Magyar Telekom Telecommunications
Public Limited Company

Consolidated Financial Statements

FOR THE YEAR ENDED DECEMBER 31, 2006

Prepared in accordance with
International Financial Reporting Standards
(IFRS)

MAGYAR TELEKOM

INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF MAGYAR TELEKOM PLC.**

MAGYAR TELEKOM

CONSOLIDATED BALANCE SHEETS

	Notes	At December 31, HUF 2005 as restated (Note 2.1)	HUF 2006	USD 2006 (unaudited – Note 2.1)
		(in HUF millions)		(million USD)
ASSETS				
Current assets				
Cash and cash equivalents	6	46,060	77,840	406
Other financial assets	7	1,817	2,692	14
Trade and other receivables	8	95,956	104,016	543
Current income tax receivable	9	1,679	6,735	35
Inventories	10	8,414	10,460	54
Assets held for disposal	11	2,302	6,825	36
Total current assets		156,228	208,568	1,088
Non current assets				
Property, plant and equipment – net	12	580,736	550,900	2,875
Intangible assets – net	13	319,797	331,740	1,731
Investments in associates	14	5,118	5,771	30
Deferred tax assets	9	14,966	9,575	50
Other non current assets	15	6,103	25,041	131
Total non current assets		926,720	923,027	4,817
Total assets		1,082,948	1,131,595	5,905
LIABILITIES				
Current liabilities				
Loans from related parties	16	74,648	74,000	386
Loans and other borrowings – third party	17	43,602	29,605	155
Trade and other payables	18	119,464	200,589	1,047
Current income tax payable	9	1,472	1,736	9
Deferred revenue	19	918	234	1
Provision for liabilities and charges	20	6,817	8,414	44
Total current liabilities		246,921	314,578	1,642
Non current liabilities				
Loans from related parties	16	212,000	185,432	968
Loans and other borrowings – third party	17	14,215	20,697	108
Deferred revenue	19	267	170	1
Deferred tax liabilities	9	3,189	5,647	29
Provision for liabilities and charges	20	3,141	3,344	17
Other non current liabilities	18	5,521	8,560	45
Total non current liabilities		238,333	223,850	1,168
Total liabilities		485,254	538,428	2,810
EQUITY				
Shareholders' equity				
Common stock		104,281	104,277	544
Additional paid in capital		27,382	27,380	143
Treasury stock		(1,926)	(1,504)	(8)
Cumulative translation adjustment		(420)	(1,474)	(8)
Revaluation reserve for available for sale financial assets – net of tax		149	-	-
Reserve for equity settled share based transactions		119	49	-
Retained earnings		397,982	397,311	2,074
Total shareholders' equity		527,567	526,039	2,745
Minority interests		70,127	67,128	350
Total equity		597,694	593,167	3,095
Total liabilities and equity		1,082,948	1,131,595	5,905

These consolidated financial statements were authorized for issue by the Board of Directors on March 22, 2007 and signed on their behalf by:

Christopher Mattheisen Chairman and Chief Executive Officer	Thilo Kusch Chief Financial Officer

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

MAGYAR TELEKOM

CONSOLIDATED INCOME STATEMENTS

	Notes	For the year ended December 31, HUF 2004 as restated (Note 2.1)	2005 as restated (Note 2.1)	2006	USD 2006 (unaudited – Note 2.1)
		(in HUF millions, except per share amounts)			(million USD)
Fixed line services	21	331,983	329,206	343,866	1,795
Mobile services	22	264,809	285,848	327,330	1,708
Revenue		596,792	615,054	671,196	3,503
Employee related expenses	23	(109,497)	(92,783)	(95,253)	(497)
Depreciation and amortization		(137,666)	(114,686)	(122,249)	(638)
Payments to other network operators		(87,483)	(88,587)	(93,154)	(486)
Cost of telecommunications equipment sales		(40,971)	(37,221)	(59,714)	(312)
Other operating expenses	25	(134,577)	(148,032)	(168,010)	(877)
Operating expenses		(510,194)	(481,309)	(538,380)	(2,810)
Other operating income	26	7,121	8,009	3,575	19
Operating profit		93,719	141,754	136,391	712
Finance expenses	27	(37,914)	(34,497)	(30,102)	(157)
Finance income	28	1,768	2,996	4,692	24
Share of associates' profits	14	1,896	330	703	4
Profit before income tax		59,469	110,583	111,684	583
Income tax expense	9	(16,142)	(21,858)	(24,220)	(126)
Profit for the year		43,327	88,725	87,464	457
Attributable to:					
Equity holders of the Company (Net income)		34,641	78,415	75,453	394
Minority interests		8,686	10,310	12,011	63
		43,327	88,725	87,464	457
Earnings per share (EPS) information:					
Profit attributable to the equity holders of the Company		34,641	78,415	75,453	394
Weighted average number of common stock outstanding (thousands) used for basic EPS		1,037,912	1,038,803	1,040,321	
Average number of dilutive share options (thousands)		318	417	290	
Weighted average number of common stock outstanding (thousands) used for diluted EPS		1,038,230	1,039,220	1,040,611	
Basic earnings per share (HUF and USD)		33.38	75.49	72.53	0.38
Diluted earnings per share (HUF and USD)		33.37	75.46	72.51	0.38

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

MAGYAR TELEKOM

CONSOLIDATED CASHFLOW STATEMENTS

	Notes	For the year ended December 31, HUF 2004 as restated (Note 2.1)	2005 as restated (Note 2.1)	2006	USD 2006 (unaudited – Note 2.1)
			(in HUF millions)		(million USD)
Cashflows from operating activities					
Cash generated from operations	29	245,773	243,893	236,888	1,236
Interest paid		(34,030)	(31,078)	(29,876)	(156)
Income tax paid		(21,992)	(11,479)	(19,388)	(101)
Net cash generated from operating activities		189,751	201,336	187,624	979
Cashflows from investing activities					
Purchase of property plant and equipment (PPE) and intangible assets	30	(91,748)	(103,587)	(96,790)	(505)
Purchase of subsidiaries and business units	31	(17,273)	(35,927)	(35,327)	(184)
Cash acquired through business combinations	5	16	1,866	379	2
Interest received		1,452	2,195	2,002	10
Dividend received		2,633	1,729	157	1
Proceeds from / (payments for) other financial assets – net		43	(371)	407	2
Proceeds from disposal of subsidiaries ……………………...	5	-	-	115	1
Proceeds from disposal of PPE and intangible assets		4,090	2,529	6,798	35
Net cash used in investing activities		(100,787)	(131,566)	(122,259)	(638)
Cashflows from financing activities					
Dividends paid to shareholders and minority interest		(78,294)	(84,551)	(77)	-
Proceeds from loans and other borrowings		338,680	263,329	183,051	955
Repayment of loans and other borrowings		(332,481)	(242,595)	(218,619)	(1,141)
Proceeds from sale of treasury stock		-	1,969	491	3
Net cash used in financing activities		(72,095)	(61,848)	(35,154)	(183)
Exchange gains / (losses) on cash and cash equivalents		(2,122)	1,259	1,569	8
Change in cash and cash equivalents		14,747	9,181	31,780	166
Cash and cash equivalents, beginning of year		22,132	36,879	46,060	240
Cash and cash equivalents, end of year	6	36,879	46,060	77,840	406

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

MAGYAR TELEKOM

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Shares of common stock (a)	Common stock (a)	Additional paid in capital (b)	Treasury stock (c)	Cumulative translation adjustment (d)	Revaluation reserve for AFS financial assets – net of tax (e)	Reserve for equity settled share based transactions (f)	Retained earnings (g)	Share-holders' equity	Minority interests (h)	Equity
Balance at January 1, 2004 ………………………..	1,042,811,600	104,281	27,382	(3,842)	825	-	-	431,464	560,110	70,274	630,384
Dividend (i) …………………………………………..								(72,654)	(72,654)		(72,654)
Dividend declared to minority interests (j) …………..									-	(5,651)	(5,651)
Business combinations (k) …………………………..									-	(9,109)	(9,109)
Purchase of investment in T-Systems Hungary ………								(1,679)	(1,679)		(1,679)
Cumulative Translation Adjustment …………………					(3,851)				(3,851)	(4,103)	(7,954)
Profit for the year …………………………………….								34,641	34,641	8,686	43,327
Balance at December 31, 2004 as previously reported	1,042,811,600	104,281	27,382	(3,842)	(3,026)	-	-	391,772	516,567	60,097	576,664
Adoption of changes in IAS 39 - net of tax (Note 2.6) …..								(733)	(733)		(733)
Adoption of IFRS 2 (Note 2.18 c) ………………………							178	(178)	-		-
Balance at December 31, 2004 as restated ………	1,042,811,600	104,281	27,382	(3,842)	(3,026)	-	178	390,861	515,834	60,097	575,931
Dividend (i) …………………………………………..								(72,654)	(72,654)		(72,654)
Dividend declared to minority interests (j) …………									-	(11,913)	(11,913)
Business combinations (k) ……................................									-	9,447	9,447
Sale of Telit ………………....................................								495	495		495
Capital injection in TSH …………………………								669	669		669
Share options exercised by managers (m) …………				1,916				196	2,112		2,112
Share options exercised by CEO (m) …………							(143)		(143)		(143)
Share based payments (Note 24) ………………………							84		84		84
Cumulative Translation Adjustment …………………					2,606				2,606	2,141	4,747
Profit for the year – as previously reported …………								78,564	78,564	10,355	88,919
Effect of changes in IAS 39 - net of tax (Note 2.1.1)								(149)	(149)	(45)	(194)
Profit for the year as restated ………………………..								78,415	78,415	10,310	88,725
Change in reserve for AFS financial assets (Note 7) ……						149			149	45	194
Balance at December 31, 2005 as restated ………..	1,042,811,600	104,281	27,382	(1,926)	(420)	149	119	397,982	527,567	70,127	597,694

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (continued)

	Shares of common stock (a)	Common stock (a)	Additional paid in capital (b)	Treasury stock (c)	Cumulative translation adjustment (d)	Revaluation reserve for AFS financial assets – net of tax (e)	Reserve for equity settled share based transactions (f)	Retained earnings (g)	Share-holders' equity	Minority interests (h)	Equity
Balance at January 1, 2006 ………………………..	1,042,811,600	104,281	27,382	(1,926)	(420)	149	119	397,982	527,567	70,127	597,694
Reduction in capital											
as a result of merger with T-Mobile H (n) ……………	(43,385)	(4)	(2)					(12)	(18)		(18)
Dividend (i) …………………………………………..								(76,122)	(76,122)		(76,122)
Dividend declared to minority interests (j) ………......									-	(43)	(43)
Sale of Cardnet (o) …………………………………...									-	(71)	(71)
MakTel's purchase of its own shares (p) ……………..									-	(14,856)	(14,856)
Result of TSH's sale of a business unit (l) …………..								205	205		205
Share based payments (Note 24) ………………………							36		36		36
Share options exercised by CEO (q) …………………							(106)	(282)	(388)		(388)
Share options exercised by managers (m) …………..				422				87	509		509
Change in reserve for AFS financial assets (Note 7) …….						(149)			(149)	(45)	(194)
Cumulative Translation Adjustment …………………					(1,054)				(1,054)	5	(1,049)
Profit for the year …………………………………….								75,453	75,453	12,011	87,464
Balance at December 31, 2006 ……………………..	1,042,768,215	104,277	27,380	(1,504)	(1,474)	-	49	397,311	526,039	67,128	593,167
Of which treasury stock ……………………………..	(1,917,824)										
Shares of common outstanding at December 31, 2006 ……………………………..	1,040,850,391										

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (notes)

(a) The total amount of issued shares of common stock of 1,042,768,215 (each with a nominal value of HUF 100) is fully paid as at December 31, 2006. In addition to these shares, total shareholders' equity includes one Series "B" preference share at the nominal value of HUF 10,000 at December 31, 2006. This Series “B” share is held by the Ministry of Economics and Transport, 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. A bill has been submitted to the Hungarian Parliament which, if approved, will transform the “B” share into an ordinary share and thus abolish these special rights. The number of authorized ordinary shares on December 31, 2006 is 1,042,768,215.

(b) Additional paid in capital represents the amount above the nominal value of the shares that was received by the Company during capital increases.

(c) Treasury stock represents the cost of the Company’s own shares repurchased.

(d) Cumulative translation adjustment represents the foreign exchange differences arising on the consolidation of foreign subsidiaries

(e) Revaluation reserve for available for sale financial assets includes the unrealized gains and losses net of tax on available for sale financial assets. Any realized gains or losses are taken out of this reserve and recognized in the income statement (Note 7).

(f) Reserve for equity settled share based transactions includes the compensation expenses accrued in equity related to share settled compensation programs. When equity instruments are issued or treasury shares are utilized as part of the program, the accumulated balance is taken out of the reserve (Note 24).

(g) Retained earnings include the accumulated and undistributed net income of the Group. The distributable reserves of the Company under Hungarian law at December 31, 2006 amounted to approximately HUF 294,000 million (HUF 282,000 million at December 31, 2005).

(h) Minority interests represent the minority shareholders’ share of the net assets of subsidiaries, in which the Group has less than 100% ownership.

(i) In 2006 Magyar Telekom Plc. declared HUF 73 dividend per share (HUF 70 in 2005, HUF 70 in 2004).

(j) The dividend declared to minority interests in 2004 and 2005 almost entirely reflects the dividend declared by MakTel, Magyar Telekom’s Macedonian subsidiary, to its minority shareholders. In 2006 MakTel did not declare dividends. The amount of dividend declared in 2006 to minorities includes the amount declared to the minority owners of smaller subsidiaries.

(k) Business combinations in 2004 include the reduction of minority interest as a result of the purchase of additional shares in Stonebridge and other already consolidated subsidiaries. The increase in 2005 is the result of the acquisition of Crnogorski Telekom (CGT), in which the Group acquired a 76.53% share of ownership (Note 5).

(l) In 2006 TSH sold one of its business units to another member of Deutsche Telekom group. TSH’s gain on the transaction (HUF 418 million) resulted in an increase of TSH’s net assets, the Group’s share of which (HUF 205 million) was recognized directly in retained earnings.

(m) In 2005 Magyar Telekom’s CEO and other managers exercised a portion of their share options, and the Company used its treasury shares reserved for the option programs. As a result of these transactions, the Company sold 2,443,341 of its treasury shares to the CEO and other managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 53 million (HUF -143 million recognized against the Reserve for equity settled share based payments and HUF 196 million recognized in Retained earnings). In 2006 managers exercised further options, for which the Company used its treasury shares. As a result of these transactions, the Company sold 538,835 of its treasury shares to the managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 87 million, which was recognized in retained earnings. For more details on the programs see Note 24.

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (notes - continued)

(n) In 2006 Magyar Telekom Plc. merged with T-Mobile Hungary, its 100% subsidiary. During the merger, the owners of 43,385 shares expressed their intention not to participate as owners in the merged Company. Consequently, the Company withdrew these shares and paid off these owners with a corresponding decrease in share capital, additional paid in capital and retained earnings, and the merged Company was registered with 43,385 less shares.

(o) In 2006 the Company sold the total of its 72% ownership in Cardnet, which resulted in the reduction of Minority interests (Note 5.4).

(p) In 2006 MakTel repurchased 10% of its shares from the Government of Macedonia during a public tender issued for the sale of the Government shares. As a result of this transaction, Magyar Telekom's share of ownership increased from 51% to 56.67% resulting in a decrease in the minority interest in MakTel and T-Mobile MK (Note 5.1.5).

(q) On December 5, 2006, Elek Straub, the former CEO and Chairman of the Company resigned. As part of the resignation agreement, Mr. Straub exercised 1,181,178 of his share options, of which 487,465 would only have vested on July 1, 2007, which was accelerated. The full transaction was settled in cash instead of shares as intended by the original agreement. By December 31, 2006 the Company has accumulated HUF 155 million (including HUF 7 million for pre-mature vesting) in a Reserve for equity settled share based transactions, of which HUF 106 million was released. The closing balance of this reserve of HUF 49 million represents the amount reserved for the 103,530 options (granted in 2000) Mr. Straub still has open (Note 24).

Together with the approval of these financial statements for issue, the Board of the Company proposes a HUF 70 per share dividend distribution to be approved by the Annual General Meeting of the Company in April 2007.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 GENERAL INFORMATION

1.1 About the Company

Magyar Telekom Plc., (the "Company" or “Magyar Telekom Plc.”) with its subsidiaries form Magyar Telekom Group (“Magyar Telekom” or “the Group”). Magyar Telekom is the principal supplier of telecommunications services in Hungary, Macedonia and Montenegro and alternative service provider in Bulgaria, Romania and in the Ukraine. These services are subject to various telecommunications regulations depending on the countries of operations (Note 1.3).

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

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

The immediate controlling shareholder of the Company is MagyarCom GmbH owning 59.21% of the issued shares, while the ultimate controlling parent of Magyar Telekom is Deutsche Telekom AG (DT or DTAG).

The consolidated financial statements are prepared and presented in millions of Hungarian Forints (HUF), unless stated otherwise, and in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union.

These financial statements of the Company were approved for issue by the Company’s Board of Directors (the Board), however, the Annual General Meeting (AGM) of the owners, authorized to accept these financials, have the right to require amendments before acceptance. As the owners are represented in the Board of the Company that approved these financial statements for issuance, the probability of any potential change required by the AGM is extremely remote, and has never happened in the past.

On February 22, 2005, the Extraordinary General Meeting approved the renaming of Magyar Távközlési Rt. (Matáv) to Magyar Telekom Rt. and rebranding its products, which was completed by December 2005. As agreed, DTAG supported the renaming and the product rebranding. The impact of renaming and product rebranding on the consolidated financial statements as of December 31, 2005 included HUF 7,281 million of expenditures accounted for in the operating expenses and a compensation by DTAG of HUF 7,281 million disclosed separately in Note 35.

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

1.2 Investigation into certain consultancy contracts

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

Although the investigation has not been finalized, based on the independent investigators' findings and conclusions to date, these contracts were entered into without full compliance with internal company procedures regarding the entry into such contracts. Moreover, sufficient evidence could not be obtained that adequate value was received under these contracts. In its 2005 preliminary results announcement the Company had capitalized the HUF 1.12 billion payment made related to two of these contracts. As a result of the findings of the investigation, the Group has expensed the total amount of the HUF 2 billion paid under these four contracts, and discloses these expenses under Other operating expenses (Note 25).

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

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

As a result of the delays in finalizing its 2005 financial statements due to the investigation, the Company and some of its subsidiaries have failed and may fail to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. The Company has been fined HUF 13 million to date as a consequence of such delays. The Company has notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation and is in contact with these authorities regarding the investigation and has responded to a number of inquiries these authorities have raised.

1.3 Public service concession and license arrangements

Hungarian Fixed line

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

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

The NCA assigned 18 relevant markets in the area of electronic communications in 2004. In 2004 and 2005 Magyar Telekom was designated as an SMP (an operator with significant market power) in 12 markets. These included all retail and wholesale voice markets, the market of wholesale leased line and termination, the market of minimum set of leased lines and the wholesale broadband market. At the end of 2006 the analysis of the 18 relevant markets was started again by the NCA. Most likely, Magyar Telekom will be designated as an SMP on the same 12 markets as before.

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

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

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

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

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

Macedonian Fixed line

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

During the exclusivity period MakTel was obliged to provide universal services. It is expected that the Agency for Electronic Communications (Agency) will initiate a public tender proceeding for the purpose of electing one or more universal service providers (USP) in 2007, according to the conditions determined in the relevant by-laws enacted in December 2006.

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

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

MakTel as an SMP operator has the obligation to enable its subscribers to access publicly available telephone services of any interconnected operator with officially signed interconnection contract. On November 15, 2006, MakTel signed the first RIO based Interconnection Agreement with an alternative fixed network operator. The launch of the competitors' offers for long-distance, fixed to mobile and international calls is expected before the end of the first quarter of 2007. Number portability is scheduled to be fully implemented by July 1, 2007. Due to the short notice, the implementation of number portability will not be technically feasible within the given timeframe, and MakTel will take the appropriate legal steps to respond to this.

Montenegrin Fixed line

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

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

Prices of CGT must be approved by the Telecommunications Agency. CGT's tariff structure is currently highly unbalanced, monthly access fees and local calls are inexpensive, whereas long-distance and international calls are very expensive, and businesses are charged approximately twice as much as individuals. During the privatization process, a schedule for the cost-based re-alignment of prices for access lines and traffic, rebalancing tied to the timing of market liberalization was agreed with the Montenegrin government. The first rebalancing due in the fourth quarter of 2006 was postponed to the second quarter of 2007 in order to avoid overlap with the re-branding of the company.

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

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

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

A cable television tender was launched in the fourth quarter of 2006 as well as a fixed wireless access tender in the first quarter of 2007 enabling potential fixed line competitors to enter the market in 2007 using alternative technologies.

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

Hungarian Mobile

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

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

The Minister is entitled to extend the concession period for both the GSM 900 and the DCS 1800 public mobile radio telephone services upon their expiration. The extension can be for another 7.5 years without the issuance of a tender invitation.

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

On December 7, 2004, T-Mobile H obtained 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 December 7, 2019) with an option to extend it for another 7.5 years. T-Mobile H was 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, which was met. It is also obliged to reach a population-wide coverage of 30% within 36 months of license acquisition. As of August 26, 2005 T-Mobile H had started to provide 3G service and has been operating it in compliance with the license conditions.

