CONSOLIDATED ANNUAL REPORT

OF MAGYAR TELEKOM TELECOMMUNICATIONS PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2017

EGYÜTT. VELED

CONSOLIDATED FINANCIAL STATEMENTS AND MANAGEMENT REPORT

OF MAGYAR TELEKOM TELECOMMUNICATIONS

PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2017

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CONSOLIDATED FINANCIAL STATEMENTS

OF MAGAYAR TELEKOM TELECOMMUNICATIONS PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2017

PREPARED IN ACCORDANCE WITH

INTERNATIONAL FINANCIAL REPORTING STANDARDS

AS ENDORSED BY THE EUROPEAN UNION (EU IFRS) pwc

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Magyar Telekom Telecommunication Public Limited Company

Report on the audit of the consolidated financial statements

Opinion

We have audited the accompanying consolidated financial statements of Magyar Telekom Telecommunication Public Limited Company. (the "Company") and its subsidiaries (together the "Group") which comprise the consolidated statements of financial position as of 31 December 2017 (in which the total of consolidated statement of financial position is MHUF 1 109 661), the consolidated statements of profit or loss and other comprehensive income (in which the total comprehensive income for the year is profit of MHUF 36 840), the consolidated statement of changes in equity, the consolidated statement of cash flows for the year then ended and the notes to the consolidated financial statements including a summary of the significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and they have been prepared, in all material respects, in accordance with the supplementary requirements of Act C of 2000 on Accounting ("Accounting Act") relevant for the consolidated annual financial statements prepared in accordance with IFRS as adopted by the EU.

Our opinion is consistent with our additional report to the audit committee.

Basis for opinion

We conducted our audit in accordance with Hungarian National Standards on Auditing ("HNSA") 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 consolidated financial statements" section of our report.

We are independent of the Group in accordance with the applicable laws of Hungary, with the Hungarian Chamber of Auditors' Rules on ethics and professional conduct of auditors and on disciplinary process and, for matters not regulated in the Rules, with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board (IESBA Code of Ethics) and we also comply with further ethical requirements set out in these.

The non-audit services that we have provided to the Group, in the period from 1 January 2017 to 31 December 2017, are disclosed in note 21 to the financial statements.

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To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable laws and regulations in Hungary and that we have not provided non-audit services that are prohibited under Article 5 of Regulation of the European Parliament and Committee No 537/2014 and Subsection (1) and (2) of Section 67/A of Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors.

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

Our audit approach

Overview

Materiality	Materiality applied was MHUF 5,100, which is 2,5% of the consolidated EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization)
Group Scoping	In addition to the parent company, Magyar Telekom Telecommunication Plc. we included two subsidiaries in our audit, Makedonski A.D. and T-Systems Magyarország Zrt., which are operating in Macedonia and Hungary. These three companies account for the 97% of the consolidated revenues and for 92% of the consolidated EBITDA.
Key Audit Matters	• Goodwill impairment assessment • Accuracy of revenue recognition due to complex billing systems • Disposal of Crnogorski Telekom A.D. and its presentation in the financial statements

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

Materiality	MHUF 5 100 (2016: MHUF 4 900)
Determination	2,5% of the consolidated EBITDA
Rationale for the materiality benchmark applied	We chose consolidated EBITDA as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most commonly measured by users, and is a generally accepted benchmark in the telecommunication industry. We chose 2,5%, which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector. This is consistent with the basis for our materiality calculation in the previous year.

Group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

We have identified two subsidiaries: Makedonski A.D. operating in Macedonia and T-Systems Magyarország Zrt. operating in Hungary, which, in our view, required an audit of their complete financial information, due to their financial significance to the Group.

For the remaining components we performed analytical review on Group level. This together with additional procedures performed at the Group level, including testing of consolidation journals and intercompany eliminations, gave us the evidence we needed for our opinion on the consolidated financial statements as a whole.

Key audit matters

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

Key audit matter	*How our audit addressed the key audit matter*
Goodwill impairment assessment As at 31 December 2017, goodwill relating to the Hungarian and Macedonian segments amounted to MHUF 192 085 and MHUF 20 199 respectively out of a total goodwill balance of MHUF 212 284.	We agreed the cash flow forecasts used in the impairment assessment to forecasts approved by the board of directors. We considered management's expectations in respect of material impacts of the external environment and planned operational improvements and whether these were

Key audit matter	*How our audit addressed the key audit matter*
Impairment assessments involve significant estimates, as they are sensitive to the change in assumptions (in particular the input variables and the long term growth rate, the discount rate and the assumptions underlying future operating cash flows). The management concluded that there was no need for impairment of goodwill. Details of the nature of the goodwill impairment assessment performed by management are given in notes 3.2 and 10.4 to the financial statements.	appropriately reflected in the cash flow forecasts. We compared actual historical cash flow performance with previous forecasts and determined whether any differences fell within an acceptable range. We independently calculated a weighted average cost of capital with reference to market data and compared the long term growth rate to market data. We assessed the sufficiency of the sensitivity analysis performed by management and performed further sensitivity analysis, primarily focused on changes in operating cash flows. We read notes 3.2 and 10.4 of the consolidated financial statements in order to assess whether they in line with the criteria of the IAS 36. Based on our procedures, we noted no material exceptions and considered management's key assumptions to be within reasonable ranges.
Accuracy of revenue recognition due to complex billing systems The accuracy of revenues recorded is an inherent industry risk. This is because telecommunication 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. Total revenue for the group was MHUF 610 851. Detailed disclosures and related accounting policies are in notes 2.1.2. and 18 of the consolidated financial statements.	We evaluated the relevant IT systems and the design of controls, and tested the operating effectiveness of controls over the: • Capturing and recording of revenue transactions; • Authorization of price changes and the input of those to the billing systems; and • Calculation of amounts billed to the customers. 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 includes customer bills for consumers and corporate customers. We have not identified any material misstatements as a result of our procedures.

Key audit matter	*How our audit addressed the key audit matter*
Disposal of Crnogorski Telekom A.D. and its presentation in the financial statements In January 2017 the Company closed the disposal of its 76,53% investment in Crnogorski Telekom to Hrvatski Telekom d.d. The Group did not have a disposal in the past years, which would have been similar in significance and complexity. As a result of the disposal, the structure of the consolidated financial statements changed due to the discontinuance of the Montenegro segment. The consolidated statements of profit or loss and other comprehensive income and the consolidated statements of cash flows include the positions related to the discontinued operation. The disposed net assets amount to MHUF 47 205, the profit after tax of the discontinued operations is MHUF 9 256. These and the details of the impact of the disposal of Crnogorski Telekom A.D. are disclosed in note 26 to the consolidated financial statements.	We have examined the sales contract related to the transaction, and evaluated whether the accounting of the transaction was presented in the consolidated financial statements accordingly. We have evaluated the elimination of the non-controlling interest and cumulative translation adjustment related to Crnogorski Telekom A.D. We read notes 26 of the consolidated financial statements to assess whether they are in line with the criteria of the IFRS 5 Discontinued operations. We have not identified any material misstatements as a result of our procedures

Other information: the consolidated business report

Other information comprises the consolidated business report of the Group. Management is responsible for the preparation of the consolidated business report in accordance with the provisions of the Accounting Act and other relevant regulations, Our opinion on the consolidated financial statements expressed in the "Opinion" section of our independent auditor's report does not cover the consolidated business report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the consolidated business report and, in doing so, consider whether the consolidated business report is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If based on our work performed we conclude that the consolidated business report is materially misstated we are required to report this fact and the nature of the misstatement.

Based on the Accounting Act, it is also our responsibility when reading the consolidated business report to consider whether the consolidated business report has been prepared in accordance with the provisions of the Accounting Act and other relevant regulations, if any, and to express an opinion on this and on whether the consolidated business report is consistent with the consolidated financial statements.

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 consolidated 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), g) and h) of Subsection (2) of Section 95/B of the Accounting Act has been provided.

As the Company is a public interest entity preparing consolidated financial statements and the conditions in Paragraph a) and b) of Subsection (5) of Section 134 of the Accounting Act are met at the balance sheet date, the Company shall publish a non-financial statement required by Section 95/C in its consolidated business report relating to the companies included in the consolidation. In this respect, we shall state whether the consolidated business report includes the non-financial statement required by Section 95/C, and Subsection (5) of Section 134 of the Accounting Act.

In our opinion, the consolidated business report of the Group, also including the information prepared under Paragraphs e) and f) of Subsection (2) of Section 95/B, is consistent with the consolidated financial statements in all material respects, and the consolidated business report has been prepared in accordance with the provisions of the Accounting Act. As there is no other regulation prescribing further requirements for the consolidated business report, we do not express an opinion in this respect.

We are not aware of any other material inconsistency or material misstatement in the consolidated business report and therefore we have nothing to report in this respect.

We state that the information referred to in Paragraphs a)-d), g) and h) of Subsection (2) of Section 95/B of the Accounting Act has been provided. The consolidated business report includes the non-financial statement required by Subsection (1) of Section 95/C, and Subsection (5) of Section 134 of the Accounting Act.

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

Management is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and to prepare the consolidated financial statements in accordance with the supplementary requirements of the Accounting Act relevant for the consolidated annual financial statements prepared in accordance with IFRS as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated 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 consolidated 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 Group'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 in the consolidated financial statements and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group'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 consolidated 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 Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that gives a true and fair view.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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 consolidated 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.

Report on other legal and regulatory requirements

We were first appointed as auditors of the Group on 31 December 1991. Our appointment has been renewed annually by shareholder resolutions representing a total period of uninterrupted engagement appointment of 26 years.

The engagement partner on the audit resulting in this independent auditor's report is Árpád Balázs.

Budapest, 28 February 2018

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

Árpád Balázs
Statutory auditor
Licence number: 006931

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.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Note	At December 31, 2016	At December 31, 2017
		(in HUF millions)	
ASSETS			
Current assets			
Cash and cash equivalents	4.2.1	10,805	5,399
Trade and other receivables	4.2.2, 12.1	157,645	157,745
Other current financial assets	4.2.3.1	5,104	8,162
Current income tax receivable	6.1	2,225	384
Inventories	7	16,643	17,175
		192,422	188,865
Assets held for sale	8	1,556	162
Total current assets		193,978	189,027
Non current assets			
Property, plant and equipment	9	483,174	458,343
Intangible assets	10	478,263	441,458
Investments in associates and joint ventures	11	1,078	1,324
Deferred tax assets	6.3	73	59
Other non current financial assets	4.2.3.2	18,254	19,323
Other non current assets	12.2	709	127
Total non current assets		981,551	920,634
Total assets		1,175,529	1,109,661
LIABILITIES			
Current liabilities			
Financial liabilities to related parties	4.4.1	72,589	35,191
Other financial liabilities	4.4.2	22,600	8,757
Trade payables	4.4.3	136,623	135,446
Current income tax payable	6.1	719	324
Provisions	13	4,493	3,267
Other current liabilities	14	40,537	43,596
		277,561	226,581
Liabilities associated with assets held for sale	8	-	-
Total current liabilities		277,561	226,581
Non current liabilities			
Financial liabilities to related parties	4.4.1	247,179	231,646
Other financial liabilities	4.4.2	50,098	47,608
Deferred tax liabilities	6.3	8,740	13,743
Provisions	13	9,528	9,231
Other non current liabilities	15	1,090	779
Total non current liabilities		316,635	303,007
Total liabilities		594,196	529,588
EQUITY			
Equity of the owners of the parent			
Common stock		104,275	104,275
Capital reserves		27,890	27,282
Treasury stock		(825)	(2,187)
Retained earnings		375,660	396,320
Accumulated other comprehensive income		31,490	21,505
Total Equity of the owners of the parent		538,490	547,195
Non-controlling interests	16	42,843	32,878
Total equity		581,333	580,073
Total liabilities and equity		1,175,529	1,109,661

Budapest, February 20, 2018

Christopher Mattheisen
Chief Executive Officer, Board member

János Szabó
Chief Financial Officer

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

CONSOLIDATED STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	Note	2016 (re-presented)	2017
		For the year ended December 31, (in HUF millions, except per share amounts)	
Revenues	18	574,035	610,851
Direct costs	19	(212,397)	(245,777)
Employee related expenses	20	(78,878)	(80,240)
Depreciation and amortization	9, 10	(111,310)	(108,174)
Other operating expenses	21	(106,176)	(105,918)
Operating expenses		(508,761)	(540,109)
Other operating income	22	10,911	6,746
Operating profit		76,185	77,488
Interest income	23	471	543
Interest expense	24	(18,564)	(13,525)
Other finance expense - net	25	(8,909)	(8,645)
Net financial result		(27,002)	(21,627)
Share of associates' and joint ventures' net profit	11	78	343
Profit before income tax		49,261	56,204
Income tax	6.2	4,859	(15,958)
Profit for the year from continuing operations		54,120	40,246
Profit for the year from discontinued operations	26.2.1	3,103	9,526
Profit for the year		57,223	49,772
Other comprehensive income			
(Items that are or may be reclassified subsequently to profit or loss):			
Exchange differences on translating foreign operations		(287)	(439)
Revaluation of available-for-sale financial assets		64	19
Other comprehensive income from continuing operations, net of tax		(223)	(420)
Other comprehensive income from discontinued operations, net of tax	26.2.1	(275)	(12,512)
Other comprehensive income for the year, net of tax		(498)	(12,932)
Total comprehensive income from continuing operations		53,897	39,826
Total comprehensive income from discontinued operations	26.2.1	2,828	(2,986)
Total comprehensive income for the year		56,725	36,840
Profit attributable to:			
Owners of the parent		54,279	46,727
From continuing operations		51,876	37,239
From discontinued operations		2,403	9,488
Non-controlling interests		2,944	3,045
From continuing operations		2,244	3,007
From discontinued operations		700	38
		57,223	49,772

	Note	For the year ended December 31, 2016 (re-presented)	2017
		(in HUF millions, except per share amounts)	
Total comprehensive income attributable to:			
Owners of the parent		53,945	36,742
From continuing operations		51,763	36,948
From discontinued operations		2,182	(206)
Non-controlling interests		2,780	98
From continuing operations		2,134	2,878
From discontinued operations		646	(2,780)
		56,725	36,840
Earnings per share (EPS) information:			
Profit attributable to the owners of the Company		54,279	46,727
From continuing operations		51,876	37,239
From discontinued operations		2,403	9,488
Weighted average number of common stock outstanding (thousands) used for basic EPS		1,041,799	1,040,073
Average number of dilutive share options		767	4,585
Weighted average number of common stock outstanding (thousands) used for diluted EPS		1,042,566	1,044,658
Basic earnings per share (HUF)		52.10	44.93
From continuing operations		49.79	35.82
From discontinued operations		2.31	9.11
Diluted earnings per share (HUF)		52.06	44.93
From continuing operations		49.75	35.82
From discontinued operations		2.31	9.11

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Note	For the year ended December 31, 2016 (re-presented)	2017
		(in HUF millions)	
Cashflows from operating activities			
Profit for the year		54,120	40,246
Depreciation and amortization		111,310	108,174
Income tax expense		(4,859)	15,958
Net financial result		27,002	21,627
Share of associates' and joint ventures' result		(78)	(343)
Change in assets carried as working capital		3,653	(17,959)
Change in provisions		(3,115)	(1,581)
Change in liabilities carried as working capital		2,174	21,817
Income tax paid		(11,713)	(10,425)
Dividend received		14	111
Interest and other financial charges paid		(24,252)	(19,949)
Interest received		455	382
Other non-cash items		(5,929)	(647)
Net cash generated from operating activities from continuing operations		148,782	157,411
Net cash generated from operating activities from discontinued operations		6,043	(23)
Net cash generated from operating activities		154,825	157,388
Cashflows from investing activities			
Purchase of property plant and equipment (PPE) and intangible assets	28	(96,396)	(90,800)
Purchase of subsidiaries and business units	29	(128)	(3,791)
Cash acquired through business combinations		-	475
Proceeds from other financial assets		96	3,030
Payments for other financial assets		(184)	(5,897)
Proceeds from disposal of PPE and intangible assets		9,902	2,629
Proceeds from disposal of subsidiaries and business units		3,484	1
Payments for interests in associates and joint ventures		-	-
Net cash used in investing activities from continuing operations		(83,226)	(94,353)
Net cash used in investing activities from discontinued operations		(5,973)	36,292
Net cash used in investing activities		(89,199)	(58,061)
Cashflows from financing activities			
Dividends paid to Owners of the parent and Non-controlling interest		(21,312)	(29,403)
Proceeds from loans and other borrowings	4.4.2.2	143,794	101,310
Repayment of loans and other borrowings	4.4.2.2	(184,217)	(169,042)
Repayment of other financial liabilities	4.4.2.3	(8,347)	(7,485)
Treasury share purchase		(550)	(2,139)
Net cash used in financing activities from continuing operations		(70,632)	(106,759)
Net cash used in financing activities from discontinued operations		(1,703)	2,041
Net cash used in financing activities		(72,335)	(104,718)
Exchange differences on cash and cash equivalents from continuing operations		(26)	(15)
Exchange differences on cash and cash equivalents from discontinued operations		(18)	-
Change in cash and cash equivalents		(6,753)	(5,406)
Cash and cash equivalents, beginning of year		17,558	10,805
Cash and cash equivalents, end of year	4.2.1	10,805	5,399

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	pieces	In HUF millions									
			Capital reserves				Accumulated Other Comprehensive Income				
	Shares of common stock (a)	Common stock (a)	Additional paid in capital (b)	Reserve for equity settled share based transactions (c)	Treasury stock (d)	Retained earnings (e)	Cumulative translation adjustment (f)	Revaluation reserve for AFS financial assets – net of tax (g)	Equity of the owners of the parent	Non-controlling interests (h)	Total Equity
Balance at December 31, 2015	1,042,742,543	104,275	27,379	33	(307)	337,014	31,892	(68)	500,218	44,713	544,931
Dividend declared to Owners of the parent (i)						(15,633)			(15,633)	–	(15,633)
Dividend declared to Non-controlling interests (j)									–	(4,650)	(4,650)
Equity settled share based transactions (c)				478	32				510	–	510
Treasury share purchase (k)					(550)				(550)	–	(550)
Transactions with owners in their capacity as owners		–	–	478	(518)	(15,633)	–	–	(15,673)	(4,650)	(20,323)
Other Comprehensive income							(371)	37	(334)	(164)	(498)
Profit or loss						54,279			54,279	2,944	57,223
Total Comprehensive Income						54,279	(371)	37	53,945	2,780	56,725
Balance at December 31, 2016	1,042,742,543	104,275	27,379	511	(825)	375,660	31,521	(31)	538,490	42,843	581,333
Dividend declared to Owners of the parent(i)						(26,067)			(26,067)	–	(26,067)
Dividend declared to Non-controlling interests (j)									–	(3,320)	(3,320)
Equity settled share based transactions (c)				(608)	777				169	–	169
Treasury share purchase (k)					(2,139)				(2,139)	–	(2,139)
Disposal of subsidiaries (l)									–	(6,743)	(6,743)
Transactions with owners in their capacity as owners		–	–	(608)	(1,362)	(26,067)	–	–	(28,037)	(10,063)	(38,100)
Other Comprehensive income							(9,995)	10	(9,985)	(2,947)	(12,932)
Profit or loss						46,727			46,727	3,045	49,772
Total Comprehensive Income						46,727	(9,995)	10	36,742	98	36,840
Balance at December 31, 2017	1,042,742,543	104,275	27,379	(97)	(2,187)	396,320	21,526	(21)	547,195	32,878	580,073
Of which treasury stock	(4,625,555)										
Shares of common stock outstanding at December 31, 2017	1,038,116,988										

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

NOTES TO THE CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(a) The total amount of issued shares of common stock of 1,042,742,543 (each with a nominal value of HUF 100) is fully paid as at December 31, 2017. The number of authorized ordinary shares on December 31, 2017 is 1,042,742,543.

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 non-resident or foreign 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.

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.

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

(c) Reserve for equity settled share based transactions includes the compensation expenses accrued in this reserve related to share settled compensation programs. See also Note 20.1.2.

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

(e) Retained earnings include the accumulated and undistributed profit of the Group. The distributable reserves of the Company under Hungarian law (Section 5 (b) 114/B of Act C of 2000 on Accounting relating to untied retained earnings available for the payment of dividends) at December 31, 2017 amounted to approximately HUF 424 billion (HUF 262 billion at December 31, 2016).

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

(g) Revaluation reserve for available-for-sale (AFS) financial assets includes the unrealized gains and losses net of tax on available-for-sale financial assets.

(h) Non-controlling interests represent the Non-controlling shareholders' share of the net assets of subsidiaries in which the Group has less than 100% ownership (Note 16).

(i) Dividends payable to the Company's shareholders and to Non-controlling shareholders of the Group's subsidiaries are recorded as a liability and debited against equity (Retained earnings or Non-controlling interests) in the Group's financial statements in the period in which the dividends are approved by the shareholders.

(j) The amount of dividends declared to Non-controlling interests includes predominantly the dividends declared to the Non-controlling owners of Makedonski Telekom (MKT) and Crnogorski Telekom (CT), the Group's subsidiaries.

(k) In 2017 Magyar Telekom Plc. purchased 4,534,758 ordinary shares for the purpose of the new employee incentive program (Note 20.1.2.5). In 2016 Magyar Telekom Plc. purchased 1,252,616 ordinary shares for the purpose of the Employee Share Ownership Program (ESOP) (Note 20.1.2.4), of which the ESOP sold 25,764 shares due to the revision of the number of the participants in the program. These share transactions were carried out on the Budapest Stock Exchange through UniCredit Bank Hungary Zrt., as investment service provider.

(l) 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.. Details of the disposal are disclosed in Note 26.2.1.

Together with the approval of these financial statements for issue, the Board of Directors of the Company proposes a dividend distribution in total HUF 26,069 million to be approved by the Annual General Meeting of the Company in April 2018. In 2017 Magyar Telekom Plc. paid in total HUF 26,067 million dividend.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 GENERAL INFORMATION

1.1 About the Company

Magyar Telekom Telecommunications Public Limited Company (the Company or Magyar Telekom Plc.) with its subsidiaries form Magyar Telekom Group (Magyar Telekom or the Group). Magyar Telekom is the principal provider of telecommunications services in Hungary, Macedonia and Montenegro and alternative service provider in Bulgaria and Romania. These services are subject to various telecommunications regulations depending on the countries of operations (Note 34).

The Company was incorporated in Hungary on December 31, 1991 and commenced business on January 1, 1992. The Company's registered office is Krisztina körút 55., 1013 Budapest, Hungary. Name of the Court of Registration and the registration number of the Company: Metropolitan Court as Court of Registration, Cg. 01-10-041928.

Magyar Telekom Plc. is listed on the Budapest Stock Exchange and its shares are traded on the Budapest Stock Exchange. Magyar Telekom's American Depository Shares (ADSs) each representing five ordinary shares were also traded on the New York Stock Exchange until November 12, 2010, when the ADSs were delisted. Magyar Telekom terminated the registration of its shares and ADSs in the US in February 2012. The Company maintains its American Depositary Receipt program on a Level I basis.

The ultimate controlling parent of Magyar Telekom is Deutsche Telekom AG (DT or DTAG) who fully consolidates Magyar Telekom Group. Deutsche Telekom Europe B.V. (Stationsplein 8, 6221 BT Maastricht, the Netherlands), a member of the Deutsche Telekom Group, is the direct owner of 59.21% of the Company's issued shares and voting rights. The consolidated financial statements of DT AG are available at DT AG's website (www.telekom.com/en), while those of Magyar Telekom Group are available at its registered office and on its corporate website.

The consolidated financial statements are prepared and presented in millions of Hungarian Forints (HUF), unless stated otherwise.

The Company's Board of Directors (the Board) accepted the submission of these consolidated financial statements of the Company on February 20, 2018 to the Annual General Meeting (AGM) of the owners, which is authorized to approve these financial statements, but also has the right to require amendments before approval. As the controlling shareholders are represented in the Board of the Company that accepted the submission of these financial statements, the probability of any potential change required by the AGM is extremely remote, and has never happened in the past.

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

1.2 Composition of the Group

At December 31, 2016 and 2017 the principal operating subsidiaries of the Group were as follows:

Subsidiaries	Group interest in capital as at December 31, 2016	2017		Activity
Incorporated in Hungary:				
T-Systems Magyarország Zrt., Budapest.......	100.00%	100.00%		System integration and IT services
GTS Hungary Kft., Budapest........................	100.00%	0.00%	(a)	Alternative ICT provider
Telekom New Media Zrt, Budapest	100.00%	100.00%		Interactive service provider of telecommunications applications
Incorporated in Macedonia:				
Makedonski Telekom A.D., Skopje (MKT)	56.67%	56.67%		Telecom service provider
Stonebridge A.D., Skopje	100.00%	100.00%		Holding company
Incorporated in Montenegro:				
Crnogorski Telekom A.D., Podgorica (CT) ...	76.53%	0.00%	(b)	Telecom service provider
Incorporated in Romania:				
Combridge S.R.L., Bucharest	100.00%	100.00%		Wholesale telecom service provider
Incorporated in Bulgaria:				
Novatel EOOD, Sofia..................................	100.00%	100.00%		Wholesale telecom service provider

At December 31, 2016 and 2017 the joint ventures of the Group were as follows:

Joint ventures	Group interest in capital as at December 31, 2016	2017	Activity
Incorporated in Hungary:			
E2 Hungary Zrt., Budapest	50.00%	50.00%	Energy services to business customers

(a) In September 2017, GTS Hungary Kft. merged into T-Systems Magyarország Zrt..

(b) 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. The closing of the transaction also took place in January 2017 (Note 26.2.1).

The Group's interest in the capital of the above subsidiaries equals the voting rights therein. There is no significant entity in the Group that is not controlled even though more than half of the voting rights are held. There is one structured entity in the Group that is fully consolidated, see Note 20.1.2.5.

All subsidiary undertakings are included in the consolidation.

1.3 Financial information – impact of re-presentation changes

There were two major changes compared to 2016:

a) as a result of the sale of Crnogorski Telekom (details in Note 26.2.1) the 2016 figures were re-presented and
b) telecom tax was reclassified from Other operating expenses to Direct costs (details in Notes 19 and 21).

The above had no impact on the Statement of financial position and on the Statement of changes in equity.

The table below shows the impacts of these on the 2016 Consolidated Statement of profit or loss and other comprehensive income.

(in HUF millions, except per share amounts)	2016 as reported	Effect of discontinued operations (a)	Effect of reclassification (b)	2016 as re-presented
Revenues	602,651	(28,616)	-	574,035
Direct costs	(196,869)	8,732	(24,260)	(212,397)
Employee related expenses	(83,327)	4,449	-	(78,878)
Depreciation and amortization	(117,476)	6,166	-	(111,310)
Other operating expenses	(136,406)	5,970	24,260	(106,176)
Operating expenses	(534,078)	(3,299)	-	(537,377)
Other operating income	10,990	(79)	-	10,911
Operating profit	79,563	(3,378)	-	76,185
Interest income	760	(289)	-	471
Interest expense	(18,570)	6	-	(18,564)
Other finance expense - net	(9,005)	96	-	(8,909)
Net financial result	(26,815)	(187)	-	(27,002)
Share of associates' and joint ventures' loss	78	-	-	78
Profit before income tax	52,826	(3,565)	-	49,261
Income tax	4,397	462	-	4,859
Profit for the year from continuing operations	57,223	(3,103)	-	54,120
Profit for the year from discontinued operations	-	3,103	-	3,103
Profit for the year	57,223	-	-	57,223
Other comprehensive income (Items that are or may be reclassified subsequently to profit or loss):				
Exchange differences on translating foreign operations	(562)	275	-	(287)
Revaluation of available-for-sale financial assets	64	-	-	64
Other comprehensive income for the year from continuing operations	(498)	275	-	(223)
Other comprehensive income for the year from discontinued operations	-	(275)	-	(275)
Other comprehensive income for the year	(498)	-	-	(498)
Total comprehensive income for the year from continuing operations	56,725	(2,828)	-	53,897
Total comprehensive income for the year from discontinued operations	-	2,828	-	2,828
Total comprehensive income for the year	56,725	-	-	56,725

(in HUF millions, except per share amounts)	2016 as reported	Effect of discontinued operations (a)	Effect of reclassification (b)	2016 as re-presented
Profit attributable to:				
Owners of the parent	54,279	-	-	54,279
From continuing operations	54,279	(2,403)	-	51,876
From discontinued operations	-	2,403	-	2,403
Non-controlling interests	2,944	-	-	2,944
From continuing operations	2,944	(700)	-	2,244
From discontinued operations	-	700	-	700
	57,223	-	-	57,223
Total comprehensive income attributable to:				
Owners of the parent	53,945	-	-	53,945
From continuing operations	53,945	(2,182)	-	51,763
From discontinued operations	-	2,182	-	2,182
Non-controlling interests	2,780	-	-	2,780
From continuing operations	2,780	(646)	-	2,134
From discontinued operations	-	646	-	646
	56,725	-	-	56,725

(in HUF millions, except per share amounts)	2016 as reported	Effect of discontinued operations (a)	Effect of reclassification (b)	2016 as re-presented
Earnings per share (EPS) information:				
Profit attributable to the owners of the Company	54,279	-	-	54,279
From continuing operations	54,279	(2,403)	-	51,876
From discontinued operations	-	2,403	-	2,403
Weighted average number of common stock outstanding (thousands) used for basic EPS	1,041,799	-	-	1,041,799
Average number of dilutive share options (thousands	767	-	-	767
Weighted average number of common stock outstanding (thousands) used for diluted EPS	1,042,566	-	-	1,042,566
Basic earnings per share (HUF)	52.10	-	-	52.10
From continuing operations	52.10	(2.31)	-	49.79
From discontinued operations	-	2.31	-	2.31
Diluted earnings per share (HUF)	52.06	-	-	52.06
From continuing operations	52.06	(2.31)	-	49.75
From discontinued operations	-	2.31	-	2.31

The table below shows the impact of the re-presentation as a result of the discontinued operations on the 2016 Consolidated Statement of cash flows. As the reclassification of the telecom tax had no impact on the Statement of cash flows, this is not presented.

(in HUF millions)	2016 as reported	Effect of discontinued operations (a)	2016 as re-presented
Cashflows from operating activities	154,825	(6,043)	148,782
Cashflows from investing activities	(89,199)	5,973	(83,226)
Cashflows from financing activities	(72,335)	1,703	(70,632)
Exchange differences on cash and cash equivalents	(44)	18	(26)
Cashflows from continuing operations	(6,753)	1,651	(5,102)
Net cash generated from operating activities from discontinued operations	-	6,043	6,043
Net cash used in investing activities from discontinued operations	-	(5,973)	(5,973)
Net cash used in financing activities from discontinued operations	-	(1,703)	(1,703)
Exchange differences on cash and cash equivalents from discontinued operations	-	(18)	(18)
Cashflows from discontinued operations	-	(1,651)	(1,651)
Change in cash and cash equivalents	(6,753)	-	(6,753)
Cash and cash equivalents, beginning of year	17,558	-	17,558
Cash and cash equivalents, end of year	10,805	-	10,805

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The consolidated financial statements of Magyar Telekom have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU). All standards and interpretations endorsed by the EU effective as at December 31, 2017 and applicable to Magyar Telekom had been adopted. These consolidated financial statements also comply with the Hungarian Accounting Act on consolidated financial statements, which refers to the IFRS as endorsed by the EU.

The consolidated financial statements are presented in millions of HUF unless stated otherwise.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3.

2.1.1 Standards, significant amendments and interpretations effective and adopted by the Group in 2017

None.

2.1.2 Standards, amendments and interpretations that are not yet effective and have not been early adopted by the Group

Certain new accounting standards, interpretations and their amendments have been published that are not mandatory for 31 December 2017 reporting periods and have not been early adopted by the Group. The Group's assessment of the impact of these new standards and interpretations is set out below.

Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 9 Financial Instruments	IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting. In December 2011, in November 2013 and in July 2014, the IASB amended the standard in order to make further changes to the classification and measurement rules and also introduced a new impairment model. These latest amendments now complete the new financial instruments standard.	The adoption of the new standard and its amendments will not result in material changes in the financial statements of the Group. ▪ The new provisions on the classification of financial assets will give rise to changes in measurement and presentation of certain debt instruments failing to meet the „solely payments of principal and interest" (SPPI) criterion. ▪ The new provisions on the accounting of impairment losses will lead to expected losses having to be expensed earlier in some cases. Application of the simplified approach also for financial assets with a significant financing component will lead to a minor increase in impairment losses (HUF 0.8 billion). The impairment losses on contract assets to be recognized for the first time as of January 1, 2018 in accordance with IFRS 15 is disclosed with the effects of IFRS 15.	The application of the new standard and its amendments is required for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The European Union has endorsed the standard and its amendments.

Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 15 Revenue from Contracts with Customers	The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and new guidance for multiple-element arrangements.	The adoption of the new standard will result in significant changes in the financial statements of the Group, primarily in respect of the timing of revenue recognition and in respect of capitalization of costs of obtaining a contract with a customer and contract fulfilment costs. ▪ In the case of multiple-element arrangements (e.g., mobile contract plus handset) with subsidized products delivered in advance, a larger portion of the total remuneration is attributable to the component delivered in advance (mobile handset), requiring earlier recognition of revenue in future. This leads to the recognition of what is known as a contract asset – a receivable arising from the customer contract that has not yet legally come into existence – in the statement of financial position. ▪ At the same time, it results in higher revenue from the sale of goods and merchandise and to lower revenue from the provision of services. ▪ In the future, expenses for sales commissions (customer acquisition costs) must be capitalized and recognized over the estimated customer retention period. ▪ On first-time application of the standard, both total assets and shareholders' equity will increase due to the capitalization of contract assets and customer acquisition costs. ▪ Deferral, i.e., later recognition of revenue in cases where "material rights" are granted, such as offering additional discounts for future purchases of further products. ▪ Contract liabilities (which, as deferred revenue, were already recognized as liabilities in the past) must be netted against the contract assets for each customer contract.	The application of the new standard is required for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The European Union has endorsed this standard.

		▪ For the purposes of determining whether Magyar Telekom sells products for its own account (principal = gross revenue) or for the account of others (agent = net revenue), it is unlikely that there will be any material change. ▪ Magyar Telekom will utilize the option for simplified initial application, i.e., contracts that are not completed by January 1, 2018 will be accounted for as if they had been recognized in accordance with IFRS 15 from the very beginning. The cumulative effect arising from the transition will be recognized as an adjustment to the opening balance of equity in the year of initial application. Prior-year comparatives will not be adjusted; however an explanation of the reasons for the changes in items in the statement of financial position and the income statement for the current period will be provided as a result of applying IFRS 15 for the first time. The effects were analyzed in a Group-wide project on implementation of the new standard. Based on management's current estimate, the changeover to the new standard is expected to result in a cumulative increase in retained earnings of HUF 19 billion before taxes. As a consequence, HUF 1.9 billion income tax will arise. This effect will be mainly attributable to the first-time recognition of ▪ Contract assets (HUF 14 billion) that, under IFRS 15, would have led to the earlier recognition of revenue from the sale of goods and merchandise, and ▪ Deferred customer acquisition costs (HUF 5 billion) that, under IFRS 15, would have resulted in the later recognition of selling expenses. ▪ As regards to the new standard's impact on the consolidated income statement, Magyar Telekom expects the overall share of revenue from the provision of services to decrease, and the overall share of revenue from the sale of goods and merchandise to	

		increase by between 1 and 3 percentage points with respect to total revenue. As described, IFRS 15 means revenue will be recognized earlier and expenses will be recognized later for contracts not yet concluded by January 1, 2018. However, as the accounting effects of the changeover to the new standard will be recognized directly in equity, the only effects on profit or loss in 2018 will be related to changes in the point in time at which revenue and expenses are realized. On the assumption that business development remains unchanged, this will mean the following for a mass market characterized by a large number of customer contracts that are being concluded at different points in time: ▪ For existing contracts, lower service revenues and higher selling expenses from the amortization of capitalized contract assets and customer acquisition costs will be largely compensated for by ▪ higher revenue, on the conclusion of new contracts, from the sale of goods and lower selling expenses from the capitalization of contract assets and customer acquisition costs. Compared with the current accounting method, major effects on earnings can thus arise only if business development changes, for example, if volumes or prices change or if there are changes to business models or products offered.	

