Annual Report 2006

Magyar Telekom

Common goals, common successes

- Focus on broadband products
- Increasingly efficient integrated operations
- Expansion and growth in convergent markets

Magyar Telekom

Group Center

Lines of Business

T-Com

Wireline Services

Market leadership in wireline telephony and Internet:
3.4 million fixed lines,*
572,000 broadband connections

Broadband: 60% growth, increased speed and coverage

Traffic-enhancing flat-rate packages

Integrated nationwide retail network

T-Home TV: digital IPTV service launched

T-Online: market leadership in web content services

T-Mobile

Mobile Services

Market leadership in mobile communications:
5.7 million mobile phone customers *

Successful integration, first fixed–mobile scheme launched

Introducing the real mobile broadband: HSDPA

Web'n'walk: mobile Internet

Mobile multimedia over 3G network: video phone, mobile TV

Entering the notebook market

T-Systems

Corporate Services

Market leadership in business communications:
3,000 key business partners, full Magyar Telekom Group product portfolio

A decisive market player in IT, ICT outsourcing and systems integration

New consolidated subsidiaries, expanding product portfolio

Managed ICT services

Group-level integrated relationship-management

Electronic bill management

* In Hungary, Macedonia and Montenegro.

Our vision

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

Magyar Telekom (www.magyartelekom.hu) is the principal provider of telecom services in Hungary. It provides a broad range of fixed line services including telephony, data transmission, value-added services, and it is Hungary's largest mobile carrier and leading Internet service provider.
Magyar Telekom is the majority owner of MakTel, the sole fixed line operator and its subsidiary T-Mobile Macedonia, the country's leading mobile operator. Magyar Telekom also has a majority stake in Crnogorski Telekom, Montenegro's largest telecom operator which provides fixed line, mobile and Internet services.
Magyar Telekom was incorporated in 1991 (under the name Matáv) and privatized in 1993. Magyar Telekom shares were introduced to national and international stock exchange dealing both in Budapest and New York in 1997. Magyar Telekom's majority shareholder (59.21%) is MagyarCom Holding GmbH, fully owned by Deutsche Telekom AG.
From March 1, 2006 Magyar Telekom's registered company name is Magyar Telekom Telecommunications Public Limited Company, the abbreviated name is Magyar Telekom Plc.

Awards and recognition

- **April 2006:** The Euromoney annual corporate survey put Magyar Telekom in the 2nd place in the region in terms of usability of its Internet site, and it also placed 2nd in mobile and wireline telephony in terms of convincing and consistent strategy.

- **May 2006:** A Reader's Digest survey covering 14 European countries found T-Mobile to be the Most Trusted Brand in the mobile operator category in Hungary, just like in the previous 5 years.

- **May 2006:** The commercial spot of Magyar Telekom's Világvonal (World Line) service won a Bronze Blade prize at the Golden Blade Creative Commercial Festival.

- **June 2006:** The joint application of T-Com and Allround Informatika – as first Hungarian companies ever – won the World Billing Award, the highest international recognition for billing technologies, in the Best Revenue Assurance/Management Project category.

- **July 2006:** Magyar Telekom was ranked as first among 100 leading Hungarian companies based on the survey by Terra Idea research group which measures the online communication of corporate social responsibility.

- **October 2006:** The professional jury appointed by Figyelő Top 200 awarded Magyar Telekom as the Corporate Donor of the Year in Hungary.

- **October 2006:** In the Accountability Rating Hungary 2006 Magyar Telekom was ranked as best in corporate social responsibility on the basis of a comparative survey of leading Hungarian companies.

- **November 2006:** György Simó, head of T-Com and CEO of T-Online Hungary, was given the international Leadership Award by Dale Carnegie & Associates for his merits in organization development.

- **November 2006:** Magyar Telekom won the Integrating Employer 2006 award of the Budapest Municipality in the forprofit category in recognition of its outstanding achievements in creating equal opportunities for its employees.

- **November 2006:** Magyar Telekom earned the Chairman's Award of the Central European University with its outstanding support of the University's activities.

- **November 2006:** Magyar Telekom' Procurement Directorate won a nomination and became a finalist for the year's European Logistics Award for Excellence.

- **February 2007:** Magyar Telekom won the Deutsche Telekom Group's international Diversity Award 2006 for its achievements in creating equal opportunities for its employees.

Contents

Letter to our shareholders

Dear Shareholders,

2006 saw a number of positive developments for Magyar Telekom. Despite strong competition in all areas, we preserved our leading position in our key businesses. Both revenue growth of 9% and EBITDA growth of 1% were comfortably in line with our full year targets. The gross additions to tangible and intangible assets to sales ratio was 13.5%, in line with our goal of maintaining the ratio below 15% in 2006. In terms of parent company headcount efficiency, we reached our target of 500 lines per employee ratio by the end of February 2006.