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

In January 2005 and October 2006 the NCA designated T-Mobile H as having significant market power in the mobile voice call termination market, and it is currently subject to regulatory obligations regarding the termination charge of calls into its network.

Macedonian Mobile

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

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

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

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

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

Montenegrin Mobile

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

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

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

No obligation for number portability is in force.

A tender for 3G mobile frequencies was launched in December 2006. The government plans to issue two 3G licenses and a combined 2G/3G license for a third operator. The Group intends to participate in the tender.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below, and in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. In Magyar Telekom's case these are identical to the IFRS as issued by the IASB and effective for 2006.

The consolidated financial statements are shown in millions of HUF. For the convenience of the reader, the consolidated balance sheet, income statement and cashflow statement for the year 2006 are also presented in millions of U.S. dollars (USD) translated at a rate of HUF 191.62 to USD 1 (the official rate of the National Bank of Hungary at December 31, 2006). These translations are supplementary information, and are unaudited.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

2.1.1 Amendments to published standards effective and adopted by the Group in 2006

- IAS 39 (Amendment), The Fair Value Option

The Group adopted the changes in its accounting policies required by IAS 39 (Amendment), The Fair Value Option. The amendment to the existing standard has been applied by the Group, and resulted in changes, as follows.

The Group had investments classified as financial asset at fair value through profit and loss in 2005. In 2006 these investments were no longer in accordance with the amended criteria of IAS 39 for the designation of financial instruments at fair value through profit and loss, therefore were reclassified to the available-for-sale financial asset category.

In 2005 the gain or loss arising from a change in the fair value of the financials asset was recognized through the income statement, but as it is reclassified to available-for-sale financial asset, the gain shall have been recognized directly in equity. As the amendment is applied retrospectively, the opening balance of retained earnings for 2006 and the comparative amounts for the prior year have been restated accordingly (Note 7).

- IFRIC 4, Determining whether an Arrangement contains a Lease

The Group adopted IFRIC Interpretation 4, Determining whether an Arrangement contains a Lease, which gives further guidance on the topics of how to determine whether an arrangement is, or contains a lease, when the assessment of the above should be made as well as how the payments for a lease arrangements should be separated from payments for any other elements in the arrangement. The PMR services (Note 33 c) commenced in 2006 were accounted for according to IFRIC 4.

2.1.2 Standards, amendments and interpretations effective in 2006 but not relevant for the Group

The following standards, amendments and interpretations are mandatory for accounting periods beginning on January 1, 2006, but are not relevant to the Group's operations:

- IAS 19 (Amendment), Employee Benefits
- IAS 21 (Amendment), The Effects of Changes in Foreign Exchange Rates;
- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts;
- IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
- IFRS 6, Exploration for and Evaluation of Mineral Resources;
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds.
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment;

2.1.3 Interpretations to existing standards and new standards that are not yet effective and have not been early adopted by the Group

The following interpretations to existing standards have been published that will have to be applied by Magyar Telekom from January 1, 2007, and which the Group has not early adopted.

- IFRS 7 Financial Instruments: Disclosures, and the complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures. IFRS 7 introduces new disclosures relating to financial instruments. This standard will not have any impact on the recognition or measurement of the Group's financial instruments.

- IFRIC 8 Scope of IFRS 2. IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2. We do not expect IFRIC 8 to have material impact on the Group's accounts.

- IFRIC 9 Reassessment of Embedded Derivatives. IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cashflows that otherwise would be required under the contract, in which case reassessment is required. We do not expect IFRIC 9 to have material impact on the Group's accounts.

- IFRIC 10 Interim Financial Reporting and Impairment. IFRIC 10 prohibits the impairment losses recognized in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. We do not expect IFRIC 10 to have any impact on the Group's accounts as Magyar Telekom has always carried out the impairment tests on these assets in the last quarter of the year unless a triggering event required an impairment in an interim period, which would not be reversed in the same financial year.

- IFRIC 11 Interpretation to IFRS 2 - Group and Treasury shares transactions. Under IFRS 2 it was not defined exactly how it should be calculated where the employees of a subsidiary received the shares of a parent. IFRIC 11 clarifies that certain types of transactions are accounted for as equity-settled or cash-settled transactions under IFRS 2. It also addresses the accounting for share-based payment transactions involving two or more entities within one group. We do not expect IFRIC 11 to have material impact on the Group's accounts.

- IFRIC 12 Service Concession Agreements. This interpretation applies to companies that participate in service concession arrangements and provides guidance on the accounting by operators in public-to-private service concession arrangements. The Group is currently analyzing the potential changes IFRIC 12 may cause in the Group's accounting treatments.

- IFRS 8 Operating Segments. Under IFRS 8, segments are components of an entity regularly reviewed by an entity's chief operating decision-maker. Items are reported based on the internal reporting. IFRS 8 also sets out requirements for related disclosures about products and services, geographical areas and major customers. The Group has been planning to change its operating segments from 2007, regardless of the issuance of IFRS 8, and we will comply with the requirements of IFRS 8.

2.1.4 Interpretations to existing standards that are not yet effective and not relevant for the Group's operations

The following interpretation to existing standards has been published that is mandatory for the Group from January 1, 2007, but is not relevant for the Group's operations.

- IFRIC 7 Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective from March 1, 2006). IFRIC 7 provides guidance on how to apply the requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As none of the group entities operate in a hyperinflationary economy, IFRIC 7 is not relevant to the Group's operations.

2.1.5 Revenue recognition

Magyar Telekom has reassessed its status in the provision of a number of value added services, where revenue was accounted for on a gross basis implying a principal status rather than an agent status in the provision of the service. A gross basis means that revenues included the full amount of fees collected from customers, and payments to related service providers were included in operating expenses. After analyzing the relationships with our subcontractors one by one, we have changed our judgment of the situation in some cases and determined that in these cases the Group is more the selling agent of these products than the principal provider of the service.

This change had a decreasing impact on the Fixed line Voice - retail revenues and the Mobile Non voice revenues, with equivalent corresponding effects in operating expenses. The change resulted in netting revenues with expenses, and has no impact on operating profit, net income or equity. Prior year's reported numbers have been restated accordingly (Note 2.1.7).

2.1.6 Taxes

The Group has changed its accounting policy to disclose the Hungarian local business tax and innovation fee as income taxes as we have established that these taxes have the characteristics of income taxes rather than operating expenses. In previous years, these taxes were disclosed among operating expenses.

This change in the disclosure of these taxes had a decreasing impact on operating expenses and an equivalent increase in income taxes. The change resulted in no impact on net income or equity. Prior year's reported numbers have been restated accordingly (Note 2.1.7).

2.1.7 Summary of impacts on the income statement

The table below shows the impact on the income statement of the above changes.

	2004	2005
	in HUF millions	
Revenue		
As reported	601,438	620,697
Change in revenue recognition - netting (Note 2.1.5)	(4,646)	(5,643)
As restated	596,792	615,054
Operating expenses		
As reported	(516,174)	(487,309)
Change in revenue recognition - netting (Note 2.1.5)	4,646	5,643
Change in accounting policy for taxes (Note 2.1.6)	8,455	8,366
As restated	(503,073)	(473,300)
Finance income		
As reported	1,768	3,209
Change in accounting policy for financial assets (Note 2.1.1)	-	(213)
As restated	1,768	2,996
Income tax expense		
As reported	(7,687)	(13,511)
Change in accounting policy for taxes (Note 2.1.6)	(8,455)	(8,366)
Change in accounting policy for financial assets (Note 2.1.1)	-	19
As restated	(16,142)	(21,858)

2.2 Consolidation

(a) Subsidiaries

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

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

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

In case of acquisitions where the transaction takes place between companies under common control (i.e. with other Deutsche Telekom group companies), the transaction is recorded at cost and any gains, losses or differences between the book value and the sale-purchase price are recognized in retained earnings.

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

Transactions with minority interests are treated as third party transactions. Gains or losses arising on disposals to minority interests are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

Since March 31, 2004, Magyar Telekom has been applying the provisions of IFRS 3 – Business Combinations. Although IFRS 3 continues to require purchase price allocation for new acquisitions, in case of additional shares acquired in subsidiaries already controlled (step acquisition), no purchase price allocation is made. Consequently, the difference between the consideration paid and the share of the carrying value of net assets acquired is accounted for as goodwill.

(b) Associates and joint ventures

Associates are all entities over which the Group has significant influence but not control, generally embodying in a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost. The Group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognized in the income statement (Share of associates' profits). The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Accounting policies of associates have been adjusted where necessary to ensure consistency with the policies adopted by the Group.

At December 31, 2006 and 2005 the principal operating subsidiaries and associates of the Group were as follows:

Subsidiaries	Group interest in capital as at December 31,		Activity
	2005	2006	
Incorporated in Hungary:			
T-Online..	100.00%	100.00%	Internet service and content provider
T-Kábel	100.00%	100.00%	Cable TV operator
Emitel	100.00%	100.00%	Local fixed line telecom service provider
Dataplex ……………………………………..	-	100.00%	IT hardware co-location service provider
BCN Rendszerház (BCNR)	100.00%	100.00%	System integration and IT services
KFKI-LNX (KFKI) …………………………	-	100.00%	System integration and IT services
T-Mobile Hungary (T-Mobile H)..................	100.00%	n/a (a)	Cellular telecom service provider
Pro-M ………………………………………..	100.00%	100.00%	Professional Mobile Radio (PMR) network operator (Note 33 c)
Incorporated in Macedonia:			
Makedonski Telekommunikacii (MakTel) ...	51.00%	56.67%	Fixed line telecom service provider
T-Mobile Macedonia (T-Mobile MK)	51.00%	56.67%	Cellular telecom service provider
Stonebridge	100.00%	100.00%	Holding company
Incorporated in Montenegro:			
Crnogorski Telekom (CGT) ………………	76.53%	76.53%	Fixed line telecom service provider
T-Mobile Crna Gora (T-Mobile CG) ………	76.53%	76.53%	Cellular telecom service provider
Internet Crna Gora (ICG) ……………………	76.53%	76.53%	Internet service and content provider
Incorporated in Romania:			
Combridge ………………………………….	100.00%	100.00%	Alternative telecommunications service provider
Incorporated in Bulgaria:			
Orbitel ……………………………………….	-	100.00%	Alternative telecommunications and internet service provider

(a) T-Mobile Hungary merged into Magyar Telekom Plc. during 2006 (Note 1.1)

Associates / Joint ventures	Group interest in capital as at December 31,		Activity
	2005	2006	
Incorporated in Hungary:			
Hunsat	50.00%	50.00%	Satellite telecommunications
T-Systems Hungary (TSH)	49.00%	49.00%	System integration and IT services
Magyar RTL (M-RTL)	25.00%	25.00%	Television broadcast company

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

2.3 Foreign currency translation

2.3.1 Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency').

The consolidated financial statements are presented in millions of HUF, which is the Company's functional and presentation currency.

2.3.2 Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement (Finance income).

2.3.3 Group companies

The results and financial position of all of the Group's entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date are incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at that date. The fair value adjustments resulting from the purchase price allocation and goodwill are accounted for in HUF for acquisitions before March 31, 2004, after which date these adjustments arising on consolidation are accounted for in the functional currency of the subsidiary as required by IAS 21 – The Effects of Changes in Foreign Exchange Rates.

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet.
- Income statements are translated at average exchange rates.
- All resulting exchange differences are recognized directly in the consolidated equity (Cumulative translation adjustment). When a foreign operation is fully or partially disposed of, exchange differences that were recorded in equity are recognized in the income statement as part of the gain or loss on sale

(Finance income).

2.4 Cash and cash equivalents

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

2.5 Financial assets

The Group classifies its financial assets in the following categories:

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

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

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading. Assets in this category are classified as current assets (Other financial assets).

(b) Loans and receivables

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

(c) Available-for-sale financial assets (AFS)

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

(d) Recognition, measurement and disclosure

Gains or losses on the re-measurement or sale of financial assets or the directly related transaction costs are recognized in either the income statement (Finance income), or in the equity (Revaluation reserve for AFS financial assets – net of tax), as described below.

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

AFS financial assets and ‘financial assets at fair value through profit or loss’ are subsequently carried at fair value. Loans and receivables are carried at amortized cost using the effective interest method. Gains or losses arising from changes in the fair value of the ‘financial assets at fair value through profit or loss’ category are recognized in the income statement (Finance income) in the period in which they arise. Dividend income from ‘financial assets at fair value through profit or loss’ is recognized in the same way when the Group’s right to receive payments is established.

Changes in the fair value of monetary and non-monetary securities classified as available-for-sale financial assets are recognized in equity (Revaluation reserve for AFS financial assets – net of tax).

Financial assets are derecognized when the rights to receive cashflows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the income statement.

Interest on available-for-sale securities calculated using the effective interest method is recognized in the income statement (Finance income).

Dividends on available-for-sale equity instruments are recognized in the income statement (Finance income) when the Group’s right to receive payments is established.

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

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for AFS financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the income statement – is removed from equity and recognized in the income statement. Impairment losses recognized in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2.7.

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.

2.6 Derivative financial instruments and hedging activities

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Magyar Telekom does not apply hedge accounting for its financial instruments, therefore all gains and losses are recognized in the income statement (Finance income).

The fair value of derivative financial instruments is included in current Other financial assets or other current liabilities.

The revised interpretation of IAS 39 – Financial Instruments – Recognition and Measurement does not consider contracts denominated in a currency that is not the functional currency of either of the contracting parties as a separable host contract and an embedded derivative if the contract currency is widely used in that market. As a result of the change in the interpretation, Magyar Telekom restated its opening retained earnings as at January 1, 2005, and eliminated the carrying amounts of these embedded derivatives previously recognized (HUF 873 million) and the related deferred tax liability (HUF 140 million) in the balance sheet against Retained earnings as at December 31, 2004.

2.7 Trade and other receivables

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments (more than 30 days overdue) are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cashflows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the income statement (Other operating expenses - Bad debt expense). When a trade receivable is established to be uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against the period's bad debt expense.

2.8 Inventories

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

Phone sets are often sold for less than cost in connection with promotions to obtain new subscribers with minimum commitment periods (Note 4 g). Such loss on the sale of equipment is only recorded when the sale occurs if the normal resale value of the phone sets exceeds cost.

2.9 Assets held for disposal

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

2.10 Property, plant and equipment (PPE)

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

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

Government grants relating to the purchase of property, plant and equipment are deducted from the original cost of the items and are recognized in the income statement through the reduced amount of depreciation of the related assets over their useful lives. Investment tax credits relating to qualifying investment projects (Note 9) are also recognized in this manner.

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

When assets are scrapped, the cost and accumulated depreciation are removed from the accounts and the loss is recognized in the income statement as depreciation expense.

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

Maintenance and repairs are charged to expense when incurred.

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

The useful lives assigned are as follows:

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

2.11 Intangible assets

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

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use. These costs are amortized over the estimated useful life of the software. Costs associated with developing or maintaining computer software programs are recognized as an expense as incurred. Costs directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognized as intangible assets. Direct costs include the software development employee related costs and an appropriate portion of relevant overheads. Computer software development costs recognized as assets are amortized over their estimated useful lives. As these assets represent an immaterial portion of all software, these are not disclosed separately.

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

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets and contingent liabilities of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions completed before March 31, 2004 was amortized using the straight-line method over its estimated useful life. Goodwill arising on acquisitions after this date is not amortized. Following the change in the IFRS regulations, amortization of goodwill arising on acquisition before March 31, 2004 was discontinued from January 1, 2005, and the accumulated amortization was eliminated against the gross book value of the goodwill. From 2004 impairment testing is carried out on an annual basis for all goodwill in the last quarter of the year based on the carrying values as at September 30 of the year.

Goodwill is carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

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

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

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

2.12 Impairment of PPE and intangible assets

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

Goodwill is allocated to cash generating units. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose. Magyar Telekom allocates goodwill to the Hungarian and Foreign operations of its business segments (Fixed line and Mobile), and conducts the impairment testing at this level, which is the lowest level at which management monitors goodwill. Goodwill is tested for impairment annually or more frequently if circumstances indicate that impairment may have occurred.

The fair values of investments in subsidiaries listed on active stock exchanges are based on current bid prices. If the market for the shares of subsidiaries is not active or the subsidiaries are not listed and for 100% owned subsidiaries the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cashflow analyses and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs. The fair values determined as described above are used as a basis when establishing the need for an impairment on the goodwill allocated to the cash generating units of the segments.

See also Note 4.

2.13 Loans and other borrowings

Borrowings are recognized initially at fair value less transaction costs, and subsequently measured at amortized costs using the effective interest rate method. The effective interest is recognized in the income statement (Finance expense) over the period of the borrowings.

Fair values of loans and other borrowings calculated using the discounted cashflow method is also presented in the financial statements (Notes 16 and 17).

2.14 Trade and other payables

Trade and other payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method. The carrying values of trade and other payables approximate their fair values due to their short maturity.

2.15 Provisions

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

Provisions are measured and recorded as the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

Provisions for obligations expected to fall due after 12 months are recognized at their present value and are accreted until utilization or reversal against Finance expense.

2.16 Treasury stock

When the Company or its subsidiaries purchase the Company's equity shares, the consideration paid including any attributable incremental external costs are deducted from the Shareholders' equity as Treasury stock until they are re-sold or cancelled. When such shares are subsequently sold, the treasury share balance decreases by the original cost of the shares, thereby increasing the equity, while any gains or losses are also recognized in equity (Retained earnings). Treasury stock transactions are recorded on the transaction date.

2.17 Revenues

Revenue is primarily derived from services provided to Magyar Telekom's customer subscribers and other third parties using Magyar Telekom's telecommunications network, and equipment sales. Revenues for all services and equipment sales (Notes 21 and 22) are shown net of VAT, discounts and after eliminating sales within the Group, and are recognized when the amount of the revenue can be reliably measured, it is probable that future economic benefits will flow to the Group and specific criteria are met for the provision of each of the Group's services described below.

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

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

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

Wholesale (incoming) traffic revenue is recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (interconnect) for the use of their networks, where appropriate. The revenues and costs of these transit calls are stated gross in these consolidated financial statements as the Group is the principal supplier of these services using its own network freely defining the pricing of the services, and recognized in the period of related usage.

2.17.1 Fixed line service revenues

The Fixed line segment comprises the activities of the residential and business units of the Group.

(a) Residential service revenues

The Group provides customers with narrow and broadband access to its fixed network. It also sells, leases, and services telecommunications equipment for its customers and provides additional telecommunications services. Service revenues are recognized when the services are provided in accordance with contractual terms and conditions.

Revenue and expenses associated with the sale of telecommunications equipment and accessories are recognized when the products are delivered, provided there are no unfulfilled company obligations that affect the customer's final acceptance of the arrangement.

Revenues from rentals and operating leases are recognized monthly as the fees accrue.

Internet revenues consist primarily of revenues from subscriber fees and charges for advertising and e-commerce. Subscriber fees - consisting primarily of basic monthly charges for Internet services and Internet access as well as use-related fees - are recognized as revenue in the period the service is provided.

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

Transaction revenues are recognized upon notification from the customer that qualifying transactions have occurred and collection of the resulting receivable by the Group is reasonably assured.

(b) Business service revenues

Contracts for network services, which consist of the installation and operation of communication networks for customers, have an average duration of 2-3 years. Revenues for voice and data services are recognized under such contracts when used by the customer.

Revenue from outsourcing contracts reflects the extent of actual services delivered in the period in accordance with the terms of the contract. The contracts are analyzed based on the requirements of IFRIC 4, and if they include embedded lease elements, the revenues attributable to these are recognized according to IAS 17, Leases as disclosed in Note 2.22.

Revenue from service contracts billed on the basis of time and material used is recognized as the services are provided.

Revenue from systems integration contracts requiring the delivery of customized products and/or services is generally covered by one of the following types of contracts: fixed-price or time and material-based. For fixed-price contracts, revenue is generally recognized based on proportional performance. In the case of contracts billed on the basis of time and material, revenue is recognized as the services are rendered.

Revenue from maintenance services is recognized over the contractual period or as the services are provided.

Revenue from hardware sales or sales-type leases is recognized when the product is shipped to the customer, provided there are no unfulfilled company obligations that affect the customer's final acceptance of the arrangement. Any costs of these obligations are recognized when the corresponding revenue is recognized.

Revenue from rentals and leases is recognized monthly as the fees accrue.

Revenues from construction contracts are accounted for using the percentage-of-completion method. The stage of completion is determined on the basis of the costs incurred to date as a proportion of the estimated total costs. Receivables from construction contracts are classified in the balance sheet item as Trade and other receivables. If the total actual and estimated expenses exceed revenues for a particular contract, the loss is recognized immediately.

2.17.2 Mobile service revenues

Mobile Communications revenues primarily include revenues from the provision of voice and non-voice mobile services and sales of mobile handsets and accessories.

Mobile services revenues include monthly service charges, charges for special features, call charges, and roaming charges billed to T-Mobile customers, as well as other mobile operators. Mobile services revenue is recognized based upon minutes of use and contracted fees less credits and adjustments for discounts.

Revenues from roaming customers of the Group and other service providers are recognized and presented on a gross basis.

The revenue and related expenses associated with the sale of mobile phones, wireless data devices, and accessories are recognized when the products are delivered and accepted by the customer.

