by year they were by far overfulfilled in 2004 too.

## PREPARATION FOR MARKET LIBERALIZATION

MakTel's monopoly position in the fixed line telephone services market was to be officially terminated in January 2005. So a top priority for the company in 2004 has been the preparation for full market liberalization. All business areas were restructured under the corporate program Road to Success that supported preparations. As a result of the new customer-focused and market-oriented organizational structure MakTel's operation has become simpler and more transparent and can react more flexibly to market requirements and changes. Preparations for liberalization were completed by MakTel in a shorter time than other Central and Eastern European incumbent operators.

## MORE EFFICIENT MARKETING AND SALES

Simultaneously with the new marketing strategy, a new organizational structure was created to ensure more efficient support to sales with the focus on customer relationship management. With the restructuring of the business units a single marketing and sales unit was created with three sales channels: key accounts, residential and small enterprise customers, and the newly established wholesale sales.

## INNOVATIVE FIXED LINE PRODUCT PORTFOLIO

In 2004 MakTel introduced time-based billing with which a wide range of new residential and business tariff packages can be created on the fixed line market. At the end of 2004 customers activated tariff packages on about 9.6% of the lines; the most popular package was the Macedonian version of Chatting. MakTel's ADSL service was the first broadband Internet solution in the Macedonian market. Voice mail and other intelligent network services, such as Green number, Blue number and Televoting were launched in 2004. The Metro Ethernet broadband data service was introduced for business customers and the wholesale IP product portfolio was successfully created (reverse charge dial-up service, IP port services, wholesale ADSL for Internet service providers).

## HUMAN RESOURCES

MakTel's human resource strategy follows DT's and the Matáv Group's strategic policy. Its key components include





managing diversity, headcount rationalization, recruitment and workforce retention. In the course of preparations for liberalization, MakTel has successfully carried out its restructuring as well as a headcount reduction program with good conditions that affected 22% of the total headcount. The company offers help and information for the departing employees under a support program, among others about the possibility of starting up an own venture. Since 2004 MakTel's website is also used for announcing new career opportunities and inviting online applications.

#### **CORPORATE SOCIAL RESPONSIBILITY**

As a responsible corporate citizen MakTel supported culture and sports and contributed to the development of education also in 2004. Just a few examples of events and programs sponsored by MakTel: swimming marathon, Ohrid summer festival, children's festival, construction of MakTel playgrounds, sponsoring basketball and volleyball. In 2004 MakTel established the E-Macedonia Foundation in memory

of the late President of the Republic Boris Trajkovski to promote development of the information society.

#### **SUCCESSFUL INTERNATIONAL ACQUISITION BID**

In line with Matáv's growth strategy in 2004 successful steps were made for another international acquisition. In December 2004 a binding offer was made at the public tender invited for the acquisition of Montenegro's telecommunications company Telekom Crne Gore. As the first ranked in the tender we have acquired the 73% majority stake of the company in March 2005. This success proved again that our experience and performance as international strategic investor is recognized by decision-makers in South-East Europe.



Strengthening our presence in South-East European markets



MakTel's popular news portal site also enhances Internet usage

# Human Resources

## COMPETITIVE AND EFFICIENT HEADCOUNT PLANNING

As a part of its mid-term strategy, the Matáv Group has decided to carry out headcount reduction of around 20% (32% at the parent company) along with an organization restructuring. In September 2004 Matáv and the employee interest organizations reached an agreement stating that in 2005 and 2006 Matáv Rt.'s headcount will be reduced by a total of 2,600 of which 800 will be employed by the companies performing outsourced activities. Headcount reduction will be made in several steps. At Group level (including MakTel) the headcount rationalization plan will affect about 3,750 people. With this by the end of 2006 the fixed lines per employee indicator will reach an internationally competitive level, above 500 at the parent company (Matáv Rt.). Executive positions will be terminated at a higher rate than that of the average headcount reduction.

## GREATER CHANCE WITH CARE

Matáv lays great emphasis also on care for those who leave the company. Various solutions are applied in our outplacement program that reduce to a large extent unilateral dismissals. Parents with many children or single parents are offered 6-hour employment instead of 8 by the company. For part-time employees, 3-year employment will be granted. A favorable reserve base was created for employees over 50 who still do not have the service time needed for retirement. The earlier proven Esély (Chance) program is designed to support departing employees with training and help in finding a new job through its 3 offices in Budapest and 7 in other cities.

## MATÁV FOR DIVERSITY AND EQUAL OPPORTUNITIES

In September Matáv held a conference on Diversity in Society, Economy and Scientific Life, with the support of the government and the German-Hungarian Chamber of Industry and Commerce. Matáv, caring about equal opportunities for employees and diversity, offers partial teleworking and distance learning opportunities for its employees and operates an insurance-based welfare system. As a responsible corporate citizen we launched in 2004 several programs that speed up the process of ensuring equal opportunities in the

society and the economy. Round table discussions were held at the University of All Knowledge on diversity and free Internet courses were started for the disadvantaged.

## EXPANDING ONLINE SERVICES

Matáv developed its electronic administration of human resources into a complex system that is unique in Hungary and is accessible via the company's intranet. In 2004, 9 new modules were added to the system's internal services, such as online modification of own personal data, filling in tax return statements and application for holiday service.

The employees can at any time access their own updated job description. Protection and security of personal data was enhanced with the introduction of a new IT platform. In 2004 the Matáv Group was present at numerous job forums with its Rajtkő (Starting block) program for interns that attracted almost 400 fresh graduate economists and engineers who made applications on Matáv's website. Out of this number, 20 fresh graduates can work as interns for 7 months at a company of the Group.

## TRAINING PROGRAMS FOR SPREADING THE INTERNET

In 2004 we continued our free Internet courses held for the disadvantaged. This initiative reached several disadvantaged groups, such as people with mobility disabilities or hearing disabilities and the Roma minority. The participants welcomed the training and the 15-hour free Internet access provided by Axelero. The series of lectures on the Internet connected with the University of All Knowledge lectures has continued. Presentations captured a capacity audience and encountered great interest.

## PROFESSIONAL FORUMS AND TRAININGS

The series of Academic Days, started in the previous year, in 2004 covered all member companies and during the year 12 programs were held with more than 560 participants. This event proved its worth by strengthening Group-level thinking. A Sales Master Course was launched in November 2004 for executives playing a key role in the Matáv Group's results. Another professional forum operating at Group level is the Customer Relations Round Table where member companies are offered joint professional consultation and coordination and review of opportunities for development to promote their business success.

## MARKETING TRAINING PROGRAM ON SEVERAL LEVELS

To support marketing activities, marketing-focused training is provided to all Matáv Group employees with specific subjects tailored to the needs of given job groups.



From 2004, Matáv Gallery is open also for the public



Matáv Group Children's Day: we care for the next generations



The basic level training was designed for employees working in non-marketing areas with distance learning materials and related courses. People with marketing education are offered a refresher program with the involvement of university lecturers on subjects selected on the basis of a previous survey. At the third level specific development training was launched in 2004 for the sales staff, primarily for the shop personnel, then in 2005 account managers, call center operators, official partners and sales managers will be involved.

#### **E-LEARNING AND DISTANCE LEARNING**

In the area of professional training on the web, e-learning and distance learning Matáv launched new initiatives primarily for faster and more efficient further training of

the employees. The use of distance learning materials and training courses became a general practice in 2004. As a good example, over 8,000 employees successfully completed the personal data protection skills distance learning program in a few weeks. A distance learning version of ECDL (European Computer Driving Licence) subjects meeting the new requirements was also elaborated. A multimedia CD-ROM was prepared to support the nationwide Internet courses for the disadvantaged. Accessibility on the Internet of the training program materials has been ensured.



"Matáv gives back": our donations are delivered to the most needy



# Corporate Social Responsibility

## LEADERSHIP IN CORPORATE SOCIAL RESPONSIBILITY

Matáv offers sponsorships in Hungarian cultural life that reflect its economic role and it is one of the biggest corporate donors in the non-governmental sphere too. Over the last three years Matáv contributed to the development of more than 400 non-profit organizations. With our corporate social responsibility strategy we have been sponsoring for 10 years initiatives aiming at solution of social and health problems. Matáv is Hungary's only company that offers not only occasional aid to players of the culture scene, but maintains cultural and educational institutions, such as the Matáv Symphony Orchestra, Tivadar Puskás Technical School, Post Museum and University of All Knowledge. In 2004 we opened the Matáv Gallery to the public where contemporary works of art exhibited can be visited.

## NEW PROGRAM: "MATÁV GIVES BACK"

Matáv's diverse donation activity has been carried out since March 2004 under the "Matáv gives back" program in a structured, unified way to ensure that the HUF 200 million worth of donations to the non-governmental sphere in 2004 are delivered to the most needy. Decisions on the donations are taken by the Board of Trustees of the program.

The program is based on four pillars:

- "Really important donations" – direct financial donations;
- "Charitable numbers" – free services for the collection of residential donations;
- "Really important conversions" – reduced-price telephone accesses and crisis line services;
- "Matáv employees gives back" – individual donations of our employees.



### **“REALLY IMPORTANT DONATIONS”**

With the aid of the “Matáv gives back” program, among others, the National Ambulance Service was equipped with life-saving respiratory equipment, the National Therapy Center obtained an incubator, the Baranya County Hospital and the Hospice Foundation received ECG equipments, the Budapest Children’s Clinic established baby-mom rooms and the Schöpf-Merei Hospital obtained a cancer detecting apparatus. Matáv, in line with Hungary’s leading corporations, offered HUF 10 million for the establishment of shelters for the homeless.

### **“CHARITABLE NUMBERS”**

The Matáv Donation Line was the first “charitable number” in the “Matáv gives back” program. Customers calling the 1788 number donate HUF 100 for the published purpose to support the work of public benefit organizations. Since May 2002 more than HUF 117 million in donations were collected this way for 16 non-profit organizations. The Donation Line is a unique initiative also by European standards. Matáv achieved great success with the introduction of the 1771 charity number. In May 2004, over HUF 70 million in donations were collected on this number for the Pál Heim Children’s Hospital. The victims of the tsunami in Southeast Asia in December 2004 received HUF 200 for each call to Matáv’s helpline 1749 that generated more than HUF 58 million for the needy from our customers.

### **“REALLY IMPORTANT CONVERSATIONS”**

In March 2004 an NGO Tariff Package was introduced to offer national fixed line telecommunications service to non-profit foundations and organizations with an average discount of 30%. The discount tariff package can be used annually by 100 non-governmental organizations selected on the basis of applications. From November more than 400 non-governmental organizations without broadband connection received free ADSL access for one year through applications. This donation is worth more than HUF 50 million. Thanks to Matáv these organizations can perform their job more efficiently with broadband Internet connection.

### **“MATÁV EMPLOYEE GIVES BACK”**

In 2004 Matáv added more than HUF 8.5 million to the individual donations of its employees under the “Addition to individual donations” program. Over the last three years employees feeling responsibility for the society donated more than HUF 15 million primarily to non-profit organizations in the area of health, education and art, or caring for disadvantaged children. Thanks to the program now in its fourth year the willingness of Matáv employees to give donations is continuously rising.

### **WWF-MATÁV: BIRD PROTECTION PROGRAM**

Since September 2004 Matáv cooperates with the Hungarian organization of WWF (World Wildlife Fund) to contribute with our joint efforts to elimination of illegal hunting and trade in protected birds. Matáv contributes with a donation of HUF 15 million and publicity support to the bird protection program called Bird Care.

### **SUCCESSES WITH TRADITION**

In September 2004 the University of All Knowledge started its fifth semester. So far 94 lectures have been given in 5 semesters under the joint popular science project of the Matáv Group and the Hungarian Academy of Sciences. An estimated 250-300 thousand people follow the lectures on television each week. In April the Matáv Vivicittá city run was held with the largest ever participation, more than 8,500 competitors. In three cities (Budapest, Debrecen and Szeged) conventional running was accompanied also by walking. In 2004 already for the third time children and their parents were invited at summer week-ends to the free series of events at the Matáv Children’s Island. Stage performances, music and sport programs and novelties such as the Ability Park that brought people with disabilities closer, attracted a record of almost 100,000 visitors.

### **FRIENDS OF THE FUTURE**

In 2004 Axelerio also contributed to the development of training and culture and gave donations to support the work of organizations caring for people with disabilities and disadvantaged children where Internet offers an opportunity for a fuller life and catching up. One of Axelerio’s partners is the Future-friendly Foundation whose voluntary workers help young people at risk of drugs, alcohol and other addictions with community and sport programs and broadband Internet access.

### **SPORTS AND CULTURE**

T-Mobile Hungary is a Diamond Grade Main Sponsor of the Hungarian Olympic Team and it sponsors the leading soccer, handball and water polo clubs. Aid to the National Opera and the National Széchényi Library play a key role in T-Mobile’s cultural sponsorship that includes also support for staging productions in numerous country towns. T-Mobile’s social sponsorship is managed in cooperation with the Maltese Charity Service.

# Frequently Asked Questions

## *Answered by Elek Straub, Chairman and CEO*

**WHAT IS THE RATIONALE BEHIND MATÁV'S REBRANDING TO MAGYAR TELEKOM? ADOPTING INTERNATIONAL BRANDS IN THE MOBILE BUSINESS IS JUSTIFIED DUE TO COMPETITION FROM GLOBAL OPERATORS, BUT WHAT ARE THE BENEFITS OF SUCH A MOVE IN THE FIXED LINE SEGMENT?**

*Based on our experience and lessons learnt from Westel's rebranding to T-Mobile Hungary, telecommunications industry benchmarks show an increasing importance and sophistication of supranational brands. With the rebranding, Matáv has the opportunity to leverage the "T" brand family, introducing such leading global telecom brands in Hungary as T-Com, T-Systems, T-Online.*

*The rebranding will help Matáv to build a strong image, solid brand awareness and contribute to a new, more dynamic perception of our wireline operations. Moreover, the introduction of the full T-brand portfolio in Hungary shall allow us to act as a real group vis-à-vis our clients and better serve their needs. In the long run, customers will enjoy the increased convenience of being able to access reliable, complex solutions from a single source. As a result, I strongly believe that the rebranding is an excellent opportunity to increase customer satisfaction and to improve our competitive power in the Hungarian telecommunications market.*

**MATÁV'S 2004 FIGURES WERE STRONGLY IMPACTED BY REGULATORY CHANGES AND INTENSIFYING COMPETITION. WHAT ARE YOUR EXPECTATIONS ON THE FUTURE DEVELOPMENT OF THE REGULATORY ENVIRONMENT AND HOW DO YOU EVALUATE YOUR COMPETITIVE POSITION?**

*It is true indeed that in 2004, Matáv experienced the most drastic regulatory impact in the company's history so far. The significant cuts in both fixed line and mobile interconnection rates and the introduction of number*





*portability allowed our competitors to take advantage of the new conditions and also attracted further entrants to the telecommunications market.*

*Looking at this year and beyond, we expect a far more limited effect from regulation. Although the prospective cut in mobile termination fees is also likely to hit fixed line revenues as at least a part of the decrease will have to be passed onto customers, I believe the steep decreases in fixed line interconnection fees that we have seen in the past are not likely to be repeated as interconnection rates in general are now close to the respective European Union levels. However, we certainly cannot exclude some further changes, in line with the EU trends. We welcome the regulator's declared intention to converge the termination fees of mobile operators as well as reduce the difference between Matáv and the respective rates of LTOs.*

*Regarding the regulatory impact in 2005, we are also facing some uncertainties. In 2004, in line with the EU practice, the National Communications Authority began to perform a series of analyses of the Hungarian fixed line and mobile market areas, some of which are still to be finalised. Our Macedonian subsidiary, MakTel is also facing the expected effects of the fixed line liberalisation this year: the gradual introduction of new service obligations, likely to be accompanied by increasing competition.*

*As for our competitive position, I am pleased to report that despite intensifying competition, Matáv has managed to preserve its leading positions in the main markets. We expect our competitors to continue to focus on increasing their market shares, however, Matáv will also continue to play a proactive role in preserving the company's future competitiveness.*