In the Hungarian fixed line business, revenue growth was fuelled by the increasing system integration and IT revenues, as well as our focus on broadband services, which were able to counterbalance the ongoing drop in traffic revenues. In the traditional voice market, mobile, cable and alternative providers remain the main competitors. To protect our customer base, we are continuously migrating customers to flat-rate packages with a loyalty period. As a result, the ratio of customers on a fixed-term contract was above 40% in the residential segment by the end of the year. The number of broadband customers increased by 60% year-on-year and our aim is to further increase broadband penetration in the next years through new offers and increased bandwidth. This will be helped by the IPTV services launched in November 2006, offering interactive entertainment services to our customers. In addition, the acquisition of iWiW, the leading Hungarian online social network, has improved our content offers. The network had more than 1.7 million registered members by the end of January 2007 and is the third most visited web page in Hungary. System integration and IT revenues almost tripled in 2006 mainly reflecting the consolidation of Dataplex since April and KFKI since mid-September. Through these companies, we gained a strong position in the growing IT, system integration and telco-outsourcing market. This year, our competitive position in this market will be further strengthened by the operations of T-Systems Hungary, of which we gained control on January 1, 2007.

In 2006 we already saw the initial positive impacts of the fixed-mobile integration, especially in terms of sales and customer retention. For example, we fully integrated our store network, which now provides an all-encompassing service to our

customers, and unified the client relationship management of business customers. According to our estimate, the net present value of the benefits of the integration will be around HUF 60 bn in the 2007-2009 period.

While penetration levels in the Hungarian mobile market increased to 99% by the end of the year, we maintained our clear leadership with market share of above 44% and increased our customer base by 6%. As new additions were driven mostly by postpaid clients, the improvement in our customer mix positively affected our underlying performance. Revenue per user levels remained broadly stable compared to last year, as the higher usage and the increasing role of data-related value-added services offset the tariff decline and the cut in the mobile termination rates. The successful sales activity was supported by the integrated fixed-mobile shop network and marketing activities. In addition, new wireless Internet subscriptions played a significant role, thanks to the HSDPA service launched in May 2006. T-Mobile was the first operator in Hungary to offer super-fast HSDPA services, supporting a successful mobile broadband rollout. By the end of December, the population based HSDPA coverage was about 30% in Hungary. The network offers speed of up to 3 megabit per second. The rollout of the country-wide TETRA (unified digital radio) network for the emergency services, which we will operate for the next 9 years, was also completed by January 2007.

Both fixed and mobile businesses at our international operations in Macedonia and Montenegro showed an excellent performance, making a considerable contribution to our profitability. The revenue increase was also helped by the full consolidation effect of Crnogorski Telekom and the favorable foreign exchange movements. In addition, we have rebranded the mobile company in Macedonia and both the mobile and the fixed operations in Montenegro in the third quarter of 2006, the positive effects of which have already been felt.

At the Macedonian fixed line operations, the strong mobile substitution resulted in a decline of outgoing traffic revenues, while Internet and incoming traffic revenues increased. Broadband customer base doubled and the number of dial-up users also grew significantly. The profitability of the business was impressive in 2006 with a close to 45% EBITDA margin thanks to our restructuring efforts and to the earlier headcount rationalization programs. For the future we expect more pressure on profitability through increasing competition from alternative operators, given the start of the liberalization process in 2006. Mobile penetration in Macedonia reached 68% by the end of 2006. Despite strong competition, the market share of T-Mobile Macedonia remained high at close to 67%, helped by the rebranding campaign. While tariff levels have continued to decrease, higher usage and a strong increase in enhanced revenues kept ARPU levels flat in local currency terms.

Montenegrin fixed line business revenues were helped by the growing wholesale and Internet revenues as a result of the increasing number of tourists and DSL customers. Although fixed to mobile substitution already puts pressure on fixed line traffic, the company was successful in line preservation. Crnogorski Telekom has fully integrated fixed and mobile operations to increase efficiency, which gave scope for further headcount reduction. Mobile penetration significantly increased throughout 2006, however this also includes a high number of tourists using Montenegrin SIM cards in the summer period. Thanks to the expanding number of visitors, traffic revenues showed a strong increase, while MOU and ARPU levels were broadly flat driven by the strong dilution effect. Although our market share slightly decreased to 41%, our postpaid market share reached 47% thanks to the new offers related to the rebranding campaign.