Title of standard	Nature of change	Impact on consolidated financial statements	Application date and EU endorsement
IFRS 16 Leases	IFRS 16 requires entities when they are a lessee, to ▪ recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments on the statement of financial position, initially measured at the present value of non-cancellable lease payments (including inflation-linked payments), and payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease; ▪ recognize amortization of right-of-use assets and interest on lease liabilities over the lease term; and ▪ separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the statement of cash flows.	The most significant effect of IFRS 16 will be an increase in right-of-use assets and lease liabilities, the extent of which will have to be determined after thorough analysis. The Group mainly leases cell sites, rooftops, office buildings and retail shops, line and access networks, space on masts or towers and cars that will be affected by the new standard. Details of the Group's leases (including lease commitments) are disclosed in note 17. On the lessor (sell) side, MT Group will mainly have to analyze the extent of which multiple element arrangements with embedded leases may be affected by the revised definition of leases. Other than that, we do not expect a considerable impact on the financial statements of the Group at this time, as lessor accounting itself is not changing significantly through the introduction of IFRS 16.	An entity is required to apply IFRS 16 for annual periods beginning on or after 1 January 2019 and permits to apply the new Leases Standard early, if the entity also applies IFRS 15 Revenue from Contracts with Customers at or before the date of early application. The European Union has endorsed this standard.

There are no other standards or amendments that are not yet effective and that would be expected to have a material impact on the Group in the current or future reporting periods and on foreseeable future transactions.

2.2 Consolidation

2.2.1 Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

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

Subsidiaries are consolidated from the date on which control is transferred to the Group, and are no longer consolidated from the date control ceases. The acquisition method of accounting is used to account for business combinations. The cost of an acquisition is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition whereby costs directly attributable to the acquisition are expensed. The excess of the cost of acquisition over the fair value of the net assets and contingent liabilities of the subsidiary acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized in the Profit for the year (Other operating income).

If applicable, the Group recognizes at the acquisition date a liability for any contingent purchase consideration. If the amount of contingent consideration accounted for as a liability changes as a result of a post-acquisition event (such as meeting an earnings target), it is recognized in accordance with other applicable IFRSs as appropriate rather than as an adjustment of goodwill.

As for the measurement of non-controlling interest, the Group may recognize 100% of the goodwill of the acquired entity, not only the Group’s portion of the goodwill. This is elected on a transaction-by-transaction basis. The Group attributes their share of losses to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

In a step acquisition, the fair values of the acquired entity's assets and liabilities, including goodwill, are measured on the date when control is obtained. Accordingly, goodwill is measured as the difference at the acquisition date between the fair value of any investment the business held before the acquisition, the consideration transferred and the fair value of the net asset acquired and non-controlling interest is recorded at fair value when the Group elects the fair value option.

In case of acquisitions where the transaction takes place between companies under common control (i.e. with other Deutsche Telekom Group companies), the transaction is recorded at the carrying amounts as recorded in the selling owner’s accounts, and any gains, losses or differences between the carrying amount and the sale-purchase price are recognized in Retained earnings. The consolidated financial statements include the results of subsidiaries acquired from parties under common control from the date of the closing of the transaction.

A partial disposal of an investment in a subsidiary while control is retained is accounted for as an equity transaction with owners, therefore gain or loss is not recognized in profit or loss for such disposals.

A partial disposal of an investment in a subsidiary that results in loss of control triggers re-measurement of the residual interest to fair value. Any difference between fair value and carrying amount is a gain or loss on the disposal, recognized in profit or loss (Other income).

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

There is one structured entity in the Group that is fully consolidated, see Note 20.1.2.5.

2.3 Foreign currency translation

2.3.1 Functional and presentation currency

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

The consolidated financial statements are presented in millions of HUF, as the Group’s presentation currency is the Hungarian Forint.

2.3.2 Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the Profit for the year (Other finance expense – net).

2.3.3 Group companies

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

- For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date are incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at the date of acquisition. The fair value adjustments resulting from the purchase price allocation and goodwill are accounted for in HUF for acquisitions before March 31, 2004, after which date these adjustments arising on consolidation are accounted for in the functional currency of the subsidiary.
- Assets and liabilities for each Statement of financial position presented are translated at the closing rate at the date of that Statement of financial position.
- Items of Profit or loss and other comprehensive income are translated at annual cumulated average exchange rates.
- All resulting exchange differences are recognized in the consolidated equity (Cumulative translation adjustment). When a foreign operation is fully or partially disposed of so that control is given up, exchange differences that were recorded in equity until the date of the sale are recognized in the Profit for the year as part of the gain or loss on sale (Other operating income).

2.4 Comparative information

In order to maintain consistency with the current year presentation in the Financial statements and the Notes thereto, certain items have been reclassified for comparative purposes. Material changes in disclosures, if any, are described in detail in the relevant notes.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the prevailing circumstances. The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, rarely equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are outlined below.

3.1 Useful lives of assets

The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technological development and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions. We believe that this is a critical accounting estimate since it involves assumptions about technological development in an innovative industry and heavily dependent on the investment plans of the Group. Further, due to the significant weight of depreciable assets in our total assets, the impact of any changes in these assumptions can be material to our financial position, and results of operations. As an example, if Magyar Telekom was to shorten the average useful life of its assets by 10%, this would result in additional annual depreciation and amortization expense of approximately HUF 12 billion (2016: HUF 12 billion). See Notes 9 and 10 for the changes made to useful lives in 2017.

The Group constantly introduces a number of new services or platforms including, but not limited to, the 3G and 4G based broadband services in the mobile communications and the fiber-to-the-home rollout in the fixed line operations. In case of the introduction of such new services, the Group conducts a revision of useful lives of the already existing platforms, but in the vast majority of the cases these new services or assets are designed to co-exist with the existing platforms, resulting in no change-over to the new technology. Consequently, the useful lives of the existing platforms usually do not require shortening.

3.2 Estimated impairment of goodwill

Goodwill is not amortized, but tested for impairment annually or more frequently. The recoverable amounts of the operating segments are calculated based on fair value less cost to sell determined by the discounted projected cash flows of the operating segments over the next ten years with a terminal value. This is highly judgmental, which carries the inherent risk of arriving at materially different recoverable amounts if estimates used in the calculations proved to be inappropriate. The Group has an implemented policy to make the impairment test based on a 10-year cash flow projection on reasonable and supportable assumptions that present the management's best estimate on market participants' assumptions and expectations. We use 10 year cash flow projections as the payback period of our investments in the telecommunications operations often exceeds 5 years.

In order to determine the recoverable amounts of the operating segments, the Group calculates the operating segments' fair values less cost to sell. In the calculations, Magyar Telekom uses a range of weighted average cost of capital (WACC) and estimated perpetual growth rate (PGR) depending on the country of operations and the characteristics of the markets the Group's segments operate in. The WACCs are determined based on CAPM (capital asset pricing model) using the average betas of the peer group, 10 year zero coupon yields and a debt ratio in line with the usual indebtedness of listed peer telecommunications companies, while the PGRs used are in line with the long-term average growth rate for the particular segment.

Costs of certain central functions that are not cross charged are also considered in the fair value calculations, when conducting the goodwill impairment tests. The costs of these central functions are allocated to the operating segments based on the segments' revenue share of the Group's total revenue.

Goodwill is allocated to the operating segments of the Group: MT-Hungary and Macedonia in 2017 and MT-Hungary, Macedonia and Montenegro in 2016. Magyar Telekom's reporting structure changed in 2017 as a result of the disposal of Crnogorski Telekom AD, which made up the Montenegro segment. See also Note 26.2.1.

In 2017 and 2016, no goodwill had to be impaired. Details of the carrying amounts of goodwill allocated to the segments are in Note 10.4.

The tables below show the WACCs and PGRs used in the fair value calculations of the Group's operating segments for the goodwill impairment test conducted in 2017 and 2016. The tables below also include sensitivity analyses that show how much impairment would have been recognized as at December 31, 2017 or 2016 for the goodwill allocated to the operating segments if we changed the sensitive parameters in the calculations.

In 2017 we disclose what impact a 4 percentage point increase of the WACC would have on the goodwill. In case of the PGRs we disclose what impact a 8 percentage point decrease of the PGR would have on the goodwill. In case of the cash flow projections we disclose what impact a 20% or a 40% lower than projected cash flow stream would have on the goodwill.

2017	**MT-Hungary**	**Macedonia**
WACC		
Used in the calculation	6.39%	6.77%
If changed to	10.39%	10.77%
Potential impairment (HUF million)	-	7,095
PGR		
Used in the calculation	1.0%	1.0%
If changed to	-7.0%	-7.0%
Potential impairment (HUF million)	-	2,063
Cash-flow		
If changed by	-20%	-20%
Potential impairment (HUF million)	-	-
If changed by	-40%	-40%
Potential impairment (HUF million)	-	2,297

In 2016 we disclosed what impact a 2 percentage point increase of the WACC would have on the goodwill. In case of the PGRs we disclosed what impact a 5 percentage point decrease of the PGR would have on the goodwill. In case of the cash flow projections we disclosed what impact a 10% or a 25% lower than projected cash flow stream would have had on the goodwill.

2016	MT-Hungary	Macedonia	Montenegro
WACC			
Used in the calculation	6.68%	7.17%	9.70%
If changed to	8.68%	9.17%	11.70%
Potential impairment (HUF million)	-	6,128	1,104
PGR			
Used in the calculation	1.0%	1.0%	0.0%
If changed to	-4.0%	-4.0%	-5.0%
Potential impairment (HUF million)	-	9,877	261
Cash-flow			
If changed by	-10%	-10%	-10%
Potential impairment (HUF million)	-	-	-
If changed by	-25%	-25%	-25%
Potential impairment (HUF million)	-	7,050	4,755

The table below shows what changes can be observed in the 10 year plans prepared in 2016 compared to those prepared in 2017.

	MT-Hungary	Macedonia	Montenegro
Cumulative average growth rate of revenues during the 10 years compared to 2017	0.9%	0.3%	n.a.
Cumulative average growth rate of revenues during the 10 years compared to 2016	n.a.	-0.1%	-0.6%
Cumulative average growth rate of EBITDA during the 10 years compared to 2017	1.2%	1.3%	n.a.
Cumulative average growth rate of EBITDA during the 10 years compared to 2016	n.a.	1.7%	0.1%
Cumulative average growth rate of Capex during the 10 years compared to 2017	3.2%	-3.3%	n.a.
Cumulative average growth rate of Capex during the 10 years compared to 2016	n.a.	0.0%	-11.8%

Magyar Telekom's management believes that preparing the value in use (VIU) calculation was unnecessary, since it would have resulted in a lower value than the FVLCS. The VIU method is assuming a model without future investments, meaning that additional capex and related revenues and gains to be recognized in the future cannot be considered in the calculations. Assuring the revenues on long term in a telecom business very much depends on future investments. In Magyar Telekom on average only approximately 20%

of the capex spent in a year is related to maintenance. Others are new investments, also related to providing new connections to the network. It is obvious, that without this the revenue generation would start to decline sharply on a long term. Consequently, we did not prepare the value in use calculations for any of the segments.

3.3 Estimated impairment of trade and other receivables

We calculate impairment for doubtful accounts receivable based on estimated losses resulting from the inability of our customers to make required payments. For the largest customers and other telecommunications service providers, impairment is calculated on an individual basis, while for other customers it is estimated on a portfolio basis, for which we base our estimate on the aging of our accounts receivable balance and our historical write-off experience, customer credit-worthiness and recent and expected changes in our customer payment terms. These factors are reviewed annually, and changes are made to the calculations when necessary. In addition, we consider also the nature of the business (residential, business, fixed line, mobile, internet, cable TV, etc.) and the environment in which the Group's entities operate in the various markets. If the financial condition of our customers were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the impairment losses recognized so far. See also Note 5.1.2.

3.4 Subscriber acquisition and retention costs

Subscriber acquisition and retention costs primarily include the loss on the equipment sales (revenues and costs disclosed separately) and fees paid to subcontractors that act as agents to acquire new customers or retain the existing subscribers. The Group's agents also spend a portion of their agent fees for marketing the Group's products, while a certain part of the Group's marketing costs could also be considered as part of the subscriber acquisition and retention costs. The up-front fees collected from customers for activation or connection are marginal compared to the incremental acquisition and retention costs. These revenues and costs are recognized when the customer is connected to the Group's fixed or mobile networks. No such costs or revenues are capitalized or deferred. These acquisition and retention costs (losses) are recognized immediately as they are not accurately separable from other marketing costs. Among these, net losses on equipment sales of the Group amounted to HUF 18.2 billion in 2017 (2016: HUF 18.1 billion). In addition, agent fees amounted to HUF 6.1 billion in 2017 (2016: HUF 7.1 billion), while the Group's marketing costs amounted to HUF 11.4 billion in 2017 (2016: HUF 12.6 billion).

3.5 Annual fees of mobile licenses

Magyar Telekom's primary activities are the fixed line and mobile operations in Hungary, Macedonia and Montenegro. These services are in most cases regulated by these countries' laws or other legislations. These services in most cases require the acquisition of a license or concession, which usually requires a one-off fee and annual payments. It is judgmental whether we consider the annual fees to be reliably estimable or not. If we consider that we can reliably estimate these annual fees, the present value of those are capitalized as part of the cost of the license, otherwise these are recognized as costs in the period they relate to.

As the conditions of the new license contract concluded in Hungary in 2014 and 2013 (see Note 34.1) substantially changed compared to the old ones, in addition to the initial cost of the new frequencies in 2014 (HUF 59 billion) and the renewal of the old ones in 2013 (HUF 38 billion) we also recognized the discounted present value of the future annual license fees (HUF 39 billion in 2014 and HUF 17 billion in 2013).

In 2013 Magyar Telekom concluded an Authority Contract with the National Media and Infocommunications Authority (NMIAH) on the prolongation of the then existing 900 MHz and 1800 MHz frequencies until April, 2022. The Contract included provisions on lowering the annual fee of these and the 2100 MHz bands in the form of a legislation. The reduction of the annual fees was a result of the Hungarian mobile operators' years of interest enforcement efforts as former fees were far higher than the European average. The probability of the modification of these Authority Contract based fees prior to the expiry of the term has become very low as the parties agreed in all terms and provisions of the contract, including the reduced fees of the bands, until 2022. It would be unprecedented that the annual fees change prior to the expiry of the term of the contract. While the mobile operators took significant efforts prior to the recent amendment to reduce the fees, the lowered fees in the newly concluded contract are more favorable for MT than the fee in the authority decree. Based on the same consideration, the mobile operators also initiated the reduction of the fees of those bands that were outside the scope of the modification of the Authority Contract. The fee of the 2100 MHz band, which can be used until 2019, was reduced by 50% pursuant to the relevant National Media and Infocommunications Authority decree and this was such an extensive reduction that it makes the revision of the fees until the expiry of the contracts in 2019 very unlikely. The mobile operators had reached their objectives as the annual fee obligation was significantly reduced and it is now aligned to the EU trends.

The Authority Contract concluded between the Company and the NMIAH in October 2014 on the use of the new 800MHz, 900 MHz and 1800 MHz frequency bands also includes annual fees that are in line with the ones achieved in 2013, i.e. we considered them reliably estimable to capitalize their discounted present value as part of the cost of the license.

In 2016 Crnogorski Telekom concluded a Contract with the Agency for Electronic Communications and Postal Services of Montenegro (the Agency) on the prolongation of the then existing 900 MHz, 1800 MHz, 2100 MHz and 1900 MHz frequencies until 2031. In addition, Crnogorski Telekom won the rights of use of the 800 MHz FDD and 2600 MHz FDD and TDD frequency blocks in the tender for spectrum licences. See also Note 10. In total the one-off license fee was EUR 27.3 million (approximately HUF 8.5 billion) which was paid in 2016. As this agreement also included annual fees that we considered reliably estimable, their discounted present value was capitalized as part of the cost of the license.

In case of the other frequency license fees of the Group, we did not consider the annual fees to be reliably estimable at the time of acquisition, therefore, those were not capitalized.

4 FINANCIAL INSTRUMENTS

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets of the Group include cash and cash equivalents, equity instruments of another entity (available-for-sale) and contractual rights to receive cash (trade receivables) or another financial asset from another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity (derivatives).

Financial liabilities of the Group include liabilities that originate from contractual obligations to deliver cash or another financial asset to another entity (non-derivatives); or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity (derivatives).

Financial liabilities, in particular, include liabilities to banks and related parties, finance lease payables, trade payables and derivative financial liabilities and other financial liabilities.

4.1 Financial assets – accounting policies

The Group classifies its financial assets in the following categories:

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

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

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

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Any gains or losses on derecognition are recognized in Profit for the year and are calculated as the difference between (a) the sum of the consideration received and any cumulative gain or loss that had been recognised in other comprehensive income and (b) the carrying amount derecognized.

4.1.1 Impairment of financial assets

The Group assesses at each financial statement date whether there is objective evidence that a financial asset is impaired. There is objective evidence of impairment if as a result of loss events that occurred after the initial recognition of the asset have an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Impairment losses of financial assets are recognized in the Profit for the year against allowance accounts to reduce the carrying amount until the derecognition of the financial asset.

(a) Financial assets measured at amortised cost

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it is assessed collectively for impairment. Assets that are individually assessed for impairment and for which an impairment loss is recognized are not included in a collective assessment of impairment. Collective assessment is carried out by grouping together assets with similar risk characteristics.

Individual assessment of impairment is carried out for debtors under litigation; bankruptcy proceedings and for the total receivables of customers with more than 1 year overdue receivables. Individual assessment is also performed in special circumstances, if there is an overdue receivable from any designated customer with different credit risk attributes.The carrying amount of loans and receivables, which would otherwise be past due, whose terms have been renegotiated is not impaired if the collectability of the renegotiated cash flows are considered ensured.

In assessing collective impairment, the Group uses historical information on the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than suggested by historical trends. The Group's benchmark policy for collective assessment of impairment of trade and other receivables is based on the aging of the receivables due to the large number of relatively similar type of customers.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the loss is recognized in the Profit for the year.

Impairment loss on cash and cash equivalents and bank deposits with original maturities over 3 months and its reversal are recognized in the Profit for the year (Other finance expense – net). Impairment loss on trade and other receivables and its reversal are recognized in Direct costs in the Profit for the year (Bad debt expense). Impairment losses on Employee loans and any reversal is recognized in the Profit for the year (Employee related expenses).

If the amount of impairment loss subsequently decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), then the previously recognised impairment loss is reversed through the Profit for the year by adjusting the allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in the Profit for the year as a reduction to Direct costs (Bad debt expense).

When the Group considers that there are no realistic prospects of recovery of the asset (i.e. uncollectible), the relevant amounts are written off. The amounts written off and subsequent recoveries of amounts previously written off are recognised in the same line item of the Statement of profit or loss as the impairment losses.

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

Impairment losses on available-for-sale financial assets are recognised by reclassifying the losses accumulated in the Revaluation reserve for AFS financial assets to the Profit for the year (Other finance expense – net). The amount reclassified is the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in the Profit for the year. If the fair value of an impaired available-for-sale debt security subsequently increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through th Profit for the year (Other finance expense – net).

Impairment losses recognised in Profit for the year for an investment in an equity instrument classified as available-for-sale are not reversed through the Profit for the year.

4.1.2 Financial assets at fair value through profit or loss

The "financial assets at fair value through profit or loss" measurement category includes the following financial assets:

- Financial assets incurred for the purpose of selling immediately or in the near term and thus classified as "held for trading"
- Derivative financial assets not involved in an effective hedge relationship are classified as "held for trading"

Assets in this category are normally classified as current assets (Other current financial assets). Derivatives aimed to hedge the cash flow risk of non current financial instruments are classified as non current assets (Non current financial assets).

No reclassification between categories has been made in the past and no reclassifications are expected in the future.

Assets in this category are initially recognized and subsequently carried at fair value. Gains or losses arising from changes in the fair value are recognized in the Profit for the year (Other finance expense – net) in the period in which they arise. The Group only classifies derivative financial instruments in this category.

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and their fair values are re-measured at subsequent financial statement dates. Magyar Telekom does not apply hedge accounting for its financial instruments, therefore all gains and losses are recognized in the Profit for the year (Other finance expense – net).

4.1.3 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables are included in current assets, except those with maturities over 12 months after the financial statement date. These are classified as Non-current financial assets.

The following items are assigned to the "loans and receivables" measurement category:

- cash and cash equivalents
- bank deposits with original maturities over 3 months
- trade receivables
- employee loans
- other receivables

Loans and receivables are initially recognized at fair value plus any directly attributable transaction costs and subsequently carried at amortized cost using the effective interest method, less any impairment.

(a) Cash and cash equivalents

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

(b) Bank deposits with original maturities over 3 months

Bank deposits with original maturities over 3 months include bank deposits and other liquid deposits and securities with original maturities over three months.

(c) Trade and other receivables

Trade receivables include the receivables for the services rendered and goods sold from the customers of the Group while other receivables mainly include advances and prepayments.

(d) Employee loans

Employee loans are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less any impairment loss.

The difference between the nominal value of the loan granted and the initial fair value of the employee loan is recognized as prepaid employee benefits (Other non current assets). Interest income on the loan granted calculated by using the effective interest method is recognized as Interest income, while the prepaid employee benefits are amortized to Employee related expenses evenly over the term of the loan.

4.1.4 Available-for-sale (AFS) financial assets

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

The AFS measurement category includes:

- equity instruments that are neither consolidated nor included using the equity method in the consolidated financial statements
- debt instruments

AFS financial assets are initially recognized and also subsequently carried at fair value. The unrealized changes in the fair value of AFS financial assets are recognized in Accumulated other comprehensive income (Revaluation reserve for AFS financial assets).

Interest on AFS debt securities calculated using the effective interest method is recognized in the Profit for the year (Interest income). Dividends on AFS equity instruments are recognized in the Profit for the year (Interest income) when the Group's right to receive payments is established.

4.2 Financial assets in the statement of financial position

4.2.1 Cash and cash equivalents

Cash and cash equivalents include cash on hand and in banks, and all highly liquid deposits and securities with original maturities of three months or less, and exclude all overdrafts. These financial assets are exposed to credit risks, for which see more details in Note 5.1.2. No impairment had to be recognized for any of these balances in the reported years.

In HUF millions	**At December 31,**	
	2016	**2017**
Cash on hand	111	175
Cash in bank (demand deposits)	7,398	3,807
Bank deposits with original maturities less than 3 months	3,296	1,417
	10,805	5,399

Average interest rates	**At December 31,**	
	2016	**2017**
Cash on hand	0.00%	0.00%
Cash in bank (demand deposits)	0.03%	0.09%
Bank deposits with original maturities less than 3 months	0.35%	0.35%
Average interest rate	0.13%	0.16%

Cash and cash equivalents by currency	At December 31,	
In HUF millions	2016	2017
HUF	2,768	1,865
MKD	3,706	1,703
EUR	3,568	784
RON	290	594
USD	453	411
Other	20	42
	10,805	5,399

Cash and cash equivalents by country of location	At December 31,	
In HUF millions	2016	2017
Macedonia	4,778	2,643
Hungary	3,317	2,064
Montenegro	2,261	-
Other countries	449	692
	10,805	5,399

4.2.2 Trade receivables

4.2.2.1 Trade receivables – carrying amounts

		At December 31,	
In HUF millions		2016	2017
Trade receivables from third parties		135,885	135,082
Trade receivables from Deutsche Telekom Group companies		10,744	9,029
Trade receivables from associates and joint ventures		77	326
Total trade receivables	(a)	146,706	144,437

(a) Age profile of Trade receivables

The following tables show the age profile of the Group's trade receivables by country of operation by days outstanding (past due). The carrying amounts of past due receivables are shown net of impairment losses charged as of the financial statement dates.

In HUF millions	Carrying amount as of Dec 31, 2017	of which not past due	of which past due by					
			less than 30 days	30-60 days	61-90 days	91-180 days	181-360 days	over 360 days
Hungary	130,277	113,727	10,208	2,261	1,143	961	529	1,448
Macedonia	13,365	9,853	1,570	482	278	352	444	386
Montenegro	-	-	-	-	-	-	-	-
Other countries	795	634	76	24	11	30	14	6
Total	144,437	124,214	11,854	2,767	1,432	1,343	987	1,840

In HUF millions	Carrying amount as of Dec 31, 2016	of which not past due	of which past due by					
			less than 30 days	30-60 days	61-90 days	91-180 days	181-360 days	over 360 days
Hungary	121,398	104,746	11,116	1,713	627	878	946	1,372
Macedonia	15,459	11,477	1,117	379	203	1,018	660	605
Montenegro	8,882	6,306	1,152	376	291	324	308	125
Other countries	967	746	64	28	24	4	101	0
Total	146,706	123,275	13,449	2,496	1,145	2,224	2,015	2,102

The vast majority of trade receivables is impaired on a portfolio basis. The vast majority of past due trade receivables is partly or fully impaired depending on the period of delay of payments. Only insignificant amounts of past due trade receivables are not impaired based on past experience of payment behavior of certain business and governmental customers. As these amounts are not significant, these are not disclosed separately.

Non past due receivables (except for receivables arising from installment sales) are not assessed collectively for impairment, but in case of bankruptcy of the customer or defaults on installment payments non past due receivables may have to be partly or fully impaired, the amount of which is not significant, therefore, not disclosed separately. The non past due trade receivables represent approximately 2.4 months of revenue (2016: 2.6 months of revenue). As disclosed in Note 5.1.2, the annual bad debt expense of the Group is approximately 0.9 percent of the annual consolidated revenue (2016: 1.4%), therefore, we can estimate that approximately this percentage of the non past due portion of trade receivables will not be collected, i.e. will have to be impaired in future periods, but are not impaired at the end of the reporting period. In case of installment receivables from mobile equipment sales impairment is recognized on receivables not due yet.

The Group has no collaterals related to its trade receivables.

4.2.2.2 Impairment losses of trade receivables

The table below shows the impairment losses and changes therein for 2016 and 2017.

In HUF millions	At December 31,	
	2016	2017
Impairment loss, beginning of period	36,471	37,590
Charged to expense – net (included in Direct costs)	8,508	5,575
Translation difference	(77)	(41)
Impairment losses of acquired companies on acquisition	-	-
Decrease of impairment losses due to sale of subsidiary	-	(6,301)
Utilized	(7,312)	(6,787)
Impairment loss, end of period	37,590	30,036

The line Charged to expense - net includes also this type of change in impairment related to Crnogorski Telekom AD which was considered as discontinued operation in 2017 (see also note 26.2.1).

The carrying amount of trade receivables that would otherwise be past due or impaired whose terms have been renegotiated is not material therefore no separate disclosure is provided on those.

The amount of trade receivables that are individually determined to be impaired is not material, therefore, these are not disclosed separately.

The table below includes the impairment losses and the changes therein in 2016 and 2017 for the countries of operation of the Group.

In HUF millions	At December 31, 2015	Charged to expense	Translation difference (and rounding)	Impairment losses of acquired companies on acquisition	Utilized (1)	At December 31, 2016
Hungary	21,362	7,453	2	-	(7,016)	21,801
Macedonia	9,205	293	(37)	-	(91)	9,370
Montenegro	5,865	628	(40)	-	(205)	6,248
Other countries	39	134	(2)	-	-	171
Group	36,471	8,508	(77)	-	(7,312)	37,590

(1) Utilized means reversed on derecognition (settlement, write-off or factoring).

In HUF millions	At December 31, 2016	Charged to expense	Translation difference (and rounding)	Decrease of impairment losses due to sale of subsidiary	Utilized (1)	At December 31, 2017
Hungary	21,801	4,742	1	-	(6,472)	20,072
Macedonia	9,370	774	(36)	-	(293)	9,815
Montenegro	6,248	55	-	(6,301)	(2)	-
Other countries	171	4	(6)	-	(20)	149
Group	37,590	5,575	(41)	(6,301)	(6,787)	30,036

(1) Utilized means reversed on derecognition (settlement, write-off or factoring).

See also Note 5.1.2 for further analysis of credit risks related to Trade receivables.

4.2.3 Other financial assets

Other financial assets include receivables due within 12 months (current) and due after 12 months (non current) from the financial statement date. These financial assets are exposed to credit risks, for which see more details in Note 5.1.2. The impairment loss accounted or reversed for other current and non current financial assets is not material.

4.2.3.1 Other current financial assets

In HUF millions		At December 31, 2016	At December 31, 2017
Bank deposits with original maturities over 3 months	(a)	950	3,523
Finance lease receivable	(b)	602	246
Loans and receivables from employees	(c)	800	325
Derivative financial instruments contracted with related parties	(d)	1,505	2,978
Derivative financial instruments contracted with third parties	(e)	-	-
Other		1,247	1,090
		5,104	8,162

(a) Bank deposits with original maturities over 3 months were deposited in Macedonia predominantly in euro. They amounted to HUF 3,523 million as at December 31, 2017 (2016: HUF 950 million).

4.2.3.2 Other non current financial assets

In HUF millions		At December 31, 2016	2017
Finance lease receivable	(b)	594	346
Loans and receivables from employees	(c)	4,226	1,429
Trade receivables over one year	(f)	8,763	16,690
Derivative financial instruments contracted with related parties	(d)	3,763	-
Financial assets available for sale	(g)	309	325
Other		599	533
		18,254	19,323

(b) See Note 17.2.1 for more information on Finance lease receivable.

(c) Loans and receivables from employees primarily represent the housing loans provided to the employees of the Group. There are no significant past due employee receivables, and the loans are pledged with mortgage.

(d) Derivative financial instruments contracted with related parties include the fair value of open currency forwards and cross-currency interest rate swaps (see more details in Note 5.1.1.1 and 5.1.1.3).

(e) Derivative financial instruments contracted with third parties include the fair value of open currency forwards, cross-currency interest rate swaps and commodity price swaps (see more details in Note 5.1.1.1).

(f) Trade receivables over one year include receivables from customers paying over 1-2 years in installments for telecommunications equipment sold. The impairment losses of trade receivables over one year amounted to HUF 1,358 million as at December 31, 2017 (2016: HUF 741 million).

(g) Financial assets available for sale include insignificant investments in equity securities.

4.3 Financial liabilities – accounting policies

There are two measurement categories for financial liabilities used by the Group:

- Financial liabilities carried at amortized cost
- Financial liabilities at fair value through profit or loss

No reclassification between categories has been made in the past and no reclassifications are expected in the future. Both types of financial liabilities are initially recognized at fair value, while subsequent measurements are different (see below). We derecognize a financial liability (or a part of a financial liability) from the Statement of financial position when, and only when, it is extinguished – i.e. when the obligation specified in the contract is discharged, cancelled or expired.

4.3.1 Financial liabilities carried at amortized cost

The measurement category for “financial liabilities measured at amortized cost” includes all financial liabilities not classified as “at fair value through profit or loss”.

(a) Loans and other financial liabilities

Loans and other financial liabilities are recognized initially at fair value less transaction costs, and subsequently measured at amortized costs using the effective interest rate method. The effective interest is recognized in the Profit for the year (Interest expense) over the period of the liabilities.

(b) Trade and other payables

Trade and other payables (including accruals) are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

4.3.2 Financial liabilities at fair value through profit or loss

The Group currently has no intention of measuring non-derivative financial liabilities at fair value, therefore, only derivative financial instruments are assigned to this category.

The Group does not apply hedge accounting, therefore, all derivatives are measured at fair value through profit or loss.

Derivatives are initially recognized at fair value at the date a derivative contract is entered into and their fair values are re-measured at subsequent balance sheet dates. Magyar Telekom does not apply hedge accounting for its financial instruments, therefore all gains and losses are recognized in the Profit for the year (Other finance expense – net).

4.4 Financial liabilities in the statement of financial position

4.4.1 Financial liabilities to related parties

Financial liabilities to related parties include HUF and EUR denominated loans taken from DT Group. In addition, for the whole nominal amount and interest payment of loans denominated in EUR granted by DTIF we have cross-currency interest rate swap agreements in place (with DT AG) so that Magyar Telekom's exposure in fact remains in HUF. The loans and the related swap agreements are accounted for and disclosed on a gross basis. These loans were primarily taken for significant acquisitions in the past and for dividend payments. These loans, when expiring, are also refinanced by DT, depending on the actual financing need of Magyar Telekom.

The tables below show the details of the financial liabilities towards Deutsche Telekom Group members as at December 31, 2017 and 2016.

December 31, 2017	Carrying amount in HUF millions	Lender	Currency	Effective Interest rate (%)	Fixed / floating	Maturity	Original Term
	15,555	DTIF	EUR	4.08	fixed	Nov 2018	7 years
	12,982	DT AG	HUF	0.30	floating	Cashpool	N/A
	(97)	DT AG	EUR	0.00	floating	Cashpool	N/A
	468	DT AG	USD	1.48	floating	Cashpool	N/A
Due within 1 year	28,908						
Accrued interest	6,034						
Derivatives	249						
Total current	35,191						
	35,000	DT AG	HUF	5.89	fixed	Mar 2019	5 years
	20,000	DT AG	HUF	4.98	fixed	Jun 2019	5 years
	50,000	DT AG	HUF	4.33	fixed	Oct 2019	5 years
	35,000	DT AG	HUF	3.83	fixed	Jun 2020	5 years
	40,626	DTIF	EUR	1.99	fixed	Jan 2021	6 years
	45,657	DTIF	EUR	1.60	fixed	Jul 2021	5 years
Non current	226,283						
Derivatives	5,363						
Total non current	231,646						

December 31, 2016	Carrying amount in HUF millions	Lender	Currency	Effective Interest rate (%)	Fixed / floating	Maturity	Original Term
	15,000	DT AG	HUF	2.86	fixed	Apr 2017	2 years
	7,192	DTIF	EUR	3.71	fixed	May 2017	6 years
	38,866	DT AG	HUF	0.70	floating	Cashpool	N/A
	3,736	DT AG	EUR	0.28	floating	Cashpool	N/A
	1,698	DT AG	USD	0.72	floating	Cashpool	N/A
Due within 1 year	66,492						
Accrued interest	6,097						
Derivatives	-						
Total current	72,589						
	15,652	DTIF	EUR	4.08	fixed	Nov 2018	7 years
	35,000	DT AG	HUF	5.89	fixed	Mar 2019	5 years
	20,000	DT AG	HUF	4.98	fixed	Jun 2019	5 years
	50,000	DT AG	HUF	4.33	fixed	Oct 2019	5 years
	35,000	DT AG	HUF	3.83	fixed	Jun 2020	5 years
	40,838	DTIF	EUR	1.99	fixed	Jan 2021	6 years
	47,237	DTIF	EUR	1.60	fixed	Jul 2021	5 years
Non current	243,727						
Derivatives	3,452						
Total non current	247,179						

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

In HUF millions	At December 31, 2016		2017	
	Book value	Fair value	Book value	Fair value
HUF denominated loans				
At fixed rate	155,000	173,972	140,000	154,475
At floating rate	38,866	38,866	12,982	12,981
	193,866	212,838	152,982	167,456
EUR denominated loans				
At fixed rate	110,919	120,669	101,838	109,122
At floating rate	3,736	3,736	(97)	(97)
	114,655	124,405	101,741	109,025
USD denominated loans				
At fixed rate	-	-	-	-
At floating rate	1,698	1,698	468	468
	1,698	1,698	468	468
Accrued interest	6,097	6,097	6,034	6,034
Derivatives	3,452	3,452	5,612	5,612
Total related party financial liabilities	319,768	348,490	266,837	288,595

The weighted average interest rate on related party loans was 3.44% in 2017 (3.06% in 2016). The fixed interest rate loans are exposed to fair value risk as it can be seen in the table above. Any decrease of market interest rates will result in an increase of the fair value of the fixed interest rate liabilities.