**IN 2004, YOU STARTED TO IMPLEMENT A MAJOR RESTRUCTURING PROGRAM. DO YOU SEE RESTRUCTURING AS THE ONLY WAY TO IMPROVE MATÁV'S PROFITABILITY OR WILL MATÁV BE ABLE TO EXPLOIT FURTHER OPPORTUNITIES FOR TOP-LINE GROWTH?**

*In our mid-term strategy, we set a target of achieving a low single digit revenue organic growth. This indicates our firm belief that further potential for top-line growth exists, mainly driven by the data business in both fixed line and mobile segments. In addition, acquisitions like Telekom Montenegro shall also contribute to the Group's top-line figures.*

*As for the cost side, the restructuring program is certainly the primary tool for achieving a significant efficiency increase. However, let me also mention that beyond the headcount rationalisation, sizeable savings will be achieved through our continuous efforts to introduce additional cost rationalisation initiatives, such as exploiting Group synergies, outsourcing and renegotiating contracts. I am convinced that all these steps will contribute to an improved performance and thus further enhance shareholder value.*

**IN 2004, T-MOBILE HUNGARY WAS AWARDED A 3G LICENCE. WHAT ARE YOUR EXPECTATIONS ON THE ROLLOUT OF UMTS SERVICES?**

*Market leader T-Mobile Hungary has always attached utmost attention to delivering services of excellent quality to its customers. I believe the invitation for bids for the use entitlement of UMTS frequency bands has created balanced conditions for the provision of third generation mobile services in the interest of all stakeholders. Introducing 3G services is a further milestone in the company's efforts to continuously provide new, state-of-the-art services and solutions to its customers. UMTS services shall be available in downtown Budapest from 2006 at the latest, and thanks to the continuous network development, T-Mobile Hungary's 3G network will cover at least 30 percent of the Hungarian population by 2008. In addition to excellent voice quality, UMTS networks will bring about huge changes in the penetration of messaging services, broadband Internet access, as well as in multimedia solutions, in the field of live video transmission and broadcasting. Such a wide service portfolio will allow T-Mobile Hungary to offer tailor-made solutions that serve the requirements of customers even more than today's GSM services, contributing to increased customer retention.*

*We expect the rollout to have a beneficial impact on T-Mobile Hungary's operational figures. Value added services are anticipated to become mass market products due to the capacity and performance delivered by the UMTS network, and this way customer ARPU becomes more diversified than now. Regarding the impact of UMTS on Matáv Group's financial statements, let us be aware of the fact that in the first phase we have to count with significant expenditure on both the licence and the network build-out. As it certainly takes some time for UMTS to generate wide demand, operating expenses will mostly offset revenues in the first years of the service. However, based on former experiences with WAP, GPRS and MMS, the dispersion of 3G enabled handsets is soon going to be continuous. With a broader rollout and an anticipated fall in handset prices, the service is expected to generate a positive margin as soon as in a few years' time.*

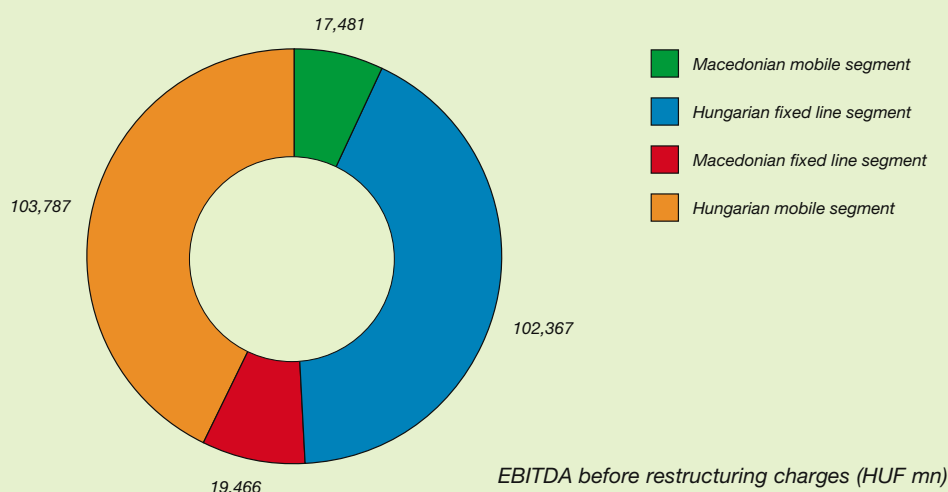
*I strongly believe that investing in UMTS positively contributes to the company's value and to the preservation of the long term competitiveness in the market. In line with its leading role in innovation, T-Mobile Hungary will open new perspectives in mobile communication and offer the best, most sophisticated multimedia experience to all customers.*



# Management Report for the 2004 Financial Year

## HIGHLIGHTS

- Total revenues of Matáv Group decreased by 1.0% to HUF 601.4bn (EUR 2.4bn using the 2004 average exchange rate of 251.68 HUF/EUR) as a result of lower fixed line and higher mobile revenues.
- Matáv has modified its segment disclosure. The primary segments are based on the business lines (fixed line and mobile operations), which include both Hungarian and Macedonian activities. In addition, the Company's secondary format for reporting segment information is geographical segments.
- Revenues from fixed line services decreased by 6.8%. The ADSL-driven growth of leased lines and data transmission revenues continued and could partially offset the decline of traffic revenues recognized in both Hungary and Macedonia. The number of ADSL lines at Matáv parent company almost doubled in 2004. Traffic revenues were adversely impacted by the increased Hungarian competitive and regulatory pressure and the drop in Hungarian domestic transit between mobile and fixed line local telecom operators. In 2004, no revenue was recognized from the Universal Telecommunications Support Fund. In Macedonia, the macroeconomic limitations together with growth in mobile use have resulted in lower fixed line traffic.
- Revenues from mobile services increased by 7.5%, reaching HUF 267.3bn primarily driven by a higher customer base. T-Mobile Hungary's subscriber base increased by 7.1% to 4.0 million with a market share of 46.2% at the end of 2004. As a result of the significant increase in Macedonian mobile penetration in 2004, MobiMak customer base increased by 43.7% to 752,462 revenue producing customers equaling a market share of 76% at the end of the year.
- Group EBITDA amounted to HUF 222.9bn with an EBITDA margin of 37.1% including HUF 20.7bn restructuring charges and additional employee benefits relating to future terminations primarily recognized in the fixed line segment. Excluding the restructuring charges of HUF 20.2bn, EBITDA was HUF 243.1bn with EBITDA margin at 40.4%. The restructuring program is aiming to improve internal efficiency with headcount rationalization mainly at the fixed segment.



## REGULATORY ENVIRONMENT OVERVIEW

At the end of 2001, the Hungarian telecommunications market became fully liberalized except for 23 local concession areas where concession rights expired only in May and November 2002. In November 2003, the Parliament approved the new Hungarian Electronic Communications Act in compliance with the latest regulatory framework of the European Union. This Act became effective in January 2004. Fixed line geographical number portability has been available since January 2004, mobile and non-geographical number portability was introduced in May 2004. Reference offers have been extended to include for example local bitstream access, FRIACO (Flat Rate Internet Access Call Origination) and Internet call origination. Furthermore, carrier selection services have been enhanced to include local and Internet calls, as well.

The Universal Telecommunications Support Fund provided compensation from February 1, 2002 for mandatory uneconomical universal services, including the low user package. The Fund paid all universal service providers the difference between the subscription fee of ordinary and low user packages up to a certain limit. However, from 2004, the universal service funding has changed from a revenue loss compensation to net avoidable cost compensation based system and the obligation of providing a low user package has been revoked.

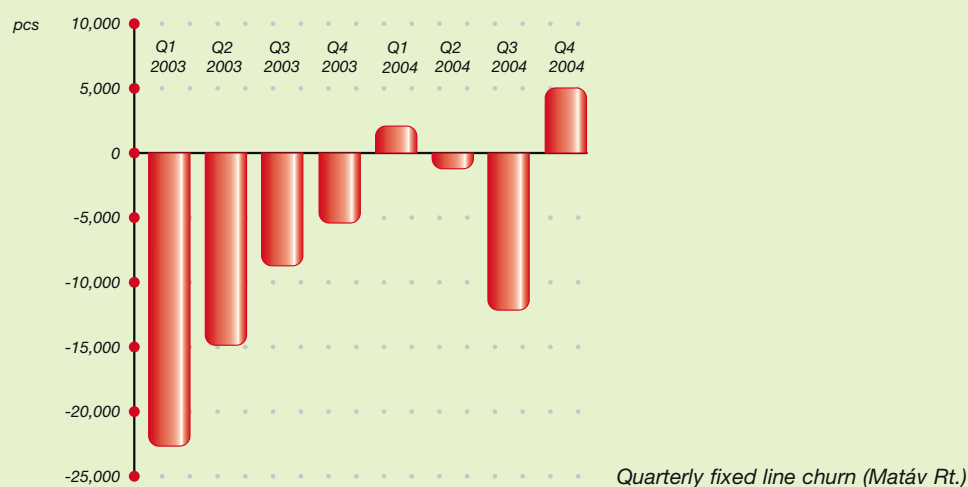
In 2004, the national regulatory authority has commenced the regular market analysis based on the EU recommendation on the 18 product and service markets of the electronic communications sector. As a result, some of the prevailing obligations may be lifted, while others could be amended with new ones. For example, regulation of fixed line transit services in reference offers may be removed, whereas the prices of Matáv's wholesale national bitstream access and wholesale leased line termination will most probably become regulated. Additionally, the price cap system on end-user prices will be modified from 2005 introducing a cap (consumer price index, CPI) on the aggregate increase to the access fees of residential and non-residential lines. In 2004, the overall level of the retail price increase for universal services was regulated (anticipated CPI minus 3%), with specific price caps for subscription fees and local calls.

In Macedonia, the liberalization of the fixed line services commences in 2005.

In 2004, the current three Hungarian mobile operators, including T-Mobile Hungary, the mobile arm of Matáv, were granted the right to use a UMTS frequency block for 15 years. The UMTS service will start no later than 2006.

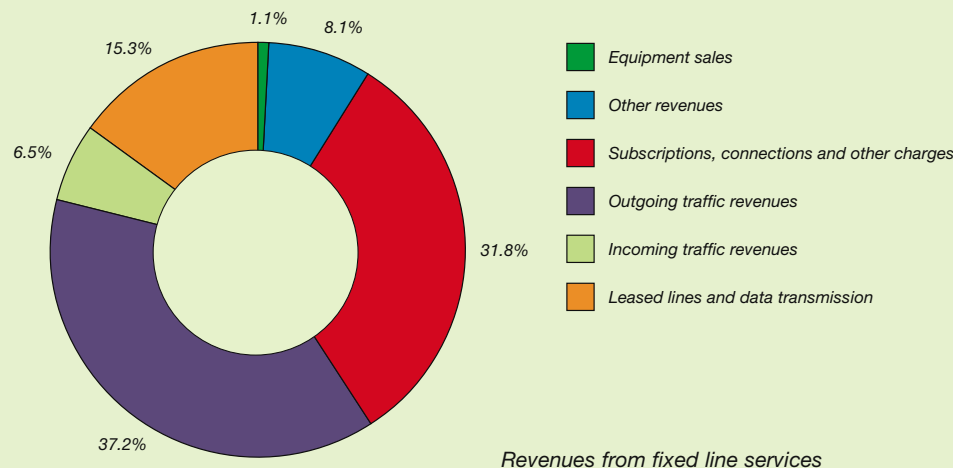
## FIXED LINE SEGMENT: PRESERVING PSTN VALUE AND STEADY BROADBAND EXPANSION

The number of residential PSTN lines increased at the Matáv parent company and Internet revenues continue to grow. However, restructuring eroded results considerably, with EBITDA margin for the segment on external revenues at 30.4%.



By the end of 2004, the total number of Matáv Rt. lines decreased by only 0.2% with a 0.2% increase to residential PSTN lines that has been a challenging target of Matáv. Hence, fixed line penetration was stable at 37.5% in Matáv's service area. Lines per fixed line employee at the Matáv parent company increased to 365. Additionally, the number of installed ADSL lines increased to 203,654 from 103,564 a year ago.

The total number of MakTel lines increased by 1.1% driven by growth in ISDN channels; fixed line penetration was broadly stable at 29.0%. Lines per fixed line employee at MakTel increased to 263.



External revenues of the segment declined by 6.8% primarily driven by lower traffic revenues and no recognized revenue from the Universal Telecommunications Support Fund compared to HUF 6bn reimbursement in 2003. Lower traffic revenues mainly reflect the drop in Hungarian domestic transit and increased competition as well as lower fixed-to-mobile tariffs driven by the decreased mobile termination fees of Pannon GSM and T-Mobile Hungary. Additionally, limitations of the Macedonian disposable income and increasing mobile penetration there adversely impacted international fixed line revenues. Furthermore, the foreign exchange impact in translating Macedonian denar to Hungarian forint compared to 2003 was a negative 1%.

Some of the expenses decreased in parallel to revenues (for example, mobile termination fees paid to Pannon GSM) with others subject to cost control efforts. In the attempt to preserve longer term internal efficiency, Matáv is exercising a major headcount reduction program aiming to reduce the 2006 full time equivalent closing headcount of the parent company to around 5,500 employees. Out of the total Group HUF 20.2bn restructuring charges related to headcount reduction, HUF 20.1bn (including HUF 14.1bn provisions) reduced the profitability of the fixed segment. Excluding this impact, the fixed line EBITDA margin on external revenues would only have declined to 36.5% from 38.3% in 2003 primarily as a result of Hungarian competitive and regulatory pressure and Macedonian mobile cannibalization. Group headquarter expenses are recognized mainly at this segment.

#### **FIXED LINE VOICE OPERATIONS: ENTRANCE OF NEW COMPETITORS IN HUNGARY**

In 2004, Hungarian competition, including that in the residential segment, further intensified. For example, Tele2 has entered Matáv service area in April with a residential call-by-call service and in the last quarter of 2004, cable operators (including UPC) launched voice services. By the end of 2004, the number of ported fixed numbers was just over 1% of the total Hungarian fixed lines.

Consolidated revenues from subscriptions, connections and other charges decreased by 2.6% to HUF 106.2bn mainly driven by discounted connection fees, lower revenue from PBX services and other charges (for example some Hungarian wholesale Internet packages were terminated and itemized billing became free of charge).

Customized tariff packages represented around 58% of the total number of lines at the parent company by the end of 2004. The success of the packages and the sales activity resulted in increased residential PSTN lines at the end of 2004 over end-2003 and higher revenue from equipment sales. Matáv also offers packages for clients of other local fixed line operators, partially hedging the revenue fallout caused by some traffic moving to competitors. In promoting line retention, customization in Macedonia commenced and by the end of 2004 approached 10% of the PSTN lines.

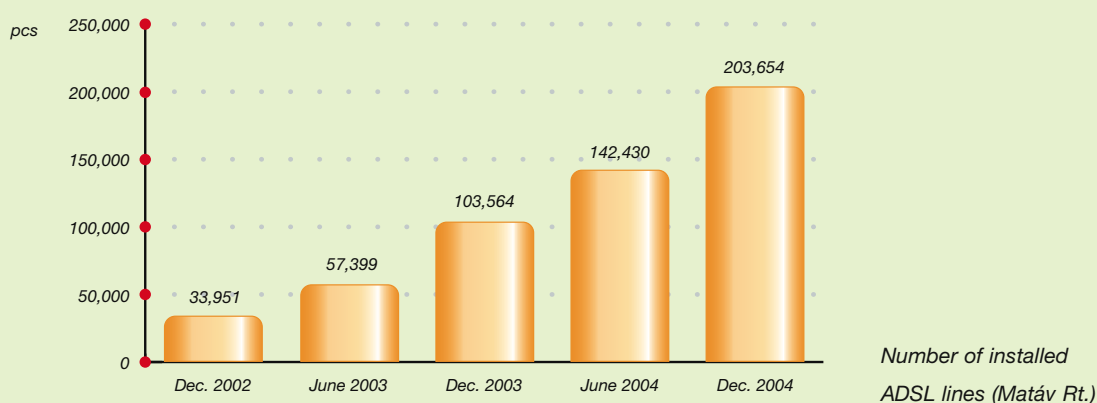
Total outgoing traffic revenues reduced by 13.9% to HUF 124.6bn. The outgoing domestic minutes of Matáv and Emitel decreased by 3.7%, and outgoing international minutes declined by 4.9% mainly due to competitors capturing traffic, broadband cannibalization (e.g. dial-up minutes) or further increased mobile penetration. At the parent company, fixed-to-mobile calls revealed the most significant decline of 5.5% to 946.5 million minutes followed by a 3.4% decrease in local and Internet traffic to 5,050.2 million minutes. Domestic long distance calls fell 3.2% to 1,673.9 million minutes. In Macedonia, the increasing mobile penetration is believed to have an adverse impact on fixed traffic volumes. In respect of tariffs, the lower Hungarian fixed-to-mobile termination fees of Pannon GSM and T-Mobile Hungary allowed a reduction in end-user prices. Furthermore, customized tariff packages offer certain discounts to encourage retention of the customer base. The majority of these discounts reduce outgoing traffic revenues.