Value added services mostly include SMS, MMS, WAP as well as directory assistance and similar services. Value added services, where the Group does not act as a principal in the transaction, are included in this category on a net basis. Revenues from premium rate services are also included in this category, recognized on a gross basis when the delivery of the service over Magyar Telekom's network is the responsibility of the Group and the Group also bears substantial risks of these services, otherwise presented on a net basis.

2.18 Employee benefits

(a) Short term employee benefits

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

(b) Pensions

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

Magyar Telekom does not have significant defined post-employment benefit schemes.

(c) Share based compensation

Magyar Telekom adopted IFRS 2 – Share-based Payment as of January 1, 2005. The standard requires the Group to reflect in its income statement and balance sheet the effects of share based payment transactions, including expenses associated with transactions in which share options are granted to employees. Accordingly, Magyar Telekom recognizes the costs of services received from its employees in a share based payment transaction when services are received. Magyar Telekom recognizes a corresponding increase in its equity reserves (Reserve for equity settled share based transactions) if the services are received in an equity-settled share based payment transaction. Before the adoption of IFRS 2, the Group did not recognize employee expenses in relation to share based compensations.

As at December 31, 2004 the Group set up this reserve and transferred the amount from its Retained earnings that would have been recognized to that date in this reserve. Compensation expense for share settled share based transactions is recognized against this reserve in 2005 and 2006.

If the services are received in a cash-settled share based payment transaction, the Group recognizes the expense against a liability, re-measured at each balance sheet date.

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

Bonuses tied to the long term performance of the Magyar Telekom share are recognized in the income statement at their time-proportioned fair value (Note 24) against an accumulating liability in Trade and other payables.

(d) 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.

2.19 Research and Marketing expenses

Research as well as marketing costs are expensed as incurred.

2.20 Borrowing costs

Borrowing costs are recognized as an expense as incurred, net of amounts capitalized. Interest on borrowings (that were all taken for construction purposes) was capitalized as part of the cost of the relevant fixed asset, up to the date of commissioning and is then amortized over the period the asset is depreciated. The rate used to determine the amount of borrowing costs eligible for capitalization was defined as the ratio of equity to debt financing, where debt excludes short term borrowings and loans related to the financing of acquisitions. As all loans taken for capital expenditure on tangible and intangible assets were repaid by the end of 2003, no interest was capitalized in 2004 and 2005. In 2006 the Group took a dedicated loan for the expansion of the broadband technology in Hungary, therefore interest is capitalized as part of the cost of the assets constructed from this source of finance.

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. As the Group does not incur significant amounts of additional borrowing costs, the weighted average interest rate equals the effective borrowing costs.

2.21 Income taxes

(a) Corporate income taxes

Corporate income taxes are payable to the central tax authorities of the countries in which the Group's consolidated entities operate. The basis of the tax is the taxable entities' accounting profit adjusted for non-deductible and non-taxable items. The tax rates and the determination of the tax base vary among the countries in which the Group operates.

(b) Other income taxes

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, determined at a substantially higher level than the corporate tax base. These other income taxes are deductible from the corporate tax base.

(c) Deferred taxes

Deferred tax is recognized applying the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit. Deferred tax is determined using income tax rates that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred tax is also provided on taxable temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2.22 Leases

(a) Operating lease –Group as 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.

(b) Finance lease – Group as lessor

Leases of assets where Magyar Telekom transfers substantially all the benefits and risks of ownership are recognized and disclosed as sales revenue against a finance lease receivable. The revenue equals the estimated present value of the future minimum lease payments receivable and any un-guaranteed residual value (net investment in the lease). Thereby, any gains are deferred and recognized over the period of the lease, while any losses are recognized immediately. Each lease receipt is then allocated between the receivable and finance income so as to achieve a constant rate of return on the finance balance outstanding. The interest element of the lease receipt is recognized as Finance income.

(c) Finance lease – Group as lessee

Leases of property, plant and equipment where Magyar Telekom assumes substantially all the benefits and risks of ownership are classified as finance leases. 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 of interest on the finance balance outstanding. The corresponding lease obligations, net of finance charges, are included in the balance sheet (Third party loans and other borrowings). The interest element of the lease payments is charged to the income statement (Finance expense) 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.

(d) Operating lease –Group as lessee

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

(e) Sale and leaseback transactions

Sale and leaseback transactions involve the sale of an asset by Magyar Telekom and the leasing of the same asset or part of it back to Magyar Telekom. When sale and leaseback transactions qualify as finance leases any gain on the sale is deferred and recognized in the income statement over the lease term through lower depreciation expense. If the leaseback qualifies as an operating lease, any gains or losses on the sale are recognized in the income statement (Other operating income), while the lease payments are also recognized in the income statement (Other operating expenses) on a straight line basis over the period of the lease.

2.23 Earnings per share

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

2.24 Dividends

Dividends payable to the Company’s shareholders and to minority shareholders of the subsidiaries are recorded as a liability and debited against equity (Retained earnings or Minority interests) in the Group’s financial statements in the period in which they are approved by the shareholders.

2.25 Segment reporting

Magyar Telekom determines segments primarily based on products and services that are subject to risks and returns that are different from those of other businesses. The primary segments are based on the business lines (Fixed line and Mobile operations) both including Hungarian and Foreign operations. The Company’s secondary format for reporting segment information is geographical.

2.26 Comparative information

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

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose us to a variety of financial risks: market risk (including currency risk, fair value interest rate risk and cashflow interest rate risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. The Group occasionally uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by a central treasury department (Group Treasury) in line with the main guidelines approved by the Board of Directors. Group Treasury identifies, evaluates and hedges financial risks in close co-operation with the Group's operating units.

3.1.1 Market risk

(a) Foreign exchange risk

Magyar Telekom is exposed to interest and foreign exchange rate risk associated with its cash and debt portfolio and anticipated transactions. Magyar Telekom is exposed to foreign exchange risk 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. As the vast majority of the revenues and expenses of the Hungarian entities arise in HUF, the functional currency of Magyar Telekom is HUF, and as a result, Magyar Telekom's objective is to minimize the level of its financial risk in HUF terms. During 2006 and 2005, the Group's borrowings were denominated primarily in HUF. The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the EUR and USD. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities.

The Group has subsidiaries in the Southern and Eastern European region, whose net assets are exposed to foreign currency translation risk. The Group is present in Macedonia, Montenegro, and to a lesser extent in Bulgaria, Romania and Ukraine. Romania and Bulgaria joined the European Union on January 1, 2007, which over time mitigates the currency risk of these countries. The high amount of foreign currency (EUR and USD) denominated cash portfolio accumulated by the Macedonian subsidiaries creates additional foreign exchange risk exposure on local and Group level.

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

(b) Cashflow and fair value interest rate risk

The Group's interest rate risk primarily arises from long-term borrowings. Borrowings taken at variable rates expose the Group to cashflow interest rate risk. Borrowings taken at fixed rates expose the Group to fair value interest rate risk. It is the Group's policy to maintain more than 50% of its borrowings in fixed rate instruments. As the Group also has increasing amount of interest-bearing assets in Macedonia and Montenegro, managing the interest rate feature of the portfolio in these countries is also in focus.

3.1.2 Credit risk

Credit risk is managed on a group basis. Credit risk arises from cash and cash equivalents and deposits with banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding receivables and committed transactions.

The Group's cash balances in Hungary are deposited in banks and financial institutions with a minimum rating of 'A'. This risk is very low, since the policy is to use the excess cash for debt repayment purposes instead of accumulating cash. As to the international subsidiaries, the credit risk, if any, is mitigated by keeping the cash in a number of local banks.

For wholesale customers, risk control assesses the credit quality of the customer, taking into account its financial position, past experience and other factors. Individual risk limits are set based on internal or external ratings in accordance with limits set by the Board. The utilization of credit limits is regularly monitored.

The risk related to retail customers is limited due to the large number of customers comprising Magyar Telekom's customer base and their dispersion across many different industries and geographic areas.

3.1.3 Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, the availability of funding from an adequate amount of committed credit facilities including facilities with local (Hungarian) banks and with Deutsche Telekom.

Management monitors rolling forecasts of the Group's liquidity reserve on the basis of expected cashflows.

3.2 Capital risk management

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

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt. Consistent with others in the industry, the Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by equity (including minority interest) and net debt. Net debt is calculated as total borrowings less cash and cash equivalents.

During 2006, the Group's strategy, which was unchanged from 2005, was to maintain a gearing ratio within 30% to 40% and a BBB (investment grade) credit rating. The gearing ratio at December 31, 2006 was 27.9% (2005: 33.2%). The decrease in the gearing ratio during 2006 resulted from delayed declaration of dividends as a result of the on-going investigation (Note 1.2).

3.3 Fair value estimation

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Other techniques, such as estimated discounted cashflows, are used to determine fair value for the remaining financial instruments. The fair value of forward foreign exchange contracts is determined using quoted spot exchange rates and appropriate interest rates at the balance sheet date.

The carrying value less impairment provision of trade and other receivables and trade and other payables are assumed to approximate their fair values due to their short-term nature. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cashflows at the current market interest rate that is available to the Group for similar financial instruments.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, rarely equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are outlined below.

(a) Useful lives of assets

The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technological development and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions. We believe that the accounting estimate related to the determination of the useful lives of assets is a critical accounting estimate since it involves assumptions about technological development in an innovative industry. Further, due to the significant weight of depreciable assets in our total assets, the impact of any changes in these assumptions could be material to our financial position, and results of operations. As an example, if Magyar Telekom was to shorten the average useful life of its assets by 10%, this would result in additional annual depreciation and amortization expense of approximately HUF 12 billion.

(b) Estimated impairment of goodwill

Goodwill is no longer amortized, but tested for impairment annually or more frequently. As all of our subsidiaries are either not listed on stock exchanges or there is no active market for their shares, the recoverable amounts of the business units and reportable segments are calculated based on fair value determined by the discounted projected cashflows of these units over the next ten years and a terminal value. This is highly judgmental, which carries the inherent risk of arriving at materially different fair values if estimates used in the calculations would prove to be inappropriate. The Group has an implemented policy to make the impairment test based on a 10-year cashflow projection on a reasonable and supportable assumption that presents the management's best estimate. In the calculations, Magyar Telekom used a weighted average cost of capital (WACC) of 7.95% to 10.35% depending on the country of operations and the sub-sector of telecommunications. Perpetual growth rate estimates range between -6.76% and +3% also depending on the country of operations and the sub-sector of telecommunications. The WACC was determined based on CAPM model using the average betas of the peer group, 10 year zero coupon yields and the group average debt ratio of 35%, which is in line with the usual indebtedness of listed peer telecommunications companies, while the perpetual growth rates used are in line with the long-term average growth rate for the telecommunications sector.

For the Hungarian sub-units of the Fixed line CGU, we used a WACC of 10.35% and perpetual growth rates ranging between -6.76% and +3%. If we had used a growth rate of 0% for all these units of the CGU, it would have resulted in an impairment charge of approximately HUF 9,498 million. If Magyar Telekom had used a WACC of 10.85% (an increase of 0.50%) and an unchanged perpetual growth rate compared to the current calculations after the ten year projected period in the same CGU, it would have resulted in an impairment charge of approximately HUF 6,287 million. Any further increase in the WACC or a negative growth rate applied would have resulted in further amounts of impairment, initially related to goodwill allocated to the Hungarian CGU of the Fixed line segment.

(c) Estimated impairment of property, plant and equipment, and intangibles

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

(d) Estimated impairment of trade and other receivables

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

(e) Provisions

Provisions in general are highly judgmental, especially in the cases of legal disputes. The Group assesses the probability of an adverse event as a result of a past event and if the probability is evaluated to be more than fifty percent, the Group fully provides for the total amount of the liability.

(f) Asset retirement obligations

The Group is exposed to legal asset retirement obligations mainly related to its fixed network. The amounts and timing of such future expenses are difficult to predict. Provisions have been calculated based on past history of costs related to dismantling and removing network assets and restoring the site on which they were located. Estimates of future cashflows have been discounted using credit adjusted risk free rates ranging from 7.35 % to 8.30 %. Due to the high level of uncertainty, future expenses may be different from those provided for.

(g) Subscriber acquisition costs

Subscriber acquisition costs primarily include the loss on the equipment sales (revenues and costs disclosed separately) and fees paid to subcontractors that act as agents to acquire new customers. The Group's agents spend a portion of their agent fees for marketing the Group's products. A part of the Group's marketing costs could also be considered as subscriber acquisition cost. The up-front fees collected from customers for activation or connection are marginal compared to the costs. These revenues, costs and losses are recognized when the customer is connected to the Group's fixed or mobile networks. No such costs or revenues are deferred. These acquisition costs (losses) are recognized immediately as they are not accurately separable from other marketing costs and there is no guarantee of recovering these subsidies from the future revenue generated from the customers. Among these costs, net equipment losses of the Group amounted to HUF 11,088 million, while agent fees amounted to HUF 11,012 million in 2006.

5 BUSINESS COMBINATIONS

5.1 Acquisitions in 2006

5.1.1 Orbitel

On November 29, 2005 Magyar Telekom concluded an agreement to acquire a 100% stake in Orbitel for EUR 7.85 million (HUF 1,944 million). Orbitel is a Bulgarian alternative telecommunications and internet service provider offering countrywide voice and data services to the business community utilizing IP technology. In 2005, the company generated revenues of EUR 11.5 million. Orbitel has been consolidated from the date of the financial closing, February 3, 2006.

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

In HUF millions	**Fair values**	**Carrying values**
Purchase price of ownership acquired ………….	1,944	
Additional costs directly attributable to the business combination …	38	
Consideration paid………………………………	1,982	
Net assets acquired ………………………………	1,013	
Goodwill ………………………………………..	969	
Net assets acquired:		
Cash ……………………………………………….	22	22
Other financial assets …………………………...	6	6
Receivables ……………………………………..	335	335
Income tax receivable ……………………………	7	7
Inventory …………………………………………	12	12
Property, plant and equipment ………………….	524	381
Intangible assets ………………………………....	812	221
Other non current assets …………………………..	3	3
Trade and other payables ……………………….	(384)	(384)
Loans and other borrowings ……………………	(190)	(190)
Net deferred tax liability ………………………..	(134)	(24)
	1,013	389

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separate asset. Further, the customer value recognized only represents the customers and services rendered to them existing on the acquisition date, while the majority of the goodwill represents the value of, and the future revenues from, customers to be acquired from the acquisition date or the planned extension of services.

5.1.2 Dataplex

On December 12, 2005 Magyar Telekom agreed to acquire a 100% stake in Dataplex Kft. for HUF 5.1 billion, based on the net debt position of the company at the time of the agreement. Dataplex is major player in the Hungarian IT hardware co-location market with revenues of around HUF 1.3 billion in 2005. The financial closing of the transaction took place following the approval by the Hungarian Competition Authority, on April 5, 2006. Dataplex is consolidated in the Fixed line segment of the Group since that date.

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

In HUF millions	**Fair values**	**Carrying values**
Purchase price of ownership acquired ………….	5,113	
Additional costs directly attributable to the business combination …	35	
Consideration paid………………………………	5,148	
Net assets acquired ………………………………	1,100	
Goodwill ………………………………………..	4,048	
Net assets acquired:		
Cash ……………………………………………….	1	1
Receivables ……………………………………..	148	148
Inventory …………………………………………	6	12
Property, plant and equipment ………………….	811	801
Intangible assets ………………………………...	933	1
Trade and other payables ……………………….	(556)	(556)
Loans and other borrowings ……………………	(56)	(56)
Net deferred tax liability ………………………..	(187)	-
	1,100	351

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separable asset. Further, the customer value recognized only represents the customers existing on the acquisition date, while the majority of the goodwill represents the value of, and future revenues from, customers to be acquired from the acquisition date.

5.1.3 KFKI Group

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

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

In HUF millions	**Fair values**	**Carrying values**
Purchase price of ownership acquired ………….	8,170	
Additional purchase price contingent upon results	1,500	
Additional costs directly attributable to the business combination …	170	
Consideration paid………………………………	9,840	
Net assets acquired ………………………………..	5,372	
Goodwill ………………………………………..	4,468	
Net assets acquired:		
Cash ……………………………………………….	344	344
Receivables ……………………………………..	2,629	2,629
Income tax receivable ……………………………	33	33
Inventory …………………………………………	656	656
Property, plant and equipment ………………….	663	632
Intangible assets ………………………………...	5,514	233
Trade and other payables ……………………….	(2,687)	(2,687)
Loans and other borrowings ……………………	(587)	(587)
Provisions ………………………………………..	(154)	(154)
Net deferred tax liability ………………………..	(1,039)	23
	5,372	1,122

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separate asset. Further, the customer value recognized only represents the customers existing on the acquisition date, while the majority of the goodwill represents the value of, and future revenues from, customers to be acquired from the acquisition date.

5.1.4 IWIW, Adnetwork, MFactory

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

In May 2006 Magyar Telekom acquired the 100% ownership of Adnetwork Kft, the leading Hungarian online advertisement network for an initial purchase price of HUF 168 million and additional price of HUF 10 million. Adnetwork was established in 2005 and generated revenues of HUF 28 million in 2005.

In December 2006 Magyar Telekom acquired a 75.05% stake in MFactory, one of the leading Hungarian mobile content producers and aggregators for HUF 469 million. In addition, the Company also has an option to increase its stake in MFactory to 100% from 2009, while MFactory's minority owners have a put option for their shares. The Group considers this combination of the options to be of a liability nature (in an amount of HUF 166 million), therefore MFactory is consolidated as a 100% subsidiary in the Fixed line segment of the Group in 2006, while the initial goodwill arising on the business combination is allocated to the Mobile segment. MFactory's revenue amounted to HUF 190 million in 2006.

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

The fair values of the net assets of iWiW equal their carrying values. Due its immaterial size, no fair valuation was done for Adnetwork's net assets, while due to the late acquisition of MFactory, the purchase price allocation has not been finalized until the approval of these financial statements.

In HUF millions	**Carrying values**
Purchase price of ownership acquired ………….	1,767
Further purchase price payable for the remaining shares in MFactory ……………..	166
Additional purchase price and costs directly attributable to the business combination …………	11
Consideration paid ………………………………...	1,944
Net assets acquired ………………………………	83
Goodwill …………………………………………..	1,861
Net assets acquired:	
Cash ……………………………………………….	12
Receivables ………………………………………..	73
Intangible assets …………………………………	53
Income tax payable ………………………………..	(5)
Trade and other payables ………………………….	(50)
	83

5.1.5 MakTel – own shares

In June, 2006 MakTel acquired 10% of its own shares at a public auction held by the Macedonian Government (the minority owner) for EUR 60.9 million (HUF 16,579 million including additional costs). Following the share repurchase transaction, Magyar Telekom's voting rights in MakTel increased from 51.0% to 56.7%, while the Macedonian Government's share of ownership fell to 36.8%, with the rest of the shares owned by smaller minority shareholders. The difference between the purchase price of the shares and the decrease in the minority interests was recognized as goodwill in an amount of HUF 1,724 million, all allocated to the Mobile segment.

5.1.6 MobilPress

In December 2006 Magyar Telekom agreed to acquire a 100% stake in MobilPress for HUF 600 million plus the dividend to be declared for 2006 (max. HUF 50 million). The transaction was subject to the approval of the Hungarian Competition Authority. The transaction was closed on January 25, 2007, and MobilPress has been consolidated since that date, included in the Fixed line segment. MobilPress is one of the major Hungarian mobile content providers and manages, among others, the t-zones portal, with revenues around HUF 1.5 billion in 2006.

The carrying values of MobilPress's net assets at acquisition as well as the consideration paid are disclosed in the table below. The Group has not finalized the purchase price allocation for this recent acquisition, therefore the fair values are not available at the date of these financial statements.

In HUF millions	**Carrying values**
Purchase price of ownership acquired …………….	600
Additional expected purchase price ………………	50
Consideration paid ………………………………...	650
Net assets acquired ………………………………..	93
Goodwill …………………………………………..	557
Net assets acquired:	
Cash ……………………………………………….	64
Receivables ………………………………………..	266
Non current assets …………………………………	56
Trade and other payables ………………………….	(285)
Short term borrowings …………………………….	(2)
Non current liabilities ……………………………..	(6)
	93

5.2 Acquisitions in 2005

5.2.1 Crnogorski Telekom (CGT)

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

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

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

In HUF millions	Total	Net assets included in the Fixed line segment on first consolidation	Net assets included in the Mobile segment on first consolidation
Purchase price of ownership acquired ………	34,954		
Additional costs directly attributable to the business combination ………………..	973		
Consideration paid	35,927		
Fair value of net assets acquired	30,805		
Goodwill	5,122	-	5,122
Fair value of net assets acquired:			
Cash	1,866	-	-
Receivables	7,678	6,442	1,236
Income tax receivable	339	-	-
Inventory	609	426	183
Property, plant and equipment	28,687	22,495	6,192
Intangible assets	9,958	3,700	6,258
Other non current assets	1,080	1,080	-
Trade and other payables	(3,917)	(3,148)	(769)
Loans and other borrowings	(3,290)	-	-
Provisions	(1,951)	(1,914)	(37)
Net deferred tax liability	(807)	-	-
	40,252	27,339	12,939
Minority interests	(9,447)		
Total	30,805		

The goodwill arising on this acquisition partly represents the assembled workforce that can not be recognized as a separable asset. Further, the customer values recognized only represent the customers existing on the acquisition date, while the majority of the goodwill represents the value of customers to be acquired from the acquisition date.