The aggregate balance of the cashpool is a liability which also included cashpool receivables (HUF 97 million) as at December 31, 2017.

Derivatives contracted with related parties include cross-currency interest rate swaps and FX forwards concluded with DT AG to change the Group's exposure to HUF in case of the EUR denominated loans and to cover FX needs of expected future foreign currency outflows.

There were no defaults or breaches in connection with the financial liabilities to related parties.

4.4.2 Other financial liabilities

4.4.2.1 Other financial liabilities - Balances

The table below shows the current balances of Other financial liabilities.

In HUF millions		At December 31, 2016	2017
Bank loans	(a)	11,501	-
Annual frequency fee payable	(b)	3,275	3,492
Debtor overpayment		1,180	1,110
Finance lease payable	(c)	2,344	882
Building exchange payable	(d)	952	15
Other		3,348	3,258
Total other financial liabilities – current		22,600	8,757

The table below shows the non current balances of Other financial liabilities.

In HUF millions		At December 31, 2016	2017
Annual frequency fee payable	(b)	45,215	41,722
Finance lease payable	(c)	3,478	3,291
Other		1,405	2,595
Total other financial liabilities – non current		50,098	47,608

There were no defaults or breaches in connection with other financial liabilities.

(a) Bank loans

The Group had no revolving loans at December 31, 2017. (Loans totaling HUF 11,500 million at December 31, 2016 were revolving loans which could be prepaid at any time and drawn down in one to six month rolling periods. The weighted average interest rate on bank loans was 0.95% in 2016.)

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

In HUF millions	At December 31,			
	2016		2017	
	Book value	Fair value	Book value	Fair value
HUF denominated bank loans				
At fixed rate	-	-	-	-
At floating rate	11,500	11,500	-	-
	11,500	11,500	-	-
Accrued interest	1	1	-	-
Total bank loans	11,501	11,501	-	-

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

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

(b) Annual frequency fee payable

On October 15, 2014 Magyar Telekom and the NMIAH signed the Authority Contract for the use of the 800 MHz, 900 MHz and 1800 MHz frequency bands that came into force on that day. Magyar Telekom acquired the frequency usage rights in the above listed spectrums till June 15, 2034. See Note 34.1 for more details of the agreement. This agreement provides sufficient basis for a reliable estimate of the future annual fees payable related to these Hungarian frequency licenses, as a result of which the present value of the annual fees payable (HUF 39,038 million) was recognized as part of the carrying amount of the licenses as intangible assets, with corresponding current and non current financial liabilities falling due from 2015 to 2034.

On September 6, 2013 Magyar Telekom and the NMIAH signed the modification of the Authority Contract for the use of the 900 MHz and 1800 MHz frequency bands. See Note 34.1 for more details of the agreement. This agreement provides sufficient basis for a reliable estimate of the future annual fees payable related to these Hungarian frequency licenses, as a result of which the present value of the annual fees payable (HUF 17,332 million) was recognized as part of the carrying amount of the licenses as intangible assets, with corresponding current and non current financial liabilities falling due from 2014 to 2022.

(c) Finance lease payable

See Note 17.2.2 for the details of finance leases.

(d) Building exchange payable

The Group entered into a real estate transaction in Macedonia in 2012, by which four old buildings were exchanged for a new one. The difference between the cost of the new building (HUF 10.7 billion) and the trade-in value of the old buildings (HUF 6.9 billion) was payable in six yearly instalments, the present values of which were recognized as current and non current financial liabilities.

4.4.2.2 Proceeds/repayments of loans and other borrowings

Cash payments for regular bank loans and related party loans are included in the Repayment of loans and other borrowings line of the Statements of cash flows.

4.4.2.3 Repayment of other financial liabilities

Repayment of other financial liabilities in the Statements of cash flows includes the cash payments for other financial liabilities as disclosed below.

	For the year ended December 31,	
In HUF millions	**2016**	**2017**
Annual frequency fee payable	2,989	3,188
Finance lease payable	3,989	1,878
Building exchange liability	887	937
Other	482	1,482
Repayment of other financial liabilities	8,347	7,485

4.4.2.4 Additional disclosure about changes in liabilities arising from financing activities

As a result of the 2016 January amendment of IAS 7, the below additional disclosures are provided in order to enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment is required to be applied for annual periods beginning on or after January 1, 2017 and it was endorsed by the EU in November 2017.

The following table includes changes in net debt reconciled with their effects on the Consolidated statement of cash flows.

In HUF millions	Opening					Changes affecting cash flows from financing activities					Closing
	Balance at January 1, 2017	Changes in cash and cash equivalents	Changes affecting cash flows from operating activities	Changes in financial liabilities without cash movement	Changes affecting cash flows from investing activities	Proceeds from loans and borrowings (continuing operation)	Proceeds from loans and borrowings (discontinued operation)	Repayment of loans and other borrowings	Repayment of other financial liabilities	Other	Balance at December 31, 2017
Related party loans	316,316		(1,665)	(2,438)		97,516	2,041	(150,545)			261,225
Derivatives from related parties	3,452			5,512	(3,352)						5,612
Bank loans	11,501		(1)	3,203		3,794		(18,497)			-
Payable for building exchange transaction	952								(937)		15
Frequency fee payable	48,490		(88)						(3,188)		45,214
Finance lease liabilities	5,822			229					(1,878)		4,173
Debtors overpayment	1,180		(70)								1,110
Other financial liabilities	4,753		(135)	2,717					(1,482)		5,853
-Less cash and cash equivalents	(10,805)	5,406									(5,399)
-Less other current financial assets	(5,104)		564	(3,421)	(201)						(8,162)
Net debt	**376,557**	**5,406**	**(1,395)**	**5,802**	**(3,553)**	**101,310**	**2,041**	**(169,042)**	**(7,485)**	**-**	**309,641**
Treasury share purchase										(2,139)	
Dividends paid to Owners of the parent and Non-controlling interest										(29,403)	
Net cash used in financing activities										**(104,718)**	

4.4.3 Trade payables

In HUF millions	At December 31, 2016	At December 31, 2017
Payable to DT Group companies	16,156	12,026
Payable to associates and joint ventures	1,720	23
Other trade payables	118,747	123,397
	136,623	135,446

4.5 Additional disclosures on financial instruments

4.5.1 Financial assets and liabilities

The Group classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1)
- inputs other than quoted prices included within Level 1 observable for the asset or liability, either directly or indirectly (Level 2)
- inputs for the asset or liability that are not based on observable market data (Level 3)

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The significance of an input is assessed against the fair value measurement in its entirety.

There was no transfer between Level 1 and Level 2 financial instruments. Loans and receivables and most of the financial liabilities are measured at amortized cost, but fair value information is also provided for these. The fair values of these assets and liabilities were determined using level 3 type information. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques, mainly by applying the discounted cash flow method. The cash flow estimations are based on the relevant underlying contracts and the discount rates are calculated based on the interest rate benchmarks applicable for the relevant maturities and currencies (BUBOR, BIRS, EURIBOR, EUR swap yields). Foreign exchange conversion is made based on central bank FX fixings (preferably that of the Central Bank of Hungary). There are no assets or liabilities carried at fair value where the fair value was determined using level 3 type information.

The tables below include the carrying amounts and fair values of the Group's financial assets and liabilities as at December 31, 2017 and 2016.

4.5.1.1 Financial assets – Carrying amounts and fair values

December 31, 2017 In HUF millions	Carrying amount Loans and receivables	Held-to-maturity	Available-for-sale (Level 1)	FVTPL (Level 2)	Total	Fair value
Cash and cash equivalents	5,399	-	-	-	5,399	5,399
Bank deposits with original maturities over 3 months	3,523	-	-	-	3,523	3,523
Trade receivables within one year	144,437	-	-	-	144,437	144,437
Trade receivables over one year	16,690	-	-	-	16,690	17,814
Loans and receivables from employees	1,754	-	-	-	1,754	1,897
Derivative financial instruments contracted with related parties	-	-	-	2,978	2,978	2,978
Finance lease receivable	592	-	-	-	592	629
Financial assets AFS	-	-	325	-	325	325
Other current	1,090	-	-	-	1,090	1,090
Other non current	533	-	-	-	533	765
Total	174,018	-	325	2,978	177,321	178,857

December 31, 2016 In HUF millions	Carrying amount Loans and receivables	Held-to-maturity	Available-for-sale (Level 1)	FVTPL (Level 2)	Total	Fair value
Cash and cash equivalents	10,805	-	-	-	10,805	10,805
Bank deposits with original maturities over 3 months	950	-	-	-	950	950
Trade receivables within one year	146,706	-	-	-	146,706	146,706
Trade receivables over one year	8,763	-	-	-	8,763	9,316
Loans and receivables from employees	5,026	-	-	-	5,026	5,027
Derivative financial instruments contracted with related parties	-	-	-	5,268	5,268	5,268
Finance lease receivable	1,196	-	-	-	1,196	1,230
Financial assets AFS	-	-	309	-	309	309
Other current	1,247	-	-	-	1,247	1,247
Other non current	599	-	-	-	599	439
Total	175,292	-	309	5,268	180,869	181,297

Loans and receivables are measured at amortized cost, while available-for-sale and held-for-trading assets are measured at fair value.

Fair value through profit or loss assets include derivative financial instruments, the fair values of which are based on a discounted cash flow method. The calculation is prepared by Magyar Telekom based on money market interest rate curves, basis swap points and spot FX rates from Reuters database published at the last working day of the reporting period. The present value of the expected future cash flows are discounted to the reporting date using money market interest rates and basis swap points in the specific currency from Reuters and exchanged to HUF using spot FX rate. The difference between the HUF present value of the payable and receivable is accounted for as assets or liabilities.

The carrying values of assets measured at amortized cost with short times to maturity approximate their fair values.

Financial assets available for sale include insignificant investments in equity instruments, all measured at fair value, which is the Macedonian stock exchange price of the equity instruments.

4.5.1.2 Financial liabilities – Carrying amounts and fair values

December 31, 2017	Carrying amount		Total	Fair value
In HUF millions	Measured at amortized cost	FVTPL (Level 2)		
Financial liabilities to related parties	261,225	5,612	266,837	288,595
Trade payables	135,446	-	135,446	135,446
Payable for building exchange transaction	15	-	15	15
Frequency fee payable	45,214	-	45,214	55,130
Finance lease liabilities	4,173	-	4,173	9,009
Debtors' overpayment	1,110	-	1,110	1,110
Other current	3,258	-	3, 258	3, 258
Other non current	2,595	-	2,595	2,590
Total	453,036	5,612	458,648	495,153

December 31, 2016	Carrying amount		Total	Fair value
In HUF millions	Measured at amortized cost	FVTPL (Level 2)		
Financial liabilities to related parties	316,316	3,452	319,768	348,490
Bank loans	11,501	-	11,501	11,501
Trade payables	136,623	-	136,623	136,623
Payable for building exchange transaction	952	-	952	952
Frequency fee payable	48,490	-	48,490	53,051
Finance lease liabilities	5,822	-	5,822	9,305
Debtors' overpayment	1,180	-	1,180	1,180
Other current	3,348	-	3,348	3,348
Other non current	1,405	-	1,405	1,452
Total	525,637	3,452	529,089	565,902

Derivatives are measured at fair value, while all other financial liabilities are measured at amortized cost.

Additional fair value information on the loans and other borrowings is provided in Notes 4.4.1 and 4.4.2.

The carrying values of the current financial liabilities measured at amortized cost approximate their fair values.

FVTPL liabilities include derivative financial instruments, the fair values of which are calculated the same way as FVTPL assets disclosed above in Note 4.5.1.1.

4.5.2 Items of income, expense, gains and losses arising on financial instruments

The tables below include income, expense, gains and losses arising on financial instruments in 2017 and 2016.

2017 In HUF millions	From interest	From subsequent measurement			From derecog-nition	From fee expense	Total net gain / (loss)
		Change in fair value	Currency translation	Impair-ment loss			
Available-for-sale financial assets (Level 1)	-	19	-	-	-	-	19
FVTPL financial instruments (Level 2)	-	(4,448)	-	-	(325)	-	(4,773)
Loans and receivables	327	-	(161)	(5,520)	-	(4,813)	(10,167)
Financial liabilities measured at amortized cost	(12,091)	-	1,268	-	-	(42)	(10,865)
Net gain/(loss) on financial instruments	(11,764)	(4,429)	1,107	(5,520)	(325)	(4,855)	(25,786)

2016 In HUF millions	From interest	From subsequent measurement			From derecog-nition	From fee expense	Total net gain / (loss)
		Change in fair value	Currency translation	Impair-ment loss			
Available-for-sale financial assets (Level 1)	-	63	-	-	-	-	63
FVTPL financial instruments (Level 2)	-	(3,961)	-	-	(127)	-	(4,088)
Loans and receivables	389	-	(536)	(7,880)	-	(4,824)	(12,851)
Financial liabilities measured at amortized cost	(17,298)	-	563	-	-	(35)	(16,770)
Net gain/(loss) on financial instruments	(16,909)	(3,898)	27	(7,880)	(127)	(4,859)	(33,646)

The tables above include the amounts before capitalization of borrowing costs (See Note 24).

Impairment losses on Loans and receivables includes all expenses incurred or expected to be incurred in relation to the default of our customers. Before writing off or factoring, we impair the receivables to their recoverable amounts through the use of an impairment provision account, as a result of which the actual write-off or factoring of these receivables results in no derecognition gains or losses.

4.5.3 Offsetting financial assets and financial liabilities

For the financial assets and liabilities subject to enforceable netting arrangements, each agreement between the Group and the counterparty (typically roaming and interconnect partners) allows for net settlement of the relevant trade receivable and payable.

The following trade receivables and trade payables are subject to offsetting agreements, and are presented after netting in the Consolidated statements of financial position.

In HUF millions	At December 31, 2016		At December 31, 2017	
	Trade and other receivables	Trade payables	Trade and other receivables	Trade payables
Gross amounts of recognized financial instruments............	160,926	139,904	160,750	138,451
Gross amounts of financial instruments set off....................	(3,281)	(3,281)	(3,005)	(3,005)
Net amounts of recognized financial instruments presented in the statement of financial position.....................................	157,645	136,623	157,745	135,446

4.5.4 Other disclosures about financial instruments

Magyar Telekom is also exposed to risks that arise from the possible drawdown of guarantees in a nominal amount of HUF 10.7 billion as at December 31, 2017 (2016: HUF 10.2 billion). These guarantees were issued by banks on behalf of Magyar Telekom as collateral to secure the fulfillment of the Group's certain contractual obligations. The Group has been delivering on its contractual obligations and expects to continue doing so in the future, therefore no significant drawdown of the guarantees happened in 2017 or 2016, and is not expected to happen in the future.

There were no financial assets or liabilities, which were reclassified into another financial instrument category.

No financial assets were transferred in such a way that part or all of the financial assets did not qualify for derecognition.

The Group does not have compound financial instruments with multiple embedded derivatives.

5 FINANCIAL RISK MANAGEMENT

5.1 Financial risk factors

Magyar Telekom is primarily exposed to credit risks related to its financial assets. In addition, the Group 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 Group'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. Nevertheless, hedge accounting is not applied to such transactions, considering that not all the criteria in IAS 39 are met.

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 Group's Equity.

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

5.1.1 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 Group'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. At the end of 2017 Magyar Telekom fulfilled both criteria; Total Debt to EBITDA ratio of 1.74 in 2017 (2016: 1.99; 2016 continuing operation: 2.09), the allowed maximum of which would be 2.8 and EBITDA to Interest Expense ratio of 8.58 in 2017, (2016: 7.34; 2016 continuing operation: 6.94), the allowed minimum of which would be 3.0. The Group'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 Group'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 the Hungarian entities 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 (2017) and the preceding reporting period (2016). 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.

5.1.1.1 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 given operating segment of the Group. Differences resulting from the translation of the foreign subsidiaries' financial statements into the Group's presentation currency are not taken into consideration. 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 Group from Deutsche Telekom or its financing vehicle, Deutsche Telekom International Finance B.V. (DTIF) are denominated in EUR, while, at the same time, cross-currency interest rate swaps or FX 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 Group 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 hedging transactions 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**	
	Strengthening	**Weakening**
At December 31, 2017		
EUR/HUF (5% movement)		
Loan	(5,092)	5,092
Swap agreements	5,462	(5,462)
Net effect	370	(370)
At December 31, 2016		
EUR/HUF (5% movement)		
Loan	(5,546)	5,546
Swap agreements	6,041	(6,041)
Net effect	495	(495)

(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 or buys foreign currencies through FX forward transactions, 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 Group's foreign currency denominated liabilities (other than the above described loans) exceed the Group's foreign currency denominated assets, therefore changes of the functional currencies' exchange rates would have the following impact on the profit of the Group.

In order to reduce the above exposure, Magyar Telekom occasionally enters into derivative contracts. The negative fair value of the related open short term forward positions was HUF 0.2 billion as of December 31, 2017 (2016: 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, 2017		
EUR/HUF (5% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances	(882)	882
Related forward agreements	996	(996)
Net effect	114	(114)
USD/HUF (20% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances	(618)	618
Related forward agreements	574	(574)
Net effect	(44)	44
EUR/MKD (20% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances	(190)	190
Related forward agreements	0	0
Net effect	(190)	190
USD/MKD (20% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank balances	64	(64)
Related forward agreements	0	0
Net effect	64	(64)

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	(655)	655
Related forward agreements	467	(467)
Net effect	(188)	188
USD/HUF (20% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank	(1,176)	1,176
Related forward agreements	399	(399)
Net effect	(777)	777
EUR/MKD (20% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank	(174)	174
Related forward agreements	0	0
Net effect	(174)	174
USD/MKD (20% movement)		
Net balance of FX denominated trade payables and trade receivables plus bank	36	(36)
Related forward agreements	0	0
Net effect	36	(36)

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 20% fluctuation of the functional currency HUF against USD and a more than 20% fluctuation of the functional currency MKD against the EUR and USD is possible as extraordinary market conditions may cause extreme volatility on FX markets.

5.1.1.2 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 Group's Hungarian operations is primarily used to repay loans, however, significant amount of cash of the Group's Macedonian subsidiary is mostly held in local banks. These amounts are deposited primarily on fixed interest rate terms in order to minimize exposure to market changes that would potentially adversely affect the cash flows from these instruments.

Due to the extremely low interest rates, even a reasonably possible change in the interest rates would not have a significant impact on the Group'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 Group is managed centrally. The analysis below describes the Group'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 Group 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 89% of the Group's total debt as of December 31, 2017 (2016: 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 11% of the Group's total debt as of December 31, 2017 (2016: 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**	
	100bp increase	**100bp decrease**
At December 31, 2017		
Floating rate instrument	(134)	134
IR swap	(155)	155
Cash-flow sensitivity (net)	(289)	289
At December 31, 2016		
Floating rate instrument	(558)	558
IR swap	(228)	228
Cash-flow sensitivity (net)	(786)	786

5.1.1.3 Price risk

As Magyar Telekom transferred its business energy operations to E2 from 2016, for the purpose of these financial statements no relevant risk remained in this field and no sensitivity information for price risk is disclosed.

5.1.2 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 Group's risk management policy Magyar Telekom Group companies deposit 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.

Cash and cash equivalents and Bank deposits with maturities over 3 months held in Macedonia are primarily denominated in MKD and EUR. Cash and cash equivalents and Bank deposits with maturities over 3 months deposited in Macedonia run higher counterparty risk, due to the small amount of internationally substantial financial institutions in that countries. The deposits in Macedonia of HUF 4.9 billion as of December 31, 2017 (2016: HUF 4.2 billion) are fully covered with bank guarantees issued by international financial institutions rated at BBB.

Concentrations of credit risk relating to trade receivables are limited due to the large number of customers comprising the Group'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.

The following table contains the carrying amount of trade receivables broken down by country of operation. The vast majority of these balances are denominated in the functional currency of the countries of operations (HUF in Hungary, MKD in Macedonia and EUR in Montenegro).

In HUF millions	**At December 31,**	
	2016	**2017**
Hungary	121,398	130,277
Macedonia	15,459	13,365
Montenegro	8,882	-
Other	967	795
	146,706	144,437

The amounts in the table above are shown net of provisions for impairment losses. The annual bad debt expense of the Group in 2017 was 0.9% (2016: 1.4%) of the consolidated revenues. Adverse changes in customer payment behavior in the future, however, may result in higher impairment losses. Each additional 1 percentage point of uncollectible revenue would result in additional impairment charges of HUF 6.1 billion in 2017 (2016: HUF 5.7 billion) considering only the continuing operations.

There are varying credit checking practices applied across the members of the Group as described below.

Hungary

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.

Macedonia

The process of managing the credit risk from operating activities includes preventive measures such as creditability checking and prevention barring, corrective measures during legal relationship for example reminding and disconnection activities, collaboration with collection agencies and collection after legal relationship as litigation process and court proceedings. The overdue payments are monitored based on customer type, amount of debt, average invoiced amount and number of disconnections. The credit risk is controlled through credibility checking – which determines that the customer is not indebted and the customers' credit worthiness and through preventive barring – which determines the credit limit based on the usual level of the customer's previous traffic revenues. There is no concentration of risk in Macedonia either with any single customer or group of customers with similar characteristics. The procedures in Macedonia ensure on a permanent basis that sales are made to customers with an appropriate credit history and that an acceptable level of credit exposure is not exceeded.

Montenegro

Since 2010, when Customer finance department was formed, a number of processes related to limitation of credit risk have been established, changed and improved. In the period 2010-2014 Montenegro had a constant decline of Bad debt expense and overall improvement of collection rates. In 2015 bad debt results reflected fact that implementation of new billing and delay or skip in dunning process leads to lower collection and increased costs. Together with new billing and CRM a number of processes have been changed including dunning and credit checking processes. These processes were under permanent monitoring and improvement during 2016 too. In 2016, focus was on business customers as well as on new residential customers. Fraud prevention and revenue assurance processes were also affected and the goal was to keep the previously reached level of risk protection while the new system is in stabilization phase by avoiding larger incidents.

5.1.3 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 Group's Treasury management aims at maintaining flexibility in funding by keeping committed credit lines available. The undrawn credit lines amounted to HUF 41.0 billion as at December 31, 2017 (2016: HUF 29.7 billion). In addition to the above, Deutsche Telekom confirmed its readiness to finance Magyar Telekom Group's budgeted financing needs until the end of June 2019.

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, 2017 and 2016. 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.

December 31, 2017 (in HUF millions)	**Total**	**within 1 year**	**1 to 5 years**	**after 5 years**
Trade payables	135,446	135,446	-	-
Financial liabilities to related parties	227,101	18,562	208,539	-
Bank loans	-	-	-	-
Finance lease liabilities	10,925	2,079	5,076	3,770
Other financial liabilities	52,192	7,875	16,298	28,019
Total other financial liabilities	63,117	9,954	21,374	31,789
Total cash flows	425,664	163,962	229,913	31,789
Open swap positions' cash flows				
Gross cash inflow in EUR million	352	62	290	-
Gross cash inflow in HUF million (at spot rate)	109,170	19,229	89,941	-
Gross cash outflow in HUF million	113,396	18,106	95,290	-
Net cash inflow in HUF million	(4,226)	1,123	(5,349)	-
Open forward positions' cash flows				
Gross cash inflow in EUR million	64	64	-	-
Gross cash inflow in USD million	11	11	-	-
Total gross cash inflow in HUF million (at spot rate)	22,696	22,696	-	-
Gross cash outflow in HUF million	23,037	23,037	-	-
Net cash inflow in HUF million	(341)	(341)	-	-

December 31, 2016 (in HUF millions)	Total	within 1 year	1 to 5 years	after 5 years
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
Open swap positions' cash flows				
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)	-
Open forward positions' cash flows				
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	-	-

The average maturity of Magyar Telekom's debt portfolio was 2.19 years as at December 31, 2017 (2016: 2.64 years). The floating interest payments arising from the financial instruments were calculated using the last interest rates fixed before December 31, 2017 and 2016.

5.2 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an 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 Group. 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 Group 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 – Note 4.4.1
- plus Other current and non current financial liabilities – Note 4.4.2
- less Cash and cash equivalents – Note 4.2.1
- less Other current financial assets – Note 4.2.3.1

During 2016 and 2017, the Group'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, 2017 was 34.8% (2016: 39.3%, 2016 continuing operation: 39.3%). The Company paid HUF

26,067 million dividend in 2017 (HUF 15,633 million dividend in 2016), and the Company's Board recommends to declare a HUF 26,069 million dividend at the April 2018 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 in the standalone financial statements does not fall below two thirds of its Common stock. The Company is in compliance with this regulation, and no such statutory regulation exists for consolidated equity.

The equity capital, which the Group manages, amounted to HUF 580 billion on December 31, 2017 (2016: HUF 581 billion).

6 INCOME TAX

6.1 Income taxes – accounting policies

Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to a business combination, or items recognised directly in equity or in other comprehensive income.

6.1.1 Current taxes

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable in respect of previous years. The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received that reflects uncertainty related to income taxes, if any. It is measured using tax rates enacted or substantively enacted at the reporting date. Current tax also includes any tax arising from dividends. Current tax assets and liabilities are offset only if certain criteria are met.

Income taxes comprises of corporate income taxes and other income taxes.

6.1.1.1 Corporate income taxes

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

As Magyar Telekom Plc. is listed on the Budapest Stock Exchange, it was obliged to adopt IFRSs in its statutory financial statements from 2017 in accordance with the Act C of 2000 on Accounting. In the first and in the second year following the IFRS transition, taxpayers, who adopt IFRS in their statutory financial statements, are obliged to pay the total sum of their current taxes (i.e. corporate income tax and local business tax) calculated for the tax year preceding the year of the IFRS transition, if in these two years their current tax liabilities are lower than in the tax year preceding the IFRS transition (minimum tax). Magyar Telekom Plc. does not have this minimum tax payment obligation in 2017. If the calculated tax does not reach the amount of the minimum tax in 2018, the difference will be accounted for as Other operating expenses.

6.1.1.2 Other income taxes

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, usually determined at a substantially higher level than the corporate tax base, but applying a significantly lower tax rate.

6.1.2 Deferred taxes

Deferred tax is recognized applying the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated financial statements.

Deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit.

Deferred tax is determined using income tax rates that have been enacted or substantially enacted by the financial statement date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

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

Deferred tax is measured at the tax rates that are expected to apply to temporary differences when they reverse using income tax rates enacted or substantially enacted at the reporting date.

6.2 Income taxes in the Statement of profit or loss

The table below shows the income tax expenses charged in the Profit for the year.

In HUF millions	For the year ended December 31,	
	2016	2017
Corporate income tax	2,120	1,553
Other income taxes	8,260	8,850
Deferred income taxes	(15,239)	5,555
Total income tax expense	(4,859)	15,958

6.2.1 Tax expense reconciliation

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

In HUF millions		For the year ended December 31,	
		2016	2017
Consolidated IFRS profit before income tax		49,262	56,204
Tax at 19% (2016) / 9% (2017)..		(9,360)	(5,058)
Impact of different tax rates	(a)	1,138	(140)
Tax shield of items not subject to income tax	(b)	659	56
Tax impact of non deductible items	(c)	(1,459)	(2,557)
Other income taxes	(d)	(8,260)	(8,850)
Impact of tax deductibility of other income taxes..................................	(e)	1,569	797
Energy suppliers' tax	(f)	(110)	(180)
(De)/recognized deferred tax on tax losses	(g)	(485)	(272)
Investment tax credit accretion	(h)	457	246
Withholding tax on expected dividends...	(i)	(119)	-
Impact of CIT rate change in deferred tax...	(j)	20,829	-
Income tax expense		4,859	(15,958)
Effective tax rate		(9.86%)	28.39%

(a) Impact of different tax rates

The corporate tax rate in Hungary was 10% for the first HUF 500 million tax base (on an annual basis) of the legal entities, above which the general rate of 19% applied until December 31, 2016. From January 1, 2017 a flat tax rate of 9% is effective in Hungary. In 2016 the impact of the lower tax rate applicable to the Hungarian legal entities of the Group is included in this line of the reconciliation.

This line of the reconciliation also includes the tax impacts of the different tax rates of the foreign countries where the Group is also present through its subsidiaries. The corporate tax rate is 10% in Macedonia, 16% in Romania and 10% in Bulgaria in the reported years. This line of the reconciliation also includes the tax impacts of the above differences compared to the 19%/9% general tax rate of Hungary applied to the profit before tax of the Group.

(b) Tax shield of items not subject to income tax

This line of the reconciliation primarily includes the tax shield impact of expenses, which are not included in the consolidated profit before tax, but deductible when determining the standalone corporate income tax base. These items include the depreciation of assets (or additional values of assets) which are not included in the assets of the consolidated statements of financial position, and which are not considered in the deferred tax calculation.

(c) Tax impact of non deductible items

This line of the reconciliation includes the negative tax impact of the expenses included in the consolidated profit and loss, but non deductible when determining the standalone corporate income tax base. These items primarily include the non deductible receivable impairment and write-downs and penalties.

(d) Other income taxes

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, determined usually at a substantially higher level than the corporate tax base, but with substantially lower tax rates (max 2%). As the first line of the reconciliation calculates theoretical tax expense calculated using the general corporate tax rate, the Hungarian local business tax and the innovation fee impose additional income tax expenses for the Hungarian entities of the Group, included in this line of the reconciliation.

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

The Hungarian local business tax and innovation fee are deductible expenses for corporate tax purposes, the positive tax impact of which is included in this line of the reconciliation.

(f) Energy suppliers' tax

This line of reconciliation includes the Energy suppliers' additional tax levied on energy supplier companies' profits in Hungary. The tax base is the profit before tax adjusted by certain items that increase or decrease the tax base. Magyar Telekom Plc. is also considered as an energy supplier company subject to the energy suppliers' additional tax, in proportion to its energy revenues. As tax credit can be utilized for the energy supplier's tax to the extent that the tax liability can be decreased by a half, this effect is also included in this line of the reconciliation.

(g) (De)/recognized deferred tax on tax losses

Deferred tax asset is recognized on tax losses only to the extent that the realization of the related tax benefit is probable in the foreseeable future. Deferred tax assets on tax losses that will probably not be recovered are un-recognized in the period of the loss or de-recognized in subsequent periods. On the other hand, when the recoverability of the previously un/derecognized tax losses becomes probable, these deferred tax assets are recognized.

(h) Investment tax credit accretion

Investment tax credit accretion includes the increase of the net present value of the investment tax credit deriving from the utilization of the tax credits in periods subsequent to the year of recognition. See also Note 6.3.2.1.

(i) Withholding tax on expected dividends

Macedonia and Montenegro levy a 5% withholding tax on dividend distribution to Hungary. This line of the reconciliation included solely in 2016 the amount of withholding tax accruing on the Group's share of the potential profits of our Montenegrin subsidiary.

(j) Impact of CIT rate change in deferred tax

The Hungarian corporate income tax rate of 10%/19% has been decreased to flat rate 9% as of 1 January 2017 which has already been recognized as of 31 December 2016 in deferred tax positions. This line includes the change of the deferred tax balance triggered by the tax rate change.

6.3 Deferred taxes

6.3.1 Current taxes in the Statement of financial position

Current income tax receivable and payable balances in the Statements of financial position represent the amount of corporate and other income taxes receivable from, and payable to, the tax authorities of the countries in which the Group operates.

6.3.2 Deferred taxes in the Statement of financial position

The Group's deferred tax balances and the movements therein are as follows:

In HUF millions	Balance at Dec. 31, 2015	Effect on profit	Balance at Dec. 31, 2016	Effect on profit	Other movements	Change due to sale of subsidiary	Balance at Dec. 31, 2017
Deferred tax assets and (liabilities)							
Investment tax credits (Note 6.3.2.1)	12,413	(1,506)	10,907	(3,169)			7,738
Net operating loss carry-forward (Note 6.4.)	1,107	(485)	622	(272)			350
Investments in subsidiaries	240	(240)	-	-			-
Withholding tax	(691)	572	(119)	119			-
Other financial assets	(1,063)	738	(325)	397	(119)		(47)
Impairment of receivables and inventory	4,021	(2,239)	1,782	(371)			1,411
Property, plant and equipment and intangible assets	(19,833)	10,206	(9,627)	(907)	(57)	714	(9,877)
Goodwill	(19,425)	7,448	(11,977)	(866)			(12,843)
Trade and other payables	94	(92)	2	67			69
Loans and other borrowings	(4,251)	2,770	(1,481)	1,481			-
IFRS transition	-	-	-	(1 362)			(1,362)
Deferred revenue	(19)	(26)	(45)	(97)			(142)
Provisions for liabilities and charges	3,501	(1,907)	1,594	(575)			1,019
Total net deferred tax liability	(23,906)	15,239	(8,667)	(5,555)	(176)	714	(13,684)
Of which deferred tax liabilities	(23,953)		(8,740)				(13,743)
Of which deferred tax assets	47		73				59
Items included in other movements:							
Investment tax credit adjusted against P&L					(57)		
Relating to the merger of subsidiary					(119)		
Relating to the sale of subsidiary						714	

Items included in the Other movements column in 2017 indicate the investment tax credit decrease (HUF 57 million) which was adjusted against the P&L in deferred taxes, as well as the tax effect of the fair value adjustment relating to the merger of Serverinfo Kft (HUF 119 million). The deferred tax balances as at December 31, 2017 do not include the tax effects of the Montenegrin subsidiary (HUF 714 million), as Crnogorski Telekom constituted a discontinued operation. The column of Change due to sale of subsidiary indicates this difference in 2017.

The Group consists of a number of legal entities, most of which have deferred tax assets and liabilities. The assets and liabilities are netted by legal entity so that one legal entity has either a deferred tax asset or a liability and the consolidated Statement of financial position includes these balances accordingly.

The Group's net deferred tax liability balance as at December 31, 2017 is HUF 13,684 million which includes a high amount of individual deferred tax asset and liability items (see in the above table). Of these items, approximately HUF 2,342 million net deferred tax asset is expected to reverse in 2018 (deferred tax asset of HUF 2,572 million and deferred tax liability of HUF 230 million).

The Group's net deferred tax liability balance as at December 31, 2016 was HUF 8,667 million which includes a high amount of individual deferred tax asset and liability items (see in the above table). Of these items, approximately HUF 1,446 million net deferred tax asset was expected to reverse in 2017 (deferred tax asset of HUF 3,351 million and deferred tax liability of HUF 1,905 million).

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

Temporary differences associated with investments in subsidiaries for which deferred tax liabilities or assets have not been recognized amounted to a net liability of HUF 11,016 million at December 31, 2017 (HUF 27,521 million at December 31, 2016).