Total incoming traffic revenues decreased by 29.7% to HUF 21.7bn as a combined result of lower domestic transit and incoming international traffic in Hungary, as well as significantly reduced fixed line interconnection fees and lower international settlement rates. Some of these changes resulting in lower traffic revenues had a favorable impact on the payments to other network operators.

The number of Matáv's cable television subscribers was up by 5.9%, reaching 383,904 at the end of 2004. The growth in cable television revenue resulting from the increased average number of cable TV subscribers and the higher revenue from televoting was not able to offset the decline of other revenues mainly due to the Universal Telecommunications Support Fund. In 2004, no revenue was recognized from the Fund compared to HUF 6bn a year ago.

## DATA AND INTERNET: SUCCESS OF BROADBAND

The most significant momentum of the segment is provided by the Internet, which also supports fixed line retention. Driven by broadband, the volume of Internet subscribers expanded further in 2004.

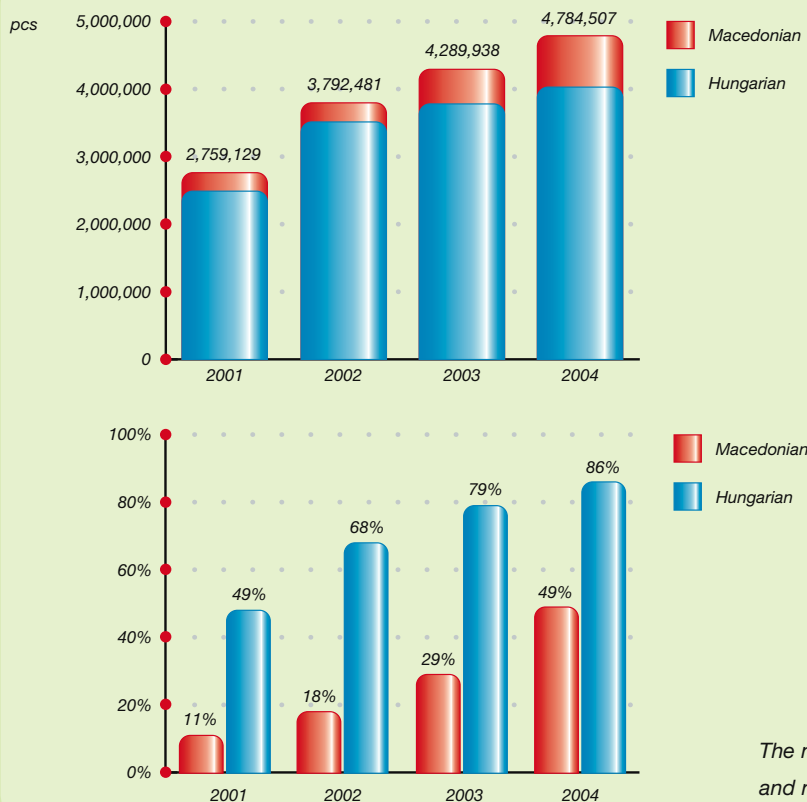


Consolidated revenues from leased lines and data transmission amounted to HUF 51.0bn in 2004, a 22.8% increase compared to 2003, primarily driven by the successful rollout of wholesale ADSL services in Hungary. The number of installed lines at the parent company almost doubled to 203,654 by the end of 2004 and the service was launched in Macedonia reaching 2,447 ADSL lines. The average number of Internet subscribers at the Hungarian Internet service provider subsidiary Axelero increased by 32.2%, with a significant increase in broadband users generating higher revenue. Axelero holds an estimated 42% share of the dial-up market in Hungary and is the market leader with an Internet penetration around 7%. At MakTel, the number of Internet subscribers (including prepaid from January 1, 2004) increased by more than 32% by the end of 2004, the Internet penetration is estimated to be approaching 5%.



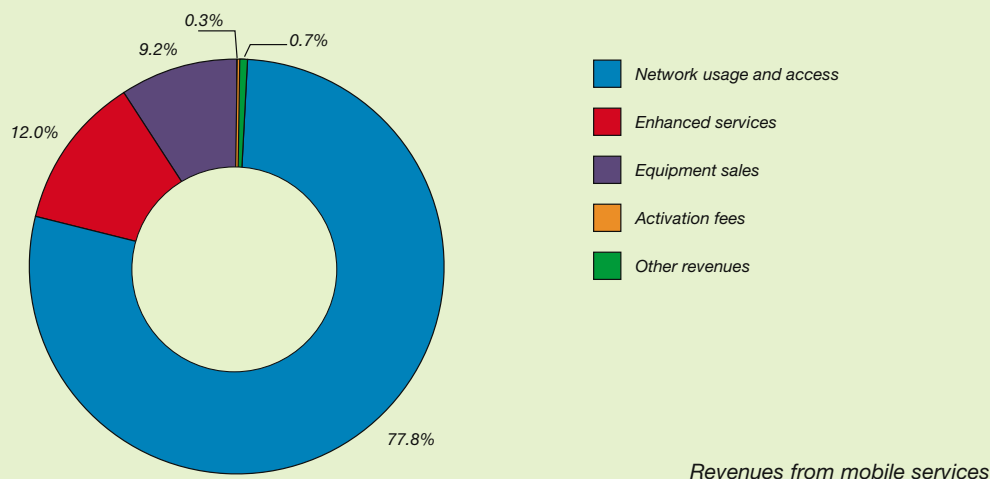
## MOBILE SEGMENT: REBRANDING IN HUNGARY

T-Mobile Hungary kept a clear market leadership with a market share of 46.2% at the end of 2004. Lower Hungarian acquisition cost favorably influenced margins but competition to acquire new customers in Macedonia mitigated the impact. Reported EBITDA of the segment grew by 7.3% with a broadly stable EBITDA margin on external revenues of 45.3%.



Hungarian mobile penetration increased by almost 8 percentage points in 2004, reaching 86.4% at the end of the year. Westel was rebranded as T-Mobile Hungary at the time of the EU accession in response to the increased role of and focus on global brands and to leverage the already close co-operation with T-Mobile International. 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) further decreased by 16.8% to HUF 10,275 despite the increased ratio of postpaid subscribers. The successful postpaid flat rate package 'Relax' contributed to the positive change in the customer mix resulting in an increased proportion of postpaid customers to 28.9% at the end of 2004 from 26.1% a year ago. Hungarian mobile number portability commenced in May 2004, but the ported numbers did not reach 1% of total Hungarian mobile subscribers by the end of the year.

Macedonian mobile penetration increased by more than 19 percentage points in 2004, reaching 48.5% at the end of the year. The proportion of postpaid customers at MobiMak, the Macedonian mobile arm was 15.8% at the end of 2004 down from 18.9% a year ago as penetration growth is mainly driven by the prepaid segment. MobiMak had a leading market share of 76% at end-2004.



In 2004, external revenues of the mobile segment increased by 7.5%, reaching HUF 267.3bn with revenues from network usage and access increasing by 7.7% to HUF 208.2bn. The weighted average number of our Hungarian and Macedonian mobile subscribers increased by 10.8% and 43.4% respectively. At the end of 2004, T-Mobile Hungary reported 4.0 million, while MobiMak had 752,462 revenue-producing customers.

T-Mobile Hungary's 15.9% overall churn rate reflects competition and migration to postpaid segment. The Hungarian average monthly minutes of use (MOU) increased by 0.9% to 115 also reflecting the positive impact of the flat rate packages. The average revenue per user (ARPU) declined by 6.0% to HUF 4,945 (or EUR 19.6 using the 2004 average exchange rate of 251.68 HUF/EUR) mainly as a result of competition-driven discounts, conscious package selection and lower interconnection revenues. The fixed-to-mobile termination fees of T-Mobile Hungary were further cut in mid-2004 by nearly 9%.

The increasing proportion of prepaid subscribers with generally lower usage and revenue and some competitive pressure from the other mobile operator heavily impacted the corresponding operational figures of MobiMak. The average monthly minutes of use (MOU) decreased by 21.4% to 66 with the average revenue per user (ARPU) declining 27.7% to HUF 3,804 (or EUR 15.1 using the 2004 average exchange rate of 251.68 HUF/EUR).

Consolidated revenue from enhanced services increased by 13.9% to HUF 31.9bn in 2004, suggesting a continuously increasing role in revenues with mobile messaging (SMS, MMS) representing the most significant source of revenue.

## ANALYSIS OF EXPENSES

Employee-related expenses increased considerably primarily driven by the restructuring charges and additional employee benefits relating to future terminations (HUF 20.7bn including HUF 14.2bn provisions) and annual wage increases. At the end of 2004, total group headcount amounted to 13,724 representing a 6.7% decline compared to 14,710 at the end of 2003.

Depreciation and amortization amounted to HUF 137.7bn, compared to HUF 128.3bn in 2003 (an increase of 7.3%) primarily due to the higher impairment losses related to telecom exchanges reaching HUF 5.3 bn (mainly driven by impairment of managed leased line node equipment and operational system) and HUF 4.4bn impairment of the Westel brand name (resulting from the T-Mobile Hungary rebranding). Amortization of goodwill (mainly from the acquisition of Westel and the MakTel Group) was HUF 13.9bn in 2004 compared to HUF 13.8bn in 2003.

Payments to other network operators amounted to HUF 87.6bn, compared to HUF 84.4bn in 2003 (an increase of 3.7%). Higher mobile penetration resulted in increased traffic to the second Macedonian mobile service provider, Cosmofon and higher mobile traffic to the Hungarian operators Pannon GSM and Vodafone Hungary. International mobile roaming was also up. On the other hand, Hungarian domestic transit volumes were lower, Hungarian fixed line interconnection fees and Pannon GSM mobile termination fees decreased along with average international settlement rates limiting the growth of this expense line.

The cost of telecommunications equipment sales was broadly stable at HUF 41.0bn. Higher fixed line and Macedonian mobile handset sales and higher average handset prices at T-Mobile Hungary were partially offset by lower number of gross additions in Hungary.

Other operating expenses were HUF 140.5bn, compared to HUF 143.7bn in 2003, a decrease of 2.2%. This was primarily driven by the reduced role of the Universal Telecommunications Support Fund. In 2003, HUF 5.1bn expenses were recognized due to the Fund compared to no expense in 2004 except for the net HUF 0.5bn modification recognized on reimbursements and obligations after the year 2003 that were different from those anticipated. Some of the major expenses increased including consultancy, the marketing costs and agency fees relating to for example the ADSL campaigns and the enhanced and content services.

Net interest and other charges were HUF 36.1bn in 2004 compared to HUF 40.0bn in 2003. The decrease is mostly due to the lower average loan balance in 2004 and a loan prepayment charge of HUF 1.7bn in 2003. At the end of 2004, loans remained almost exclusively Hungarian Forint-denominated. The net debt to total capital (net debt plus equity plus minority interest) ratio was 32.9% with a net debt of HUF 283.2bn at the end of 2004, down from HUF 291.7bn at year-end 2003.



Income tax expense decreased in line with lower profit before tax and lower Hungarian statutory corporate income tax rate (down to 16% in 2004 from 18%).

## CASH FLOW GENERATION

Strong cash flow also used for increasing dividend.

In 2004, net cash flow from operating activities decreased by 4.2% to HUF 189.8bn reflecting mainly higher interest paid along with regulatory and competitive pressure on EBITDA. However, the Group was still able to preserve its strong cash generation. The higher interest paid is attributable to the increased average forint denominated loans compared to 2003 (foreign exchange gains and losses on loans modifies repayment of loans rather than cash flows from operating activities). Purchase of tangible and intangible assets amounted to HUF 91.7bn, including the first HUF 5.5bn installment of the UMTS license fee. The increased purchase of subsidiaries and business units included a 7.4% stake in Stonebridge from CosmoTelco and the acquisition of 49% stake in T-Systems Hungary. Increased real estate sales contributed to the higher proceeds from disposal of non-current assets. Since Matáv increased its dividend from HUF 18 per share to HUF 70 on 2003 earnings, dividends paid to shareholders and minority interests increased to HUF 78.3bn from HUF 23.5bn in 2003.

# Consolidated Financial Statements

## **Report of Independent Registered Public Accounting Firm** **to the Board of Directors and Shareholders of Magyar Távközlési Rt.**

*We have audited the accompanying consolidated balance sheets of Magyar Távközlési Rt. ("Matáv") as of December 31, 2003 and 2004, and the related consolidated statements of income, cashflows and changes in shareholders' equity for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of Matáv's management. Our responsibility is to express an opinion on these financial statements based on our audits.*

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

*In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Matáv as of December 31, 2003 and 2004, and the consolidated results of its operations and its cashflows for each of the three years in the period ended December 31, 2004 in accordance with International Financial Reporting Standards.*



PricewaterhouseCoopers

Budapest, Hungary

February 21, 2005



# Consolidated Balance Sheets

		At December 31,		
	Note	2003	2004	2004
		(in HUF millions)		(million USD)
				(unaudited), note 2
<b>ASSETS</b>				
<b>Current Assets</b>				
Cash and cash equivalents	6	22,132	36,879	205
Other financial assets held for trading	7	494	576	3
Trade and other receivables	8	94,909	86,989	482
Inventories	9	9,997	7,669	43
Assets held for disposal	10	3,612	3,063	17
<b>Total Current Assets</b>		<b>131,144</b>	<b>135,176</b>	<b>750</b>
<b>Non-current Assets</b>				
Property, plant and equipment - net	11	620,990	570,390	3,164
Intangible assets - net	12	289,234	299,051	1,659
Associates	14	4,827	5,750	32
Deferred taxes	28	4,584	12,527	69
Other non-current assets	15	8,058	6,664	37
<b>Total Non-current Assets</b>		<b>927,693</b>	<b>894,382</b>	<b>4,961</b>
<b>Total Assets</b>		<b>1,058,837</b>	<b>1,029,558</b>	<b>5,711</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>				
<b>Current Liabilities</b>				
Loans from related parties	18	126,644	60,000	333
Loans and other borrowings – third party	18	66,292	34,538	192
Derivative financial liabilities	17	87	-	-
Trade and other payables	19	101,373	109,973	610
Deferred revenue	20	1,971	1,502	8
Provision for liabilities and charges	21	5,299	15,537	86
<b>Total Current Liabilities</b>		<b>301,666</b>	<b>221,550</b>	<b>1,229</b>
<b>Non-current Liabilities</b>				
Loans from related parties	18	73,675	177,675	985
Loans and other borrowings – third party	18	47,669	48,395	268
Deferred revenue	20	2,475	1,186	7
Deferred taxes	28	1,768	1,280	7
Provision for liabilities and charges	21	1,200	2,761	15
Other non-current liabilities		-	47	-
<b>Total Non-current Liabilities</b>		<b>126,787</b>	<b>231,344</b>	<b>1,283</b>
<b>Total liabilities</b>		<b>428,453</b>	<b>452,894</b>	<b>2,512</b>
<b>Minority Interests</b>				
Minority Interests	22	70,274	60,097	333
<b>Shareholders' Equity</b>				
Common stock		104,281	104,281	578
Additional paid in capital		27,382	27,382	152
Treasury stock		(3,842)	(3,842)	(21)
Cumulative translation adjustment		825	(3,026)	(17)
Retained earnings		431,464	391,772	2,173
<b>Total Shareholders' Equity</b>		<b>560,110</b>	<b>516,567</b>	<b>2,865</b>
<b>Total Liabilities and Shareholders' Equity</b>		<b>1,058,837</b>	<b>1,029,558</b>	<b>5,711</b>