5.3 Pro forma information on business combinations

The following pro forma information shows the most important financial data of the Group, including the subsidiaries acquired as if they had been consolidated at the beginning of the financial year in which the acquisition was made, and also how much the business combinations contributed to the reported figures since the acquisition date.

	2004	2005	2006
	(in HUF millions)		
Revenues			
Reported	596,792	615,054	671,196
Pro forma – if consolidated from beginning of year	596,792	620,376	684,099
Contribution since date of business combination	-	20,521	12,465
Net income			
Reported	34,641	78,415	75,453
Pro forma – if consolidated from beginning of year	34,641	78,049	76,267
Contribution since date of business combination	-	1,364	191

5.4 Disposal of Cardnet in 2006

During 2006 the Company sold the total of its 72% ownership in Cardnet. The table below shows the amount of assets and liabilities disposed of, the sale consideration received and the gain on the sale. The gain was recognized in the income statement (Finance income).

	HUF millions
Fair value of consideration received	305
Carrying amounts of net assets disposed of	(255)
Reduction of Minority interest	71
Gain on the sale	121
Net assets disposed of:	
Cash	190
Receivables and inventory	74
PPE and Intangible assets	43
Trade and other payables	(52)
	255

6 Cash and cash equivalents

	At December 31,		
	2005	2006	
	(in HUF millions)		Average interest rate
HUF	1,794	1,873	4.37%
MKD	21,916	32,717	3.35%
EUR	13,527	34,029	3.38%
Other	8,823	9,221	4.21%
	46,060	77,840	3.49%

	At December 31,	
	2005	2006
	(in HUF millions)	
Cash on hand	166	1,556
Cash in banks and other cash equivalents	45,894	76,284
	46,060	77,840

7 Other financial assets

	At December 31,	
	2005	2006
	(in HUF millions)	
Finance lease receivable (Note 33 c)	-	1,856
Derivative financial instruments	-	378
Available for sale financial assets	1,817	458
	1,817	2,692

The carrying value of the other financial assets included in the table above approximates or equals their fair value depending on the measurement policy applied to them.

The Finance lease receivable represents the short term portion of the finance lease receivable from the PMR services (Note 33 c).

Derivative financial instruments as at December 31, 2006 include the fair value of open currency forwards.

Available for sale financial assets as at December 31, 2005 included the fair value of the Group's investment in CKB, a Montenegrin Bank. The Group had the intention to sell this investment acquired through the business combination with Crnogorski Telekom in 2005, but there was no active market for these shares. In 2005, the Group received additional shares in the form of a dividend and also participated in the share capital increase of CKB to maintain its relatively significant share of ownership (11.8%) to benefit from the planned sale. As these additional shares were acquired at a discount compared to the estimated fair value, the Group recognized a revaluation gain (as restated – Note 2.1.1) against an equity reserve (Revaluation of AFS financial assets – net of tax) in 2005. In 2006 the Group sold its CKB shares with a gain and released the revaluation reserve to the income statement (Finance income).

The table below shows the revaluation related to the CKB shares.

	At December 31, 2005	At December 31, 2006
	(in HUF millions)	
Revaluation gain	213	-
Less tax	(19)	-
Revaluation – net	194	-
Less minority interest	(45)	-
Included in Revaluation reserve for AFS financial assets– net of tax	149	-

8 Trade and other receivables

	At December 31, 2005	At December 31, 2006
	(in HUF millions)	
Domestic trade receivables	100,206	102,009
Foreign trade receivables	5,252	2,827
Receivables from associates	1,008	771
Receivables from Deutsche Telekom Group companies	3,771	7,991
Advances paid for current assets	2,577	1,680
Other taxes receivable	1,515	3,318
Prepayments and accrued income	3,686	7,598
Other receivables	7,932	6,603
	125,947	132,797
Allowance for impairment loss	(29,991)	(28,781)
	95,956	104,016

The allowance for impairment loss and changes therein for 2005 and 2006 are as follows:

	At December 31, 2005	At December 31, 2006
	(in HUF millions)	
Impairment loss, beginning of period	(24,276)	(29,991)
Charged to expense (included in other operating expenses)	(6,266)	(5,066)
Impairment losses of acquired companies on acquisition	(3,674)	(116)
Utilized and translation differences	4,225	6,392
Impairment loss, end of period	(29,991)	(28,781)

9 Income tax

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Corporate income tax	9,352	11,686	6,423
Other income taxes	8,455	8,366	8,529
Deferred income taxes	(1,665)	1,806	9,268
Total income tax expense	16,142	21,858	24,220

Current income tax receivable and payable in the balance sheet represent the amount of corporate and other income taxes receivable from, and payable to, the tax authorities of the countries in which the Group operates.

9.1 Tax rate reconciliation

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

	Note	For the year ended December 31,		
		2004	2005	2006
		(in HUF millions)		
IFRS profit before income tax		59,469	110,583	111,684
Tax at 16%		(9,515)	(17,693)	(17,869)
Impact of different tax rates	(a)	491	435	(323)
Tax on items not subject to tax	(b)	2,091	1,394	2,405
Tax on non deductible expenses	(c)	(3,204)	(1,093)	(1,955)
Impact of tax incentives	(d)	584	897	778
Other income taxes	(e)	(8,455)	(8,366)	(8,529)
Impact of tax deductibility of other income taxes	(f)	1,691	2,008	2,701
Withholding tax	(g)	-	-	(2,034)
De-recognized deferred tax on tax losses	(h)	-	-	(255)
Broadband tax credit accretion	(i)	175	560	861
Income tax expense		(16,142)	(21,858)	(24,220)

(a) Impact of different tax rates

The corporate tax rate in Hungary was 16% in 2004, 2005 and in the first 8 months of 2006. As of September 1, 2006 a so called Solidarity tax was introduced in Hungary, which is an extra 4% tax on a base very similar to the corporate tax base, with fewer adjusting items from accounting profit before tax to arrive at the tax base. Therefore, the tax rate in the last 4 months of 2006 can be considered 20%. The tax rate reconciliation for 2006 also includes 16%, while the difference arising due to the introduction of the Solidarity tax is included in this line of the reconciliation.

The Group is also present in foreign countries where the tax rate is generally lower than in Hungary. The tax rate in Macedonia was 15% in 2004, 2005 and 2006, while the enacted tax rate for 2007 is 12%, while from 2008 this will be reduced further, to 10%. Deferred tax balances have been recalculated accordingly.

The corporate tax rate is 9% in Montenegro, 16% in Romania, 15% in Bulgaria, and 25% in the Ukraine.

This line of the reconciliation also includes the tax impacts of the different tax rates of the foreign countries where the Group is also present through its subsidiaries.

(b) Tax on items not subject to tax

Items not subject to income tax consist primarily of the other income from DTAG (Note 35), which is not taxable, as well as the share of associates' profit as it is included net of tax in the Profit before income tax. This line of the reconciliation includes the tax impact of the above items.

(c) Tax on non deductible expenses

This line of the reconciliation shows the tax impact of the non deductible expenses, including premature receivable write-downs, certain impairment losses and entertainment expenses.

(d) Tax incentives

Tax incentives include the tax impact of qualifying investments in property, plant and equipment in Macedonia, which can be utilized as a reducing item in the calculation of the corporate tax base.

(e) Other income taxes

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, determined at a substantially higher level than the corporate tax base. As the first line of the reconciliation calculates theoretical tax expense calculated using the corporate tax rate, the Hungarian local business tax and the innovation fee impose additional tax expenses for the Hungarian entities of the Group.

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

These Hungarian other income taxes are deductible expenses for corporate tax purposes. In addition, a certain percentage of the local business tax paid is deductible further from the corporate tax base (25% in 2004, 50% in 2005 and 100% in 2006).

(g) Withholding tax

The Group is present through its subsidiaries in Macedonia, which introduced withholding tax of 5% on dividend distribution to Hungary as of January 1, 2006. Montenegro also levies a 5% withholding tax on dividend distribution to Hungary. The reconciliation includes the amount of deferred tax calculated and recognized on the undistributed profits of these subsidiaries that are expected to be subject to withholding tax in case of dividend distributions.

(h) De-recognized deferred tax on tax losses

Deferred tax asset is created on tax losses only to the extent that the realization of the related tax benefit is probable. Deferred tax assets on tax losses that will probably not be recovered are de-recognized.

(i) Broadband investment tax credit accretion

Broadband investment tax credit accretion shows the increase of net present value of the investment tax credit deriving from the utilization of the tax credits in year(s) following the year of recognition.

9.2 Deferred taxes

Magyar Telekom's deferred tax balances are as follows:

	Balance at Dec. 31, 2004	Income statement effect	Other move-ments	Balance at Dec. 31, 2005	Income statement effect	Other move-ments	Balance at Dec. 31, 2006
Deferred tax assets and (liabilities)							
Investment tax credits ……………….	6,849	741	3,066	10,656	856	2,788	14,300
Net operating loss carry-forward ……	3,721	2,354	1	6,076	(4,859)	-	1,217
Investments in subsidiaries ………….	(1,334)	434	-	(900)	(300)	-	(1,200)
Withholding tax ……………………..	-	-	-	-	(2,034)	-	(2,034)
Other financial assets ………………..	(140)	43	121	24	(350)	19	(307)
Impairment of receivables, inventory	3,464	264	-	3,728	(678)	-	3,050
Property, plant and equipment and intangible assets	(4,795)	(1,918)	(852)	(7,565)	(88)	(1,388)	(9,041)
Goodwill ……………………………..	-	(1,864)	-	(1,864)	(2,262)	-	(4,126)
Trade and other payables	81	23	-	104	259	-	363
Loans and other borrowings	205	(49)	-	156	123	-	279
Deferred revenue	380	(223)	-	157	(157)	-	-
Provisions for liabilities and charges ..	2,816	(1,611)	-	1,205	222	-	1,427
Total net deferred tax assets	11,247	(1,806)	2,336	11,777	(9,268)	1,419	3,928
Add back: deferred tax liability	1,280			3,189			5,647
Deferred tax assets	12,527			14,966			9,575

Items included in other movements	2005 Other movements	2006 Other movements
Investment tax credit recognized against cost of PPE ……..	5,373	3,109
Utilization of investment tax credit	(2,307)	(321)
Change in accounting policy – embedded derivatives ………………..	140	-
AFS financial assets – valuation differences recognized directly in equity	(19)	19
Currency translation adjustment arising on consolidation……………...	(44)	(29)
Arising on business combinations …….	(807)	(1,359)
	2,336	1,419

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

Deferred tax arising on investment tax credits are recognized against the cost of the related investment.

Deferred tax on certain embedded derivatives (HUF 140 million) was derecognized against the opening retained earnings as at December 31, 2004 as a result of the change in accounting policy in 2005 for the recognition of embedded derivatives.

Deferred tax arising on the revaluation of available-for-sale financial assets recognized directly in equity is also recognized directly in equity.

Temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognized amounts to HUF 4,602 million at December 31, 2006 (2005: HUF 7,452 million).

If the Group's Macedonian subsidiaries distributed all their distributable reserves in the form of a dividend, the Group would have to pay HUF 1,275 million withholding tax in addition to the amount for which a deferred tax liability is recognized as at December 31, 2006 (HUF 1,640 million). If the Group's Montenegrin subsidiaries distributed all their distributable reserves in the form of a dividend, the Group would have to pay HUF 1,081 million withholding tax in addition to the amount for which a deferred tax liability is recognized as at December 31, 2006 (HUF 394 million). As the Group can control the timing and the form of the dividends, deferred tax liabilities have only been recognized to the extent of the planned dividend distributions of the subsidiaries' retained earnings (results of 2005 and 2006) in the foreseeable future.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. Tax losses amounting to HUF 1,572 million will expire in 2007 and HUF 1,674 million in 2008. The remaining balance of tax losses of 4,361 million is not subject to statutory limitations.

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

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

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

Earned in year	Amount of broadband investment	Amount of tax credit earned	Tax credit utilized	Accretion recognized in tax expense to date	Tax credit carried forward at December 31, 2006
2003 …...	6,356	2,765	(171)	745	3,339
2004 …	7,115	3,174	(90)	569	3,653
2005 …	13,959	5,563	(2,204)	282	3,641
2006 …	12,347	3,844	(177)	-	3,667
Total …...	39,777	15,346	(2,642)	1,596	14,300
			Expires in	2007	3,339
				2014	7,242
				2015	1,124
				2016	2,595
					14,300

In order to utilize the tax credits and certain tax deductibility opportunities earned by the Group’s entities, they have to comply with strict requirements as set out in the relevant tax regulations. Management believes that the Group has complied with the requirements to recognize these as deferred tax assets.

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

10 Inventories

	At December 31,	
	2005	2006
	(in HUF millions)	
Cables, wires and other materials	3,493	4,143
Inventory for resale	6,215	7,473
Subtotal	9,708	11,616
Less allowances for obsolete inventory	(1,294)	(1,156)
	8,414	10,460

11 Assets held for disposal

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

12 Property, plant and equipment - net

	Land and related rights	Buildings	Telecom. equipment	Other equipment	Total
	in HUF millions				
At January 1, 2005					
Cost ………………………………………	5,543	112,328	868,615	135,396	1,121,882
Accumulated depreciation …………………	(1,629)	(20,756)	(428,763)	(96,581)	(547,729)
Carrying amount …………………………..	3,914	91,572	439,852	38,815	574,153
Of which held for disposal …………………..					(3,063)
					571,090
Carrying amount - January 1, 2005 ………	3,914	91,572	439,852	38,815	574,153
Exchange differences ……………………	27	500	2,106	149	2,782
Acquisitions ……………………………..	1,226	6,502	19,116	1,843	28,687
Additions ………………………………..	185	6,625	54,194	14,701	75,705
Disposals ………………………………..	(203)	(818)	(201)	(313)	(1,535)
Impairment charge ………………………	-	(75)	(199)	(117)	(391)
Depreciation charge ………………………	(214)	(3,137)	(76,916)	(16,096)	(96,363)
Carrying amount - December 31, 2005 ……	4,935	101,169	437,952	38,982	583,038
At December 31, 2005					
Cost ………………………………………	6,743	124,636	931,111	143,832	1,206,322
Accumulated depreciation …………………	(1,808)	(23,467)	(493,159)	(104,850)	(623,284)
Carrying amount …………………………..	4,935	101,169	437,952	38,982	583,038
Of which held for disposal …………………..					(2,302)
					580,736
Carrying amount - January 1, 2006 ………	4,935	101,169	437,952	38,982	583,038
Exchange differences ……………………	2	(14)	194	37	219
Acquisitions ……………………………..	-	134	518	1,321	1,973
Additions ………………………………..	123	4 217	57,070	13,005	74,415
Disposals ………………………………..	(187)	(3,254)	(701)	(394)	(4,536)
Impairment charge …………………………	(85)	(174)	(1,404)	(64)	(1,727)
Depreciation charge ………………………	(172)	(3,400)	(78,151)	(13,934)	(95,657)
Carrying amount - December 31, 2006 ……	4,616	98,678	415,478	38,953	557,725
At December 31, 2006					
Cost ………………………………………..	6,654	124,145	972,654	154,113	1,257,566
Accumulated depreciation …………………	(2,038)	(25,467)	(557,176)	(115,160)	(699,841)
Carrying amount ……………………………	4,616	98,678	415,478	38,953	557,725
Of which held for disposal …………………..					(6,825)
					550,900

The closing balance of Property, plant and equipment includes assets in the course of construction in an amount of HUF 19,232 million as at December 31, 2006 (2005: HUF 28,069 million). In the table above the assets in course of construction are shown in the categories where the capitalization is expected.

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

Additions to property, plant and equipment are shown net of the investment tax credit related to broadband investments of HUF 3,109 million in 2006 (2005: HUF 5,373 million). For more details, see Note 9.

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

Impairment losses charged in 2006 relate to various assets, the recoverable amounts of which were defined based on the respective assets' values in use as these were found higher than their fair value less cost to sell. Value in use was determined using discounted cashflow analyses. The discount rates used were in the range of 11.49-11.86% in 2006.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2006 the gross book value of the leased back assets is HUF 1,134 million (2005: HUF 752 million) and the net book value is HUF 903 million (2005: HUF 645 million).

Included mainly in other equipment are assets leased under finance lease conditions. At December 31, 2006 the gross book value of the leased assets is HUF 1,142 million and the net book value is HUF 1,057 million. The Group had no such assets as at December 31, 2005.

Included in telecommunications equipment at December 31, 2006 are assets leased under operating lease contracts to customers with a gross book value of HUF 7,744 million (2005: HUF 5,657 million) and net book value of HUF 2,125 million (2005: HUF 2,217 million). Depreciation for the year of these assets amounted to HUF 876 million (2005: HUF 934 million). The future minimum lease payments receivable under these contracts are disclosed in Note 33 (d).

As a result of the continuous revision of the useful life of the Group's assets, the lives of certain assets were changed as of January 1, 2006. These assets mainly included IT equipment and software, and the change in life resulted in HUF 58 million higher depreciation expense in 2006.

HUF 2,369 million of PPE has restricted titles as at December 31, 2006 (2005: HUF 1,094 million), which serve as pledges for loans or other borrowings.

13 Intangible assets - net

	Goodwill	Software	Concessions and licenses	Brand name	Other	Total
			in HUF millions			
At January 1, 2005						
Cost	297,858	90,101	36,829	160	6,026	430,974
Accumulated amortization	(70,938)	(50,019)	(7,877)	(24)	(3,765)	(132,623)
Carrying amount	226,920	40,082	28,952	136	2,261	298,351
Carrying amount - January 1, 2005	226,920	40,082	28,952	136	2,261	298,351
Exchange differences	115	336	61	35	81	628
Acquisitions	5,122	1,698	2,820	1,740	3,700	15,080
Additions	-	16,705	-	-	6,964	23,669
Amortization charge	-	(14,676)	(2,055)	(278)	(922)	(17,931)
Carrying amount - December 31, 2005	232,157	44,145	29,778	1,633	12,084	319,797
At December 31, 2005						
Cost	232,157	110,038	40,139	1 940	16,562	400,836
Accumulated amortization	-	(65,893)	(10,361)	(307)	(4,478)	(81,039)
Carrying amount	232,157	44,145	29,778	1,633	12 084	319,797
Carrying amount - January 1, 2006	232,157	44,145	29,778	1,633	12,084	319,797
Exchange differences	(78)	84	4	71	27	108
Acquisitions	13,070	391	177	1,418	5,308	20,364
Additions	-	16,379	7	-	72	16,458
Disposals	-	(122)	-	-	-	(122)
Impairment	-	-	-	(1,302)	(44)	(1,346)
Amortization charge	-	(17,659)	(2,741)	(400)	(2,719)	(23,519)
Carrying amount - December 31, 2006	245,149	43,218	27,225	1,420	14,728	331,740
At December 31, 2006						
Cost	245,149	121,675	40,705	1,578	20,339	429,446
Accumulated amortization	-	(78,457)	(13,480)	(158)	(5,611)	(97,706)
Carrying amount	245,149	43,218	27,225	1,420	14,728	331,740

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

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

The Group regularly carries out an impairment test on goodwill in the last quarter of the financial years. We established in all cases that the carrying amount of goodwill allocated to the cash generating units did not suffer impairment as the recoverable amounts of the CGUs based on fair values determined using discounted projected cashflows proved to be higher than the carrying values. Consequently, no goodwill impairment was charged in any of the reported years. The cashflows attributable to the national CGUs were projected for the coming ten years with terminal values determined.

The most significant amounts of goodwill are allocated to the Hungarian and the Foreign operations of the Mobile segment. Beyond the 10-year planning period, the perpetual growth rates of these Mobile operations were determined from 0% to 2% depending on the country of operations. The weighted average cost of capital was determined at 10.54% for the Hungarian Mobile operations, and in the range of 9.5% to 10.14% for the Foreign Mobile operations depending on the country of operations.

The most significant individual intangible assets as of December 31, 2006 are listed in the table below.

Description	Carrying amount in HUF millions	Remaining useful life (years)
Goodwill allocated to Hungarian Mobile	161,935	-
Goodwill allocated to Foreign Mobile	45,803	-
Goodwill allocated to Hungarian Fixed line	23,472	-
Goodwill allocated to Foreign Fixed line	13,939	-
T-Mobile H UMTS licence	15,463	13
T-Mobile H DCS 1800 licence	7,413	8
Other intangible assets	63,715	8
	331,740	

14 Investments in associates

	For the year ended December 31,	
	2005	2006
	(in HUF millions)	
Opening balance of associates	5,750	5,020
Capital injection to TSH	669	205
Share of associates' profits	330	703
Dividends	(1,729)	(157)
Closing balance of associates	5,020	5,771

The following table shows the total assets and liabilities as at December 31, 2006, and revenues and profit for the year ended December 31, 2006 of the major associates of the Group.

	Hunsat	T-Systems Hungary	Magyar RTL
		(in HUF millions)	
Total assets	1,173	11,051	30,190
Total liabilities	1,073	7,909	18,213
Revenues	3,494	14,004	31,814
Profit for the year	145	21	3,340

The profit of T-Systems Hungary in 2006 includes the profit on the sale of a business unit to a subsidiary of its majority owner, T-Systems International in an amount of HUF 418 million, the Group's share of which was recognized directly in the Retained earning of the Group. See more details in the Equity notes. .