Looking forward to 2007, we are targeting stable revenue and EBITDA in forint terms over 2006 reported figures. Our target for gross additions to tangible and intangible assets to revenues ratio is below 14% in 2007. Regarding our strategy going forward, I would like to underline three areas to which we intend to give strong impetus. The first is excellence through a stronger customer focus and significantly improved service quality. The second is greater efficiency through improvements in operational cost structure, headcount productivity and leveraging new, integrated revenue opportunities. Last but not least, our goal remains to seek growth in the form of value-creating acquisitions in the future, both in Hungary and in our region.

Christopher Mattheisen
Chairman and Chief Executive Officer

The Management Committee of Magyar Telekom

Christopher Mattheisen, Chairman and Chief Executive Officer, Chairman of the Management Committee

Born in 1961. Degrees in economics from Indiana University, Bloomington and Columbia University, New York. First came to Hungary in 1990 to start a consulting company for business analysis and strategic planning. From 1993 to 1996 was the founding Marketing and Sales Director of Westel 900 (later T-Mobile Hungary). From there moved on to Poland to participate in launching Era GSM for US West International as Director of Marketing, Sales and Strategy. From 1997 to 1999 headed up in London US West's (later MediaOne) marketing and sales activities for its European mobile subsidiaries. Subsequently served at BT Cellnet as Business Marketing and Sales Director. From September 2002 was member of Magyar Telekom's Management Committee and Chief Officer responsible for Residential Services. From January 2005 to June 2006 served as Chief Operating Officer leading the Wireline Services line of business (T-Com). Appointed Magyar Telekom's Chief Executive Officer from December 6, 2006 and elected member and Chairman of the Board of Directors on December 21, 2006.

Thilo Kusch, Chief Financial Officer

Born in 1965. He studied communication engineering and business administration at Technische Universität, Berlin. From 1989 to 1992 he successfully established his own company selling PCs and PC networks to residential and small business customers. From 1992 he worked in a leading position in Arthur D. Little's telecoms, IT, media and entertainment practice as a management consultant. From 1998 he was telecoms equity analyst with Dresdner Kleinwort Wasserstein. He joined Deutsche Telekom Group in 2001 as Senior Director in charge of IPO preparations and investor relations for T-Mobile International. Since April 2002 he was a Senior Executive Vice President of Deutsche Telekom in charge of investor relations. He was appointed Chief Financial Officer of Magyar Telekom as of September 20, 2006 and elected member of the Board of Directors on November 6, 2006.

Dr. Tamás Pásztory, Chief Human Resources and Legal Officer*

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

*Resigned from his postion as of March 30, 2007.

György Simó, Chief Operating Officer, Wireline Services

Born in 1967. He graduated in 1997 at ELTE Sociology Department. During his studies he received a scholarship in sociology at the New School for Social Research, New York. In 1991 he founded and acted as host, later as Board of Trustees Chairman of Tilos Radio. From 1996 to 1998 he was Vice-Chairman of AMARC-Europe, the European Association of Community Radio Broadcasters. From 1999 he was Program Director, from April 2000 Chief Officer and Executive Director, then from September Senior Chief Officer of Matávnet (from 2001 Axelero Internet) responsible for media, strategy and communication. From November 2003 he became CEO of Axelero Internet, from May 2005 CEO of T-Online Hungary, Deputy Head of T-Com and Head of T-Com's Internet Services Division. From September 20, 2006 he has been Chief Operating Officer, Wireline Services of Magyar Telekom and member of the Management Committee.

Zoltán Tankó, Chief Operating Officer, Corporate Services

Born in 1957. A Budapest Technical University graduate in electrical engineering, he worked from 1980 as computer development engineer in Budapesti Rádiótechnikai Gyár, and from 1982 in Kőbányai Gyógyszerárugyár. From 1984 he held various positions at Műszertechnika and was promoted to Vice President in 1987 and Chief Officer in charge of telecommunications in 1990. He joined Magyar Telekom in 1996 as Director of Business Communications and was promoted to Chief Sales Officer of the company as of January 1, 2000. Member of the Management Committee since November 14, 2000. From January 1, 2002 he has been Chief Officer, Business Solutions and from January 1, 2005 Chief Operating Officer, Corporate Services.

