



MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

ANNUAL REPORT AND BUSINESS REPORT

FOR THE YEAR ENDED DECEMBER 31, 2016



EGYÜTT. VELED

MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

ANNUAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2016

PREPARED IN ACCORDANCE WITH
THE HUNGARIAN ACCOUNTING LAW
(HAR)



INDEPENDENT AUDITOR'S REPORT
(Free translation)

To the shareholders of Magyar Telekom Telecommunications Public Limited Company

Opinion

We have audited the accompanying financial statements of Magyar Telekom Telecommunications Public Limited Company ("the Company") which comprise the balance sheet as at 31 December 2016 (in which the balance sheet total is MHUF 984,574, the profit after tax is MHUF 28,536), the related income statement for the year then ended, and the notes to the financial statements, which include a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2016, and of the results of its operations for the year then ended in accordance with the provisions of Act C of 2000 on Accounting ("Accounting Act"), in force in Hungary.

Basis for opinion

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

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Hungary. We have fulfilled our other ethical responsibilities in accordance with those requirements.

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

Key audit matters

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

| <i>Key audit matter</i> | <i>How our audit addressed the key audit matter</i> |
|--|--|
| <p><i>Impairment assessment of investments in related companies</i></p> <p>As at 31 December 2016, the Company's investment in Stonebridge A.D. was MHUF 77,476.</p> <p>We focused on the impairment assessment of the Company's investment in Stonebridge A.D.</p> | <p>We agreed the cash flow forecasts used in the impairment assessment to Board approved forecasts. We considered the directors' expectations in respect of material impacts of the external environment and planned operational improvements and whether these were</p> |



| Key audit matter | How our audit addressed the key audit matter |
|--|--|
| <p>as it is sensitive to changes in assumptions (in particular the long term growth rate, the discount rate and the assumptions underlying future operating cash flows).</p> <p>The directors concluded that there was no impairment of the above investment.</p> <p>Details of investments are given in note 6.</p> | <p>appropriately reflected in the cash flow forecasts.</p> <p>We compared actual historical cash flow performance with previous forecasts and determined whether any differences fell within an acceptable range.</p> <p>We independently calculated a weighted average cost of capital by making reference to market data and compared the long term growth rate to market data.</p> <p>We assessed the sufficiency of the sensitivity analysis performed by the directors and performed further sensitivity analyses, primarily focused on changes in operating cash flows.</p> <p>We read note 6 of the financial statements.</p> <p>Based on our procedures, we noted no material exceptions and considered management's key assumptions to be within reasonable ranges.</p> |
| <p>Accuracy of revenue due to complex billing systems</p> <p>The accuracy of revenue amounts recorded is an inherent industry risk. This is because telecom billing systems are complex and process large volumes of data with a combination of different products sold and price changes in the year, through a number of different systems.</p> <p>Total revenue for the Company was MHUF 468,255 as disclosed in note 24 and 25 of the Company's financial statements.</p> <p>For further details of the accounting policies related to revenue, please refer to note 2.4 of the Company's financial statements.</p> | <p>We evaluated the relevant IT systems and the design of controls, and tested the operating effectiveness of controls over the:</p> <ul style="list-style-type: none">• capturing and recording of revenue transactions;• authorisation of rate changes and the input of this information to the billing systems; and• calculation of amounts billed to the customers. <p>We also tested a sample of items from the customer billing systems to the invoices raised and checked these to the cash received from the customers. Our testing included customer bills for consumer and corporate customers.</p> <p>We have not identified any material misstatements as a result of our procedures.</p> |



Other information: the business report

The other information comprises the business report of the Company. Management is responsible for the preparation of the business report in accordance with the provisions of the Accounting Act and other relevant regulations. Our opinion on the financial statements does not cover the business report.

In connection with our audit of the financial statements, our responsibility is to read the business report and, in doing so, consider whether the business report is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Based on the Accounting Act, in respect of the business report, our responsibility is to read the business report identified above and, in doing so, consider whether the business report has been prepared in accordance with the provisions of the Accounting Act and other relevant regulations, if any.

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

In our opinion, the 2016 business report of the Company, also including the information prepared under Paragraphs e) and f) of Subsection (2) of Section 95/B, is consistent with the 2016 financial statements and the business report has been prepared in accordance with the Accounting Act.

As there is no other regulation prescribing further requirements for the business report, in respect of this, our opinion on the business report does not express the opinion required by Section (5) h) of 156 of the Accounting Act.

In addition, in light of the knowledge and understanding of the entity and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the business report, and shall give an indication of the nature of any such misstatements. We have nothing to report in this respect.

We state that the information referred to in Paragraphs a)-d) and g) of Subsection (2) of Section 95/B of the Accounting Act has been provided.

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

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with the Accounting Act, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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



Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that gives a true and fair view.

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

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



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

Budapest, 1 March 2017

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

Balázs Árpád
Statutory auditor
Licence number: 006931

Translation note:

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



BALANCE SHEET AS OF DECEMBER 31, 2016

ASSETS

All amounts in millions of HUF

| | Note | December 31, 2015 | December 31, 2016 |
|---|------|-------------------|-------------------|
| A. FIXED ASSETS AND FINANCIAL INVESTMENTS | | 878 835 | 847 575 |
| I. Intangible assets | 4 | 335 120 | 289 939 |
| 3. Rights | | 249 444 | 233 629 |
| 4. Intellectual property | | 5 816 | 9 506 |
| 5. Goodwill | | 79 860 | 46 804 |
| II. Tangible assets | 5 | 378 560 | 376 196 |
| 1. Land and buildings and related rights | | 231 968 | 221 196 |
| - Land | | 2 758 | 2 659 |
| - Buildings | | 58 721 | 52 151 |
| - Telecommunication network | | 160 415 | 156 742 |
| - Other properties | | 9 578 | 9 161 |
| - Real estate related rights | | 496 | 483 |
| 2. Technical equipment, machinery and vehicles | | 101 661 | 89 943 |
| - Telecommunication equipment and machinery | | 100 526 | 89 048 |
| - Other technical equipment, machinery and vehicles | | 1 135 | 895 |
| 3. Other equipment and vehicles | | 8 527 | 12 231 |
| 5. Construction-in-progress | | 36 392 | 52 826 |
| 6. Advance payments on construction-in-progress | | 12 | 0 |
| III. Financial investments | | 165 155 | 181 440 |
| 1. Non-current investments in related parties | 6 | 154 792 | 172 487 |
| 7. Other non-current loans granted | 7 | 10 363 | 8 953 |
| B. CURRENT ASSETS | | 96 181 | 97 138 |
| I. Inventories | 8 | 10 249 | 12 224 |
| 1. Raw materials | | 171 | 288 |
| 2. Work in progress and semi-finished products | | 7 | 64 |
| 5. Goods for resale | | 10 071 | 11 872 |
| II. Receivables | | 80 579 | 83 620 |
| 1. Accounts receivable | 9 | 56 384 | 55 959 |
| 2. Receivables from related parties | 10 | 16 540 | 18 571 |
| 6. Other receivables | 11 | 7 655 | 9 090 |
| III. Securities | 12 | 4 507 | 35 |
| 1. Investments in related parties | | 4 200 | 0 |
| 4. Treasury stock, quotas | | 307 | 35 |
| IV. Liquid assets | | 846 | 1 259 |
| 1. Cash and cheques | | 160 | 63 |
| 2. Bank deposits | | 686 | 1 196 |
| C. ACCRUALS | 13 | 41 101 | 39 861 |
| 1. Accrued income | | 39 154 | 36 013 |
| 2. Prepaid costs and expenses | | 1 947 | 3 848 |
| TOTAL ASSETS | | 1 016 117 | 984 574 |

Budapest, February 22, 2017


 Christopher Mattheisen
 Chief Executive Officer,
 Member of the Board


 János Szabó
 Chief Financial Officer

The Notes form an integral part of these financial statements.



BALANCE SHEET AS OF DECEMBER 31, 2016

LIABILITIES AND SHAREHOLDERS' EQUITY

All amounts in millions of HUF

| | Note | December 31, 2015 | December 31, 2016 |
|--|------|-------------------|-------------------|
| D. <u>SHAREHOLDERS' EQUITY</u> | 14 | 412 657 | 425 558 |
| I. Common stock | | 104 274 | 104 274 |
| <i>- of this treasury stock at par value</i> | | 39 | 8 |
| II. Unpaid share capital (-) | | 0 | 0 |
| III. Capital reserves | | 58 952 | 58 952 |
| IV. Retained earnings | | 228 731 | 233 761 |
| V. Restricted reserves | | 307 | 35 |
| VI. Valuation reserves | | 0 | 0 |
| VII. Profit after tax | | 20 393 | 28 536 |
| E. <u>PROVISIONS</u> | 15 | 17 449 | 17 706 |
| 1. Provision for expected obligations | | 17 449 | 17 706 |
| F. <u>LIABILITIES</u> | | 537 777 | 479 018 |
| I. Subordinated liabilities | | 0 | 0 |
| II. Non-current liabilities | | 291 246 | 301 991 |
| 8. Non-current liabilities to other related parties | 16 | 218 563 | 236 416 |
| 9. Other non-current liabilities | 17 | 72 683 | 65 575 |
| III. Current liabilities | | 246 531 | 177 027 |
| 1. Current borrowings | | 176 | 175 |
| <i>- of this convertible bonds</i> | | 0 | 0 |
| 2. Current loans | 18 | 13 066 | 11 500 |
| 3. Advances received | | 681 | 726 |
| 4. Accounts payable | 19 | 55 358 | 46 154 |
| 6. Current liabilities to related parties | 20 | 15 044 | 16 526 |
| 8. Current liabilities to other related parties | 21 | 130 689 | 66 454 |
| 9. Other current liabilities | 22 | 31 517 | 35 492 |
| G. <u>ACCRUALS</u> | 23 | 48 234 | 62 292 |
| 1. Deferred revenue | | 3 140 | 9 244 |
| 2. Accrued expenses | | 43 612 | 51 572 |
| 3. Other deferred income | | 1 482 | 1 476 |
| <u>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</u> | | 1 016 117 | 984 574 |

Budapest, February 22, 2017


 Christopher Mattheisen
 Chief Executive Officer,
 Member of the Board


 János Szabó
 Chief Financial Officer

The Notes form an integral part of these financial statements.



INCOME STATEMENT FOR THE PERIOD ENDED DECEMBER 31, 2016

All amounts in millions of HUF

| | Note | January-December, 2015 | January-December, 2016 |
|---|------|------------------------|------------------------|
| 1. Net domestic sales | 24 | 488 076 | 448 284 |
| 2. Net export sales | 25 | 14 199 | 19 971 |
| I. Sales revenues | | 502 275 | 468 255 |
| 3. Change in self-manufactured inventories | | -8 | 57 |
| 4. Capitalized value of self-manufactured assets | | 26 940 | 10 883 |
| II. Own work capitalized | | 26 932 | 10 940 |
| III. Other income | 26 | 23 250 | 30 833 |
| of which: reversal of impairment | | 3 449 | 3 033 |
| 5. Costs of raw material | | 27 406 | 14 245 |
| 6. Costs of services | 27 | 92 934 | 94 573 |
| 7. Costs of other services | | 8 101 | 8 740 |
| 8. Cost of goods sold | 28 | 100 240 | 73 481 |
| 9. Costs of (mediated) services sold | 29 | 57 497 | 49 921 |
| IV. Material-type expenses | | 286 178 | 240 960 |
| 10. Salaries and wages | 30 | 45 742 | 43 310 |
| 11. Other employee related expenses | 30 | 6 875 | 6 837 |
| 12. Employee related contributions | | 14 567 | 13 703 |
| V. Employee related expenses | | 67 184 | 63 850 |
| VI. Depreciation and Amortization | | 91 125 | 97 591 |
| VII. Other expenses | 32 | 79 043 | 72 898 |
| of which: impairment | | 16 430 | 12 864 |
| A. PROFIT FROM OPERATING ACTIVITIES | | 28 927 | 34 729 |
| 13. Dividends and profit sharing (received or due) of which: received from related parties | | 5 495 5 495 | 14 871 14 871 |
| 16. Other interest income received of which: received from related parties | | 1 148 475 | 1 586 276 |
| 17. Other income from financial transaction | | 11 745 | 2 647 |
| VIII. Income from financial transactions | | 18 388 | 19 104 |
| 18. Loss on the sale of financial investments of which: related to related parties | | 90 0 | 918 0 |
| 20. Interest expense of which: to related parties | | 19 820 153 | 15 395 72 |
| 21. Impairment of investments, securities and bank deposits | | -782 | 4 491 |
| 22. Other expenses from financial transactions | | 6 650 | 3 631 |
| IX. Expenses from financial transactions | | 25 778 | 24 435 |
| B. RESULT FROM FINANCIAL TRANSACTIONS | 33 | -7 390 | -5 331 |
| C. PROFIT BEFORE TAXES | | 21 537 | 29 398 |
| X. Tax expense | 35 | 1 144 | 862 |
| D. PROFIT AFTER TAX | | 20 393 | 28 536 |

Budapest, February 22, 2017

Christopher Mattheisen
Chief Executive Officer,
Member of the Board

János Szabó
Chief Financial Officer

The Notes form an integral part of these financial statements.



MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016



0 NOTE ADDED FOR TRANSLATION

This annual report for December 31, 2016 is the English translation of the Annual Report issued in Hungarian language and prepared in accordance with Act C of 2000 on Accounting and with generally accepted accounting principles in Hungary.

These principles may be different from International Financial Reporting Standards or accounting principles of any other country. No adjustments have been made to conform the Annual Report with any accounting principles other than Hungarian.

The Auditors' report is a translation of the Auditors' report issued in Hungarian language on the Hungarian Annual Report as outlined above.

In the event of any discrepancy, whether in the Auditors' report or in the Annual Report, the Hungarian original version prevails.



1 BACKGROUND AND GENERAL INFORMATION

1.1 General Information about Magyar Telekom Plc.

Official name of the Company: Magyar Telekom Telecommunications Public Limited Company

Abbreviated name of the Company: Magyar Telekom Plc.

Registered office of the Company: 1013 Budapest, Krisztina krt. 55.

Name of the Court of Registration: Metropolitan Court as Court of Registration. Registration number of the Company: Cg: 01-10-041928

The Hungarian Telecommunications Company, the legal predecessor of Magyar Telekom Telecommunications Public Limited Company ("Magyar Telekom Plc." or the "Company") was founded by the Ministry of Transport, Communications and Construction on January 1, 1990. The Company was transformed by the Board of Directors of the State Asset Holding Ltd. into a wholly owned company limited by shares as of December 31, 1991. The Company was privatized on December 22, 1993, when the MagyarCom consortium acquired a 30.1 per cent stake in the Company. At the second stage of the privatization, which took place in December 1995, MagyarCom became the majority owner.

On November 14, 1997 the Company was listed on both the Budapest and the New York Stock Exchanges.

In June 1999, the State Privatization and Holding Company sold its remaining stake (5.75 per cent) through a secondary offering. After this transaction, the proportion of publicly traded shares increased to 40.47 per cent. Share of MagyarCom in the Company decreased to 59.53 per cent.

In 2000, the Company increased its common stock through issuing new shares in the amount of HUF 63 million, which were held mainly within Magyar Telekom Group. As a result of this transaction, the proportion of publicly traded shares increased to 40.51 per cent and MagyarCom's ownership changed to 59.49 per cent.

In 2002, the Company carried out HUF 490 million additional increase in common stock, which shares were repurchased. As a result of this transaction, the proportion of publicly traded shares changed to 40.32 per cent, the proportion of repurchased treasury stock to 0.47 per cent and MagyarCom's ownership changed to 59.21 per cent.

The Extraordinary General Meeting of the Company held on February 22, 2005 approved the decision of the Board of Directors to change the official name of Magyar Telecommunications Company Ltd. into Magyar Telekom Telecommunications Company Ltd., with short name of Magyar Telekom Ltd. The change was registered by the Court of Registry on May 6, 2005.

In 2006 the name of Magyar Telekom Telecommunications Company Ltd. changed to Magyar Telekom Telecommunications Public Limited Company, with short name of Magyar Telekom Plc. The change was registered by the Court of Registry on February 28, 2006.

The Company's American Depository Shares (ADSs) were traded on the New York Stock Exchange until November 12, 2010, when the ADSs were delisted. Magyar Telekom Plc. terminated the registration of its shares in the US in February 2012. The Company maintains its American Depository Receipt (ADR) program on a Level I basis.

On October 4, 2013 MagyarCom Holding GmbH owned by Deutsche Telekom AG merged into T-Mobile Global Holding Nr. 2 GmbH which is also owned by Deutsche Telekom AG in 100 per cent. Subsequently, on December 18, 2013 T-Mobile Global Holding Nr. 2 GmbH contributed its shares as capital increase into its fully owned subsidiary, CMobil B.V. with headquarters in the Netherlands (Stationsplein 8, 6221 BT Maastricht, the Netherlands). As a result of this transaction CMobil B.V. became Magyar Telekom Plc.'s shareholder with direct voting right of 59.21 per cent (registered in Share Register on February 7, 2014).

The name of the company changed to Deutsche Telekom Europe B.V. with effect from March 1, 2015.

Considering that the Deutsche Telekom Europe B.V. is the 100 per cent subsidiary of T-Mobile Global Holding Nr. 2 GmbH and T-Mobile Global Holding Nr. 2 is the 100 per cent subsidiary of Deutsche Telekom AG, after the transaction the indirect voting right and influence of Deutsche Telekom AG in Magyar Telekom Plc. remained unchanged.



Persons authorized to sign the annual report:

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

János Szabó - Chief Financial Officer (residence: Budapest)

In Magyar Telekom Plc., the accounting services are supervised by the Director of Accounting and Tax, Tamás Deák (certificate number: 188739. Area of speciality: entrepreneurial activity. Status: registered. Residence: Sukoró).

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

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

1.2 The Company's activity

Magyar Telekom Plc.'s primary activity is providing fixed line and mobile telecommunication services for public and business customers. The Company provides voice and non-voice (SMS, MMS, internet, data and content provision) within mobile services; voice, data, internet and TV services within fixed line services.

In addition, the Company sells equipment needed for using fixed line and mobile services (telephones, tablets, notebooks, TV sets etc.).

The Company started its electricity and natural gas retail activities in 2010.

The purpose of Magyar Telekom Plc.'s participation in the energy market is to provide more integrated domestic services in case of residential customers and business services in case of business customers.

Business model related to energy supply activity of Magyar Telekom Plc. is subject to review regularly. After the latest review the Company decided to discontinue its natural gas supply provided for residential customers with effect of July 31, 2015.

On July 9, 2015 the Company made an agreement with MET Holding AG to establish E2 Hungary Zrt. as a jointly controlled entity. From January 1, 2016 the E2 Hungary Zrt. provides both electricity and gas supply services for business customers.

1.3 Employee share ownership program (ESOP)

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

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

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



Magyar Telekom transferred 1,533,636 treasury shares in August 2016 to the established ESOP Organization of which it sold 25,764 shares due to the revision of the number of the participants in the program. The ESOP Organization was fully consolidated as at December 31, 2016 as it was controlled by the Company.

In 2016 HUF 493 million was recognized as expenses for the program.

2 ACCOUNTING POLICIES

The accounting policies of Magyar Telekom Plc. include basic accounting principles, measurement methods and procedures as well as methods and tools used for enforcing the provisions of the Hungarian Accounting Regulations.

Magyar Telekom Plc. maintains its records both in accordance with the Hungarian Accounting Regulations (HAR) and International Financial Reporting Standards (IFRS). The differences between the two reports are solely due to differences in the respective accounting principles.

The closing day of the Company's business year is December 31. The balance sheet preparation date is January 2, 2017 in respect of the annual report for 2016.

Magyar Telekom Plc. uses version "A" of the balance sheet and version "A" of the income statement (total cost method) when preparing its annual report in accordance with the Hungarian Accounting Regulations. Amounts in the annual report are stated in HUF millions. The currency of accounting is the Hungarian Forint (HUF).

The Hungarian Act on Accounting allows for certain captions in the balance sheet to be broken-down or omitted so Magyar Telekom Plc. breaks down

- Land and buildings and related rights:
 - Land
 - Buildings
 - Telecommunication network
 - Other properties
 - Real estate related rights
- Technical equipment, machinery and vehicles:
 - Telecommunication equipment and machinery
 - Other technical equipment, machinery and vehicles

and the following captions are omitted:

- Adjusted value of intangible assets
- Breeding stock
- Adjusted value of tangible assets
- Non-current loans granted to independent undertakings
- Adjusted value of financial investments
- Valuation difference of invested financial assets
- Animals for breeding and fattening and other livestock
- Finished products
- Valuation difference of receivables
- Valuation difference of derivative instruments (positive)
- Valuation difference of securities
- Valuation reserve for adjustments
- Fair value reserve
- Subordinated liabilities to related parties
- Subordinated liabilities to companies linked by virtue of major participating interests
- Subordinated liabilities to independent undertakings
- Subordinated liabilities to other economic entities
- Valuation difference of liabilities
- Valuation difference of derivative instruments (negative)

Moreover the Company does not disclose in the balance sheet and in the income statement those captions marked with Arabic characters where there were no data either for the previous year or this year.

In 2016, these captions were as follows:

- Capitalized costs of foundation and restructuring
- Capitalized costs of experimental development
- Advance payments on intangible assets
- Non-current loans granted to related parties
- Non-current major participating interest
- Non-current loans granted to companies linked by virtue of major participating interests
- Other investments (Financial investments)
- Non-current loans granted to independent undertakings
- Non-current bonds and other securities
- Advance payments on inventories
- Receivables from companies linked by virtue of major participating interests
- Receivables from other related companies
- Bills receivable
- Major participating interest
- Other investments (Securities)
- Marketable securities
- Deferred expenses
- Provision for expected expenses
- Other provisions
- Non-current borrowings
- Convertible bonds
- Debt from issuance of bonds
- Investment and development loans
- Other non-current loans
- Non-current liabilities to related parties
- Non-current liabilities to companies linked by virtue of major participating interests
- Bills of exchange payable
- Current liabilities to companies linked by virtue of major participating interests
- Income and gains on financial investments (from securities and loans)
- Expenditure and loss on financial investments (from securities and loans)

Since January 1, 2005 the Company has complied with its obligation to prepare the consolidated financial statements by preparing those in accordance with the International Financial Reporting Standards.

The consolidated financial statements of Deutsche Telekom AG (Friedrich-Ebert-Alle 140, 53113 Bonn, Germany) also includes Magyar Telekom Plc. and its subsidiaries.

2.1 Definition of the accounting principles, guidelines and methods

Magyar Telekom Plc. interprets the significant error in preparing its annual report as follows:

Items must be considered significant in all cases if, in the year when discovered by any form of audit, the total of all errors (whether negative or positive) for a given financial year and the impacts thereof - increasing or decreasing the profit or loss or the equity - exceeds 2 per cent of the balance sheet total of the financial year. If the Company reveals a significant error through self-revision, then modifications relating to prior years are presented next to the prior years' figures for each balance sheet and income statement item.

The Company has set up regulations for valuation of assets and liabilities, scrapping, cost calculation, stocktaking, cash management, and system of documentation as required by the Hungarian Accounting Regulations.

Until further decision, the Company does not use the allowed alternative treatment in the Hungarian Accounting Regulations for the valuation of fixed assets at market value and valuation of certain financial instruments at fair value.

2.2 Basic principles applied to the separation of accounts related to energy supply

From 2010, Magyar Telekom Plc.'s activity expanded with providing electricity and natural gas services based on individual authorization.

Magyar Telekom Plc. worked out the rules for accounting separation based on the Act LXXXVI of 2007 on electricity and on the Act XL of 2008 on natural gas supply and the principles connected to this are recorded in its accounting policies. These principles are defined for each general ledger account in its chart of accounts.

Every general ledger account is assigned to one of the following categories:

- Telecommunication or Other activity: those general ledger accounts which contain items connected exclusively to either telecommunication activity or non-telecommunication and non-energy supply activities (e.g. property rental fee revenues).
- Energy: contains items connected exclusively to energy supply activity and can be allocated definitely to electricity or to natural gas services activity.
- To be allocated: settlements on these accounts are connected to telecommunication, to other and to energy supply activities. Amounts on these accounts are allocated to energy supply, telecommunication or other activities based on further allocation rules.

As a result of allocation, the difference between the Assets and Liabilities sides of the balance sheet is disclosed as "difference because of separation" in Liabilities.

The Company discloses its separated balance sheet and income statement in Appendix 1.

General rule applied during allocation is that if a general ledger account contains the settlement of energy activities (directly or indirectly from an allocation process) and there is no any subledger then the separation of the balance between electricity and gas activities are based on the weighted proportion of the point of delivery (POD) numbers.