15 Other non current assets

	At December 31, 2005	At December 31, 2006
	(in HUF millions)	
Finance lease receivable	-	16,163
Employee loans	4,089	4,305
Prepaid employee benefits	-	1,183
Other	2,014	3,390
	6,103	25,041

Other non current assets are either carried at fair value or at amortized cost, in which case it usually approximates fair value.

The Finance lease receivable represents the long term portion of the finance lease receivable from the PMR services (Note 33 c).

16 Loans from related parties

Related party loans are taken from Deutsche Telekom International Finance (DTIF), the treasury vehicle of Deutsche Telekom Group, and are denominated in HUF.

The table below shows the details of the loans outstanding as at December 31, 2006.

	Carrying amount (HUF millions)	Interest rate (%)	Fixed / variable	Repayable
	20,000	7.55	fixed	Jan 2007
	14,000	10.20	fixed	May 2007
	20,000	7.61	fixed	May 2007
	20,000	7.45	fixed	Dec 2007
Due within 1 year	74,000			
	5,000	9.68	fixed	Sep 2009
	25,000	9.61	fixed	Oct 2009
	20,000	7.53	fixed	Oct 2009
	28,000	8.91	variable	Oct 2009
	60,000	8.56	fixed	May 2012
	47,432	8.35	variable	Jan 2013
Due after 1 year	185,432			
	259,432			

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

	At December 31,			
	2005		2006	
	(in HUF millions)			
	Book value	Fair value	Book value	Fair value
Fixed rate	257,675	268,599	184,000	188,914
Variable rate	28,973	28,973	75,432	75,432
Total related party loans	286,648	297,572	259,432	264,346

The weighted average interest rate on related party loans was 8.45% in 2006 (8.45% in 2005, 10.14% in 2004).

The majority of the Group's related party loans is subject to fixed interest rates that are exposed to fair value risk as it is stated in the table above. Any decrease of market interest rates will result in an increase of the fair value of the liabilities.

17 Loans and other borrowings – third party

		At December 31,	
		2005	2006
		(in HUF millions)	
Current bank loans		43,196	28,846
Non current bank loans		13,278	18,250
Total bank loans	(a)	56,474	47,096
Current other borrowings		406	759
Non current other borrowings		937	2,447
Total other borrowings	(b)	1,343	3,206
		57,817	50,302
Total falling due within one year		43,602	29,605
Total falling due after one year		14,215	20,697
		57,817	50,302

(a) Bank loans

At December 31, 2006, principal repayments of bank loans fall due in:

	Maturity	
	As at December 31,	
	2005	2006
Year	(in HUF millions)	
Within 1 year	43,196	28,846
1-5 years	13,278	18,250
After 5 years	-	-
	56,474	47,096

All bank loans are denominated in HUF. The weighted average interest rate on bank loans was 7.86% in 2006 (6.53% in 2005, 10.25% in 2004).

Loans totaling HUF 17,708 million at December 31, 2006 are revolving loans (2005: HUF 3,825 million) which can be prepaid at any time and may be drawn down in one to six month rolling periods.

The following table shows the weighted average interest rates of bank loans as at December 31, 2006.

	Maturities						
	2007	2008	2009	2010	2011	There-after	Total
	(in HUF millions, except percentages)						
Variable rate	25,474	5,500	8,750	4,000	-	-	43,724
Average interest rate	7.4%	8.47%	8.41%	8.52%	-	-	7.84%
Fixed rate	3,372	-	-	-	-	-	3,372
Average interest rate	8.14%	-	-	-	-	-	8.14%
Total	28,846	5,500	8,750	4,000	-	-	47,096

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

	At December 31,			
	2005		2006	
	(in HUF millions)			
	Book value	Fair value	Book value	Fair value
Fixed rate	848	848	3,372	3,372
Variable rate	55,626	55,626	43,724	43,724
Total bank loans	56,474	56,474	47,096	47,096

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

The majority of the Group's third party loans and borrowings are subject to variable interest rates, which are exposed to cashflow risks. If interest rates are rising, it results in higher cash outflows through interest payments.

(b) Other borrowings

The majority of other borrowings is finance lease payables. See Note 33 (a) for more detail.

(c) Credit facilities and pledges

At December 31, 2006, Magyar Telekom had un-drawn committed credit facilities of HUF 91,864 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.

18 Trade and other payables

(a) Current liabilities

	At December 31,	
	2005	2006
	(in HUF millions)	
Domestic trade payables	58,292	59,526
Foreign trade payables	5,919	7,486
Salaries and wages	8,794	7,222
Other taxes and social security	12,190	13,162
Amounts received in advance	6,861	6,603
Accrued expenses and prepayments received	6,587	9,965
Accrued interest to DTIF	6,198	3,756
Accrued interest to third parties	461	298
Amounts owed to DT Group companies	3,567	6,207
Payable to associates	694	1,287
Dividend payable to MagyarCom GmbH	-	45,074
Dividends payable to others	77	31,093
Other payables	9,824	8,912
	119,464	200,589

Dividends payable increased significantly as the General Meeting of Magyar Telekom approved the 2005 financial statements in December 2006, and the dividends approved were only paid in January 2007. In all prior years these dividends were approved in April and almost entirely paid before the end of the financial year. The delay in 2006 was due to the investigation (Note 1.2).

Included in other payables as at December 31, 2006 is an amount of HUF 4,590 million (2005: HUF 2,950 million) potentially repayable to universal customers related to the reduced fixed to mobile termination charges (Note 34), which was accounted for as a reduction of revenues.

(b) Non current liabilities

The majority of Other non current liabilities is the long term portion of payables in relation to the acquisition of a service contract in 2005 for the operation of a Hungarian governmental backbone network. The total amount of these payables amount to HUF 6,192 million as at December 31, 2006 (2005: HUF 6,098 million), the short term portion of which (HUF 1,075 million) is included in Trade and other payables (Other payables).

19 Deferred revenue

Deferred revenue includes amounts collected for services to be delivered in future periods.

20 Provision for liabilities and charges

	Severance	Customer loyalty programs	Legal cases	Other	Total
			(in HUF millions)		
January 1, 2005	13,022	1,785	3,160	331	18,298
Acquired through business combinations	-	-	173	1,778	1,951
Amounts utilized / retired	(10,721)	(1,701)	(2,945)	(509)	(15,876)
Additions	1,328	1,823	2,257	177	5,585
December 31, 2005	3,629	1,907	2,645	1,777	9,958
January 1, 2006	3,629	1,907	2,645	1,777	9,958
Acquired through business combinations	-	-	-	154	154
Amounts utilized / retired	(2,639)	(1,837)	(2,455)	(1,145)	(8,076)
Additions	3,063	1,965	2,462	2,232	9,722
December 31, 2006	4,053	2,035	2,652	3,018	11,758
Less: non current portion	(220)	(1,401)	(411)	(1,312)	(3,344)
Current provision	3,833	634	2,241	1,706	8,414

(a) Severance

The provision for severance as at December 31, 2006 mostly relates to the employee terminations in 2007 in Macedonia and Montenegro. The long term portion relates to severances payable in 2008, in accordance with the agreement made with employee representatives of Magyar Telekom Plc. in 2004.

771 employees were dismissed in 2006 (2005: 1600), related to which severance payments were made. The balance of provision as at December 31, 2006 relates to 1,032 employees (2005: 600) primarily working in network and back office areas.

The total payments made in relation to employee termination in 2006 amounted to HUF 6,099 million (2005: HUF 14,535 million), of which HUF 2,639 million (2005: HUF 10,721 million) was charged against the provision for liabilities and charges as at December 31, 2005, while the rest was recognized as employee related expense in 2006.

(b) Customer loyalty

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

(c) Legal cases

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

(d) Other provisions

Other provisions as at December 31, 2006 include asset retirement and guarantee obligations and further other individually small items.

21 Revenues – Fixed line services

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Voice retail	218,526	197 679	182,280
Voice wholesale	22,179	25,579	28,691
Internet	30 138	39 783	49 733
Data	24,931	26,792	27,121
System integration - IT	9,422	9,023	24,679
Multimedia	13 364	15 037	17 506
Equipment	4,834	5,205	4,249
Other revenues	8,589	10,108	9,607
Total Fixed line revenues	331,983	329,206	343,866

22 Revenues – Mobile services

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Voice	207,636	225,003	240,885
Non voice	30,047	36,539	39,658
Equipment and activation	25,369	23,472	25,280
Other revenues	1,757	834	21,507
Total Mobile revenues	264,809	285,848	327,330

Other revenues in 2006 include the revenue from the sale of network assets (Note 33 c) constructed for the PMR services commenced in 2006 and the services rendered on this network. The related costs of the sale of these network assets are included in Cost of equipment sales.

23 Employee related expenses

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Short term benefits	92,733	90,605	92,638
Share based payments (Note 24)	70	270	281
Termination benefits	20,180	5,142	6,523
Total before capitalization	112,983	96,017	99,442
Expenses capitalized	(3,486)	(3,234)	(4,189)
	109,497	92,783	95,253
Total amount paid to defined contribution plans (including social security)	25,876	21,797	21,737

24 Share-based compensation

(a) Management share option plan

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

On July 1, 2002, the Company granted 3,964,600 options to participants of the stock option plan at an exercise price of HUF 933 for the first tranche (exercisable in 2003) and HUF 950 for the second and third tranches (exercisable in 2004 and 2005). As the Company's share price as quoted on the BÉT (Budapest Stock Exchange) on the grant date was HUF 833 per share, there was no intrinsic value to the options. The options have a life of five years from the grant date, meaning that the options are forfeited without replacement or compensation on June 30, 2007.

The option with respect to a maximum of one-third of the shares that can be purchased under the first tranche may be exercised from July 1, 2003 until the end of the term. The option with respect to a maximum of a further one-third of the shares that can be purchased under the second tranche may be exercised from July 1, 2004 until the end of the term. The option with respect to the rest of the shares that can be purchased under the third tranche may be exercised from July 1, 2005 until the end of the term.

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

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

	2004	2005	2006	Average exercise price (HUF)
Opening number of share options	3,655	3,207	1,929	944
Number of share options exercised	-	(991)	(539)	944
Forfeited share options	(448)	(287)	(83)	944
Closing number of share options	3,207	1,929	1,307	944
Number of exercisable options at end of year	2,138	1,929	1,307	944

The average share price on the exercise dates in 2006 was HUF 1,060.

(b) The former CEO's share option plan

The former CEO of Magyar Telekom was granted share options in 2000, 2001, 2002, 2003 and 2004. The exercise price of the options was determined in US dollars and the options had no intrinsic values on the grant dates in 2000, 2001, 2002 and 2003, while those granted in 2004 had an intrinsic value of HUF 63 million. One third of the options granted vested after one year, another one third vested two years after the grant date, while the last third vested after three years. The options are exercisable for ten years after the grant date. The Group recognized compensation expense in an amount of HUF 36 million in 2006 (2005: HUF 84 million) among employee related expenses against equity (Reserve for equity settled share based transactions).

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

	Options granted in year					
	2000	2001	2002	2003	2004	Total
Number of options granted (thousand)	103	250	303	619	1,462	2,737
Exercised (thousand) – in 2005	-	(250)	(303)	(413)	(487)	(1,453)
Exercised (thousand) – in 2006	-	-	-	(206)	(975)	(1,181)
Outstanding (thousand) at December 31, 2006	103	-	-	-	-	103
Exercisable (thousand) at December 31, 2006	103	-	-	-	-	103
Exercise price in USD	7.36	2.93	3.48	3.62	3.87	
Remaining contractual life at December 31, 2006 (years)	3.5	-	-	-	-	

In 2006, the former CEO resigned and exercised his remaining options from 2003 and 2004. Although the last third of the 2004 grant would not have been exercisable, the resignation agreement concluded between the Company and the CEO allowed the early exercising of these 487 thousand options. Further, the settlement was concluded in cash even though the plan was originally intended as equity settled. The options granted in 2000 remain exercisable with the original conditions. The closing share price on the exercise date was HUF 1,060.

(c) Mid-term incentive plan (MTIP)

In 2004 Magyar Telekom launched a Mid Term Incentive Plan (MTIP) for its top management, whereby the targets to be achieved are based on the performance of the Magyar Telekom share. The MTIP is a cash settled long term incentive instrument which is planned to cover five years, with a new package being launched in each year, and with each tranche lasting for three years.

The first tranche of the program spans the period between January 1, 2004 and December 31, 2006. The second tranche of the program spans the period between January 1, 2005 and December 31, 2007, while the third tranche of the program spans the period between January 1, 2006 and December 31, 2008. Participants include top and senior managers of the Group.

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

The absolute performance target is achieved when the Magyar Telekom share price, adjusted for dividends paid during the tenure, is more than 35 percent higher at the end of the lock–up period than at the beginning of the plan. The basis of the calculation is the unweighted average closing price of the Magyar Telekom share at the Budapest Stock Exchange during the last 20 trading days before the beginning and the end of the plan. The share price calculated according to the above was HUF 755 at the grant date of the first tranche, HUF 843 at the grant date of the second tranche and HUF 949 at the grant date of the third tranche.

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

The 2004 program ended on December 31, 2006. The absolute performance target was met, while the relative target was not.

Total compensation expense accrued for the three tranches of the program as at December 31, 2006 is HUF 501 million (HUF 245 million expensed in 2006, HUF 186 million in 2005 and HUF 70 million in 2004). The expenses are included in employee related expenses recognized against payables to employees.

25 Other operating expenses

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Materials, maintenance and service fees	58,104	60,696	79,043
Subcontractors and agent commissions	17,942	21,593	24,960
Marketing	22,189	24,888	21,868
Fees and levies	11,813	13,455	14,919
Consulting	7,082	7,571	11,621
Rental and operating lease	6,716	7,246	7,925
Bad debt expense	6,114	6,266	5,066
Other expenses	4,617	6,317	2,608
	134,577	148,032	168,010

Other expenses in 2005 include HUF 2,059 million paid under four consulting contracts entered into by the Group, as to which the Company has not been able to obtain sufficient evidence that it or its subsidiaries received adequate value. This amount also includes the operating tax implications of the payments as well. See Note 1.2 for more details.

26 Other operating income

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Compensation for rebranding (Note 35)	5,920	7,281	1,435
Gain on sale of PP&E, Intangible assets and assets held for disposal	1,201	728	2,140
	7,121	8,009	3,575

27 Finance expenses

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Interest expense	34,731	31,340	27,325
Other finance expenses	3,183	3,157	2,831
Less: Interest capitalized	-	-	(54)
	37,914	34,497	30,102

The capitalization rate used to determine the amount of borrowing costs eligible for capitalization is 3 month BUBOR + 0.17525%.

28 Finance income

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Gain on sale of financial instruments	-	-	1,190
Gain on sale of subsidiary	191	-	121
Gains / (losses) on the valuation of derivative financial instruments	647	-	377
Net foreign exchange gains / (losses)	(523)	1,014	(659)
Finance lease interest income	-	-	480
Interest and other financial income	1,453	1,982	3,183
	1,768	2,996	4,692

29 Cash generated from operations

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Profit for the year	43,327	88,725	87,464
Income tax expense	16,142	21,858	24,220
Finance expenses	37,914	34,497	30,102
Finance income	(1,768)	(2,996)	(4,692)
Share of associates' profits	(1,896)	(330)	(703)
Depreciation and amortization	137,666	114,686	122,249
Change in payables	(3,517)	9,715	9,694
Change in inventory	2,825	(303)	(732)
Change in receivables	7,180	(9,497)	(19,532)
Amortization of deferred revenue	(1,758)	(1,503)	(781)
Other financial expenses paid	(3,183)	(3,157)	(3,604)
Other cashflows from operations	12,841	(7,802)	(6,797)
Cash generated from operations	245,773	243,893	236,888

30 Purchase of property plant and equipment and intangible assets

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Additions to property, plant and equipment	60,973	75,705	74,415
Additions to intangible assets	34,177	23,669	16,458
Total additions to tangible and intangible assets	95,150	99,374	90,873
Recognition of investment tax credit (Note 9.2)	6,849	5,373	3,109
Change in payables relating to capital expenditures	(10,251)	(1,160)	2,808
	91,748	103,587	96,790

31 Purchase of subsidiaries and business units

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
KFKI	-	-	9,840
Dataplex	-	-	5,148
Orbitel	-	-	1,982
CGT	-	35,927	-
T-Systems Hungary	3,430	-	-
Stonebridge / MakTel	13,355	-	16,579
Other	488	-	1,778
Total purchase of subsidiaries and business units	17,273	35,927	35,327

Other items include the consideration paid for smaller business combinations and for additional shares of ownership in subsidiaries already consolidated.

32 Segment information

Magyar Telekom has two primary segments, Fixed line and Mobile services, both of which include Hungarian and Foreign operations. Certain disclosures below are extended to show further details on Fixed line and Mobile segments accordingly.

The Fixed line segment is the primary telecommunications service provider in Hungary, Macedonia and Montenegro. To a lesser extent, Magyar Telekom is also present through its subsidiaries in Romania, Bulgaria and Ukraine, providing alternative telecommunications services.

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

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

(a) Primary reporting format

The following tables present a summary of operating results of the Group by business segment. The segments presented below are substantially consistent with the format used by the Company's Management Committee.

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Revenues			
Fixed line – Hungary	298,707	284,985	292,193
Fixed line – Foreign operations	45,693	57,983	68,953
	344,400	342,968	361,146
Less: intra-segment revenue	(1,271)	(2,284)	(3,569)
Total revenue of Fixed line segment	343,129	340,684	357,577
Less: revenue from Mobile segment	(11,146)	(11,478)	(13,711)
Fixed line revenue from external customers	331,983	329,206	343,866
Mobile - Hungary	260,568	266,217	297,209
Mobile – Foreign operations	33,734	42,693	52,399
	294,302	308,910	349,608
Intra-segment revenue	(58)	(27)	(42)
Total revenue of Mobile segment	294,244	308,883	349,566
Less: revenue from Fixed line segment	(29,435)	(23,035)	(22,236)
Mobile revenue from external customers	264,809	285,848	327,330
Total revenue of the Group	596,792	615,054	671,196

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Depreciation and amortization			
Amortization of goodwill - Hungary	1,601	-	-
Amortization of goodwill – Foreign operations	684	-	-
Impairment of tangible and intangible assets	5,355	316	2,457
Other depreciation and amortization	74,021	71,579	72,617
Fixed line segment	81,661	71,895	75,074
Amortization of goodwill - Hungary	9,540	-	-
Amortization of goodwill – Foreign operations	2,051	-	-
Impairment of tangible and intangible assets	4,426	75	616
Other depreciation and amortization	39,988	42,716	46,559
Mobile segment	56,005	42,791	47,175
Total depreciation and amortization of the Group	137,666	114,686	122,249
Segment results (Operating profit)			
Fixed line - Hungary	17,941	45,269	32,128
Share of associates' profits – (Hungary)	1,896	330	703
Fixed line – Foreign operations	7,024	8,961	11,492
Fixed line segment	26,861	54,560	44,323
Mobile - Hungary	59,707	75,219	75,677
Mobile – Foreign operations	9,047	12,305	17,095
Mobile segment	68,754	87,524	92,772
Less: Share of associates' profits	(1,896)	(330)	(703)
Total operating profit of the Group	93,719	141,754	136,391

		At December 31,		
		2004	2005	2006
		(in HUF millions)		
Assets				
Goodwill – Hungary		13,655	13,655	23,472
Goodwill – Foreign operations		12,972	12,972	13,939
Associates		5,750	5,020	5,771
Assets held for disposal		3,063	2,302	5,937
Other assets		519,841	541,239	513,703
Fixed line segment		555,281	575,188	562,822
Goodwill – Hungary		161,374	161,374	161,935
Goodwill – Foreign operations		38,918	44,156	45,803
Associates		-	-	-
Assets held for disposal		-	-	888
Other assets		226,754	247,872	269,119
Mobile segment		427,046	453,402	477,745
Inter-segment elimination		(8,404)	(8,347)	(3,122)
Total segment assets		973,923	1,020,243	1,037,445
Unallocated assets	(a)	55,645	62,705	94,150
Total assets of the Group		1,029,568	1,082,948	1,131,595
Liabilities				
Fixed line segment		88,711	90,170	172,389
Mobile segment		50,604	54,305	52,044
Inter-segment elimination		(8,404)	(8,347)	(3,122)
Total segment liabilities		130,911	136,128	221,311
Unallocated liabilities	(b)	321,993	349,126	317,117
Total liabilities of the Group		452,904	485,254	538,428

(a) Unallocated assets include cash and cash equivalents and current and deferred income tax assets
(b) Unallocated liabilities include loans and other borrowings and current and deferred income tax liabilities

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Capital expenditure on PPE and Intangible assets			
Additions to Goodwill	2,958	-	11,777
Other additions due to business combinations	832	26,195	9,267
Purchases of tangible and intangible assets	38,351	53,052	49,645
Fixed line segment	42,141	79,247	70,689
Additions to Goodwill	5,717	5,122	1,293
Other additions due to business combinations	-	12,450	-
Purchases of tangible and intangible assets	56,799	46,322	41,228
Mobile segment	62,516	63,894	42,521
Total Group	104,657	143,141	113,210

(b) Secondary reporting format

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

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Revenues			
Revenue generated in Hungary	529,059	526,947	565,770
Less: inter-segment revenue	(682)	(1,020)	(2,254)
Revenue from external customers – Hungary	528,377	525,927	563,516
Revenue generated in Macedonia	68,352	67,547	74,056
Less: inter-segment revenue	(283)	(311)	(760)
Revenue from external customers – Macedonia	68,069	67,236	73,296
Revenue generated in Montenegro	-	20,521	30,683
Less: inter-segment revenue	-	(62)	(229)
Revenue from external customers – Montenegro	-	20,459	30,454
Revenue generated in other countries	509	2,133	4,784
Less: inter-segment revenues	(163)	(701)	(854)
Revenue from external customers – other countries	346	1,432	3,930
Total revenue of the Group	596,792	615,054	671,196

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Capital expenditure on PPE and Intangible assets			
Additions to Goodwill	1,001	-	10,377
Other additions due to business combinations	832	-	9,138
Purchases of tangible and intangible assets	84,191	84,764	77,875
Hungary	86,024	84,764	97,390
Additions to Goodwill	7,624	-	1,724
Other additions due to business combinations	-	-	-
Purchases of tangible and intangible assets	10,756	9,052	7,340
Macedonia	18,380	9,052	9,064
Additions to Goodwill	-	5,122	-
Other additions due to business combinations	-	38,645	-
Purchases of tangible and intangible assets	-	4,278	3,541
Montenegro	-	48,045	3,541
Additions to Goodwill	50	-	969
Other additions due to business combinations	-	-	129
Purchases of tangible and intangible assets	203	1,280	2,117
Other countries	253	1,280	3,215
Total Group	104,657	143,141	113,210

		At December 31,		
		2004	2005	2006
Assets		(in HUF millions)		
Hungary		822,742	817,984	846,969
Macedonia		151,215	146,867	139,835
Montenegro		-	54,541	49,331
Other countries		961	2,758	7,671
Total		974,918	1,022,150	1,043,806
Inter-segment elimination		(995)	(1,907)	(6,361)
Total segment assets		973,923	1,020,243	1,037,445
Unallocated assets	(a)	55,645	62,705	94,150
Total assets of the Group		1,029,568	1,082,948	1,131,595

(a) Unallocated assets include cash and cash equivalents and current and deferred income tax assets

33 Commitments

(a) Finance lease –Group as lessee

Finance leases in 2005 and 2006 relate to the sale and lease back of spaces in buildings accommodating telephone exchanges. The average contract term of these leases is 10 years, and the contracts include renewal options but no purchase options.