These consolidated financial statements were accepted for the Board of Directors on February 21, 2005 and signed on their behalf by:



Elek Straub  
Chairman and Chief Executive Officer



Dr. Klaus Hartmann  
Chief Financial Officer

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

# Consolidated Income Statements

	Note	For the year ended December 31,			
		2002	2003	2004	2004
		(in HUF millions, except per share amounts)			(million USD) (unaudited), note 2
Fixed line services	23	368,221	358,655	334,174	1,854
Mobile services	24	222,364	248,597	267,264	1,482
<b>Revenues</b>		<b>590,585</b>	<b>607,252</b>	<b>601,438</b>	<b>3,336</b>
Employee related expenses	25	(89,264)	(87,920)	(109,497)	(607)
Depreciation and amortization		(122,741)	(128,334)	(137,666)	(764)
Payments to other network operators		(81,078)	(84,449)	(87,580)	(486)
Cost of telecommunications equipment sales		(39,744)	(40,811)	(40,971)	(227)
Other operating expenses – net	26	(135,518)	(143,674)	(140,460)	(779)
<b>Total Operating Expenses</b>		<b>(468,345)</b>	<b>(485,188)</b>	<b>(516,174)</b>	<b>(2,863)</b>
<b>Operating profit</b>		<b>122,240</b>	<b>122,064</b>	<b>85,264</b>	<b>473</b>
Net financial expenses	27	(27,919)	(40,002)	(36,146)	(200)
Share of associates' results before income tax	14	691	963	2,297	13
<b>Profit Before Income Tax</b>		<b>95,012</b>	<b>83,025</b>	<b>51,415</b>	<b>285</b>
Income tax	28	(13,245)	(13,685)	(8,088)	(45)
<b>Profit After Income Tax</b>		<b>81,767</b>	<b>69,340</b>	<b>(43,327)</b>	<b>240</b>
Minority Interest	22	(13,639)	(11,865)	(8,686)	(48)
<b>Net Income</b>		<b>68,128</b>	<b>57,475</b>	<b>34,641</b>	<b>192</b>
<b>Basic Earnings Per Share</b>					
Weighted average number of common stock outstanding (thousands)		1,037,587	1,037,912	1,037,912	1,037,912
Net income		68,128	57,475	34,641	192
Basic earnings per share (HUF and USD)		65.66	55.38	33.38	0.19
<b>Diluted Earnings Per Share</b>					
Weighted average number of common stock outstanding for diluted earnings per share (thousands)		1,037,587	1,037,912	1,037,912	1,037,912
Net income		68,128	57,475	34,641	192
Diluted earnings per share (HUF and USD)		65.66	55.38	33.38	0.19

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

## Consolidated Cash Flow Statements

	Note	For the year ended December 31,			
		2002	2003	2004	2004
		(in HUF millions)		(million USD)	
					(unaudited), note 2
<b>Cash Flows from Operating Activities</b>					
Cash generated from operations	29	239,536	240,497	234,681	1,302
Interest paid		(27,259)	(30,063)	(34,030)	(189)
Income tax paid		(13,234)	(12,318)	(10,900)	(60)
<b>Net Cash Flows from Operating Activities</b>		<b>199,043</b>	<b>198,116</b>	<b>189,751</b>	<b>1,052</b>
<b>Cash Flows from Investing Activities</b>					
Purchase of tangible and intangible assets	13	(109,988)	(90,788)	(91,748)	(509)
Purchase of subsidiaries and business units	5	(13,459)	(7,992)	(17,273)	(96)
Cash acquired through business combinations		-	61	16	-
Interest received		660	908	1,452	8
Dividend received		1,437	575	2,633	15
Proceeds from sale of trading investments – net		(120)	266	43	-
Proceeds from disposal of non-current assets		1,529	2,269	4,090	23
<b>Net Cash Flows from Investing Activities</b>		<b>(119,941)</b>	<b>(94,701)</b>	<b>(100,787)</b>	<b>(559)</b>
<b>Cash Flows from Financing Activities</b>					
Dividends paid to shareholders and minority interest		(11,437)	(23,507)	(78,294)	(434)
Proceeds from loans and other borrowings		217,429	192,057	338,680	1,879
Repayment of loans and other borrowings		(286,787)	(260,583)	(332,481)	(1,844)
Proceeds from issue of common stock		4,973	-	-	-
Purchase of treasury stock		(4,488)	(3,842)	-	-
Proceeds from sale of treasury stock		85	3,842	-	-
Other		171	(2)	-	-
<b>Net Cash Flows from Financing Activities</b>		<b>(80,054)</b>	<b>(92,035)</b>	<b>(72,095)</b>	<b>(400)</b>
Effect of foreign exchange rate changes					
on cash and cash equivalents		(314)	1,901	(2,122)	(12)
<b>Change in Cash and Cash Equivalents</b>		<b>(1,266)</b>	<b>13,281</b>	<b>14,747</b>	<b>82</b>
Cash and cash equivalents, beginning of year		10,117	8,851	22,132	123
Cash and cash equivalents, end of year	6	8,851	22,132	36,879	205

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

# Consolidated Statements of Changes in Shareholders' Equity

	Shares of common stock (a) (pcs)	Common stock	Additional paid in capital	Treasury stock (in HUF millions)	Cumulative translation adjustment	Retained earnings (g)	Total Share- holders' equity
<i>Balance at December 31, 2001</i>	<i>1,037,358,870</i>	<i>103,736</i>	<i>22,955</i>	<i>(163)</i>	<i>(2,420)</i>	<i>336,192</i>	<i>460,300</i>
<i>Price correction of acquisition of T-Mobile Hungary (b)</i>						<i>485</i>	<i>485</i>
<i>Dividend</i>						<i>(11,410)</i>	<i>(11,410)</i>
<i>Sale of treasury stock (c)</i>				<i>163</i>		<i>(78)</i>	<i>85</i>
<i>Stock issuance (d)</i>	<i>552,730</i>	<i>55</i>	<i>429</i>				<i>484</i>
<i>Stock issuance (e)</i>	<i>4,900,000</i>	<i>490</i>	<i>3,998</i>				<i>4,488</i>
<i>Purchase of treasury stock (e)</i>				<i>(4,488)</i>			<i>(4,488)</i>
<i>Cumulative Translation Adjustment</i>					<i>(1,928)</i>		<i>(1,928)</i>
<i>Net income</i>						<i>68,128</i>	<i>68,128</i>
<i>Balance at December 31, 2002</i>	<u><i>1,042,811,600</i></u>	<u><i>104,281</i></u>	<u><i>27,382</i></u>	<u><i>(4,488)</i></u>	<u><i>(4,348)</i></u>	<u><i>393,317</i></u>	<u><i>516,144</i></u>
<i>Dividend (h)</i>						<i>(18,682)</i>	<i>(18,682)</i>
<i>Sale of treasury stock (c)</i>				<i>4,488</i>		<i>(646)</i>	<i>3,842</i>
<i>Purchase of treasury stock (c)</i>				<i>(3,842)</i>			<i>(3,842)</i>
<i>Cumulative Translation Adjustment</i>					<i>5,173</i>		<i>5,173</i>
<i>Net income</i>						<i>57,475</i>	<i>57,475</i>
<i>Balance at December 31, 2003</i>	<u><i>1,042,811,600</i></u>	<u><i>104,281</i></u>	<u><i>27,382</i></u>	<u><i>(3,842)</i></u>	<u><i>825</i></u>	<u><i>431,464</i></u>	<u><i>560,110</i></u>
<i>Dividend (h)</i>						<i>(72,654)</i>	<i>(72,654)</i>
<i>Purchase of investment in T-Systems Hungary (f)</i>						<i>(1,679)</i>	<i>(1,679)</i>
<i>Cumulative Translation Adjustment</i>					<i>(3,851)</i>		<i>(3,851)</i>
<i>Net income</i>						<i>34,641</i>	<i>34,641</i>
<i>Balance at December 31, 2004</i>	<u><i>1,042,811,600</i></u>	<u><i>104,281</i></u>	<u><i>27,382</i></u>	<u><i>(3,842)</i></u>	<u><i>(3,026)</i></u>	<u><i>391,772</i></u>	<u><i>516,567</i></u>
<i>Of which treasury stock</i>	<i>(4,900,000)</i>						
<i>Shares of common stock outstanding at December 31, 2004</i>	<u><i>1,037,911,600</i></u>						

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



## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (NOTES)

- (a) *In addition to the 1,042,811,600 issued shares of common stock (nominal value of HUF 100), total shareholders' equity includes one Series "B" preference share at the nominal value of HUF 10,000 at December 31, 2004. This Series "B" share is held by the Prime Minister's Office and bestows certain rights on its owner, including access to information, and the appointment of a Director. This share may only be held by the Government or its nominee. The number of authorized shares on December 31, 2004 is 1,054,911,600.*
- (b) *After the acquisition of the 49% of ownership in T-Mobile Hungary ("T-Mobile") from Deutsche Telekom in 2001, the final purchase price was reduced by HUF 485 million in 2002 from the estimated amount due to the lower amount of dividend declared by T-Mobile Hungary for the year 2001. The difference in the purchase price was accounted against retained earnings as the transaction took place between entities under common control.*
- (c) *In 2002 the Company sold 96,097 shares of its common stock for HUF 85 million, resulting in a loss of HUF 78 million. In 2003 the Company sold and repurchased its 4,900,000 shares of common stock for HUF 3,842 million, which resulted in a loss of HUF 646 million.*
- (d) *In 2002 Investel (a consolidated subsidiary of the Group) sold its 552,730 Matáv shares for HUF 484 million outside the group. These shares were registered by Matáv and subscribed by Investel in 2000 but issued outside the group for the first time in 2002.*
- (e) *As a result of the new employee stock ownership program launched in 2002, the Company issued 4,900,000 shares of common stock, which were repurchased immediately. See note 30 for more details.*
- (f) *In September 2004 Matáv acquired a 49% share of ownership in T-Systems Hungary (TSH), since which time TSH is an equity consolidated associate company of Matáv Group. As both Matáv and TSH belong to the Deutsche Telekom group, the transaction concerned between entities under common control. As a result, the difference between the carrying value of the shares in T-Systems International's books (HUF 1,751 million) and the purchase price (HUF 3,430 million) was accounted for against the retained earnings of the Group.*
- (g) *The distributable reserves of the Company under Hungarian law at December 31, 2004 amounted to approximately HUF 283,000 million (HUF 317,000 million at December 31, 2003).*
- (h) *In 2004 Matáv declared and paid HUF 70 dividend per share (HUF 18 per share in 2003).*

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

# Notes to the Consolidated Financial Statements

## 1 GENERAL INFORMATION

Magyar Távközlési Rt. (the "Company" or "Matáv Rt.") with its subsidiaries form the Matáv Group ("Matáv" or "the Group"). Matáv is the principal supplier of telecommunications services in Hungary and Macedonia. Matáv 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.

Matáv is Hungary's and Macedonia's largest fixed line and mobile telecommunications provider. In addition, Matáv provides leased lines, data transmission, corporate networks, cable television, internet services and sells and leases telecommunications equipment in Hungary and in Macedonia.

The regulatory environment under which the Group operates are summarized as follows.

### *Hungarian fixed line*

The regulation of the Hungarian telecommunications market was fundamentally changed on December 23, 2001 when the Act on Communications came into force. The Act on Communications provided the main legal framework for the Hungarian liberalized telecommunications market until the end of 2003.

On January 28, 2002, the Minister leading the Prime Minister's office and Matáv concluded the Contract on Universal Service Provision. According to this contract, the national concession was terminated on January 31, 2002, while in the five local areas the local concessions terminated on May 24, 2002. Act C of 2003 on Electronic Communications, the latest regulation on the telecommunications sector, came into effect on January 1, 2004 and the Act on Communications was superseded at that time. The Act on Electronic Communications has fundamentally changed the authority structure of the liberalized telecommunications market. The National Communications Authority ("NCA") is the supreme supervisory body. The NCA has a close cooperation with the Competition Office and the General Inspectorate for Consumer Protection. On June 30, 2004, the Minister of Informatics and Communications (the Minister) appointed Matáv as the universal service provider in Matáv's former concession area and the Minister and Matáv concluded a modified Contract on Universal Service Provision. The new contract is valid until December 31, 2008 and can be extended for an additional 4 years. Upon the termination of its concession contract in its three primary areas on November 1, 2002, Matáv's subsidiary, Emitel also concluded the Contract on Universal Service Provision with the Minister.

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 services include access to fixed line voice telephony services of regulated minimum quality enabling access to Internet services at a regulated minimum speed, a regulated density of public payphones, a public register of subscribers, national domestic inquiry service as well as cost-free call-barring and emergency calls.

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. A separate Ministerial Decree determines the detailed rules applicable to calculate the net avoidable costs. The compensation was available for universal service providers from the Universal Electronic Communications Support Fund in 2002 and 2003.

Matáv was designated as an SMP (company with significant market power) on the telephony and leased lines market by the regulator at the end of 2003. In the first quarter of 2004, the NCA requested the service providers to provide extensive operating data for market assessment and identification of operators to be given an SMP status.

According to the Act on Electronic Communications, the Minister acting in agreement with the Minister of Finance is responsible for regulating maximum tariffs for universal services. Tariff regulation in Hungary is currently based on the price-cap method. There is a price cap for universal service packages and the draft SMP resolution on residential and business access markets has introduced a new price cap for all subscription fees.

Matáv's regulated access prices currently include an access deficit, i.e., Matáv's subscription fees do not cover the costs of access. According to the Pricing Act and the relating ministerial decrees, the access deficit should be eliminated. Decree 3/2002 (I.21.) MeHVM deals with the access deficit problem by allowing an annual increase in subscription fees of universal pricing plans above annual inflation rate.

According to the Act on Electronic Communications, designated SMP operators in the relevant market of the unbundled access or broadband access are obliged to unbundle local loops and prepare reference offers for unbundled local loops (whether fully or partially unbundled) and bit-stream access and to provide these services when there is a request for them by other telecommunications service providers.

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.

The cost base for the price of these services has to be calculated using Fully Distributed Costs (FDC) as determined by Ministerial Decree 18/2003 (XII.27.). In 2003 the Long Run Incremental Costs (LRIC) was applicable, while in 2002 the Fully Allocated Costs (FAC) methodology was used.

The SMPs must prepare reference offer for the unbundling of the local loops and bit-stream unbundling. The reference offer forms the basis of the agreements to be concluded with other service providers. The reference offer of each SMP must be approved by the NCA, which keeps a public, open register. SMPs are also obliged to prepare reference offers for interconnection and to provide these services upon the reference offer when there is a request for them by other telecommunications service providers. SMPs are also obliged to enter into agreements for access to their networks on the basis of an offer put forward by another service provider. If the provider is obliged to prepare a reference interconnection offer, such as Matáv, this offer must be in line with the reference offer. The NCA has the competence to arbitrate in dispute cases and may establish provisional arrangements between the parties. The reference offer of the SMPs must be approved by the NCA.

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 an interconnection agreement between the affected service providers, a carrier selection number and the connection of the calls to the desired end user.

Fixed line telecommunications service providers are obliged under the law to provide number portability on their networks starting January 1, 2004, and to allow subscribers to change service providers without changing their telephone numbers in the same geographic location. In addition, starting May 1, 2004, non-geographic number portability have been implemented.

#### **Macedonian fixed line**

The Group is also present in the Macedonian fixed line telecommunications market through its subsidiary, MakTel. MakTel is the sole fixed line service provider in Macedonia. MakTel has a concession contract to provide services until December 31, 2018. Further, MakTel had exclusive rights in (a) Fixed Voice Telephony Services, Leased Line Services and (b) to construct, lease, own, develop, maintain and operate Fixed Public Telecommunication Networks until December 31, 2004. These exclusive rights include local, national and international long distance public fixed voice services independently of the technology used, including voice over Internet Protocol services.