At a significant part of general ledger accounts the allocation is based on proportion of direct margin because of the different profit of telecommunication and energy products. The direct margin is the difference between revenues and direct costs related to it; corrected by the effect of utility costs reduction, the amount of discount related to energy services connected to telecommunication services. Items are separated to energy services and to telecommunication/other services in the proportion of direct margin.

In case of the information are available in subledger then allocated amounts on energy activities are defined by individual items based on data supply.

In case of some items the allocation ratio depends on costs. The cost ratio on energy services is equal to the quotient of the material-type expenses for energy services in 100 per cent (electricity and/or gas) and the total material-type expenses of the Company. Other cost dependent items are allocated in the proportion of employee related expenses.

Items related to IT systems connected to energy retail services are directly allocated to energy activities.

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

2.3 Valuation methods used for the preparation of the Balance Sheet

2.3.1 Assets

2.3.1.1 Recognition and measurement of non-current assets

Intangible and tangible fixed assets

Magyar Telekom Plc. carries intangible and tangible fixed assets at historical cost less accumulated depreciation, in case of advance payments on intangible assets and on construction-in-progress at historical cost less impairment. Property, plant and equipment includes the capitalized value of improvements and refurbishment that extend the useful life of the asset, increase its capacity and/or functionality.

One-off and regular usage fees of the acquired frequency usage rights are payable by the Company. If the regular (monthly, quarterly or annual) charges are reliably estimable based on the related Authority Contract and the Company does not expect any further services for these charges in the future (meaning that the one-off and regular charges are paid for the same substance), the total amount of regular charges are considered part of the acquisition cost of the frequency usage rights. These charges are capitalized as part of the concession rights and recognized as current and non-current liabilities. Otherwise the amount of usage fee paid regularly and proportionally to time is recognized as cost of other services in the income statement.

Borrowing costs connected directly to loans taken for the acquisition or production of fixed assets are capitalized by the Company.

Depreciation policy

In case of tangible and intangible fixed assets the depreciation and amortization are based on the gross value of the asset or in case a residual value is defined for tangible fixed asset then the gross value reduced by the residual value.

The method of depreciation is straight-line based on gross value using rates derived from useful lives.

Depreciation starts on the day when the asset is placed into operation and it is over when the useful life of the asset elapsed or the day the asset is derecognized from the books for any reason. The Company records depreciation and amortization monthly in proportion to the days of the given month.

The Company records depreciation of intangible and tangible fixed assets based on the useful lives as follows:

In case of intangible fixed assets:

| | <u>Years</u> |
|--------------------------------|--------------|
| Concession rights and licenses | 8–25 |
| Goodwill | 5-10 |
| Other intangibles | 3–15 |

In case of tangible fixed assets:

| | <u>Years</u> |
|---|--------------|
| Buildings | 10–50 |
| Networks and other real estate related rights | 7–38 |
| Technical equipment, machinery and vehicles | 2–25 |
| Other equipment | 2–12 |

Useful lives are determined based on generally accepted international telecommunication industry practices and development potentials. Magyar Telekom Plc. regularly reviews the useful lives of fixed assets and modifies them if necessary.

The Company determines residual values for those groups of assets where the residual values are considered to be significant. Residual value is considered to be significant if the expected realizable value exceeds the expected scrap value when the asset is



taken out of service. The Company determines residual value for buildings, vehicles and customer premises equipment (CE routers, 3play equipment etc.) installed at customer premises (purchased through closed-end lease contracts). Determination of residual value is carried out on an individual basis. Residual value is not considered to be significant for intangible assets and other groups of the tangible fixed assets so zero residual value were determined for these assets.

The Company applies residual values only for assets capitalized after January 1, 2001. No residual value is calculated for additional capitalization on assets purchased before January 1, 2001.

The Company does not use the option given in Section 80. (2) of Act on Accounting which allows that the acquisition value of intangible and tangible assets with an individual purchase cost below HUF 100,000 may be charged in one sum as depreciation upon the commencement of use. These assets are recorded individually and their purchase cost are settled following their commencement of use as depreciation during their expected useful lives.

The Company records extraordinary depreciation in cases where the value of the asset permanently decreased due to the fact that it is no longer needed, damaged or destroyed, or if the book value is permanently and significantly in excess of the market value.

If the reasons for the extraordinary depreciation of intangible and tangible assets on the basis of market value no longer exist or have changed, the recognized extraordinary depreciation shall be eliminated and the affected intangible and tangible assets shall be adjusted back to their market value (not to exceed their net value determined in consideration of the straight-line depreciation). The Company records the reversal of extraordinary depreciation as other income.

In case of goodwill the reversal of extraordinary depreciation is inapplicable.

Capitalized value of foundation, restructuring and experimental development

The Company does not capitalize foundation, restructuring and experimental development costs.

Goodwill

As from January 1, 2016 the Company records the difference between the acquisition cost of the purchased business line, sites of operation or store chain and the market value of assets less the value of liabilities assumed as goodwill if the acquisition cost is higher. That amount has to be considered also as acquisition cost which is part of the purchase price but it is under warranty, assurance or guarantee retention agreed in the sales contract and its financial settlement occurs at a different time.

In case the acquisition cost is lower the Company records negative goodwill which is recognized as Deferred income and is amortized to Other income over a period of five years.

No goodwill may be recognized relating to purchase of investments representing ownership, management or influence rights.

As the Act on Accounting allows, the Company still discloses the goodwill related to such investments which were purchased and settled before January 1, 2016 but are not recorded in the books due to termination for any reasons as goodwill.

Intellectual property

Since 2005 only those assets have been recorded as intellectual property which are in the ownership of the Company.

Those intellectual properties where the Company has only the rights of use are recorded as Rights. Their useful lives are the same as those of the intellectual property.

Own work capitalized

Direct costs incurred in the construction of property, plant and equipment constructed by the Company are capitalized. The Company records materials provided to subcontractors at delivery as construction in progress.

Financial investments

Long term investments in subsidiaries are recorded at cost when established or at original purchase price less goodwill when acquired. At the end of the financial year, the Company's investments are impaired if the market value of the equity investment is permanently and significantly lower than its book value. The impairment review is carried out on an individual basis.

Loans granted include loans to subsidiaries, associated companies and other companies as well as long term loans given to employees for housing purposes.

In case of accounts receivables with installments, the Company recognizes impairment on receivables not yet due (recorded as non current receivables) considering the amount estimated to be recovered. This impairment proportion is governed by the rules related to determining the proportion of impairment of receivables.

2.3.1.2 Recognition and measurement of current assets

Inventories

The Company discloses the purchased inventories in its balance sheet at purchase price.

The records are based on rolling average price in case of raw materials and on standard price plus variance in case of goods for resale.

Inventories include materials and assets which future usage can not be determined at the time of purchase (i.e. whether they will be used for an investment project or maintenance). Inventories also include advance payments on inventories and assets held for sale reclassified from tangible and intangible fixed assets.

Tangible and intangible fixed assets reclassified to inventories are valued on an individual basis. Besides these assets Magyar Telekom Plc. considers its inventories as low value items.

The Company records impairment on inventories purchased if:

- the purchased inventories are of reduced value or
- the reliable current market price known at the balance sheet preparation date is permanently and substantially lower than the book value of the inventories or they have low turnover or none

The Company follows the valuation on individual basis for determination and recognition of impairment.

Phone sets are often sold below purchase price under campaigns for acquiring or retaining subscribers which requires commitments for a minimum period of time. However the defined selling price under these campaigns by itself gives no reason for impairment.

If the market value of the previously impaired inventory substantially and permanently exceeds its book value the Company reduces the difference with the reversal of the impairment recorded earlier.

Trade receivables and other receivables

The balance of trade receivables reflects invoiced and acknowledged amounts.

The Company discloses in the balance sheet only those receivables which are accepted by customers. If the customer does not (or only partly) accept the amount of the claim then the unaccepted part is not disclosed in the balance sheet.

In case of receivables under legal procedures when the debtor accepted the claim earlier but does not pay for some reason, the amount of the claim is disclosed in the balance sheet but its book value is 100 per cent impaired.

Impairment of trade receivables is assessed on two levels. Trade receivables that are individually significant and the ones that are not individually significant are separated. Magyar Telekom Plc. decided to consider items above HUF 200 million to be individually significant for the purposes of assessing accounts receivables for impairment. In case of these items the existence of objective evidence is assessed individually.

In case of items that are individually not significant it is also assessed individually whether objective evidence of impairment exists.

Based on the Section 55. (2) of Act on Accounting the amount of impairment may also be established as a percentage of the amount of such receivables recorded in the books (collective assessment of impairment). Magyar Telekom Plc. evaluates the telecommunications customers - concerning their high volume - using the method of collective assessment (ageing) and the impairment is applied in percentage terms.

The Company set up the impairment categories according to customer groups with similar credit risk exposure.



The Company does not impair receivables from related parties and non-current loans granted to related parties except an individual item has an objective evidence for impairment.

The Company uses the following rates for impairment:

| Overdue | Rate of impairment ¹ |
|----------------------------------|---------------------------------|
| Not due yet ² | 0%-21% |
| 1-30 days | 0%-70% |
| 31-60 days | 0%-70% |
| 61-90 days | 0%-85% |
| 91-180 days | 0%-95% |
| 181-360 days | 0%-100% |
| 361-720 days | 50%-100% |
| more than 720 days | 50%-100% |
| Customers in state of bankruptcy | 100% |

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

² 21 per cent impairment is recognized on receivables not due yet in case of defaults on installment receivables from mobile equipment sales. In case of non-overdue receivables 5 per cent or 11 per cent impairment were recognized.

Securities

The Company discloses the original cost of bonds, shares, other securities held for sale and the repurchase value of treasury stock as Securities in current assets. It also contains the book value of related parties decided to be sold in a year.

The Company discloses in all cases among current assets the following items:

- repurchased treasury stock
- debt securities with a maturity of less than one year

2.3.1.3 Accruals (asset)

Accrued income

The Company discloses the revenues which are only invoiced after the balance sheet date (revenues not yet accounted for as receivables) but are to be accounted for as revenue in respect of the period concluded by the balance sheet date as accrued income. In particular: revenues from current year traffic and international settlements etc. to be invoiced in the following period.

Prepayments for costs and expenses

The Company discloses the expenses incurred prior to the balance sheet date which can only be accounted for as costs or expenditures in respect of the period following the balance sheet date as prepayments. In particular: rental fees, insurance fees, subscription fees, etc.

2.3.2 Liabilities and Shareholders' equity

2.3.2.1 Valuation reserve

Until further decision, Magyar Telekom Plc. does not apply the allowed alternative treatment in the Hungarian Accounting Regulations for the recognition of a valuation reserve.

2.3.2.2 Restricted reserve

Magyar Telekom Plc. records restricted amounts from capital reserves and retained earnings as restricted reserve. These items include the acquisition cost of the repurchased treasury stock and the amount of development reserves according to the Corporate Tax Law.

2.3.2.3 Provisions

Provisions include the following uncertain liabilities and commitments:

- severance payments due to dismissals before retiring age,
- pending legal cases,
- environmental liabilities,
- guarantee liabilities determined by law,
- future demolition or recovery liabilities deriving from a contract,
- provision in respect of valuation of derivatives,
- liabilities related to customer loyalty program,

2.3.2.4 Accruals (liability)

Deferred revenue

Amounts received prior to the balance sheet date but not to be accounted for as income in the current year are disclosed as deferred revenue. In particular, revenues of monthly tariff packages collected (invoiced) in advance, unearned prepaid card traffic revenues which will be earned as revenues following the current year, etc.

Accrued expenses

Costs or expenditures recognized in the current period for which no invoice had been received by the balance sheet date are disclosed as accrued expenses. In particular: co-provider and roaming fees, commission fees, consultancy, maintenance expenses etc. related to the current year but not yet invoiced.

Deferred income

The Company accounts as deferred income among others the following items:

- financially settled amount of subsidies for development projects,
- amount of liability cancelled or assumed by a third party related to assets carried as fixed assets,
- market value of assets received without consideration or discovered as a surplus

The Company releases the deferred income to extraordinary revenue in proportion to the related asset accounted for as cost or expenditure.

2.3.3 Valuation of items in foreign currencies

Receivables and liabilities denominated in foreign currencies are valued at the official exchange rate of the Central Bank of Hungary (MNB) on December 31.

2.3.4 Derivatives

The Company records derivatives (forward, swap and energy swap deals) among off-balance sheet items as commitments of future receivables or liabilities on transaction price.

The Company calculates the fair value of every derivative (with the original aim of delivery and of non-deliverable/clearing transaction) as of the balance sheet date and discloses it in the Notes. In addition the Company creates provision for expected losses related to commitments from derivatives with the original aim of delivery, represented by the negative fair value of the transactions. In case of deals with the original aim of non-delivery the negative fair value of the transactions is accounted for as accrued expenses and disclosed as other expenses on financial transactions in the income statement.

2.4 Measurement principles applied in the preparation of the Income Statement

The Company considers those economic events as income, expense or expenditure of exceptional size or incidence which resulted (after taxation) an increase or decrease in shareholders' equity with 20 per cent or more. The Company discloses in all cases the income, expense or expenditure of exceptional size or incidence in the Notes.

The Company discloses the consideration, excluding value added tax, received for the sale of inventories purchased and for services rendered during the period of contractual performance in the financial year, increased by any price subsidies and extra charges and reduced by discounts as net sales revenues.

Revenues corresponding to invoices issued to the customer based on performance under the conditions defined in the contract, as acknowledged or approved by the customer, or the consideration received in cash excluding any value added tax are recorded as revenue by the Company.

The Company discloses as domestic sales revenues in particular:

- sale of inventories purchased or own production for domestic customers,
- the value of services supplied to resident customers regardless of whether they are paid for in HUF, foreign exchange, foreign currency or by import purchases,
- the value of direct sales to a free zone company or to a company operating in a transit area.

Based on the Section 74. (2) of Act on Accounting the exports sales revenue includes the value of sales and services supplied to non-resident customers regardless of the location of the services provided, except the customer is non-residential in the territory of Hungary and has not officially informed Magyar Telekom Plc. (e.g. non-resident customer - whose registered office, place of abode or permanent residence is situated abroad - buys phone sets in the distribution network).

The Company discloses as export sales in particular:

- visitor fees invoiced for roaming partners,
- services provided for foreign vendors,
- revenues from international co-providers.

Revenues and expenses are recognized in line with the accrual concept of accounting.

Non-realized exchange rate differences are recognized as follows:

- if the net balance of non-realized foreign exchange gains and losses is a gain, it is recorded as other income from financial transactions,
- if the net balance is a loss, it is recorded as other expenses from financial transactions.

The Company recognizes dividends approved by the General Meeting of the subsidiaries and associates in the year when declared. Interim dividends paid by the subsidiaries and associates are recorded as liability until final approval.

The fees paid by Magyar Telekom Plc. to carrier, mobile and international service providers for call termination are invoiced to the customers by Magyar Telekom Plc. Therefore the payments for calls initiated in Magyar Telekom Plc.'s network and terminated by carrier, mobile and international service providers as well as payments for leased lines (both domestic and international) are recorded and disclosed as Costs of mediated services sold.

2.5 Application of HAR standards related to business year started January 1, 2016

In the Annual Report for the business year started January 1, 2016 the Company discloses the data in effect on the balance sheet date of the previous financial year as data carried over from the previous financial year according to the breakdown prescribed for the balance sheet and profit and loss statement in the Act on Accounting.

As a result the prior year's assets and liabilities arising in connection with related parties and other related parties, income from financial transactions - except dividends received or due - and expenses on financial transactions, dividends declared (payable) and extraordinary income and extraordinary expenses were reclassified from January 1, 2016 as prescribed and applicable according to the Act on Accounting. These reclassifications are disclosed in details in the Notes.



2.6 Application of International Financial Reporting Standards (IFRS) for Magyar Telekom Plc.'s Annual Report

According to the Act on Accounting the Company maintains its records and will prepare its Annual Report in accordance with IFRS from the business year started January 1, 2017.

2.7 Other

Magyar Telekom Plc. pays special attention to meeting environmental protection guidelines and regulations in its activities. The necessary power supply batteries used in switches and power generators and used cell phones are stored and neutralized in accordance with the applicable environmental protection laws.

The Company did not have penalty expenses due to environmental liabilities in 2016 or in any previous years.

3 SUMMARY OF THE COMPANY'S FINANCIAL POSITION AND LIQUIDITY

The Company's financial position and liquidity as of December 31, 2015 and 2016 are represented by the following financial ratios:

| | <u>2015</u> | <u>2016</u> |
|---|-------------|-------------|
| Liquidity ratio (= current assets / current liabilities) | 0.39 | 0.55 |
| Operating margin (= operating profit / (sales revenues + other income)) | 0.06 | 0.07 |
| Operating return on assets (= operating profit / total assets) | 0.03 | 0.04 |
| Leverage ratio (= non-current liabilities / (non-current liabilities + equity)) | 0.41 | 0.42 |



The following is the cash-flow statement for the years ended on December 31, 2015 and 2016:

| | 2015 | 2016 |
|--|----------------|----------------|
| I. Cash flows from operating activities (lines 1-14) | 99,753 | 122,967 |
| 1. Profit before taxes (before dividend received) | 15,713 | 14,479 |
| 2. Depreciation and amortization | 91,125 | 97,591 |
| 3. Impairment losses charged and reversed | 15,648 | 17,355 |
| 4. Change in provisions | 4,329 | 257 |
| 5. Profit or loss on the sale of non-current assets | -953 | -3,403 |
| 6. Change in accounts payable | -80 | 1,188 |
| 7. Change in other current liabilities ¹ | -3,006 | 1,626 |
| 8. Change in accruals (liability) | -1,909 | 13,983 |
| 9. Change in accounts receivable | -16,437 | -9,195 |
| 10. Change in current assets (without accounts receivable and cash and cash equivalents) | -5,042 | 475 |
| 11. Change in accruals (asset) | 115 | 1,240 |
| 12. Income tax paid (on profit and loss) | -953 | -1,625 |
| 13. Dividend and shares paid/payable ¹ | 0 | -15,635 |
| 14. Other non cash items | 1,203 | 4,631 |
| II. Cash flows from investing activities (lines 15-17) | -73,122 | -71,005 |
| 15. Acquisition of fixed assets and financial investments | -79,210 | -84,514 |
| 16. Proceeds from sale of fixed assets and financial investments | 954 | 2,907 |
| 17. Dividends and advance dividends received | 5,134 | 10,601 |
| III. Cash flows from financing activities (lines 18-29) | -28,632 | -51,549 |
| 18. Proceeds from issue of shares | 0 | 0 |
| 19. Proceeds from the issuance of bonds | 0 | 0 |
| 20. Loans received | 135,129 | 125,521 |
| 21. Redemption from non-current loans granted and bank deposits | 741 | 687 |
| 22. Non-repayable liquid assets received | 445 | 123 |
| 23. Share capital decrease | 0 | 0 |
| 24. Treasury stock repurchases | 0 | 0 |
| 25. Repayment of bonds | -3 | -1 |
| 26. Repayment of loans | -165,412 | -176,629 |
| 27. Non-current loans granted and bank deposits | -224 | -152 |
| 28. Non-repayable donations given | 0 | 0 |
| 29. Change in liabilities to founders and other non-current liabilities | 692 | -1,098 |
| IV. Change in liquid assets (lines I. + II. + III.) | -2,001 | 413 |
| Cash at the beginning of the year | 2,847 | 846 |
| Cash at year-end | 846 | 1,259 |

¹ From 2016, in consequence of the change in Act on Accounting the dividends shall be settled in the year of approval. Accordingly the previous year's lines of other current liabilities and dividend and shares paid/payable were corrected with HUF 15,635 million dividend related to 2015 and paid in 2016.

4 INTANGIBLE ASSETS

The following table is a summary of intangible fixed asset movements between January 1, 2015 and December 31, 2016:

| | GROSS BOOK VALUE | | | | Total |
|--|------------------|-----------------------|----------------|-------------------------------|----------------|
| | Rights | Intellectual property | Goodwill | Advances on intangible assets | |
| Opening balance as of January 1, 2015 | 420,837 | 18,083 | 221,905 | 467 | 661,292 |
| Additions | 22,008 | 1,555 | 6,116 | 0 | 29,679 |
| Disposals | -4,048 | -57 | -2,961 | -467 | -7,533 |
| Reclassifications | 1,410 | -1,499 | 0 | 0 | -89 |
| Closing balance as of December 31, 2015 | 440,207 | 18,082 | 225,060 | 0 | 683,349 |
| Additions | 17,803 | 6,034 | 0 | 0 | 23,837 |
| Disposals | -642 | 0 | -32,511 | 0 | -33,153 |
| Reclassifications | 477 | -477 | 0 | 0 | 0 |
| Closing balance as of December 31, 2016 | 457,845 | 23,639 | 192,549 | 0 | 674,033 |
| AMORTIZATION | | | | | |
| Opening balance as of January 1, 2015 | 165,304 | 12,142 | 138,065 | 0 | 315,511 |
| Charge for the year | 28,810 | 857 | 10,096 | 0 | 39,763 |
| Impairment | 0 | 0 | 0 | 0 | 0 |
| Disposals | -3,937 | -57 | -2,961 | 0 | -6,955 |
| Reclassifications | 587 | -676 | 0 | 0 | -89 |
| Closing balance as of December 31, 2015 | 190,764 | 12,266 | 145,200 | 0 | 348,230 |
| Charge for the year | 33,525 | 2,261 | 9,724 | 0 | 45,510 |
| Impairment | 0 | 0 | 0 | 0 | 0 |
| Disposals | -466 | 0 | -9,179 | 0 | -9,645 |
| Reclassifications | 394 | -394 | 0 | 0 | 0 |
| Closing balance as of December 31, 2016 | 224,217 | 14,133 | 145,745 | 0 | 384,095 |
| NET BOOK VALUE as of December 31, 2015 | 249,444 | 5,816 | 79,860 | 0 | 335,120 |
| NET BOOK VALUE as of December 31, 2016 | 233,629 | 9,506 | 46,804 | 0 | 289,939 |



The main components of the changes in 2016:

Rights

The gross value of rights increased by HUF 17,803 million in the current year. Significant part of this increase was caused by the software rights of use connected to SAP and related systems due to the implementation of the new SAP One.ERP system (HUF 3,263 million), to a new, integrated customer relations and billing system (HUF 2,063 million) and to the Webshop application (HUF 1,918 million), as well as the upgrade of business warehouse (HUF 595 million) and IMS software and licence (HUF 560 million).

Intellectual properties

The increase is mainly due to the upgrades of the billing software for mobile services (HUF 230 million) and the development of Bingo Big Data (HUF 208 million).

In 2016, the Company reviewed the useful life of rights and intellectual properties and changed the useful life where the Company deemed it necessary. Due to the changes HUF 33 million more amortization was charged in 2016.

Goodwill

The movements of goodwill in 2016 are summarized as follows:

| Description | Net value as of December 31, 2015 | Reclassification to Investments | Amortization charge/ extraordinary amortization in 2016 | Net value as of December 31, 2016 |
|--|---|------------------------------------|---|---|
| T-Mobile Magyarország Távközlési Rt. ¹ | 54,417 | 0 | -9,116 | 45,301 |
| GTS Hungary Kft. ² | 6,097 | -6,097 | 0 | 0 |
| T-Systems Magyarország Zrt. (KFKI Zrt.) ² | 4,345 | -4,345 | 0 | 0 |
| Stonebridge A.D. ² | 2,934 | -2,934 | 0 | 0 |
| Combridge S.R.L. ² | 818 | -818 | 0 | 0 |
| Novatel E.O.O.D. ² | 447 | -447 | 0 | 0 |
| Other ^{1,2} | 10,802 | -8,691 | -608 | 1,503 |
| Total | 79,860 | -23,332 | -9,724 | 46,804 |

¹ As the Act on Accounting allows, the Company still discloses the goodwill related to such investments which were purchased and settled before January 1, 2016 but are not recorded in the books due to termination for any reasons as goodwill. In these cases the depreciation and amortization is based on the useful lives determined earlier.

² Goodwill related to purchased and existing investments which were disclosed in the books as of December 31, 2015 were reclassified to investments from January 1, 2016 according to the Act on Accounting.