Future lease payments under finance leases related to sale and lease back transactions at December 31, 2005 and 2006 are as follows:

	2005			2006		
Amounts in HUF millions	**Present value**	**Interest component**	**Minimum lease payment**	**Present value**	**Interest component**	**Minimum lease payment**
Within 1 year	51	160	211	124	274	398
1-5 years	336	519	855	668	794	1,462
After 5 years	474	265	739	585	280	865
Total	861	944	1,805	1,377	1,348	2,725

Finance leases other than sale and lease back in 2006 mainly relate to vehicles and IT equipment. The average contract term of the leases is 3-5 years. No such finance leases existed at December 31, 2005.

Future lease payments under finance leases other than sale and lease back transactions at December 31, 2006 are as follows:

	At December 31, 2005			At December 31, 2006		
Amounts in HUF millions	**Present value**	**Interest component**	**Minimum lease payment**	**Present value**	**Interest component**	**Minimum lease payment**
Within 1 year	-	-	-	288	99	387
1-5 years	-	-	-	1,071	129	1,200
After 5 years	-	-	-	-	-	-
Total	-	-	-	1,359	228	1,587

(b) Operating lease –Group as lessee

Operating lease commitments are mainly in respect of the rental of cell sites, and to a lesser extent, related to buildings, network and other telecommunications facilities.

	At December 31,	
Amounts in HUF millions	**2005**	**2006**
Within 1 year	5,410	6,869
1-5 years	13,903	18,813
After 5 years	10,494	17,667
Total	29,807	43,349

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

(c) Finance lease –Group as lessor

The Group won a governmental tender in Hungary in 2005 to build and operate a Professional Mobile Network (PMR) for the emergency services of the country. As the service is provided to one buyer, the Hungarian Government, and required the construction of a customer specific asset, the Group analyzed the revenue to be generated over the coming 9 years to account for the sale type lease of the network separately from the continuous telecommunications services to be provided.

The table below shows the lease receivables during the term of the agreement.

Amounts in HUF millions	At December 31, 2005			At December 31, 2006		
	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt
Within 1 year	-	-	-	1,856	1,330	3,186
1-5 years	-	-	-	8,907	4,690	13,597
After 5 years	-	-	-	7,256	902	8,158
Total	-	-	-	18,019	6,922	24,941

The interest component represents the unearned finance income. The present value due within one year is included in Current assets (Other financial assets), while the present value after one year is included in Other non current assets. The finance income accruing to the Group over the lease term is recognized in the income statement (Finance income).

(d) Operating lease – Group as lessor

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

Amounts in HUF millions	At December 31, 2006
	Minimum lease receipt
Within 1 year	1,508
1-5 years	1,664
After 5 years	38
Total	3,210

(e) Purchase commitments for tangible assets

As of December 31, 2006, Magyar Telekom had contractual commitments for capital expenditures of HUF 6.3 billion (HUF 3.2 billion in 2005, HUF 6.1 billion in 2004) falling due within 1 year.

(f) Purchase commitments for investments

In December 2006, Magyar Telekom agreed to acquire a 100% stake in MobilPress. The transaction was closed on January 25, 2007. See Note 5.1.6 for more details.

As agreed in December 2006, the Company signed a sale-purchase agreement to acquire an additional 2% ownership in TSH effective from January 1, 2007 for a purchase price of HUF 60 million. TSH has been an associate of the Group since September 2004.

34 Contingencies

Mobile termination charges in Hungary

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

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

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

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

35 Related party transactions

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

(a) Deutsche Telekom Group

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

The Company is directly owned by MagyarCom GmbH, which is a holding company of DTAG. Magyar Telekom pays dividends annually to its owners including MagyarCom GmbH.

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

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

The Company's Hungarian mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004, while other Hungarian companies were renamed in 2005. The renaming continued in 2006 in Macedonia and Montenegro. The expenditures incurred in connection with the launch and promotion of the new brands and the loss of value caused by discontinuing the old brands were compensated in value by Deutsche Telekom AG. The compensation received was recognized in the income statement (Other operating income).

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

	2004	2005	2006
	(in HUF millions)		
Revenues from telecom services provided to DT Group	9,548	8,056	7,127
Costs of telecommunications services provided by DT Group	(9,560)	(11,303)	(13,016)
Consulting expenses to MagyarCom Services Kft.	(1,488)	(1,140)	(918)
Other income from DTAG …………………..................................	5,920	7,281	1,435
Interest expense to DTIF	(23,271)	(24,518)	(21,389)
Dividends paid to MagyarCom GmbH	(43,222)	(43,222)	-
Dividend payable to MagyarCom GmbH ………………………	-	-	(45,074)
Accounts receivable from DT Group	1,396	3,711	7,991
Accounts payable to MagyarCom Services Kft	(410)	(313)	(163)
Accounts payable to other DT Group companies	(2,358)	(3,254)	(6,044)
Accrued interests payable to DTIF	(5,491)	(6,198)	(3,756)
Loans payable to DTIF and DTAG	(237,675)	(286,648)	(259,432)

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

(b) Governments

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

(c) Associates

Hunsat is an enterprise founded by the Company (50%) and Antenna Hungária Rt. (50%). The revenues of Hunsat include commissions received from Hungarian telecommunications companies for the use of services of international satellite agencies. The operational transactions and balances with Hunsat are insignificant. Dividends received from Hunsat amounted to HUF 157 million in 2006 (2005: HUF 1,376 million, 2004: HUF 2,133 million).

M-RTL is a Hungarian television broadcast company, in which Magyar Telekom has a 25% effective share of ownership through a holding company, IKO-Telekom Média Holding Rt. M-RTL sells airtime through media agencies to Magyar Telekom, and Magyar Telekom provides telecom services to M-RTL mainly through an interactive service provider. Consequently, the direct operating transactions between M-RTL and the Group are insignificant. M-RTL declared dividends to Magyar Telekom directly and indirectly in an amount of HUF 605 million in 2006 (2005: HUF 550 million, 2004: HUF 500 million).

T-Systems Hungary (TSH) is an associated company of Magyar Telekom, in which the Company acquired a 49% share of ownership in September 2004. The acquisition took place through share purchase from T-Systems International, a Deutsche Telekom Group company, and a capital increase in TSH. The All inter-company transactions and balances with TSH are included in the Deutsche Telekom Group relations table, earlier in this note.

(d) Board and supervisory board members

The remuneration of the members of the Company's Board of Directors amounted to HUF 8 million in 2006 (2005: HUF 10 million, 2004: HUF 9 million). The remuneration of the members of the Company's Supervisory Board amounted to HUF 17 million in 2006 (2005: HUF 14 million, 2004: HUF 10 million).

(e) Key management

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

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

	At December 31,		
	2004	**2005**	**2006**
	(in HUF millions)		
Salaries and other short-term employee benefits	800	670	647
Contractual termination expense	-	350	432
Share based compensation (Note 24) ……………………………………	101	130	112
	901	1,150	1,191

The Group does not provide loans to its key management.

36 Events after the balance sheet date

Employee termination disputes in Montenegro

In 2005 CGT offered a voluntary lay-off program with beneficial terms for employees accepting the offer. In 2006 CGT announced another voluntary redundancy which had even more beneficial terms. After the announcement of the 2006 program, employees laid off in 2005 believe that they had been misled about the conditions of the lay-off. These former employees have announced that unless CGT indemnifies them for the difference in the terms, they would sue for being mislead in 2005.

Although the Group may have to pay indemnity to the former employees, currently the Group cannot estimate the outcome of the future legal action, and the amount of the indemnity payments that could be ruled. The Group has no legal or constructive obligation as at December 31, 2006, and has not raised a valid expectation on part of the former employees that they will be indemnified.

Reconciliation to U.S. GAAP (unaudited)

Magyar Telekom's consolidated financial statements are prepared in accordance with International Financial Reporting Standards, which in certain respects differ from U.S. GAAP, the generally accepted accounting principles in the USA. The principal differences between IFRS and U.S. GAAP are presented below, together with explanations of the adjustments that affect Net income for each of the three years in the period ended December 31, 2006 and Equity as of December 31, 2005 and 2006.

		For the year ended December 31,		
	Notes	**2004**	**2005**	**2006**
		(in HUF millions)		
Profit attributable to the equity holders of the Company (Net income) under IFRS – as reported		34,641	78,564	75,453
Restatement for changes in IAS 39 ……………………..		-	(149)	-
Profit attributable to the equity holders of the Company (Net income) under IFRS – as restated		34,641	78,415	75,453
Profit attributable to minority interests under IFRS		8,686	10,355	12,011
Restatement for changes in IAS 39 ……………………..		-	(45)	-
Profit attributable to minority interest under IFRS – as restated		8,686	10,310	12,011
Adjustments of Net income for U.S. GAAP:				
Revenue recognition	(a)	4,749	4,237	3,608
Asset retirement obligation	(b)	(871)	(402)	(320)
Employee expenses…………………………………..	(c)	950	(1,110)	(108)
Interest capitalized……………………………………...	(d)	420	472	140
Derivatives	(e)	-	(227)	676
Other financial assets (reverse IFRS restatement) …...	(e)	-	213	(213)
Other income (rebranding)	(f)	(5,920)	(7,281)	(1,435)
Purchase price allocation (business combinations)	(g)	(6,977)	(4,775)	(4,513)
Goodwill...	(h)	13,876	-	-
Tax………………… ………………………………...	(i)	(1,503)	591	(729)
Profit after tax ………..		4,724	(8,282)	(2,894)
Minority interest ……………………………………..	(j)	319	(873)	(1,227)
Total U.S. GAAP adjustments on Net income		5,043	(9,155)	(4,121)
Net income under U.S. GAAP		39,684	69,260	71,332
Minority interest under U.S. GAAP …………………….		8,367	11,183	13,238

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

	Notes	At December 31, 2005	At December 31, 2006
		(in HUF millions)	
Total Shareholders' equity under IFRS		527,567	526,039
Minority interests under IFRS		70,127	67,128
Total equity under IFRS		597,694	593,167
Adjustments for U.S. GAAP:			
Revenue recognition	(a)	(9,468)	(5,860)
Asset retirement obligation	(b)	(1,409)	(1,729)
Employee expenses	(c)	(213)	-
Interest capitalized	(d)	5,465	5,605
Derivatives	(e)	646	1,322
Purchase price allocation (business combinations)	(g)	8,132	5,594
Goodwill	(h)	14,237	12,403
Tax	(i)	(5,049)	(6,102)
Minority interests	(j)	2,190	918
Total U.S. GAAP adjustments on Shareholders' equity		14,531	12,151
U.S. GAAP adjustment on Minority interests	(j)	(2,190)	(918)
Total U.S. GAAP adjustments on Equity		12,341	11,233
Total Shareholders' equity under U.S. GAAP		542,098	538,190
Minority interests under U.S. GAAP		67,937	66,210
		610,035	604,400

The amounts included in the table above show the cumulative adjustments on the net assets by reconciling item.

(a) Revenue recognition

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

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

In the U.S. GAAP accounts there is a higher amount of deferred revenues and there are deferred expenses as well related to the direct costs of the activations and connections due to the amounts deferred until December 31, 2003, not yet fully amortized to revenue and expense respectively.

(b) Asset retirement obligation

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

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

(c) Employee expenses

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

In addition, different amount of expense was recognized in the IFRS accounts for share based payments according to IFRS 2 than in the U.S. GAAP accounts according to APB 25 in 2004 and 2005. As of January 1, 2006 the Group adopted FAS 123R, which is substantially the same as IFRS 2, therefore the accounting treatment of share based payments is now the same, but due to the earlier adoption of IFRS 2 than FAS 123R, there is still a difference in the 2006 income statement, but there are no further differences in equity.

(d) Interest capitalized

In the IFRS accounts Magyar Telekom capitalized a gradually decreasing amount of interest in prior years, and did not capitalize any interest in 2004 and 2005. This was the case as all loans taken for capital investment projects in prior years had been gradually repaid by the end of 2003. In 2006, however, interests are capitalized again related to a loan specifically taken for certain investments in PPE.

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

(e) Derivatives and other financial assets

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

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

A further improvement was made to IAS 39 effective from January 1, 2006, which resulted in another restatement of the Group’s 2005 IFRS accounts. The restatement related to the fair valuation of an equity investment, related to which the gain recognized as a result of the fair valuation in 2005 had to be restated, and deferred in an equity reserve until realization of the gain by way of a sale of the investment, which happened in 2006. With this change in the IFRS regulations, IFRS has become more in line with U.S. GAAP. Due to the immaterial size of the difference, the Group had not made U.S. GAAP adjustments for this issue in prior periods. Further, as the respective investments were sold in 2006, we do not restate our U.S. GAAP accounts. At December 31, 2006, there’s no valuation difference deferred in equity either in the IFRS or in the U.S. GAAP accounts.

(f) Other income (rebranding)

The Company’s Hungarian mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004, while other companies of the Group were renamed in 2005 and 2006 (Note 35) to implement the “T” brands. The compensation received from DTAG is shown as Other operating income in the IFRS income statement. Under U.S. GAAP, Magyar Telekom recognizes the compensation received as a contribution of capital by the majority shareholder. This results in a lower net income in the U.S. GAAP accounts, but the Shareholders’ equity is no different in this respect.

(g) Purchase price allocation (business combinations)

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

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

(h) Goodwill

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

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

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

(i) Tax

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

(j) Minority interest

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

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

MAGYAR TELEKOM GROUP

MAGYAR TELEKOM TELECOMMUNICATIONS PUBLIC LIMITED COMPANY

Business Report of 2006

March 2007

Introduction

The consolidated annual report of the Magyar Telekom Telecommunications Public Limited Company ("Magyar Telekom Plc." or "the Company") has been prepared pursuant to the International Financial Reporting Standards. Magyar Telekom Group ("Magyar Telekom" or "the Group") is composed of Magyar Telekom Plc. and 50 business enterprises (of which 32 enterprises are direct and 18 are indirect investments).

Magyar Telekom classified its investments in line with the International Financial Reporting Standards, and as of December 31, 2006 the Company declared 28 direct and 16 indirect investments as subsidiaries subject to consolidation.

There are six companies involved in consolidation as associated enterprises, in which Magyar Telekom as the parent company has a stake of between 20 and 50 percent.

As of December 31, 2006 Magyar Telekom has not classified any of its investments as jointly managed enterprise, or other participation.

Magyar Telekom is the principal provider of fixed line telecommunications services in Hungary, with approximately 2.6 million fixed access lines at December 31, 2006. The Group is also Hungary's largest mobile telecommunications service provider, with more than 4.4 million mobile subscribers (including users of prepaid cards) at December 31, 2006.

Magyar Telekom Plc. is listed in the Budapest and the New York Stock Exchanges.

Magyar Telekom Plc.'s headquarters are located at 55 Krisztina krt., 1013 Budapest, Hungary.

Share Capital

As of December 31, 2006, the share capital of Magyar Telekom Plc. was HUF 104,276,831,500, consisting of 1,042,768,215 Series "A" ordinary shares and one Series "B" voting preference share.

All Series "A" ordinary shares have a nominal value of HUF 100 and the Series "B" Share has a nominal value of HUF 10,000. The holder of the Series "B" Share enjoys certain preferential voting and other rights described below.

Shareholder	Number of shares	Percentage of share capital
MagyarCom	617,452,081	59.21
Publicly traded [1]	422,859,475	40.55
Treasury shares	2,456,659	0.24
	1,042,768,215	100.00
Holder of Series "B" Shares	1	

(1) Of our publicly traded shares, JP Morgan Chase Bank had 12,229,840 ADRs, evidencing 61,149,200 shares on its accounts as of December 31, 2006, for registered holders, such amount representing 5.9 percent of the total shares outstanding. We do not know whether this percentage may be indicative of the percentage of our ordinary shares held by U.S. persons.

The number of treasury shares held by Magyar Telekom declined from 2,456,659 to 1,917,824, due to options exercised as part of the company's management incentive program on December 29, 2006. The decreased share number was reflected in the company's share register from January 2, 2007, as the settlement date of the transactions was on the first working day following the trade date.

SBC Communications Inc ("SBC") and Deutsche Telekom AG ("DT") jointly managed and operated MagyarCom until SBC's 50 percent ownership in MagyarCom was transferred to DT in June 2000. DT now controls Magyar Telekom indirectly.

Voting Rights and Voting

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

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

Series "B" Share

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

1. to nominate one member of the Board of Directors and one member of the Supervisory Board and effectively to elect, remove or replace these members;

2. if the Company's registered capital is increased, a new class of shares is issued or the rights attached to a particular class of shares change, to require the Articles of Association to be amended so that the voting rights of the Series "B" Share will be sufficient to nominate, elect or remove the Series "B" director or Supervisory Board member;

3. to inspect the shareholders' register and the books maintained by a depository of the Company's shares approved by the Company and to request copies of the register or books;

4. if the Company dissolves without a successor company, to purchase all or part of the Company's assets, including shares of subsidiaries or affiliates, for a price equal to the appraised fair market value of such assets;

5. to request from the Board of Directors detailed information about a material fact significantly affecting the Company's financial position; and

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

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

1. increase and decrease of the Company's registered capital;

2. change of rights attached to any class of shares, including any amendment to the rights of the Series “B” Share or the creation of a new class of shares with rights superior or equal to the rights or adversely affecting the rights of the Series “B” Share, or any amendment to the rights attached to any existing class of shares that would grant them rights superior or equal to the rights attached to the Series “B” Share;

3. merger into or consolidation with another business entity, de-merger, transformation into another form of business association and termination of the Company without a legal successor;

4. transfer, creation of encumbrance of a valuable right that enables the Company to operate according to the Universal Telecommunications Service Contract;

5. election or removal of the Series “B” director or Supervisory Board member;

6. conversion of a type of shares;

7. transfer of all or a substantial part of the assets of the Company that would render the Company incapable of performing its obligations under the Universal Telecommunications Service Contract;

8. amendment to the Articles of Association which would impair the rights of the holder of the Series “B” Share, including authorizing the Board of Directors to increase the Company's registered capital;

9. issuance of convertible bonds or bonds conferring preemptive rights; and

10. decisions on significant transfers of shares.

Transfer of Shares

The holder of the Series “B” Share and other shareholders holding at least a simple majority of the shares must generally approve a transfer of shares that would result in a person or group of persons gaining ten percent or more of the outstanding voting stock of the Company. The consent of the holder of the Series “B” Share is also required to transfer shares if the transferee would acquire more than 49.9 percent of the outstanding voting stock of the Company.

When registering a transfer of shares, the registrar may request evidence that the shares were transferred in accordance with the Articles of Association. If the Company establishes that the transfer occurred in violation of the Articles of Association or if the transferee refuses to produce the necessary evidence, the Company may refuse to register the transfer. The Board of Directors may invalidate registrations based on untrue, false or misleading statements. A registered shareholder must notify the Company within eight days of any transfers of its shares or it will be liable for liquidated damages.