The regulation of the Macedonian telecommunication market is expected to be fundamentally modified during 2005 when a new Law on Electronic Communication is planned to enter into force. Macedonian regulatory authorities tend to follow the regulatory framework of the European Community for liberalization of the telecommunication market.

In accordance with the Telecommunication Act, as of December 31, 2004 MakTel started to provide universal services on the entire territory of the Republic of Macedonia. Universal service is a package of basic telecommunications services that should be available to all users of public telecommunication services at reasonable and non-discriminatory prices. In accordance with the provisions of the Telecommunication Act the Minister of Transport and Communications has adopted, and the Telecommunication Directorate has implemented, regulations governing the provision of universal services and the compensation procedures to be used for payment of such services. The regulations concerning the provision of universal services govern:

- an identification and description of the universal services to be provided;
- procedures that will be used to select universal services providers (by public tender procedure or otherwise);
- a requirement that universal services be made available to handicapped persons;
- methods for establishing the maximum prices for universal services;

- a mechanism for compensating for performing universal service by the providers of telecommunication services (including contributions by other public telecommunication service providers and public telecommunication operators);
- a description of the information that must be provided by public telecommunication operators and public telecommunication service providers for the purpose of calculating the cost of providing universal services; and
- other conditions relating to the provision of universal services.

The Telecommunication Directorate is authorized to implement tariff regulation for the provider designated with Significant Market Power (SMP) status or when the market for a certain service is not competitive. Thirteen services provided by MakTel are regulated with the concession contract. Tariff regulation and maximum allowed tariff changes of the regulated services are based on the price-cap method. MakTel is undergoing a tariff rebalancing process of the regulated tariffs, which is planned to continue in the forthcoming period. Rebalancing means the elimination of cross financing between the telecommunications services in order to better reflect the cost of the services in pricing.

#### **Hungarian mobile**

On October 7, 1999 an amended concession contract was signed between the Ministry of Transport, Communications and Water Management and T-Mobile Hungary (T-Mobile), Matáv's subsidiary, extending T-Mobile's rights and obligations to also provide service in the 1800 MHz band in Hungary. The duration of the DCS concession is fifteen years. T-Mobile started commercial operation in the 1800 MHz band on November 16, 2000.

In accordance with T-Mobile's Deed of Association, the initial duration of the concession regarding the (a) GSM 900 public mobile radio telephone service is a period of fifteen years calculated from the execution of the concession agreement (November 4, 1993 to November 4, 2008). Regarding the (b) DCS 1800 public mobile radio telephone service shall be fifteen 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 expiry. Regarding the GSM 900 public mobile radio telephone service, after November 4, 2008, regarding the DCS 1800 public mobile radio telephone service, after October 7, 2014, for another 7.5 years without issuing a tender invitation.

In November 2002, the National Communications Authority (NCA) pronounced T-Mobile as a significant market power in the interconnections market.

On December 7, 2004 the NCA awarded T-Mobile 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 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.

#### **Macedonian mobile**

MobiMak, Matáv's subsidiary, is the leading mobile service provider in Macedonia, which has a concession contract to provide mobile telecommunications services until December 31, 2018, which can be renewed for an additional 20 years without a tender. The concession agreement was amended in 2002 after the entry of the second mobile operator in order to equalize the terms of the concession contracts of both operators.

According to the concession agreement concluded between the Macedonian Ministry of Transport and Communications and MobiMak, MobiMak 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 places within the Republic of Macedonia and places outside of the Republic of Macedonia.

According to the concession agreement, MobiMak may set and modify its tariffs for Mobile Public Telephony Services at its own discretion.

## **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 compliance with International Financial Reporting Standards (IFRS).

The consolidated financial statements are shown in millions of Hungarian Forints (HUF). For the convenience of the reader, the consolidated balance sheet, income statement and cashflow statement for the year 2004 are also presented in millions of U.S. dollars (USD) translated at a rate of HUF 180.29 to USD 1 (the official rate of the National Bank of Hungary at December 31, 2004). 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.

**(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 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 of the subsidiary acquired is recorded as goodwill. Inter-company transactions, balances and unrealized gains on transactions between 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, Matáv is 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, 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' results before income tax". Related taxes are included in income tax expense. The cumulative post-acquisition movements are adjusted against the cost of investment. Associates are entities over 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 Matáv holds a 50% share of ownership with a third party owner of the other 50%. Matáv has no significant joint ventures.

At December 31, 2004 and 2003 the principal operating subsidiaries and associates of the Group, which are incorporated in Hungary and Macedonia, were as follows:

	Group interest in capital as at December 31,		
Subsidiaries	2003	2004	Activity
Incorporated in Hungary:			
Axelero	100%	100%	Internet service and content provider
BCN Rendszerház	100%	100%	Solutions for business customers
Emitel	100%	100%	Local telecommunications operator
InvesTel	100%	100%	Cable TV holding
MatávkábelTV	100%	100%	Cable TV operator
T-Mobile Hungary	100%	100%	Cellular telecommunications service provider
Incorporated in Macedonia:			
Makedonski Telekomunikacii AD (MakTel)	45.65%	51%	Fixed line telecom. services
MobiMak AD	45.65%	51%	Cellular telecom. services
Telemacedonia AD	88.03%	100%	Management consulting
Stonebridge AD	89.51%	100%	Holding company

	Group interest in capital as at December 31,		
Associates	2003	2004	Activity
<i>Incorporated in Hungary:</i>			
Hunsat	50%	50%	Satellite communications
Magyar RTL (M-RTL)	25%	25%	Television broadcast company
T-Systems Hungary (TSH)	-	49%	Systems integration for business customers
G4 - Matávör	50%	-	Security monitoring

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 measurement currency of the reporting entities at the exchange rates at the balance sheet date and any unrealized exchange gains and losses are recognized immediately. Gains and losses that arise on foreign currency transactions and financing activities are included under net 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 measurement currency of the subsidiary as required by the new IFRS standard, IFRS 3 – Business Combinations.

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

At January 1, 2001 the Group adopted IAS 39 – Financial Instruments – Recognition and Measurement, and classified its financial assets into the following categories: trading, held-to-maturity, available-for-sale and loans receivable.

Financial assets that are highly liquid and are acquired principally for the purpose of generating profit from short-term fluctuations in price are classified as other financial instruments held for trading or cash and cash equivalents depending on their maturities.

Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in other non-current assets.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale. These are included in other non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, at which time they are transferred to current assets.

Loans and receivables are created by providing money, goods, or services directly to a debtor, other than those that are originated with the intent to be sold immediately or in the short term.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Trading and available-for-sale financial assets are carried at fair value, while held-to-maturity investments and loans receivable are carried at amortized cost. Any changes in the carrying values are accounted for in the income statement under the caption "Net financial expenses".

Trading investments include securities issued by the government, the maturities of which are between three months and one year.

Regular way purchases and sale of financial assets are recognized and derecognized, as applicable, using settlement date accounting.

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

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

Amounts due 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.

**(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 basis.

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

**(g) Assets held for disposal**

Assets held for disposal include real estates that are no longer needed for the future operations of the Company, 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 recoverable amount. Recoverable amount is defined as the expected selling price less transaction costs. These assets continue to be depreciated until the sale, in accordance with IAS 16 – Property, Plant and Equipment.

**(h) Property, plant and equipment**

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

Maintenance and repairs are charged to expense when incurred.

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

The useful lives assigned are as follows:

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

**(i) Intangible assets**

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

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

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

Costs associated with the acquisition of long term licenses are capitalized including any related borrowing costs. 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 of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions is reported in the balance sheet as an intangible asset and is amortized using the straight-line method over its estimated useful life related to acquisitions before March 31, 2004. Goodwill arising on acquisitions after this date is not amortized, but tested for impairment annually or more frequently when circumstances indicate the risk of impairment, in accordance with IFRS 3.

*Intangible assets other than goodwill arising on acquisitions after March 31, 2004 are amortized over their respective economic useful lives.*

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

**(j) Impairment of non-current assets**

*Matáv regularly reviews its non-current assets, including property, plant and equipment, intangible assets and other long-term investments for impairment. Impairment losses are recognized as an expense for assets whose carrying value exceeds their recoverable amount, which is the higher of value in use or expected net selling price. Impairment losses of tangible and intangible assets are included in the depreciation and amortization line of the income statement, while impairment losses of other non-current financial assets are included in net financial expenses.*

*The value in use of non-current assets is determined at the cash generating unit level, using discounted cashflow analysis.*

**(k) Leases**

*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.*

*Lessee*

*Leases of property, plant and equipment where Matáv assumes substantially all the benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the fair value of the asset or if lower, at the estimated present value of the future minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding 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 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.*

*Sale and leaseback transactions*

*Sale and leaseback transactions involve the sale of an asset by Matáv and the leasing of the same asset or part of it back to Matáv. 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.*

**(l) Deferred taxes**

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

*The principal temporary differences arise from depreciation on property, plant and equipment, impairment of receivables, provisions for liabilities and charges and tax losses and investment tax credits carried forward.*

**(m) Loans and other borrowings**

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

*Borrowing costs are recognized as an expense as incurred, net of amounts capitalized. Interest on general borrowings 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 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 during 2004.*



Effective borrowing cost (note 18) 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 18). 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) 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.

Matáv does not have defined benefit pension schemes.

*(2) Equity and equity based compensation benefits*

The Company does not recognize any compensation expense related to equity compensation plans (note 30).

Bonuses tied to the long term performance of the Matáv share are recognized in the income statement at their time-proportioned fair value (note 30).

*(3) Termination benefits*

Termination benefits are payable whenever an employee's employment is terminated before the nominal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The 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 are recognized when Matáv has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Costs related to the ongoing activities of the Group are not provided in advance.

*(q) Treasury stock*

When the Company or its subsidiaries purchases the Company's equity share capital, the consideration paid including any attributable incremental external costs are deducted from total shareholders' equity as treasury stock until they are cancelled. When such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

*(r) Revenues*

Revenue is primarily derived from services provided to Matáv's customer subscribers and other third parties using Matáv's telecommunications network, and equipment sales. Revenues for all services and equipment sales (note 23 and 24) 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 delivered 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 recognizes the revenue for each of the deliverables at their invoiced amounts.

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

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

Matáv's IFRS revenue recognition policies for the different groups of services are as follows.

**1. Activation fees (fixed line and mobile)**

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)**

Monthly subscription fees represent a fixed monthly fee charged to customer subscribers for access to Matáv's network. Such fees are recognized in the month during which the customer is permitted access to the network.

**3. Outgoing traffic revenue**

Outgoing traffic represents customer and third party use of Matáv's telecommunications network. Customers and third parties 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.

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**

Incoming traffic revenue is recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (including roaming) 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.

**(s) R&D and Marketing expenses**

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

**(t) Earnings per share**

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

**(u) Dividends**

Dividends are recorded in the Group's financial statements in the period in which they are approved by the Group's shareholders.

**(v) Segment reporting**

Matáv determines segments primarily based on products and services that are subject to risks and returns that are different from those of other businesses. Matáv has changed its previously applied segment disclosure as a result of the change in the management and reporting structure of the Group. Prior years' segment disclosures have been amended to facilitate comparability with the disclosure of 2004.

The primary segments are based on the business lines (fixed line and mobile operations), which include both Hungarian and Macedonian activities. Reported segments are consistent with information used by management for internal reporting and monitoring purposes. In addition, the Company's secondary format for reporting segment information is geographical segments.

*(w) Comparative information*

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

**3 Financial risk management**

*(a) Financial risk factors*

*Matáv 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 measurement currency of Matáv is HUF, and as a result, Matáv's objective is to minimize the level of its financial risk in HUF terms.*

*(1) Foreign exchange risk*

*The National Bank of Hungary lifted the devaluation of the Hungarian Forint against the Euro in October 2001 after widening the intervention band from +/-2.25% to +/-15% as of May 4, 2001. The introduction of this new foreign exchange regulation increased the foreign exchange risk of the Group significantly. In order to mitigate this increased risk, Matáv minimized its foreign currency borrowings in 2002 and 2003. The remaining foreign exchange exposure of Matáv 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 Matáv very rarely has to buy or sell foreign currency on the market.*

*Matáv occasionally enters into derivative contracts for risk reduction purposes. These foreign currency forward contracts and swap arrangements are taken to reduce the exchange rate risk related to the foreign exchange denominated payment obligations.*

*(2) Interest rate risk*

*Matáv 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 Matáv 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 Matáv places its cash with substantial credit institutions. Cash and cash equivalents held by the Macedonian subsidiaries are denominated in Macedonian Denars, Euros and in U.S. dollars.*

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

*(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*

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

*(c) Fair value estimation*

*The fair value of publicly traded derivative financial instruments and trading and available-for-sale securities is based on quoted market prices at the balance sheet date. The fair value of interest rate swaps is calculated as the present value of the estimated future cashflows. 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 value of future cashflows are used to determine fair value for the remaining financial instruments.*

#### 4 Segment information

Matáv has two primary segments, fixed line and mobile telecommunications, which include both Hungarian and international activities.

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

The Mobile segment provides digital services in the 900 and 1,800 MHz frequency bandwidths in Hungary and Macedonia.

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

Until January 1, 2004 Matáv had three operating segments, fixed line telecommunications, mobile telecommunications and international activities. Fixed line telecommunications segment included the Hungarian fixed line entities, while the Mobile segment included T-Mobile Hungary (formerly Westel and Westel 0660), the Hungarian mobile company. The international segment included the Macedonian subsidiaries of the Group (both fixed line and mobile providers).

From January 1, 2004 Matáv reorganized its segment disclosure to reflect the change in the management and reporting structure of the Group. In the current disclosure the old International segment was split into fixed line operations and mobile operations, which were added to the Hungarian fixed line operations and the Hungarian mobile operations respectively.

**Primary reporting format:** The following tables present a summary of operating results of the Group by business segment for the years ended December 31, 2002, 2003 and 2004. The segments presented below are substantially consistent with the format used by the Company's Management Committee.