5 TANGIBLE FIXED ASSETS

The following table is a summary of tangible fixed asset movements – without construction in progress and advance payments for construction in progress – between January 1, 2015 and December 31, 2016:

| GROSS BOOK VALUE | Land and buildings and related rights | Technical equipment, machinery and vehicles | Other equipment and vehicles | Total |
|--|---------------------------------------|---|------------------------------|------------------|
| Opening balance as of January 1, 2015 | 472,240 | 586,817 | 57,092 | 1,116,149 |
| Additions | 19,702 | 35,474 | 4,054 | 59,230 |
| Disposals | -8,482 | -94,984 | -6,825 | -110,291 |
| Reclassifications | 9,208 | -12,923 | 1,022 | -2,693 |
| Closing balance as of December 31, 2015 | 492,668 | 514,384 | 55,343 | 1,062,395 |
| Additions | 13,514 | 23,085 | 4,657 | 41,256 |
| Disposals | -12,612 | -78,524 | -3,380 | -94,516 |
| Reclassifications | 184 | -12,224 | 12,107 | 67 |
| Closing balance as of December 31, 2016 | 493,754 | 446,721 | 68,727 | 1,009,202 |
| DEPRECIATION | | | | |
| Opening balance as of January 1, 2015 | 237,823 | 486,691 | 49,480 | 773,994 |
| Charge for the year | 17,386 | 30,699 | 3,277 | 51,362 |
| Impairment | 0 | 0 | 0 | 0 |
| Disposals | -4,854 | -92,358 | -6,744 | -103,956 |
| Reclassifications | 10,345 | -12,309 | 803 | -1,161 |
| Closing balance as of December 31, 2015 | 260,700 | 412,723 | 46,816 | 720,239 |
| Charge for the year | 18,557 | 30,382 | 2,807 | 51,746 |
| Impairment | 0 | 0 | 0 | 0 |
| Disposals | -6,676 | -76,381 | -3,148 | -86,205 |
| Reclassifications | -23 | -9,946 | 10,021 | 52 |
| Closing balance as of December 31, 2016 | 272,558 | 356,778 | 56,496 | 685,832 |
| NET BOOK VALUE as of December 31, 2015 | 231,968 | 101,661 | 8,527 | 342,156 |
| NET BOOK VALUE as of December 31, 2016 | 221,196 | 89,943 | 12,231 | 323,370 |

Further details are disclosed in Appendix 2.

The main reasons of the changes in 2016 are as follows:

Land and buildings and related rights

The increase in buildings and other real estate (HUF 1,164 million) is mainly due to the expansion and capitalization on rented buildings (HUF 482 million).

The gross value of telecommunication networks increased by HUF 12,320 million (see Appendix 2) of which the significant items are:

- client-side copper based network (HUF 4,515 million),
- fiber optic telecom cables of local network (HUF 3,723 million),
- ducts (HUF 1,026 million).

The decrease in real estate and related rights is mainly due to the sale of Infopark building G (gross value is HUF 7,245 million, net value is HUF 4,875 million).

Technical equipment, machinery and vehicles

The increase is due to the capitalization and extension of telecommunication equipment of HUF 23,085 million in gross value, of which the significant items are:

- MSAN equipment for TV and internet services (HUF 9,513 million),
- routers (HUF 2,476 million),
- Internet KTV modems (HUF 1,365 million),
- DVBS infrastructure and set top box (HUF 1,307 million),
- telecommunication equipment purchased from GTS (HUF 1,295 million),
- closed-end leased set-top boxes (HUF 1,165 million),
- FTtx equipment (HUF 1,048 million).

HUF 78,524 million decrease in gross value of technical equipment is mainly due to the following sales and scrappings:

- subscriber telecommunication switches (gross value is HUF 29,952 million, net value is zero),
- mobile micro- and data transmission equipment (gross value is HUF 6,555 million, net value is HUF 1,406 million),
- digital telecom transmission equipment (gross value is HUF 5,170 million, net value is HUF 0 million),
- MLLN node equipment (gross value is HUF 8,253 million, net value is HUF 1 million),
- ADSL node equipment (gross value is HUF 3,677 million, net value is HUF 124 million),
- CE routers (gross value is HUF 2,564 million, net value is HUF 51 million).

In 2016, HUF 12,107 million gross value (HUF 2,086 million net value) was reclassified from Technical equipment, machinery and vehicles to Other equipment and vehicles due to the revised classification of measuring, installation and testing equipment.

Other equipment and vehicles

Other equipment and vehicles increased by HUF 4,657 million in gross value, of which the significant items are:

- capitalization and extension of IT application and other servers (HUF 2,776 million),
- capitalization and extension of computers and peripheral devices not serving the core activities (HUF 604 million).

The HUF 3,380 million decrease in gross value of other equipment and vehicles is mostly due to scrapping and sales.

Scrappings mainly related to the following assets:

- furniture (gross value is HUF 408 million, net value is HUF 20 million),
- Intranet equipment (gross value is HUF 380 million, net value is HUF 1 million),
- measuring and development-purpose equipment (gross value is HUF 317 million, net value is HUF 14 million).

Sales mainly related to the following assets:

- passenger cars for personal use (gross value is 809 million, net value is HUF 129 million),
- IT application and other server (gross value is HUF 375 million, net value is zero).

In 2016, the Company reviewed the useful life of tangible assets and changed the useful lives where the Company deemed it necessary. In consequence, HUF 529 million less depreciation was charged in 2016.

6 NON-CURRENT INVESTMENTS IN RELATED PARTIES

6.1 Changes of Non-current investments in 2016

As of December 31, 2015 and 2016, the Company's significant non-current investments are summarized as follows (further details on investments (ownership, voting rights, shareholders' equity data) are disclosed in Appendix 3):

| | Ownership direct (%) | Ownership indirect (%) | Net book value | | Effect of correction due to goodwill in investments |
|-----------------------------|-------------------------|---------------------------|-------------------|----------------|--|
| | | | December 31, 2016 | 2015 | |
| Stonebridge A.D. | 100.00% | | 75,065 | 77,476 | 2,934 |
| Crnogorski Telekom A.D. | 76.53% | | 39,979 | 39,713 | 0 |
| T-Systems Magyarország Zrt. | 100.00% | | 19,944 | 32,451 | 12,506 |
| GTS Hungary Kft. | 100.00% | | 8,172 | 9,779 | 6,097 |
| Combridge S.R.L. | 100.00% | | 2,317 | 3,114 | 818 |
| Novatel E.O.O.D. | 100.00% | | 1,723 | 2,155 | 447 |
| E2 Hungary Zrt. | 50.00% | | 1,000 | 1,000 | 0 |
| Telekom New Media Zrt. | 100.00% | | 700 | 700 | 0 |
| Other | | | 5,892 | 6,099 | 530 |
| | | | 154,792 | 172,487 | 23,332 |

At the end of 2016, non-current investments decreased by HUF 824 million due to the balance sheet date revaluation of the book value of investments.

In 2016, the book value of certain investments was corrected with the net value (as of January 1, 2016) of the earlier recognized goodwill related to purchased investments which resulted an increase of HUF 23,332 million in investments.

In 2016, HUF 4,490 million impairment was recorded in connection with GTS Hungary Kft.

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

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

In December 2000, Magyar Telekom Plc., on behalf of a consortium, reached an agreement with the government of Macedonia to purchase 51 percent of Makedonski Telekom A.D., the leading telecommunication provider of Macedonia. The 51 percent ownership acquired by Magyar Telekom Plc. was contributed in 2001 to a newly established Macedonian holding company, Stonebridge A.D. residing in Skopje. Magyar Telekom Plc. has 100 per cent share in Stonebridge A.D. since 2004 and the company has 51 per cent share in Makedonski Telekom. The company suspended its liquidation procedure and restored its normal activities in January 2014.

Crnogorski Telekom A.D.

In 2004, Magyar Telekom Plc. won the tender for the sale of a 51.12 per cent stake in Crnogorski Telekom A.D. issued by the Montenegrin Privatization Agency. Crnogorski Telekom is the leading telecommunication service provider of Montenegro. The share purchase agreement was signed in 2005 in the amount of EUR 114 million. In 2005, Magyar Telekom Plc. acquired a further 25.41 per cent share for EUR 27 million based on an agreement with minority shareholders.

T-Systems Magyarország Zrt.

In 2006 Magyar Telekom Plc. purchased the 100 per cent ownership in KFKI Zrt. Thereafter the company has undergone several transformations whereby ICON Zrt., BCN Rendszerház Kft., KFKI-DIREKT Kft. and EPT Zrt. were merged into the company. In 2012, the company changed its name and continues its activities under the name of T-Systems Magyarország Zrt. Also in 2012, the company concluded a merger contract with Dataplex Kft., IQSYS Kft. and ISH Informatika Kft. and these companies merged into T-Systems Magyarország Zrt. In 2013, after the conclusion of another merger contract, DATEN-KONTOR Kft. merged into T-Systems Magyarország Zrt.

GTS Hungary Távközlési Kft. (GTS Hungary Kft.)

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

GTS Hungary Kft. is a leading alternative infocommunication service provider in Hungary, provides fixed line voice, data, internet and IT services for business and residential customers.

Combridge S.R.L.

The company is an alternative telecommunication service provider of Romania. Its main activities are: international and domestic leased line connection, international internet access, international IPVPN services, roaming services and international VoIP call termination.

Novatel E.O.O.D.

The company was established in 2004 with headquarters in Bulgaria. The company's main activities are: international and domestic leased line connection, international internet access and IPVPN services, roaming services, infocommunication business solutions and international call termination.

E2 Hungary Energiakereskedelmi és Szolgáltató Zrt. (E2 Hungary Zrt.)

In the first quarter of 2015, Magyar Telekom Plc. signed an agreement with MET Holding AG, one of the leading energy retail suppliers of the region, to establish a joint venture which provides natural gas and electricity services for primarily business customers. The primary aim of the company is to improve and optimize the energy operations serving the business customers in the energy market presence. The joint venture was registered at Metropolitan Court as Court of Registration as of July 7, 2015.

**Telekom New Media Szolgáltató Zártkörűen Működő Részvénytársaság (Telekom New Media Zrt.)**

The company was established by a merger of three companies when Telekom New Media Kft. and Telekom Content & Rights Kft. merged into Telekom New Média Holding Zrt. with effect from July 31, 2010. After the merger the company continues its activities under the name of Telekom New Media Szolgáltató Zártkörűen Működő Részvénytársaság (Telekom New Media Zrt.). Telekom New Media Zrt. is the leading participant of the premium rated interactive market.

7 OTHER NON-CURRENT LOANS GRANTED

Other non-current loans granted as of December 31, 2015 and 2016 are summarized as follows:

| | <u>2015</u> | <u>2016</u> |
|--|----------------------|---------------------|
| Long term part of installment receivables from equipment sales | 7,481 | 6,649 |
| Long term part of housing loans granted to employees | 2,729 | 2,230 |
| Other deposits given | <u>153</u> | <u>74</u> |
| Total | <u>10,363</u> | <u>8,953</u> |

8 INVENTORIES

Materials mainly include network maintenance materials, while the majority of goods are telecommunication goods and unused fixed assets held for sale.

The following is a movement table of inventories between January 1, 2015 and December 31, 2016:

| | <u>2015</u> | <u>2016</u> |
|------------------------|----------------------|----------------------|
| Opening balance | 9,828 | 10,249 |
| Change in inventories | 928 | 2,178 |
| Impairment loss | <u>-507</u> | <u>-203</u> |
| Closing balance | <u>10,249</u> | <u>12,224</u> |

The impairments on inventories between January 1, 2015 and December 31, 2016 are as follows:

| | <u>2015</u> | <u>2016</u> |
|--------------------------------|---------------------|---------------------|
| Opening balance | 4,639 | 5,146 |
| Current year increase | 507 | 203 |
| Current year decrease/disposal | <u>0</u> | <u>0</u> |
| Closing balance | <u>5,146</u> | <u>5,349</u> |

9 ACCOUNTS RECEIVABLE

As of December 31, 2015 and 2016 accounts receivable include the following:

| | 2015 | 2016 |
|------------------------------|---------------|---------------|
| Domestic accounts receivable | 75,120 | 75,527 |
| Foreign accounts receivable | 1,130 | 1,176 |
| Impairment of receivables | -19,866 | -20,744 |
| Total | 56,384 | 55,959 |

The impairments on receivables between January 1, 2015 and December 31, 2016 are as follows:

| | 2015 | 2016 |
|--------------------------------|---------------|---------------|
| Opening balance | 17,334 | 19,866 |
| Current year increase | 9,896 | 9,282 |
| Current year decrease/disposal | -7,364 | -8,404 |
| Total | 19,866 | 20,744 |

10 RECEIVABLES FROM RELATED PARTIES

Receivables from related parties as of December 31, 2015 and 2016 are summarized as follows:

| | 2015 | 2016 |
|---|---------------|---------------|
| Receivables from T-Systems Magyarország Zrt. ¹ | 9,017 | 12,124 |
| Receivables from Crnogorski Telekom A.D. ² | 44 | 2,096 |
| Receivables from Novatel E.O.O.D. ³ | 1,593 | 1,601 |
| Receivables from E2 Hungary Zrt. ⁴ | 3,338 | 1,165 |
| Receivables from GTS Hungary Kft. | 302 | 251 |
| Receivables from Telekom New Media Zrt. | 161 | 152 |
| Receivables from Origo Zrt. ⁵ | 403 | 0 |
| Other ^{2,6} | 1,682 | 1,182 |
| Total | 16,540 | 18,571 |

¹ The vast majority of the balance is the Cash-pool receivable from T-Systems Magyarország Zrt. (HUF 11,852 million).

² The major part of the receivables from Crnogorski Telekom A.D. is the loan granted (HUF 2,022 million). In 2015, this receivable was in Other.

³ The major part of the receivables from Novatel E.O.O.D. is also the loan granted (HUF 1,590 million).

⁴ The complete energy trade for business customers has been transferred to E2 Hungary Kft. (a joint venture company of Magyar Telekom Plc. and MET Holding AG) from January 1, 2016. The significant decrease in receivables is due to the use of advance payments in the E2 Hungary Zrt.'s invoices.

⁵ The Company signed an agreement with New Wave Media Kft. on the sale of its 100 per cent ownership in Origo Zrt. The transaction was finished on February 5, 2016.

⁶ Other contains the receivables from Makedonski Telekom A.D. which was disclosed on a separate line in previous year, while the receivables from Crnogorski Telekom A.D. was in Other in 2015.

11 OTHER RECEIVABLES

The Company's other receivables as of December 31, 2015 and 2016 are as follows:

| | <u>2015</u> | <u>2016</u> |
|--------------------------------|---------------------|---------------------|
| Roaming discount receivables | 2,029 | 3,108 |
| Tax receivables | 1,287 | 2,643 |
| Advance payments given | 1,141 | 1,076 |
| Receivables from dealers | 792 | 719 |
| Receivables from employees | 717 | 555 |
| Receivables from forward deals | 80 | 0 |
| Other | <u>1,609</u> | <u>989</u> |
| Total | <u>7,655</u> | <u>9,090</u> |

12 SECURITIES

The amount of HUF 35 million includes the cost of the repurchased treasury stock.

In 2016, shares with book value of HUF 272 million was derecognized from repurchased treasury stock and transferred to ESOP Organization.

Also in 2016, the sale of investment in Origo Zrt. was finished and so the book value of securities further decreased by HUF 4,200 million.

The number and face value of repurchased treasury stock are detailed in Note 14.

13 ACCRUALS (ASSETS)

| | <u>2015</u> | <u>2016</u> |
|---|----------------------|----------------------|
| Accrued income from telecommunication activities | 31,650 | 32,320 |
| Accrued income from related parties | 657 | 1,836 |
| Accrued income from electricity and gas retail services | 4,568 | 660 |
| Other | <u>2,279</u> | <u>1,197</u> |
| Accrued income | 39,154 | 36,013 |
| Rental fees and operating costs | 1,307 | 1,345 |
| License fees | 142 | 395 |
| Employee share ownership program (ESOP) | 0 | 190 |
| Insurance fees | 121 | 102 |
| Prepaid costs and expenses related to electricity and gas retail services | 233 | 54 |
| Other | <u>144</u> | <u>1,762</u> |
| Prepaid costs and expenses | 1,947 | 3,848 |
| Total | <u>41,101</u> | <u>39,861</u> |

14 SHAREHOLDERS' EQUITY

The Company's owners' structure based on the shareholder registration in the Share Register as of December 31, 2016:

| Shareholder | Number of shares | Nominal value (HUF/per share) | Total value (HUF million) | Ownership percentage (%) |
|--------------------------------------|----------------------|----------------------------------|------------------------------|--------------------------------|
| Deutsche Telekom Europe B.V. | 617,436,759 | 100 | 61,744 | 59.21% |
| Other foreign companies | 226,137,746 | 100 | 22,614 | 21.69% |
| Domestic companies | 54,834,370 | 100 | 5,483 | 5.26% |
| Domestic and foreign private persons | 75,350,098 | 100 | 7,535 | 7.23% |
| Other (not named and nominees) | 67,244,694 | 100 | 6,724 | 6.45% |
| Government in total | 153,669 | 100 | 15 | 0.01% |
| Magyar Telekom ESOP | 1,507,872 | 100 | 151 | 0.14% |
| Repurchased treasury stock | 77,335 | 100 | 8 | 0.01% |
| Total | 1,042,742,543 | | 104,274 | 100.00% |

Changes in the equity items between January 1, 2015 and December 31, 2016 are summarized as follows:

| | Common stock | Capital reserves | Retained earnings | Restricted reserves ¹ | Profit after tax |
|--|-----------------|---------------------|----------------------|-------------------------------------|---------------------|
| Opening balance as of January 1, 2015 | 104,274 | 58,952 | 191,996 | 307 | 36,735 |
| Reclassifications | 0 | 0 | 36,735 | 0 | -36,735 |
| Profit of the year | 0 | 0 | 0 | 0 | 20,393 |
| Dividend ² | 0 | 0 | 0 | 0 | 0 |
| Balance as of December 31, 2015 | 104,274 | 58,952 | 228,731 | 307 | 20,393 |
| Reclassifications | 0 | 0 | 20,665 | -272 | -20,393 |
| Profit of the year | 0 | 0 | 0 | 0 | 28,536 |
| Dividend ² | 0 | 0 | -15,635 | 0 | 0 |
| Balance as of December 31, 2016 | 104,274 | 58,952 | 233,761 | 35 | 28,536 |

¹ In 2016, treasury stock with book value of HUF 272 million was transferred to the ESOP Organization and the relevant restricted reserves were reversed and transferred to retained earnings.

² From 2016, in consequence of the change in Act on Accounting the dividends shall be settled in the year of approval. Accordingly HUF 15,635 million dividend related to 2015 and paid in 2016 decreases the equity in 2016.

15 PROVISIONS

Provisions were increased and reversed under the following titles between January 1, 2015 and December 31, 2016:

| | Severance payments, employee bonuses | Asset retirement obligation and environmental liabilities | Customer loyalty program | Derivatives | Legal cases | Other | Total |
|--|--------------------------------------|---|--------------------------|--------------|--------------|------------|---------------|
| Opening Balance as of January 1, 2015 | 3,816 | 6,660 | 1,614 | 95 | 444 | 491 | 13,120 |
| Increase | 4,631 | 534 | 1,051 | 808 | 255 | 626 | 7,905 |
| Decrease | -2,099 | -252 | -628 | -46 | -96 | -455 | -3,576 |
| Closing Balance as of December 31, 2015 | 6,348 | 6,942 | 2,037 | 857 | 603 | 662 | 17,449 |
| Increase | 1,168 | 511 | 1,110 | 2,597 | 639 | 596 | 6,621 |
| Decrease | -4,196 | -460 | -859 | 0 | -216 | -633 | -6,364 |
| Closing Balance as of December 31, 2016 | 3,320 | 6,993 | 2,288 | 3,454 | 1,026 | 625 | 17,706 |

16 NON-CURRENT LIABILITIES TO OTHER RELATED PARTIES

This caption contains the non-current portion of other related party loans received from Deutsche Telekom Finance B.V and Deutsche Telekom AG. The following is a movement table of non-current liabilities to other related parties between January 1, 2015 and December 31, 2016:

| | 2015 | 2016 |
|-----------------------------|----------------|----------------|
| Opening balance | 240,428 | 218,563 |
| Drawdown | 90,107 | 40,334 |
| Reclassification | -112,440 | -22,272 |
| Foreign exchange difference | 468 | -209 |
| Closing balance | 218,563 | 236,416 |

The short term portion of related party loans (HUF 22,153 million) is disclosed in Note 21.

The installments due over one year of non-current loans are as follows:

| Maturity | Amount |
|--------------|----------------|
| 2018 | 15,551 |
| 2019 | 105,000 |
| 2020 | 35,000 |
| 2021 | 80,865 |
| Total | 236,416 |

17 OTHER NON-CURRENT LIABILITIES

This caption mainly contains the non-current part (HUF 65,264 million) of the frequency fees to be paid by the Company until the end of the frequency usage rights term based on the conditions in the Authority Contract related to frequency usage rights concluded with the NMIAH.

In addition this caption contains HUF 311 million long term finance lease.

18 CURRENT LOANS

The following is a movement table of current loans between January 1, 2015 and December 31, 2016:

| | 2015 | 2016 |
|-----------------------------|---------------|---------------|
| Opening balance | 43,833 | 13,066 |
| Drawdown | 9,500 | 0 |
| Repayment | -41,691 | -1,574 |
| Reclassification | 1,515 | 0 |
| Foreign exchange difference | -91 | 8 |
| Closing balance | 13,066 | 11,500 |

19 ACCOUNTS PAYABLE

The accounts payable as of December 31, 2015 and 2016 contain the following main items:

| | 2015 | 2016 |
|--------------------|---------------|---------------|
| Domestic suppliers | 46,852 | 35,325 |
| Foreign suppliers | 8,506 | 10,829 |
| Total | 55,358 | 46,154 |

20 CURRENT LIABILITIES TO RELATED PARTIES

The current liabilities to related parties as of December 31, 2015 and 2016 are summarized as follows:

| | 2015 | 2016 |
|---|---------------|---------------|
| Liabilities to T-Systems Magyarország Zrt. | 8,524 | 8,429 |
| Liabilities to GTS Hungary Kft. ¹ | 709 | 3,114 |
| Liabilities to E2 Hungary Zrt. ² | 0 | 1,687 |
| Liabilities to Telekom New Media Zrt. | 279 | 263 |
| Liabilities to Combridge S.R.L. | 606 | 229 |
| Liabilities to Crnogorski Telekom A.D. ³ | 3,451 | 14 |
| Liabilities to Origo Zrt. | 292 | 0 |
| Other | 1,183 | 2,790 |
| Total | 15,044 | 16,526 |

¹ The majority of this liability is the HUF 2,400 million loan payable.

² The complete energy trade for business customers has been transferred to E2 Hungary Kft. (a joint venture company of Magyar Telekom Plc. and MET Holding AG) from January 1, 2016.

³ The decrease of liabilities to Crnogorski Telekom A.D. is due to the repayment of the loan.

21 CURRENT LIABILITIES TO OTHER RELATED PARTIES

This caption contains the short term part of the loans from Deutsche Telekom Finance B.V. and Deutsche Telekom AG (HUF 22,153 million) and cash-pool liability to Deutsche Telekom AG (HUF 44,301 million).

The loans by maturity are summarized as follows:

| Maturity | Interest | Amount |
|--------------|---------------|---------------|
| 04.01.2017. | FIX: 2.80500% | 15,000 |
| 05.19.2017. | FIX: 5.20025% | 7,153 |
| Total | | 22,153 |

Deutsche Telekom AG has expressed its commitment to finance the Company's budgeted financing needs until the end of June, 2018.

22 OTHER CURRENT LIABILITIES

Other current liabilities as of December 31, 2015 and 2016 are summarized as follows:

| | <u>2015</u> | <u>2016</u> |
|---|----------------------|----------------------|
| Liability from topping up the universal balance | 6,808 | 7,179 |
| Annual frequency fee ¹ | 6,009 | 6,022 |
| Liabilities to government ² | 6,006 | 5,232 |
| SIP government grant ³ | 0 | 5,104 |
| Discount granted subsequently on roaming traffic | 3,405 | 3,857 |
| Value Added Tax | 1,359 | 2,957 |
| Finance lease liabilities | 2,779 | 2,054 |
| Customer overpayments | 1,329 | 1,144 |
| Payables to employees and related contributions | 985 | 598 |
| Personal income tax | 915 | 551 |
| Liabilities to mobile service providers related to wholesale call termination fees ⁴ | 1,286 | 334 |
| Dividends payable ⁵ | 0 | 0 |
| Other ⁶ | 636 | 460 |
| Total | <u>31,517</u> | <u>35,492</u> |

¹ Contains the sum of frequency fees becoming due within one year based on the conditions in the Authority Contract related to frequency usage rights concluded with the NMIAH.

² In 2016, the main part of liabilities to government is telecommunication tax (HUF 4,012 million) and social contribution (HUF 888 million).

³ Advance payment gained for the Superfast Internet Program (SIP) investment project.

⁴ The National Media and Infocommunications Authority of Hungary (NMIAH) further reduced the mobile wholesale termination fees from April 1, 2015. The Company appealed against this decision and applied the higher fees in the invoices after April 1, 2015 in conjunction with the interconnect partners. The Company's appeal for restoring the fees was rejected by the court decision on September 24, 2015 and the providers correct retrospectively the invoices with the higher fee. After these corrections the overpayments will be refunded. Liabilities currently still existing from the pending settlements are disclosed in this line.