Deferred tax liability on goodwill is related to the goodwill arising from the acquisition of subsidiaries (Emitel and T-Mobile) in the Company's financial statements, which had merged into Magyar Telekom Plc. The amortization of goodwill is a tax deductible expense in corporate income tax, while under IFRSs there is no amortization accounted in the books. The difference deriving from the two types of accounting is represented by the deferred tax liability

6.3.2.1 Investment tax credits

In order to increase broadband internet penetration in Hungary, companies investing over HUF 100 million in a year in broadband assets (e.g. DSL lines, UMTS assets) from 2003 could apply for a corporate tax reduction. MT accomplished such tax credit programs between 2003 and 2008. The tax credit programs commenced in 2012 and 2013 are "large investment" programs, which enable companies to invest not only in broadband related assets, if the investment value exceeds HUF 3 billion and certain special criteria (i.e. headcount increase) are met. In case of both types of tax credit programs, the potential reduction of the corporate tax charge is defined as a percentage of the companies' capital investment in qualifying assets. As both of these investment tax credits are of a government grant nature, Magyar Telekom recognized the deferred tax asset against the cost of the related investment. There are no unrecognized tax credits. If the tax credits are not utilized in the year when earned, the amount of tax credits carried forward can be utilized at a higher amount as outstanding amounts are accreted. This accretion is recognized as an increase in the investment tax credit balance against a reduction in the current year deferred tax expense.

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

Earned in year	Amount of qualifying investment	Amount of tax credit earned	Accretion recognized in tax expense to date	Tax credit utilized	Tax credit carried forward at December 31, 2017	Tax credit carried forward at December 31, 2016	Expires in year
2007	10,681	2,827	2,888	(5,715)	-	1,724	2017
2012	11,451	3,518	516	(1,470)	2,564	4,028	2021
2013	14,604	4,580	426	(2)	5,004	4,986	2023
2014	490	161	9	-	170	169	2023
Total	37,226	11,086	3,839	(7,187)	7,738	10,907	

In order to utilize the tax credits and certain tax deductibility opportunities earned by the Group's entities, they have to comply with strict requirements as set out in the relevant tax regulations. The most important requirement for all investment tax credits is that the relevant assets have to be operated for at least 5 years. However, for those earned in 2012 and in 2013 certain increase in headcount and/or salary has to be maintained for at least 4 subsequent years following the first year of tax credit utilization. The headcount of the Company has to be increased by 150 and maintained in the subsequent 4 years from the first utilization of the investment tax credit (which is 2012 and 2014). The 2013 tax credit program was finished in January 2014, so the first utilization of 2013 tax credit is in

2014. The base year for both programs is 2011. Management believes that the headcount criterion is not a substantive requirement. There was a significant headcount increase in 2012 due to insourcing of certain activities carried out by subcontractors before and there are further insourcing plans in place. Based on the above, management believes that the Group has complied and will be able to comply with the requirements to recognize these as deferred tax assets.

6.4 Tax loss carry forwards

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable.

The table below shows the tax losses carried forward of the Group.

Expires in year	Tax loss carry forwards at December 31, 2016	Tax loss carry forwards at December 31, 2017
2016	84	-
2017	138	125
2018	22,620	22,442
2019	5,641	88
2020	194	129
2021	-	2
2022	-	2
2025	7,023	3,915
Total	35,700	26,703
Tax losses for which deferred tax is recognized	6,907	3,884
Tax losses for which deferred tax is not recognized	28,793	22,819
Total	35,700	26,703

The Hungarian corporate tax law was amended as of January 1, 2015 including that all tax loss carry forwards incurred up to December 31, 2014 may be used to reduce the pre-tax profit until no later than December 31, 2025.

6.5 Tax reviews

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

6.6 Dividends paid by Magyar Telekom Plc.

The dividends paid and payable by Magyar Telekom Plc. to its owners may be subject to withholding or income taxes of the owners, which do not have an impact on the amount of the dividend declared or on the Company's tax expense as these taxes – if any – are levied on the owners.

6.7 IFRS Transition of Magyar Telekom Plc.

As Magyar Telekom Plc. is listed on the Budapest Stock Exchange, it was obliged to adopt IFRSs in its statutory financial statements from 2017 in accordance with the Act C of 2000 on Accounting. As a result of the IFRS transition, Magyar Telekom Plc. has an IFRS transition difference of HUF 22.7 billion, which qualifies as a corporate income tax increasing item. The corporate income tax incurred in relation to this transition difference will be paid in 3 equal instalments in 2017-2019.

Other companies of the Group did not elect to adopt IFRS for their local financial statements.

7 INVENTORIES

7.1 Inventories – accounting policies

Inventories are stated at the lower of cost or net realizable value using the historical cost method of accounting, and are valued on a weighted average basis. The cost of inventories comprises all costs of purchase, cost of construction and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Phone sets are often sold for less than cost in connection with promotions to obtain new subscribers with minimum commitment periods (Note 3.4). Such loss on the sale of equipment is only recorded when the sale occurs if the normal resale value is higher than the cost of the phone set. If the normal resale value is lower than costs, the difference is recognized as impairment.

Impairment losses on Inventories are recognized in Other operating expenses.

7.2 Inventories in the statement of financial position

	At December 31,	
In HUF millions	**2016**	**2017**
Inventory for resale	12,793	16,247
Other inventory	4,398	1,111
Subtotal	17,191	17,358
Less allowances	(548)	(183)
	16,643	17,175

The impairment loss accounted or released for inventories is not material therefore no separate table of movements is disclosed.

The Group has no inventory pledged as security as at December 31, 2016 or December 31, 2017.

8 ASSETS HELD FOR SALE AND LIABILITIES ASSOCIATED WITH ASSETS HELD FOR SALE

8.1 Non current assets held for sale – accounting policies

An asset (typically real estate) is classified as held for sale if it is no longer needed for the future operations of the Group, and has been identified for sale, which is highly probable to take place within 12 months. These assets are accounted for at the lower of carrying value or fair value less cost to sell. Depreciation is discontinued from the date of designation to the held for sale status. When an item of PPE or intangible assets is designated for sale, and the fair value is determined to be lower than the carrying amount, the difference is recognized in the Profit for the year (Depreciation and amortization) as an impairment loss.

8.2 Assets held for sale in the statement of financial position

	At December 31,	
In HUF millions	**2016**	**2017**
Property, plant and equipment	1,556	162
Total assets held for sale	1,556	162

Assets held for sale include primarily land and buildings identified for sale, which is expected within 12 months, as a result of the continuing improvement of utilization of properties. These assets are presented at carrying amount as no impairment had to be recognized when reclassified as held for sale.

9 PROPERTY, PLANT AND EQUIPMENT

9.1 Property, plant and equipment (PPE) – accounting policies

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

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

Government grants relating to the purchase of PPE are deducted from the original cost of the items and are recognized in the Profit for the year through the reduced amount of depreciation of the related assets over their useful lives. Investment tax credits relating to qualifying investment projects (Note 6.3.2.1) are also recognized in this manner.

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

Subsequent expenditure on an asset that meets the recognition criteria to be recognized as an asset or an addition to an asset is capitalized, while maintenance and repairs are charged to expense when incurred.

When assets are scrapped, the cost and accumulated depreciation are removed from the accounts and the loss is recognized in the Profit for the year (Depreciation and amortization).

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

Depreciation is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. On an annual basis, Magyar Telekom reviews the useful lives and residual values for consistency with current development plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 9.3. The annual revisions are conducted in the second quarter of the year and the resulting changes are applied from the third quarter of the year. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year.

The useful lives assigned to different types of property, plant and equipment are as follows:

	Years
Buildings	5–50
Duct, cable and other outside plant	3–38
Other telecommunications equipment	2–25
Other equipment	2–12

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

The fair values of the individual tangible and intangible assets of the Group in most cases cannot be determined as individual assets do not generate cash flows. Instead, the Group determines CGUs to which the individual assets are allocated and the fair values can only be determined at CGU level, primarily by using discounted cash flow analyses. See also Note 3.2. Corporate assets which have the distinctive characteristics of not generating cash inflows independently of other assets or groups of assets are allocated to CGUs when conducting impairment tests.

Goodwill is tested for impairment annually or more frequently if circumstances indicate that impairment may have occurred. When conducting the impairment tests, Magyar Telekom allocates goodwill to its cash generating units determined at operating segment level. See also Note 3.2. Operating segments may include one clearly identifiable company or a group of companies, or certain components of one company and other companies as well.

The Group establishes the segments' recoverable amounts by determining their fair value less cost to sell by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analyses and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs. The fair values determined as described above are used as a basis when establishing the need for an impairment of any goodwill allocated to the operating segments. See also Note 3.2. If the calculated fair value less cost to sell is lower than the carrying amount of the operating segment, goodwill is impaired.

The impairment losses of PPE and intangible assets are accounted for in the Depreciation and amortization line of the Statement of profit or loss.

9.2 Property, plant and equipment in the statement of financial position

In HUF millions	Land and equivalent rights	Buildings	Telecom. equipment	Other equipment	Total
At January 1, 2016					
Cost	9,551	163,073	1,127,191	94,007	1,393,822
Accumulated depreciation	(2,274)	(59,936)	(762,836)	(73,423)	(898,469)
Carrying amount	7,277	103,137	364,355	20,584	495,353
Of which held for sale					(2,149)
					493,204
Carrying amount – January 1, 2016	7,277	103,137	364,355	20,584	495,353
Exchange differences	(8)	(132)	(283)	(30)	(453)
Additions due to business combinations	-	-	(130)	-	(130)
Changes due to revisions of asset retirement obligations	-	(109)	247	-	138
Investments	-	1,946	63,283	6,953	72,182
Disposals	(462)	(5,254)	(147)	(387)	(6,250)
Depreciation charge	(138)	(4,832)	(61,397)	(7,801)	(74,168)
Decrease due to sale of subsidiary	-	(54)	(190)	(57)	(301)
Reclassifications	(926)	(354)	(616)	255	(1,641)
Carrying amount – December 31, 2016	5,743	94,348	365,122	19,517	484,730
At December 31, 2016					
Cost	8,194	154,876	1,079,697	104,073	1,346,840
Accumulated depreciation	(2,451)	(60,528)	(714,575)	(84,556)	(862,110)
Carrying amount	5,743	94,348	365,122	19,517	484,730
Of which held for sale					(1,556)
					483,174
Carrying amount – January 1, 2017	5,743	94,348	365,122	19,517	484,730
Exchange differences	-	(74)	(204)	(18)	(296)
Additions due to business combinations	432	3,644	66	1,951	6,093
Changes due to revisions of asset retirement obligations	-	297	(30)	-	267
Investments	1	2,125	44,986	10,256	57,368
Disposals	(20)	(995)	(48)	(289)	(1,352)
Depreciation charge	(74)	(5,003)	(51,721)	(7,428)	(64,226)
Decrease due to sale of subsidiary	(811)	(5,478)	(16,972)	(818)	(24,079)
Reclassifications	185	539	212	(936)	-
Carrying amount – December 31, 2017	5,456	89,403	341,411	22,235	458,505
At December 31, 2017					
Cost	7,873	151,129	1,014,408	104,535	1,277,945
Accumulated depreciation	(2,417)	(61,726)	(672,997)	(82,300)	(819,440)
Carrying amount	5,456	89,403	341,411	22,235	458,505
Of which held for sale					(162)
					458,343

The closing balance of Property, plant and equipment (PPE) includes assets in the course of construction in an amount of HUF 61,452 million as at December 31, 2017 (2016: HUF 62,357 million). In the table above the assets in course of construction are shown in the categories where the asset is expected to be classified when placed into service.

Exchange differences include the translation impact arising on the consolidation of foreign subsidiaries of the Group.

Additions due to business combinations include the fair value or carrying value of the assets acquired by Magyar Telekom through business combinations at the time of the acquisition. Differences between the preliminary and the final purchase price allocations are also included in this line.

Changes due to revisions of asset retirement obligations represent the adjustments of the carrying amounts of the assets against a provision for asset retirement obligation (see also Note 13.2.4).

Investments represent the regular investing activity in PPE assets. The below table includes the Investments by type of operation.

In HUF millions	2016	2017
Investments in continuing operations	68,051	57,278
Investments in discontinued operations	4,131	90
	72,182	**57,368**

The below table includes the Depreciation charge by type of operation.

In HUF millions	2016	2017
Depreciation charge in continuing operations	(70,509)	(63,950)
Depreciation charge in discontinued operations	(3,659)	(276)
	(74,168)	**(64,226)**

The reclassifications between asset categories or their impact on depreciation expense was not material.

No impairment was identified in 2017 and 2016.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2017 the gross book value of the assets leased back is HUF 4,048 million (2016: HUF 3,775 million) and the net book value is HUF 1,529 million (2016: HUF 1,533 million).

Included mainly in buildings and telecom equipment are also assets leased under finance lease conditions other than sale and lease back. At December 31, 2017 the gross book value of the finance leased assets is HUF 3,826 million (2016: HUF 7,211 million) and the net book value is HUF 1,060 million (2016: HUF 3,750 million).

Included in telecommunications equipment at December 31, 2017 are assets leased under operating lease contracts to customers with a gross book value of HUF 127 million (2016: HUF 373 million) and 0 net book value (2016: HUF 0 million).

The Group has no PPE with restricted titles or pledged as security as at December 31, 2017 or December 31, 2016.

9.3 Review of useful lives

The reviews of the useful lives (and residual values) of property, plant and equipment during 2017 affected the lives of a large number of assets primarily leased set-top box assets subsequently reclassified to own use . The revisions resulted in the following change in the original trend of depreciation in the current and future years.

In HUF millions	2017	2018	2019	2020	After 2020
Increase / (decrease) in depreciation expense	(2,235)	(503)	1,329	954	455

10 INTANGIBLE ASSETS

10.1 Intangible assets – accounting poolicies

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

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use. These costs are amortized over the estimated useful life of the software. Costs associated with developing or maintaining computer software programs are generally recognized as an expense as incurred. Costs directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognized as intangible assets. Direct costs include the software development employee related costs and an appropriate portion of relevant overhead and borrowing costs. Computer software development costs recognized as assets are amortized over their estimated useful lives. Most computer software capitalized include acquired elements representing the majority of the cost and own costs incurred to a lesser extent. These are considered as non self developed software. Computer software fully developed by own resources represent an immaterial portion of all software, therefore these are not disclosed separately.

Costs associated with the acquisition of long term frequency licenses are capitalized. The present value of the future annual payments for the use of the frequencies are also capitalized if these payments can be estimated reliably, or otherwise recognized as Other operating expenses in the year the payment obligation refers to. The useful lives of concessions and licenses are determined based on the underlying agreements and are amortized on a straight line basis over the period from availability of the frequency for commercial use until the end of the initial concession or license term. Renewal periods are considered in the determination of useful life only if we are sure that it will be realized without further consideration to be transferred.

Amortization is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. Other than goodwill, the Group has no intangible assets with indefinite useful life. The amortization expense is presented in the depreciation and amortization line of the Statement of profit or loss.

On an annual basis, Magyar Telekom reviews the useful lives for consistency with current development and replacement plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 10.3. The annual revisions are conducted in the second quarter of the year and the resulting changes are applied from the third quarter of the year. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year.

The estimated useful lives of intangible assets other than goodwill are are as follows:

	Years
Software	2–24
Concessions and licenses	3–25
Other intangible assets	3–10

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets and contingent liabilities of the acquired subsidiary or business at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses. Impairment testing is carried out on an annual basis for all goodwill in the last quarter of the year based on the carrying values as at September 30 of the year. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill allocated to the entity or business sold.

In determining whether an asset that incorporates both intangible and tangible elements should be treated under IAS 16 – Property, Plant and Equipment or as an intangible asset under IAS 38 – Intangible Assets, management uses judgment to assess which element is more significant and recognizes the assets accordingly.

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

The fair values of the individual tangible and intangible assets of the Group in most cases cannot be determined as individual assets do not generate cash flows. Instead, the Group determines CGUs to which the individual assets are allocated and the fair values can only be determined at CGU level, primarily by using discounted cash flow analyses. See also Note 3.2. Corporate assets which have the distinctive characteristics of not generating cash inflows independently of other assets or groups of assets are allocated to CGUs when conducting impairment tests.

Goodwill is tested for impairment annually or more frequently if circumstances indicate that impairment may have occurred. When conducting the impairment tests, Magyar Telekom allocates goodwill to its cash generating units determined at operating segment level. See also Note 3.2. Operating segments may include one clearly identifiable company or a group of companies, or certain components of one company and other companies as well.

The Group establishes the segments' recoverable amounts by determining their fair value less cost to sell by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analyses and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs. The fair values determined as described above are used as a basis when establishing the need for an impairment of any goodwill allocated to the operating segments. See also Note 3.2. If the calculated fair value less cost to sell is lower than the carrying amount of the operating segment, goodwill is impaired.

The impairment losses of PPE and intangible assets are accounted for in the Depreciation and amortization line of the Statement of profit or loss.

10.2 Intangible assets in the statement of financial position

In HUF millions	Goodwill	Concessions and licenses	Software	Other	Total
At January 1, 2016					
Cost	218,497	190,658	286,288	18,679	714,122
Accumulated amortization	-	(37,138)	(190,228)	(6,719)	(234,085)
Carrying amount	218,497	153,520	96,060	11,960	480,037
Carrying amount – January 1, 2016	218,497	153,520	96,060	11,960	480,037
Exchange differences	(44)	(45)	(55)	(21)	(165)
Additions due to business combinations	207	-	-	(19)	188
Investments	-	9,266	29,723	2,084	41,073
Disposals	-	-	(28)	-	(28)
Decrease due to sale of subsidiary	(562)	(94)	(515)	(4)	(1,175)
Amortization charge	-	(15,570)	(25,049)	(2,689)	(43,308)
Reclassifications	-	-	1,641	-	1,641
Carrying amount – December 31, 2016	218,098	147,077	101,777	11,311	478,263
At December 31, 2016					
Cost	218,098	198,322	296,027	20,444	732,891
Accumulated amortization	-	(51,245)	(194,250)	(9,133)	(254,628)
Carrying amount	218,098	147,077	101,777	11,311	478,263
Of which held for sale					-
					478,263
Carrying amount – January 1, 2017	218,098	147,077	101,777	11,311	478,263
Exchange differences	-	(21)	(31)	6	(46)
Additions due to business combinations	631	-	-	117	748
Investments	-	-	24,827	4,180	29,007
Disposals	-	-	(72)	-	(72)
Decrease due to sale of subsidiary	(6,445)	(10,393)	(4,342)	(797)	(21,977)
Amortization charge	-	(15,151)	(26,278)	(3,036)	(44,465)
Reclassifications	-	-	-	-	-
Carrying amount – December 31, 2017	212,284	121,512	95,881	11,781	441,458
At December 31, 2017					
Cost	212,284	184,071	305,563	22,904	724,822
Accumulated amortization	-	(62,559)	(209,682)	(11,123)	(283,364)
Carrying amount	212,284	121,512	95,881	11,781	441,458
Of which held for sale					-
					441,458

Exchange differences include the translation impact arising on the consolidation of foreign subsidiaries of the Group.

Additions due to business combinations include the fair value of assets acquired by Magyar Telekom through business combinations in the reported years and the goodwill arising on these business combinations. Differences between the preliminary and the final purchase price allocations are also included in this line.

Investments represent the regular investing activity in intangible assets. The below table includes the Investments by type of operation.

In HUF millions	**2016**	**2017**
Investments in continuing operations	29,672	28,920
Investments in discontinued operations	11,401	87
	41,073	**29,007**

Additions to Concessions and licenses in 2016 included the one-off license fee of certain frequency bands (see also Note 3.5) and any directly attributable costs of preparing these assets for its intended use (e.g. consultancy fees).

The amortization expense as well as the impairment losses of intangible assets including also goodwill is accounted for in the depreciation and amortization line of the Statement of profit or loss. The below table includes the Amortization charge by type of operation.

In HUF millions	**2016**	**2017**
Amortization charge in continuing operations	(40,801)	(44,224)
Amortization charge in discontinued operations	(2,507)	(241)
	(43,308)	**(44,465)**

The reclassifications between asset categories or their impact on amortization expense was not material.

The Group has no intangible assets with restricted title or pledged as security as at December 31, 2017 or December 31, 2016.

10.3 Useful lives

The reviews of the useful lives of intangible assets during 2017 affected the lives of a large number of assets primarily software. The revisions resulted in the following change in the original trend of amortization in the current and future years.

In HUF millions	**2017**	**2018**	**2019**	**2020**	**After 2020**
Increase / (decrease) in depreciation expense	(1,776)	(182)	461	438	1,059

10.4 Goodwill

For the goodwill impairment tests, the total amount of goodwill was allocated to the operating segments of the Group and the recoverable amounts of the operating segments were determined based on fair values less costs of disposal based on Level 3 inputs in the fair value calculations (Note 4.5.1). The recoverable amounts of the segments disclosed in the table below exclude net debts (Note 5.2), which are not allocated to the segments. For further information, please also see Note 3.2.

In HUF millions	As at December 31, 2016			2017		
	Carrying amount of goodwill allocated	Carrying amount of operating segment (incl. goodwill)	Recoverable amount of operating segment	Carrying amount of goodwill allocated	Carrying amount of operating segment (incl. goodwill)	Recoverable amount of operating segment
MT-Hungary	191,454	807,989	1,392,344	192,085	791,806	1,703,753
Macedonia	20,199	62,316	142,735	20,199	63,265	180,004
Montenegro	6,445	36,240	56,488	-	-	-
Total	218,098	906,545	1,591,567	212,284	855,071	1,883,757

The Group regularly carries out an impairment test on goodwill in the last quarter of the financial years. During the annual impairment test conducted in the last quarter of 2016 and 2017 no goodwill impairment was established for any goodwill of the Group.

10.5 Significant individual other intangible assets

The Group's most significant individual other intangible assets are the mobile licenses. The carrying values and remaining amortization periods of the significant licenses are listed in the table below. For further information on these assets, please see Note 34.

In HUF millions	As at December 31, 2016 Carrying amount	2016 Remaining amortization period (years)	2017 Carrying amount	2017 Remaining amortization period (years)
Hungarian mobile licenses acquired in 2014	87,174	18	82,192	17
Hungarian mobile licenses prolonged in 2013	39,180	5	31,717	4
Montenegrin 4G license	9,051	15	-	n.a.
Hungarian 3G license	5,358	3	3,581	2
Macedonian 4G license	2,713	17	2,534	16
Macedonian 2G/3G license	809	2	417	1
Other	2,792		1,071	
Total concessions and licenses	147,077		121,512	

11 INVESTMENTS IN ASSOCIATES AND JOINT ARRANGEMENTS

11.1 Associates and joint arrangements – accounting policies

Associates are entities over which the Group has significant influence but not control, generally reflecting a voting right between 20% and 50%.

Joint arrangements are arrangements where the parties are bound by a contractual arrangement of which two or more parties have joint control and which exist only when decisions about the relevant activities require the unanimous consent of the parties sharing the control.

If the parties that have joint control of the arrangement have rights to the net assets of the arrangement, it is a joint venture.

If the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement, it is a joint operation.

Investments in associates and joint ventures are accounted for using the equity method of accounting and are initially recognized at cost. The Group's investment in associates and joint ventures includes goodwill arising on acquisitions, and net of any accumulated impairment loss.

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

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

In case of a joint operation, the assets, liabilities, revenues and expenses relating to the joint operation are recognized to the extent of the Group's interest in the joint operation.

11.2 Associates

The Group had no significant associates at December 31, 2016 and 2017. The Group had no contingent liabilities or commitments relating to its associates at December 31, 2016 and 2017.

11.3 Joint ventures

The only joint venture of the Group at December 31, 2016 and 2017 was E2 Hungary Zrt. established in 2015 by Magyar Telekom Plc. and MET Holding AG. E2 Hungary provides energy services for business customers from 2016. The company's issued capital is HUF 200 million, and additional HUF 1,800 million was contributed as additional paid-in capital which were fully paid by both parties. The joint venture is set up by the parties on a 50:50 ownership basis with balanced rights in the management structure. The investment was recognized at cost in 2015 and E2 Hungary Zrt. is accounted for using the equity method. The operations of the company resulted in HUF 254 million profit in 2016 and in HUF 999 million profit in 2017. HUF 193 million was declared as dividend in 2017. As at December 31, 2016 the Company had an advance receivable oustanding from E2 amounting to HUF 912 million for the energy services to be provided by E2 to the Company and its remaining customers. It was settled in 2017.

The Group had no contingent liabilities or commitments relating to its joint ventures at December 31, 2016 and 2017.

The following table shows the total assets and liabilities as at December 31, 2016 and 2017, and revenues and profit for the year ended December 31, 2016 and 2017 of E2, the single significant joint venture of the Group.

In HUF millions	2016	2017
Current assets	19,564	14,246
Non current assets	65	108
Current liabilities	17,419	11,356
Non current liabilities	-	-
Revenues	61,699	53,878
Profit/ (Loss) for the year	254	999

11.4 Joint operations

Magyar Telekom and Telenor Hungary agreed in 2015 to jointly operate and develop their 800MHz 4G mobile networks in all parts of Hungary except Budapest. The primary goal of the agreement was to accelerate 4G mobile broadband coverage rollout in the countryside and to offer higher bandwidth to the 4G customers, in line with the coverage obligations of the 800 MHz spectrum contract signed in 2014 with the NMIAH. Based on the agreement, Telenor Hungary maintains sites in West Hungary and Magyar Telekom operates sites in the eastern region of the country.

The Company assessed the agreement as joint operation as strategic decisions are made jointly by Magyar Telekom and Telenor, and there is no separate vehicle to control the operation of the arrangement. The Company does not share the obligations for liabilities and any returns or expenses beyond the assets included in the agreement.

Therefore only the assets owned by the Company are recognized while there is no need to present the partner's assets, liabilities, or revenues and expenses. The charges from MT to Telenor and from Telenor to MT are almost equal and settled on a net basis and accounted for in the statement of profit or loss and the effect of this settlement is not significant.

In case any of the parties initiates the termination of this contract, in order to ensure the continuous service for the customers the Company might be exposed to additional capital expenditure. The probability is estimated remote by the Management currently.

12 OTHER ASSETS

12.1 Other current assets

	At December 31,	
In HUF millions	2016	2017
Prepayments and advance payments	6,417	8,756
Advance payments to Joint ventures (Note 11.3)	912	-
Other taxes receivable	1,736	1,659
Other	1,874	2,893
Total other receivables	10,939	13,308

12.2 Other non current assets

Other non current assets mainly include long-term prepaid employee benefits relating to housing loans provided by the Group to employees at lower than market interest rates (see note 4.1.3 (d)).

13 PROVISIONS

13.1 Provisions – accounting policies

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

Provisions are measured and recorded as the best estimate of the economic outflow required to settle the present obligation at the financial statement date. The estimate can be calculated as the weighted average of estimated potential outcomes or can also be the single most likely outcome. Expenses for provisions are recognized in the statement of profit or loss line where the actual expense is expected to be incurred. When a provision is released unused, it is released to the same line of the statement of profit or loss where it was originally provided for.

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

13.2 Provisions in the statement of financial position

In HUF millions	Severance	Share-based payments	Other employee related	Total Employee related	Legal cases	ARO	Other	Total
January 1, 2016	5,556	217	1,709	7,482	1,524	6,942	1,144	17,092
Amounts reversed	(291)	(11)	(179)	(481)	(251)	(264)	(808)	(1,804)
Additions	1,074	382	368	1,824	768	402	803	3,797
Interest	-	1	12	13	38	107	-	158
Exchange rate difference	-	-	(5)	(5)	(4)	-	(1)	(10)
Amounts utilized (incl. interest component)	(4,258)	-	(580)	(4,838)	(159)	(87)	(128)	(5,212)
December 31, 2016	2,081	589	1,325	3,995	1,916	7,100	1,010	14,021
Of which current	1,636	-	494	2,130	1,492	11	860	4,493
Of which non current	445	589	831	1,865	424	7,089	150	9,528
January 1, 2017	2,081	589	1,325	3,995	1,916	7,100	1,010	14,021
Amounts reversed	(633)	(44)	(37)	(714)	(156)	(73)	(846)	(1,789)
Additions	2,851	431	216	3,498	25	340	605	4,468
Decrease due to sale of subsidiary	-	(4)	(177)	(181)	(34)	-	-	(215)
Interest	-	4	-	4	(112)	157	-	49
Exchange rate difference	-	-	(3)	(3)	(3)	-	-	(6)
Amounts utilized (incl. interest component)	(2,694)	(128)	(534)	(3,356)	(624)	(36)	(14)	(4,030)
December 31, 2017	1,605	848	790	3,243	1,012	7,488	755	12,498
Of which current	1,356	0	528	1,884	871	19	493	3,267
Of which non current	249	848	262	1,359	141	7,469	262	9,231

The Interest lines in the table above include the subsequent unwinding of the discount applied at initial recognition and the interest element of any provision recognized, as well as the release of the interest / accretion element in case of reversal of provisions.

Magyar Telekom does not expect any reimbursement with regards to the provisions recognized, therefore, no related assets have been recognized in the financial statements.

13.2.1 Severance

The majority of the provision for severance as at December 31, 2017 relates to the stand-by-pool and the employee terminations payable in 2018 in relation to the further efficiency improvement in Magyar Telekom Plc. The stand-by-pool of employees includes people whose legal status is an employee, however, these people do not provide services to the Company any more, but the Company provides a reduced amount of compensation and pays social security expenses for them. This is a way of severance that is not paid in one lump sum but in monthly installments following the discontinuation of services. The majority of the provision for severance as at December 31, 2016 also related to the stand-by-pool and the employee terminations paid in 2017 in relation to the efficiency improvement in Magyar Telekom Plc.

1,044 employees left the Group in 2017 (2016: 1,265), related to which termination payments were made. The balance of provision as at December 31, 2017 relates to 406 employees and former employees in the stand-by-pool (2016: 486).

The total payments made in relation to employee termination in 2017 amounted to HUF 4,066 million (2016: HUF 6,590 million).

13.2.2 Share-based payments

The bases of the provisions for share-based payments are described in Note 20.1.

13.2.3 Legal cases

Provisions for legal cases mainly include amounts expected to be paid to regulatory and competition authorities as well as to ex-employees and trading partners as a result of legal disputes. There are numerous legal cases for which provisions were recognized, which are individually not material.

13.2.4 Asset retirement obligations (ARO)

Asset retirement obligations primarily exist in case of the telecommunications structures constructed on third parties' properties. The Group carries out a revision of the necessary provisions every year. The revisions did not result in material changes in 2017 or 2016.

13.2.5 Other provisions

Other provisions include guarantee obligations, onerous contracts and further other individually small items.

14 OTHER CURRENT LIABILITIES

		At December 31,	
In HUF millions		**2016**	**2017**
Deferred revenue and advances received		15,310	13,891
Other taxes and social security		14,159	14,520
Salaries and wages		5,233	10,466
Advances received for asset-related grants	(a)	5,104	4,648
Dividend payable to non-controlling interests		461	22
Other liabilities		270	49
		40,537	43,596

(a) Advances received for asset-related grants

In 2016 HUF 12.2 billion of EU funds were granted to Magyar Telekom Group as a result of the first and second rounds of a tender aimed at developing digital networks nationwide to cover households in Western and Eastern parts of Hungary with a fixed network capable of reaching speed of at least 30 Mbps. The Company used up HUF 1,416 million of this advance in 2017. See also Note 9 for government grants relating to the purchase of PPE and Note 28 for details of Purchase of PPE and intangible assets.

15 OTHER NON CURRENT LIABILITIES

Other non current liabilities primarily include deferred revenues related to long term projects and customer loyalty programs.

16 NON-CONTROLLING INTERESTS

Non controlling interests included the minority shareholders in Makedonski Telekom (MKT) and Crnogorski Telekom (CT) in 2016. As a result of the sale of Crnogorski Telekom, the 2017 balance includes only the minority shareholders in MKT. See also Note 26.2.1.

In HUF millions	MKT	CT (discontinued)	Other	Total
Balance at January 1, 2016	34,419	10,294	-	44,713
Dividend declared	(3,234)	(1,416)	-	(4,650)
Total comprehensive income	2,134	646	-	2,780
Balance at December 31, 2016	33,319	9,524	-	42,843
Dividend declared	(2,728)	-	(592)	(3,320)
Total comprehensive income	2,879	(2,781)	-	98
Decrease due to sale of subsidiary	-	(6,743)	-	(6,743)
Balance at December 31, 2017	33,470	-	(592)	32,878

16.1 Summarized financial information on subsidiaries with material non-controlling interests

The information below includes the amounts as included in the consolidation, before inter-company eliminations.

a) Summarized balance sheets

In HUF millions	MKT		CT (discontinued)	
	2016	2017	2016	2017
Current assets	24,871	22,425	12,907	-
Current liabilities	(23,093)	(18,607)	(14,118)	-
Non-current assets	98,008	97,872	50,517	-
Non-current liabilities	(2,059)	(3,660)	(2,257)	-
Net assets	97,727	98,030	47,049	-

b) Summarized income statements

In HUF millions	MKT		CT (discontinued)	
	2016	2017	2016	2017
Revenues	53,414	51,795	28,648	2,023
Profit before income tax	6,075	7,930	3,447	184
Profit for the period	5,132	6,890	2,985	161

c) Summarized cash flows

In HUF millions	MKT		CT (discontinued)	
	2016	2017	2016	2017
Net cash generated from operating activities	18,276	19,227	6,001	3,691
Net cash from investing activities	(9,837)	(12,630)	(2,525)	(6,073)
Dividends/capital reduction paid to Controlling interests	(6,676)	(3,566)	(4,575)	-
Dividends/capital reduction paid to Non-controlling interests	(3,234)	(2,728)	(1,416)	-
Other cash flows from financing activities	(1,663)	(2,417)	1,698	(4)
Net cash used in financing activities	(11,573)	(8,711)	(4,293)	(4)

16.2 Transactions with non-controlling interests

There were no material transactions with non-controlling interests in 2017 or 2016 other than the dividend payments.

The only significant non-controlling interest of the Group is the Macedonian Republic, holding shares in MKT. MKT and Magyar Telekom did not execute as part of its normal business activities any transactions that were individually material in the 2017 or 2016 financial year with companies controlled by the Macedonian Republic or companies over which the Macedonian Republic can exercise a significant influence.

17 LEASES

17.1 Leases – accounting policies

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for a period of time set out in the contract. A lease can be either an operating lease or a finance lease.

According to the accounting principle of substance over (legal) form, in practice not only those arrangements can accounting-wise qualify for leases that are denominated as leases.

In the Group's practice, the following can be in particular arrangements that are not legally leases but might contain leases:

- arrangements assigning network capacity rights to others
- outsourcing-type arrangements (i.e. whereby the Group outsources its own resources/assets/some of its activities/certain employees to another company).

An arrangement contains a lease, if the fulfilment of the arrangement is dependent on the use of a specific asset or assets or if the arrangement conveys a right to use the asset(s). The arrangement conveys the right to use the asset(s) when the arrangement conveys the control over the use of the underlying asset(s) for the lessee. If an arrangement contains a lease, then the lease element of the arrangement should be classified and accounted for as either operating or finance lease. The element of the arrangement other than the lease element should be accounted for in accordance with the applicable standards.

For the purpose of applying the classification and accounting rules payments and other consideration required by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease and those for other elements on the basis of their relative fair values. In doing such separation, a significant degree of estimation might be necessary.

It is the task of the contracting organizations of the Company and supporting controlling departments to inform the relevant accounting experts related to each new lease transaction who then have the responsibility of deciding whether the agreements in question contain a lease element and determining their booking.

a) Finance lease – Group as lessor

Leases of assets where Magyar Telekom transfers substantially all the benefits and risks of ownership are recognized and disclosed as revenue against a finance lease receivable. The revenue equals the estimated present value of the future minimum lease payments receivable and any unguaranteed residual value (net investment in the lease). The cost of the asset sold in a finance lease transaction is recognized at the inception of the lease. Each lease receipt is then allocated between the receivable and interest income so as to achieve a constant rate of return on the finance receivable balance outstanding. The interest element of the lease receipt is recognized in Interest income.