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
<b>Revenues</b>			
Hungarian Fixed line	336,306	324,552	301,743
International Fixed line	47,793	49,689	45,184
Total	384,099	374,241	346,927
Less: intra-segment revenues	(1,122)	(1,552)	(907)
Total revenue of Fixed line segment	382,977	372,689	346,020
Less: inter-segment revenues	(14,756)	(14,034)	(11,846)
Fixed line revenue from external customers	368,221	358,655	334,174
Hungarian Mobile	232,612	254,141	263,023
International Mobile	29,482	31,575	33,734
Total	262,094	285,716	296,757
Intra-segment revenues	(19)	(20)	(58)
Total revenue of Mobile segment	262,075	285,696	296,699
Less: inter-segment revenues	(39,711)	(37,099)	(29,435)
Mobile revenue from external customers	222,364	248,597	267,264
Total revenue of the Group	590,585	607,252	601,438



	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
<b>Depreciation and amortization</b>			
Hungarian Fixed line – amortization of goodwill	2,343	1,599	1,601
Hungarian Fixed line – other depreciation and amortization	74,325	70,262	70,965
Hungarian Fixed line	76,668	71,861	72,566
International Fixed line – amortization of goodwill	642	663	684
International Fixed line – other depreciation and amortization	5,524	9,081	8,411
International Fixed line	6,166	9,744	9,095
Fixed line segment (a)	82,834	81,605	81,661
Hungarian Mobile – amortization of goodwill	9,540	9,540	9,540
Hungarian Mobile – other depreciation and amortization	25,883	30,355	38,031
Hungarian Mobile	35,423	39,895	47,571
International Mobile – amortization of goodwill	1,926	1,989	2,051
International Mobile – other depreciation and amortization	2,558	4,845	6,383
International Mobile	4,484	6,834	8,434
Mobile segment (a)	39,907	46,729	56,005
Total depreciation and amortization of the Group	<u>122,741</u>	<u>128,334</u>	<u>137,666</u>
<b>Segment results (Operating profit)</b>			
Hungarian Fixed line	43,666	44,090	13,061
International Fixed line	15,136	11,765	7,028
Fixed line segment	58,802	55,855	20,089
Hungarian Mobile	52,390	55,030	56,128
International Mobile	11,048	11,179	9,047
Mobile segment	63,438	66,209	65,175
Total operating profit of the Group	<u>122,240</u>	<u>122,064</u>	<u>85,264</u>
<b>Share of associates' results before income tax</b>			
Fixed line (Hungary)	691	963	2,297
Total	<u>691</u>	<u>963</u>	<u>2,297</u>

	At December 31,		
	2002	2003	2004
	(in HUF millions)		
<b>Assets</b>			
Assets of Hungarian fixed line	557,139	517,286	468,219
Associates of Hungarian fixed line	4,607	4,827	5,750
Hungarian fixed line	561,746	522,113	473,969
International fixed line	94,221	109,320	108,844
Intra-segment elimination	(360)	(879)	(369)
Fixed line segment	655,607	630,553	582,445
Hungarian mobile	358,582	357,634	362,406
International mobile	64,558	71,637	77,077
Intra-segment elimination	(1)	(1)	(42)
Mobile segment	423,139	429,270	439,441
Inter-segment elimination	(10,379)	(8,025)	(8,404)
Total segment assets	1,068,367	1,051,798	1,013,482
Unallocated assets (b)	9,084	7,039	16,076
Total assets of the Group	<u>1,077,451</u>	<u>1,058,837</u>	<u>1,029,558</u>
<b>Liabilities</b>			
Hungarian fixed line	85,056	69,138	84,801
International fixed line	9,070	5,918	4,039
Intra-segment elimination	(360)	(879)	(369)
Fixed line segment	93,766	74,177	88,472
Hungarian mobile	38,242	43,222	47,535
International mobile	3,015	2,526	3,393
Intra-segment elimination	(1)	(1)	(42)
Mobile segment	41,256	45,747	50,886
Inter-segment elimination	(10,379)	(8,025)	(8,404)
Total segment liabilities	124,643	111,899	130,954
Unallocated liabilities	377,228	316,554	321,940
Total liabilities of the Group	<u>501,871</u>	<u>428,453</u>	<u>452,894</u>
	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
<b>Capital expenditures on tangible and intangible assets</b>			
Hungarian fixed line	49,245	39,662	39,494
International fixed line	13,047	8,227	5,270
Fixed line segment	62,292	47,889	44,764
Hungarian mobile	41,532	37,131	41,440
International mobile	6,164	5,768	5,543
Mobile segment	47,696	42,899	46,983
Total capital expenditure of the Group	<u>109,988</u>	<u>90,788</u>	<u>91,748</u>

(a) Depreciation and amortization of the segments include impairment losses charged on the tangible and intangible assets of the segments. Impairment losses charged in the reported years are disclosed in notes 11 and 12.

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

*Secondary reporting format:* Matáv's fixed line and mobile segments operate in Hungary and Macedonia. The geographical segment reporting information is included in the tables below.

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
<b>Revenues</b>			
Revenues generated in Hungary	524,164	538,810	534,051
Less: inter-segment revenues	(909)	(1,322)	(682)
Revenues from external customers – Hungary	523,255	537,488	533,369
Revenues generated in Macedonia	67,562	70,014	68,352
Less: inter-segment revenues	(232)	(250)	(283)
Revenues from external customers – Macedonia	67,330	69,764	68,069
Total revenue of the Group	<u>590,585</u>	<u>607,252</u>	<u>601,438</u>
<b>Purchase of tangible and intangible assets</b>			
Hungary	90,777	76,793	80,934
Macedonia	19,211	13,995	10,813
Purchase of tangible and intangible assets of the Group	<u>109,988</u>	<u>90,788</u>	<u>91,748</u>
<b>Assets</b>			
Hungary	910,992	873,126	829,016
Macedonia	157,736	179,553	184,876
Total	1,068,728	1,052,678	1,013,893
Inter-segment elimination	(361)	(880)	(411)
Total segment assets	1,068,367	1,051,798	1,013,482
Unallocated assets	9,084	7,039	16,076
Total assets of the Group	<u>1,077,451</u>	<u>1,058,837</u>	<u>1,029,558</u>

## 5 Acquisitions

### *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 Matáv 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) on June 20, 2003 and Matáv paid EUR 21 million (HUF 5,545 million) to SEEF on July 27, 2003. In 2004, SEEF exercised its put option for the remaining 3.05% share of ownership in Stonebridge. Matáv 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 based on the provisions of IAS 22 – Business combinations, while the 2004 acquisition was accounted for based on the new IFRS 3 – Business combinations.

CosmoTelco, the other co-owner, and the Company entered into a call option agreement whereby CosmoTelco had the right to acquire additional shares in Stonebridge from Matáv such that CosmoTelco's holding could have been increased its original 7.44 percent stake in Stonebridge to 29 percent of the issued share capital of Stonebridge. The price was defined as Matáv's acquisition cost plus holding costs. Before the expiration of CosmoTelco's call option on February 8, 2002, Matáv and CosmoTelco amended the option agreement as a result of which CosmoTelco had until February 2003 to exercise its option for a 10% share in Stonebridge. Matáv paid a fee of EUR 7 million (HUF 1,715 million) in return for CosmoTelco letting the option for the remaining 11.55% share expire unexercised on February 8, 2002. In 2003, the parties agreed that CosmoTelco allowed its option to lapse, and Matáv paid EUR 2.5 million (HUF 658 million) to CosmoTelco.

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

#### Acquisition of 49% share of ownership in T-Systems Hungary

As of September 30, 2004, Matáv 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 the Deutsche Telekom Group, Matáv applied predecessor accounting. This means that Matáv 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 accounted in the shareholders' equity. The goodwill taken over from TSI's accounts is included in the value of the associate.

#### Purchase of subsidiaries and business units in the cash flow statement

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
T-Mobile Hungary	11,515	-	-
Stonebridge	-	5,545	13,355
Amounts paid to CosmoTelco for unexercised call option	1,715	658	-
T-Systems Hungary	-	-	3,430
Other	229	1,789	488
Total purchase of subsidiaries and business units	<u>13,459</u>	<u>7,992</u>	<u>17,273</u>

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

## 6 Cash and cash equivalents

	At December 31,		
	2003	2004	
	(in HUF millions)		Average interest rate
HUF	1,097	1,552	7.15%
MKD	14,669	22,110	4.81%
EUR	4,572	7,815	1.45%
Other	1,795	5,402	1.82%
	<u>22,132</u>	<u>36,879</u>	<u>3.75%</u>

	At December 31,	
	2003	2004
	(in HUF millions)	
Cash on hand	200	93
Cash in banks	9,430	36,773
Financial assets held for trading with maturities of less than 3 months	12,502	13
	<u>22,132</u>	<u>36,879</u>



## 7 Other financial assets held for trading

Other financial assets held for trading include financial instruments with maturities between three to twelve months, including embedded derivatives related to foreign exchange denominated service and rental contracts where the contract currency is not the functional currency of either of the contracting parties.

## 8 Trade and other receivables

	At December 31,	
	2003	2004
	(in HUF millions)	
Domestic trade receivables	71,584	71,498
Foreign trade receivables	21,611	19,723
Receivables from associates	746	555
Receivables from Deutsche Telekom Group companies	2,692	1,200
Advances paid for current assets	715	796
Income tax receivable	2,455	3,549
Other taxes receivable	2,530	4,259
Prepayments and accrued income	4,700	2,128
Other receivables	8,836	7,557
	115,869	111,265
Allowance for impairment loss	(20,960)	(24,276)
	<u>94,909</u>	<u>86,989</u>

The allowance for impairment loss and changes therein for 2003 and 2004 are as follows:

	At December 31,	
	2003	2004
	(in HUF millions)	
Impairment loss, beginning of period	(20,499)	(20,960)
Charged to expense (included in other operating expenses)	(4,450)	(6,082)
Utilized	3,989	2,766
Impairment loss, end of period	<u>(20,960)</u>	<u>(24,276)</u>

## 9 Inventories

	At December 31,	
	2003	2004
	(in HUF millions)	
Cables, wires and other materials	4,430	3,933
Inventory for resale	7,052	4,724
Subtotal	11,482	8,657
Less allowances for obsolete inventory	(1,485)	(988)
	<u>9,997</u>	<u>7,669</u>

## 10 Assets held for disposal

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

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

	Land	Buildings	Duct, cable and other outside plant	Telephone- exchanges	Other	Capital work in progress	Total
<i>(in HUF millions)</i>							
<b>Cost</b>							
January 1, 2004	4,413	116,366	274,922	565,806	123,094	17,140	1,101,741
Change in the Composition of the Group	-	1	-	-	275	126	402
Additions	20	3,744	9,040	38,200	10,621	(792)	60,833
Disposals	(433)	(2,766)	(1,702)	(20,161)	(8,703)	-	(33,765)
Translation adjustment	(2)	(1,014)	(2,282)	(3,863)	(1,087)	(191)	(8,439)
Reclassifications	-	-	-	-	(1,207)	-	(1,207)
December 31, 2004	<u>3,998</u>	<u>116,331</u>	<u>279,978</u>	<u>579,982</u>	<u>122,993</u>	<u>16,283</u>	<u>1,119,565</u>
<b>Depreciation</b>							
January 1, 2004	-	23,695	81,556	287,174	84,714	-	477,139
Change in the Composition of the Group	-	-	-	-	86	-	86
Charge for the year	-	3,394	11,419	66,170	17,442	-	98,425
Impairment losses	-	77	-	5,278	-	-	5,355
Disposals	-	(1,528)	(1,651)	(19,621)	(8,404)	-	(31,204)
Translation adjustment	-	(254)	(899)	(1,547)	(662)	-	(3,362)
Reclassifications	-	-	-	-	(327)	-	(327)
December 31, 2004	<u>-</u>	<u>25,384</u>	<u>90,425</u>	<u>337,454</u>	<u>92,849</u>	<u>-</u>	<u>546,112</u>
<b>Net book value</b>							
December 31, 2004	<u>3,998</u>	<u>90,947</u>	<u>189,553</u>	<u>242,528</u>	<u>30,144</u>	<u>16,283</u>	<u>573,453</u>
Of which assets held for disposal							<u>(3,063)</u>
<b>Net book value as at December 31, 2004</b>							<u><u>570,390</u></u>
<b>Net book value</b>							
December 31, 2003	<u>4,413</u>	<u>92,671</u>	<u>193,366</u>	<u>278,632</u>	<u>38,380</u>	<u>17,140</u>	<u>624,602</u>
Of which assets held for disposal							<u>(3,612)</u>
<b>Net book value as at December 31, 2003</b>							<u><u>620,990</u></u>

Change in the composition of the Group includes the assets of the companies that were acquired by Matáv in 2004.

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

Additions to property, plant and equipment are shown net of the investment tax credit related to broadband investments of HUF 6,849 million.

For more details, see note 28.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2004 the gross book value of the leased back assets is HUF 567 million and the net book value is HUF 516 million.

Included in telecommunication exchanges at December 31, 2004 are assets leased under operating lease contracts to customers with a gross book value of HUF 5,436 million (2003: HUF 7,406 million) and net book value of HUF 2,730 million (2003: HUF 3,445 million). Depreciation for the year of these assets amounted to HUF 463 million (2003: HUF 1,150 million).

Impairment losses charged in 2004 mainly relate 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. The impairment loss charged in 2004 is related to the fixed line segment.

As of January 1, 2004 the Company revised the useful lives of certain fixed assets, which resulted in a net increase to the depreciation charge of HUF 177 million for 2004. These assets include servers, software licenses, billing systems, transmission technical equipment, public phones, etc. The useful lives of these assets were revised as part of a regular practice in line with the requirements of IFRS, and have been changed to reflect technological changes since their setting into operation.

## 12 Intangible assets – net

	Concession costs and licenses	Software	Leasehold interest	Brand name	Goodwill	Total
<i>(in HUF millions)</i>						
<b>Cost</b>						
January 1, 2004	20,399	77,183	7,017	7,706	289,183	401,488
Change in the composition of the Group	-	182	-	365	8,675	9,222
Additions	17,072	17,076	169	-	-	34,317
Disposals	-	(3,988)	(423)	(7,546)	-	(11,957)
Translation adjustment	(41)	(945)	-	-	-	(986)
Reclassification	-	1,207	-	-	-	1,207
December 31, 2004	37,430	90,715	6,763	525	297,858	433,291
<b>Amortization</b>						
January 1, 2004	6,869	41,453	4,031	2,839	57,062	112,254
Change in the composition of the Group	-	31	-	-	-	31
Charge for the year	1,638	13,073	527	346	13,876	29,460
Impairment losses	-	-	-	4,426	-	4,426
Disposals	-	(3,986)	(404)	(7,546)	-	(11,936)
Translation adjustment	(28)	(294)	-	-	-	(322)
Reclassification	-	327	-	-	-	327
December 31, 2004	8,479	50,604	4,154	65	70,938	134,240
<b>Net book value</b>						
December 31, 2004	28,951	40,111	2,609	460	226,920	299,051
<b>Net book value</b>						
December 31, 2003	13,530	35,730	2,986	4,867	232,121	289,234

Change in the composition of the Group includes the assets of the companies that were acquired by Matáv in 2004 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.

On March 22, 2004, the Board of Matáv decided to rename the Hungarian mobile subsidiary from Westel to T-Mobile Hungary. As a result of the decision, the carrying value of the capitalized Westel brand name had to be impaired and then de-recognized as the renaming was completed by June 5, 2004.

## 13 Purchase of tangible and intangible assets

	<i>For the year ended December 31,</i>		
	2002	2003	2004
<i>(in HUF millions)</i>			
Additions to property, plant and equipment	84,906	70,767	60,833
Additions to intangible assets	13,033	17,506	34,317
Total additions to tangible and intangible assets	97,939	88,273	95,150
Recognition of investment tax credit (note 28)	-	-	6,849
Change in payables relating to capital expenditures	12,049	2,515	(10,251)
	109,988	90,788	91,748

## 14 Associates

	For the year ended December 31,	
	2003	2004
	(in HUF millions)	
Opening balance of associates	4,607	4,827
Additions to associates	-	1,761
Share of associates' profit before tax	963	2,297
Share of associates' corporate tax	(168)	(401)
Disposal of associates	-	(101)
Dividend payments	(575)	(2,633)
Closing balance of associates	<u>4,827</u>	<u>5,750</u>

## 15 Other non-current assets

	At December 31,	
	2003	2004
	(in HUF millions)	
Employee loans	3,158	3,515
Other loans receivable	3,489	326
Derivative instruments	-	435
Other	<u>1,411</u>	<u>2,388</u>
	<u>8,058</u>	<u>6,664</u>

## 16 Financial instruments

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

In connection with the acquisition of the 44% stake in MakTel and the remaining 49% of T-Mobile Hungary in 2001, Matáv received loans from Deutsche Telekom International Finance B.V. (DTIF). In 2002, Matáv entered into several swap agreements with Deutsche Telekom AG in order to exchange the cash flows of the EUR loans payable to HUF cash flows.

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 and 2004 were limited to foreign currency forward contracts. In addition, Matáv has derivative financial instruments embedded in host contracts. These instruments are measured and disclosed according to IAS 39.

The net carrying amounts of current financial assets including cash and cash equivalents, other financial assets held for trading, and trade and other receivables 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, which approximates their fair values.

The fair value of liabilities other than loans and other borrowings approximate their carrying values due to their relatively short maturity. For the fair value of loans and other borrowing see note 18.

## 17 Derivative financial liabilities

Derivative financial liabilities as at December 31, 2003 included the fair value of the embedded derivative financial instruments. At December 31, 2004 the fair value of derivatives was positive, therefore, is included in the assets (notes 7 and 15). Embedded derivatives mainly included foreign exchange denominated service and rental contracts where the contract currency is not the functional currency of either of the contracting parties.