⁵ From 2016, in consequence of the change in Act on Accounting the dividends shall be settled in the year of approval.

Accordingly the previous year's other current liabilities was corrected with HUF 15,635 million dividend related to 2015 and paid in 2016. Dividends payable after the result of 2016 shall be decided by the General Meeting in 2017.

⁶ Dividends payable for previous years unsettled financially are disclosed in Other.

23 ACCRUALS (LIABILITIES)

| | 2015 | 2016 |
|--|---------------|---------------|
| Financial transactions (premium on bonds) ¹ | 725 | 7,275 |
| Deferred subscription and traffic fees | 1,422 | 908 |
| Deferred revenue from related parties | 189 | 179 |
| Other ^{1,2} | 804 | 882 |
| Deferred revenue | 3,140 | 9,244 |
| Accrued expenses to related parties | 3,481 | 8,319 |
| Interest on owners' loans | 6,112 | 5,942 |
| Rental fees | 4,782 | 5,565 |
| Expenses related to TV services | 3,566 | 4,286 |
| Charges for public utility services | 1,443 | 3,803 |
| Payroll related expenses | 4,644 | 3,255 |
| Payments to mobile operators | 2,680 | 3,324 |
| Marketing expenses | 2,367 | 2,272 |
| Maintenance expenses | 1,717 | 2,410 |
| Commission fees | 1,782 | 1,793 |
| Insurance fees related to services ³ | 460 | 1,289 |
| Consultancy fees | 774 | 867 |
| Fees related to contracted employees ³ | 757 | 820 |
| Expenses from energy services | 1,092 | 656 |
| Expenses related to value added services and content providing | 122 | 402 |
| Payment to other fixed line network operators | 388 | 230 |
| Mediated SI/IT services | 219 | 111 |
| Other (vendor accruals) ^{3,4} | 7,226 | 6,228 |
| Accrued expenses | 43,612 | 51,572 |
| Deferred income | 1,482 | 1,476 |
| Total | 48,234 | 62,292 |

¹ In 2015, financial transactions were disclosed in Other according to the breakdown as of 2015.

² Deferred revenues from energy services (HUF 272 million) were disclosed on a separate line in 2015.

³ In 2015, these items were disclosed in Other (vendor accruals).

⁴ In 2015, accrued interest expenses (HUF 4 million) were disclosed on a separate line, this year the Other (vendor accruals) contains them.



24 NET DOMESTIC SALES

Net domestic sales in the years ending December 31, 2015 and 2016 were as follows:

| | <u>2015</u> | <u>2016</u> |
|---|-----------------------|-----------------------|
| Voice retail | 137,787 | 133,659 |
| Voice wholesale | 8,816 | 5,445 |
| Non-voice | 76,819 | 82,410 |
| Sale of handsets and other devices | 37,064 | 40,168 |
| Other mobile revenues | <u>16,470</u> | <u>17,023</u> |
| Revenues from mobile services | 276,956 | 278,705 |
| Voice retail | 48,964 | 45,305 |
| Voice wholesale | 1,202 | 957 |
| Internet | 43,036 | 43,843 |
| Data | 7,941 | 7,709 |
| TV | 34,500 | 36,364 |
| Sale of handsets and other devices | 6,783 | 5,376 |
| Other fixed line services | <u>7,515</u> | <u>8,553</u> |
| Revenues from fixed line services | 149,941 | 148,107 |
| System integration and IT revenues | 5,322 | 6,154 |
| Energy revenues | 50,924 | 6,891 |
| Other sales revenues | <u>4,933</u> | <u>8,427</u> |
| Total net domestic sales | <u>488,076</u> | <u>448,284</u> |

25 NET EXPORT SALES BY GEOGRAPHICAL AREAS

Net export sales by geographical areas in the years ending December 31, 2015 and 2016 are summarized as follows (sales are solely connected with services provided):

| | <u>2015</u> | | <u>2016</u> | |
|-------------------------------|----------------------|-----------------------|----------------------|-----------------------|
| | Value | % | Value | % |
| Europe (inside the EU) | 11,941 | 84.10% | 18,291 | 91.59% |
| Europe (outside the EU) | 1,068 | 7.52% | 853 | 4.27% |
| Asia | 676 | 4.76% | 397 | 1.99% |
| America | 290 | 2.05% | 296 | 1.48% |
| Africa | 211 | 1.48% | 98 | 0.49% |
| Australia | <u>13</u> | <u>0.09%</u> | <u>36</u> | <u>0.18%</u> |
| Total net export sales | <u>14,199</u> | <u>100.00%</u> | <u>19,971</u> | <u>100.00%</u> |

26 OTHER INCOME

Other income in the years ending December 31, 2015 and 2016 are as follows:

| | 2015 | 2016 |
|--|----------------------|----------------------|
| Revenue from sale of intangible and tangible fixed assets ¹ | 1,891 | 9,491 |
| Default interest, penalties, damage compensations | 8,110 | 7,472 |
| Reversal of provisions ² | 3,576 | 6,364 |
| Discount received subsequently | 2,045 | 3,108 |
| Other income from reversal of impairment | 3,449 | 3,033 |
| Revenue from receivable factoring | 685 | 1,055 |
| Other ³ | 3,494 | 310 |
| Total | <u>23,250</u> | <u>30,833</u> |

¹ The increase is due to the other income from sale of two real estates.

² Details of provisions are disclosed in Note 15.

³ In 2015, certain items were disclosed in Extraordinary expenses. Further details are disclosed in Appendix 5.

27 COSTS OF SERVICES

Costs of services in the years ending December 31, 2015 and 2016 are as follows:

| | 2015 | 2016 |
|---|----------------------|----------------------|
| Repair and maintenance costs | 18,083 | 20,289 |
| Rental fees | 18,551 | 18,989 |
| Marketing expenses | 9,104 | 9,816 |
| Commissions paid | 9,123 | 8,835 |
| Other services related to revenues | 6,699 | 8,099 |
| Costs of outsourced sales and management services related to business customers | 5,790 | 6,072 |
| Consultancy | 2,733 | 3,400 |
| Payments to international network operators | 3,378 | 3,340 |
| Postage, costs of delivery and storage | 3,162 | 3,013 |
| Brand license fee | 3,996 | 2,384 |
| Database and 'infodok' expenses | 1,069 | 1,949 |
| Expenses of rented workforce and operator activities | 1,590 | 1,900 |
| Property operating costs | 3,673 | 1,623 |
| Education, training expenses | 971 | 926 |
| Costs of property security and cash transport services | 669 | 701 |
| Travel and accommodation costs | 491 | 541 |
| Administrative services and related costs | 330 | 370 |
| Translation and interpretation fees | 99 | 102 |
| Other | 3,423 | 2,224 |
| Total | <u>92,934</u> | <u>94,573</u> |

28 COST OF GOODS SOLD

Cost of goods sold in the years of 2015 and 2016 contains the following major items:

| | <u>2015</u> | <u>2016</u> |
|-------------------------|-----------------------|----------------------|
| Goods sold ¹ | 63,346 | 69,815 |
| Energy ² | 36,759 | 3,565 |
| Other | <u>135</u> | <u>101</u> |
| Total | <u>100,240</u> | <u>73,481</u> |

¹ Contains costs of mobile and fixed devices, accessories and other equipment.

² The significant decrease is due to that the complete energy trade for business customers has been transferred to E2 Hungary Kft. (a joint venture company of Magyar Telekom Plc. and MET Holding AG) from January 1, 2016.

29 COSTS OF (MEDIATED) SERVICES SOLD

Costs of mediated services sold in the years ending December 31, 2015 and 2016 are as follows:

| | <u>2015</u> | <u>2016</u> |
|--|----------------------|----------------------|
| Payment to mobile operators | 16,622 | 15,847 |
| Costs of TV services | 14,224 | 14,758 |
| Costs of content providing and mobile trade services sold | 8,444 | 9,279 |
| Costs of mediated SI/IT services | 4,029 | 4,353 |
| System usage and other charges related to electricity and gas retail services ¹ | 11,155 | 3,215 |
| Payment to other fixed line network operators | 2,062 | 1,757 |
| Other | <u>961</u> | <u>712</u> |
| Total | <u>57,497</u> | <u>49,921</u> |

¹ The significant decrease is due to that the complete energy trade for business customers has been transferred to E2 Hungary Kft. (a joint venture company of Magyar Telekom Plc. and MET Holding AG) from January 1, 2016.



30 EMPLOYEES

The average statistical number of employees in 2015 and 2016 are as follows (by function):

| | | 2015 | | | | | |
|---|--------------|--|--------------------|--------------------------------|--------------------------|-----------------------------------|--------------------------------|
| | | Average statistical number of employees (person) | Salaries and wages | Employee related contributions | | | Other payroll related expenses |
| | | | | Social contribution tax | Healthcare contributions | Vocational training contributions | |
| Full-time employees | | | | | | | |
| | blue collar | 771 | 2,828 | 770 | 84 | 87 | 822 |
| | white collar | 5,994 | 41,367 | 11,269 | 597 | 1,272 | 5,868 |
| | total | 6,765 | 44,195 | 12,039 | 681 | 1,359 | 6,690 |
| Part-time employees | | | | | | | |
| | blue collar | 1 | 3 | 1 | 0 | 0 | 1 |
| | white collar | 133 | 511 | 139 | 12 | 16 | 114 |
| | total | 134 | 514 | 140 | 12 | 16 | 115 |
| Employees total | | | | | | | |
| | blue collar | 772 | 2,831 | 771 | 84 | 87 | 823 |
| | white collar | 6,127 | 41,878 | 11,408 | 609 | 1,288 | 5,982 |
| | total | 6,899 | 44,709 | 12,179 | 693 | 1,375 | 6,805 |
| Employees not in headcount ¹ | | 0 | 1,033 | 281 | 7 | 32 | 70 |
| Total | | 6,899 | 45,742 | 12,460 | 700 | 1,407 | 6,875 |

| | | 2016 | | | | | |
|---|--------------|--|--------------------|--------------------------------|--------------------------|-----------------------------------|--------------------------------|
| | | Average statistical number of employees (person) | Salaries and wages | Employee related contributions | | | Other payroll related expenses |
| | | | | Social contribution tax | Healthcare contributions | Vocational training contributions | |
| Full-time employees | | | | | | | |
| | blue collar | 694 | 2,726 | 730 | 171 | 42 | 809 |
| | white collar | 5,427 | 38,991 | 10,441 | 1,233 | 595 | 5,838 |
| | total | 6,121 | 41,717 | 11,171 | 1,404 | 637 | 6,647 |
| Part-time employees | | | | | | | |
| | blue collar | 0 | 0 | 0 | 0 | 0 | 0 |
| | white collar | 100 | 463 | 124 | 19 | 7 | 91 |
| | total | 100 | 463 | 124 | 19 | 7 | 91 |
| Employees total | | | | | | | |
| | blue collar | 694 | 2,726 | 730 | 171 | 42 | 809 |
| | white collar | 5,527 | 39,454 | 10,565 | 1,252 | 602 | 5,929 |
| | total | 6,221 | 42,180 | 11,295 | 1,423 | 644 | 6,738 |
| Employees not in headcount ¹ | | 0 | 1,130 | 303 | 21 | 17 | 99 |
| Total | | 6,221 | 43,310 | 11,598 | 1,444 | 661 | 6,837 |

¹ Includes employees absent permanently, who are excluded from the average statistical number of employees.

Due to the change in Section 91. a) of Act on Accounting the employee related contributions are disclosed by function and title in 2016.

31 REMUNERATION OF THE BOARD OF DIRECTORS AND THE SUPERVISORY BOARD

The compensation granted to members of the Board of Directors and the Supervisory Board of the Company in the years ending December 31, 2015 and 2016 is summarized below:

| | <u>2015</u> | <u>2016</u> |
|--------------------|------------------|------------------|
| Board of Directors | 16 | 16 |
| Supervisory Board | 63 | 63 |
| Total | <u>79</u> | <u>79</u> |

The members of the Board of Directors and the Supervisory Board have not received any advance payments or loans in 2016. Loans granted to the members of the Supervisory Board are limited to the employee delegates and had been granted to them in their capacity as employees. The changes in these loans in 2016 were as follows:

| | <u>2016</u> |
|--|-----------------|
| Balance as of December 31, 2015 | 4 |
| Loans repaid in 2016 | -2 |
| Closing balance as of December 31, 2016 | <u>2</u> |

The loans are repayable monthly, the average remaining payment term is 21 months. Interest rate of loans: 6.14 per cent or free of interest.

The Company did not offer guarantees on behalf of the members of the Board of Directors and the Supervisory Board and has no retirement pension liability to them.

32 OTHER EXPENSES

Other expenses in the years ending December 31, 2015 and 2016 were as follows:

| | <u>2015</u> | <u>2016</u> |
|---|----------------------|----------------------|
| Taxes, contributions, fees (Government taxes) | 42,916 | 40,587 |
| Impairment of receivables and inventories, extraordinary depreciation of intangible and tangible fixed assets | 16,430 | 12,864 |
| Provisions ¹ | 7,905 | 6,621 |
| Net book value of fixed assets sold | 938 | 5,521 |
| Discount granted subsequently on roaming traffic | 2,834 | 3,037 |
| Factored receivables | 1,746 | 2,661 |
| Assets contributed and service provided free of charge ² | 928 | 393 |
| Write-off of uncollectible receivables | 186 | 158 |
| Dimenzió contributions ² | 206 | 141 |
| Receivables waived ² | 3,065 | 134 |
| Other | 1,889 | 781 |
| Total | <u>79,043</u> | <u>72,898</u> |

¹ Details of provisions are disclosed in Note 15.

² These items were disclosed in Extraordinary expenses in 2015. Further details are disclosed in Appendix 5.

33 RESULTS FROM FINANCIAL ACTIVITIES

Results from financial activities in the years ending December 31, 2015 and 2016 were as follows:

| | 2015 | 2016 |
|--|---------------|---------------|
| Dividends from GTS Hungary Kft. | 0 | 5,000 |
| Dividends from Stonebridge A.D. | 0 | 4,764 |
| Dividends from Crnogorski Telekom A.D. | 5,090 | 4,620 |
| Other | 405 | 487 |
| Dividends and profit sharing (received or due) | 5,495 | 14,871 |
| Interest from Deutsche Telekom ¹ | 622 | 1,276 |
| Interest from related parties ¹ | 475 | 276 |
| Interest from banks | 4 | 0 |
| Other | 47 | 34 |
| Other interest income received | 1,148 | 1,586 |
| Realized foreign exchange gain | 11,595 | 2,556 |
| Other | 150 | 91 |
| Other income from financial activities | 11,745 | 2,647 |
| Income from financial transactions | 18,388 | 19,104 |
| Loss on the sale of financial investments¹ | 90 | 918 |
| Interest to Deutsche Telekom | 19,208 | 15,167 |
| Interests to related parties | 153 | 72 |
| Other interests | 664 | 276 |
| Interest capitalized | -205 | -120 |
| Interest expense | 19,820 | 15,395 |
| Impairment of investments | -782 | 4,491 |
| Realized foreign exchange loss | 5,599 | 3,113 |
| Non-realized foreign exchange loss | 1,047 | 369 |
| Other | 4 | 149 |
| Other expenses from financial activities | 6,650 | 3,631 |
| Expenses from financial transactions | 25,778 | 24,435 |
| Results from financial activities | -7,390 | -5,331 |

¹ In 2015, Interest from related parties contained the interest from Deutsche Telekom.

² Certain items were disclosed in Extraordinary expenses in 2015. Further details are disclosed in Appendix 5.

34 TRANSACTIONS WITH RELATED PARTIES AND MEMBERS OF DEUTSCHE TELEKOM GROUP

Balances of transactions with related parties not disclosed in the balance sheet and income statement separately are detailed as follows.

Loans received from owners are disclosed as Non-current liabilities to other related parties or Current liabilities to other related parties. Their interests are disclosed separately as expenses from financial transactions in the income statement.

Revenues and expenses (mainly relating to telecommunication services) from the members of Deutsche Telekom Group were not disclosed separately as transactions with related parties.

Transactions with related parties and members of Deutsche Telekom Group in the years ending December 31, 2015 and 2016 are summarized as follows:

| | 2015 | 2016 |
|---|----------------|----------------|
| Net domestic sales | 488,076 | 448,284 |
| - of which: related parties | 6,608 | 7,609 |
| - of which: members of Deutsche Telekom Group | 2,237 | 5,545 |
| Net export sales | 14,199 | 19,971 |
| - of which: related parties | 874 | 699 |
| - of which: members of Deutsche Telekom Group | 6,667 | 5,011 |
| Other income¹ | 23,250 | 30,833 |
| - of which: related parties | 1,014 | 46 |
| - of which: members of Deutsche Telekom Group | 2,398 | 2,152 |
| Accounts receivable | 56,384 | 55,959 |
| - of which: members of Deutsche Telekom Group | 1,184 | 1,587 |
| Other receivables | 7,655 | 9,090 |
| - of which: related parties | 0 | 69 |
| - of which: members of Deutsche Telekom Group | 2,004 | 3,037 |
| Accrued income | 39,154 | 36,013 |
| - of which: related parties | 0 | 1,836 |
| - of which: members of Deutsche Telekom Group | 888 | 1,045 |
| Prepaid expenses | 1,947 | 3,848 |
| - of which: related parties | 0 | 203 |
| - of which: members of Deutsche Telekom Group | 132 | 1,742 |
| Accounts payable | 55,358 | 46,154 |
| - of which: members of Deutsche Telekom Group | 2,531 | 4,988 |
| Current liabilities to other related parties | 130,689 | 66,454 |
| - of which: members of Deutsche Telekom Group | 130,689 | 66,454 |
| Other current liabilities | 47,152 | 35,492 |
| - of which: members of Deutsche Telekom Group | 12,678 | 3,372 |
| Deferred Income | 3,140 | 9,244 |
| - of which: related parties | 0 | 179 |
| - of which: members of Deutsche Telekom Group | 938 | 7,465 |
| Accrued expenses | 43,612 | 51,572 |
| - of which: related parties | 0 | 8,319 |
| - of which: members of Deutsche Telekom Group | 10,319 | 9,728 |

¹ Certain items were disclosed in Extraordinary expenses in 2015. Further details are disclosed in Appendix 5.

35 CORPORATE INCOME TAX

The differences between profit before tax and the tax base for the years ending December 31, 2015 and 2016 are presented below:

| | 2015 | 2016 |
|--|-----------------|-----------------|
| Profit before tax | 21,537 | 29,398 |
| Depreciation according to the Act on Accounting | 103,913 | 101,011 |
| Impairment of receivables, recognized impairment in previous year | 9,681 | 9,217 |
| Recognition of provisions | 7,905 | 6,621 |
| Increase of expenditure and decrease of income discovered by tax audit or self-revision | 1,714 | 1,179 |
| Non-repayable donations, assets and services given free of charge, assumed liabilities | 329 | 360 |
| Penalty, sanction | 611 | 297 |
| Recoverable receivables waived and expired | 2,980 | 29 |
| Non-realized foreign exchange difference taken into account in previous years | 2,649 | 0 |
| Other tax base increasing items | 487 | 445 |
| Tax base increasing items | 130,269 | 119,159 |
| Depreciation according to the Tax Law | -100,776 | -107,596 |
| Dividend income | -5,495 | -14,871 |
| Reversal of provisions | -3,576 | -6,364 |
| Bad debt write-off, received payments on uncollectible receivables, reversal of impairment | -4,358 | -4,514 |
| Decrease of expenditure and increase of income discovered by tax audit or self-revision | -1,269 | -2,630 |
| Donations | -2 | -1 |
| Realized gain on disposal of investments | -1,580 | 0 |
| Other tax base decreasing items | -782 | 0 |
| Tax base decreasing items | -117,838 | -135,976 |
| Tax base | 33,968 | 12,581 |
| Calculated amount of tax | 6,409 | 2,345 |
| Tax credit | -5,792 | -1,976 |
| Corporate Income Tax | 617 | 369 |
| Energy suppliers' tax | 343 | 41 |
| Withholding tax paid abroad | 257 | 469 |
| Tax liability | 1,217 | 879 |
| Tax liability (self-revision) | -73 | -17 |
| Total tax liability | 1,144 | 862 |

35.1 Information on investment tax credits

Tax credit on broadband Internet investments announced for 2006: "Tax credit cannot exceed HUF 2,292 million at present value."

Tax credit on broadband Internet investments announced for 2007: "Investment tax credit cannot exceed HUF 1,318 million at present value."

12.724/2005 Ministry of Finance Resolution: "The tax credit is applicable in connection with construction of WLAN put into service by T-Mobile Magyarország Rt. which also provides broadband internet service and cannot exceed HUF 334 million at present value."

Tax credit on broadband Internet investments announced for 2006 by T-Mobile. The tax credit is applicable in connection with construction of WLAN which also provides broadband internet service and cannot exceed HUF 835 million at present value.

Based on the claim filed to the Ministry of Finance on February 3, 2012, the investment tax credit to be utilized relating to the 2012 fixed line telecommunication investment cannot exceed HUF 4,317 million at present value.

Based on the claim filed to the Ministry of Finance on February 3, 2012, the investment tax credit to be utilized relating to the 2012 mobile telecommunication investment cannot exceed HUF 4,769 million at present value.

Based on the claim filed to the Ministry of Finance on 31 October 2012, the investment tax credit to be utilized relating to the 2013 fixed line telecommunication investment cannot exceed HUF 2,986 million at present value.

Based on the claim filed to the Ministry of Finance on 31 October 2012, the investment tax credit to be utilized relating to the 2013 mobile telecommunication investment cannot exceed HUF 2,418 million at present value.

35.2 Other tax related information

Since January 1, 2013 Magyar Telekom Plc. is subject to utility network tax. Owners of ducts, pipes, cables, etc. used for electricity, telecommunication, natural gas, heating, water and wastewater services are subject to a tax based on the length of their utilities. The Company, which is also subject to this tax for the ducts and cables, recognized a utility tax expense of HUF 7,259 million in 2016.

Since July 1, 2012 Magyar Telekom Plc. is subject to telecommunication tax. The telecommunication tax was imposed on SMS/MMS services, as well as on mobile and fixed line telecommunication voice services provided on the telecommunication network. The amount of telecommunication tax was HUF 24,142 million in 2016.

36 DIVIDEND

Together with the approval of these financial statements for issue, the Board of Directors of the Company proposes a HUF 25 per share dividend distribution (in total HUF 26,067 million) to be approved by the Annual General Meeting of the Company in April 2017. In 2016 Magyar Telekom Plc. declared HUF 15 dividend per share (in total HUF 15,635 million).

37 OFF-BALANCE SHEET ITEMS

Off-balance sheet items mainly derive from contractual commitments (contracted construction-in-progress and other development commitments, guarantee obligations, acquisition obligations etc.).

Off-balance sheet items also include receivables and liabilities related to forward and swap deals not closed until the balance sheet date.

Off-balance sheet items are detailed in Appendix 4.



38 HAZARDOUS WASTE

The following table shows the movement of hazardous waste at the Company in 2016:

| | <u>Hazardous waste (kg)</u> |
|--------------------------|-----------------------------|
| December 31, 2015 | 2,849 |
| Increase: | |
| Lead batteries | 210,406 |
| Other | 1,955 |
| Increase in total | 212,361 |
| Decrease: | |
| Lead batteries | -211,364 |
| Other | -3,876 |
| Decrease in total | -215,210 |
| December 31, 2016 | 0 |

HUF 405 million environmental expenses were recorded in 2015 and HUF 356 million in 2016.

39 RESEARCH & EXPERIMENTAL DEVELOPMENT COSTS

At Magyar Telekom Plc. the research and experimental development costs was HUF 46.3 million as of December 31, 2016.

40 SELF-REVISIONS

At Magyar Telekom Plc., financial events that are related to prior years are recorded in the current year through self-revision.

In 2016, the total of all errors (whether negative or positive) for a given financial year (separately for each year) and the impacts thereof – increasing or decreasing the profit or loss or the equity – do not exceed the value limit set out in the Act on Accounting and in the accounting policy i.e. the 2 per cent of the balance sheet total of the financial year.

Accordingly, the discovered errors related to previous years were not disclosed in a separate column in the balance sheet and income statement and so they are part of the current year figures of the income statement.