Finance leases mainly include equipment provided to business customers as part of our outsourcing contracts where the Company is the service provider.

b) Finance lease – Group as lessee

Leases of property, plant and equipment where Magyar Telekom assumes substantially all the benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the fair value of the asset or if lower, at the estimated present value of the future minimum lease payments against a finance lease payable. Each lease payment is allocated between the finance lease liability and interest expense so as to achieve a constant rate of interest on the outstanding balance payable. The finance lease obligations, net of finance charges, are included in the Statement of financial position (Other financial liabilities). The interest element of the lease payments is charged to the Profit for the year (Interest expense) over the lease period. Property, plant and equipment acquired under finance lease contracts are depreciated over the shorter of the lease term or the useful life of the asset.

c) Operating lease – Group as lessor

Assets leased to customers under operating leases are included in Property, plant and equipment in the Statement of financial position. They are depreciated over their expected useful lives on a basis consistent with similar assets. Rental revenue is recognized as revenue on a straight-line basis over the lease term.

d) Operating lease – Group as lessee

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

e) Sale and leaseback transactions

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

17.2 Finance leases

17.2.1 Finance lease – Group as lessor

Finance leases mainly include equipment provided to business customers as part of our outsourcing contracts where the Group is the service provider.

Future lease receivables under finance leases at December 31, 2016 and 2017 are as follows:

In HUF millions	At December 31, 2016			At December 31, 2017		
	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt
Within 1 year	602	137	739	246	19	265
1–5 years	372	54	426	163	46	209
After 5 years	222	31	253	183	31	214
Total	1,196	222	1,418	592	96	688

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

The unguaranteed residual values accruing to the benefit of the Group are insignificant.

17.2.2 Finance lease – Group as lessee

Finance leases in 2016 and 2017 mainly relate to the sale and lease back of spaces in buildings accommodating telephone exchanges. In most cases the contracts are denominated in EUR, the term of the leases is 5–15 years, and the contracts include renewal options but no purchase options.

Future lease payments under finance leases related to sale and lease back transactions at December 31, 2016 and 2017 are as follows:

In HUF millions	At December 31, 2016			At December 31, 2017		
	Present value	Interest component	Minimum lease payment	Present value	Interest component	Minimum lease payment
Within 1 year	98	786	884	438	810	1,248
1–5 years	582	2,578	3,160	649	2,577	3,226
After 5 years	1,257	1,282	2,539	1,201	1,213	2,414
Total	1,937	4,646	6,583	2,288	4,600	6,888

Finance leases other than sale and lease back in 2016 and 2017 mainly relate to IPTV set-top-boxes, vehicles and IT equipment. In most cases the contract term of the leases is 2–5 years partly with renewal options and mostly with no purchase options.

Future lease payments under finance leases other than sale and lease back transactions at December 31, 2016 and 2017 are as follows:

In HUF millions	At December 31, 2016			At December 31, 2017		
	Present value	Interest component	Minimum lease payment	Present value	Interest component	Minimum lease payment
Within 1 year	2,246	331	2,577	444	387	831
1–5 years	786	1,038	1,824	626	1,224	1,850
After 5 years	853	592	1,445	815	541	1,356
Total	3,885	1,961	5,846	1,885	2,152	4,037

The Group has no contingent rents related to its finance leases. The Group does not sub-lease any of the assets leased in a finance lease contract.

17.3 Operating leases

17.3.1 Operating lease – Group as lessor

The following table includes the future minimum lease payments receivable by the Group for the operating leases of mobile tower sections and PBX (private business exchange) equipment where Magyar Telekom is the lessor.

In HUF millions	At December 31, 2016	2017
Within 1 year	406	411
1–5 years	418	579
After 5 years	298	523
Total	1,122	1,513

17.3.2 Operating lease – Group as lessee

Operating lease commitments are mainly in respect of the rental of mobile cell sites, and to a lesser extent, related to buildings, network and other telecommunications facilities and equipment. The following table includes the future minimum lease payments payable of the Group:

In HUF millions	At December 31, 2016	2017
Within 1 year	10,723	11,501
1–5 years	26,274	24,569
After 5 years	7,085	4,847
Total	44,082	40,917

The lease commitments represent a high amount of individually immaterial lease agreements, the terms of which vary on a wide range, spanning from 1 to 20 years with renewal options in most cases, but no purchase options.

18 REVENUE

18.1 Revenue – accounting policies

18.1.1 Sale of goods

Revenue from sale of goods (equipment) is recognised when risks and rewards of ownership have been transferred to the customer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. The timing of the transfer of risks and rewards varies depending on the individual terms of the agreement. Revenue from sale of goods is measured net of returns, trade discounts and volume rebates.

18.1.2 Rendering of services

The Company recognises revenue from rendering of services in proportion to the stage of completion of the service at the reporting date. The method of assesment of the stage of completion depends on the type of the service.

18.1.3 Loyalty programs

Customers of the Group are often granted loyalty awards (credit points) based on their usage of the Group's services including timely payment of their invoices. Loyalty awards can be accumulated and redeemed to obtain future benefits (e.g. call credits, handset discounts, etc.) from the operators of the Group. When customers earn their credit points, the fair value of the credit points earned (residual method) are deducted from the revenue invoiced to the customer, and recognized as Other liabilities (deferred revenue). On redemption (or expiry) of the points, the deferred revenue is released to revenue as the customer has collected (or waived) the undelivered element of the deemed bundle.

The loyalty program of Magyar Telekom Plc. was ceased as of July 1, 2017 which resulted in the reversal of the related deferred income for the unredeemed loyalty awards.

18.1.4 Revenue from operating leases

Revenues from operating leases are recognized as revenue on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease. Operating lease revenue are primarily recognized as System integration and IT revenue.

18.2 Revenues from major service lines

18.2.1 Mobile and Fixed line telecommunications revenues

Revenue is primarily derived from services provided to Magyar Telekom's customer subscribers and other third parties using Magyar Telekom's telecommunications network, and equipment sales.

Customer subscriber arrangements typically include an equipment sale, subscription fee and charge for the actual voice, internet, data or multimedia services used. The Group considers the various elements of these arrangements to be separate earnings processes and classifies the revenue for each of the deliverables into the categories using the residual method for each of the elements. These units are identified and separated, since they have value on a standalone basis and are sold not only in a bundle, but separately as well. Therefore the Group recognizes revenues for all of these elements using the residual method, i.e. the amount of consideration allocated to the delivered elements of the arrangements equals the total consideration less the fair value of the undelivered elements. The revenue allocable to a delivered item, however, is limited to the amount that is not contingent upon the delivery of additional items (the non contingent amount). The revenue to be recognized is therefore restricted by the amount received that is not contingent upon undelivered elements of the arrangement.

The Group provides customers with narrow and broadband access to its fixed, mobile and TV distribution networks. Service revenues are recognized when the services are provided in accordance with contractual terms and conditions. Airtime revenue is recognized based upon minutes of use and contracted fees less credits and adjustments for discounts, while subscription and flat rate revenues are recognized in the period they relate to.

Revenues and expenses associated with the sale of telecommunications equipment and accessories are recognized when the products are delivered, provided that there are no unfulfilled obligations that affect the customer's final acceptance of the arrangement. In case the equipment is sold on installments with payment terms exceeding 12 months, the amount of the revenue immediately recognized is the present value of the installments.

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

Revenues from premium rate services are recognized on a gross basis when the delivery of the service over Magyar Telekom's network is the responsibility of the Group, the Group determines the prices of these services and bears substantial risks of these services; otherwise these revenues are presented on a net basis.

Customers may also purchase prepaid mobile, public phone and internet credits (cards) which allow those customers to use Magyar Telekom's telecommunications network for a selected amount of time. Customers must pay for such services at the date when the card is purchased. Revenues from the sale of cards are recognized when used by the customers or when the credits expire with unused traffic.

Third parties using Magyar Telekom's telecommunications network include roaming customers of other service providers and other telecommunications providers which terminate or transit calls on Magyar Telekom's network. These wholesale (incoming) traffic revenues are recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (interconnect) for the use of their networks, where applicable. The revenues and costs of these transit calls are stated gross in the Financial statements as the Group is the principal supplier of these services using its own network freely defining the pricing of the services, and recognized in the period of related usage.

18.2.2 System integration (SI) and IT revenues

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

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

Revenue from system integration contracts requiring the delivery of customized products and/or services is generally covered by one of the following types of contracts: fixed-price or time and material-based. For fixed-price contracts, revenue is generally recognized based on percentage of completion taking into account the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs. In the case of contracts billed on the basis of time and material, revenue is recognized as the services are rendered.

Revenue from maintenance services (generally fixed fee per month) is recognized over the contractual period or as the services are provided. Revenue from repairs, which are not part of the maintenance contract, billed on the basis of time and material used is recognized as the services are provided.

Revenue from hardware and software sales or sales-type leases is recognized when the risk of ownership is substantially transferred to the customer, provided there are no unfulfilled obligations that affect the customer's final acceptance of the arrangement. Any related costs of these revenues are recognized when the revenue is recognized.

Revenues from construction contracts are accounted for using the percentage-of-completion method. The stage of completion is determined on the basis of the costs incurred to date as a proportion of the estimated total costs. Receivables from construction contracts are classified in the Statement of financial position as Trade receivables. If the total actual and estimated expenses exceed revenues for a particular contract, the total expected loss is recognized immediately (Direct costs) against a provision.

18.2.3 Energy retail revenues – gas and electricity

Magyar Telekom Plc. entered the liberalized Hungarian gas and electricity retail market in 2010. The purpose of Magyar Telekom Plc.'s participation in the energy market has been to provide more integrated services to its residential and business customers. Magyar Telekom has offered a fixed percentage discount on the energy bills of its residential telecommunications service customers compared to the incumbent service providers' offers at the location of the customers, thereby also ensuring customer retention. We usually offered individual prices to our business customers.

The annual quantity of the electricity and natural gas consumption is estimated based on the actual customer number and their expected consumption as well as historic weather inputs. These estimates are calculated and continuously updated by customer segment in the energy market: universal residential, universal small business and competitive market clients. These segments are further broken down to sub-groups based on their pricing characteristics so that energy costs and revenues can be estimated with adequate reliability. As time passes during the year, more and more accurate estimates are available for both costs and revenues. Costs and revenues are continuously updated on a year-to-date basis.

Revenues from large business customers (competitive market) are recognized and invoiced based on their actual consumption. Revenues from universal customers are invoiced at flat fee for 11 months, based on the previous year's consumption and the difference between the flat fees charged and the metered annual consumption is settled in the 12th month. Revenues, however, are recognized based on estimated actual consumption throughout the customer year, the beginning of which may be at any time in the year depending on the customer contract date. Due to the large number of customers and sufficient historical data (portfolio effect), the estimated consumption and the resulting costs and revenues are not materially different from the actual amounts.

Revenues from energy retail services are recognized on a gross basis as the delivery of the service is the responsibility of the Company, we determine the prices of these services and bear substantial risks of estimating and purchasing the gas and electricity quantities, resulting in significant "inventory" risks of under or over purchasing the consumed quantities.

For details of the Company's participation on the energy market see Note 34.3.

18.3 Revenue in the Statement of profit or loss

	For the year ended December 31,	
In HUF millions	**2016**	**2017**
Mobile revenues		
Voice retail	146,965	141,185
Voice wholesale	10,346	9,987
Data	62,776	73,992
SMS	16,921	17,259
Equipment	54,950	64,210
Other mobile revenues	14,249	16,023
Total Mobile revenue	306,207	322,656
Fixed line revenues		
Voice retail	50,175	45,977
Broadband retail	49,292	49,334
TV	41,859	45,188
Equipment	5,421	9,254
Data retail	9,526	10,690
Wholesale	20,151	19,050
Other fixed line revenues	17,337	16,615
Total Fixed line revenue	193,761	196,108
System integration and IT revenue	67,289	87,485
Revenue from energy services	6,778	4,602
	574,035	610,851

None of the Group's customers represent a significant source of revenue. Revenues from transactions with a single external customer (or group of entities that – knowingly to us – are under common control of a third party or government) do not exceed 10 per cent of the Group's revenues.

19 DIRECT COSTS

In HUF millions		For the year ended December 31, 2016	2017
Interconnect costs		19,629	18,885
SI/IT service related costs		39,458	60,438
Telecom tax	(a)	24,260	25,085
Bad debt expense		7,880	5,520
Energy service related costs		6,779	4,787
Other direct costs	(b)	114,391	131,062
		212,397	245,777

In 2017 telecom tax was reclassified from Other operating expenses to Direct costs. In order to maintain consistency with the 2017 year presentation of direct costs, the 2016 direct costs are also presented in the new structure. Since telekom tax is directly related to revenue, better fair view is provided as a result of the reclassification. Management believes that the new cost breakdown presentation of the Group is more transparent.

(a) Telecom tax was introduced in Hungary for fixed and mobile voice and mobile SMS/MMS services, effective from July 1, 2012. The tax imposed on fixed and mobile usage amounts to HUF 2 per minute and HUF 2 per SMS/MMS for private individual subscribers' subscriptions and to HUF 3 per minute and HUF 3 per SMS/MMS for non-private individual subscribers' subscriptions. The tax is capped at HUF 700 and HUF 5,000 per month per calling number for private and non-private individuals' subscriptions, respectively.

(b) Other direct costs include costs of mobile and fixed device, accessories and other equipment, agent commissions and non-voice direct costs.

20 EMPLOYEE RELATED EXPENSES

20.1 Employee related expenses – accounting policies

20.1.1 Short term employee benefits

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

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

20.1.2 Share based compensation

Magyar Telekom recognizes the costs of services received from its employees in a share based payment transaction when services are received. Magyar Telekom recognizes a corresponding increase in its equity reserves (Reserve for equity settled share based transactions) if the services are received in an equity-settled share based payment transaction. When the share based compensation program is completed, i.e. the shares are transferred to the employees' ownership or the share options have forfeited, the respective reserve is transferred to Retained earnings. If the services are received in a cash-settled share based payment transaction, the Group recognizes the expense against a liability, re-measured to fair value at each financial statement date.

Fair values are determined using option pricing models (such as Black–Scholes and Monte Carlo simulation) and other relevant techniques. As Magyar Telekom Plc. and DT AG are listed and actively traded on the stock exchanges, the share prices and their history are readily available as a basis for fair value calculations.

Bonuses tied to the long term performance of the Magyar Telekom and Deutsche Telekom shares are recognized in the Profit for the year at their time-proportioned fair value against an accumulating balance in Provisions.

20.1.2.1 Share Matching Plan of Magyar Telekom's CEO

In December 2011 the Board of Directors approved the implementation of the revolving Share Matching Plan of Magyar Telekom. The program was implemented for the CEO of Magyar Telekom starting in 2012. An amount of minimum 10% of the gross annual bonus of the CEO was to be invested in shares of Magyar Telekom. The CEO had the option of voluntary increase to a maximum of 33.3% of his bonus. These shares are to be held for a period of at least 4 years (lock-up period). After the lock-up period of 4 years has passed, one additional share (matching share) will be granted for every share acquired as part of the aforementioned personal investment. The program was planned to be revolving in 5 consecutive years starting in 2012.

In 2017 HUF 5 million was recognized as expenses for the program (2016: HUF 17 million).

Magyar Telekom implemented amendments to the CEO's Share Matching Plan from July 1, 2015 so that the CEO has to invest in DT shares instead of MT shares. The other principles remained the same.

20.1.2.2 Share Matching Plan of Deutsche Telekom

As of July 1, 2015, Magyar Telekom Group implemented Share Matching Plan for all executives (cca. 60). Participation in the program is voluntary, with the exception of the CEO, who is obliged to participate in the program with the conditions above.

The participant is required to invest a minimum of 10% of his/her gross annual bonus in Deutsche Telekom shares, with an option to voluntary increase this amount to a maximum of 33.3% (personal investment). These shares shall be kept for at least 4 years (the lock-up period), the participant is granted matching shares upon expiry of the lock-up period. The share allocation ratio of the program (1:1, 1:2 or 1:3) depends on the evaluation of the participant's performance in the previous year. Deutsche Telekom grants the matching shares to the participant based on the acquired Deutsche Telekom shares by the participant within the framework of the program. The program starts annually if the free cash flow target of Deutsche Telekom Group was met in the previous year.

In 2017 HUF 27 million was recognized as expenses for the program (2016: HUF 19 million).

20.1.2.3 Long-term incentive program (LTI)

As of January 1, 2015 Magyar Telekom Group changed its existing LTI program, turning it into a share-based compensation program. Approximately 60 executives may participate in the program. The CEO's participation is unconditional, while other executives may participate only if the evaluation of the participant's performance in the previous year meets the requirements.

LTI is payable in cash tied to the achievement of four key strategic indicators. In the framework of the program, in each year a new four-year tranche is to be launched. Payment is due after the end of the program term depending on the evaluation of the achievement of the pre-set targets (0 to 150%).

At the beginning of the program, the relevant incentive amount is converted into a number of virtual shares of DTAG and awarded to the plan participant in the form of virtual shares (basic number). The annual level of target achievement is determined at the end of each year. This target achievement level is multiplied on a pro rata basis by the basic number of virtual shares awarded. The number of virtual shares calculated using this method shall then be "fixed" for the plan participant as the binding result for that specific year ("annual result"). At the end of the plan term, the four binding annual results shall be added together. The resulting total number of virtual shares shall be converted into cash applying the then prevailing share price of DTAG, which is paid to the plan participants. For dividend payments during the plan term, the virtual shares shall be treated as real shares. The dividends shall be taken into account as follows: The first/second/third dividend payments shall be "reinvested" into virtual shares when the actual dividends are paid on real shares. The fourth (and last) dividend payment shall not be reinvested but paid in cash together with the plan payment following the DTAG shareholders' meeting at which a decision is made regarding this dividend payment. The plan currency is euro.

In 2017 HUF 380 million was recognized as expenses for the program (2016: HUF 370 million).

20.1.2.4 Share transfer to ESOP Organization

In July 2016 Magyar Telekom launched a Remuneration Policy based employee share ownership program (ESOP) under which Magyar Telekom shares were distributed to the vast majority of the employees of Magyar Telekom Plc. and T-Systems Hungary Ltd.. This program was in addition to the Company's regular remuneration package. The award of shares was 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 was 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 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 was expected to distribute the shares amongst 6,646 employees in April 2017, where each eligible individual was entitled to receive 226 shares.

In accordance with the ESOP Act the ESOP Organization manages the financial instruments provided to the ESOP Organization in accordance with the effective remuneration policies approved by the Company 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 supreme body. 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 25,764 shares were sold by the ESOP Organization due to the revision of the number of the participants in the program. The ESOP Organization is fully consolidated from its set up as it was established and it is controlled by the Company. As the improvement of the oFCF of MT-Hungary segment was confirmed by the Board of Directors, the ESOP Organization distributed the shares amongst 6,452 employees in April 2017.

In 2017 HUF 164 million was recognized as expenses for the program (2016: HUF 493 million).

20.1.2.5 Bonus payment via ESOP Organization

By reshaping the current remuneration structure, the Company has launched an incentive program based on the new remuneration policy in 2017, by which the corporate financial targets, approximately half (50%) of the total bonus, will be paid via the ESOP Organization for Magyar Telekom Plc. and T-Systems Magyarország Zrt. eligible employees. Under the new incentive program, the Company purchased 4,534,758 Magyar Telekom shares worth HUF 2,139 million during 2017. The purchased shares were transferred to the ESOP Organization in several installments. The vesting conditions of the new program are (a) that the operating free cash flow for the MT-Hungary segment for the financial year ending December 31, 2017 to exceed that for the previous year ending December 31, 2016 and (b) that the effected employee is employed by Magyar Telekom Plc. or T-Systems Magyarország Zrt. in March 2018 (vesting date). In accordance with the remuneration program those employees of the Company and T-Systems Magyarország Zrt. are rewarded who are under the personal scope of the Remuneration policy approved on February 22, 2017 by the Company's Board of Directors.

If the vesting conditions are met the corporate financial target will be paid in cash based on the employees' claims arising from the conversion of the transferred Magyar Telekom ordinary shares into cash expectedly in March 2018 via the ESOP Organization. The Company considers January 1, 2017 as grant date with respect to the initial assumptions of the newly formed share based program because the parties had a common understanding on the relevant terms defined by historical conditions at that date.

The Company is expected to be able to cover the significant proportion of the bonus payments related to the corporate financial target via the ESOP based on the formula in the Remuneration policy and relevant internal regulation. The remaining part of the total bonus will be granted to the employees as supplementary benefit when the exchange rate for converting the shares into cash by the ESOP Organization is already known. The Company is liable to repurchase the shares under the Articles of Association of the ESOP Organization.

Employees who fall out of the scope of the Remuneration policy before the management of the ESOP Organization asserts the fulfillment of the vesting conditions, are not entitled for the benefit via the ESOP Organization, such benefits will be paid off by the Company under the relevant internal regulations.

In 2017 HUF 2.1 billion was recognized as the total expenses of the program which was recognized in the statement of financial position as Other current liability.

20.1.3 Termination benefits

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

20.2 Employee related expenses in the Statement of profit or loss

In HUF millions	For the year ended December 31, 2016	2017
Short term benefits (Notes 20.1.1)	81,805	80,562
Termination benefits (Note 20.1.3)	3,036	3,618
Equity settled share based compensations (Notes 20.1.2.1 and 20.1.2.2)	36	32
Cash settled share based compensations (Note 20.1.2.3)	375	380
Employee share ownership program (ESOP Note 20.1.2.4)	493	164
Bonus payment via ESOP (Note 20.1.2.5)	-	2,131
Total before capitalization	85,745	86,887
Expenses capitalized	(6,867)	(6,647)
	78,878	80,240
Total costs expensed in relation to defined contribution plans (including social security contribution)	18,442	16,288
Average number of employees (full time equivalent)	9,488	9,135
Closing number of employees (full time equivalent)	9,432	9,154

21 OTHER OPERATING EXPENSES

In HUF millions		For the year ended December 31, 2016	2017
Utility tax	(a)	7,265	7,418
Rental and leasing expenses		16,968	17,931
Marketing expenses		11,987	11,383
Energy costs		9,021	8,351
Cost of other purchased services	(b)	51,235	52,408
Other operating expenses		9,700	8,427
		106,176	105,918

In 2017 telecom tax was reclassified from Other operating expenses to Direct costs. In order to maintain consistency with the 2017 year presentation of Other operating expenses, the 2016 Other operating expenses are also presented in the new structure. Management believes that the new cost breakdown presentation of the Group is more transparent.

Research as well as marketing costs are expensed as incurred. Research costs recognized by the Group were not material in either of the presented years.

(a) Utility tax

In 2012 the Hungarian Parliament adopted an act imposing a new tax on utility networks, effective from January 1, 2013. The act provides that a tax of HUF 125 per meter is levied on the owners of ducts providing for electricity, telecommunication, natural gas, heating, water and wastewater services. For telecommunication networks, the level of tax levied depends on the length of ducts: 20%

of the HUF 125 per meter is levied on the first 170,000 meter length of ducts, 40% is levied between 170,000 and 250,000 meters, 80% is levied between 250,000 and 300,000 meters, while the total HUF 125 per meter has to be paid for all ducts above 300,000 meters.

(b) Audit costs included in Cost of other purchased services

Cost of other purchased services among others include expenses incurred in relation to the audit of the standalone and consolidated financial statements of the members of the Group as well as other services provided by PricewaterhouseCoopers (PwC) as follows.

	For the year ended December 31,	
In HUF millions	**2016**	**2017**
Audit of the financial statements	371	380
Other audit related fees	156	29
Other non audit related fees	121	-
Total expenses payable to PwC	648	409

Audit of the financial statements is the aggregate fees of PwC in connection with the audit of our annual financial statements and services performed in relation to legal obligations and submissions required by regulatory provisions.

Other audit-related fees are the aggregate fees of PwC for review of the second quarterly report (in 2016 all the four quarterly reports) and services which are normally performed by the external auditor in connection with the auditing of the annual financial statements, e.g. advice on issues of accounting and reporting, which were not classified as audit services.

Other non audit related fees are fees of PwC primarily related to consulting services and services like participation by Magyar Telekom employees in conferences and training sessions organized by PwC.

22 OTHER OPERATING INCOME

	For the year ended December 31,	
In HUF millions	**2016**	**2017**
Income on the sale of PPE, Intangible assets and assets held for sale - net	4,170	1,290
Gain on sale of Origo (Note 26.2.2)	2,149	-
Income received for the relocation and reconstruction of our own network	1,111	939
Brand license fee	-	500
Income from insurance compensation	302	163
Income from intra-DT group support services	107	104
Other operating income	3,072	3,750
	10,911	6,746

23 INTEREST INCOME

In HUF millions	For the year ended December 31, 2016	2017
Interest income on loans and receivables	389	327
Finance lease interest income	38	27
Reversal of interest element of provisions	30	175
Dividend income	14	14
	471	543

24 INTEREST EXPENSE

In HUF millions	For the year ended December 31, 2016	2017
Interest expense payable to DT	13,890	9,094
Other interest expense	3,451	3,212
Finance lease interest expense	1,185	1,209
Accretion / interest on provisions	158	49
less: borrowing costs capitalized	(120)	(39)
	18,564	13,525

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense. Borrowing costs include interest and other costs that the Group incurs in connection with the borrowing of funds. The borrowing costs eligible for capitalization are capitalized applying the weighted average of the borrowing costs applicable to the general borrowings of the Group that are outstanding during the period. A qualifying asset is an asset that necessarily takes a substantial period of time, in general over 12 months, to get ready for its intended use.

Total Interest expense is shown net of borrowing costs capitalized using average borrowing rates of 2.92%-3.46% in 2017 (2016: 3.77%-4.33%). When calculating the borrowing rates, Other finance expenses (included in Note 25) are also considered.

25 OTHER FINANCE EXPENSE – NET

In HUF millions	For the year ended December 31, 2016	2017
Fee expense	4,885	4,856
Net foreign exchange losses / (gains) on financial instruments	(27)	(1,107)
Other net foreign exchange losses	(37)	123
Losses / (gains) on the subsequent measurement of derivatives contracted with related parties	3,882	4,448
Losses / (gains) on the subsequent measurement of derivatives contracted with third parties	79	-
Losses / (gains) on the derecognition of derivatives contracted with related parties	207	337
Losses / (gains) on the derecognition of derivatives contracted with third parties	(80)	(12)
Losses / (gains) on the derecognition of AFS financial instruments (Reclassifications from Other comprehensive income)	-	-
	8,909	8,645

26 CHANGES IN THE GROUP

26.1 Business combinations

26.1.1 Acquisition of SERVERINFO

In October 2016 T-Systems Magyarország Zrt. signed an agreement with WING Group to buy 100% of SERVERINFO-INGATLAN Kft. (Serverinfo). As a result of the transaction Magyar Telekom Group gains ownership of the property where its highly secure data center with state of the art technical infrastructure is located. The value of the transaction is EUR 14.4 million (approximately HUF 4.4 billion) including loans of HUF 3.2 billion of Serverinfo, which were repaid subsequent to the closing of the transaction. Serverinfo manages the rentals and the maintenance of the property where the data center of T-Systems Magyarország Zrt. is located. The majority of the consideration relates to the fair value of the property. The closing of the transaction took place in January 2017.

The carrying values of assets and liabilities acquired as well as the consideration transferred are disclosed in the table below.

In HUF millions	Carrying values
Consideration transferred	1,485
Less: Fair value of the net assets acquired	(1,150)
Goodwill	335
Net assets acquired:	
Cash and cash equivalents	475
Trade and other receivables	55
Income tax receivables	1
Property, plant and equipment	4,079
Loans	(3,203)
Trade and other payables	(138)
Deferred tax liability	(119)
	1,150

The total purchase price was paid in cash in 2017.

Serverinfo and GTS Hungary Kft. merged into TSM Hungary Zrt. as of September 30, 2017. Magyar Telekom made its decision on the merger in line with its portfolio simplification strategy.

26.1.2 Cable TV network and operations

In 2017 and 2016, the Group acquired a number of cable TV businesses in individually insignificant transactions. All these acquisitions qualified as business combinations of the MT-Hungary operating segment. The vast majority of the total purchase price was paid in cash in 2017 and 2016.

The table below shows the summary of the individually insignificant transactions.

In HUF millions	2016	2017
Consideration transferred	58	2,428
Less: Fair value of the net assets acquired	39	2,132
Add back: Difference between the preliminary and final PPA value	188	-
Goodwill	207	296

26.2 Disposals of subsidiaries

26.2.1 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 (HUF 38.5 billion). The closing of the transaction took place in January 2017.

This subsidiary was previously not classified as held for sale but it was considered as a separate cash generating unit and reportable segment as well, therefore the sale constituted a discontinued operation. Impact on the segment disclosures is in Note 33.2.1. The comparative consolidated statement of profit or loss and other comprehensive income has been restated to show the discontinued operation separately from continuing operations of the Group. See also Note 1.3. In the Consolidated Statements of cash flows the proceeds from the sale of subsidiaries and business units are disclosed net of the Cash and cash equivalents of the subsidiaries sold.

26.2.1.1 Results of the discontinued operation

In HUF millions	For the year ended December 31, 2016	For the year ended December 31, 2017
Revenues	28,616	2,027
Direct costs	(8,732)	(533)
Employee related expenses	(4,449)	(332)
Depreciation and amortization	(6,166)	(517)
Other operating expenses	(5,970)	(525)
Operating expenses	(25,317)	(1,907)
Other operating income	79	73
Operating profit	3,378	193
Net financial result	187	7
Income tax from discontinued operations	(462)	(23)
Profit after tax from discontinued operations	3,103	177
Gain on sale of discontinued operation	-	10,504
Income tax on gain on sale of discontinued operation	-	(1,155)
Profit for the year from discontinued operations	3,103	9,526
Other comprehensive income from discontinued operations	(275)	(12,512)
Total comprehensive income from discontinued operations	2,828	(2,986)

26.2.1.2 Effect of the disposal on the financial position of the Group

In HUF millions	At disposal in 2017
Cash and cash equivalents	2,062
Trade and other receivables	8,860
Other current financial assets	452
Other current assets	736
Inventories	558
Property, plant and equipment	24,079
Intangible assets (including goodwill)	21,977
Deferred tax assets	718
Other non current financial assets	3,060
Other non current assets	540
Current financial liabilities	(2,826)
Other current liabilities	(1,099)
Trade payables	(9,260)
Current income tax payable	(408)
Provisions	(215)
Non current financial liabilities	(590)
Deferred tax liabilities	(1,439)
Net assets and liabilities	47,205
Consideration received	38,458
Cash and cash equivalents disposed of	2,062
Net cash inflows	36,396

26.2.2 Disposal of Origo

In 2016 Magyar Telekom sold its 100% shareholding in Origo Zrt. This subsidiary did not constitute a discontinued operation. The closing of the transaction took place in February 2016. Origo had been a consolidated subsidiary of the Group included in the MT-Hungary operating segment. The gain on the sale of Origo was recognized in Q1 2016.

In the Consolidated Statements of cash flows the proceeds from the sale of subsidiaries and business units are disclosed net of the Cash and cash equivalents of the subsidiaries sold.

26.3 Pro forma information

The pro forma information shows the most important financial data of the Group, as if the business combinations that took place in that year had been consolidated from the beginning of the year of acquisition, and also how much the business combination contributed to the reported figures since the acquisition date. Cable TV acquisitions were insignificant in 2016 and 2017 therefore their contribution to the Group's operations was also insignificant. The sale of Crnogorski Telekom A.D. is considered as a discontinued operation, which resulted in re-presented 2016 figures. As Serverinfo was acquired in January 2017, and its inclusion in the Group's operations was not significant, it does not affect the proforma information. As Origo was sold on February 5, 2016, and its exclusion from the Group's operations was not significant, it does not affect the proforma information either.

27 EARNINGS PER SHARE

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

28 PURCHASE OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

The table below shows the reconciliation of investments in property, plant and equipment and intangible assets and the cash payments made for these investments from continuing operations. The investments in both property, plant and equipment and intangible assets of discontinued operations are included in the Net cash used in investing activities from discontinued operations line of the Consolidated Statement of cash flows. Capitalized borrowing costs are included in the Investments in PPE and intangible assets, where applicable.

In HUF millions		For the year ended December 31, 2016	2017
Investments in property, plant and equipment (Note 9.2)		68,051	57,278
Investments in intangible assets (Note 10.2)		29,672	28,920
Total investments in PPE and intangible assets		97,723	86,198
Net change of advances received for asset-related grants	(a)	(5,104)	456
Capitalized leases	(b)	(1,459)	(272)
Change in trade payables relating to capital expenditures	(c)	5,236	4,418
Cash payments for purchases of PPE and intangible assets		96,396	90,800

(a) Advances received for asset-related grants

In 2016 HUF 12.2 billion of EU funds have been granted to Magyar Telekom Group (Details in Note 14 (a).) HUF 5.1 billion were received by the Company as advance for this grant, and none of this was used up in 2016. In 2017, additional HUF 1.0 billion were received by the Company as advance for this grant, and HUF 1.4 billion of this was used up. As such grants are deducted from the original cost of the items (Note 10.1), the amount reduces cash payments for purchases of PPE and intangible assets.

(b) Capitalized leases

Investments in PPE as a result of finance lease transactions do not usually result in immediate cash payments. The cash payments throughout the lease term appear as Repayment of other financial liabilities (Financing cash flow) and Interest and other financial charges paid (Operating cash flow).

(c) Change in trade payables relating to capital expenditures

Change in payables relating to capital expenditures includes the effect that the actual cash settlement of the vendor invoices is made subsequent to the recognition of the investment.

29 PURCHASE OF SUBSIDIARIES AND BUSINESS UNITS

In HUF millions	For the year ended December 31, 2016	2017
Acquisition of Serverinfo (Note 26.1.1)	-	1,485
Cable TV businesses (Note 26.1.2)	128	2,306
Cash payments for purchases of subsidiaries and business units	128	3,791

Cash payments related to the purchases of subsidiaries and business units include advance payments made before the closing of the transaction, the initial purchase price paid on the closing of the transaction as well as amounts paid as additional contingent purchase prices disbursed in years following the year of the business combination.

30 CONTINGENT ASSETS AND LIABILITIES

30.1 Contingent assets

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence of uncertain future events not within the control of the Group. These assets are not recognized in the statement of financial position.

The Group has no contingencies where the inflow of economic benefits would be probable and material.

30.2 Contingent liabilities

No provision is recognized for contingent liabilities. A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events (excluding executory contracts) not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability.

The most significant contingent liabilities of the Group are described below. No provisions have been recognized for these cases as management estimates that it is unlikely that these claims originating from past events would result in any material economic outflows from the Group, or the amount of the obligation cannot be measured with sufficient reliability.

30.2.1 Hungary

30.2.1.1 Guarantees

Magyar Telekom Plc. is exposed to risks that arise from the possible drawdown of guarantees for which see more details in Note 4.5.4.

31 PURCHASE COMMITMENTS

31.1 Purchase commitments for tangible and intangible assets

The table below summarizes Magyar Telekom's contractual purchase commitments for tangible and intangible assets with the majority falling due within two years.

In HUF millions	At December 31, 2016	2017
Property, plant and equipment	4,697	9,813
Intangible assets	5,174	5,310
Total	9,871	15,123

31.2 Purchase commitments for businesses

As at December 31, 2017 and 2016 the Group had no significant committed business combinations.