## 18 Loans and other borrowings

Note	At December 31,	
	2003	2004
	(in HUF millions)	
Current loans from related parties	126,644	60,000
Non current loans from related parties	73,675	177,675
Total loans from related parties	(a) 200,319	237,675
Current bank loans	65,685	34,161
Non current bank loans	46,625	47,266
Total bank loans	(b) 112,310	81,427
Current other borrowings	607	377
Non current other borrowings	1,044	1,129
Total other borrowings	1,651	1,506
Total third party loans and other borrowings	113,961	82,933
Total loans and other borrowings	314,280	320,608

At December 31, 2004, principal repayments fall due in:

Year	Maturity at December 31,	
	2003	2004
	(in HUF millions)	
2004	192,936	-
2005	15,660	94,538
2006	97,007	103,538
2007	5,163	25,673
2008	3,042	23,053
2009	-	33,063
Thereafter	472	40,743
Total loans and other borrowings	314,280	320,608

The effective borrowing cost (total interest payable and other charges) for Matáv's loans and borrowings was 11.9% in 2004 (11.9% in 2003, 7.0% in 2002). The weighted average interest rate on borrowings was 10.9% in 2004 (7.5% in 2003, 6.4% in 2002).

### (a) Loans from related parties

All the related party loans are taken from DTIF, and are denominated in HUF. The table below shows the details of the loans outstanding as at December 31, 2004.

Amount (HUF millions)	Interest rate (%)	Fixed / variable	Repayable
40,000	10.53	variable	May 2012
20,000	10.35	variable	May 2008
73,675	9.36	fixed	Jan 2006
40,000	10.95	fixed	May 2005
25,000	9.61	fixed	Oct 2009
20,000	11.16	fixed	Jan 2005
14,000	10.20	fixed	May 2007
5,000	9.68	fixed	Sep 2009
Total	237,675		

(b) **Bank loans**

All loans are denominated in HUF at December 31, 2003 and 2004.

Loans totaling HUF 25,581 million at December 31, 2004 are revolving loans (HUF 38,913 million in 2003) 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 15,500 million (HUF 40,550 million in 2003) being due and payable in 30 days if not remedied. At December 31, 2004 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 rates of bank loans as at December 31, 2004.

	Maturities					Total
	2005	2006	2007	2008	2009	
	(in HUF millions, except percentages)					
Bank loans (HUF denominated)						
Variable rate	34,161	29,141	12,125	3,000	3,000	81,427
Average interest rate	10.06%	10.37%	10.37%	11.16%	9.77%	10.25%

(c) **Fair values**

The following table is a summary of Matáv's market sensitive debt instruments, including fair value calculated using the discounted cash flow method.

	At December 31,			
	2003		2004	
	(in HUF millions)			
	Book value	Fair value	Book value	Fair value
Bank loans				
Fixed rate	14,500	15,202	-	-
Variable rate	97,810	97,810	81,427	81,427
Total bank loans	112,310	113,012	81,427	81,427
Related party loans				
Fixed rate	150,318	147,683	177,675	178,997
Variable rate	50,000	50,000	60,000	60,000
Total related party loans	200,318	197,683	237,675	238,997

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

(d) **Credit facilities and pledges**

At December 31, 2004, Matáv had un-drawn committed credit facilities of HUF 40,664 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 440 million.

## 19 Trade and other payables

	At December 31,	
	2003	2004
	(in HUF millions)	
Domestic trade payables	46,744	46,066
Foreign trade payables	6,155	6,183
UMTS license fee payable	-	11,500
Salaries and wages	9,670	10,175
Other taxes and social security	9,351	8,305
Amounts received in advance	8,314	6,380
Accrued expenses and prepayments	4,132	5,457
Accrued interest to DTIF	4,674	5,491
Accrued interest to third parties	1,022	906
Amounts owed to DT Group companies	1,561	2,321
Payables to associates	143	1,621
Income tax payable	506	52
Dividends payable	50	61
Other payables	9,051	5,455
	<u>101,373</u>	<u>109,973</u>

## 20 Deferred revenue

	At December 31,	
	2003	2004
	(in HUF millions)	
Beginning of period	7,178	4,446
Amortization	<u>(2,732)</u>	<u>(1,758)</u>
End of period	<u>4,446</u>	<u>2,688</u>
Amount to be recognized within one year	1,971	1,502

## 21 Provision for liabilities and charges

	Severance	Customer loyalty programs	Other	Total
	(in HUF millions)			
January 1, 2004	1,570	1,453	3,476	6,499
Amounts utilized / retired	<u>(1,570)</u>	<u>(1,453)</u>	<u>(1,699)</u>	<u>(4,722)</u>
Additions	<u>13,022</u>	<u>1,785</u>	<u>1,714</u>	<u>16,521</u>
December 31, 2004	<u>13,022</u>	<u>1,785</u>	<u>3,491</u>	<u>18,298</u>
Less: non current portion	<u>(1,491)</u>	<u>(1,215)</u>	<u>(55)</u>	<u>(2,761)</u>
Current provision	<u>11,531</u>	<u>570</u>	<u>3,436</u>	<u>15,537</u>

The provision for severance as at December 31, 2004 relates to the employee termination in 2005 and 2006 in accordance with the agreement made with employee representatives in 2004.

The number of employees impacted by the headcount reduction in 2005 and 2006 is approximately 1,900 and includes mostly network and back office personnel.

The total payment made in relation to employee termination in 2004 amounted to HUF 7,549 million, of which HUF 1,570 million was charged against the provision for liabilities and charges as at December 31, 2003, while the rest was recognized as employee related expense in 2004.

The total payment made in relation to employee termination in 2003 amounted to HUF 9,200 million, of which HUF 8,099 million was charged against the provision for liabilities and charges as at December 31, 2002, while the rest was recognized as an expense in 2003.

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

Other provisions include liabilities deriving mainly from legal cases and tax revisions.

## 22 Minority interests

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

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Beginning of period	48,169	59,436	70,274
Acquisition of additional Stonebridge shares (note 5)	-	(1,871)	(6,914)
Other new acquisitions and minority bought out	1,254	105	(2,195)
Share of results for the year	13,639	11,865	8,686
Dividends paid / payable to minority shareholders	(56)	(4,796)	(5,651)
CosmoTelco option	(1,126)	(658)	-
Cumulative translation adjustment	(2,444)	6,193	(4,103)
End of period	<u>59,436</u>	<u>70,274</u>	<u>60,097</u>

## 23 Revenues – fixed line services

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Subscriptions, connections and other charges	108,073	109,063	106,224
Outgoing domestic traffic revenues	135,562	131,659	112,381
Outgoing international traffic revenues	17,285	13,096	12,255
Total outgoing traffic revenues	<u>152,847</u>	<u>144,755</u>	<u>124,636</u>
Incoming domestic traffic revenues	15,024	10,797	5,883
Incoming international traffic revenues	22,764	20,024	15,781
Total incoming traffic revenues	<u>37,788</u>	<u>30,821</u>	<u>21,664</u>
Leased lines and data transmission	36,117	41,502	50,976
Equipment sales	3,648	3,249	3,678
Other revenues	29,748	29,265	26,996
Total fixed line revenues	<u>368,221</u>	<u>358,655</u>	<u>334,174</u>

Included in other revenues in 2003 is HUF 6,032 million (HUF 6,061 million in 2002) of subsidies from the Universal Telecommunication 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.

## 24 Revenues – mobile services

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Network usage and access	178,917	193,322	208,193
Enhanced services	19,769	28,037	31,945
Equipment sales	18,679	23,109	24,549
Activation fees	2,097	1,534	820
Other revenues	2,902	2,596	1,757
Total mobile revenues	<u>222,364</u>	<u>248,597</u>	<u>267,264</u>

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



## 25 Employee related expenses

Matáv had 13,724 full time equivalent employees at December 31, 2004, while at the end of 2003 the number of employees was 14,710.

Employee related expenses include salaries, bonuses, contributions to defined contribution pension and other welfare funds, social security and other employee related taxes as well as termination benefits payable to employees. For more details on termination benefits, see note 21.

Payments to defined contribution pension plans are included in employee related expenses and amounted to HUF 2,712 million in 2004 (HUF 2,537 million in 2003 and HUF 2,218 million in 2002).

## 26 Other operating expenses – net

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Materials, maintenance and service fees	57,538	57,992	58,104
Subcontractors and agent commissions	18,098	21,792	22,491
Fees and levies	24,014	23,833	20,268
Marketing	13,514	16,902	22,189
Consulting	7,483	6,102	7,082
Rental fees	6,348	6,338	6,716
Impairment losses on receivables	4,972	4,450	6,082
Other expenses	3,551	6,265	3,448
Total expenses	135,518	143,674	146,380
Other income	-	-	(5,920)
	<u>135,518</u>	<u>143,674</u>	<u>140,460</u>

Other income includes compensation received from Deutsche Telekom AG for the loss of value incurred in discontinuation of the Westel brand name.

Contributions payable to the Universal Telecommunication Support Fund were accrued as part of Fees and levies in 2002 (HUF 5,064 million) and in 2003 (HUF 5,098 million). According to the decision of the National Communications Authority on the actual amounts payable, HUF 1,353 million of the accruals was reversed in 2004 on the same line as the expenses. As the Fund was not operational with respect to 2004, no additional amounts payable were accrued in 2004.

The remuneration of the members of the Company's Board of Directors amounted to HUF 9 million in 2004 (HUF 9 million in 2003, HUF 7 million in 2002). The remuneration of the members of the Company's Supervisory Board amounted to HUF 10 million in 2004 (HUF 9 million in 2003, HUF 7 million in 2002).

## 27 Net financial expenses

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Interest expense:			
HUF	14,173	21,315	34,611
Foreign currency	12,459	4,469	120
(Gains) / losses on derivative financial instruments	9,435	972	(647)
Net foreign exchange losses / (gains)	(10,948)	8,799	523
Other financial expenses	3,686	5,364	3,183
Total financial expenses	28,805	40,919	37,790
Interest capitalized	(226)	(41)	-
Interest and other financial income	(660)	(876)	(1,644)
	<u>27,919</u>	<u>40,002</u>	<u>36,146</u>

## 28 Income tax

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Income tax charge on the profit for the year	(15,113)	(12,259)	(9,352)
Deferred income taxes	2,004	(1,258)	1,665
Income tax on the Group's share of the results of associates	(136)	(168)	(401)
Income tax expense	<u>(13,245)</u>	<u>(13,685)</u>	<u>(8,088)</u>

The Company and T-Mobile Hungary qualified for a reduction in income tax payable on meeting certain conditions. The reduction in the tax payable amounted to a 100% allowance for five years from the date of qualification, and a 60% allowance for a further five years. Through 1998, Matáv Rt. and T-Mobile qualified for the 100% allowance. From January 1, 1999, Matáv Rt. utilized the reduced allowance of 60% (effective tax rate of 7.2%), 2003 being the last year of tax reduction.

In order to increase broadband internet penetration in Hungary, the Hungarian Government decided that companies investing over HUF 100 million in internet broadband assets (e.g. ADSL lines) in 2003 and in 2004 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 internet assets. In 2004 Matáv invested HUF 8.9 billion (HUF 6.6 billion in 2003) in broadband assets. As a result of this new tax incentive, Matáv Rt. is entitled to a total corporate tax reduction of HUF 6,849 million (HUF 3,879 million from 2004 and HUF 2,970 million from 2003), which can be used by Matáv Rt. in the years 2003–2008, of which Matáv used HUF 33 million in 2003. As the recoverability of these tax credits was uncertain in 2003, no deferred tax asset was recognized in 2003. Due to the change of the assessment of the recoverability, Matáv recognized a deferred tax asset of HUF 6,849 in 2004. As these investment tax credits are of a governmental grant nature, Matáv recognized the deferred tax asset against the cost of the related investment (notes 11 and 13).

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 Group were amended accordingly at the end of 2003.

Deferred taxes have been recognized for all temporary differences arising on the valuation of investments in subsidiaries and associates in the parent companies' books.

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 5,334 million will expire in 2006, HUF 4,418 million in 2007 and HUF 2,298 million in 2008. The remaining balance of the recognized tax losses of HUF 2,809 million is not subject to statutory limitations.

Matáv's deferred tax balances are as follows:

	Balance at December 31, 2003	Income statement effect	Other movements	Balance at December 31, 2004
	(in HUF millions)			
<b>Deferred tax assets and (liabilities)</b>				
Net operating loss carry-forward	2,377	1,344	-	3,721
Investment tax credits	-	-	6,849	6,849
Investments in subsidiaries	(500)	(832)	(2)	(1,334)
Impairment of receivables, inventory and financial investments	3,142	381	(59)	3,464
Property, plant and equipment and intangible assets	(3,725)	(1,050)	(20)	(4,795)
Financial assets held for trading	(36)	(104)	-	(140)
Trade and other payables	(61)	144	(2)	81
Loans and other borrowings	221	(16)	-	205
Deferred revenue	616	(236)	-	380
Provisions for liabilities and charges	782	2,034	-	2,816
Total net deferred tax assets	2,816	1,665	6,766	11,247
Add back: deferred tax liability	1,768			1,280
Deferred tax assets	<u>4,584</u>			<u>12,527</u>

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

Included in other movements HUF 6,849 million is due to the recognition of the investment tax credit against the cost of the related assets constructed. The remaining amount includes currency translation adjustments of HUF -24 million and HUF -59 million deferred tax arising on the consolidation of subsidiaries acquired in 2004.

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,		
	2002	2003	2004
	(in HUF millions)		
IFRS profit before income tax	95,012	83,025	51,415
Tax at 18%	(17,102)	(14,945)	-
Tax at 16%	-	-	(8,226)
Effect of reduced tax rates	2,686	567	191
Impact of tax rate change from 18% to 16% enacted for 2004	-	(296)	-
Impact of tax incentives	1,015	901	584
Tax on items not subject to tax	1,012	1,745	1,953
Tax effect of recognition / (non-recognition) of tax losses	1,925	-	-
Tax on non deductible expenses	(2,837)	(2,586)	(2,189)
Temporary differences reversing at different rates	192	1,097	-
Income tax expense (before associates' tax)	(13,109)	(13,517)	(7,687)
Share of associates tax expense	(136)	(168)	(401)
Income tax expense	<u>(13,245)</u>	<u>(13,685)</u>	<u>(8,088)</u>

Items not subject to income tax consist primarily of amortization of connection fees deferred before July 1995 to revenue as well as the share of associates' profit before income tax as the results of the associates are not included in the reconciliation.

## 29 Cash generated from operations

	For the year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Net income	68,128	57,475	34,641
Minority interest	13,639	11,865	8,686
Income tax expense	13,245	13,685	8,088
Share of associates' results before income tax	(691)	(963)	(2,297)
Net financial expenses	27,919	40,002	36,146
Depreciation and amortization	122,741	128,334	137,666
Change in payables	(4,454)	2,885	(3,474)
Change in inventory	552	4,117	2,825
Change in receivables	(1,092)	(2,168)	4,500
Amortization of deferred revenue	(3,353)	(2,732)	(1,758)
Bank and other finance charges paid	(3,296)	(5,364)	(3,183)
Other cash flows from operations	6,198	(6,639)	12,841
Cash generated from operations	<u>239,536</u>	<u>240,497</u>	<u>234,681</u>

## 30 Share-based compensation

### Share option plans

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 the maximum of one-third of the shares that can be purchased under the relevant option (first tranche) could be exercised from July 1, 2003 until the end of the term. No options were exercised in 2003 and 2004 as they were out of the money through the period.

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

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

In addition to the above plan, the CEO of Matáv has been granted share options every year starting 2000. 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. The options granted in 2004 had an intrinsic value of HUF 63 million. One third of the options granted vest after one year, another one third vests 2 years after the grant date, while the last third vest after 3 years. The options are exercisable for 10 years after the grant date.

No compensation expense has been recognized in these financial statements for the fair value of the options described above.

#### Mid-term incentive plan (MTIP)

In 2004 Matáv launched a Mid Term Incentive Program (MTIP) for its top management, whereby the targets to be achieved are based on the performance of the Matáv 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. Participants in the first tranche are employees of Matáv Group 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 Matáv – share specific and a relative Index target.

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

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

The plan participants shall receive the grant amount in full, if both performance targets are achieved and only one half of the sum shall be paid if only one performance target is achieved. If neither of the performance targets is achieved, no payment shall be paid.

Payments granted on the basis of the first program tranche shall take place after December 31, 2006, i.e. the official evaluation of the achievement of the targets.

The compensation costs accrued in 2004 for the MTIP is HUF 70 million included in employee related expenses.