41 IMPORT PURCHASES

Import purchases by geographical areas in the years ending December 31, 2015 and 2016 are summarized as follows:

| | 2015 | | | 2016 | | |
|-------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Services | Products | Total | Services | Products | Total |
| Europe (inside EU) | 19,604 | 29,170 | 48,774 | 25,585 | 32,895 | 58,480 |
| Asia | 2,295 | 1,062 | 3,357 | 2,436 | 1,427 | 3,863 |
| Europe (outside the EU) | 1,197 | 7,700 | 8,897 | 756 | 2,936 | 3,692 |
| America | 371 | 14 | 385 | 772 | 443 | 1,215 |
| Africa | 137 | 0 | 137 | 115 | 0 | 115 |
| Australia | 12 | 0 | 12 | 3 | 0 | 3 |
| Total | 23,616 | 37,946 | 61,562 | 29,667 | 37,701 | 67,368 |

During 2016, Magyar Telekom Plc. purchased HUF 37,701 million import products of which less than 30 per cent were recognized as fixed assets, while the rest was goods for resale.

During 2016, the amount of imported services was HUF 29,667 million. 53 per cent of these are included in cost of services, 45 per cent mediated services and the remaining part in other services and other payroll related expenses.

42 REMUNERATION OF AUDITOR

Fees charged by the auditors for the years ending December 31, 2015 and 2016 are summarized as follows:

| | 2015 | 2016 |
|--------------------------|------------|------------|
| Audit | 232 | 248 |
| Other assurance services | 146 | 129 |
| Other non-audit services | 168 | 117 |
| Total | 546 | 494 |

Budapest, February 22, 2017



Christopher Mattheisen
Chief Executive Officer,
Member of the Board



János Szabó
Chief Financial Officer



APPENDIX 1A
BALANCE SHEET RELATED TO ENERGY SERVICES – ASSETS

| | December 31, 2015 | | | | December 31, 2016 | | | | Total |
|---|-------------------|--------------|------------------|------------------|-------------------|------------|----------------|----------------|-------|
| | Electricity | Gas | Other | Total | Electricity | Gas | Other | Total | |
| data in millions of HUF | | | | | | | | | |
| A. FIXED ASSETS AND FINANCIAL INVESTMENTS | | | | 878 835 | 484 | 213 | 846 878 | 847 575 | |
| I. Intangible assets | | | | 335 120 | 422 | 270 | 289 247 | 289 939 | |
| 1. Rights | 458 | 377 | 248 609 | 249 444 | 422 | 270 | 232 937 | 233 629 | |
| 4. Intellectual property | 0 | 0 | 5 816 | 5 816 | 0 | 0 | 9 506 | 9 506 | |
| 5. Goodwill | 0 | 0 | 79 860 | 79 860 | 0 | 0 | 46 804 | 46 804 | |
| II. Tangible assets | | | | 378 560 | 62 | -57 | 376 191 | 376 196 | |
| 1. Land and buildings and related rights | 97 | 266 | 231 605 | 231 968 | 54 | -50 | 221 192 | 221 196 | |
| - Land | 4 | 10 | 2 744 | 2 759 | 2 | -2 | 2 659 | 2 659 | |
| - Buildings | 80 | 220 | 58 421 | 58 721 | 44 | -41 | 52 148 | 52 151 | |
| - Telecommunication network | 0 | 0 | 160 415 | 160 415 | 0 | 0 | 156 742 | 156 742 | |
| - Other properties | 13 | 36 | 9 578 | 9 578 | 8 | -7 | 9 160 | 9 161 | |
| - Real estate related rights | 0 | 0 | 496 | 496 | 0 | 0 | 483 | 483 | |
| 2. Technical equipment, machinery and vehicles | 0 | 0 | 101 661 | 101 661 | 0 | 0 | 89 943 | 89 943 | |
| - Telecommunication equipment and machinery | 0 | 0 | 100 526 | 100 526 | 0 | 0 | 89 048 | 89 048 | |
| - Other technical equipment, machinery and vehicles | 0 | 0 | 1 135 | 1 135 | 0 | 0 | 895 | 895 | |
| 3. Other equipment and vehicles | 12 | 32 | 8 483 | 8 527 | 8 | -7 | 12 230 | 12 231 | |
| 5. Construction-in-progress | 0 | 0 | 36 392 | 36 392 | 0 | 0 | 52 826 | 52 826 | |
| 6. Advance payments on construction-in-progress | 0 | 0 | 12 | 12 | 0 | 0 | 0 | 0 | |
| III. Financial investments | | | | 165 155 | 0 | 0 | 181 440 | 181 440 | |
| 1. Non current investments in related parties | 0 | 0 | 154 792 | 154 792 | 0 | 0 | 172 487 | 172 487 | |
| 7. Other non current loans granted | 16 | 12 | 10 335 | 10 363 | 0 | 0 | 8 953 | 8 953 | |
| B. CURRENT ASSETS | | | | 96 181 | 831 | 30 | 96 277 | 97 138 | |
| I. Inventories | | | | 10 249 | 0 | 0 | 12 224 | 12 224 | |
| 1. Raw materials | 0 | -1 | 172 | 171 | 0 | 0 | 288 | 288 | |
| 2. Work in progress and semi-finished products | 0 | 0 | 7 | 7 | 0 | 0 | 64 | 64 | |
| 5. Goods for resale | 0 | 0 | 10 071 | 10 071 | 0 | 0 | 11 872 | 11 872 | |
| II. Receivables | | | | 80 579 | 830 | 31 | 82 759 | 83 620 | |
| 1. Accounts receivable | 2 725 | 2 982 | 74 872 | 56 384 | 743 | 14 | 55 202 | 55 959 | |
| 2. Receivables from related parties | 2 583 | 56 | 16 432 | 16 540 | 16 | -14 | 18 569 | 18 571 | |
| 6. Other receivables | 90 | 88 | 7 477 | 7 655 | 71 | 31 | 8 988 | 9 090 | |
| III. Securities | | | | 4 507 | 0 | 0 | 35 | 35 | |
| Investments in related parties | 0 | 0 | 4 200 | 4 200 | 0 | 0 | 0 | 0 | |
| 4. Treasury stock, quotas | 0 | 0 | 307 | 307 | 0 | 0 | 35 | 35 | |
| IV. Liquid assets | | | | 846 | 1 | -1 | 1 259 | 1 259 | |
| 1. Cash and cheques | 0 | 1 | 159 | 160 | 0 | 0 | 63 | 63 | |
| 2. Bank deposits | 1 | 3 | 682 | 686 | 1 | -1 | 1 196 | 1 196 | |
| C. ACCRUALS | | | | 41 101 | 508 | 205 | 39 148 | 39 861 | |
| 1. Accrued income | 1 840 | 2 728 | 34 586 | 39 154 | 507 | 153 | 35 353 | 36 013 | |
| 2. Prepaid costs and expenses | 2 | 239 | 1 706 | 1 947 | 1 | 52 | 3 795 | 3 848 | |
| TOTAL ASSETS | 5 151 | 6 639 | 1 004 327 | 1 016 117 | 1 823 | 448 | 982 303 | 984 574 | |

APPENDIX 1B BALANCE SHEET RELATED TO ENERGY SERVICES – LIABILITIES

| | December 31, 2015 | | | | December 31, 2016 | | | | data in millions of HUF |
|---|-------------------|---------------|------------------|------------------|-------------------|---------------|----------------|----------------|-------------------------|
| | Electricity | Gas | Other | Total | Electricity | Gas | Other | Total | |
| D. SHAREHOLDERS' EQUITY | -4 832 | -5 618 | 423 107 | 412 657 | -4 884 | -5 983 | 436 425 | 425 568 | |
| I. Common stock | 0 | 0 | 104 274 | 104 274 | 0 | 0 | 104 274 | 104 274 | |
| - of this treasury stock at par value | 0 | 0 | 39 | 39 | 0 | 0 | 0 | 0 | |
| II. Unpaid share capital (*) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| III. Capital reserves | 0 | 0 | 58 952 | 58 952 | 0 | 0 | 58 952 | 58 952 | |
| IV. Retained earnings | -4 479 | -5 774 | 238 984 | 228 731 | -4 832 | -5 618 | 244 211 | 233 761 | |
| V. Restricted reserves | 0 | 0 | 307 | 307 | 0 | 0 | 35 | 35 | |
| VI. Valuation reserves | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| VII. Net income | -353 | 156 | 20 590 | 20 393 | -52 | -365 | 28 953 | 28 536 | |
| E. PROVISIONS | 30 | 23 | 17 396 | 17 449 | 0 | 0 | 17 706 | 17 706 | |
| 1. Provision for expected obligations | 30 | 23 | 17 396 | 17 449 | 0 | 0 | 17 706 | 17 706 | |
| F. LIABILITIES | 1 769 | 2 714 | 533 274 | 537 777 | 477 | -348 | 478 889 | 479 018 | |
| I. Subordinated liabilities | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| II. Non current liabilities | 328 | 906 | 290 012 | 291 246 | 221 | -204 | 301 974 | 301 991 | |
| 8. Non current liabilities to other related parties | 296 | 819 | 217 448 | 218 563 | 202 | -186 | 236 400 | 236 416 | |
| 9. Other non current liabilities | 32 | 87 | 72 564 | 72 683 | 19 | -18 | 65 574 | 65 575 | |
| III. Current liabilities | 1 461 | 1 808 | 243 262 | 246 531 | 256 | -144 | 176 915 | 177 027 | |
| 1. Current borrowings | 0 | 0 | 176 | 176 | 0 | 0 | 175 | 175 | |
| - of this convertible bonds | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| 2. Current loans | 18 | 49 | 12 989 | 13 066 | 10 | -9 | 11 499 | 11 500 | |
| 3. Advances received | 0 | 0 | 681 | 681 | 0 | 0 | 726 | 726 | |
| 4. Accounts payable | 938 | 938 | 53 482 | 55 358 | 0 | -190 | 46 344 | 46 154 | |
| 6. Current liabilities to related parties | 7 | 19 | 15 018 | 15 044 | 4 | -3 | 16 525 | 16 526 | |
| 8. Current liabilities to other related parties | 178 | 489 | 130 022 | 130 689 | 57 | -52 | 66 449 | 66 454 | |
| 9. Other current liabilities | 320 | 313 | 30 884 | 31 517 | 185 | 110 | 35 197 | 35 492 | |
| G. ACCRUALS | 2 620 | 2 170 | 43 444 | 48 234 | 1 362 | -70 | 61 000 | 62 292 | |
| 1. Deferred revenue | 62 | 211 | 2 867 | 3 140 | 1 | 0 | 9 243 | 9 244 | |
| 2. Accrued expenses | 2 568 | 1 959 | 39 095 | 43 612 | 1 361 | -70 | 50 281 | 51 572 | |
| 3. Other deferred income | 0 | 0 | 1 482 | 1 482 | 0 | 0 | 1 476 | 1 476 | |
| DIFFERENCE BECAUSE OF SEPARATION | 5 544 | 7 350 | -12 894 | 0 | 4 868 | 6 849 | -11 717 | 0 | |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | 5 151 | 6 639 | 1 004 327 | 1 016 117 | 1 823 | 448 | 982 303 | 984 574 | |



APPENDIX 1C INCOME STATEMENT RELATED TO ENERGY SERVICES

data in HUF millions

| | January-December, 2015 | | | | January-December, 2016 | | | |
|---|------------------------|---------------|----------------|----------------|------------------------|-------------|----------------|----------------|
| | Electricity | Gas | Other | Total | Electricity | Gas | Other | Total |
| 1. Net domestic sales | 25 315 | 25 612 | 437 149 | 488 076 | 6 414 | 477 | 441 393 | 448 284 |
| 2. Net export sales | 0 | 0 | 14 199 | 14 199 | 0 | 0 | 19 971 | 19 971 |
| I. Sales revenues | 25 315 | 25 612 | 451 348 | 502 275 | 6 414 | 477 | 461 364 | 468 255 |
| 3. Change in self-manufactured inventories | 0 | 0 | -8 | -8 | 0 | 0 | 57 | 57 |
| 4. Capitalised value of self-manufactured assets | 37 | 101 | 26 802 | 26 940 | 9 | -9 | 10 883 | 10 883 |
| II. Own work capitalized | 37 | 101 | 26 794 | 26 932 | 9 | -9 | 10 940 | 10 940 |
| III. Other income | 119 | 107 | 23 024 | 23 250 | 12 | 9 | 30 812 | 30 833 |
| of which: reversal of impairment | 0 | 0 | 3 449 | 3 449 | 0 | 0 | 3 033 | 3 033 |
| 5. Costs of raw material | 40 | 97 | 27 269 | 27 406 | 4 | -4 | 14 245 | 14 245 |
| 6. Costs of services | 86 | 187 | 92 661 | 92 934 | 62 | 26 | 94 485 | 94 573 |
| 7. Costs of other services | 25 | 34 | 8 042 | 8 101 | 4 | -3 | 8 739 | 8 740 |
| 8. Cost of goods sold | 18 905 | 17 855 | 63 480 | 100 240 | 3 081 | 483 | 69 917 | 73 481 |
| 9. Costs of (mediated) services sold | 5 672 | 5 486 | 46 339 | 57 497 | 3 080 | 134 | 46 707 | 49 921 |
| IV. Material-type expenses | 24 728 | 23 659 | 237 791 | 286 178 | 6 231 | 636 | 234 093 | 240 960 |
| 10. Salaries and wages | 258 | 199 | 45 285 | 45 742 | 0 | 0 | 43 310 | 43 310 |
| 11. Other employee related expenses | 42 | 32 | 6 801 | 6 875 | 0 | 0 | 6 837 | 6 837 |
| 12. Employee related contributions | 84 | 65 | 14 418 | 14 567 | 0 | 0 | 13 703 | 13 703 |
| V. Employee related expenses | 384 | 296 | 66 504 | 67 184 | 0 | 0 | 63 850 | 63 850 |
| VI. Depreciation and Amortization | 135 | 122 | 90 868 | 91 125 | 179 | 116 | 97 296 | 97 591 |
| VII. Other expenses | 480 | 1 373 | 77 190 | 79 043 | 47 | 71 | 72 780 | 72 898 |
| of which: impairment | 28 | 180 | 16 222 | 16 430 | 7 | -212 | 13 069 | 12 864 |
| A. PROFIT FROM OPERATING ACTIVITIES | -256 | 370 | 28 813 | 28 927 | -22 | -346 | 35 097 | 34 729 |
| 13. Dividends and profit sharing (received or due) | 7 | 21 | 5 467 | 5 495 | 13 | -12 | 14 870 | 14 871 |
| of which: received from related parties | 7 | 21 | 5 467 | 5 495 | 13 | -12 | 14 870 | 14 871 |
| 16. Other interest income received | 2 | 4 | 1 142 | 1 148 | 1 | -1 | 1 586 | 1 586 |
| of which: received from related parties | 1 | 2 | 472 | 475 | 0 | 0 | 276 | 276 |
| 17. Other income from financial activities | 323 | 197 | 11 225 | 11 745 | 6 | -3 | 2 638 | 2 647 |
| VIII. Income from financial transactions | 332 | 222 | 17 834 | 18 388 | 20 | -10 | 19 094 | 19 104 |
| 18. Loss on the sale of financial investments | 0 | 0 | 90 | 90 | 0 | 0 | 918 | 918 |
| of which: related to related parties | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 20. Interest expense | 27 | 74 | 19 719 | 19 820 | 13 | -12 | 15 394 | 15 395 |
| of which: to related parties | 0 | 1 | 152 | 153 | 0 | 0 | 72 | 72 |
| 21. Impairment of investments, securities and bank deposits | 0 | 0 | -782 | -782 | 0 | 0 | 4 491 | 4 491 |
| 22. Other expenses on financial transactions | 207 | 210 | 6 233 | 6 650 | 11 | 6 | 3 614 | 3 631 |
| IX. Expenses from financial transactions | 234 | 284 | 25 260 | 25 778 | 24 | -6 | 24 417 | 24 435 |
| B. RESULT FROM FINANCIAL TRANSACTIONS | 98 | -62 | -7 426 | -7 390 | -4 | -4 | -5 323 | -5 331 |
| C. PROFIT BEFORE TAXES | -158 | 308 | 21 387 | 21 537 | -26 | -350 | 29 774 | 29 398 |
| X. Tax expense | 195 | 152 | 797 | 1 144 | 26 | 15 | 821 | 862 |
| D. PROFIT AFTER TAX | -353 | 156 | 20 590 | 20 393 | -52 | -365 | 28 953 | 28 536 |

APPENDIX 1D
GAS-ENGINE SMALL POWER PLANT

data in HUF millions

| | 2015 | 2016 |
|---|------|------|
| Technical equipment, machinery and vehicles | 224 | 184 |
| Net domestic sales | 2 | 2 |
| Costs of raw material | 60 | 65 |
| Costs of services | 56 | 58 |
| Salaries and wages | 6 | 6 |
| Employee related contributions | 2 | 2 |
| Depreciation and Amortization | 41 | 41 |
| Other expenses | 4 | 5 |

APPENDIX 2A
 LAND AND BUILDINGS AND RELATED RIGHTS

| Description | Land | Building | Telecommunication Network | Other Properties | Real Estate related Rights | (in HUF millions) |
|---|-------|----------|---------------------------|------------------|----------------------------|--------------------------------------|
| | | | | | | Real Estate and related Rights Total |
| 1. Gross value | | | | | | |
| 11. Opening gross value (on January 1, 2016) | 2 758 | 89 763 | 377 546 | 18 194 | 4 407 | 492 668 |
| 12. Additions | 0 | 1 016 | 12 320 | 148 | 30 | 13 514 |
| 13. Disposals | -99 | -8 930 | -3 292 | -168 | -123 | -12 612 |
| 14. Reclassifications | 0 | -49 | 326 | -93 | 0 | 184 |
| 15. Closing gross value (on December 31, 2016) | 2 659 | 81 800 | 386 900 | 18 081 | 4 314 | 493 754 |
| 2. Accumulated depreciation | | | | | | |
| 21. Opening depreciation (on January 1, 2016) | 0 | 31 042 | 217 131 | 8 616 | 3 911 | 260 700 |
| 22. Annual depreciation | 0 | 2 296 | 15 714 | 504 | 43 | 18 557 |
| 23. Extraordinary depreciation | 0 | 0 | 0 | 0 | 0 | 0 |
| 24. Disposals | 0 | -3 685 | -2 742 | -126 | -123 | -6 676 |
| 25. Reclassifications | 0 | -4 | 55 | -74 | 0 | -23 |
| 26. Closing depreciation (on December 31, 2016) | 0 | 29 649 | 230 158 | 8 920 | 3 831 | 272 558 |
| 3. Net book value (on December 31, 2016) | 2 659 | 52 151 | 156 742 | 9 161 | 483 | 221 196 |
| Of which residual value | 0 | 0 | 0 | 0 | 0 | 0 |

APPENDIX 2B
TECHNICAL AND OTHER EQUIPMENT, MACHINERY AND VEHICLES

| Description | (in HUF millions) | | | | | |
|--|---|---|--|--------------------------|---|---|
| | Telecommunication Equipment, Machinery | Other Technical Equipment, Machinery and vehicles | Technical Equipment, Machinery and Vehicles Total | Other Equipment Total | Technical and Other Equipment Total | Technical and Other Equipment used for environmental protection |
| 1. Gross value | | | | | | |
| 11. Opening gross value (on January 1, 2016) | 509 823 | 4 561 | 514 384 | 55 343 | 569 727 | 33 |
| 12. Additions | 22 400 | 685 | 23 085 | 4 657 | 27 742 | 0 |
| 13. Disposals | -78 139 | -385 | -78 524 | -3 380 | -81 904 | 0 |
| 14. Reclassifications | -12 365 | 141 | -12 224 | 12 107 | -117 | 0 |
| 15. Closing gross value (on December 31, 2016) | 441 719 | 5 002 | 446 721 | 68 727 | 515 448 | 33 |
| 2. Accumulated depreciation | | | | | | |
| 21. Opening depreciation (on January 1, 2016) | 409 297 | 3 426 | 412 723 | 46 816 | 459 539 | 33 |
| 22. Annual depreciation | 29 812 | 570 | 30 382 | 2 807 | 33 189 | 0 |
| 23. Extraordinary depreciation | 0 | 0 | 0 | 0 | 0 | 0 |
| 24. Disposals | -76 023 | -358 | -76 381 | -3 148 | -79 529 | 0 |
| 25. Reclassifications | -10 415 | 469 | -9 946 | 10 021 | 75 | 0 |
| 26. Closing depreciation (on December 31, 2016) | 352 671 | 4 107 | 356 778 | 56 496 | 413 274 | 33 |
| 3. Net book value (on December 31, 2016) | 89 048 | 895 | 89 943 | 12 231 | 102 174 | 0 |
| Of which residual value | 1 922 | 0 | 1 922 | 634 | 2 556 | 0 |

APPENDIX 3

SIGNIFICANT DIRECT INVESTMENTS OF MAGYAR TELEKOM PLC.

| Company | Headquarter | Ownership Direct (%) | Ownership Indirect (%) | Ownership Direct and Indirect (%) | Voting Rights (%) | Common Stock | Reserves | Profit or loss after tax | Equity |
|--|---|----------------------|------------------------|-----------------------------------|-------------------|--------------|----------|--------------------------|--------|
| Combridge S.R.L. ¹ | Sf. Gheorghe, Vitorului 24, 7. C. 16 | 100.00% | | 100.00% | 100.00% | 2,042 | 458 | 16 | 2,516 |
| Crnogorski Telekom A.D. Podgorica ¹ | Moskovska 29, Podgorica 81000, Montenegro | 76.53% | | 76.53% | 76.53% | 38,522 | 26 | 2,913 | 41,461 |
| E2 Hungary Zrt. | 1117 Budapest, Infopark sétány 1. | 50.00% | | 50.00% | 50.00% | 200 | 1,756 | 254 | 2,210 |
| GTS Hungary Kft. | 2040 Budapest, Ipartelep utca 13-15. | 100.00% | | 100.00% | 100.00% | 2,043 | 2,390 | 702 | 5,135 |
| Novatel E.O.O.D. ¹ | 1680 Sofia, Bulgaria blvd 98, building Astra, entrance D, fl. 3., office 5G | 100.00% | | 100.00% | 100.00% | 1,758 | -55 | -3 | 1,700 |
| Stonebridge Communications A.D. ¹ | 1000 Skopje, Kej 13 Noemvri, No. 6., Municipality of Centar | 100.00% | | 100.00% | 100.00% | 61,051 | 5,377 | -1,577 | 64,851 |
| Telekom New Media Zrt. | 1222 Budapest, Nagytétényi út 29. | 100.00% | | 100.00% | 100.00% | 670 | -26 | 49 | 693 |
| T-Systems Magyarország Zrt. | 1117 Budapest, Budatoki út 56. | 100.00% | | 100.00% | 100.00% | 2,002 | 18,478 | 1,674 | 22,154 |

(in HUF millions)

All data in the table related to the capital is the last known figures by Magyar Telekom Plc. and not yet audited.

¹The equity figures of foreign subsidiaries are based on IFRS reports and were translated using foreign exchange rates as of December 31, 2016.



APPENDIX 4
OFF-BALANCE SHEET ITEMS

(HUF million)

| | Total |
|---|--------|
| Guarantee obligation | 10 076 |
| Commitment for capital expenditure and other developments | 6 165 |
| Commitment for capital expenditure with related parties | 72 |
| Environmental protection, restoration and other obligations | 200 |
| Commitment for acquisition | 0 |

Forward and swap deals

Open swap F/X deals on December 31, 2016 were contracted on the OTC market with the original aim of delivery

| ID | Date | Off-balance sheet liability (HUF million) | Off-balance sheet receivable | Value date | Exchange rate | Fair value (Profit+ / Loss) (HUF million) |
|--------------|------------|---|------------------------------|------------|---------------|---|
| 1Z4000198 | 07.06.2011 | -13 250 | EUR 50 000 000 | 11.20.2018 | 265.00 | 3 763 |
| 1Z4000200 | 07.06.2011 | -6 095 | EUR 23 000 000 | 05.19.2017 | 265.00 | 1 404 |
| 1Z5000035 | 05.22.2015 | -40 625 | EUR 130 000 000 | 01.18.2021 | 312.50 | -2 748 |
| 1Z6000034 | 09.13.2016 | -40 126 | EUR 130 000 000 | 07.27.2021 | 308.67 | -704 |
| Total | | -100 096 | Total EUR 333 000 000 | | | 1 714 |

¹ Expected, financially not realized amount of negative difference is recognized as accrued expense.