32 RELATED PARTY TRANSACTIONS

No impairment was recognized for receivables from related parties in the reported years.

32.1 Deutsche Telekom Group and the Federal Republic of Germany

32.1.1 Deutsche Telekom Group

Deutsche Telekom AG is the ultimate (indirect) controlling owner of Magyar Telekom Plc. holding 59.21% of the voting rights attached to the Company's shares. Deutsche Telekom Group has a number of fixed line, mobile and IT service provider subsidiaries worldwide, with whom Magyar Telekom Group has regular transactions.

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

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

In HUF millions	2016	2017
Revenues from services provided to DT Group companies	15,547	18,370
Costs of services provided by DT Group companies	(10,379)	(13,151)
Income from support services provided to DT Group companies	107	104
Interest expense to DTIF	(4,449)	(2,297)
Interest expense to DTAG	(9,441)	(6,797)
Dividend paid to parent company	9,262	26,672
Accounts receivable from DT Group companies	10,744	9,029
Accounts payable to DT Group companies	(16,156)	(12,026)
Loans payable to DTIF	(110,919)	(101,838)
Loans payable to DTAG	(199,300)	(153,353)
Fair value of swap agreements with DTAG – asset	5,268	2,978
Fair value of swap agreements with DTAG – liability	(3,452)	(5,612)

Deutsche Telekom has pledged its support for Magyar Telekom's budgeted financing needs through to June 30, 2019.

32.1.2 The Federal Republic of Germany

The Federal Republic of Germany is both a direct and an indirect shareholder and holds approximately 32 percent of the share capital of DTAG. Due to the average attendance at the shareholders' meetings, the Federal Republic of Germany represents a solid majority at the shareholders' meetings of DTAG, although it only has a minority shareholding, making DTAG a dependant company of the Federal Republic. Therefore, the Federal Republic and the companies controlled by the Federal Republic or companies over which the Federal Republic can exercise a significant influence are classified as related parties of DTAG, and consequently of Magyar Telekom as well.

DTAG and Magyar Telekom did not execute as part of its normal business activities any transactions that were individually material in the 2017 or 2016 financial year with companies controlled by the Federal Republic or companies over which the Federal Republic can exercise a significant influence.

32.2 Associates and joint ventures

The Group has no significant associates and the transactions with them are not material.

E2 Hungary Zrt. is a joint venture of the Magyar Telekom Group since July 9, 2015. The company started its operations in 2016 and provides energy services for business customers since then. See also note 11.3.

The Group did not have material transactions with its joint venture in either 2016 or 2017.

32.3 Board and Supervisory Board members

In HUF millions	For the year ended December 31, 2016	2017
Remuneration of the members of the Board of Directors	16	16
Remuneration of the members of the Supervisory Board	63	63
Loans granted to the members of the Board of Directors	-	-
Loans granted to the members of the Supervisory Board	2	2

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.

32.4 Key management

Key management has been identified as the members of the Company's Management Committee, which is the chief operating decision making body of Magyar Telekom.

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

In HUF millions	For the year ended December 31, 2016	2017
Salaries and other short-term employee benefits	1,727	1,168
Contractual termination expense	-	-
Share based compensation (Note 20.1)	33	25
	1,760	1,193
Of which costs expensed in relation to defined contribution plans (including social security contribution)	347	295

The Group does not provide loans to its key management.

33 REPORTABLE SEGMENTS AND INFORMATION ABOUT GEOGRAPHICAL AREAS

33.1 Segment information

The Group's segments are reported in a manner consistent with the internal reporting provided to the chief operating decision makers, the members of the Management Committee (MC) of Magyar Telekom Plc. The MC is responsible for allocating resources to, and assessing the performance of, the operating segments on a monthly basis. The accounting policies and measurement principles of the operating segments are very similar to those applied for the Group described in the previous sub-notes of the Summary of significant accounting policies. The differences primarily originate from the fact that the operating segments' annual results are determined and closed at an earlier stage, around January 8–10 each year, than these Financial statements. Any items discovered and requiring adjustment between the closing date of the segment results and the approval date of the Financial statements are reflected in the next year's segment results.

The operating segments' revenues include revenues from external customers as well as the internal revenues generated from inter-segment support services.

The operating segments' results are monitored by the MC down to EBITDA (Earnings before interest, tax, depreciation and amortization) level, which is defined by the Group as Operating profit without Depreciation and amortization expense.

The MC does not monitor the assets and liabilities at segment level.

Another important KPI monitored at segment level is capital expenditure (Capex), which is determined as the annual investments in PPE and Intangible assets.

33.2 Reportable segments

As of Q1 2017, Magyar Telekom's operating segments are MT-Hungary and Macedonia. Magyar Telekom disposed of its majority stake in Crnogorski Telekom A.D. in January, 2017, and as such, the Montenegrin segment is no longer part of the Group's consolidated results. Further information about this discontinued operation is provided in Note 26.2.1.

The MT-Hungary segment operates in Hungary, providing mobile and fixed line telecommunications, TV distribution, information communication and system integration services, energy retail services to millions of residential and business customers under the Telekom and T-Systems brands. Residential and SMB customers are served by the Telekom brand and key business customers (large corporate and public sector customers) are served by the T-Systems brand. The MT-Hungary segment is also responsible for the wholesale of mobile and fixed line services within Hungary, and performs strategic and cross-divisional management, as well as support functions on behalf of the Group including Procurement, Treasury, Real Estate, Accounting, Tax, Legal and Internal Audit. This segment is also responsible for the Group's points of presence in Bulgaria and Romania, which mainly provide wholesale services to local companies and operators. The Macedonian segment is responsible for the Group's full-scale mobile and fixed line telecommunications operations in Macedonia.

33.2.1 Information regularly provided to the Management Committee (MC)

The following tables present the segment information by reportable segment regularly provided to the MC of the Company, reconciled to the corresponding Group numbers. The information regularly provided to the MC includes several measures of profit which are considered for the purposes of assessing performance and allocating resources, including EBITDA adjusted for the impact of certain items considered as "special influence". These items vary year-over-year in nature and magnitude. Management believes that Revenue, EBITDA and Capex are the segment measures that are most consistent with the measurement principles used in measuring the corresponding amounts in these financial statements.

Revenues	For the year ended December 31,	
In HUF millions	2016	2017
Total MT-Hungary revenues	520,994	559,248
Less: MT-Hungary revenues from other segments	(292)	(127)
MT-Hungary revenues from external customers	520,702	559,121
Total Macedonia revenues	53,414	51,795
Less: Macedonia revenues from other segments	(81)	(65)
Macedonia revenues from external customers	53,333	51,730
Total consolidated revenue of the segments	574,035	610,851
Measurement differences / rounding between segment and Group revenue	-	-
Total revenue of the Group from continuing operations	**574,035**	**610,851**
Total Montenegro revenues (discontinued)	28,648	2,023
Less: Montenegro revenues from other segments (discontinued)	(32)	4
Montenegro revenues from external customers (discontinued)	28,616	2,027
Total revenue of the Group	**602,651**	**612,878**

Segment results (EBITDA)	For the year ended December 31,	
In HUF millions	2016	2017
MT-Hungary	168,920	164,968
Macedonia	19,162	20,225
Total EBITDA of the segments from continuing operations	188,082	185,193
Measurement differences / rounding between segment and Group EBITDA	(587)	469
Total EBITDA of the Group from continuing operations	**187,495**	**185,662**
Montenegro (discontinued)	9,439	702
Income from sale of Crnogorski Telekom (segment Montenegro)	-	10,504
Measurement differences / rounding between segment and Group EBITDA	105	8
Total EBITDA of the Group from discontinued operations	**9,544**	**11,214**
Total EBITDA of the Group	**197,039**	**196,876**

Capital expenditure (Capex) on PPE and Intangible assets	As at December 31,	
In HUF millions	2016	2017
MT-Hungary	87,391	73,936
Macedonia	10,306	12,529
Montenegro (discontinued)	6,481	177
Total capital expenditure of the segments	104,178	86,642
Acquisition of mobile licenses (Note 10)	9,232	-
Other measurement differences between segment and Group Capex	(155)	(267)
Total investments of the Group in PPE and Intangible assets	**113,255**	**86,375**

The acquisition of mobile licenses is not considered part of the Capex measure of the segments. Total investments of the Group in PPE and Intangible assets correspond to the "Investments" lines disclosed in Notes 9, 10 and 28.

33.3 Information about geographical areas

The table below shows the revenues generated from external customers in the countries where the Group operates, using the same measurement principles as for the corresponding Group numbers.

Revenues	For the year ended December 31,	
In HUF millions	2016	2017
Hungary	515,990	554,831
Macedonia	53,333	51,730
Romania	2,982	2,307
Bulgaria	1,730	1,983
Total revenue of the Group from continuing operations	**574,035**	**610,851**
Montenegro (discontinued)	28,616	2,027
Total revenue of the Group	**602,651**	**612,878**

The table below shows the Non current assets of the Group located in the countries of operations (including goodwill allocated to operating segments operating in these countries) and the reconciliation to the total Non current assets of the Group, using the same measurement principles as for the corresponding Group numbers.

Non current assets	As at December 31,	
In HUF millions	2016	2017
Hungary	815,757	800,940
Macedonia	95,918	95,845
Montenegro (discontinued)	46,939	-
Bulgaria	3,086	3,038
Romania	1,524	1,429
Total excluding Non current financial assets and Deferred tax assets	963,224	901,252
Other non current financial assets (Note 4.2.3.2)	18,254	19,323
Deferred tax assets (Note 6.3.2)	73	59
Total Non current assets of the Group	981,551	920,634

34 PUBLIC SERVICE CONCESSION AND LICENSE ARRANGEMENTS

Magyar Telekom's primary activities are the fixed line and mobile operations in Hungary, Macedonia. These services are in most cases regulated by these countries' laws or other legislations. These services in most cases require the acquisition of a license or concession, which usually requires a one-off fee and annual payments.

The most important features of the regulations of these services are described below.

34.1 Hungarian Mobile

Magyar Telekom Plc. is the market leading mobile service provider in Hungary. The Implementation of the EU New Regulatory Framework (NRF) Review package had been completed by the amendment of the Act C of 2003 on Electronic Communications (hereinafter: Communications Act). The National Media and Infocommunications Authority of Hungary (NMIAH) is the supreme supervisory body and is responsible for secondary legislation making and the preparation of relevant decrees.

In June 2012, the Hungarian Parliament adopted the modification of the Electronic Communications Law extending the scope of competence and tasks of the NMIAH. Pursuant to the amendment, all spectrum related issues are dealt with by the NMIAH.

On December 7, 2004, the Company obtained the spectrum usage right of certain frequency blocks for the deployment and operation of an IMT2000/UMTS mobile telecommunications system (3G system). The duration of the spectrum license is 15 years (until December 7, 2019) with an option to extend it for another 7.5 years.

The Company won a tender for a spectrum usage right for a 26 GHz block on April 30, 2009. On May 14, 2012 the NMIAH granted spectrum license to Magyar Telekom for 4 pieces of basic spectrum blocks (2 x 28 MHz each) in the 26 GHz band. Furthermore Telekom acquired GTS Hungary Ltd's blocks in the 26 GHz band for HUF 114.6 million HUF net, and has a usage right for it from November 1, 2016. Blocks purchased in 2012 are to be prolonged in 2018, conditions are to be renegotiated meanwhile the prolongation procedure.

The Company filed an auction bid in December 2011 with the NMIAH for the right of use of unused spectrum in the 900 MHz frequency band, related to the provision of mobile telecommunications services. The spectrum can be utilized in a technology-neutral manner. The NMIAH announced its first-instance decision on the result of the 900 MHz auction (Auction) on January 30, 2012. Magyar Telekom won the right of use of two duplex frequency blocks of 1 MHz each for a period of 15 years.

On September 6, 2013 Magyar Telekom and the NMIAH signed the modification of the Authority Contract on the use of the 900 MHz and 1800 MHz frequency bands. The main stipulations of the modification are the following:

- Magyar Telekom's spectrum usage rights in the 1800 MHz frequency band otherwise expiring on October 7, 2014 and in the 900 MHz frequency band otherwise expiring on May 4, 2016 were prolonged and harmonized until April 2022.
- Magyar Telekom will retain spectrum usage right also until April 2022 on the two duplex 1 MHz frequency blocks in the 900 MHz frequency band won in the 900 MHz auction in 2012. Accordingly, Magyar Telekom currently has frequency usage rights of 10 MHz duplex frequency blocks in the 900 MHz frequency bands and of 15 MHz duplex blocks in the 1800 MHz frequency band.
- The initial fee of the prolongation and harmonization of 900 MHz/1800 MHz spectrum licenses was HUF 38 billion. However, Magyar Telekom was required to pay HUF 34 billion out of the aforementioned amount, considering the expiry of the frequency blocks won in 2012 being changed from the original 2027 date to 2022.

On May 22, 2014, the NMIAH published the "Documentation for the tender announced in the subject of spectrum licenses for broadband services". Blocks in 800 MHz / 900 MHz / 1800 MHz / 2600 MHz and 26 GHz frequency bands were auctioned.

On September 29, 2014 the NMIAH published the tender results so that Magyar Telekom acquired the following frequencies for an aggregate amount of HUF 58,650 million:

- 2 x 10 MHz in 800 MHz
- 2 x 2 MHz in 900 MHz
- 2 x 30 MHz in 2600 MHz
- 2 x 10 MHz in 1800 MHz.

On October 15, 2014 Magyar Telekom and the NMIAH signed the Authority Contract on the use of the 800MHz, 900 MHz and 1800 MHz frequency bands that came into force right on that day. For the new bands the frequency license and radio permission were issued on October 17, 2014 to Magyar Telekom.

As a result of the last tender Magyar Telekom acquired frequency usage rights in the above listed spectrums till June 15, 2029. The Authority Contract can be prolonged with further 5 years if all requirements defined in the contract are met.

The Company is subject to number portability regulation since 2004, applicable only in case of other mobile operators. The Company is designated as an SMP operator in the mobile wholesale call termination market (new M2, old M7 market) and subject to regulatory obligations regarding the termination charge of calls into its network, mobile termination rate (MTR). At the end of August 2011, the NMIAH delivered its third market analysis decisions on the M2 market. On the mobile voice market the three mobile operators had to cut their wholesale prices by 40% in three steps. The last mobile market resolution was published on March 18, 2015 with a newly defined pure Bottom-Up Long Run Incremental Costing model (pure BU-LRIC) resulting in an MTR of 1.71 HUF/min net cost based fee.

Since June 30, 2007, an EU regulation has been regulating international roaming tariffs for wholesale and retail customers on the basis of a price cap system. The first EU roaming regulation prescribed a glide-path that mandated annual reductions of wholesale and retail prices. (EU Roaming Regulation I.)

As of July 2009 the EU also introduced regulated tariffs for SMS and data roaming similarly to the regulation of voice roaming. (EU Roaming Regulation II.)

As of July 1, 2012 the EU further broadened the European roaming regulation with a new regulatory measure: separate sales of regulated roaming services. As a result Magyar Telekom had to implement the technical possibility to host an Alternative Roaming Provider in its network and also it allows its own customers to use Local Break-out solutions within the EU offered by a foreign EU member country's mobile operator from July 1, 2014. (EU Roaming Regulation III.)

The actual EU roaming regulation - "Full Roam Like At Home With Fair Use Policy Possibility" - is applied from June 15, 2017. (EU Roaming Regulation IV.). As a result, European retail roaming price levels for voice, SMS and data are equal to domestic prices since summer 2017. The Commission implementing regulation (EU) 2016/2286 of 15 December 2016 laid down detailed rules on the application of fair use policy and on the methodology for assessing the sustainability of the abolition of retail roaming surcharges and on the application to be submitted by a roaming provider for the purposes of that assessment.

34.2 Hungarian Fixed line

Universal services are basic communications services (including access to communication services at a fixed location, public payphones, directory and directory enquiry services) that should be available to all customers at an affordable price. The NMIAH published its request for proposal on the provision of universal services on November 4, 2013. The Company submitted a bid for access on fixed location and for national directory enquiry service. As a result of a tendering procedure MT was designated by the NRA as a universal service provider for public payphones (came into force June 1, 2014); for fixed line access (came into force with the conclusion of the authority contract with NMIAH on July 1, 2014) and for directory services, phonebook (came into force Aug 1, 2014).

In the electronic communications field Magyar Telekom was designated as an SMP operator (a service provider with significant market power) on the regulated markets. The current relevant markets include retail and wholesale telephony and broadband services stipulated by the EU (according to the second recommendation on the relevant markets).

Magyar Telekom is Hungary's leading fixed line broadband service provider in the wholesale market and one of the leading ones in the retail market. In accordance with the effective resolution, all retail fixed products shall be 'reproducible' by competitors based on the wholesale service. Consequently, the full retail portfolio shall have a wholesale equivalent. Previous regulation defined a retail minus price setting. The NMIAH published the latest resolutions with regards to markets 3a and 3b on December 15, 2017. Service fee calculation for all relevant regulated services – both markets 3a and 3b - are with a BU-LRIC+ model. The new fees will have to be applied from the next reference unbundling offer's approval (MARUO), assumed to be in end of Q2 2018.

SMP operators are obliged to prepare reference unbundling offer for access to (physical) passive network infrastructure (RUO) and to provide these services when there is a request for them by other telecommunications service providers. The reference offer of each SMP operator must be approved by the NMIAH. The price setting of the next RUO services are based on a hypothetical BU-LRIC+ model, that was built by the advisor of the NMIAH. Magyar Telekom was designated as an SMP in both 3a and 3b markets and is obliged to submit its next MARUO in March 2018 with an assumed approval in end of Q2 2018. As a novelty the resolutions contain geographical segmentation in the access regulation, as a start of a deregulation path, in a limited number of settlements and the virtual unbundling obligation (L2-WAP).

The fourth round of the market analysis procedure of the fix call origination and fix call termination (ex M2 and ex M3) markets was closed in 2013, when conditions were set. The NMIAH published its actual fifth round market analysis procedures' draft resolutions on November 9. The draft resolution's FTR (fix termination rate) proposal - that is based on a pure BU-LRIC model - is 0.26 HUF/min. The new fee – that is to be applied symmetrically - is assumed to have an effect from end of Q2 2018 altogether for 144 operators.

The next MARIO and the call origination and supplementary interconnection service fees come into force in end of Q2 2018.

Fixed line telecommunications service providers are obliged to provide number portability on their networks starting January 1, 2004.

34.3 Energy services in Hungary

Magyar Telekom has been providing electricity and natural gas services in Hungary since May 2010 as an electricity and natural gas supplier.

Magyar Telekom decided to exit from the residential segment of the gas market with effect from July 31, 2015, following changes in the energy market environment. From October 1, 2016 Magyar Telekom seized its operation in the public procurement gas market as the natural gas services segment of the energy business was outsourced to E2 Hungary Zrt., a joint venture owned by Magyar Telekom Plc. and MET Holding AG to operate in the business and public procurement segment of the Hungarian gas and energy market. In accordance with the agreement of the owners, Magyar Telekom transferred its business energy operations to E2 and serves the business customers through its joint venture.

Magyar Telekom decided to exit from the residential segment of the electricity market with effect from November 1, 2017.

Magyar Telekom's energy revenues contain energy fees, system operator relevant fees and other fees. In case of the residential customers and a part of the business customers (universal customers) the sales price is based on the Universal Service Providers' (USP) price which is regulated by the Minister of National Development.

The exit from the residential electricity business has no direct impact on the operation of E2.

34.4 Macedonian Mobile

The Group is also present in the Macedonian mobile market through its subsidiary, Makedonski Telekom AD Skopje (MKT, previously T-Mobile). The Macedonian telecommunications sector is regulated by the Electronic Communications Law (ECL) enacted in March 2014 as primary legislation and rulebooks as secondary legislation.

On September 5, 2008 the Agency, ex officio, issued a notification to T-Mobile for those public electronic communication networks and/or services which have been allocated thereto under the Concession Contracts. The license for radiofrequencies used by T-Mobile with a bandwidth of 25 MHz in the GSM 900 band, was also issued in a form regulated in the ECL with a validity period until September 5, 2018, which can be renewed up to an additional 20 years in accordance with the ECL. Due to changes in the bylaws the 900 MHz band was opened for UMTS technology and based on T-Mobile's request the radiofrequency license was changed so that these frequencies are now available for both GSM and UMTS technology.

In 2008 a decision for granting three 3G licenses was published. The validity of the license is 10 years i.e. December 17, 2018, with a possibility for extension for 20 years in accordance with the ECL. License prolongation is expected in 2018.

On December 19, 2014, amendments of the ECL were enacted. One of the most important changes was implemented by Article 75-a, which regulates the prices of international roaming. According to this article, the Agency has the right with Decision to determine the maximum prices for services which are offered to roaming users from countries with whom the Republic of Macedonia concluded agreement for the reduction of prices of roaming services in public mobile communication networks, on reciprocal base, which cannot be higher than the prices of the same services in the EU. In the period of 3 years from 2015, the prices will be reduced to the maximum determined.

Both mobile operators on the market, T-Mobile and One.VIP are designated as operators with SMP status on relevant wholesale market "Access and call origination on public mobile networks". The Agency imposed same regulatory remedies for both operators:

- mobile access obligation for all MVNO hybrid types (including Reseller),

- cost based price for Full MVNO
- retail minus (-35%) for the Reseller,
- obligation for access to MMS services and mobile data based on technology neutrality

An MVNO, Lyca Mobile hosted on One.VIP network entered the Macedonian market and started retail operations in July 2016 under regulated wholesale conditions.

Both operators, Telekom and One.VIP are designated as operators with SMP status on relevant wholesale market “Wholesale call termination on public mobile networks”. The current termination rates are symmetrical for all mobile operators. Telekom and One.VIP are also operators with SMP obligations on relevant wholesale market “Wholesale SMS termination in public mobile networks”.

The Agency announced new analysis at the end of the year 2017 for mobile and SMS termination.

An auction procedure concluded in August 2013 awarded the whole 790 – 862 MHz band together with the unassigned spectrum in the 1740–1880 MHz band for Long Term Evolution (LTE) technology in a public tender. Each of the 3 Macedonian mobile operators, at that time, acquired an LTE radiofrequency license of 1x10 MHz in the 800 MHz band and 2x15 MHz in the 1800 MHz band. Each license was acquired for a one-off fee of EUR 10.3 million (approximately HUF 3.2 billion). The license is for 20 years, until December 1, 2033, with an extension option for 20 years, in accordance with the ECL.

The Director of the Agency brought a Decision on December 10, 2014 for the value of points for calculation of annual fee for the usage of radiofrequencies (RF). The value of the points is 0.8 EUR (approximately HUF 250) which means that all annual fees for radiofrequencies are reduced by 20% from January 1, 2015, compared to the previous value. Formulas for the calculation of annual RF fees are defined in the relevant rulebook.

After the merger of One and VIP, One.VIP submitted a request on November 18, 2016 to the Agency for change of the licenses for using radio frequencies in land mobile service with record numbers 108269/1, 108271/1, 104068, 104069, 104711, 108269/2 and 108267/2. The Agency brought resolution not to approve the reshuffling request of One.VIP.

Based on public debate at the begining of 2017 the Agency adopted changes in the Rulebook on Radiofrequencies fees:

- Decrease of RF fees from 2.3 GHz to 3 GHz for 43% (from 16 800 EUR/MHz to 9600 EUR/MHz)
- Decrease of RF fees above 3 GHz for 76 % (from 16 800 EUR/MHz to 4000 EUR/MHz)
- Decrease of RF fees above 55 GHz (E band RF links) for 50% (from 8000 EUR/250 MHz to 4000 EUR/250 MHz)

The change is favorable for existing operators and for new entrants, especially for 2.6 GHz (not occupied).

Licence duration of two licences previously owned by VIP was until 2017, 10 MHz from 900 MHz band and 10 MHz from 1800 MHz band expired on March 23, 2017, positioned in the lower parts of the bands. Based on request from One.VIP for licence prolongation, the Agency brought resolution No. 0804-974 from November 2, 2016 not to prolong these two licences. At the moment these radiofrequencies are not allocated and not available for sale to the existing operators.

These RFs will be subject to Public tender already announced in Agency annual program for 2017 with possibility for new MNO and/or MVNO. However, One.VIP will have still competitive advantage due to significant amount (20 MHz) of spectrum on 800 MHz band.

On May 26, 2017 One.VIP submitted a request to the Agency for change of the licence for using radio frequencies in land mobile service with registered number 108267/2, whereby the following radiofrequency block is allocated: 1770-1785/1865-1880 MHz. On October 9, 2017, the Agency issued resolution for refusal of one.VIP’s request for reshuffling on 1800 MHz with explanation that reshuffling cannot be performed with parts of spectrum are not yet allocated.

34.5 Macedonian Fixed line

Makedonski Telekom has SMP obligations on several regulated markets for fixed services.

At the beginning of 2015, the regulation on access to fiber was implemented, with Local Bitstream Access over NGA on level 3 and 4 and VULA (Virtual Unbundled Local Access) regulation on level 2. The introduction of new technologies (VDSL Vectoring technology in 2017) announced by MKT for the retail customers leads to the introduction on new wholesale access products and reshaping the regulatory obligations.

Final document for wholesale central access for mass-market products provided at a fixed location market analyses (Market 6) was published in April 2017. For the first time the Agency imposed regulation of access to Hybrid Fiber Coaxial Access (HFC). All existing obligations for the copper and fiber network remain unchanged. All obligations are for MKT and for One.VIP operator as SMP on the broadband market. In the same time analyses of wholesale local access provided at a fixed location market (Market 5) was finished. All existing obligations imposed on this market remain unchanged for MKT and One.VIP operator was also designated as SMP operator with imposed obligations for access to specific network elements (ducts and dark fiber).

In the middle of 2016, the obligation for IP interconnection (following the PSTN to IMS migration) was prolonged latest until the middle of 2017 for all operators with interconnection with Makedonski Telekom, and until the end of 2017 for interconnection between mobile or alternative operators. This process of IP interconnection is still ongoing at the the end of 2017.

According to the Rulebook for technical conditions and building infrastructure (from July15, 2014), Makedonski Telekom AD is obliged to build its infrastructure underground in urban areas with over 15,000 citizens for buildings for collective living with more than eight apartments. MKT has a Digital Agenda obligation for coverage of 100% and 50% of all Macedonian households with 30 Mbps and 100 Mbps broadband speed respectively, with a technology neutral basis until the end of 2020.

The amendments in September 2016 with a new obligation for registering on the new & existing electronic networks (ATLAS), pertain to joint building and use of networks and a new obligation for the Agency to publish the received reports on the optic backbone segment measurements by all operators. All existing operators on Macedonian market have obligation latest until end of June 2017 to submit data for already built infrastructure until September 2016.

The tender for USO provider has been published at the end of 2016, and one of the main criteria is the required amount for a refund. MKT won the tender and signed contracts with the Agency for the following universal services:

- Fixed access and access to disabled users (voice and internet of minimum 2Mbit/s download)
- Public payphones

The tender for USO provider was completed at the end of 2016 and also R3 Infomedia signed contract with the Agency for the Telephone Directory and Directory Inquiry universal services.

Following the market trends and EU regulation, the Agency made decisions for deregulation on several markets: trunk segment of leased lines and avoiding regulation of the Ethernet leased line services; minimal set of leased lines (retail); WLR (Wholesale Line Rental) market; traditional retail fixed voice services. MKT has a cost based price obligation for the Regulated wholesale services, using Long Run Incremental Costs methodology (LRIC).

35 EVENTS AFTER THE REPORTING PERIOD

35.1 Acquisition of ITgen Kft.

In November 2017 T-Systems Magyarország Zrt. signed a Share Purchase Agreement to acquire a 100% stake in ITgen Kft., an SAP technology and security specialist, for a purchase price plus a potential earnout payment totalling to a maximum of HUF 1.2 billion, dependent on 2018, 2019 and 2020 financial performance. In 2016, ITgen delivered revenues of around HUF 0.8 billion and EBITDA of HUF 0.3 billion. The closing of the transaction took place in January 2018.

Budapest, February 20, 2018.

Christopher Mattheisen
Chief Executive Officer, Board member

János Szabó
Chief Financial Officer

CONSOLIDATED BUSINESS REPORT

MAGYAR TELEKOM TELECOMMUNICATIONS
PUBLIC LIMITED COMPANY

FOR THE YEAR ENDED DECEMBER 31, 2017

INTRODUCTION

The Company's activities are described in Note 1 of the Consolidated Financial Statements, while the business report provides additional information on the following topics:

- THE COMPANY'S SHARE CAPITAL, VOTING RIGHTS AND TRANSFER OF SHARES
- CORPORATE GOVERNANCE
- SOCIAL COMMITMENTS, LABOUR STANDARDS, HUMAN RIGHTS
- 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 2017
- 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, 2017, 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 Section 2 of the Articles of Association (http://www.telekom.hu/about_us/investor_relations/corporate_governance/corporate_governance_documents). Information concerning our ownership structure as of December 31, 2017 is described in the following table:

Shareholder	Number of shares	Percentage of share capital
Deutsche Telekom Europe B.V.	617,436,759	59.21
Publicly traded	420,680,229	40.35
Treasury shares	4,625,555	0.44
	1,042,742,543	100.00

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 non-resident or foreign 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 (https://www.telekom.hu/about_us/investor_relations/corporate_governance/board_of_directors).

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. 9/2017 (IV.7.) 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. On December 31, 2017, 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 of the Board of Directors has one vote. The Board of Directors passes resolutions by a simple majority vote.

On December 31, 2017, members of the Board of Directors, their principal occupation and the years of their original election were as follows:

Name	Born	Principal Occupation	Member since
Christopher Mattheisen................	1961	Chief Executive Officer of Magyar Telekom Plc.	2006
Dr. Mihály Patai............................	1953	Chairman-CEO of Unicredit Bank Hungary Ltd.	2012
György Mosonyi	1949	Chairman of the Supervisory Board of MOL Plc.	2012
Ralf Nejedl..................................	1970	Senior Vice President B2B Europe, Deutsche Telekom AG	2016
Frank Odzuck..............................	1959	Chief Executive Officer of Zwack Unicum Plc.	2006
Dr. Robert Hauber........................	1971	Senior Vice President Finance & Performance Management Europe, DT AG, Chairman of the Board of Directors of Magyar Telekom Plc.	2017
Guido Menzel..............................	1961	Senior Vice President Technology Europe, Deutsche Telekom AG	2017
Mardia Niehaus...........................	1963	Senior Vice President International Carrier Sales and Solutions, Deutsche Telekom AG	2017

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, 2017, the members of the Management Committee and the years of their original election were as follows:

Name	Born	Current position	Member since
Christopher Mattheisen	1961	Chief Executive Officer of Magyar Telekom Plc.	2006
János Szabó	1961	Chief Financial Officer	2013
Dr. Balázs Máthé..........................	1968	Chief Legal and Corporate Affairs Officer	2010
Tibor Rékasi	1973	Chief Commercial Officer Residential	2013
Zsuzsanna Friedl	1977	Chief Human Resources Officer	2017
Dr. Kim Kyllesbech Larsen...........	1965	Chief Technology and IT Officer	2017
Zoltán Kaszás	1968	Chief Commercial Officer Enterprise, Chief Executive Officer of T-systems Hungary Ltd.	2017

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 (https://www.telekom.hu/about_us/investor_relations/corporate_governance/supervisory_board). 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, 2017, the members of the Supervisory Board, their principal occupation and the years of their original election were as follows:

Name	Born	Principal Occupation	Member since
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' assignement 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 (https://www.telekom.hu/about_us/investor_relations/corporate_governance/audit_committee). 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, 2017, 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 also 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 its Rules of Procedure. (https://www.telekom.hu/about_us/investor_relations/corporate_governance/compensation).

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 executive officer and the chief officers, as well as the remuneration package of the chief executive officer and 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, 2017, the members of the Remuneration and Nomination Committee were as follows:

- Frank Odzuck
- Dr. Robert Hauber
- Ralf Nejedl

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 avalailable 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 of the Company:

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 the disclosure policies and insider trading guidelines. In Sections 9 to 10 the method of excercising 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 2017 in case of 10 recommendations and 6 suggestions it has not or not completely complied with due to the ownership and oragnizational 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 2017 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.

3 SOCIAL COMMITMENTS, LABOUR STANDARDS, HUMAN RIGHTS

Some of the key challenges of the sustainability strategy come from the area of human resources management. This is why human resources management has a crucial part in the achievement of our sustainability targets. Our vision is to operate in a corporate environment that is livable, likeable and successful. This set of values strengthens the commitment and satisfaction of our employees and is also attractive on the job market.

3.1.1. People strategy from the perspective of the company

- **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

In 2016-2017, we build our People Strategy around 4 pillars:

- brand and recruitment,
- training-development,
- remuneration and
- well-being.

3.1.2. People strategy from the perspective of our employees

The 2016-2017 People Strategy of Magyar Telekom has been developed in accordance with the corporate business strategy and sustainability strategy. 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.

3.1.3. Headcount

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

	2015	2016	2017
Magyar Telekom Plc.	6,670	6,281	6,241
A Magyar Telekom Plc. and its consolidated subsidiaries	10,357	9,432	9,154

The following table provides information on the breakdown of Magyar Telekom's employees by segment:

	2015	2016	2017
MT-Hungary /Telekom Hungary[i]	7,002	7,879	7,977
T-Systems Hungary[i]	1,487	-	-
Macedonia[i]	1,327	1,019	1,177
Montenegro[i]	541	534	0
Total	10,357	9,432	9,154

[i]The operating segments of the Group:MT-Hungary and Macedonia in 2017, MT-Hungary, Macedonia and Montenegro in 2016 and Telekom Hungary, T-Systems, Macedonia and Montenegro in 2015. Please refer to the Note 33. to Consolidated financial statement.

3. 2. 1. Policies and agreements

Code of Conduct: https://www.telekom.hu/static-tr/sw/file/mt-code-of-conduct.pdf

The Code of Conduct provides the framework of orientation for all employees of Deutsche Telekom Group and Magyar Telekom Group. Additionally, it applies to people to who are viewed as equivalent to employees in functional terms, e. g. to temporary agency employees. It combines the joint requirement of compliance with legal obligations and acting with integrity and thus ensures that Deutsche Telekom and Magyar Telekom remain transparent and traceable enterprises for everybody. Deutsche Telekom and Magyar Telekom expect their suppliers and consultants to comply with the rules of behavior manifested in this Code of Conduct and to endeavor them to ensure that they are also obliged to abide to its regulation by contract.

Code of Human Rights and Social Principles:

https://www.telekom.hu/static-tr/sw/file/code-of-human-rights-social-principles-eng.pdf

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

The Code of Human Rights and Social Principles and the Equal Opportunities Plan of Magyar Telekom set the general human rights principles of the group and guidance to their group-wide implementation. Magyar Telekom Group recognizes and respects the fact that the cultural, social and legal diversity of its employees provide the foundations of operations based on equal opportunities. It is also a competitive advantage that leads to business success.

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

The Diversity Policy of Magyar Telekom Group underscores our commitment to consistently identify and utilize potential for improvement.

Suppliers' Compliance: Magyar Telekom Group is committed to respect and protect human rights and it expects its suppliers to comply with these rules of behavior. Prior to becoming authorized suppliers of Magyar Telekom and T-Systems our suppliers must register their enterprises at our vendors' registration site.

https://beszerzes.telekom.hu/beszerzes/portal_en?appid=beszerzes&page=english/registration_vendor.vm

As an obligatory part of the registration process vendors are obliged to understand and accept our Suppliers Code of Conduct that among other policies, entails our Code of Conduct, Social Charter and Diversity Policy. Our suppliers must understand and accept these policies and obligatory frameworks for their behaviors as well.