Limitation of the Rights of Shareholders

Shareholders whose names have not been entered into the Shareholders' Register and shareholders who acquired their shares in violation of the restrictions in the Articles of Association pertaining to the transfer and the acquisition of shares shall not be allowed to exercise their rights attached to such shares vis-á-vis the Company.

Amendment of the Articles of Association

The general meeting of the shareholders has the sole right to approve and amend the Articles of Association unless otherwise provided by law.

Board of Directors

Pursuant to our amended Articles of Association, the Board of Directors consists of a minimum of six and a maximum of eleven members elected at the annual general meeting of the shareholders for a term of three years. One of the current directors was nominated by the holder of the Series "B" Share pursuant to the Articles of Association, seven of the current directors were nominated by MagyarCom and two of the current directors are independent; MagyarCom therefore controls Magyar Telekom.

Management Committee

Pursuant to our amended Articles of Association and the amended Rules of Procedure of the Board of Directors, the Board of Directors established a Management Committee in 2000, which is empowered to carry out the day-to-day operations in accordance with the annual business plan.

Supervisory Board

Pursuant to the Articles of Association, the Supervisory Board consists of a minimum of three and a maximum of fifteen members elected by the shareholders for a term of three years. The Works Council nominates one third of the Supervisory Board members. The holder of the Series "B" Share has the right to nominate one member of the Supervisory Board. Meetings of the Supervisory Board require a quorum of eight members.

Compensation of Directors, Officers and Employees

Half of the MC members have an employment contract for a fixed duration. Pursuant to Hungarian legislation, if an employment contract is terminated before the end of its term, the average compensation received by the employee prior to such termination is payable for the remaining period up to 12 months. In the case of an employment contract for a fixed duration the notice period is normally six months, and severance is between 16 and 21 months. Employment contracts with our management employees contain special provisions providing for entitlements after termination of employment; therefore, the amount of severance is higher than the amount required by the applicable provisions of the Labor Code.

Magyar Telekom Plc. has entered into a collective bargaining agreement with the Hungarian telecommunications trade unions (Távközlési Szakszervezet, "TÁVSZAK" and Magyar Távközlési Ágazati Szakszevezet, "MATÁSZ"). Under the agreement, employees are generally entitled to prior notice before termination. Furthermore, employees are entitled to a specific amount of severance pay, which depends on the tenure of the employee.

Private Placement

The Board of Directors shall be authorized to increase the registered capital of the Company in order to operate the stock option program by a maximum amount of 490.000 thousand HUF, offered exclusively to such investors who wish to participate in the stock option program to be implemented at Magyar Telekom Nyrt. The issue price shall be at least the par value of the share. The authorization of the Board of Directors shall be effective for five years until the date of the General Meeting, closing the business year of 2006.

Investigation into certain consultancy contracts

In the course of conducting their audit of our 2005 financial statements, PwC identified certain contracts the nature and business purposes of which were not readily apparent. PwC notified the Audit Committee and advised them to retain independent counsel to conduct an investigation into these contracts. In February 2006, our Audit Committee retained White & Case, as its independent legal counsel, to conduct the investigation, with the additional assistance of a financial advisory firm and a digital forensics firm. In December 2006, the investigators delivered an Initial Report of Investigation. We cannot predict when the investigation will be concluded or what the final findings will be.

PwC initially raised concerns regarding two consultancy contracts entered into in 2005 by our Montenegrin subsidiaries Crnogorski Telekom and T-Mobile Crna Gora. The initial scope of the independent investigation was a complete review of these two contracts, including a review of all related documents and interviews with our, and Crnogorski Telekom and T-Mobile Crna Gora, employees and third parties with knowledge of the contracts. The financial advisory firm assisting the investigation also reviewed a sampling of our and our Montenegrin subsidiaries' account and transactional data, equaling 72 percent of the value of all transactions and 90 percent of the value of all contracts with third party vendors. For each of these test items, all available supporting documentation was reviewed. Early in the investigation, two additional consultancy contracts, which we entered into in 2005, were also called into question by the investigators, and our Audit Committee expanded the scope of the investigation to cover these contracts. The total value of these four contracts under investigation is approximately HUF 2 billion, of which HUF 1,120 million relates to the two contracts entered into by the Magyar Telekom Plc.

During the course of the investigation, it became evident that certain of Magyar Telekom, Crnogorski Telekom and T-Mobile Crna Gora employees had obstructed the investigation by destroying or tampering with electronic documents. Specifically, the digital forensics firm assisting the investigation found that ten computers assigned to seven employees showed evidence that documents had been deleted from the hard drives and "wiping" software used to make those documents permanently unrecoverable. Investigators determined that the deleted electronic documents included a number of documents related to the contracts under investigation. This deletion and wiping activity took place after our management had issued document retention memos requiring that all documents related to these contracts be retained. As a result of this deliberate destruction of documents, the investigators have been unable to review drafts of the contracts, emails and other documents that would have been relevant to the investigation.

To date, the independent investigators have been unable to find sufficient evidence to show that any of the four contracts under investigation resulted in the provision of services to us or to our subsidiaries under those contracts of a value commensurate with the payments we made under those contracts. It is unclear who the true counterparties are to the contracts, and certain of the contracts are vague as to the actual services that are to be provided. The independent investigators have been unable to determine definitively the purpose of the contracts, and it is possible that the purpose may have been improper. On the basis of the findings to date, the concerns of our auditors were well founded.

Accordingly, although the Company had originally capitalized the amounts paid under these contracts, as a result of the findings of the investigation, the Company has ultimately expensed the HUF 1,120 million paid under these two contracts, and discloses these expenses under the caption "Other Operating Expenses - Net" in 2005.

As a consequence of the investigation, we have suspended a number of employees who have since resigned. The suspended employees included senior members of our Strategy Group and a senior executive of Crnogorski Telekom. The Crnogorski Telekom Board of Directors has also been replaced.

The independent investigators' Initial Report of Investigation further identified several contracts at another subsidiary that could warrant further review. In February 2007, our Board of Directors determined that those contracts should be reviewed and expanded the scope of the independent investigation to cover these additional contracts and related transactions.

The investigation has revealed certain weaknesses in the design and operation of our internal controls and procedures. Accordingly, we have approved and are currently implementing certain remedial measures designed to enhance our internal controls to ensure compliance with Hungarian and U.S. legal requirements and NYSE listing requirements. First, the position of Magyar Telekom Group Compliance Director has been created, reporting directly to the Company Chief Financial Officer, the Supervisory Board and the Audit Committee. In conjunction with this new position, we are reviewing, with the assistance of U.S. counsel, our compliance and corporate governance policies and are establishing a comprehensive compliance-training program, with a focus on our code of ethics, insider trading policy, document retention policy, regulatory matters, and compliance with U.S. securities laws and the U.S. Foreign Corrupt Practices Act. Our Board has already approved and implemented a Magyar Telekom Group Code of Ethics for Senior Financial Officers and a Group Insider Trading Policy. Second, we are revising our internal controls relating to procurement, including centralized access to all SAP systems of subsidiaries and a requirement that all contract approvals pass through uniform rules and procedures. Third, we have revised our mergers and acquisitions process, including dividing accountability for M&A between the Strategy Group, which will remain responsible for business development, and the area of the Chief Financial Officer, which will be responsible for execution of M&A transactions. All M&A activity will require Board approval and will be reported to the Audit Committee on a semi-annual basis. Finally, our Board may make further decisions or recommendations in connection with the involvement of any senior management in the four contracts under investigation.

As previously reported, the investigation has delayed the finalization of our 2005 financial statements, and as a result we and some of our subsidiaries have failed and may fail to meet certain deadlines prescribed by U.S., Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. We have to date been fined HUF 13 million as a consequence of these delays. We have notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation, are in contact with these authorities regarding the investigation and are responding to inquiries raised by these authorities.

Analysis of results

Total Revenues

Our total revenues grew by 9.1 percent from HUF 615,054 million in 2005 to HUF 671,196 million in 2006. Increase in revenues was mainly due to higher revenues from mobile telecommunications services, which grew by 14.5 percent from 2005 to 2006, driven mainly by Pro-M’s EDR activities in the Hungarian mobile operations. The higher system integration and IT revenues as well as higher Internet revenues also contributed to the growth, which was partly offset by lower revenues from outgoing domestic and international traffic in the fixed line telecommunications services. The longer consolidation period (12 months in 2006 compared to nine months in 2005) of Crnogorski Telekom also contributed to the revenue growth.

Total Operating Expenses - Net

Our total operating expenses – net increased by 13.0 percent from 2005 to 2006. Operating expenses - net amounted to HUF 473,300 million in 2005 and HUF 534,805 million in 2006. Our total operating expenses – net as a percentage of total revenues increased from 77.0 percent in 2005 to 79.7 percent in 2006.

The details on our analysis of the consolidated financial statements for the year ended December 31, 2006 are available in our annual flash report; see “Financial Reports” section of Magyar Telekom’s website.

Overview of Magyar Telekom's Services

Fixed Line Telecommunications Services - Hungary

Domestic Voice Telephone Services

Products and Services

Public Switched Telephone Network ("PSTN"). Due to the fierce competition and mobile substitution, the number of our PSTN lines decreased from 2,252,943 as of December 31, 2005 to 2,158,547 as of December 31, 2006.

Integrated Services Digital Network ("ISDN"). ISDN allows a single access line to be used simultaneously for a number of purposes, including voice, data, facsimile and video transmission. ISDN also provides higher quality and faster transmission of signals while increasing the bandwidth capacity of the network. The coverage of ISDN is 100 percent of our network. We offer both basic ISDN access lines with two channels and multiplex ISDN access lines with 30 channels. As of December 31, 2006, we had 171,995 ISDN access lines with two channels and 4,710 ISDN access lines with 30 channels, amounting to the total of 485,290 ISDN channels. We intend to extend the life cycle of the ISDN product by offering various discounts to our customers.

Digifon Services. At the end of 2006, our network was 100 percent digitalized, which enable us to provide value added service in our whole service area. We offer a number of value added services, such as call forwarding, call waiting, call conference and caller number identity to a significant number of our fixed line telephony subscribers. These services help increase fixed line usage as they make busy signals and unanswered calls less common. We also offer bundled packages of digifon services: Digifon Home, Digifon Business, Összhang, Visszhang, etc. The most popular of these packages is the Összhang, which contains five services at a discount price. Összhang package had approximately 265,000 customers by the end of 2006.

Voice-mail. We offer a voice-mail service including call return and call capture. We also offer a voice-mail Short Message Service ("SMS"), which provides an SMS alert to the mobile handset of the customer each time he or she receives a voice-mail message. These services allow better usage of the network, provide convenience to our customers and decrease the ratio of uncompleted calls.

Directory Assistance. We offer directory inquiry services. The domestic directory assistance database includes all fixed line and postpaid mobile subscribers' data in Hungary. We offer a call completion option to subscribers, whereby calls may be connected automatically. We also offer increasingly popular Directory Assistance-Plus ("DA-Plus") service. DA-Plus offers a wide range of information including Yellow Pages, residential classified advertisements, encyclopedia- and dictionary-based information, recipes, poems, as well as telephone numbers, postal, e-mail and website addresses without any quantity restrictions. The requested information may be provided verbally, by SMS, by e-mail or by fax. The fees for the service are based on per minute usage. We also offer a call completion option to the subscribers of DA-Plus.

Subscribers

The following table sets forth information regarding total fixed access lines and penetration rates in our service areas:

	At December 31,		
	2004	**2005**	**2006**
Lines in service in Magyar Telekom Plc.'s and Emitel's service areas			
Residential lines	2,080,408	1,981,876	1,902,011
Business lines	263,889	248,955	236,019
Public payphones	27,818	22,112	20,517
Total	2,372,115	2,252,943	2,158,547
ISDN channels	530,250	500,696	485,290
Total	2,902,365	2,753,639	2,643,837
Lines installed per 100 inhabitants in Magyar Telekom Plc.'s service areas	37.5	35.6	34.2
Digital exchange capacity as % of Magyar Telekom Plc.'s total exchange capacity	92.9	100	100

Our domestic fixed line telephony subscribers can be classified into two categories: residential customers and business customers, which include our customers in the public sector. As of December 31, 2006, 74 percent of our access lines were utilized by our residential customers and 25 percent by our business customers. The remaining one percent of access lines was used for public payphones.

Tariffs

We charge fixed line subscribers a one-time connection fee, monthly subscription charges and call charges based on usage. A call charge contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration.

In 2005, we introduced flat rate packages that offer free of charge calls to customers during the flat-rate period for an additional monthly fee. We also introduced tariff packages specially developed for LTO areas, such as Teleperc, a call-by-call tariff package. In 2006, we increased the number of tariff packages to allow customers in different market segments to choose plans that best suit their calling patterns. These tariff packages also served as a tool to maintain our customer base in the fully liberalized market as those customers who select us as the operator for every traffic direction (local, long distance and international) receive the highest discounts. At the end of December 2006, approximately 83 percent of Magyar Telekom Plc.'s customers chose customized tariff packages, the most popular of which is the Felező (Halving) package with over 530,000 subscribers and the flat rate Favorit packages with approximately 550,000 customers.

International Voice Telephone Services

International telephone services consist of outgoing and incoming international telephony traffic, including voice and switched transit traffic through Hungary.

We provide international calling access to our fixed line telephony subscribers and to subscribers of other local telephone operators and mobile service providers. Our Hungary Direct and Country Direct services permit customers to charge calls made from 50 countries abroad to their home phone numbers.

Tariffs

The call charge for an international call contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration. In 2006, the average per minute rates decreased as a result of discounts given in various optional tariff packages.

International Telecommunications Hub

We believe that Hungary is geographically well positioned to serve as a telecommunications gateway between Eastern and Western Europe. We have two state-of-the-art international gateways as well as fiber optic cable connections serving 12 border crossings. These fiber optic cable connections use synchronous digital hierarchy transmission facilities and we have launched our own Dense Wavelength-Division Multiplexing ("DWDM") backbone network. To increase the utilization of our transmission network, we offer attractive price schedules for dedicated transit services through Hungary. We are DT's partner in Delivery of Advanced Network Technology to Europe ("DANTE"), which provides transmission paths interconnecting Bucharest (2x622 Mbit/s) and Sofia (2x155 Mbit/s) to the European research and educational network, GEANT through their Budapest node.

We have X.25 links, which are used for packet switched data transmission with 83 international networks. We also have ISDN connections with more than 50 international networks.

To seize the opportunities presented by the liberalization of the telecommunications market in Romania, we established interconnection arrangements with major Romanian alternative service operators and network service providers to offer transit services to Western Europe. In addition, we use our own point of presence in Austria, which enables us to engage in telephone and Internet business with alternative telecommunications carriers located in Vienna. We provide Internet transit service to several Romanian and Bulgarian ISPs on our two IP PoPs in Romania and high-capacity international Internet transit service on our IP PoPs in Hungary to ISPs in Ukraine and Macedonia.

Leased Lines

Magyar Telekom is the principal provider of leased lines in Hungary.

Leased line service establishes a permanent connection for transmission of voice and data traffic between two geographically separate points (point-to-point connection) or between a point and several other points (point-to-multipoint connection). These points can be either all within Hungary or some in Hungary and others abroad.

We lease lines to other local telephone operators and mobile service providers, who use such lines as part of their networks. We also lease lines to providers of data services. In addition, we lease lines to multi-site business customers who use leased lines to transmit internal voice and data traffic. We also offer high capacity customized digital lines to other telecommunications providers.

Flex-Com. Since 1996, we have offered Flex-Com, domestic and international digital leased lines with managed back-up systems that are dedicated to data transmission. The number of Flex-Com connections decreased from 10,289 as of December 31, 2005 to 9,165 lines as of December 31, 2006.

Frame-Flex. We also use our managed leased line network to offer Frame-Flex, a public frame relay service that is particularly suited to customers who transmit data in bursts, such as connections between local area networks. As of December 31, 2006, we had 172 Frame-Flex connections.

High Speed Leased Line ("HSLL"). The HSLL service provides permanent, digital, transparent, point-to-point leased line service between service access points ("SAPs"). The connections are established by a service provider according to the needs of its customers.

Our leased line customers pay a one-time connection fee based on the type of line leased. Monthly subscription charges vary with the type and length of lines leased and, in some cases, with the term of the lease. With the exception of leased lines required for connection with other networks, leased line charges are not subject to regulation. As part of the overall rebalancing of our rates, we have reduced our leased line charges in real terms over the last few years in response to competition, which partly offset the revenue increase generated by volume and bandwidth increases of the leased line services.

Data Transmission and Related Services

Data transmission and related services consist primarily of data transmission and network services for business customers, such as financial institutions and insurance companies, and, to a lesser extent, residential customers. The market for data transmission and related services in Hungary is highly competitive. We are the leading supplier of data transmission and related services in Hungary.

Our revenues from data transmission have grown significantly as a result of both the development of the Hungarian economy and our increasingly sophisticated services. We expect the market for these services to grow with the proliferation of personal computers and increasing consumer demand. We believe that the ability to offer new data products and services will be critical to competing effectively in the future, particularly with respect to business customers.

Datex-P. We offer Datex-P, a packet-switched data transmission service based on the X.25 protocol. The service provides low to medium speed domestic switched data communications services with international connectivity to business customers. As a result of the proliferation of new technologies, growth in the number of subscribers has stopped. Full service withdrawal is planned for 2008-2009.

ADSL. ADSL is a continuous, high-speed Internet access service. The service offers cost efficient broadband Internet access together with telephony service over existing copper wires. We sell these services mainly on a wholesale basis to ISPs, which in turn resell the services to residential and small business customers. In 2006, this service had a significant growth with the number of ADSL connections reaching 512,810 by December 31, 2006 from 329,314 at December 31, 2005.

International data products. We provide signaling links for mobile operators to facilitate international roaming. We also sell international leased lines, including international managed leased lines, international ISDN, X.400, X.25 and telegraph services. The sales of international leased lines are steadily growing, partly due to the introduction of one-stop-shopping agreements, whereby customers can order from and pay for the service at one end-point of the connection, which eliminate the need to deal with multiple service providers.

Multimedia

Our CATV group consists of two entities providing various cable television services in Hungary. The larger entity is T-Kábel Hungary, which began providing cable television services on January 1, 1999.

Through network development and acquisitions, our CATV group significantly increased its number of cable television customers during the past years. We are the second largest cable television provider in Hungary with a market share of about 18 percent. The growth of subscribers has slowed down in the past two years. The CATV group had approximately 414,000 subscribers as of December 31, 2006 compared to approximately 404,000 a year earlier.

Fixed Line Telecommunications Equipment Sales

Magyar Telekom distributes an extensive range of telecommunications equipment, from individual telephone sets to facsimile terminals and complete network systems, through a network of customer service centers. In addition to stand-alone phoneset sales, Magyar Telekom sells various packages combining telephone sets with telephone lines or tariff packages.

The telecommunications equipment sector is highly competitive and characterized by rapid technological innovation. Magyar Telekom believes that the supply and service of telecommunications equipment are integral parts of being a full service telecommunications provider and are necessary for the expansion of its customer base. In addition, these activities permit Magyar Telekom to ensure that technologically advanced equipment required for new services is available in the Hungarian market.

Other Revenues

Other revenues include construction and maintenance services as well as other miscellaneous revenues.

We construct fixed telecommunications networks and offers network maintenance services to other telecommunications operators in Hungary. These construction and maintenance services are ancillary to the construction and maintenance of Magyar Telekom's networks.

We carry out our construction mainly through subcontractors. The majority of construction revenue is derived from optical network construction, network construction related to subscriber connections and project planning.

Mobile Telecommunications Services - Hungary

We provided mobile telecommunications services in Hungary through our wholly-owned subsidiary, T-Mobile Hungary (“TMH”) prior to the merger of Magyar Telekom and TMH. TMH continues its operations within Magyar Telekom under an independent brand and as an independent business segment.

As of December 31, 2006, TMH accounted for estimated 44.5 percent of the total Hungarian mobile market in terms of subscribers. The penetration rate of mobile telephone services in Hungary increased from 92.4 percent at December 31, 2005 to 99.0 percent at December 31, 2006.

In 2006, TMH was the first mobile operator in Hungary to launch High Speed Downlink Package Access (“HSDPA”) service. TMH also launched new data products, like web‘n’walk and mobile internet based on HSDPA. TMH reached 30.3 percent HSDPA coverage based on population, which is a quite significant achievement in this short period.

In 2006, TMH continued to enhance its non-voice service portfolio, introduced several new products, increased the penetration and usage of the existing products and extended the access of some of its domestic products abroad.

Subscribers. The number of TMH subscribers has been growing over the past three years. The table below sets forth information concerning the number of TMH subscribers at the dates indicated:

	At December 31,		
	2004	2005	2006
Number of subscribers			
Postpaid subscribers	1,163,483	1,323,814	1,545,115
Prepaid subscribers	2,868,562	2,870,041	2,886,021
Total subscribers	4,032,045	4,193,855	4,431,136
Average monthly Minutes of Use ("MOU") per subscriber	115	127	142
Churn ratio (%)			
Postpaid subscribers	11.9	10.4	9.9
Prepaid subscribers	17.4	22.0	21.9
Total subscribers	15.9	18.5	17.9
Average monthly Revenue per User in HUF			
Postpaid subscribers	11,828	10,838	9,849
Prepaid subscribers	2,380	2,239	2,300
Total subscribers	4,945	4,832	4,800
Mobile penetration in Hungary (%)	86.4	92.4	99.0
TMH's market share (%)	46.2	45.0	44.5

The increase in the number of TMH subscribers since December 31, 2004 is attributable to a number of factors, including the expansion of mobile broadband services. Though the market is slowly reaching a saturation level, in 2006 total growth rate exceeded previous year's results due to significant growth in the postpaid segment.