## 31 Commitments

### (a) Lease commitments

Finance leases in 2004 relate to the sale and lease back of spaces in buildings accommodating switches. Future minimum lease payments under finance and operating leases at December 31, 2003 and 2004 are as follows:

Year	Financial Leases at December 31,	
	2003	2004
	(in HUF millions)	
2004	347	-
2005	104	150
2006	104	137
2007	104	137
2008	104	137
2009	520	137
Thereafter	-	554
Total minimum lease payments	1,283	1,252
Less: amounts representing interest	(558)	(604)
Present value of net minimum lease payments	725	648
Less: finance lease obligations included in short-term debt	250	45
Long-term finance lease obligations	475	603

Operating lease commitments were mainly in respect of the lease of buildings, network and other telecommunications facilities including cell sites.

Year	Operating Leases	
	at December 31,	
	2003	2004
	(in HUF millions)	
2004	4,825	-
2005	3,606	5,283
2006	3,436	4,932
2007	3,108	4,583
2008	2,807	4,157
2009	4,005	3,241
Thereafter	-	2,984
Total minimum lease payments	<u>21,787</u>	<u>25,180</u>

**(b) Purchase commitments**

As of December 31, 2004, Matáv had contractual commitments for capital expenditures of HUF 6.1 billion (HUF 3.4 billion in 2003, HUF 7.5 billion in 2002) falling due within 1 year.

**32 Future lease revenues**

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

Year	Lease revenues
	(in HUF millions)
2005	4,222
2006 – 2008	5,569
2009 and thereafter	341
Total minimum lease payments receivable	<u>10,132</u>

**33 Related party transactions**

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

**Deutsche Telekom Group**

Deutsche Telekom (DT) is the majority owner of Matáv. DT Group has a number of fixed line and mobile telecom service provider subsidiaries worldwide, with whom Matáv Group has regular transactions.

The Company is majority owned by MagyarCom GmbH (59.21%), which is owned by Deutsche Telekom AG. Matáv pays dividends annually to its owners including MagyarCom GmbH. These payments are made throughout the year resulting in no outstanding payable at the end of the years.

MagyarCom Services Kft., a Hungarian company owned by Deutsche Telekom, provides Matáv 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 Matáv.

Deutsche Telekom AG (DTAG) entered into cross-currency swap agreements with Matáv in 2002, the fair values of which were included in the 2002 balance sheet. In 2004, DTAG compensated Matáv for the loss in value incurred in relation to the renaming of Westel to T-Mobile Hungary. The compensation received was recognized as other operating income in the "other operating expenses – net" caption of the income statement (note 26).



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

	2002	2003	2004
	(in HUF millions)		
Revenues from telecommunication services provided to DT Group	7,589	8,682	6,921
Costs of telecommunication services provided by DT Group	(4,852)	(4,955)	(6,289)
Consulting expenses to MagyarCom Services Kft.	(2,028)	(1,287)	(1,488)
Other income from DTAG for renaming of Westel to T-Mobile Hungary	-	-	5,920
Interest expense to DTIF	(13,654)	(15,009)	(23,271)
Derivative interest paid to DTAG	(5,040)	(3,219)	-
Dividends paid to MagyarCom GmbH	(6,792)	(11,114)	(43,246)
Accounts receivable from DT Group	1,731	2,692	1,200
Accounts payable to MagyarCom Services Kft.	(573)	(456)	(410)
Accounts payable to other DT Group companies	(833)	(1,105)	(1,911)
Accrued interests payable to DTIF	(4,298)	(4,674)	(5,491)
Loans payable to DTIF	(236,446)	(200,319)	(237,675)

Deutsche Telekom has pledged its support for Matáv's financing needs through to June 30, 2006.

#### Governments

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

#### 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. Costs incurred by Matáv related to these services and paid to Hunsat amounted to HUF 94 million in 2004 (HUF 114 million in 2003 and HUF 160 million in 2002). In 2004 Matáv received advance dividend from Hunsat, which is accounted for as a payable to Hunsat until the General Assembly of Hunsat approves the dividend. This advance dividend is shown as a payable to associates in an amount of HUF 1,090 million as at December 31, 2004. Revenues from Hunsat, receivables and other payables are insignificant for all the three reported periods.

M-RTL is a Hungarian television broadcast company, in which Matáv has a 25% effective share of ownership. M-RTL sells airtime through media agencies to Matáv, and Matáv provides telecom services to M-RTL through an interactive service provider, therefore the direct operating transactions between M-RTL and the Group are insignificant. However at December 31, 2004 Matáv has HUF 500 million dividend receivable from M-RTL.

T-Systems Hungary (TSH) is an associated company of Matáv, in which the Company acquired a 49% share of ownership in September 30, 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 in the period when TSH was an associate of Matáv. 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.

#### 34 Subsequent event

On January 14, 2005 the Montenegrin Privatization Agency announced Matáv to be the winner of the tender issued for the sale of a 51.2% stake in the Montenegrin Telecommunications Company (TCG). Matáv in its binding bid offered EUR 114 million for the 51.2% stake put up for the tender. Matáv also offered to buy 100% of the TCG shares for a total amount of EUR 165 million. This allowed Matáv to enter into exclusive negotiations with the Government for the privatization of TCG. TCG is the incumbent fixed line service provider of Montenegro with a 100% owned mobile telecom service provider subsidiary, Monet. TCG is also the 100% owner of Internet Crne Gore, the leading Montenegrin internet service provider company. The share purchase agreement is expected to be concluded before June 2005, from which date these companies would become the consolidated members of Matáv Group.

## 35 Recent Accounting Pronouncements

### IFRS 2 – Share Based Payments

The objective of IFRS 2 is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. In particular, it requires an entity 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. An entity shall recognize the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received.

The entity shall recognize a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction. When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognized as expenses.

Matáv adopted IFRS 2 for its new incentive plan, the MITP (note 30), which did not result in a material impact on its financial statements.

### IFRS 3 – Business Combinations

The objective of IFRS 3 is to specify the financial reporting by an entity when it undertakes a business combination. In particular, it specifies that all business combinations should be accounted for by applying the purchase method. Therefore, the acquirer recognizes the acquiree's identifiable assets, liabilities and contingent liabilities at their fair values at the acquisition date, and also recognizes goodwill, which is subsequently tested for impairment rather than amortized.

The major impact of adopting IFRS 3 in Matáv's financial statements will be the discontinuation of the goodwill amortization from January 1, 2005. For acquisitions after March 31, 2004 Matáv already applied the provisions of IFRS 3, as required by the standard. Further change will be that IFRS 3 allows the recognition of certain intangible assets on acquisitions that were not separate from goodwill in the past when applying the provisions of IAS 22 – Business Combinations.

### IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations

The objective of IFRS 5 is to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. In particular, the IFRS requires: (a) assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and (b) assets that meet the criteria to be classified as held for sale to be presented separately on the face of the balance sheet and the results of discontinued operations to be presented separately in the income statement.

The application of IFRS 5 in Matáv's financial statements will not have a material impact as Matáv has not discontinued significant operations and does not plan to do so in the future either. In addition, Matáv has always classified its assets held for disposal separately, and these assets have been measured at the lower of carrying amount and fair value less cost to sell.

### Revision of existing IASs

The IASB revised a number of existing standards, none of which will have a material impact on Matáv's financial statements as the currently applied recognition and measurement principles are not, or not significantly different from those required in the revised standards.

# Reconciliation to U.S. GAAP

## (Unaudited)

Matáv's consolidated financial statements are prepared in accordance with International Financial Reporting Standards, which differ in certain respects from U.S. GAAP, the 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 net income for each of the three years in the period ended December 31, 2004 and total shareholders' equity as of December 31, 2003 and 2004.

	Note	For the year ended December 31,		
		2002	2003	2004
		(in HUF millions, except per share amounts)		
Net income under IFRS		68,128	57,475	34,641
Adjustments for U.S. GAAP:				
Revenue recognition	(a)	2,456	3,712	4,749
Severance provision	(b)	-	-	950
Amortization of intangible assets	(c)	(6,455)	(6,720)	(6,976)
Amortization of goodwill	(d)	14,344	13,795	13,876
Asset retirement obligation	(e)	-	(136)	(871)
Options	(f)	(155)	(1,012)	1,226
Compensation received for renaming of Westel to T-Mobile Hungary	(g)	-	-	(5,920)
Deferred income tax on U.S. GAAP adjustments		(627)	(652)	(1,437)
Minority interest impact of U.S. GAAP adjustments		462	(358)	(907)
Net income under U.S. GAAP		<u>78,153</u>	<u>66,104</u>	<u>39,331</u>
Basic earnings per share under U.S. GAAP		75.32	63.69	37.72
Diluted earnings per share under U.S. GAAP		75.32	63.69	37.72

	Notes	At December 31,	
		2003	2004
		(in HUF millions)	
Shareholders' equity under IFRS		560,110	516,567
Adjustments for U.S. GAAP:			
Revenue recognition	(a)	(11,434)	(6,685)
Severance provision	(b)	-	950
Amortization of intangible assets	(c)	(14,583)	(21,559)
Amortization of goodwill	(d)	29,535	43,411
Asset retirement obligation	(e)	(136)	(1,007)
Options	(f)	(1,167)	59
Deferred income tax on U.S. GAAP adjustments		(57)	(1,494)
Minority interest		1,363	456
Shareholders' equity under U.S. GAAP		<u>563,631</u>	<u>530,698</u>

### (a) Revenue recognition

In Matáv'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. Directly related expenses of the connections and activations were also deferred up to the amount of the revenues.

As of January 1, 2004 Matáv adopted EITF 00-21 and SAB 104 in its U.S. GAAP accounts, according to which connections and activations are no longer considered separate earnings events, but one element of a package comprising multiple deliverables. Revenues from multiple deliverable packages are recognized in proportion of the relative fair values of the individual elements. 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.).

**(b) Severance provision**

Certain severance related expenses recognized as a provision in the IFRS financial statements related to redundancies in 2005 and 2006 do not meet the criteria to be recognized as a liability in U.S. GAAP (SFAS 146). These expenses will be recognized in 2005 in the U.S. GAAP accounts.

**(c) Intangible assets**

Due to the different revenue and intangible asset recognition rules of IFRS and U.S. GAAP, the shareholders' equity of T-Mobile, MakTel and Emitel on acquisition was different, consequently the goodwill and the value of customer base on acquisition and their amortization are different.

**(d) Goodwill**

According to SFAS 141 and 142, goodwill is not amortized under U.S. GAAP in the 3-year period presented, which results in further differences between the IFRS and U.S. GAAP accounts.

**(e) Asset retirement obligation**

On January 1, 2003 Matáv 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 fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset.

The net book value of the obligation capitalized as part of the value of the related asset as at January 1, 2003 and the fair value of the obligation as at January 1, 2003 was equal, no cumulative effect of adopting the standard resulted in an income statement impact. The asset retirement obligation adjustment in the reconciliation tables reflects the net impact of the movements in the asset and provision balances in 2003 and 2004.

**(f) Options**

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 Matáv in consolidated subsidiaries. The accounting treatment for these options differs in certain cases under IFRS and U.S. GAAP. These valuation differences result in U.S. GAAP adjustments.

**(g) Compensation received for renaming of Westel to T-Mobile Hungary**

The Company's mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004. The loss of value caused by discontinuing the Westel brand and the expenditure incurred in connection with the launch and promotion of the new brand was compensated in value Deutsche Telekom AG. The compensation received for the loss of value is shown as other income and the write off of the old brand and the costs of launching and promoting the new brand are shown gross as amortization and other expenses respectively in the IFRS income statement.

Under U.S. GAAP, the Company is required to recognize the brand name write off and the additional costs mentioned above and a concurrent contribution of capital by the majority shareholder for these costs in accordance with APB 25 and SAB Topic 5-T.

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## **FINANCIAL CALENDAR 2005**

<b>FEBRUARY 11, 2005</b>	Release of 2004 full year results
<b>FEBRUARY 22, 2005</b>	Extraordinary General Meeting of shareholders
<b>APRIL 27, 2005</b>	Annual General Meeting of shareholders
<b>MAY 12, 2005*</b>	Release of 2005 1 <sup>st</sup> quarter results
<b>AUGUST 11, 2005*</b>	Release of 2005 1 <sup>st</sup> half results
<b>NOVEMBER 10, 2005*</b>	Release of 2005 1 <sup>st</sup> nine months results

\* Planned date

## **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 20F for the year ended December 31, 2004 to be filed with the U.S. Securities and Exchange Commission.

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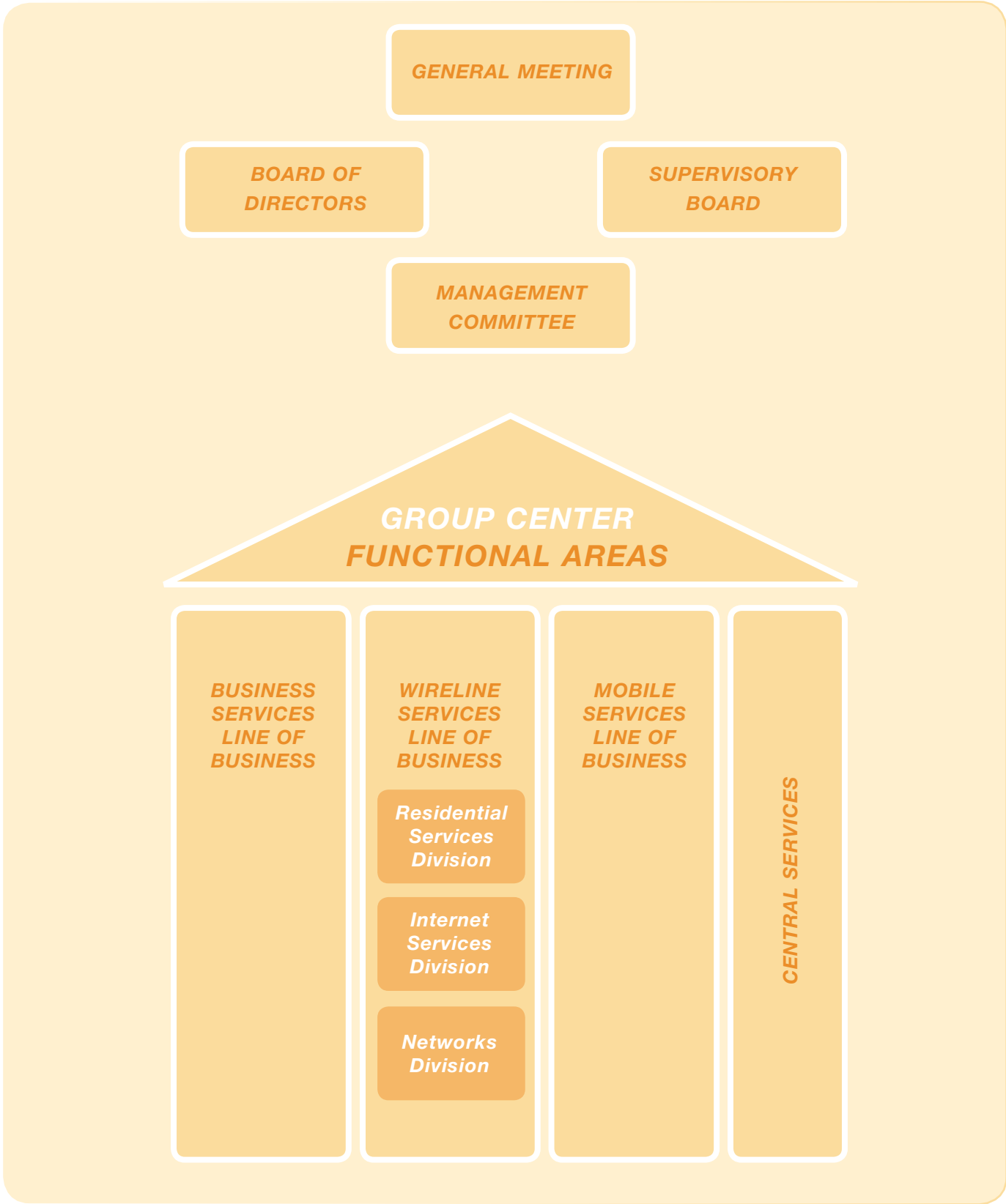
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# Organization model of the Matáv Group





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