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

Anti-discrimination and the safeguarding of equal opportunities is a key priority to Magyar Telekom Group. According to the act CXXV of 2003 on Equal Treatment and Promotion of Equal Opportunities, and the corporate protocol in place since 2010 Magyar Telekom Group has accepted its 4th Equal Opportunities Plan in order to secure the practices of equal treatment, the advancement of equal opportunities and the monitoring an improvement of the labor positions of particular disadvantaged employee groups. The Equal Opportunities plan currently in force is valid between 2016 and 2020 and has been developed in close cooperation with the employee representative bodies.

The Diversity Charter of the European Union – Hungary has joined the Diversity Charter of the European Union in 2016 and, among 50 signatory companies Magyar Telekom has also underscored its dedication to safeguard diversity as a fundamental value. Magyar Telekom has been among the signatory companies in 2017 too.

UN Guiding Principles on Business and Human Rights – According to the dedication of Magyar Telekom Group to safeguard and protect human rights along its operations as stated in the UN Guiding Principles of Business and Human Rights, the company considers the rights and guidelines stated in the Universal Declaration of Human Rights and in the ILO's Declaration on Fundamental Principles and Rights at Work to be mandatory in its own practices.

UN Human Rights Treaties ratified by Hungary – Magyar Telekom Group as a corporation legally registered in Hungary is carrying out its entire operations and business practices in full accordance with the nationally ratified UN Human Rights Treaties.

http://tbinternet.ohchr.org/_layouts/TreatyBodyExternal/Treaty.aspx?CountryID=77&Lang=EN

3.2.2. Monitoring and auditing practices

The group-level coordination of corporate sustainability operations that also incorporate labor standards, social issues and the protection of human rights is being coordinated by the Group Sustainability Coordination Council (GSCC). The levels of development and management of the corporate sustainability strategy are separated from the operative implementation level within the operation of the GSCC, thus the process of implementing sustainability activities is divided to the level of strategy development and management, and the level of operative implementation.

According to the relevant group directive the strategic tasks are allocated to the respective Chief Officers. 50% of the bonuses of Chief Officers depend on the performance of collective objectives. More detailed information about the actual operation of the GSCC and its reporting obligations towards the Management Committee could be found in the Sustainability chapter of this document and in the annual Sustainability Report.

Magyar Telekom Group's Code of Conduct covers the requirements of corporate compliance and states our collective set of values, and thus stands as an affirmation of Magyar Telekom's strong reputation, solid position and future success. The Code of Conduct applies to all board members of Magyar Telekom Group from employees to managing directors, executives and board members. Furthermore, Magyar Telekom Group expects its suppliers and consultants to comply with the rules of behavior manifested in this Code of Conduct and to endeavor them to ensure that they are also obliged to abide to its regulation by contract.

Magyar Telekom Group's Corporate Compliance Program has been elaborated with the aim to ensure that Magyar Telekom Group conducts its business with maximum consciousness and commitment, in accordance with relevant laws and regulations, in harmony with the strictest possible business ethics standards. The Compliance Program involves the Group Compliance Manager and compliance representatives of particular functional areas of operation, who are working together as members of the Group Compliance Committee. The Compliance Program has been designed to ensure that the Group conducts its business to the highest standards of awareness, transparency, accountability, commitment, and adherence to applicable laws and regulations.

External audits could be conducted as part of the control process carried out by the Hungarian Labor Inspectorate. The Inspectorate has the right to issue such an auditing process in case of public complaints or issued requests. The Inspectorate also provides counseling to the corporations in support of legal compliance.

3.3. Results of Policies

3.3.1. Diversity and Equal Opportunities

As one of the largest employers in the Hungarian ICT sector we believe that diversity contributes to the success of businesses and all kinds of organizations to a large extent. This value is also at the core when it comes to the increase of creativity and innovation, to the involvement of new partners, experts and clients, to the quick adaptation to changes and most of all, to the compliance with the legal obligations of non-discrimination in all corporate operations.

The corporate Equal Opportunities Plan of 2016-2020 addresses actions and procedures to improve the labor conditions and career perspectives of particular disadvantaged employee target groups such as women, employees with families, employees on child-care leave, employees living with disabilities, recent graduates and 50+ employees. In order to maintain this focus Magyar Telekom has developed and accepted Equal Opportunities plans since 2008 in close cooperation with the employee representative bodies. The current is the 4th Equal Opportunities Plan of the company, the guidelines, policies and actions of which cover the 2016-2020 period.

The principles of justice and equal treatment of Magyar Telekom are being defined by our Code of Conduct. Ways of non-typical employment such as Telework, flexible working hours, part-time work, employment of people living with disabilities allow the company to realize the principle of equal treatment in practice. These measures are further assisted by several measures implemented in corporate day-to-day operations, such as our large offices (FutureWork, FutureLab) that are designed to support Teleworking.

In accordance with Hungarian labor legislations we provide our employees with extra days off after their children, and after blood donation. In case of more than 40% health damage we provide our employees with extra five days off annually for rehabilitation. On top of these we also credit the voluntary work of our employees by providing days off, the proportion of which is strictly regulated in internal directives.

One of the targets of our 2016-2020 Sustainability strategy was to measure and improve the diversity culture of Magyar Telekom. We measure the state of corporate diversity culture through an internal survey between December 2017 and January 2018. After the evaluation of the results we are going to define the strategic steps, targets and result indicators of the effective improvement of our corporate diversity and equal opportunities culture that is going to be advanced through the complex implementation of operative measures.

3.3.2. Anti-discrimination and labor-market integration actions

As an employer, Magyar Telekom has issued the following actions in 2017 to improve the conditions of the employee groups marked in the 2016–2020 Equal Opportunities plan.

The company has continued to support the Romaster program of Hungarian Business Leaders Forum (HBLF) that is designated to support young roma talents to proceed with their education.

In order to secure the equal opportunities of our current and future colleagues living with disabilities, we are using a special module on our online job-application site (http://www.telekom.hu/rolunk/ karrier) since 2010, where our applicants are encouraged to state any accessibility requests they might have in order to attend the selection process.

Apart from the hiring process Magyar Telekom is dedicated to advance involvement and inclusion in the office days too. Just as we did in the past few years, in 2017 A Magyar Telekom has organized its “Have You ever tried to...?” office events involving external organizations and NGO’s. We have also provided several opportunities along its Year Kick-Off event, the ‘Mozdulj Telekom!’ (‘Get Movin’ Telekom!’) Family Sports Day and during the Autumn Health program series, where employees could get personal experiences about the daily challenges of people living with sensory and impairments and/or physical disabilities. Employees also valued the opportunity to be inspired by the strength, stamina and competitive spirit of our Paralympic champions at the Kick-Off 2017 where our athletes and Paralympic champions got together to inspire our employees.

3.3.3. Respect of Human Rights, actions against child labor and all kinds of forced labor

As disclosed in the Social Charter of Magyar Telekom Group the company rejects child labor and all kinds of forced or compulsory labor and fights against all kinds of human trafficking and modern day slavery by all means at its disposal. As the parent company of Magyar Telekom Deutsche Telekom Group is responsible for supply chain compliance auditing and management on a global level. More detailed information about the methodology and results of the global supply chain management at https://www.telekom.com/en/corporate-responsibility/assume-responsibility/assume-responsibility/supply-chain-management-355304

New employees of Magyar Telekom Group as part of their orientation process in their first two months receive compulsory education about the company principles, guidelines and practices concerning social issues, labor standards and human rights. All employees must understand and accept these guidelines as the fundaments of their own professional behavior and operations. Nevertheless, the company is aware of the fact that there could be situations in which it is harder to tell appropriate from inappropriate. In order to assist employees in making the right choices in these situations, the company offers secure internal whistleblower channels, operated by the Corporate Compliance Department. "Kérdezz!" ("Ask me!") advice portal has been set up to help resolve uncertainties as far as compliance relevant behavior is concerned. Serious misconduct must be announced for prevention purposes and for appropriate sanctions. For this reason, the "Tell me!" whistleblower portal has been established. The main principles and the detailed description of the internal inspection process is detailed in employee directives available on all employees on the shared intranet platform. Throughout the inspection process the wistleblowers' anonymity, personal and data privacy are guaranteed and handled with utmost discretion.

3.3.4. Relationship of management and employees

At present two unions and workers' council operate at Magyar Telekom, communication with them runs on two levels. Central decisions concerning the whole Company, when the employee representation bodies need to be consulted, are deliberated with the Central Workers Council and the representatives delegated by the trade unions, either in the frame of joint consultation (Interest Reconciliation Council), or separately, depending on the nature of the matter discussed. Central communication is managed both verbally (negotiation) and in writing. The Chief HR Officer and the HR Strategic Director are responsible for central level communication with the employee representation bodies. Interest enforcement issues concerning a given governance area are also discussed locally with the representatives of the trade unions and the local workers' council. The HR Business Partners of the governance area are responsible for communication with the local employee representation bodies.

Trade union and the workers' council (Central Workers Council) must be consulted and their opinion solicited on significant decisions resulting in organizational changes or changes affecting a large group of employees. In organization restructuring decisions the collective bargaining bodies have 7 days to submit their comments, in other cases 15 days. The measure in question may not be implemented during this 15-day period. Trade unions and workers' councils (Central Workers Council) must be consulted with regard to draft resolutions, aiming at organizational changes without regard to the number of employees concerned.

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, 2017, four members of the Supervisory Board were employee representatives. These members were Tamás Lichnovszky, Zsoltné Varga, Éva Őz and Sándor Hartai.

3.3.5. Freedom of organization and collective bargaining

Magyar Telekom Group acknowledges the basic rights to freedom of organization and collective agreement in its Social Charter. In line with an openness and trust that relies on a constructive social dialogue, Magyar Telekom Group declares its support to cooperation with the legitimate representatives of the employees in order to establish a balance of interests.

The Social Charter together with the long history of mutual respect and cooperation of the management and employee representative councils are the guarantees that these rights are being fully and thoroughly respected. 100% of the employment contracts of Magyar Telekom Group employees operating in Hungary fall under collective bargaining agreements developed with the Hungarian Telecommunications Trade Unions (Távközlési Szakszervezet, TÁVSZAK and Magyar Távközlési Ágazati Szakszevezet, 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.

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

3.3.6. Workforce Reduction and Redeployment

Magyar Telekom – in order to ensure the resources related to the Company's strategic objectives - has reached an agreement with the trade unions on headcount reduction and wage increase measures for 2018.

According to the terms of the agreement, the Company plans to make ca. 350 parent company employees redundant. In addition, around a further 160 employees are expected to leave the Company as a result of a number of discontinued corporate projects. The majority of the employees to be made redundant are expected to have left the Company by the end of 2017. The company shall provide active job search, labor market training and one-on-one counselling to the colleagues laid off, in the framework of Program Chance, which has proven its success in the past years, and trusts that the above support these highly-trained employees of up-to-date professional expertise in finding employment elsewhere as soon as possible.

It is planned to reinvest a significant proportion of the expected employee cost savings in resources related to the Company's strategic objectives.

As from January 1, 2018, employee salaries at the Company will rise by an average of 5%.

3.3.7. 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. In December 31, 2017, approximately 59% of employees of Magyar Telekom Plc. participated in the pension-, 36% in the self-aid-, and 65% in the health fund.

3.4. Risk management

3.4.1. Providing educational and professional background

The educational pillar of Magyar Telekom's Sustainability Strategy aims to improve the digital competencies of the clients and the wider public. It also aims to contribute to the development of industrial succession knowing that a potential throwback in the amount of available highly qualified professionals in the industry could mean a serious risk to maintaining, improvement and development of the quality of our services. In order to secure the highest quality service to our clients we need work with the best professionals. To be able to have them a competitive industrial educational background is necessary.

Upon the initiative and by funding of T-Labs (Telekom Innovation Laboratories, Berlin) the faculty Data Science and Engineering began to operate at Eötvös Loránd University from September 2016 as the first pillar of the EU Labs researcher network.

Magyar Telekom also provides practice opportunities for secondary school pupils from the relevant technological industries. In 2017 100 students have spent their obligatory practices at our company.

We supported the work of the Environment Protection Committee of the Hungarian Academy of Sciences as well as the scientific work of the National Adaptation Center. Our colleagues are in close relationship with several higher education institutes and we help the universities with consultancy for writing theses, expert education and giving lectures.

3.4.2. Employee expectations and equal opportunities

The pillars of our People Strategy are based on the aim to meet the needs of our employees, and to live up to the challenges of maintaining our company status as a highly competitive and future oriented employer. Our employees require security, stability, opportunities for advancement and competitive compensations. Magyar Telekom, as a company committed to provide equal opportunities to its employees, finds it especially important to harmonize wages and to terminate unjust wage gaps. Our tiered wage system, built on the Hay methodology, serves the above purpose. Our remuneration system is fully transparent thus our base wage tables and the relevant policies are available for all employees

As an employer dedicated to diversity as a core value, Magyar Telekom finds it important to raise the amount of women in leadership positions. As a member of Deutsche Telekom Group the objective in 2010 was to increase the proportion of female managers to 30% by 2020. Along the aim to contribute to reaching the defined target, the company strives to utilize the actual business benefits inherent to the advancement of corporate diversity culture.

Magyar Telekom considers stress, overload and burnout related risk-reduction as its priority duty in relation to its employees. In order to take charge of these risks by securing an empowering environment to develop and maintain a healthy lifestyle, employees are also provided with coaching and training opportunities that help in the advancement of their task management skills. Efficient work-life balance of employees with families is further supported by our child-friendly offices and the available, tax-free nursery and/or kindergarten support that could be selected from our cafeteria benefit scheme, thus contributing to the reduction of expenses. Taking notice of the special conditions of employees (ex. illness or the longer term domestic care of a relative) a longer period of unpaid leave is also available.

3.5 Performance indicators

Education results of the 2016-2020 Sustainability Strategy:
- 33 918 smarter brains since 2016 with the help of digital inclusion programs eg. Digital Bridge, LTI

Non-typical employment at Magyar Telekom Group
- No. of Part-time employees in 2017: 145
- No. of Flexi-time employees in 2017: 726
- No. of Teleworking employees in 2017: 2752

More women in leadership positions at Magyar Telekom Plc.
- Percentage of women in overall workforce: 41%
- Percentage of women in senior management: 22%
- Percentage of women in executive board: 13%

Volunteer work benefits at Magyar Telekom Group
- No. of volunteer working hours: 14 261
- No. of supported people by the projects: 27 400

3.6 ESOP organization

By reshaping the current remuneration structure, the Company has launched an incentive program based on the new remuneration policy in 2017, by which the corporate financial targets, approximately half (50%) of the total bonus, will be paid via the ESOP Organization for Magyar Telekom Plc. and T-Systems Magyarország Zrt. eligible employees. Under the new incentive program, the Company purchased 4,534,758 Magyar Telekom shares worth HUF 2,139 million during 2017. The purchased shares were transferred to the ESOP Organization in several installments. The vesting condition of the new program is the operating free cash flow for the MT-Hungary segment for the financial year ending December 31, 2017 to exceed that for the previous year ending December 31, 2016. In accordance with the remuneration program those employees of the Company and T-Systems Magyarország Zrt. are rewarded who are under the personal scope of the Remuneration policy approved on February 22, 2017 by the Company's Board of Directors. For further information see Note 20.1.2.5 of the Consolidated Financial Statements.

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 2017.

The aggregate compensation of the members of the Supervisory Board in their capacity as Supervisory Board members was HUF 63 million in 2017.

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 1,463 million in 2017.

On December 31, 2017, three of the seven 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 114 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.

For information about the Share Based Compensation programs, see Note 20.1.2 of the Consolidated Financial Statements.

5 RESEARCH AND DEVELOPMENT

Hungary

In 2017, within the scope of tender obligations, the research and development activities of Magyar Telekom were comprised of maintaining the R&D tender project funded and awarded by the National Research, Development, and Innovation Fund.

During 2017, in addition to the tender obligation, we have continued the development of several project related products and services that were based on the R&D activities of 2016, such as the TV application that can be used on the TVGO mobile and web platforms and is related to the topic of TV/Entertainment.

In addition to the above, we have also launched new key R&D projects in 2017 in the fields of IoT TV/Entertainment and Big Data. Amongst others, we have examined voice and gesture based remote IPTV control, the feasibility of a cloud based TV service, and also created the prototype of the TVGO application in a general Windows 10 development environment. Within the scope of the intelligent parking project, we examined the business opportunities provided by new mobile solutions, such as NB-IoT. In addition, we have done research on artificial intelligence (AI) and machine learning (ML) supported face recognition and related services. Within the same topic of AI/ML, we have created a chatbot that may later provide aid in the work done by customer service staff by leveraging the opportunities offered by online interfaces. Regarding the topic of Big Data, we have investigated the opportunities of forecasting traffic events using mobile data.

In addition to innovative domestic SMEs, the research and development tasks are performed by the internal researchers as well as the product and services development staff of Magyar Telekom. In addition, the Company leverages the synergistic effect of an internal and external knowledge base, and strives for partnership with well-known innovation centers and institutes of higher education. Our main partners are renowned Hungarian universities and research institutes, such as the Budapest University of Technology and Economics, the Eötvös Loránd University, the Budapest Corvinus University, the Óbuda University, and the Hungarian Academy of Sciences.

Within the framework of cooperation launched during the past year, we have continued our work with the Technische Universität Berlin, the Department of Data Science and Data Technology operating at the Faculty of Informatics at the Eötvös Loránd University, the research and development department of Magyar Telekom and Deutsche Telekom, and the Telekom Innovation Laboratories (T-Labs) in Berlin.
From amongst the topics of the previous year, the Telekom Open Services project was also completed in 2017.

As the partner of EIT Digital, Magyar Telekom promotes and supports even closer cooperation between higher education institutions and their industrial partners. Within this framework, the Budapest University of Technology and Economics and the Eötvös Loránd University provides professional support to students within the EIT Digital post gradual training system.

In 2017, we have launched an internal idea incubation initiative the Mission Telekom Program. All the applicants were from the employees of the Magyar Telekom group. 150 applications were received and after several rounds of selection, the teams the best five ideas were realized to prototype level. This will be followed by the go-live and business utilization of stand-alone prototypes.

In addition to the above, Magyar Telekom also believes it important to support R&D type knowledge transfer projects. As a result, it has been an active participant of the EIT ICT Labs knowledge transfer program as a professional cooperating partner since 2012, and cooperates several international R&D tender initiatives.

Macedonia

Makedonski Telekom (MKT) continues with its determination and its work to be innovation and technology leader on the market. Among the main focuses, as a continuation to the previous years, are the projects in the area of the Smart City. Further to our successful Smart Bus Transport Project implemented for the City of Skopje in 2015 and 2016 and the Smart Light project put in demo operation in 2016, during this year we have also put into demo operation solutions for a Smart Waste, Smart Parking, Smart Bench and Electrical Vehicle Charging, with an aim to demonstrate the advantages from the implementation of such smart systems and our competences in this area.

Apart of the Smart City business area, we drive full force exploring of other business possibilities for growth and development, in the field of finance, health, education etc, especially considering their business prospects and potentials in terms of top line growth of our ICT and B2B business in overall. MKT as firm supporter of the new era of smart connected way of life and working, in 2017 we have continued our pilot project in the area of Smart school - Hybrid Classroom, that is about implementation of ICT assisted solution for interactive learning at classes and at distance, in two secondary schools in the City of Skopje. Implementation of this project aims at creating positive change of way of education, providing advanced, self-driven, collaborative and interactive classroom experience for youngsters. As well its aim is to demonstrate how use of technology could support the quality and efficiency of the education, thus impacting the long-term development of the educational system as well as the society and economy.

Also, utilizing the potential coming out from the EU funded projects in the smart Internet of Things (IoT) solutions, e-government, etc., was under close loop as well.

In addition to the business development activities given above, in 2017 we put focus to the development of the projects and products for digitalization and smart working for the business segment, which we believe that are growing market potentials in the forthcoming years, expected to be driven by the advantages of the efficiency of ICT in daily workflows systems and networks, as well as by the transparency and accountability of such solutions.

Under the motto - INNOVATION SYNERGIES – WIN WITH PARTNER, we keep further on our strategic technology partnerships-Cisco Gold, EMC Cloud solution provider and Microsoft Silver Data Center. Furthermore, in 2017 we got recertification of our Oracle Platinum and HP Business partnership, and have started the process of getting a status of Microsoft Cloud Soluti on provider. These partnerships are confirmations of MKT's competences in the areas of enterprise networks, cloud, collaborations, network securities, and Data Center technologies. Such competences are deemed to be crucial assets on which we can leverage further in our ICT business development activities.

Competitive pressure in conjunction with saturated Telco market, complexity of business environment with multiple and more sophisticated customer segments, multiple vendors and complex service offerings, fast changes in the technology with new technology paradigm targeting for one universal IP network and cloud based service delivery platform, as well as changes in the regulations, are only part of the challenges that MKT will face in the next few years.

In order to keep sustainable business and major revenue streams in very complex telecommunication environment, as well as proactively influence to market trends with new business opportunities, MKT is aiming to keep technology leadership position and ensure growth through service improvement and innovation by continuous development of its infrastructure.

Development of infrastructure and investment in Technology should encompass the following objectives/trends: broadband performance, integrated service delivery platforms, efficiency and quality leadership, self-service enablers, cloud concept and "virtual" infrastructure, cost efficiency, flexibility and responsiveness – reduced time-to-market, as well as competence development.

During 2017, we have made significant steps towards achievement of our goals with development of telecommunication network, service platforms and supporting systems.

In order to ensure high quality Broad Band (BB) performance, BB market and technology leadership, MKT is continuously investing in fix and mobile access development. At the end of 2017, more than 161,000 homes passed installed capacity or 28,5% MKT network households' coverage with FTTH was reached. Regarding VDSL rollout, more than 96k VDSL CO and 5,9k VDSL FTTC homes passed were implemented. Significant improvement was also done in LTE rollout, reaching 98,5% territory coverage and 99,5% population coverage. During 2017, LTE 2CA (800+1800) were implemented on all urban and suburban macro sites which mean that 55% of all total sites were upgraded with LTE Advanced 2CA in order to gain better LTE DL throughputs.

Alongside extensive mobile BB access rollout, during 2017, high focus was set on the network quality and performance, which is confirmed by P3 "Best in Test" certificate in December 2017 which represents an internationally recognized acknowledgement for quality of mobile network, as well as by the National Report for Network Quality Parameters prepared by the Agency. Makedonski Telekom is the best in class for voice and data services and leads the overall ranking with 901 points.

The growth of BB access and continuous traffic increase are supported with further development of IP Core and transport network as cornerstone of all services. During 2017, IP Core & Transport Network Modernization project which includes modernization, reorganization and extension of all IP Core Network elements, Transport and Aggregation systems was successfully completed. MKT managed to install full DWDM network and finalized IP Core implementation and integration, as well as IP Core services migration.

In Mobile area, SW upgrade of MSS, GGSN & SGSN, as well as PCRF were performed during 2017 in order to extend support of MSS and EPC. In this time frame, CUDB project for upgrade of HLR/FNR and HSS-EPC on joint CUDB platform was successfully completed and all mobile subscribers were migrated to the new cUBD platform.

Also project for improvement of transport network redundancy based on building redundancy of all major cities based on 3 sided physical and logical path protection, creation of smaller protection rings by implementing new fiber optical routes between major sites and introduction of 2 sided network redundancy on all other IP Core sites as started.The increased mobile internet traffic is also supported with the modernization of the backhaul solutions for mobile base stations through fibre connections or radio links. At the end of 2017, only 2% of BTSs were connected via copper, which leads to complete fiber migration and copper less BTS backhaul at the beginning of 2018.

In terms of Service Platforms, during 2017, IPTV server platform was upgraded in order to extend the support till 2020. Replacement and capacity upgrade of old Storage at the remote site in Strumica was done as well. Geo-redundancy project for Live TV channels was started. OTT TV platform was future developed in order to be available for PC, Android and iOS. For providing better customer TV experience new features like Live, Vod, Timeshift, CUTV, Advertising, DRM, Reminders, Geo-location, etc were implemented.

Modernization of M-Payment platform in purpose to enable new mobile payment opportunities in flexible and user friendly way for end users were managed which brings better synchronization, consolidation of data bases, optimization of resources and clear work procedures. Commercial start for mWallet application started Q4 2017 which provided users with possibility to pay EVN and Telco taxis using Telekom specified application via their mobile phones.

Hybrid Access Solution was further developed which aggregates the bandwidth of both DSL and LTE transmission links and create a single, powerful broadband pipe between the network service node and customer's Broadband CPE.

The first LTE roaming partner was implemented during 2017 after introduction of DRA in order to support LTE roaming.

In order to provide higher efficiency, better flexibility and fast response in the provisioning, fault clearance and other processes in technology domain, implementation of New Generation OSS, Broad Band Service Assurance (BBSA), and Trouble Ticketing (TT) extension were developed New services / functionalities were implemented during 2017 like supporting new vDSL technologies, mass upload for OSP data (ODF import, OSP conduit import, Fiber OSP cable import,OSP containers xls import), Device Library extension - IPTV/MPLS/DWDM, etc.

6 REAL ESTATE, SITES OF OPERATION

We have one of the largest real estate holdings in Hungary and we are also a major real estate owner in Macedonia. 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.

Headquarters of major member companies of the Group

- Magyar Telekom Plc.: Hungary, 1013 Budapest, Krisztina krt. 55.
- T-Systems Magyarország Zrt.: Hungary, 1117 Budapest, Budafoki út 56.
- Makedonski Telekom A.D.: Macedonia, 1000 Skopje, Kej 13 Noemvri, No. 6.
- Combridge S.R.L.: Romania, Municipiul Sfantu-Gheorghe, Strada 1 DECEMBRIE 1918, parter comercial, nr. VI, Bloc 6, Judet Covasna
- Novatel EOOD: Bulgaria, Sofia Oblast, Stolichna Municipality, Sofia 1404, Triaditza District, 45A Bulgária Blvd.

Hungary

Out of the number of 1,728 bulidings that take place on the 1,496 sites of Magyar Telekom Plc, 55% is owned by the company, 5 % is jointly owned and the rest 40% is leased. These figures do not contain the technology sites, from these types of sites we have 6,075.

The total area of properties used by Magyar Telekom Plc. as of December 31, 2017 was 553,691 m^2 . The majority of sites used in our operations are smaller than 100 m^2. The largest site is our headquarters building located at Krisztina krt. 55 in Budapest, with floor space of over 30,000 m^2

Macedonia

At the end of December 2017, MKT radio access network consisted of 766 physical sites on which there are 676 2G base stations, 747 3G base stations and 706 4G base stations. 91% of the site infrastructure (towers) is in possession of MKT and 9% is leased.

The total area that is used by MKT is around 109, 256m2 as of December 2017, out of which around 44, 981 m2 are in sole possession of MKT and in great part (55 %) is attributable to 2 major buildings, the headquarters and the main technical building. The remaining 64,275 m2 are in joint possession with Macedonian Post.

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 Group'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.

Charters and initiatives of cooperation accepted and signed by Magyar Telekom group

Besides professional challenges, the Group also seeks cooperation opportunities for the solution of social and environmental problems.

The Group is a member of several working groups of the Hungarian Business Leaders Forum (HBLF):

- Partnership and Volunteering Working Group
- HBLF for Diversity HR Working Group
- Equal Opportunities Working Group
- Health Working Group
- Environmental Protection and Sustainability Working Group
- Community Programs Working Group
- Business Ethics and Transparency Working Group

HBLF-ROMASTER – Magyar Telekom is a member of the program together with other major players of the business sphere. This is the first initiative aiming to join forces, without any state involvement, in order to address the urgent and sensitive social issue of roma people's integration and working closely together in improving or solving the situation.

The Group has been an active member of ETNO's (European Telecommunications Network Operators Association) Sustainability Workgroup for years. The members work closely towards solving all kinds of sustainability-related programs. In addition to the three meetings held each year, an internet portal also helps our joint work and contributes to the sharing of best practices.

In respect of the hello holnap! fee package we held various forums with the involved organizations of people living with disabilities (AOSZ, ÉFOÉSZ, MEOSZ, MVGYOSZ). Our cooperation with these bodies is continuous, active and based on the proposals we continuously improve our relationship with disabled people and develop our relevant services. In 2016 we implement the latest version of the fee package that provides several services at the cheap price for disabled people. Our most important new initiative is that each entitled member can use two hello holnap! subscriptions to involve a family member or an attendant. In 2017 we increase further this number, thus one living with disability customer can have all together three subscriptions on their own name.

We supported the work of the Environment Protection Committee of the Hungarian Academy of Sciences as well as the scientific work of the National Adaptation Center. Our colleagues are in close relationship with several higher education institutes and we help the universities with consultancy for writing theses, expert education and giving lectures.

OECD-Guidelines – Magyar Telekom has been the first among the Hungarian companies to accept OECD Guidelines for Multinational Enterprises and set them up as mandatory guidelines for its operations.
European Union's Diversity Charter – has been signed by the company and considered as a mandatory guideline inherent in the corporate Human strategy.

UN Global Compact has been signed by the company and the current report also stands to report our achievements in the 10 principles.
UN Sustainable Development Goals – Magyar Telekom has acknowledged the SDG and through incorporating them as guidelines in its 2016-2020 the company finds the contribution to the goals a mandatory element of its operations.
Carbon Disclosure Project (CDP) – Magyar Telekom has signed the global initiative and fulfills its annual reporting obligations

https://www.telekom.hu/about_us/society_and_environment/ cooperation

Quality guarantees in the Magyar Telekom Group can be found:

https://www.telekom.hu/about_us/about_magyar_telekom/principles/quality_guarantees

7.1 Sustainability strategy

In 2016, Magyar Telekom Group started its new five-year sustainability strategic cycle, 2016-2020.

In addition to the results of our Sustainability Strategy 2011-2015, the goals and tasks defined for the period through the end of 2020 have been determined by the goals and directions applied internationally in terms of sustainable development (SDG, CDP, GeSI SMARTer2030, EU2020 climate package), which we, as a Group, adhere to. When identifying our priorities, we have focused on the expectations of the responsible investors monitoring our company and the current corporate trends. Of course, local market conditions, as well as consumer behavior and demand have also been taken into account, so that we be able to proactively meet our customers' needs.

When identifying our strategic goals, we kept in mind that our sustainable operation has a significant impact on the society, the economy and the environment. In addition to being responsible for the livable future of our several million customers and more than 10 000 employees, as a market leader ICT provider and a large enterprise of regional proportions, we are aware that our business and operational decisions influence the economy and the society of the future, too. It is our firm belief that we, as a company, are responsible for all the groups of people whom we can enable by ICT solutions, and that we have to make social, economic and environmental responsibility a part of our corporate genetic code to thus promote sustainable development and opportunities for future generations.

The main objective set forth by the fouth Sustainability strategy strategy covering the period through the end of 2020 is to make sustainability part of Magyar Telekom's business. This can be ensured, if considering all three pillars of sustainability, we are comprehensive, credible and innovative.

Until 2020, climate protection, education and awareness, and digitally enabled sustainablility are the major foci of the strategy.

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 Group's actual CO_2 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.

KPI: push Magyar Telekom Group's actual CO_2 emission below 100,000 tons

KPI: generate revenue from climate protection

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.

KPI: 100,000 digitally educated people in Hungary

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%.

KPI: awareness about Magyar Telekom, as a sustainable company should reach 50%

Awards and recognitions achieved in 2017:

- Oekom – B Prime category
- FTSE4GOOD Index membership
- CEERIUS sustainability index membership
- Disability-friendly Workplace
- Best Sustainability report Hungary 2017 - Green Frog Award

7.2 Initiatives concerning stakeholders

In order to successfully operate the company it is essential to have strong relations with stakeholders.
Below you will find a list of our key activities with our stakeholders the details of which are elaborated in the respective chapters of the Sustainability Report:

- Investors – Investor (and responsible investor) assessment
- Customers – Sustainable products and services, hello holnap! mobile app
- Employees – community solar pilot, diversity culture survey, hello holnap! points
- Regulators – conformity, regulatory relations
- Local communities – Digital Bridge, 2nd Telekom Voluntary Day Autistic Art Strategic Partnership (donations, voluntary, tablets, awareness videos)
- Non-profit organizations – Sustainability Roundtable Discussion, 10th Sustainability Day
- Suppliers – sustainable supplier chain, TOP3 sustainable supplier of Magyar Telekom
- Media – Sustainability Media Club, Press Award on the Sustainability Day
- Future generations – Become an IT expert! sustainable innovation, sustainable innovations

At the end of Y2017 we started the community solar program pilot. Most of the electricity consumption of the educational building in Kékvirág street is given by solar panels located on the roof of the building. During the program employees have the opportunity to adopt a solar panel and get extra benefit in exchange.

In 2017, we organized the Sustainability Roundtable Discussion for the 18th time, the objective of which is to have an open dialogue with our stakeholders for the sake of understanding the demands towards Magyar Telekom Group, 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 2017, we recognized organizations and businesses promoting sustainable, innovative solutions and sustainability education and awareness raising.

The tenth Sustainability Day event took place on September 30, 2017. The topic of the day was flow. Record number, nine 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 seventh time by the members of the Sustainability Media Club - established by Magyar Telekom. Awards were distributed in three categories: tv/radio/video content, written newspaper (print, online); blog, vlog. The award amounted to HUF 300 000 for each category.

In 2017, we continued to sensitize our employees to social issues by organizing volunteer work events. The strategic target of the corporate volunteering is 50,000 hours of voluntary work by Magyar Telekom employees. To achieve that they had the possibility to grow the amount of the theoretical contribution to society by educational (Digital Bridge, Be an IT expert!, Mobile scientists) and charity (eg. It is good ti give! cookie campaign) voluntary events and the Telekom Voluntary Day. The philanthropic voluntary programs are very popular among our employees eg. the seasonal blood donation or helping in caring homes operated by associations for youth living with disabilities.

In 2017, we organized the Telekom Volunteer Day for the second time. During the year 1219 colleagues worked 13,641 hours of volunteer work, by means of which a theoretical amount of HUF 58.7 million was thus donated to the society.

In 2017, we continued the "hello holnap!" employee point collection. In the fourth year of the initiative 7,023 points were collected by 2,546 colleagues. The first three employees who collected the most points were given a Csepel bike voucher and an electric car use 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.

As a part of the strategic partnership with Autistic Art, in 2017 Magyar Telekom cooperated with BOOK Kids and the Sustainability Media Club. During the campaign the Huawei Fairy Tale Tablet was the part of the Magyar Telekom portfolio. The objective was that after each of the sold fairy tale tablet Magyar Telekom donated the same tablet for those who live in homes for autistic youth operated by the Autistic Art Foundation. Thanks to the campaign 176 devices can be used by the nursing professionals for the complex and personalized development of competences of the youth living with autism.

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. New, 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 2017 is best represented by the fact that it has more than 11,000 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 4 million kilometers and twenty years of travel in 2017.

7.3 Annual Sustainability Report

Magyar Telekom Group 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 Fourth-Generation Principles set forth by the Global Reporting Initiative (GRI G4), while the 2016 Sustainability report was compiled along the newest requirement, the GRI Standard It was applied on comprehensive level and includes more information about the Group's sustainability performance. The independent assurance and certification of compliance with the GRI Standard 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

The 2017 Sustainability Report is going to be published in 2018 spring.