Open forward F/X deals on December 31, 2016 were contracted on the OTC market with the original aim of delivery

| ID | Date | Off-balance sheet liability on strike price (HUF millions) | Off-balance sheet receivable | Value Date | Exchange rate | Fair value (Profit+ / Loss) (HUF million) |
|--------------|------------|--|------------------------------|------------|---------------|---|
| 1X6005080 | 09.22.2016 | -1 542 | EUR 5 000 000 | 01.24.2017 | 308.40 | 14 |
| 1X6005084 | 09.22.2016 | -1 543 | EUR 5 000 000 | 02.21.2017 | 308.52 | 14 |
| 1X6005104 | 09.22.2016 | -1 545 | EUR 5 000 000 | 03.21.2017 | 308.93 | 13 |
| 1X6005645 | 10.24.2016 | -565 | USD 2 000 000 | 01.17.2017 | 282.66 | 22 |
| 1X6005653 | 10.24.2016 | -4 636 | EUR 15 000 000 | 01.02.2017 | 309.06 | 29 |
| 1X6006360 | 12.06.2016 | -1 021 | USD 3 500 000 | 01.09.2017 | 291.64 | 7 |
| 1X6006362 | 12.06.2016 | -379 | USD 1 300 000 | 02.13.2017 | 291.40 | 3 |
| Total | | -11 230 | Total USD 6 800 000 | | | 101 |
| | | | Total EUR 30 000 000 | | | |

APPENDIX 5
RECLASSIFICATIONS DUE TO THE CHANGE IN ACT ON ACCOUNTING

| Annual Report as of 2015 | Reclassifications | | | Annual Report as of 2016 |
|---|---------------------------|---------------------------------|---------------------------|---|
| | January-December, 2015 | due to the Act on Accounting | January-December, 2016 | |
| 1. Net domestic sales | 488 076 | | 488 076 | 1. Net domestic sales |
| 2. Net export sales | 14 199 | | 14 199 | 2. Net export sales |
| I. Sales revenues | 502 275 | | 502 275 | I. Sales revenues |
| 3. Change in self-manufactured inventories | -8 | | -8 | 3. Change in self-manufactured inventories |
| 4. Capitalized value of self-manufactured assets | 26 940 | | 26 940 | 4. Capitalized value of self-manufactured assets |
| II. Own work capitalized | 26 932 | | 26 932 | II. Own work capitalized |
| III. Other income | 22 719 | 531 | 23 250 | III. Other income |
| <i>From Extraordinary income - Assets received free of charge</i> | | 104 | | |
| <i>From Extraordinary income - Development contributions</i> | | 51 | | |
| <i>From Extraordinary income - Other extraordinary income</i> | | 376 | | |
| of which: reversal of impairment | 3 449 | | 3 449 | of which: reversal of impairment |
| 5. Costs of raw material | 27 406 | | 27 406 | 5. Costs of raw material |
| 6. Costs of services | 92 934 | | 92 934 | 6. Costs of services |
| 7. Costs of other services | 8 101 | | 8 101 | 7. Costs of other services |
| 8. Cost of goods sold | 100 240 | | 100 240 | 8. Cost of goods sold |
| 9. Costs of (mediated) services sold | 57 497 | | 57 497 | 9. Costs of (mediated) services sold |
| IV. Material-type expenses | 286 178 | | 286 178 | IV. Material-type expenses |
| 10. Salaries and wages | 45 742 | | 45 742 | 10. Salaries and wages |
| 11. Other employee related expenses | 6 875 | | 6 875 | 11. Other employee related expenses |
| 12. Employee related contributions | 14 567 | | 14 567 | 12. Employee related contributions |
| V. Employee related expenses | 67 184 | | 67 184 | V. Employee related expenses |
| VI. Depreciation and Amortization | 91 125 | | 91 125 | VI. Depreciation and Amortization |
| VII. Other expenses | 74 844 | 4 199 | 79 043 | VII. Other expenses |
| <i>From Extraordinary expense - Loans forgiven to T-Systems Magyarország Zrt.</i> | | 2 900 | | |
| <i>From Extraordinary expense - Assets contributed and service provided free of charge</i> | | 918 | | |
| <i>From Extraordinary expense - Dimenzió contributions</i> | | 206 | | |
| <i>From Extraordinary expense - Receivables waived</i> | | 165 | | |
| <i>From Extraordinary expense - Other extraordinary expense</i> | | 10 | | |
| of which: impairment | 16 430 | | 16 430 | of which: impairment |
| A. PROFIT FROM OPERATING ACTIVITIES | 32 595 | -3 668 | 28 927 | PROFIT FROM OPERATING ACTIVITIES |
| 13. Dividends and profit sharing (received or due) | 5 495 | | 5 495 | 13. Dividends and profit sharing (received or due) |
| <i>of which: received from related parties</i> | 5 495 | | 5 495 | <i>of which: received from related parties</i> |
| 16. Other interest income received | 1 148 | | 1 148 | 16. Other interest income received |
| <i>of which: received from related parties</i> | 475 | | 475 | <i>of which: received from related parties</i> |
| 17. Other income from financial transaction | 11 745 | | 11 745 | 17. Other income from financial transaction |
| VIII. Income from financial transactions | 18 388 | 0 | 18 388 | VIII. Income from financial transactions |
| | | 90 | 90 | 18. Loss on the sale of financial investments |
| <i>From Extraordinary income - Capital decrease of Stonebridge A.D.</i> | | -9 988 | | |
| <i>From Extraordinary expense - Capital decrease of Stonebridge A.D.</i> | | 10 053 | | |
| <i>From Extraordinary expense - Derecognition of Telemacedonia's book value (liquidation)</i> | | 25 | | |
| 19. Interest expense | 19 820 | | 19 820 | 20. Interest expense |
| <i>of which: to related parties</i> | 153 | | 153 | <i>of which: to related parties</i> |
| <i>to other related party</i> | 19 208 | | 19 208 | <i>to other related party</i> |
| 20. Impairment of investments, securities and bank deposits | -782 | | -782 | 21. Impairment of investments, securities and bank deposits |
| 21. Other expenses from financial transactions | 6 650 | | 6 650 | 22. Other expenses from financial transactions |
| IX. Expenses from financial transactions | 25 688 | 90 | 25 778 | IX. Expenses from financial transactions |
| RESULT FROM FINANCIAL TRANSACTIONS | -7 300 | -90 | -7 390 | RESULT FROM FINANCIAL TRANSACTIONS |
| PROFIT FROM ORDINARY ACTIVITIES | 25 295 | -3 758 | | |
| X. Extraordinary income | 10 519 | -10 519 | | |
| <i>To Loss on the sale of financial investments - Capital decrease of Stonebridge A.D.</i> | | -9 988 | | |
| <i>To Other income - Assets received free of charge</i> | | -104 | | |
| <i>To Other income - Development contributions</i> | | -51 | | |
| <i>To Other income - Other extraordinary income</i> | | -376 | | |
| XI. Extraordinary expenses | 14 277 | -14 277 | | |
| <i>To Loss on the sale of financial investments - Capital decrease of Stonebridge A.D.</i> | | -10 053 | | |
| <i>To Loss on the sale of financial investments - Derecognition of Telemacedonia's book value (liquidation)</i> | | -25 | | |
| <i>To Other expenses - Loans forgiven to T-Systems Magyarország Zrt.</i> | | -2 900 | | |
| <i>To Other expenses - Assets contributed and service provided free of charge</i> | | -918 | | |
| <i>To Other expenses - Dimenzió contributions</i> | | -206 | | |
| <i>To Other expenses - Receivables waived</i> | | -165 | | |
| <i>To Other expenses - Other extraordinary expense</i> | | -10 | | |
| B. RESULT FROM EXTRAORDINARY ACTIVITIES | -3 758 | 3 758 | | |
| C. PROFIT BEFORE TAXES | 21 537 | 0 | 21 537 | PROFIT BEFORE TAXES |
| XII. Tax expense | 1 144 | | 1 144 | X. Tax expense |
| D. PROFIT AFTER TAX | 20 393 | 0 | 20 393 | PROFIT AFTER TAX |



EGYÜTT. VELED

MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

BUSINESS REPORT

FOR THE YEAR ENDED DECEMBER 31, 2016



INTRODUCTION

The Company's activities are described in Notes to the Financial Statements (1.2 The Company's area of activity), while the business report provides additional information on the following topics:

- THE COMPANY'S SHARE CAPITAL, VOTING RIGHTS AND TRANSFER OF SHARES
- CORPORATE GOVERNANCE
- PEOPLE POLICY
- COMPENSATION OF MEMBERS OF THE BOARD OF DIRECTORS, SUPERVISORY BOARD, AND MANAGEMENT COMMITTEE
- RESEARCH AND DEVELOPMENT
- REAL ESTATE, SITES OF OPERATION
- SUSTAINABILITY
- ENVIRONMENT PROTECTION
- CORPORATE COMPLIANCE
- ECONOMIC ENVIRONMENT
- TARGETS AND STRATEGY
- INTERNAL CONTROLS, RISKS AND UNCERTAINTIES
- ANALYSIS OF FINANCIAL RESULTS FOR 2016
- SUBSEQUENT EVENTS BETWEEN THE END OF THE YEAR AND THE RELEASE OF THE REPORT

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

As of December 31, 2016, the share capital of Magyar Telekom Plc. was HUF 104,274,254,300, consisting of 1,042,742,543 Series "A" dematerialized ordinary shares. All Series "A" ordinary shares have a nominal value of HUF 100. Rights and obligations related to Series "A" ordinary shares are described in detail in the Articles of Association Section 2

(http://www.telekom.hu/about_us/investor_relations/corporate_governance/corporate_governance_documents). Information concerning our ownership structure as of December 31, 2016 is described in the following table:

| <u>Shareholder</u> | <u>Number of shares</u> | <u>Percentage of share capital</u> |
|----------------------------------|-------------------------|------------------------------------|
| Deutsche Telekom Europe B.V..... | 617,436,759 | 59.21 |
| Publicly traded | 425,228,449 | 40.78 |
| Treasury shares..... | 77,335 | 0.01 |
| | <u>1,042,742,543</u> | <u>100.00</u> |

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

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

1.1 Voting Rights and Voting

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

1.2 Transfer of Shares

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



shares. The holder of dematerialized share shall be considered the holder of the securities account on which the dematerialized shares are recorded.

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

2 CORPORATE GOVERNANCE

2.1 Annual General Meeting

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

2.2 Board of Directors

The detailed rules on the scope of authorities and operation of the Board of Directors are detailed in 6.4 of the Articles of Association and in the Rules of Procedure of the Board of Directors (http://www.telekom.hu/about_us/investor_relations/corporate_governance/corporate_governance_documents). The rules of competence regarding the capital increase and purchase of treasury shares are detailed in Sections 5.2 (b) and (p) as well as 6.4. (l) and (m) of the Articles of Association. The General Meeting by its Resolution No. 8/2016 (IV.12.) authorized the Board of Directors to purchase Magyar Telekom ordinary shares for 18 months starting from the date of approval of the resolution. See the detailed description of the authorization on the General Meetings section of our website.

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

Pursuant to the Articles of Association, the Board of Directors consists of a minimum of six and a maximum of eleven members elected by the General Meeting for a term of three years, unless otherwise provided by the General Meeting. Members of the Board of Directors can be removed or re-elected at any time by the General Meeting. On December 31, 2016, there were eight members of the Board of Directors.

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



On December 31, 2016, members of the Board of Directors, their principal occupation and the years of their original election were as follows:

| <u>Name</u> | <u>Born</u> | <u>Principal Occupation</u> | <u>Member since</u> |
|-----------------------------|-------------|--|---------------------|
| Christopher Mattheisen..... | 1961 | Chief Executive Officer of Magyar Telekom Plc. | 2006 |
| Dr. Mihály Patai..... | 1953 | Chairman-CEO of Unicredit Bank Hungary Ltd. | 2012 |
| Günter Mossal | 1961 | Vice President for Area Management, Board Area Europe, DT AG | 2012 |
| György Mosonyi | 1949 | Chairman of the Supervisory Board of MOL | 2012 |
| Ralf Nejedl..... | 1970 | Senior Vice President B2B , DT AG | 2016 |
| Frank Odzuck | 1959 | Chief Executive Officer of Zwack Unicum Plc. | 2006 |
| Dr. Ralph Rentschler | 1960 | Senior Vice President Finance, Group Headquarters and Group Services, DT AG | 2003 |
| Kerstin Günther | 1967 | Chairman of the Board of Directors of Magyar Telekom Plc Managing Director of Deutsche Telekom Pan-Net, DT AG | 2013 |

The members' assignment lasts until May 31, 2019.

2.3 Management Committee

Pursuant to the Rules of Procedure of the Board of Directors, the Board of Directors established a Management Committee in 2000. The Management Committee carries out its activities based on its Rules of Procedure approved by the Board of Directors, which is available on the Company's website (http://www.telekom.hu/about_us/investor_relations/corporate_governance/management_committee).

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

On December 31, 2016, the members of the Management Committee and the years of their original election were as follows:

| <u>Name</u> | <u>Born</u> | <u>Current position</u> | <u>Member since</u> |
|--------------------------------------|-------------|--|---------------------|
| Christopher Mattheisen | 1961 | Chief Executive Officer of Magyar Telekom Plc. | 2006 |
| András Gyenes ⁱ | 1969 | Chief Commercial Officer Residential | 2015 |
| János Szabó | 1961 | Chief Financial Officer | 2013 |
| Dr. Balázs Máthé | 1968 | Chief Legal and Corporate Affairs Officer | 2010 |
| Tibor Rékasi..... | 1973 | Chief Commercial Officer Enterprise, Chief Executive Officer of T-Systems Hungary Ltd. | 2013 |
| Éva Somorjai ⁱⁱ | 1966 | Chief Human Resources Officer | 2007 |
| Walter Goldenits ⁱⁱ | 1970 | Chief Technology and IT Officer | 2013 |
| Péter Lakatos..... | 1975 | Chief Commercial Officer SMB | 2013 |

ⁱ MC membership terminated on January 10, 2017.

ⁱⁱ MC membership terminated on December 31, 2016

2.4 Supervisory Board

The Supervisory Board carries out its activities based on Section 7 of the Articles of Association and its Rules of Procedure approved by the General Meeting (http://www.telekom.hu/static/sw/download/SB_RulesofProcedure_20150415.pdf). The Supervisory Board shall examine all submissions to be submitted to the General Meeting and present its opinion thereof at the General Meeting. The General Meeting may pass a resolution on a report pursuant to the Accounting Act and the use of the profit after income tax only upon



receipt of the written report of the Supervisory Board. The Supervisory Board makes a proposal directly to the General Meeting regarding the election, remuneration and removal of the Statutory Auditor.

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

On December 31, 2016, the members of the Supervisory Board, their principal occupation and the years of their original election were as follows:

| <u>Name</u> | <u>Born</u> | <u>Principal Occupation</u> | <u>Member since</u> |
|-------------------------|-------------|--|---------------------|
| Dr. László Pap..... | 1943 | Budapest University of Technology and Economics, Professor | 1997 |
| Dr. János Bitó..... | 1936 | Chairman of the Thesis and Final Examination Board at Pázmány Péter Catholic University, Information Technology Faculty | 2010 |
| Sándor Hartai | 1966 | Expert of TU Wholesale Directorate, Magyar Telekom | 2016 |
| Dr. János Illéssy..... | 1962 | Managing Director, Lebona Kft. | 2006 |
| Dr. Sándor Kerekes..... | 1948 | Director of Institute of Environmental Sciences, Corvinus University Budapest | 2006 |
| Konrad Kreuzer..... | 1948 | Managing Director of EUTOP Vienna, Budapest and Prague | 2006 |
| Tamás Lichnovszky..... | 1962 | Chairman of the Central Workers' Council, Magyar Telekom | 2010 |
| Martin Meffert..... | 1960 | Responsible for Corporate Governance issues of Magyar Telekom, Makedonski Telekom and Slovak Telekom at the Group Headquarters of Deutsche Telekom AG. | 2009 |
| Éva Őz..... | 1957 | Controlling Manager of Controlling Directorate, Chairwoman of the Workers' Council of Central Functions, Magyar Telekom | 2012 |
| Dr. Károly Salamon..... | 1954 | Managing Director, MIS Kft. | 2010 |
| Zsoltné Varga..... | 1969 | Quality Manager, Magyar Telekom | 2008 |
| Dr. Konrad Wetzker..... | 1950 | Chairman, School of Management of Corvinus University of Budapest | 2011 |

The members' assignment lasts until May 31, 2019.

2.5 Audit Committee

The Audit Committee executes its duties pursuant to the Articles of Association Section 7.8, and its own Rules of Procedure (http://www.telekom.hu/static/sw/download/AC_Rules_of_Procedure_03_12_2015.pdf). The members of the Audit Committee have been elected by the General Meeting from the independent members of the Supervisory Board for the same period as their membership in the Supervisory Board.



On December 31, 2016, the members of the Audit Committee were as follows:

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

2.6 Remuneration and Nomination Committee

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

The Remuneration and Nomination Committee is established by the Board of Directors of the Company to function as supporting body of the Board of Directors of the Company regarding the remuneration and certain nomination related issues of the members of the corporate bodies and the top executives of the Company in accordance with the Rules of Procedure.

(http://www.telekom.hu/static/sw/download/Rules_of_Procedure_of_the_Remuneration_and_Nomination_Committee_ENG_2013_0920.pdf).

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

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

On December 31, 2016, the members of the Remuneration and Nomination Committee were as follows:

- Dr. Ralph Rentschler
- Frank Odzuck
- Kerstin Günther

2.7 Corporate Governance and Management Report

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

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

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

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

The Corporate Governance Declaration on the Compliance with the Corporate Governance Recommendations, and regarding certain



questions the possible alterations and their explanations are included in the report. Sections 1 to 5 of the above report include the description and operation of the Board of Directors, the Supervisory Board, the relevant committees and executive management. Section 6 of the report includes a description of the internal controls and risk management procedures, while Section 8 of the report describes our disclosure policies and insider trading guidelines. In Sections 9 to 10 the method of exercising shareholders' right and the rules on conducting the General Meeting is summarized, while Section 11 contains the Remuneration Statement. The Company complies with the vast majority of the 150 recommendations and suggestions, however in the business year of 2016 in case of 10 recommendations and 6 suggestions it has not or not completely complied with due to the ownership and organizational structure or processes of the Company.

The Board of Directors, through the internal audit area, carried out an evaluation of the Company's disclosure processes in 2016 again. Based on the evaluation, the disclosure controls and procedures of the Company were effective and designed to ensure a proper basis for the timely and accurate disclosures to the market participants required under the respective accounting, capital markets and company law regulations.

2.8 Diversity

The Social Charter, Diversity Policy and the updated Equal Opportunities Plan of Magyar Telekom set the general human rights principles of the Company. Magyar Telekom rejects any discrimination on gender, age, disability, ethnic origin and race, religion and sexual orientation, and rejects all forms of discrimination in the workplace, and expressly support the realization of equal opportunities and diversity among colleagues, by taking into consideration the cultural and legal particularities. To ensure non-discrimination and equal opportunities at workplace has high priority.

The achievement of diversity goals is practiced by the company under the equal opportunities plan, which covers all employees. Our aim is to sensitize our employees, for which a program has been launched and we supported the young romas catching up by participating in the Integrom Program.

Social Charter: http://www.telekom.hu/static-tr/sw/file/Social_Charter.pdf

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

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

3 PEOPLE POLICY

We have renewed our People Strategy and identified its pillars we wish to focus on in 2016 and 2017 in line with Magyar Telekom's Business Strategy. Prior to and in preparation for that, we transformed our HR organization and operating model in the second half of 2015 in order to support the achievement of the ambitious goals set forth in our Business Strategy by an efficient and customer-focused HR.

The implementation of our corporate-level People Strategy encompassing two years is a task shared by the whole company, i.e. managerial and non-managerial personnel alike. HR facilitates the process by actions, tools and solutions.

3.1 People strategy from the aspect of the Company's

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

3.2 People strategy from the aspect of the employees

The message of our Business Strategy is that “We are building a successful ICT company with satisfied customers and dedicated colleagues”.

Our colleagues are the building blocks of that success. We implement our strategic goals with them.

We are building a competitive edge on the skills and attitude of future Telekom people.

In 2016-2017, we build our People Strategy around 4 pillars: brand and recruitment, training-development, remuneration and wellbeing.

We keep an eye on the required personal traits of the future Telekom people even in course of recruitment-selection. We segment our positions in recruitment to reach the right people by our ads. We have reviewed and renewed our online recruitment means and channels.

The objective set by another pillar of the People Strategy is achieved through the development of our employees and the expansion of their experience.

The emphasis is on self-development, for which we provide the necessary funds, digital content and online means.

We can improve the satisfaction and commitment of our employees by continuing to provide competitive remuneration packages and our diverse and wide range of benefits.

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

- Employer brand building – we create a livable and likeable workplace, which is satisfactory for our employees and offers an attractive perspective in the labor market through its future oriented methods of work. We put greater emphasis on using social media solutions in building the brand.
- Recruitment-selection – We use segment-based online recruitment channels and means to select the best candidate for the specific positions. During the selection process, we seek the attitude and personal traits defined as requirements for future Telekom employees.
- Remuneration – We retain our competitive edge in the market with our total compensation package and we are forerunners in the market with our innovations in compensation methods. We make our company attractive for employees by means of our wide range of benefits. We have a transparent, simpler and consistent job grading model, which reflects primarily the respective values of jobs, and provides for market comparison, as a basis for a competitive remuneration policy.



- Training development– We are building a digital Telekom, thus put an increasing emphasis on collaborative digital tools and solutions that enable and inspire self-development. Online training catalogue, online training materials, online coachbank and mentoring, online knowledge sharing (Share).
- Wellbeing – We take action for each other and ourselves in order to maintain our physical, mental and social wellbeing. Energized employees make us successful. We draw employees' attention to conscious preventive health efforts, volunteer work, sustainability and work-life balance.

The principles of justice and equal footing are set out in the basic standards articulated in our Code of Ethics published in 1997. Alternative forms of employment like telework, part-time work, flex-work, employment of disabled persons provide possibilities for the practical implementation of the principle of equal footing.

Equality at work and in life – is a principle that manifests in Telekom's operation. In order to enforce the principle, we adopted for the fourth time an Equal Opportunity Plan together with the employee representative bodies. The Equal Opportunity Plan contains the goals and tasks the company plans to support colleagues.

In the period of 2016-2020, our equal opportunity efforts focus on

- promoting physical and mental wellbeing,
- a family-friendly mentality,
- equal opportunities for women, including female executives,
- and the cooperation of different generations.

3.3 Headcount

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

| | 2014 | 2015 | 2016 |
|--------------------------|-------|-------|-------|
| Magyar Telekom Plc. | 7,046 | 6,670 | 6,281 |

3.4 Total Workforce Management

From 2009, Magyar Telekom introduced the TWM system. This scheme focuses on the total labor cost and not solely on headcount number and employee-related expenses. As a result, it enables us to increase the flexibility and efficiency with which all human resource-related expenses are managed, including contracted or temporary employees as well as outsourcing and entrepreneurial contracts.

3.5 Workforce Reduction and Redeployment

In recent years centralization, technological improvements and attrition have allowed us to reduce the size of our workforce. While overall personnel levels are falling, the number of highly skilled employees is increasing. We plan to further reduce the number of our employees in the long term, though in 2017 we do not have plans for headcount reduction at the Hungarian operation.

According to the terms of the agreement with Employee Representative Bodies, in order to keep salaries at competitive levels, as from January 1, 2017, employee salaries, excluding senior management, at the Company will rise by 5.5% on average.

3.6 Employee Representation and Labor Relations

Magyar Telekom Plc. has entered into a collective bargaining agreement with the Hungarian telecommunications trade unions (Távközlési Szakszervezet, TÁVSZAK and Magyar Távközlési Ágazati Szakszervezet, MATÁSZ). The agreement, which can be terminated by either party with three months' notice, applies to all Magyar Telekom Plc. employees except the CEO, regardless of their union membership status. Wage terms in the collective bargaining agreement must be renegotiated annually. If the employment is terminated due to reasons related to the employer's operation, employees are entitled to a specific amount of severance pay surplus, which depends on the tenure of the employee.

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

The Trade Union, as the official representative of employee interests in negotiations relating to the terms of employment, has the right to be informed of all corporate measures that may significantly affect the interests of employees and to commence legal action against the Company for employment-related conduct that infringes an employment rule. In addition, the Workers' Council directly represents



employee interests in dealings with management and decides jointly with management on matters involving employee welfare funds and institutions. The Workers' Council must be informed semi-annually on issues affecting our economic performance and changes in wages, employment conditions and working hours. The Workers' Council must also be consulted on corporate measures affecting employees.

Under the Act V of 2013 on the Civil Code one third of the Supervisory Board shall consist of employee representatives. The employee representatives in the Supervisory Board are nominated by the Central Workers' Council considering the opinion of the trade unions operating at the Company. Persons nominated by the Central Workers' Council shall be elected by the General Meeting to the member of the Supervisory Board, except if disqualifications exist in respect of the nominated persons. On December 31, 2016, four members of the Supervisory Board were employee representatives. These members were Tamás Lichnovszky, Zsoltné Varga, Éva Óz and Sándor Hartai.