Traffic. TMH's average traffic per subscriber is comparable to other European countries and was at a blended level of 142 minutes in 2006. Average traffic per subscriber has increased over 2005 as a result of successful tariff plans targeting both postpaid and prepaid segment.

Rates. Since January 1998, mobile subscriber rates have been deregulated, and carriers have had the freedom to set the level of fee components (i.e., connection fee, subscription charge and traffic charges).

TMH charges subscribers a one-time connection fee, monthly subscription charges, event charges and time-based traffic charges. Customers using prepaid cards do not pay monthly subscription charges (but in case of some price plans monthly recurring fees do exist). TMH does not charge subscribers for incoming calls, other than calls received while roaming. TMH receives payments from other telecommunications service providers for terminating calls on its network. TMH maintained the widest range of price plans and successfully introduced additional plans in 2006 to acquire new subscribers and develop loyalty.

TMH faced intense price-based competition in 2006. Competitors waged various campaigns, including introduction of new price plans and products, to win over TMH's subscribers. TMH responded to the competitors with its own new tariff initiatives across all of the subscriber segments.

International subsidiaries

Maktel has been a consolidated subsidiary of the Group from 2001.

Maktel is the sole fixed line service provider and the leading mobile service provider in Macedonia. Its exclusive rights in fixed line telecommunications services expired in December 2004. During the last six years, Maktel's major operational goals were to digitalize the fixed network and to increase the number of subscribers. The digitalization rate reached 100 percent by the end of 2003. Maktel had 474,949 PSTN fixed lines and 42,200 ISDN channels as of December 31, 2006 and fixed line penetration reached 23.9 percent in Macedonia.

Mobile telephony was a significant growth driver in 2006 at Maktel. T-Mobile Macedonia is the digital mobile service provider of Maktel, which became a fully owned subsidiary of Maktel on June 4, 2001. T-Mobile Macedonia's operations are based on GSM technology in the 900 MHz frequency band. The number of mobile subscribers increased by 7.7 percent to 944,530 subscribers at the end of 2006. The mobile penetration rate also grew significantly, to 68.3 percent at the end of 2006 compared to 61.3 percent a year earlier. T-Mobile Macedonia offers value-added services, such as call waiting, call forwarding, conference call, SMS, voice mail, international roaming and itemized bill.

Maktel has a 94 percent dial-up market share in the Macedonian Internet market. The number of Internet subscribers and the time they spent on the Internet is gradually increasing. Maktel provides Internet access via the public switched telephone network, leased lines and ADSL, which was introduced in January 2004. By the end of 2006, Maktel had 125,699 Internet customers. The growth in the Internet subscribers was fostered by the sale of ADSL service, which reached almost 16,500 subscribers by December 31, 2006.

Maktel also has data transmission services, such as satellite communications, frame relay, X.25 and audiotex services.

Crnogorski Telekom has been a consolidated subsidiary of the Group from March 31, 2005.

Crnogorski Telekom is the principal provider of fixed line service in Montenegro. Its exclusive rights in fixed line telecommunications services expired in December 2003. The Company is providing local, national and international services, in addition to a wide range of telecommunication services involving leased line circuits, data networks, telex and telegraph services.

Crnogorski Telekom had 173,248 analog fixed lines and 21,288 ISDN channels as of December 31, 2006.

Crnogorski Telekom’s subsidiary, T-Mobile Crna Gora, is the second mobile operator in Montenegro that started operations in 2000. Since then it showed a dynamic growth and was dedicated to offer innovative and advanced services to the Montenegrin market.

At the end of 2006, T-Mobile Crna Gora counted 331,616 subscribers. The main activities of T-Mobile Crna Gora’s operations are digital mobile telephony services based on GSM technology and non-voice services such SMS, MMS and GPRS. T-Mobile Crna Gora is actively developing market offers with various promotions and incentives to encourage use of services.

Research and development

Magyar Telekom Plc. has a department ("PKI-FI") dedicated to performance of research and development ("R&D") projects to meet the demands of the rapidly changing market, such as development of our telecommunications networks and service platforms. The R&D department works in close cooperation with educational institutions (including the Budapest University of Technical and Economic Sciences and the Technical College of Budapest), strategic investors, suppliers and domestic and international development organizations. Following our accession to the European Union, several funds aimed encouraging research and development activities became available to us as well; this encouraged us to deepen our involvement in national and international consortiums engaged in R&D.

The harmonization projects among DT Group members (Maktel, Slovak Telekom, Croatian Telekom and T-Systems International) play an important role. The joint development themes enable us to utilize group-level synergies, pursue efficient financial and human resource management and use the same third party contractors for our R&D projects.

In the last few years, to maintain or expand the competitive positions of Magyar Telekom we developed the technical platform through the R&D activities for the introduction of new VoIP and multimedia-based services, based on the next generation ("NGN") IP/Ethernet-based core and broadband fixed ("ADSL", "xDSL") and wireless ("WLAN", "WiFi") accesses.

Significant resources are devoted to the upgrading of our digital backbone network. The DWDM technology was introduced to satisfy the additional demands on the backbone network that arose in connection with broadband services, such as fast Internet access and broadband IP-VPN.

We are continuously developing our data communications and IP network and services to meet demands for broadband services. We developed the concept of a national, high-speed IP network built on DWDM and Gigabit Ethernet. Under this program, the components of our IPv6 protocol pilot network were identified.

In the last few years, we rolled out a wide range of broadband access technologies (e.g., ADSL, cable television, optical access network and managed leased line technologies) to satisfy demands for higher bandwidth. To widen the choice of broadband services, we considered the possibilities of implementing triple-play solutions. In 2006, multimedia services, including IPTV development, were tested in the Ethernet and DSLAM environment. Based upon this work, by the end of 2006, we introduced IPTV services. The possibility of introduction and application of IP High Definition TV ("HDTV") and Three Dimension ("3D") TV technologies are being investigated.

In 2006, we studied the usability of World Interoperability for Microwave Access ("WiMAX") technology. WiMAX can provide wireless broadband access with effective radius of up to several kilometers with up to 70 Mbit/s radio throughput. We also plan to implement the new generation of xDSL technologies ("VDSL2", "Gigabit capable Passive Optic Network") in the access network to extend the broadband access coverage and provide higher bit rate.

The Global Resource Information Database ("GRID") mass-computing platform prototype has been further developed providing quota management to enhance its security and to ensure resilience against data flooding attacks.

In the last two years, we laid down the basis for product developments toward the convergence of fixed and mobile networks together with TMH. A Bluetooth and WiFi-based intelligent solution has been tested in our laboratory. Our next step in this field will be a study on the FMC possibilities in IP Multimedia Subsystem ("IMS") environment, and WiFi/UMTS handsets. A study has been launched on the potential interconnection of the Next Generation fixed and mobile networks, based on the ETSI Telecoms and Internet converged Services and Protocols for Advanced Networks ("TISPAN") IMS architecture.

When we aim to provide voice service over IP networks, Name Addressing and Routing ("NAR") issues essentially differ from those that we experienced in the PSTN network. Telephone Number Mapping ("ENUM") is one of the most promising technologies to provide information for IP based call routing including information for number portability, freephone and other number or address translation capabilities, SMS and MMS. This routing is available both internally and for interconnection of networks (peering). In 2006, we set up an experimental network and interconnected it with the ENUM trial system of Deutsche Telekom to examine the possibilities of the ENUM infrastructure In 2007, we aim to build an ENUM network that will be used for dynamic call routing based on Bluetooth sensors.

We have developed a test system for hearing-impaired users, which transforms the speech signals into moving images, so users can recognize the speech by lip-reading.

Environment protection

The management committee of Magyar Telekom adopted the Sustainability Strategy of the Company in January 2005 to strengthen our commitment to sustainable development.

As a part of our commitment to sustainability, we developed a sustainability section for Magyar Telekom's website. This section includes our reports and news relating to sustainability and discusses our philosophy and approach to sustainability.

Real estate

Based on a five-year contract, we outsourced our real estate operations from February 1, 2005, thus real estate development, investment, operations and management activities are now provided by DeTe Immobilien-Hungary Zrt. for Magyar Telekom Plc. In order to exercise strategic management and control, we established the Real Estate Management Office.

Real estate holdings have the following functions:

- Technical building
- Warehouse
- Garage
- Holiday resort
- Tower
- Office
- Other social building
- Preferential office
- Apartment
- Land

According to our proprietary needs, the aim of the Real Estate Management Office is to optimize the utilization of the real estate portfolio, while selling or otherwise making use of the surplus properties on favorable terms.

Liquidity, financial instruments

We carry indebtedness at a level we consider appropriate based on a number of factors, including cash flow expectations (i.e., cash requirements for ongoing operation, investment plans), expectations of investors, analysts, rating agencies and the overall cost of capital. We announced a definite dividend policy in 2003, according to which the group level net debt ratio is to be kept between 30 to 40 percent.

The majority of our operating revenues and expenses are denominated in Hungarian forints. Accounts payable to and receivable from international carriers, which are denominated in a basket of currencies known as SDRs, are netted against one another and settled primarily in U.S. dollars and Euros. Capital expenditures are denominated partly in foreign currencies, principally U.S. dollars and euros.

We reduced foreign exchange and interest rate risks associated with our loan portfolio. At December 31, 2006, the loans were 100 percent denominated in HUF, thus the foreign exchange risk of the loan portfolio is naturally hedged by the HUF-denominated revenues.

In order to avoid potential negative effects of the exchange rate movements, in case of remarkable foreign exchange denominated cash-flow (e.g. acquisition of a foreign subsidiary or foreign exchange denominated dividend payment) after the decision on the payment, prior to the execution of the transaction we open an appropriate hedge (mainly forward) transaction. We do not have any other material derivative transactions.

Risk management policies

It is our policy that all disclosures made by us to our security holders and the investment community be accurate and complete, and fairly present our financial condition and results of operations in all material respects. Such disclosures should be made on a timely basis as required by applicable laws, rules and regulations, including by-laws of the Budapest Stock Exchange and rules adopted by the U.S. Securities and Exchange Commission ("SEC"). To achieve these objectives, we formed the Disclosure Committee and developed and have continuously enhanced our risk management policies.

Our risk management includes identification, assessment and evaluation of risks, development of necessary action plans, and monitoring of performance and results. For risk management to be effective, we must ensure that management take business decisions with full understanding of all relevant risks.

In 1999, we established a formal risk management system. In 2000, we established a department to co-ordinate all risk management tasks. This system was integrated into the risk management system of Deutsche Telekom in 2002.

All risks related to material internal and external operations, financial and legal compliance and certain other risks are evaluated and managed by a well-defined internal mechanism. A risk management handbook and a Chief Executive Officer ("CEO") directive on risk management were published in 2003. A risk management course was developed for employees responsible for risk management in all organizational areas. Risk items affecting our operations are reviewed quarterly throughout the Group. All of our subsidiaries, business units, divisions and entities are obliged to identify and report their operational risks on a quarterly basis. After evaluation of these risks, results are reported to our management, to the Audit Committee and to DT.

Following the enactment of the Sarbanes-Oxley Act, we decided to enhance our risk management procedures. As this new law requires prompt disclosure of all risk items influencing investors' decisions, we complemented our quarterly risk reporting system with a continuous reporting procedure which requires all of our departments and subsidiaries to report on a real-time basis any new material fact, information or risk that comes to their knowledge. Information thus submitted is monitored daily by the risk management department, and the Chief Financial Officer ("CFO") is notified when a new material risk or information is identified.

A CEO directive has been issued to define responsibilities of each employee in risk monitoring and management. In addition, an e-learning course was created to train our employees on requirements of the Sarbanes-Oxley Act, our enhanced reporting and corporate governance obligations and the enhanced risk reporting procedures. Completion of this course has been made compulsory for all of our employees.

We established the Disclosure Committee on July 31, 2003. The Disclosure Committee acts both in plenary meetings and through its members acting individually. It supports CEO and CFO in fulfilling their responsibility to oversee processes designed to ensure accuracy and timeliness of our disclosures.

Human policy

„Professional and committed employees, who are able to act on their own initiative, are the most important success factor of the business effectiveness of Magyar Telekom"—this is the HR vision the Group has articulated in line with its mission and strategy. The most important goal is to achieve that our company possesses the most professional human resources organization in Hungary and in international terms as well, regarded by its clients as their internal partner and consultant, which other firms also approach with confidence whenever they need to obtain experience.

Magyar Telekom's human resources strategy for the years 2003-2006 is grouped around five focal points in line with Deutsche Telekom's HR strategy. The focal points are as follows:

- Managing diversity: we endeavour to leverage group level synergies in order to achieve highest best business returns.

- Management of personnel expenses: our aim is to achieve a cost effective personnel management based on market information and best international practice.

- Total compensation: our aim is to ensure performance-based and market-competitive compensation.

- Management of skills and competences: we focus on identifying and managing knowledge and skill, and on promoting talent.

- HR efficiency and quality: our aim is to deliver high-level human resource services meeting the needs of our business partners.

Out of the nine core elements of SA8000 (Social Accountability) standard, our human resources strategy highlights the one dealing with the absence of discrimination. As far as other core elements are concerned, our company's practice is adapted to Hungarian legislative norms (among others the Constitution of the Hungarian Republic, provisions set out in the Labour Code, as well as the Universal Declaration of Human Rights). The principles of justice and equal opportunities are set out in the basic standards articulated in our Code of Ethics published in 1997, which complies with the S-OX (Sarbanes-Oxley) act. Alternative forms of employment like telework, part-time work, flex-work, employment of disabled persons provide possibilities for the practical implementation of equal opportunities.

Magyar Telekom Plc. continuously cooperates with trade unions and the Workers Council to represent employees' interests: wage and compensation elements are reviewed once a year and their upward correction is set out in a contract along with headcount efficiency measures.

The Group's wage tariff system regulated by way of the Collective Agreement complies with Article 23 of the Universal Declaration of Human Rights, which says: „Everybody is entitled to equal wage for equal work without any kind of discrimination."

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

Both in its selection processes and during the career of its employees at the company, Magyar Telekom is committed to ensure for its employees equal opportunities independently from age, gender, ethnicity, religious or political conviction, and sexual orientation. In hiring labour a special attention is paid to granting possibilities to its own employees in the first place, through either horizontal or vertical advancement: this is the FreeJob system (a data base of vacant positions accessible only to Magyar Telekom Plc. employees) accompanied by a regulation for 30 days being reserved for an exclusively internal search. The company operates an Induction Program to effectively help the accommodation of colleagues selected for the position.

Magyar Telekom Plc. pays special attention to young graduates through the „Starting-Block" trainee program, which grants employment and training to 15-20 graduates each year.

The company introduced in 1997 and has continuously developed since then its knowledge management system, which is being used for the measurement of competence and knowledge, for the definition of development areas and the review of individual tasks. Development needs are identified with the help of the Personnel Round Table for middle and top management. Development is available in the following forms:

- traditional „classroom" training within the company and outside,
- skills development training (individual and group programs administered by trainers, e.g. team building, self-awareness training)
- e-learning, i.e. distant training through an individual training „net" (e.g. media training).

Both management succession and development of professionals are key aims in the area of advancement and talent management, for which Magyar Telekom operates several, target-specific talent management programs.

Magyar Telekom is committed to excellence: the results of regular surveys among employees and customers are used as a basis for the improvement of our internal operation. In addition, the company takes advantage of the possibilities rendered by modern technologies to achieve excellence: through the enhancement and use of advanced IT systems it improves operating efficiency.

The HR area operates its web-based IT services and, through eHR solutions, it continuously broadens the range of its cost saving, efficiency improving and customer friendly services.

Magyar Telekom pays special attention to the high level of the employees' occupational safety and provides them the conditions of safe work and a working environment, which does not harm health. A special organizational unit is engaged in occupational health and safety of work issues, and develops the company's safety of work strategy and set of objectives.

Magyar Telekom puts a major emphasis on taking care of departing employees: several solutions have been developed to provide for benevolent outplacement and to reduce the number of one-sided terminations. Using the wealth of alternative forms of employment is accompanied by an outplacement system called Chance program to help departing employees find a new employment. The program provides training and helps departing employees' reintegration in the labour market.

Outlook

The telecommunications industry is undergoing a major change globally. We have observed several long-term trends which are changing the structure of the Hungarian telecommunications market. Key drivers of the long-term trends include changes in technology (i.e., IP-based broadband products and solutions, emerging wireless broadband technologies), customer requirements (i.e., mobility and ease of use, triple-play solutions), competition and regulation (i.e., low entry barriers, new business models).

To adapt to these changes in the market, we are now moving from the traditional traffic-based revenue structure to an access-based revenue structure, which will allow us to substitute declining traffic revenues with content, entertainment and bundled access revenues. In addition, we are seeking new revenue sources by entering into new non-traditional converged telecommunications markets.

We should emphasize that each segment is affected by its unique business environment, and we are subject to circumstances and events that are yet unforeseen or beyond our control. We have identified several risk factors which may affect our business in the future including changes in the regulatory environment, changes in competition, the unforeseeable effects of the announced stabilization package of the Hungarian government and changes in the foreign exchange rates just to mention the most important ones.

Magyar Telekom's current plans and outlook are based on our current best knowledge and expected circumstances. Nevertheless the behavior of our competitors can hardly be completely predicted. Therefore a stronger than assumed impact of alternative operators, new market entrants and new solutions in any country where Magyar Telekom is present could influence our business performance negatively.

We expect that our core business units will be able to continue to generate strong free cash flow. However, there are some significant elements that can have negative effects on the free cash flow, for example, the roll-out of EDR infrastructure and potential acquisitions. Despite these effects we expect to generate solid positive free cash flow in 2007 as well.

Revenues

The following reflects our current expectations with respect to our segmental plans and initiatives:

In the fixed line segment, we expect continued gradual decline in fixed line voice revenues due to continued line erosion and fixed line unit price erosion driven by mobile substitution and the increased competition in the fixed line market, including competition from PSTN resellers and VoIP or VoCATV providers. As indicated in our strategy, to mitigate the decrease in fixed line voice revenues we are now moving from the traditional traffic-based revenue structure to an access-based revenue structure, which will allow us to substitute declining traffic revenues with content, entertainment and bundled access revenues.

As the leading broadband provider in Hungary, we are committed to accelerating growth in country-wide broadband penetration by applying a multi-access cost-efficient approach. In November 2006, we launched IPTV services; in early 2007 we doubled bandwidths on our network by utilizing ADSL2 technology and to further boost market development by introducing naked DSL services.

To maintain sustainable competitiveness in the corporate sector, we have committed to further developing our IT competencies by focusing on complex service offering via managed services, system integration and outsourcing through consultancy-based selling to corporate customers.

In addition, we are seeking new revenue sources by entering new non-traditional telecommunication markets such as transactional services and commerce to generate new revenue streams in case a potential business opportunity arises to capture potential growth opportunities on new converged market areas.

In the mobile segment we expect continuing growth in net revenues. Market penetration in Hungary is now almost saturated, and we expect lower growth rates due to a smaller number of potential new subscribers. This trend is partly offset by the migration of prepaid customers to postpaid packages and the future growth potential of higher-value services, which is supported by the launch of UMTS and HSDPA services. Accordingly, leveraging first mover advantage on our newly built HSDPA capacities is one of T-Mobile Hungary's primary strategic priorities on the fast growing wireless broadband market.

Expenses

In line with our strategy, we plan to improve our internal operational efficiency in all segments. Our initial 2006 goal to improve the efficiency of our workforce by increasing the fixed lines (B-channel equivalent) per employee ratio to over 500 (a ratio that corresponds to the best practice in Western Europe) was already reached by the end of February 2006.

The merger of Magyar Telekom Plc. and TMH will enable us to further improve efficiency. We are expecting significant value generation through the gradual implementation of the integration by seizing additional revenues and optimizing operating and capital expenses. In 2006, the first impacts from the fixed-mobile integration in terms of sales and customer retention began to be seen. These were, however, offset by related costs. The next three years we expect to see a significant positive impact, with net present value of these benefits currently estimated to be around HUF 60 billion in the period of 2007-2009. The integration of our fixed and mobile businesses will particularly enhance our competitiveness in the areas of customer care and customer service, products and value propositions, back-office and supporting systems and joint network infrastructure management.

Gross additions to tangible and intangible assets

We aimed to reduce the gross additions to tangible and intangible assets to sales ratio to below 15 percent in 2006 on group level and succeeded in meeting this target. We are targeting this ratio to fall below 14 percent in 2007 excluding potential acquisitions. We expect an increasing proportion of gross additions to relate to high-growth areas in the fixed line segment, such as Internet, broadband and data transmissions, while our mobile segment will continue the roll-out of the UMTS and HSDPA infrastructure.

Revenue and EBITDA targets

Based on our former outlook and market and regulatory conditions, we expected to achieve compounded average revenue growth rate of at least three percent for the period of 2006-2007 on group level. In terms of EBITDA, we targeted to maintain the 2005 reported EBITDA level in 2006. At the end of 2006, we were fully on track to meet both of these targets. Looking forward to 2007, we are targeting stable revenue and EBITDA in forint terms over 2006 reported figures.

Budapest, March 22, 2007