8 ENVIRONMENT PROTECTION

Policies

Magyar Telekom Group upholds its commitment to sustainable development and the environment protection in the environmental policy. The policy contains obligations for the members of the Magyar Telekom Group both individually and as a Group: https://www.telekom.hu/static-tr/sw/file/Magyar_Telekom_environmental_policy.pdf

The Group-level coordination is continued to be implemented under the auspices of the Group Sustainability Coordination Council (GSCC). The levels of development and management of the corporate sustainability strategy are separated from the operative implementation level within the operation of the GSCC, thus the process of implementing sustainability activities is divided to the following levels:

1. Strategy development and strategy management level operating under the auspices of the GSCC: development of strategic concepts, implementation of the strategy, relevant communication with national and international organizations

2. Operative implementation level managed by relevant organisations of the governance areas and business units, actual operative activities, task management, data provision etc.

The GSCC's operation is regulated by a group level directive: on the regulation of Magyar Telekom Group's sustainability operation and the responsibilities and competence of stakeholders.

The top management of Magyar Telekom Group, the Management Committee receives at least once a year a report on the implementation of the tasks of the Group Sustainability Strategy and other ongoing significant sustainability activities, results, potential exposures and opportunities.

The MC is informed on the latest sustainability trends and may respond to the feedback from stakeholders through the annual report and based on the report may decide on the amendment of the strategy. The MC keeps contact with the stakeholders (e.g. General Meeting) through the GSCC. Incoming inquiries are received by the respective professional areas and critical comments regarding sustainability are transferred to the responsible staff members by the GSCC members. According to the relevant group directive the strategic tasks are allocated to the respective Chief Officers. 50% of the bonuses of Chief Officers depend on the performance of collective objectives.

Results of the policies

As a leading provider of info-communications services in the region, Magyar Telekom's commitment to sustainable development with a focus on preserving the environment lies in the centre of its mission. In our new Sustainability Strategy 2016-2020 we set the ambitious goal to reduce de level of our carbon dioxide emission below 100 000 tons.

In 2017 we continued our carbon offset project. We spent half of the income of our company car policy regulated bonus-malus system to carbon offset. Our aim was to become carbon neutral again in 2017 too. We have reached our goal by using 100% renewable energy for our electricity and we offset the rest of our emissions, by purchasing and retiring 25,000 CER (Certified Emission Reduction) units. The reduction came from a Chinese project. In 2017 Magyar Telekom Plc. has purchased 180.8 GWh of renewable energy that is equal with 100% of the total amount of electricity used by the Company. Furthermore, in 2017 we purchased 6,672 CER units to offset our Magenta1 customers for Y2018.

Our highlighted environmental and operational ecoefficiency goals are:

- Reducing our CO2 emissions (target set below 100 000 tons of CO2 by 2020)
- Energy consumption: saving energy (reduce consumption), increase of energy efficiency levels, using green energy
- Increase the energy efficiency of our buildings
- Decrease our fleet consumption, promotion travel replacement solutions, and dematerialization solutions
- Introduction of sustainable and climate friendly products and services
- Waste management: reduction of waste (increased recycling-rate)
- Measure the climate footprint of our customers and suppliers

Risks

Based on the Business Continuity Management System (BCM) we have identified the critical climate risks (floods, heat waves) that might affect our operations and we have prepared action plans for possible risk management. According to our annual assessment the rate of climate damage in the network did not reach the level of intervention (HUF 50 million damage/ month). In 2017 we have identified 659 climate related cases (storm damage) with the costs of 65,3 million HUF. In 2017 during the heatwave we allowed our colleagues to work remotely in order to reduce the energy consumption of our offices, and we increased the core temperature of our datacenters and base stations.

Performance indicators

Cumulated CO_2 emission – 97,110 tons CO_2

Group CO_2 emission by categories – Scope1: 21.543 tons CO_2, Scope2: 74.702 tons CO_2

Energy efficiency – bits transmitted / energy consumption – 95.62 Gbit/kWh

The average CO2 emission of the fleet – 119.6 g/km CO2

Group revenue related energy consumption 1,264 GJ/million HUF

9 CORPORATE COMPLIANCE

When shaping the compliance program of the Magyar Telekom Group, the goal was to ensure that the Magyar Telekom Group 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 Group contains the summary of the compliance requirement within the company, sets common values of the Group 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 Group from the employees to the members of the Board. In addition, contracted partners of the Magyar Telekom Group 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. In 2017 again an external auditor (KPMG) evaluated the effectiveness of the compliance management system of Magyar Telekom, and issued a certification that the program complies with the requirements of the new anti-corruption ISO standard.

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 on group level, 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.

Fight against bribery and corruption

Policies

Magyar Telekom des not tolerate any attempts of corruption, so numerous procedures and policies were introduced to prevent and fight corruption. Magyar Telekom complies with the anti-corruption rules the Group, and expects its business partners not engage in unlawful activities (including breaching the anti-corruption laws) such as utilize any money or other services provided by Magyar Telekom for unlawful purposes. This also includes direct or indirect payments to individual(s) to improve the perception of Magyar Telekom (or any parties acting for Magyar Telekom) or to influence any business decision. Magyar Telekom strictly prohibits any form of corruption including (but not only), receiving personal advantages or monetary gains, accepting or providing bribes or promising facilitating payments. The Group also prohibits employees to make beneficial decisions towards family, friends or close or distant acquaintances. It is not allowed to provide any gift or invitation to an event to third parties if it could potentially influence any business transaction. Magyar Telekom Group does not support morally or financially any political parties, organizations or representatives of these. Magyar Telekom will not start business relations with third parties that violate the anti-corruption clauses of the Compliance Program or the basic principles of the Code of Conduct.

Due Diligence procedures: There are no fixed procedures on how thorough due diligence should be to avoid legal responsibility or any investigation as per the anti-corruption laws. The aim of these procedures is to identify high-risk areas, and to provide indication when further due diligence or review is required.

Result of the policies

During the year, we have verified the plausibility of any complaints we have received about unethical behaviour and initiated internal investigations if necessary. If we have identified any misconduct we initiated the necessary measures and actions. Any complaints regarding breaches of internal or external rules can be sent to the Tell Me! portal of Magyar Telekom. Any questions regarding corporate compliance can be asked on the Ask Me! intranet portal.

Risk

The basis and prerequisite of the efficient defense against breaches of laws and policies is the register and analysis of compliance risks and identified other compliance relevant cases at Magyar Telekom. The yearly Compliance Risk Assessment (CRA) handles active and passive corruption separately. The risk assessment always includes Magyar Telekom, T-Systems and Makedonski Telekom. Other subsidiaries can be included on a case-by-case basis, based on information originating from internal investigations. The CRA fully covers the abovementioned companies. The Group Compliance Officer informs the Audit Committee, the Board of Directors, and the management about the result of the risk assessment and gives an update about the status of the measures in every quarter.

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.

Hungary

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 area with network developments and growing competition. An increasing technology platform-based competition is fuelled 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. In the meantime, the competition of the service providers is pushing the market to the 100Mbps + bandwidth and fiber technologies. 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. 2018 is the year of preparation for 5G networks as well. 5G networks is no longer the network with residential segment focus, but rather the industrial usage.

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.

Macedonia

After the forming of new Government on 31 May and initiating the process for local elections (15 October), the country has exited political deadlock situation focusing on new challenges.

Nevertheless, overcoming the vacuum of central and local executive power, the economy recovery on a near term would still represent a big challenge. (0,2% in Q3'17, yet new Government lowered YE projection to 1,6% GDP growth for 2017, unemployment continues lowering trend to 22,1% Q3'17)

New Government has introduced new strategy execution plan named "3-6-9 Plan", expecting positive outcome of Euroatlantic accession process.

Telekom is performing well (YoY -1,75% Revenue YtDNov'17 and +3,2%EBITDA excl. SI YtDNov'17), expecting positive overcome of extremely challenging period.

Integrated telco market overview shows stable position of Telekom with 54,6% Q3'17 revenue market share, VIP with 37,5% Q3'17and 7,9% Q3'17 to other operators.

Mobile market is remaining limited to current (2) players, although an open door is still kept further for new entrant (after several announcements by the regulator on expressed interests by 3rd parties). Lycamobile is still single mobile MVNO in the country with insignificant revenue share. Telekom with highest revenue market share with 52% Q3'17 tovards VIP with 47% Q3'17.

Fix market remains with only 2 integrated big players and other smaller operators not having info for introducing MVNO. Telekom has 56,4% Q3'17 revenue market share, VIP with 22% Q3'17 and 21,6% to other operators.

Montenegro

As announced on January 10, 2017, Magyar Telekom has disposed of its majority stake in Crnogorski Telekom. Following the closing of the transaction, the Montenegrin operation is no longer consolidated into Magyar Telekom's financials. Please refer to Note 26.2 of the Consolidated Financial Statements.

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, IoT), customer requirements (e.g., increase in mobile usability of content services and terminal devices, 4Play solutions and the extension of digital services) 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 and passed the first shock of Brexit and the uncertainty of Trump's appearance. Our business environment largely depends on the monetary policy of the FED, the growth of the Chinese and European economy and the movements of EU funds. The last 2 years have brought significant prosperity in the world economy and that pulled the Hungarian economy too.

Hungary

The biggest challenge for Magyar Telekom is probably Digi's mobile market entry, the acquisition of Invitel Távközlési Zrt. and the fixed market competition which is focusing on technology and network developments. We think that we can keep the leading position on our key markets with the continuously growing number of customers with Magenta 1 offers which connect the mobile and fixed services, and with the improvement & utilization of the HSI (high speed internet) network. 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. On midterm there is a focus on increasing the income of service based solutions for the business segment.

Macedonia

Despite the risks stemming from the current environment in Macedonia, the results showing positive perspectives in stabilization of revenues along with cost efficiency improvements leading to a sustainable turnaround in EBITDA.

Telekom has built substantial advantage on the market in terms of FMC penetration (10% of total HH and 36% of fix BB base), and this trend is expected continue in the following years (both in terms of FMC penetration as well as maintaining Telekom leadership in FMC segment).

In addition, once again, Telekom assured No.1 position in Superior technology, achieving Best in test, according P3 global tests reference.

Also Telekom maintained No.1 Brand preference and great customer satisfaction, esspecially in post-paid.

Continuing growing the market in fix BB and growth in TV and regain position No.1 (mid term).

Telekom is dedicating to stable ICT & Cloud growth pace as well as keeping main role in Digitization of society, with emphasis on Smart City projects.

With regards to regulatory strategy in alignment with DT EU strategy, Makedonski Telekom is focused at: Level playing field with OTT, Deregulations of certain markets, Digital Transformation of Western Balkan, Possibilities for accessing to structural EU funds and keeping open possibilities for addressing new business segments.

Montenegro

As announced on January 10, 2017, Magyar Telekom has disposed of its majority stake in Crnogorski Telekom. Following the closing of the transaction, the Montenegrin operation is no longer consolidated into Magyar Telekom's financials. Please refer to Note 26.2 of the Consolidated Financial Statements.

11.2 Revenue, EBITDA, Capex and FCF targets

Magyar Telekom continued to deliver strong performance in 2017. Our continued commitment to satisfy our customers' needs and constantly refresh our product offering strengthened our position in the market in several key areas including post-paid mobile, TV and fixed broadband.

The strong revenue growth recorded by the Group in the first nine months of 2017 continued into Q4 2017, resulting in a 6% revenue rise for the full year. Despite the absence of the considerable one-off profits recorded in 2016, we managed to maintain EBTDA at 2016 levels, leaving us well positioned for the year ahead.

The Hungarian operation continued on the positive trajectory set earlier this year as revenue increased across all three major services lines.

Looking ahead to 2018, we will place greater focus on the FMC segment where we are currently in a unique position to meet the full range of communication requirements of Hungarian households, for we strongly believe that the key to long-term success lies in the ability to offer truly integrated solutions to our customers. In Macedonia, we are confident that, in spite of challenging market conditions, the EBITDA turnaround is sustainable.

We expect a slight year-on-year decline in our revenues to approximately HUF 600 billion for 2018, on account of the exit of our energy business and lower equipment sales revenues. These are not expected to affect 2018 EBITDA, which we anticipate will increase to approximately HUF 190 billion for the year. We expect a slight increase in our CAPEX to around HUF 90 billion as we continue to invest in our fixed networks in Hungary. Planned enhancement of our fixed network is expected to play a key role in strengthening our ability to offer high speed internet access and in supporting digitalization. Our free cash flow will receive a slight boost in 2018 from two upcoming real-estate sales ahead of our move into new headquarters, and should total around HUF 60 billion.

In light of our current operating environment and anticipated future challenges, we forecast the Company to pay a HUF 25 dividend per share after our 2018 earnings. This forecast is subject to General Meeting approval of the planned Board of Directors' proposal in 2019.

Public guidance *

	2017 Actual	Public guidance for 2018
Revenue	HUF 611 billion	around HUF 600 billion
EBITDA	HUF 186 billion	around HUF 190 billion
Capex	HUF 86 billion	around HUF 90 billion
FCF	HUF 58 billion	around HUF 60 billion
Dividend	HUF 25 per share**	HUF 25 per share

**excluding Crnogorski Telekom financials and the transaction price of the disposal of the majority ownership*

***BoD proposal to the AGM*

11.3 Strategy

Hungary

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 2017, we successfully improved customer retention and delivered strong volume figures. We built a word class 4G mobile network and massively improved our fixed line HSI coverage in the past 3 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 behaviour, 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.

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.

Macedonia

Focusing on the period to come, new strategy execution program was developed, branded "Mission Turnaround", with special focus on the main measures and tools of strategy execution:

- Innovation initiatives (Telekom Goes Green)
- Best Network (securing the win in P3 tests)
- Customer Experience Excellence (#1 network perception and #1 ICT/Cloud provider)
- Fueling the Brand (#1 Brand consideration in Macedonia)
- Putting Frontline First (understand the customer, live what you sell, empowerment)
- Creating X-functional culture (creating start-up spirit and high performance culture)

Montenegro

As announced on January 10, 2017, Magyar Telekom has disposed of its majority stake in Crnogorski Telekom. Following the closing of the transaction, the Montenegrin operation is no longer consolidated into Magyar Telekom's financials. Please refer to Note 26.2 of the Consolidated Financial Statements.

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 2017 we accomplished control documentation and evaluation in the IT supported ICS[i] 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 2017 is still in progress, but based on the already available information, we

[i] Internal Control System

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 Group 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 Group, 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 Group 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.

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 subsidiaries to report on a real-time basis any new material fact, information or risk that comes to their knowledge. Information thus submitted is monitored 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;

- 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;
- DIGI bought retail and small business subscribers of Invitel in July 2017. The transaction is expected to be closed in Q1-2018. The deal still requires GVH (Hungarian Competition Authority) approval. As a consequence of the above transaction we may be subject of more intense competition in the fixed business;
- 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 2018;
- As of October 2017, telco service providers are allowed to sell services only with 1-year loyalty period in Hungary except device was also sold at a discounted price. Further change that mobile service providers must carry out the network unlocking of devices free of charge which were sold at a discounted price with fixed term contracts—i.e. loyalty periods—and which have expired subscriber agreements. This allows customers to choose mobile service providers more freely in the future.
- 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;
- The regulatory environment in Macedonia is getting stricter, since the Regulatory Body's aim is at widening the scope of wholesale regulation (bitstream and cost based pricing);
- More intense competition in Macedonia driven by VIP being an integrated player as well;
- 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 management

The classification of the group's financial instruments is described in detail in Note 4 and the financial risk management of the Group is described in detail in Note 5 of the Consolidated Financial Statements.

13 ANALYSIS OF FINANCIAL RESULTS FOR 2017

Key Performance Indicators (continuing operatios)	**At December 31,**	
	2016	**2017**
Revenue (HUF million)	574,035	610,851
Mobile revenues	306,207	322,656
Fixed line revenues	193,761	196,108
System Integration/Information Technology revenues	67,289	87,485
Energy service revenues	6,778	4,602
EBITDA (HUF million)	187,495	185,662
EBITDA margin	32.7%	30.4%
Operating margin	13.3%	12.7%
Capex to sales ratio	17.0%	14.1%
Net debt (HUF million)	376,557	309,641
Net debt ratio (net debt to total capital)	39.3%	34.8%

13.1 Revenues

Total revenues increased to HUF 610.9 billion in 2017, from HUF 574.0 billion in 2016, driven by the significant growth in SI/IT, equipment and mobile data revenues. Revenues grew dynamically in Hungary, while the Macedonian operation witnessed some decline.

Mobile revenues increased by 5.4% to HUF 322.7 billion in 2017, compared to HUF 306.2 billion in 2016. Lower mobile voice revenues were more than offset by higher mobile data and equipment revenues in both countries of operation.

- **Voice retail** revenues decreased by 3.9% to HUF 141.2 billion in 2017, attributal primarily to declines in Hungary, as voice retail revenues remained broadly stable in Macedonia. In Hungary, the positive effects of the expanding postpaid customer base were offset by competitive pressures which led to price erosion and lower roaming revenues as a result of EU regulation. In Macedonia, the benefits of a higher postpaid ratio, due to an increase in the postpaid customer base, were counterbalanced by lower prepaid customer numbers and strong tariff pressure across all segments.
- **Voice wholesale** revenues declined by 3.5% to HUF 10.0 billion in 2017 as increased revenues in Hungary were offset by a significant drop in Macedonia. In Hungary, higher voice wholesale revenues reflect increased traffic driven by a growing portion of flat rate packages. In Macedonia, the decline was due to the ca. 30% lower regulated mobile termination rate (MTR) that came into effect in December 2016, and a decrease in international incoming traffic.
- **Data** revenues grew by 17.9% to HUF 74.0 billion in 2017 as a result of higher subscriber numbers and increased data usage in both countries.
- **SMS** revenues increased by 2.0% to HUF 17.3 billion in 2017 as the growth in mass messaging revenues in Hungary compensated for the lower residential usage. Macedonian operations meanwhile, recorded an increase in SMS usage thanks to favourable promotional offers.
- **Mobile equipment** revenues increased by 16.9% to HUF 64.2 billion in 2017, reflecting growth in both Hungary and Macedonia. Higher accessories and third-party export sales, coupled with increased average handset prices, contributed to the increase in Hungary, while higher smartphone sales volumes supported the Macedonian performance.

Fixed line revenues increased to HUF 196.1 billion in 2017, up from HUF 193.8 billion in the previous year. The continued decline of voice revenues was fully offset by improvements in TV, data and equipment revenues.

- **Voice retail** revenues decreased by 8.4% to HUF 46.0 billion in 2017, primarily due to the compounded impact of the customer base erosion, along with a reduction in average tariff levels in both countries.
- **Broadband retail** revenues remained stable at HUF 49.3 billion in 2017 as the moderate increase in Hungarian operations was offset by lower broadband revenues in Macedonia. In Hungary, the expansion of the customer base compensated for the competition driven tariff erosion; whereas in Macedonia, the decline in the broadband ARPU coupled with unchanged customer base led to a decline.
- **TV** revenues increased by 8.0% to HUF 45.2 billion in 2017, thanks to an enlarged customer base and improving ARPUs in both Hungary and Macedonia.
- **Fixed equipment** revenues rose to HUF 9.3 billion in 2017, from HUF 5.4 billion in 2016, due to a significant increase in sales of TV sets, tablets and laptops to retail customers in Hungary, whilst in Macedonia equipment sales declined as a result of reverse trends.
- **Data retail** revenues increased by 12.2% to HUF 10.7 billion in 2017. This was primarily due to higher revenues in Hungary driven by a major project related to the 2017 Swimming Word Championship (FINA), whereas in Macedonia revenues were subdued by a lower contribution from leased line services.
- **Wholesale** revenues declined by 5.5% to HUF 19.1 billion in 2017, largely as a result of lower fixed incoming domestic and international traffic levels in Macedonia and the termination of part of our wholesale activity at our Romanian subsidiary.

System Integration (SI) and IT revenues amounted to HUF 87.5 billion in 2017, compared to HUF 67.3 billion in 2016. The main factor behind this significant 30.0% increase was the acceleration of EU fund inflows into Hungary after the temporary drop witnessed in 2016, leading to strong growth at the Hungarian operation. At the same time, System integration and IT revenues dropped in Macedonia as, following a period of political uncertainty, major public sector projects suffered some delays.

Energy Service revenues decreased to HUF 4.6 billion in 2017 compared to HUF 6.8 billion in 2016, representing a 32.1% decline that reflects the expiry of the last remaining gas universal contracts and the exit from the residential segment of the electricity market which came into effect on November 1, 2017.

13.2 Direct costs

Direct costs increased by 15.7% year-on-year to HUF 245.8 billion in 2017, from HUF 212.4 billion in 2016, mainly due to a sharp increase in SI/IT related costs coupled with an increase in other direct costs.

- **Interconnect costs** improved by 3.8% to HUF 18.9 billion in 2017, driven by the effect of the Macedonian MTR cut in December 2016. In Hungary, higher mobile traffic led to increased payments to domestic mobile operators however, this was fully offset by the decline in fixed outpayments resulting from the termination of part of our wholesale activity at our Romanian subsidiary.
- **SI/IT service related costs** increased to HUF 60.4 billion in 2017, up from HUF 39.5 billion in 2016, in line with higher SI/IT revenues in Hungary. At the same time, SI/IT costs decreased in Macedonia parallel to the decline in revenues.
- **Energy service related costs** decreased by 29.4% to HUF 4.8 billion in 2017, as a result of the expiry of the last remaining gas universal contracts coupled with the exit from the residential segment of the electricity market effective November 1, 2017.
- **Bad debt expenses** were lower by 29.9% at HUF 5.5 billion in 2017, owing to lower impairment rates applied at the Hungarian mobile operations thanks to the improved collection efficiency. At the same time, in Macedonia bad debt expense increased due to higher impairments in the mobile segment and lower positive impact from the annual impairment rate review than in 2016.
- **Telecom tax** increased by 3.4% to HUF 25.1 billion in 2017, driven by higher mobile voice traffic in both residential and business segments in light of the growing share of flat rate packages.
- **Other direct costs** increased by 14.6% to HUF 131.1 billion in 2017 primarily due to higher cost of mobile equipment, accessories and other equipment sales, in line with higher sales volume in both Hungary and Macedonia. TV and other content related costs (mainly attributable to the new content fee) and roaming outpayments also increased in Hungary.

13.3 Gross profit

Gross profit improved to HUF 365.1 billion in 2017, from HUF 361.6 billion in 2016, thanks to the strong increase in revenues.

13.4 Employee-related expenses

Employee-related expenses increased by 1.7% year-on-year to HUF 80.2 billion, owing to higher severance-related expenses in Hungary and a 1.6% increase in the average Group level headcount in 2017.

13.5 Other operating expenses

Other operating expenses remained broadly stable at HUF 105.9 billion in 2017. In Hungary, cost saving measures implemented during the year resulted in lower advisory, HR-related, material and marketing costs. However, these were offset by increased rental fees and maintenance costs and higher Hungarian utility tax. Hungarian utility tax increased by 2.1% in 2017 reflecting network acquisitions and an increased length of taxable network resulting from the refinement of the cable network records. Despite higher maintance costs resulting from the outsourcing agreement with Ericsson in Macedonia, other operating expenses declined as a result of savings realised in HR-related costs and rental fees.

13.6 Other operating income

Other operating income declined by HUF 4.2 billion year-on-year to HUF 6.7 billion, primarily attributable to the absence of one-off profits realized on the sales of Infopark Building G and Origo in 2016. That was partly counterbalanced by higher brand fee income from the E2 energy joint venture.

13.7 EBITDA

EBITDA was lower by 1.0% at HUF 185.7 billion in 2017, as the improvements in gross profit in both countries of operation were counterbalanced by higher severance expenses and a decline in other operating income in Hungary.

13.8 Depreciation and amortization

Depreciation and amortization (D&A) expenses declined by 2.8% to HUF 108.2 billion in 2017. In Hungary, the lower D&A expense was driven by useful life extensions of some assets with a remaining useful life of less than 2 years as well as the scrapping of radio technical equipment, whereas in Macedonia, the lower average asset base led to the decline.

13.9 Operating profit

Operating profit increased from HUF 76.2 billion in 2016 to HUF 77.5 billion in 2017 thanks to lower D&A that fully offset the slight EBITDA decline.

13.10 Net financial result

Net financial loss narrowed from HUF 27.0 billion in 2016 to HUF 21.6 billion in 2017 due to a lower interest expense resulting from a lower average debt level and a decline in the average interest rates on loans.

13.11 Income tax

Income tax increased from an income of HUF 4.9 billion in 2016 to an expense of HUF 16.0 billion in 2017. The primary reason for this change was the reduction in the corporate income tax rate from 19% to a flat rate of 9% as of 1 January, 2017, which was reflected in the Q4 2016 deferred tax position. Frthermore, the one-off impact of the change in the tax calculation methodology relating to the transition from local GAAP to standalone IFRS has increased income tax expense in 2017.

13.12 Profit attributable to non-controlling interests

Profit attributable to non-controlling interests increased from HUF 2.2 billion in 2016 to HUF 3.0 billion in 2017 due to higher profit for the period generated by the Macedonian subsidiary.

13.13 Cash flows

HUF millions	1-12 months 2016 (Restated)	1-12 months 2017	Change
Operating cash flow	148,782	157,411	8,629
Investing cash flow	(83,226)	(94,353)	(11,127)
Less: Proceeds from other financial assets - net	88	2,867	2,779
Investing cash flow excluding Proceeds from other financial assets – net	(83,138)	(91,486)	(8,348)
Repayment of other financial liabilities	(8,347)	(7,485)	862
Free cash flow from continuing operation	**57,297**	**58,440**	**1,143**
Net cash generated from/(used in) operating activities from discontinued operation	6,043	(23)	(6,066)
Net cash (used in)/generated from investing activities from discontinued operation*	(13,001)	36,292	49,293
Repayment of other financial liabilities from discontinued operation	(329)	0	329
Free cash flow from discontinued operation	**(7,287)**	**36,269**	**43,556**
Total free cash flow	**50,010**	**94,709**	**44,699**
Proceeds from other financial assets - net	6,940	(2,867)	(9,807)
Proceeds from/Repayment of loans and other borrowings - net	(40,423)	(67,732)	(27,309)
Dividend paid to shareholders and Non-controlling interests	(21,312)	(29,403)	(8,091)
Repurchase of treasury shares	(550)	(2,139)	(1,589)
Net cash (used in)/generated from financing activities from discontinued operation	(1,374)	2,041	3,415
Exchange differences on cash and cash equivalents	(26)	(15)	11
Exchange differences on cash and cash equivalents from discontinued operation	(18)	0	18
Change in cash and cash equivalents	**(6,753)**	**(5,406)**	**1,347**

* Less: Proceeds from other financial assets - net from discontinued operation

Free cash flow from continuing operation (FCF) overall increased from HUF 57.3 billion in 2016 to HUF 58.4 billion in 2017 due to the reasons described below:

Operating cash flow from continuing operation

Net cash generated from operating activities amounted to HUF 157.4 billion in 2017, compared to HUF 148.8 billion in 2016. Main reasons for the increase of HUF 8.6 billion were the following:

- HUF 1.8 billion **negative change** due to the lower **EBITDA** in 2017 than in 2016
- HUF 21.6 billion **negative change in active working capital** mainly as a result of the following impacts:
  - lower reduction of energy receivables compared to the corresponding period in 2016 due to the transfer of the energy services for business customers to E2 at the beginning of 2016 and the termination of the remaining residential services in 2017 (negative impact: ca. HUF 7.2 billion)
  - higher increase in SI/IT receivables in 2017 compared to 2016 , reflecting different timings of projects (negative impact: ca. HUF 2.2 billion)
  - extension of the instalment periods and the lower upfront payment relating to equipment sales, leading to a rise in outstanding balances in 2017 (negative impact: ca. HUF 12.6 billion)
- HUF 1.5 billion **positive change in provision** mostly due to the following impacts:
  - HUF 1.6 billion positive change mostly due to lower net payments of severance provision in 2017 than in 2016
  - HUF 1.8 billion positive change mostly due to higher net addition to severance provision in 2017 than in 2016
  - HUF 0.6 billion negative change mostly due to higher net payments of legal provision in 2017 than in 2016
  - HUF 0.6 billion negative change mostly due to lower net addition to legal provision in 2017 than in 2016
- HUF 19.6 billion **positive change in passive working capital** primarily driven by the following factors:
  - higher payment to SI/IT services related suppliers in 2017 (negative impact: HUF 1.3 billion)
  - improved equipment and OPEX creditors vendor management in 2017 (positive impact: HUF 19.3 billion)
  - HUF 1.0 billion positive change in passive working capital due to MTR debtor overpayments (invoiced and collected using old rate, accounted at new rate as revenue) in 2016
  - HUF 6.1 billion lower HR related personnel expense payments in 2017 than in 2016
  - HUF 2.3 billion negative change due to the termination of the Customer Loyalty Program
- HUF 1.3 billion positive change in income tax paid mainly due to the lower corporate income tax rate in 2017 and due to the self-revision and higher payment relating to local business tax in 2016
- HUF 4.1 billion **positive change** due to the lower levels of **interest expense paid** reflecting continued easing in the wider interest rate environment and refinancing of certain loans on more favourable credit terms and due to the decreased average loan amount
- HUF 5.3 billion **positive change in other non-cash items** mainly due to the booking of one-off non-cash gains resulting from the sale of Origo Zrt and Infopark G building which was partly offset by the accounting net results from the real estate sales recorded in 2017

Investing cash flow from continuing operation excluding proceeds from other financial assets – net

Net cash used in regular investing activities amounted to HUF 91.5 billion in 2017, compared to HUF 83.1 billion in 2016. Main reasons for the HUF 8.3 billion higher cash outflow were the following:

- HUF 11.5 billion **positive effect** due to lower **CAPEX** in 2017 than in 2016
- HUF 1.8 billion **negative change** due to higher amount of **CAPEX creditors** paid in 2017 than in 2016 which was further boosted by the net effect of lower inflows and higher utilized amount of EU government grant
- HUF 1.0 billion **negative change** due to the **acquisition of ServerInfo-Ingatlan Kft** (purchase price vs. cash acquired through the acquisition)
- HUF 2.3 billion **negative change** due to higher volumes **of cable TV operation acquisition** in 2017 than in 2016
- HUF 3.4 billion **negative change** in **disposal of subsidiaries** due to the sale of Origo Zrt in 2016
- HUF 7.3 billion **negative change** related to the **disposal of PPE** mainly reflecting the sale of Infopark G building and other real estate sales in 2016 (HUF 8.8 billion negative change) and the real estate sales in 2017 (HUF 1.7 billion positive change)

Repayment of other financial liabilities

Repayment of other financial liabilities decreased from HUF 8.3 billion in 2016 to HUF 7.5 billion in 2017, mainly due to the following:

- HUF 0.5 billion **negative change** due to the **repayment of a loan** related to the sale of Origo Zrt. in 2016
- HUF 2.1 billion **positive change** due to **termination of certain finance lease contracts** primarily affected 2017 compared to 2016 HUF 0.9 million **negative change** due to the bringing forward of the last repayment **instalment** relating to the financing for the Macedonian headquarters building in 2017

Free cash flow from discontinued operation (FCF) overall increased by HUF 43.6 billion mainly due to the sale of Crnogorski Telekom A.D. (disclosed within discontinued operations)

Proceeds from other financial assets - net decreased by HUF 9.8 billion, primarily due to the following:

- HUF 1.6 billion **higher amount** of Maktel's cash was invested as bank deposits over 3 months in 2017 in net terms
- HUF 7.5 billion **more amount** of TCG's cash was cashed in from bank deposits over 3 months in 2016 in net terms and no such equivalent item is appeared during 2017

Repayment of loans and other borrowings – net increased by HUF 27.3 billion, due to the reimbursement of parent company (DT AG) and certain bank loans from the sale proceeds of the Crnogorski Telekom A.D disposal in 2017

Dividends paid to Owners of the parent and Non-controlling interests increased by HUF 8.1 billion mainly due to the higher dividend payment of MT to its Owner and Non-controlling interest as DPS (dividend per share) has risen from 15 HUF in 2016 to 25 HUF in 2017

Repurchase of treasury shares increased by HUF 1.6 billion due to the higher repurchase of treasury shares for ESOP (Employee Stock Ownership Plan) in 2017, than in 2016

Net cash (used in)/generated from financing activities from discontinued operation recorded a HUF 3.4 billion positive change made up mainly of the following:

- HUF 2.0 billion **positive impact** following the sale of Crnogorski Telekom A.D. in 9M 2017, relating to the repayment of its loan with Magyar Telekom; and
- HUF 1.4 billion **positive impact** relating to Crnogorski Telekom A.D. dividend payments, as there was no such equivalent payment in 2017

Exchange differences on cash and cash equivalents both from continuing and discontinued operation had no significant effect in 2017 compared to 2016

13.14 Statements of Financial Position

The most significant change in the balances of the Statements of Financial Position from December 31, 2016 to December 31, 2017 can be observed in the following lines:

- Trade and other receivables
- Property plant and equipment and Intangible assets (including Goodwill)
- Financial liabilities to related parties (current and non current parts)
- Other current financial liabilities
- Trade payables

Trade and other receivables increased by HUF 0.1 billion from December 31, 2016 to December 31, 2017. This change is mainly caused by two opposite effects. The decrease is due to the deconsolidation of the sold Montenegrin subsidiary, Crnogorski Telekom A. D. in the amount of HUF 8.9 billion of derecognized receivables. The increase in SI/IT receivables had a opposing effect.

Property plant and equipment (PPE) and intangible assets (including Goodwill) together decreased by HUF 61.6 billion from December 31, 2016 to December 31, 2017. The decrease is mainly due to the deconsolidation of the sold Montenegrin subsidiary, Crnogorski Telekom A.D. in the amount of HUF 46.1 billion of derecognized assets. Further decrease is caused by the depreciation and scrapping of assets exceeded the capital expenditure of assets.

The current and non current parts of Financial liabilities to related parties together decreased by HUF 52.9 billion from December 31, 2016 to December 31, 2017. The change mainly results from the repayment of DT group loans with the consideration received for the sale of the Montenegrin subsidiary.

Other current financial liabilities decreased by HUF 13.8 billion from December 31, 2016 to December 31, 2017. The decrease is mainly due to certain bank loans repayments.

Trade payables decreased by HUF 1.2 billion from December 31, 2016 to December 31, 2017. This change is mainly caused by two opposite effects. The decrease is partly due to the deconsolidation of the sold Montenegrin subsidiary, Crnogorski Telekom A.D. in the amount of HUF 9.3 billion of derecognized liabilities. The increase is mainly due to the change in the balance of Handset suppliers.

There has not been any other material change in the items of the Consolidated Statement of Financial Position from December 31, 2016 to December 31, 2017. The less significant changes in balances of the Consolidated Statements of Financial Position are largely explained by the items of the Consolidated Statement of Cash Flows for 2017 and the related explanations provided above in section 13.13 Cash flows.

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

14.1 Acquisition of ITgen Kft.

In November 2017 T-Systems Magyarország Zrt. signed a Share Purchase Agreement to acquire a 100% stake in ITgen Kft., an SAP technology and security specialist, for a purchase price plus a potential earnout payment totalling to a maximum of HUF 1.2 billion, dependent on 2018, 2019 and 2020 financial performance. In 2016, ITgen delivered revenues of around HUF 0.8 billion and EBITDA of HUF 0.3 billion. The closing of the transaction took place in January 2018.

Budapest, February 20, 2018

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 undertakings included in the consolidation as a whole, and
- the business report gives a fair view of the position, development and performance of Magyar Telekom Plc. and the undertakings included in the consolidation as a whole, together with a description of the principal risks and uncertainties of its business.

Budapest, April 10, 2018

Christopher Mattheisen
Chief Executive Officer,
Member of the Board

János Szabó
Chief Financial Officer