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

3.7 Pensions and Benefit Programs

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

We provide employees with telecommunication allowances, subsidized meals, interest-free housing loans (such loans are not offered or extended to the Company's Board of Directors), discount holiday facilities and other fringe benefits. In addition to our statutory contributions to governmental health, retirement and unemployment schemes, we contribute to the employees' pension, health and self-aid savings, provided he is member of the voluntary fund, which provides private pension and health insurance as well as social benefits supplementing government pension and health benefits. We do not, however, guarantee payment by the fund to its members. At December 31, 2016 approximately 68% of employees of Magyar Telekom Plc. participated in the pension-, 44% in the self-aid-, and 63% in the health fund.

3.8 Human rights

Social Charta of Deutsche Telekom Group and Magyar Telekom is a voluntary commitment (based on the Decree of July 22, 2003 of the Group Board of Directors) on behalf of the employer side to comply with the minimal social standards throughout the entire company. It contains basic principles regarding labor relationships and conditions of employment. We expect compliance with the standards from our vendors as well. Via the Social Charta, these social standards are mandatory for the entire company, and are available to anyone. Magyar Telekom submits annual reports on the compliance with the 9 basic principles set forth in the Social Charta.

The Social Charta and more details: https://www.telekom.hu/static-tr/sw/file/Social_Charter.pdf and http://www.telekom.hu/about_us/society_and_environment/society/equal_opportunities).

Magyar Telekom strives to ensure equal chances for its employees, and to improve the situation of certain underprivileged employee groups. As part of this effort, from 2008 Magyar Telekom have accepted Equal Opportunities plans valid for periods of several years. Currently the Equal Opportunities Plan IV is in force, which determined guiding principles and an action plan for the 2016-2020 period. In addition, Magyar Telekom is open to join similar government, business and civil initiatives in order to achieve equal social opportunities.

Equal Opportunities Plan IV: (http://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_Eselyegyenlosegi_Terv_2016_2020_en.pdf).

These policies are published and declare measurable indicators concerning the human rights, and developing goals on these fields. The existence of these policies helps to fortify the employee's awareness and the engagement to legitimate behavior.

Giving support to the respective disadvantaged employee groups and to provide them equal opportunities require additional efforts and human resources.

Magyar Telekom can rely on its top management that is committed to sustainability and expects high performance regarding the compliance with human rights. These extra efforts are supported by the Chief Executive Officer and the Chief Human Resources Officer personally.

3.9 ESOP Organization

In July 2016 Magyar Telekom launched a Remuneration Policy based employee share ownership program (ESOP) under which Magyar Telekom shares will be distributed to the vast majority of the employees of Magyar Telekom Plc. and T-Systems Hungary Ltd. This program is in addition to the Company's regular remuneration package. Please refer to Note 1.3 of the Financial Statements for detailed system of control and mechanism of the employee share scheme.

4 COMPENSATION OF MEMBERS OF THE BOARD OF DIRECTORS, SUPERVISORY BOARD, AND MANAGEMENT COMMITTEE

The aggregate compensation of the members of the Board of Directors in their capacity as Board members was HUF 16 million in 2016.

The aggregate compensation of the members of the Supervisory Board in their capacity as Supervisory Board members was HUF 63 million in 2016.

The total compensation expenses (including social security and other payroll-related taxes as well as contractual termination expenses) of the members of the Management Committee (MC) was HUF 1,750 million in 2016.

On December 31, 2016, three of the eight MC members have an employment contract with fixed duration. Pursuant to Hungarian legislation, if an employment contract is terminated before the end of its term, the absence fee received for the remaining period is up to 12 months. The notice period is two months for three of the five indefinite contracts, and six months for the remaining two contracts. For two contracts the severance payment is in accordance with the Labour Code and the Collective Agreement, for the rest of the contracts the severance payment is between 3 and 16 months.

In addition to the above, the affected persons are bound by the non-compete clause, under which the employee is barred from entering into employment with any Hungarian or international competitor of Magyar Telekom and is required to refrain from providing direct or indirect services or activities of any kind to such companies for a definite period (not longer than one year) upon termination of his/her employment. Furthermore, such employee is barred from any action aimed to recruit employees of Magyar Telekom for any other company. This limitation entails certain compensation which is proportional with the above obligation. If the employee is in breach of the agreement, he/she will reimburse the net amount of compensation to the employer. In addition, the employee will be liable for a payment of compensation to the employer.

The MC members from foreign countries may be entitled to housing subsidies.

In line with the Company's remuneration guidelines, the Company provides contribution-based personal pension scheme and personal insurance scheme on behalf of the MC members. In addition, the MC members are entitled to the use of company cars.

5 RESEARCH AND DEVELOPMENT

In 2016, the Research and Development activities at Magyar Telekom covered the maintenance of R&D grant project launched and won in the frame of a tender obligation of the National Research, Development and Innovation Office.

In 2016, in addition of the tender obligation, we have launched several products and services projects developments, which are based on the R&D activities of 2015, for example, Big Data related "Mobile Insight" data acquisition module. Besides that, certain functionalities have begun its real operation within the topic of smart watch R&D (for example: Smart Watch Mobile Payment application)

In 2016, we have launched new, smaller R&D projects, especially in the area of Big Data, IoT and TV/ Entertainment. These first results are expected at the beginning of 2017.

In addition to innovative domestic SMEs, the R&D tasks are performed by Magyar Telekom's own research, product and service development staff. Besides the above, the Company exploits synergies resulting from its internal and external knowledge base, and takes efforts to establish partnerships with well-known innovation centers and institutions of university education. Our main partners are renowned Hungarian universities, research institutes such as Budapest University of Technology and Economics, Corvinus



University of Budapest, University of Szeged, University of Debrecen, and the Hungarian Academy of Sciences.

In the school year of 2016/17, in cooperation with Technical University of Berlin, data science and data technology department has been established at the Faculty of Informatics, Eötvös Loránd University. The department sponsored by Magyar Telekom's parent company, Deutsche Telekom's research and development division, the Berlin Telekom Innovation Laboratories (T-Labs in brief). In the frame of the cooperation, Magyar Telekom will support the department's research and development activities. In 2016, we have launched R&D themes about Smart City and Fraud.

Beyond the above, Magyar Telekom deems it important to support knowledge transfer projects of R&D nature as well; thus it participates actively as a professional cooperating partner and in the EU knowledge transfer program EIT ICT Labs KIC the Company joined in 2012, they are working together in more international R&D tender initiatives.

6 REAL ESTATE, SITES OF OPERATION

We have one of the largest real estate holdings in Hungary. We use substantially all of these properties for telecommunications installations, offices, warehouses, garages and shops. Our equipment and machinery primarily consist of switches, communication towers and other telecommunications equipment. In order to increase the utilization of real estates and increase efficiency, we make efforts to sell our surplus properties.

6.1 The registered office of the Company:

- 1013 Budapest, Krisztina krt. 55.

6.2 Sites of the Company:

- 1117 Budapest, Magyar tudósok krt. 9.
- 1073 Budapest, Dob u. 76-78.
- 1051 Budapest, Petőfi Sándor u. 17-19.
- 1117 Budapest, Kaposvár u. 5-7.
- 1117 Budapest, Budafoki u. 103-107.
- 1107 Budapest, Száva u. 3-5.
- 1117 Budapest, Szerémi út 4.
- 1117 Budapest, Budafoki út 56.
- 1106 Budapest, Örs vezér tere 25. 1. em.
- 1138 Budapest, Váci út 178.
- 1195 Budapest, Üllői út 201.
- 1191 Budapest, Vak Bottyán u. 75. a-c.
- 1024 Budapest, Lövház u. 2-6. 2. em.
- 1123 Budapest, Alkotás út 53.
- 1152 Budapest, Szentmihályi út 131.
- 1062 Budapest, Váci út 1-3.
- 1117 Budapest, Október huszonharmadika utca 8-10.
- 1119 Budapest, Fehérvári út 79.
- 1033 Budapest, Huszti út 32.
- 1082 Budapest, József utca 19-23.
- 1095 Budapest, Soroksári út 166/A.
- 1098 Budapest, Távíró utca 3-5.
- 1156 Budapest, Száraznád utca 1-3.

Out of the number of 1,723 buildings that take place on the 1,481 sites of Magyar Telekom Plc, 56% is owned by the company, 5 % is jointly owned and the rest 39% is leased. These figures do not contain the technology sites, from these type of sites we have 5936.



The total area of properties used by Magyar Telekom Plc. as of December 31, 2016 was 557 680 m². The majority of sites used in our operations are smaller than 100 m². The largest site is our headquarters building located at Krisztina krt. 55 in Budapest, with floor space of over 30,000 m²

7 SUSTAINABILITY

Magyar Telekom has been addressing the sustainability implications of its operations for close to twenty years, and in 2000, it was one of the first Hungarian companies to establish a sustainability unit that managed environmental issues in the beginning and coordinates sustainability processes now. Its sustainability activities are characterized by comprehensive, long-term plans, and the Company is currently implementing its fourth five-year sustainability strategy.

Being a leading ICT provider of the region, we set an example and provide opportunities by our forward-looking thinking, innovative, sustainable products and services and responsible conduct, we contribute to the establishment of a renewable society and environment.

Magyar Telekom committed to support the ten principles set forth by the UN Global Compact since 2009 in the areas of human rights, environment and anti-corruption, the results of which are also addressed by our Sustainability Reports.

Magyar Telekom's sustainability activities and achievements are comprehensively discussed in the annual Sustainability Reports, which aims to make the Company's environmental, social and economic activities transparent to everyone.

The present report includes reference only to certain key topics of our sustainability approach, namely human rights, employees, environment protection and compliance.

7.1 Sustainability strategy

Magyar Telekom's fourth Sustainability Strategy, encompassing the 2016-2020 five-year period, has been compiled in harmony with the Company's other strategies. Its main objective is to make sustainability an integral part of Magyar Telekom's business.

The main directions of creating the new strategy have been influenced by not only the strategic achievements we have already made in the previous period, but also the expectations of responsible investors, EU directives, industrial and corporate trends, as well as local, i.e. Hungarian conditions and consumption patterns.

To achieve that aim, we defined three major areas of focus:

Climate protection

Our goal is to make our customers climate-conscious, too, and to be an authentic and responsible company that helps them along that journey. It is our ambitious objective to generate revenue from our climate protection activities, as the ICT world offers especially great potential for that, at the same time to push Magyar Telekom's actual CO₂ emission below 100,000 tons. In order to achieve the above, in addition to the emission decreasing initiatives, we also need to work on elaborating "green" services specifically.

Education

We want to assume a role in educating the public and our customers. Our goal is to directly or indirectly reach 100,000 people in Hungary with our trainings by the end of the period covered by the strategy. We shall primarily focus these trainings on two areas: programs aimed at eliminating the digital gap and the succession pool of the industry.

Digitally enabled sustainability

- Being a sustainable digital company, it is our clear expectation that our customers should also use sustainable digital services. To that end, we strive to pursue responsible marketing and activities that enable and inspire others, as well as are based on sharing. In this context, our goal is that awareness about Magyar Telekom, as a sustainable company should reach 50%. Awards and recognitions achieved in 2016:
 - CEERIUS sustainability index membership
 - Experience Leader AwardThe Most Innovative Partner Of The Year: T-Systems Hungary
- The survey conducted among the public in 2016 showed that 20.7% of the responders name Magyar Telekom and its offer brands as a company of a leading role in sustainability, while 63% cannot name any companies at all. The concept of sustainability is known by 30% among the public in 2016. 86% of our employees familiar with the concept of sustainability and 64% named Magyar Telekom as a sustainability leader.

7.2 Initiatives concerning stakeholders

In 2016 we organized the Sustainability Roundtable Discussion for the 17th time, the objective of which is to have an open dialogue with our stakeholders for the sake of understanding the demands towards Magyar Telekom, discussing the arising problems, and to provide a suitable background for thinking together and co-operating in building a sustainable future.

In 2008 our Company founded the DELFIN (the word for dolphin in Hungarian) award, which in Hungarian stands for “Award for a Committed, Sustainable, and Innovative Generation”. With the DELFIN award Magyar Telekom wants to promote the idea of a sustainable development and recognize efforts made towards this goal. The award is given to suppliers offering outstanding performance in the field of sustainability, in four categories:

- Support of equal opportunity and promotion of non-discrimination inside and outside the Company;
- Innovation in the interest of sustainability;
- Sustainability education and awareness raising;
- Investment and development related to climate protection.

A jury of experts decides which submitted project should receive the award. The ninth award ceremony took place on June 10, 2016, as part of the Sustainability Roundtable. In 2016, we recognized organizations and businesses promoting sustainable, innovative solutions and sustainability education and awareness raising.

The ninth Sustainability Day event took place on September 24, 2016. The topic of the day was revolving around the chance of smart age. Record number, five thousand visitors attended the event where they participated in panel discussions on the three pillars of sustainability and examined pieces of works submitted to the creative design exhibition as well as exhibitors.

The event presented an opportunity to hand over the Sustainability Media Award for the sixth time by the members of the Sustainability Media Club - established by Magyar Telekom. Awards were distributed in three categories: “Bottom View” - for case studies describing NGO and local community matters, “Wide-angle view” - for the description of nationwide environmental and economic issues and “E-world” - for case studies describing digital education and digital literacy initiatives primarily focusing on children. The award amounted to HUF 500 000 for each category.

In 2016, we continued to sensitize our employees to social issues by organizing volunteer work events. Those interested could join our volunteer efforts as part of the Telekom Smart Digital programs, as well as other program like charitable teambuilding exercises. In 2016 was the first Telekom Volunteer Day, where 1000 employees and their relatives participated and planted 1000 plants. In 2016 1500 colleagues worked 11,412 hours of volunteer work, by means of which a theoretical amount of HUF 53.6 million was thus donated to the society.

In 2016 we continued the “hello holnap!” employee point collection. In the third year of the initiative 2,321 points were collected by 1,017 colleagues. The first three employees who collected the most points were given a Csepel bike voucher.

The children’s protection website of Magyar Telekom dedicated to threats caused by children’s media consumption. The website provides information to parents not only about ICT technologies, devices and content, but also about threats caused by their usage and consumption, as well as possible preventive measures. More details are available on:

http://www.telekom.hu/about_us/society_and_environment/society/protection_of_our_children.

On November 1, 2013, Magyar Telekom introduced its tariff package called “hello holnap!”, which was designed to accommodate specific needs of handicapped people. Since 2014, the tariff package is also available for members of the Hungarian National Autistic Society. In 2016 we renewed the fleet package, by providing more services for lower price. Now, that our subscriber can involve one family member or helper into the package.

We launched the “hello holnap!” mobile app on September 27, 2014, by which we drew attention to Telekom’s sustainability efforts in particular and sustainable lifestyles in general. By using the app, users can collect “hello holnap!” points and donate them, converted into real money by Telekom, to non-governmental organizations of their choice. The success of the mobile application in 2016 is best represented by the fact that it has more than 9,000 downloads and it is one of the most popular Telekom applications.

One pillar of atypical staffing is telework, which is one of the most important sustainability aspects of the Future Work project. Working from home in the framework of the project launched in July 2014 enabled the Company’s employees to save time and mileage. Thus, drivers can relieve the environment of as much as 1.8 million kilometers and ten years of travel.

In 2013 Magyar Telekom was among the first Hungarian companies that supported civilian organizations to cultivate community gardens in empty properties of the Company. In 2015 three community gardens started their operation. One of them, the 2600 square meter “Kerthatár” garden in Soroksári street offers land for 100 gardens. It is one of the biggest of such facilities in Budapest. The initiative ran successfully in the three community garden in 2016 as well.

7.3 Annual Sustainability Report

Magyar Telekom has committed, among other things, to publish reports about its sustainability performance annually. When the reports are compiled the GRI (Global Reporting Initiative) guidelines are applied, thus ensuring compliance with the principle that the reports have to be the cornerstones ensuring transparency and international comparability. Since 2007 Magyar Telekom has prepared reports adhering to the highest level of compliance with international standards each year, thus the 2013 Sustainability Report was the seventh to meet the requirements of the GRI A+ application level.

The 2014 and 2015 Sustainability Report was compiled along the new Fourth-Generation Principles set forth by the Global Reporting Initiative (GRI G4). It was applied on comprehensive level and includes more information about the Company’s sustainability performance. The independent assurance and certification of compliance with the GRI G4 criteria was conducted by PricewaterhouseCoopers along the ISAE 3000 international standard.

Further details on the sustainability performance of the Company can be found in the annual reports available on:
https://www.telekom.hu/about_us/society_and_environment/sustainability_reports

8 ENVIRONMENT PROTECTION

Magyar Telekom as one of the leading info-communication service provider in Hungary – in harmony with its mission – is committed to the idea of sustainable development and within it to the environmental issues. The Company, realizing its role and potential in the information society, contributes to the decrease of negative environmental impacts in Hungary by performing its activities in a regulated and controlled way, fulfilling the EU requirements and complying with international standards. Magyar Telekom’s environmental commitment and responsibilities are published in Magyar Telekom’s Environmental Policy which contains obligations for the Company: https://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_environmental_policy.pdf

Environment and climate protection performance

In 2016, Magyar Telekom procured 201 GWhs of electric power from renewing resources, which is 100% of the Company’s total electric power consumption.

In spring 2016, we relaunched again TeleBike, Magyar Telekom’s employee bike rental system. In 2016, TeleBike offered 53 regular bikes and six electric bikes, which were added to the fleet in 2014. Employees can commute between five sites, the offices of the Company located in Budapest and the sites of T-Systems Magyarország Zrt. In 2016, TeleBike had 1,561 registered users and 5,965 rents. During the year 10,200 kms were ridden and due the system 2 tons of CO₂ emission was eliminated.

We introduced a bonus-malus system based on compliance with or deviation from average emission values of benefit cars. We spent 50% of the amount collected as malus payment by users of cars with emissions above the reference values on decreasing our CO₂

footprint. One of our objectives for 2016 was that we still operate as a carbon neutral company. To this end we purchase electric power from power plants that use renewable energy sources and we entirely carbon-neutralized our fossil energy consumption footprint. With this we achieved that we are the one and only carbon neutral major enterprise in Hungary.

In 2016 Magyar Telekom continued its efforts to operate as an energy effective company. These days instead of solutions that would represent a huge leap forward, the aggregate of several smaller transformation and caring projects may jointly help us to further reduce energy consumption. Our proven ventilation technology has been upgraded this year. We implemented the so-called wardrobe type equipment thereby reduced the operation time of air-conditioners in order to save electric energy. Currently the main objective is to fine-tune the existing solutions. But new solutions are also implemented as a result of the global PSTN (Public Switched Telephone Network) replacement project. With this we take a huge step forward in the field of air conditioner replacement (reducing R22 gas consumption) and we implement lower performance power supply equipment as well. We have replaced our power supply equipment in several huge machine rooms; the improved efficiency rate resulted in millions of savings. A similar magnitude of savings is generated by the replacement of hundreds of smaller power supply units. We continued the merge of fixed line and mobile power supply operations at specific sites. Due to lower consumption we reduced our forecast electricity demand at our service provider. Smart cooling technology also develops quickly and it brings continuous results. This year we also replaced several boilers. The increase of the temperature of machine rooms is managed as a global project from containers to entire exchanges, regardless of their size. The use of temperature resistant accumulators and accumulator coating is a preparatory phase of the project. As a pilot project we equipped four buildings with LED lighting. We also take care of saving water: We installed perlaters in various premises. The investment in this equipment may return within a period of six months. This represents almost 1 million HUF saving per year. For us, the decrease of energy consumption is a global project. We strive to reduce energy consumption directly or indirectly within the frame of every development. This will result in lower consumption figures in the long run.

9 CORPORATE COMPLIANCE

When shaping the compliance program of the Magyar Telekom, the goal was to ensure that the Magyar Telekom pursues its business activity with maximum awareness of and commitment to the compliance with the applicable laws and legal provisions, in accordance with the strictest norms of ethical business conduct. To this end, we issued decrees addressing the potentially arising compliance-related risks, and we apply the procedures set out in these decrees and arrange continuous training courses for our employees related to these procedures. We established clear concise processes to report, examine, follow up and correct suspected cases of non-compliance.

The Corporate compliance program is supervised by the Group compliance officer. The Group compliance officer reports directly to the Audit Committee, and cooperates with the Board of Directors, the Supervisory Board and the management. The Corporate compliance program focuses on the Code of Conduct.

Code of Conduct of the Magyar Telekom contains the summary of the compliance requirement within the company, sets common values of the Company and is a key to the strong position, reputation and successful future of Telekom. The Code of Conduct applies to everyone within the Magyar Telekom from the employees to the members of the Board. In addition, contracted partners of the Magyar Telekom also have to know and accept these values, when registering to the procurement website.

In the year 2010 an external independent party audited the implementation of the Compliance program, and we were awarded a certificate of compliance with the external expectations and of the implementation of the system. The program was revised in 2013, including other related areas as well – such as procurement, internal audit, HR, sales. The audit was not aimed only at the implementation and control of the system in the different areas, but it measured the operational efficiency of the control system. We met the expectations and were awarded by a certificate issued by Ernst&Young as independent external party.

The first distance learning course addressing compliance was started in 2008 in the topic of “Conscious recognition of fraud and corruption”. Since then we have been providing a general eLearning course for our new employees, mandatory for all colleagues joining to the company. The course is completed with the acceptance of the Code of Conduct. Since the start of the program, 65 581 distance learning courses were completed by the employees, related to topics, such as compliance awareness, supplier due diligence, anti-corruption measures, incompatibility or insider trading.

On the top of that, our company has arranged personal training sessions for employees working in professional areas exposed to compliance and abuse related risks – both within the parent company and Hungarian and international subsidiaries – in the topics of organized anti-corruption behavior, screening of contracted partners and rules of giving and accepting gifts.

In 2016 – similarly to the practice of the previous years – risk analyses were conducted with the participation of organizations and subsidiaries of Magyar Telekom Nyrt. Based on the results of the survey, a comprehensive audit was prepared for the potential compliance and abuse risks, the result of which was submitted to the Audit Committee of the Company.

During the year we check the soundness of the reports submitted to our company in connection with unethical behavior, and if necessary, we act on these reports. In case we identify actual abuses, we take care of the necessary and adequate countermeasures. Magyar Telekom published all cases of corruption and the related countermeasures in accordance with the related applicable laws and legal provisions.

10 ECONOMIC ENVIRONMENTS

The telecommunications industry is undergoing a major change globally. Worldwide trends are driving towards an integrated telecommunications, information, media and entertainment market. The increasing need for mobility and interactivity together with local specifics create a new set-up in our economic environment in terms of infrastructure, servicing and new types of business models.

Traditional telco markets are shrinking on midterm. Market for voice services (both mobile and fixed) is saturated resulting in decreasing pricing and revenues. There is an increasing demand for data services driven by content consumption but strong competition puts pressure on prices. The fixed voice market as a major revenue and profit source is declining, mobile has started to follow this trend with stagnant customer base and lower prices. The fixed market is characterized by fixed-mobile integrated bundles, with broadband becoming a core element of service offerings. We expect continued consolidation in the fixed arena with network developments and growing competition. An increasing technology platform-based competition is fueled by the government's Digital Hungary program. The extensive development program aims to cover every household in Hungary with high-speed internet (HSI > 30 Mbit/s) access until the end of 2018. The digitalization of technology, services and education are key pillars of the country's competitiveness and the quality of life of its citizens.

Mobile market characterised by great quality and coverage from network perspective. Meanwhile the mobile voice market is characterized by increasing ratio of flat rate packages; the appearance of new market players is expected with strong impact on the market in mid-term. There is a fierce competition in broadband and content services and the battle for customer contracts has shifted from prices to quality in communication, especially focusing on network coverage and speed. The mobile broadband uptake still fuels the overall mobile market. However, the increasing regulation, in particular the abolishment of roaming fees and the decrease in mobile termination rates, is putting further pressure on market players.

The growing economic in recent years had a positive effect on the households' budget. The growing budgets however are hard to translate into growing telco spending.

11 TARGETS AND STRATEGY

11.1 Outlook

The telecommunications industry is undergoing significant changes globally. We have observed several long-term trends which are changing the structure of the telecommunications market. These long-term trends include changes in technology (e.g., IP-based broadband products and solutions, and cloud based solutions), customer requirements (e.g., increase in mobile usability of content services and terminal devices, 4Play solutions and the growing need for mobile applications) and competition and regulation (e.g. low entry barriers, new business models, convergence in the telecommunications and media broadcast industry).

Magyar Telekom's current plans and outlook are based on our best knowledge and expected circumstances. Nevertheless, we cannot predict the behavior of our competitors. Therefore, a stronger than assumed impact of other operators, new market entrants and new solutions in any country where we are present could result in a negative impact on our business performance.

Each of our business segments is affected by their own unique business environment, and we are subject to circumstances and events that are unforeseen or are beyond our control. The global economy recovered from the crisis but waiting for the impacts of Brexit and Trump effect. Our business environment is largely depends on the monetary policy of the FED, the growth of the Chinese and European economy and the movements of EU funds.

Magyar Telekom is facing several competitive and regulatory risks to growth in 2017: the expected entry of Digi into the mobile market; the ongoing obligation to register for prepaid services; and the prepaid and business mobile segments remaining very competitive. However, as an integrated operator, we believe that we are well positioned to address these challenges by maximizing the telecommunication share of wallet in household spending through further growth in our 4Play Magenta 1 subscriber base and leverage off our HSI network.

By the end of December 2016, more than 2.8 million households were covered by high speed internet, with penetration figures still on an upwards trajectory and the ratio of higher bandwidth package subscribers continuing to grow.

In addition, the SI/IT market is expected to grow further, underpinned by higher EU fund inflows; our intention is to increase our market share through a greater focus on high margin system integration projects.

11.2 Strategy

As a result of our focused strategic efforts, Magyar Telekom maintained its leading position in its Hungarian fixed voice, broadband, pay TV, mobile and ICT businesses in 2016, we successfully improved customer retention and delivered strong volume figures. We built a world class 4g mobile network and massively improved our fixed line HSI coverage in the past years

Based on our improved network capabilities we aim to provide services to all segment and customer on voice, TV broadband and IT markets. The strategic objective in the mid-term is to become more agile, enhance efficiency, simplify the product and services portfolio, increase process automation and online customer servicing. As an integrated provider we continue to deliver a unique customer experience supported by our leading brand and best technology.

While anticipating new competencies required by the changing customer behavior, technological advances, and new business models, we aim to exploit our abilities to become a leader in all digital services around the home for both customers and third parties. We continue to identify and leverage new business opportunities in e-health, cloud, IoT, finance and insurance services, support customer retention and new revenue streams both in the residential and business segments. As a result of the changed market environment we decided to exit from the residential gas market. At the same time, we established a joint venture that provides energy services for business customers in order to improve and optimize our energy operations.

Following our strategy enables us to exploit and develop our extended customer base, improve efficiency and capture growth opportunities in an extended market of information and communications technology and related industries, which secures stable cash generation in the long run.

12 INTERNAL CONTROLS, RISKS AND UNCERTAINTIES

12.1 The presentation of the systems of internal controls and the evaluation of the activity in the relevant period

Magyar Telekom's management is committed to establish and maintain an adequate internal control system to ensure the reliability of the financial reports, and minimize operating and compliance risks. Our internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in conformity with International Financial Reporting Standards (IFRS) as adopted by the European Union.

For the business year 2016 we fully accomplished control documentation and evaluation in the IT supported ICS¹ system. Transaction Level Controls describe the controls built into our business processes that have been designed and operated to ensure that material misstatements in each significant financial account and disclosure within the financial statements are prevented or detected in a timely manner.

Complete evaluation of our internal control system is based on the method established in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The operation of the internal control system is supported also by the independent internal audit function. Beyond tasks regarding the risk based internal audit work plan, contributes to the enhancement of the internal control processes and to the reduction of existing risks through ad-hoc audits. The Internal Audit area follows up the implementation of the measures defined on the basis of the audits. The Supervisory Board and the Audit Committee receive regular reports on the findings of the audits; measures, based on the findings and fulfilment of tasks.



In line with the criteria of the adopted internal control framework, management evaluates the effectiveness of internal control system within each financial year. Management's assessment for 2016 is still in progress, but based on the already available information, we believe that internal control system has been operating effectively to prevent potential material misstatements in the financial statements, and minimize operating and compliance risks.

The Company's shareholders are being informed about the operation of our internal control system through our public reports.

The management and Board of Directors of Magyar Telekom are committed to conduct all business activities of Magyar Telekom according to the highest legal and ethical standards. Based on this commitment the Board of Directors established the Corporate compliance program of Magyar Telekom.

The Corporate compliance program is applicable to all bodies, organizations, employees of Magyar Telekom, and advisors, agents, representatives as well as to all persons and organizations that work on behalf of the Company or its subsidiary.

The Corporate compliance program of Magyar Telekom ensures that the business activities of the Company are conducted with observing and in compliance with the relevant laws to the outmost extent, according to the highest standards of training and commitment. It requires the realization of guidelines and processes that manage potential compliance risks and implement specific processes in order to report, investigate, monitor and correct suspected or actual lack of compliance.

ⁱ Internal Control System

12.2 The utilization of financial instruments, risk management and hedging policies

It is our policy that all disclosures made by us to our security holders and the investment community, are accurate and complete, and fairly present our financial condition and results of operations in all material respects. Such disclosures should be made on a timely basis as required by applicable laws, rules and regulations. To achieve these objectives we developed and have continuously enhanced our risk management policies.

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

In 1999, we established a formal risk management system. This system has been operating in an integrated way with the risk management system of Deutsche Telekom since 2002.

All risks related to material internal and external operations, financial and legal compliance and certain other risks are evaluated and managed by a well-defined internal mechanism. A risk management handbook and an internal regulation on risk management were issued. A risk management course was developed for employees responsible for risk management in all organizational areas. Risk items affecting our operations are reviewed quarterly throughout the Company. All of our subsidiaries, business units, divisions and entities are obliged to identify and report their operational risks on a quarterly basis. After the evaluation of these risks, results are reported to our management, to the Board of Directors and to the Audit Committee.

For the sake of prompt disclosure of all risk items influencing investors' decisions, we enhanced our risk management procedures by adding a new element. We complemented our quarterly risk reporting system with a continuous reporting procedure which requires all of our departments and the Company to report on a real-time basis any new material fact, information or risk that comes to their knowledge. Information thus submitted is monitored and evaluated by the risk management area and the CFO is notified when a new material risk or information is identified.

An internal regulation has been issued to define responsibilities of each employee in risk monitoring and management.

12.3 Risk factors

Our financial condition, results of operations or the trading prices of our shares could be materially adversely affected by any of the risks described below. These risks are not the only risks we face. Additional risks not currently known to us, or risks that we currently regard as immaterial, could also have a material adverse effect on our financial condition, results of operations or the trading prices of our shares.

- Our operations are subject to substantial government regulations, further restrictions related to consumer protection were published; the change of the price setting methodology of already regulated wholesale products and new type of regulated access services are probable, which can result in adverse consequences for our business and results of operations;
- Net neutrality regulation has no defined framework in Hungary yet. Case-by-case decisions of the Regulatory Authority may hinder innovation.
- Mobile providers have to implement roaming fair use policy and cost control over their subscribers. These 'roam like at home' regulation may be a base for fraud and a loss of revenues.
- We are subject to more intense competition in the fixed business due to meeting our competitors on more and more area as a result of the network roll-outs
- Beyond current market players in Hungary, DIGI also acquired 2x5 MHz spectrum block in the 1800 MHz band and 1x20 MHz spectrum block in the 3400-3600 MHz band, and will most probably enter the mobile market as a new player in the first half of 2017;
- Prepaid registration obligation might negatively affect our business
- The future of our current operational model is subject to currently unforeseeable changes in the future business environment;
- Developments in the technology and telecommunications sectors may result in impairment of the carrying value of certain of our assets;
- Our business may be adversely affected by actual or perceived health risks associated with mobile communications technologies;
- System failures could result in reduced user traffic and revenue and could harm our reputation;
- Loss of key personnel could weaken our business;
- Our share price may be volatile, and the ability to sell our shares may be adversely affected due to the relatively illiquid market for our shares and ADSs;
- The value of our investments, results of operations and financial condition could be adversely affected by economic developments in Hungary and other countries;
- Unpredictable changes in the Hungarian tax regulations may have an adverse effect on our results;
- Fluctuations in the currency exchange rate could have an adverse effect on our results of operations;
- Disputes and litigation with regulators, competitors and other parties could have an adverse effect on our results of operations.
- The number of cyber attacks have been evolving at an exponential rate recently worldwide. Although Magyar Telekom provides services with highest security-standards and constantly tests and updates its cyber security countermeasures, it cannot be fully excluded that the Company will be subject of a cyber attack.

12.4 Financial risk factors

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

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

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

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

12.4.1 Market risk

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

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

The fundamentals of Magyar Telekom's financing strategy are established each year by the Board of Directors. The Company's policy is to borrow centrally using a balanced combination of medium term and short term loans, and fixed and floating interest rates on those loans. The Board of Directors has approved two debt protection ratio KPIs, and monitors their fulfillment annually. The Company's Treasury is responsible for implementing the finance policy and for ongoing risk management. The details of foreign exchange, liquidity and counterparty risk management guidelines are determined and monitored by the Company's Treasury continuously.

Magyar Telekom is exposed to interest and foreign exchange (FX) rate risk associated with its interest bearing assets and liabilities and anticipated transactions. As the vast majority of the revenues and expenses of the Hungarian entities arise in HUF, the functional currency of Magyar Telekom is HUF. Consequently, Magyar Telekom's objective is to minimize the level of its financial risk in HUF terms.

For the presentation of market risks, we also provided sensitivity analyses that show the effects of hypothetical changes of relevant risk variables on Profit before tax. These hypothetical changes were modeled to present a reasonably possible change in the relevant risk variables. The periodic effects are determined by relating the hypothetical changes in the risk variables to the balance of financial instruments at the end of the latest reporting period (2016) and the preceding reporting period (2015). The balances at the end of the reporting period are usually representative for the year as a whole; therefore the impacts are calculated using the year end balances. The methods and assumptions used in the sensitivity calculations did not change significantly compared to the previous period. As a result of the still rather volatile international capital and securities markets, higher fluctuations of the FX and interest rates are also possible.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in FX rates. Currency risks primarily arise on financial instruments denominated in a currency that is not the functional currency of the Company. Relevant risk variables are generally all non-functional currencies in which Magyar Telekom has financial instruments.

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

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

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

Sensitivity analysis

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

In HUF millions

| | Profit or loss | |
|-----------------------------|-----------------------|------------------|
| | <u>Strengthening</u> | <u>Weakening</u> |
| At December 31, 2016 | | |
| EUR/HUF (5% movement) | | |
| Loan | (5,546) | 5,546 |
| Swap agreements | 6,041 | (6,041) |
| Net effect | 495 | (495) |
| At December 31, 2015 | | |
| EUR/HUF (5% movement) | | |
| Loan | (3,218) | 3,218 |
| Swap agreements | 3,543 | (3,543) |
| Net effect | 325 | (325) |

(b) Other FX exposure

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

In order to reduce the above exposure, Magyar Telekom occasionally enters into derivative contracts. The positive fair value of the open short term forward positions was HUF 0.1 billion as of December 31, 2016 (2015: HUF 0.1 billion asset). These positions were opened to hedge the FX risks of future FX payments exceeding FX income.

Sensitivity analysis

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

In HUF millions

| | Profit or loss | |
|---|-----------------------|------------------|
| | Strengthening | Weakening |
| At December 31, 2016 | | |
| EUR/HUF (5% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank balances | (655) | 655 |
| Forward agreements | 467 | (467) |
| Net effect | <u>(188)</u> | <u>188</u> |
| USD/HUF (10% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank balances | (588) | 588 |
| Forward agreements | 200 | (200) |
| Net effect | <u>(388)</u> | <u>388</u> |
| EUR/MKD (10% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank balances | (87) | 87 |
| Forward agreements | 0 | 0 |
| Net effect | <u>(87)</u> | <u>87</u> |
| USD/MKD (10% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank balances | 18 | (18) |
| Forward agreements | 0 | 0 |
| Net effect | <u>18</u> | <u>(18)</u> |



In HUF millions

| | Profit or loss | |
|---|----------------|-----------|
| | Strengthening | Weakening |
| At December 31, 2015 | | |
| EUR/HUF (5% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank .. | (1,056) | 1,056 |
| Forward agreements | 1,897 | (1,897) |
| Net effect | 841 | (841) |
| USD/HUF (10% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank .. | (931) | 931 |
| Forward agreements | 63 | (63) |
| Net effect | (868) | 868 |
| EUR/MKD (10% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank .. | (210) | 210 |
| Forward agreements | 0 | 0 |
| Net effect | (210) | 210 |
| USD/MKD (10% movement) | | |
| Net balance of FX denominated trade payables and trade receivables plus bank .. | 22 | (22) |
| Forward agreements | 0 | 0 |
| Net effect | 22 | (22) |

As a result of the volatile international capital and securities markets, even a more than 5% fluctuation of the functional currency HUF against EUR, a more than 10% fluctuation of the functional currency HUF against USD and a more than 10% fluctuation of the functional currency MKD against the EUR and USD is possible as extraordinary market conditions may cause extreme volatility on FX markets.

Interest rate risk

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

Changes in the market interest rates of non-derivative financial instruments with fixed interest rates only affect income if these are measured at their fair value. On the other hand, all financial instruments with fixed interest rates (which are carried at amortized cost) are not subject to cash flow interest rate risk.

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

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

(a) Financial assets

Excess cash of the Company is primarily used to repay loans. Due to the extremely low interest rates, even a reasonably possible change in the interest rates would not have a significant impact on the Company's interest income.

(b) Financial liabilities

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

As the vast majority of debt portfolio is denominated in HUF, or swap agreements are in place so that the loans payable are exposed to changes in HUF interest rates, the Company is mostly exposed to the HUF interest rate fluctuations for its financial liabilities. To control this interest rate risk, a combination of fixed and floating rate debt is used. Fixed interest-bearing debts (including loans swapped to fixed interest and excluding loans swapped to floating interest) made up 76% of the total debt as of December 31, 2016 (2015: 76%).

Cash-flow sensitivity analysis for variable rate instruments

Floating interest-bearing debts (including loans swapped to floating interest and excluding loans swapped to fixed interest) made up 24% of the total debt as of December 31, 2016 (2015: 24%).

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

In HUF millions

| | Profit or loss | |
|-----------------------------------|-----------------------|-----------------------|
| | <u>100bp increase</u> | <u>100bp decrease</u> |
| At December 31, 2016 | | |
| Floating rate instrument | (558) | 558 |
| IR swap | (228) | 228 |
| Cash-flow sensitivity (net) | <u>(786)</u> | <u>786</u> |
| At December 31, 2015 | | |
| Floating rate instrument | (638) | 638 |
| IR swap | (232) | 232 |
| Cash-flow sensitivity (net) | <u>(870)</u> | <u>870</u> |

Price risk

As at December 31, 2015, Magyar Telekom had legally binding agreements on natural gas and electricity purchase, which could be materially affected by risk variables such as energy exchange prices or FX prices, or other indices. In order to minimize the risk deriving from such price changes Magyar Telekom made the necessary economic hedge actions for much of the exposure, therefore no relevant risk remained in this field, as a result no sensitivity information for price risk is disclosed. As Magyar Telekom transferred its business energy operations to E2 from 2016, there were no such agreements as at December 31, 2016. See also Note 8.2 and 14.2.

12.4.2 Credit risk

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

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

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

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

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

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

No financial assets other than trade and other receivables had to be impaired in the reported years, as they are neither past due nor are there any signs of impairment.

There are varying credit checking practices applied across the Company as described below.

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

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

12.4.3 Liquidity risk

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

Prudent liquidity risk management implies maintaining sufficient Cash and cash equivalents and Bank deposits as well as available funding through adequate amount of committed credit lines. The Company's Treasury management aims at maintaining flexibility in funding by keeping committed credit lines available. The undrawn credit lines amounted to HUF 29.7 billion as at December 31, 2016 (2015: HUF 29.0 billion), and the Company also had uncommitted credit lines from Hungarian Banks as at December 31, 2016 and 2015. In addition to the above, Deutsche Telekom confirmed its readiness to finance Magyar Telekom's budgeted financing needs until the end of June 2018.

The following two tables summarize the maturity structure of Magyar Telekom's financial liabilities including the interest payable on those liabilities as of December 31, 2016 and 2015. As the majority of the financial liabilities are paid from the cash generated from the ongoing operations, the maturity analysis of the financial assets as at the end of the reporting periods (in comparison with the financial liabilities) would not be useful, therefore, is not included in the tables below.



| <u>December 31, 2016 (in HUF millions)</u> | <u>Total</u> | <u>within 1 year</u> | <u>1 to 5 years</u> | <u>after 5 years</u> |
|--|--------------|----------------------|---------------------|----------------------|
| Trade payables | 136,623 | 136,623 | - | - |
| Financial liabilities to related parties | 348,842 | 77,082 | 271,760 | - |
| Bank loans | 11,534 | 11,534 | - | - |
| Finance lease liabilities | 12,429 | 3,461 | 4,984 | 3,984 |
| Other financial liabilities | 55,175 | 8,755 | 15,095 | 31,325 |
| Total other financial liabilities | 79,138 | 23,750 | 20,079 | 35,309 |
| Total cash flows | 564,603 | 237,455 | 291,839 | 35,309 |
| <u>Open swap positions' cash flows</u> | | | | |
| Gross cash inflow in EUR million | 389 | 36 | 353 | - |
| Gross cash inflow in HUF million (at spot rate) | 120,987 | 11,197 | 109,790 | - |
| Gross cash outflow in HUF million | (124,137) | (10,655) | (113,482) | - |
| Net cash inflow in HUF million | (3,150) | 542 | (3,692) | - |
| <u>Open forward positions' cash flows</u> | | | | |
| Gross cash inflow in EUR million | 30 | 30 | - | - |
| Gross cash inflow in USD million | 7 | 7 | - | - |
| Total gross cash inflow in HUF million (at spot rate)..... | 11,386 | 11,386 | - | - |
| Gross cash outflow in HUF million | (11,230) | (11,230) | - | - |
| Net cash inflow in HUF million..... | 156 | 156 | - | - |



| <u>December 31, 2015 (in HUF millions)</u> | <u>Total</u> | <u>within 1 year</u> | <u>1 to 5 years</u> | <u>after 5 years</u> |
|---|--------------|----------------------|---------------------|----------------------|
| Trade payables | 140,182 | 140,182 | - | - |
| Financial liabilities to related parties | 392,649 | 145,087 | 205,427 | 42,135 |
| Bank loans | 13,278 | 13,278 | - | - |
| Finance lease liabilities | 15,277 | 4,953 | 6,057 | 4,267 |
| Other financial liabilities | 59,559 | 9,412 | 34,706 | 15,441 |
| Total other financial liabilities | 88,114 | 27,643 | 40,763 | 19,708 |
| Total cash flows | 620,945 | 312,912 | 246,190 | 61,843 |
| <u>Open swap positions' cash flows</u> | | | | |
| Gross cash inflow in EUR million | 234 | 10 | 90 | 133 |
| Gross cash inflow in HUF million (at spot rate) | 73,164 | 3,243 | 28,297 | 41,624 |
| Gross cash outflow in HUF million | (72,833) | (2,914) | (27,438) | (42,481) |
| Net cash inflow in HUF million | 330 | 329 | 859 | (857) |
| <u>Open forward positions' cash flows</u> | | | | |
| Gross cash inflow in EUR million | 121 | 121 | - | - |
| Gross cash inflow in USD million | 2 | 2 | - | - |
| Total gross cash inflow in HUF million (at spot rate) | 38,553 | 38,553 | - | - |
| Gross cash outflow in HUF million | (38,607) | (38,607) | - | - |
| Net cash inflow in HUF million | (55) | (55) | - | - |

The average maturity of Magyar Telekom's debt portfolio was 2.64 years as at December 31, 2016 (2015: 2.46 years). The floating interest payments arising from the financial instruments were calculated using the last interest rates fixed before December 31, 2016 and 2015.

12.3.4 Capital risk management

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

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



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

- Current and non current financial liabilities to related parties
- plus Other current and non current financial liabilities
- less Cash and cash equivalents
- less Other current financial assets

During 2015 and 2016, the Company's mid and long term target as approved by the Board was to maintain a gearing ratio within 30% to 40%. The gearing ratio at December 31, 2016 was 39.3% (2015: 42.9%). The Company paid HUF 15 dividend per share in 2016, and as a result of the improving trend, the Company's Board recommends to declare a HUF 25 dividend per share at the April 2017 Annual General Meeting.

In addition to the above, according to the Hungarian Civil Code, Magyar Telekom Plc. has to ensure that the Company's Equity under local GAAP does not fall below its Common stock, i.e. the total of the reserves should not be negative. The Company is in compliance with this regulation.

13 ANALYSIS OF FINANCIAL RESULTS FOR 2016

13.1 Revenues

13.1.1 Net sales revenues

Net sales revenues decreased from HUF 502,275 million in 2015 to HUF 468,255 million in 2016.

Net export sales increased within net sales revenues by 40.7%, HUF 5,772 million mainly due to the increase of international mobile handset sales.

Net domestic sales decreased by HUF 39,792 million (8.2% decrease) within net sales revenues. The nominal net decrease is due to several positive and negative effects.

The largest decrease occurred in energy revenues from HUF 50,924 million to HUF 6,891 million (86.5% decrease) caused by the whole business of energy trading activity transferred to E2 Hungary Kft.

The mobile non-voice revenues changed from HUF 76,819 million to HUF 82,410 million, resulting in a 7.3% increase, which is mainly due to the higher revenues from Internet services owing to the increasing number of mobile broadband subscribers and the increase of the average revenue per subscriber.

TV services revenues increased from HUF 34,500 million to HUF 36,364 million (5.4% increase) which is caused mainly by the higher number of IP TV subscribers.

The mobil wholesale voice revenues decreased from HUF 8,816 million to HUF 5,445 million, resulting in a 38.2% decrease, which is mainly due to the reduction of roaming revenues.

Fixed line voice-retail revenues decreased to HUF 45,305 million in 2016 compared to HUF 48,964 million in 2015 (7.5% decrease), mainly driven by the lower volume of traffic and the decline in the customer base.

Mobile equipment sales revenues increased from HUF 37,064 million to HUF 40,168 million, which is mainly due to exports to third parties.

Fixed line equipment sales revenues decreased from HUF 6,783 million to HUF 5,376 million, which is due to the declining retail TV, tablet and laptop sales.

13.1.2 Other income

Other income increased from HUF 23,250 million to HUF 30,833 million (32.6% increase) which is due to the growing real estate sales revenue.

13.2 Operating expenses

Operating expenses (including material-type expenses, employee related expenses, depreciation and amortization and other expenses) decreased from HUF 523,530 million in 2015 to HUF 475,299 million in 2016 (9.2% decrease).

Material-type expenses decreased from HUF 286,178 million in 2015 to HUF 240,960 million in 2016 (decrease of 15.8%) which is caused by the decrease of cost of goods sold and costs of mediated services sold.

Cost of goods sold decreased by 26.7%, from HUF 100,240 million to HUF 73,481 million. The significant decrease is due to that the complete energy trade for business customers has been transferred to E2 Hungary Kft. (a joint venture company of Magyar Telekom Plc. and MET Holding AG) from January 1, 2016.

Costs of raw material decreased from HUF 27,406 million to HUF 14,245 million (48 % decrease). The decrease is due to the change in costs of raw material to be capitalized.

Employee related expenses decreased from HUF 67,184 million to HUF 63,850 million, however the depreciation and amortization is increased from HUF 91,125 million to HUF 97,591 million.

Other expenses decreased from HUF 79,043 million in 2015 to HUF 72,898 million in 2016. The decrease is due to the negative effect of receivables forgiven, impairment of inventories and extraordinary depreciation of intangible and tangible assets.

13.3 Financial result

The negative result from financial transactions decreased from HUF 7,390 million in 2015 to HUF 5,331 million in 2016 which is caused by more contrary effects. The result is increased due to the higher dividends received (from HUF 5,495 million to HUF 14,871 million), less interest expense (from HUF 19,820 million to HUF 15,395 million) and the decrease of foreign exchange loss (from HUF 6,646 million to HUF 3,482 million) which only partly be influenced unfavourably the decrease of realized foreign exchange gain (from HUF 11,595 million to HUF 2,556 million) and the impairment of investment in GTS Hungary Kft. (HUF 4,490 million).

14 SUBSEQUENT EVENTS BETWEEN THE END OF THE YEAR AND THE RELEASE OF THE REPORT

14.1 Sale of Crnogorski Telekom A.D.

In January 2017, the Company signed a share purchase agreement with Hrvatski Telekom d.d. for the sale of the total of its 76.53% shareholding in Crnogorski Telekom A.D. for a total consideration of EUR 123.5 million (approximately HUF 38.1 billion). The closing of the transaction also took place in January 2017.

Budapest, February 22, 2017.



Christopher Mattheisen
Chief Executive Officer, Board member



János Szabó
Chief Financial Officer

Declaration

We the undersigned declare that

- the attached annual financial statements which have been prepared in accordance with the applicable set of accounting standards and to the best of our knowledge, gives a true and fair view of the assets, liabilities, financial position and profit or loss of Magyar Telekom Plc. and
- the business report gives a fair view of the position, development and performance of Magyar Telekom Plc., together with a description of the principal risks and uncertainties of its business.

Budapest, April 7, 2017



Christopher Mattheisen
Chief Executive Officer,
Member of the Board



János Szabó
Chief Financial Officer