János Winkler, Chief Operating Officer, Mobile Services

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

The Management Committee of Magyar Telekom (left to right):
György Simó Chief Operating Officer, Wireline Services; Zoltán Tankó Chief Operating Officer, Corporate Services; Dr. Tamás Pásztory Chief Human Resources and Legal Officer; Thilo Kusch Chief Financial Officer; Christopher Mattheisen Chairman and Chief Executive Officer, Chairman of the Management Committee; János Winkler Chief Operating Officer, Mobile Services

Magyar Telekom's Board of Directors and Supervisory Board

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

Christopher Mattheisen

Born in 1961. Degrees in economics from Indiana University, Bloomington and Columbia University, New York. First came to Hungary in 1990 to start a consulting company for business analysis and strategic planning. From 1993 to 1996 was the founding Marketing and Sales Director of Westel 900 (later T-Mobile Hungary). From there moved on to Poland to participate in launching Era GSM for US West International as Director of Marketing, Sales and Strategy. From 1997 to 1999 headed up in London US West's (later MediaOne) marketing and sales activities for its European mobile subsidiaries. Subsequently served at BT Cellnet as Business Marketing and Sales Director. From September 2002 was member of Magyar Telekom's Management Committee and Chief Officer responsible for Residential Services. From January 2005 to June 2006 served as Chief Operating Officer leading the Wireline Services line of business (T-Com). Appointed Magyar Telekom's Chief Executive Officer from December 6, 2006 and elected member and Chairman of the Board of Directors on December 21, 2006.

Dr. István Földesi

Born in 1949. He spent 20 years in diplomatic service in London, Madrid and Washington as Attaché, then Counsellor. Up to 1988, he was Assistant Under-Secretary Science and Technology at Hungary's Ministry of Foreign Affairs, then to 1990 Advisor to the Prime Minister. From 1989 he was Deputy Assistant Under-Secretary International Relations at the Ministry of Foreign Affairs. Since 1992 he has been an international business consultant. From 1993 to 1995 he was Vice-Chairman, Central Europe, then East Coast, of IMPAC Integrated Control Systems, a US management consulting firm. Currently he is President of EuroAccess, a business consulting firm. He was Magyar Telekom's Director from December 13, 1994 to April 28, 1999 and Chairman of the Board in 1994–96. Magyar Telekom's Director again since April 25, 2003.

Dr. Mihály Gálik

Born in 1946. He holds a PhD in economics and is a senior university lecturer. He spent nearly two decades in the media, working for Hungarian Radio, where he held several senior positions including that of Managing Director. Afterwards, his professional career has been linked to the Budapest University of Economics (currently Corvinus University). For 3 years, he was a senior lecturer, while in the last 7 years he headed several university departments. He is a recipient of the Széchenyi Professors' Scholarship and also the author of some 70 scientific publications including four textbooks. He is Director of the Marketing and Media Institute of the Corvinus University and Head of its Media, Marketing Communications and Telecommunications Department. Magyar Telekom's Director since November 6, 2006.

Michael Günther

Born in 1944. He studied business administration at the universities of Berlin and Hamburg. From 1971 he was commercial executive at Philips. From 1987 to 1993 he was Board member of Philips Kommunikations Industrie responsible for controlling, finance and accounting as well as IT. In 1994 he joined DeTeSystems, a Deutsche Telekom subsidiary, as commercial director. In 1996 he became head of financial and controlling division at Deutsche Telekom responsible for business customers. From 1997 he was financial and controlling director of T-Mobile. He became Chief Financial Officer of T-Mobile International in 2000 and since 2001 he is Member of the Board of Management responsible for Joint Venture Management. Magyar Telekom's Director since April 26, 2002.

Dr. Klaus Hartmann

Born in 1961. He graduated in economics and holds a PhD and an MBA. He worked for Arthur Andersen in Germany, and later for the BICC Group as treasurer and operational controller. He joined Deutsche Telekom in 1995 as Manager International Capital Markets, and became Corporate Treasurer of Global One in 1997. In 2000, he returned to Deutsche Telekom as Senior Advisor to the CFO. He was appointed Magyar Telekom's CFO and Deputy Chairman of its Management Committee in November 2000. From September 2006 he is CEO of Polska Telefonia Cyfrowa. Magyar Telekom's Director since October 27, 2000.

Horst Hermann

Born in 1955. He joined Deutsche Telekom as operations manager in 1978. In 1990 he joined DT Headquarters, Corporate Strategy and Regulatory Policy. From 1994 he was Assistant Managing Director for Business Development and Finance in DT's regional Headquarters in Singapore. From 1996 he was responsible for Strategic Planning in the Bonn Headquarters again. In 1998 he joined Magyar Telekom in charge of Strategy and Business Development. In 2002 he became Chief Strategy and International Officer, also responsible for Portfolio Management and Magyar Telekom's policy on content and media. In 2003 he was appointed T-Com's Senior Executive Vice President responsible for International Business. Magyar Telekom's Director since April 25, 2003.

Thilo Kusch

Born in 1965. He studied communication engineering and business administration at Technische Universität, Berlin. From 1989 he managed his own company selling PCs and PC networks. From 1992 he worked as a leading management consultant in Arthur D. Little's telecoms, IT, media and entertainment practice. From 1998 he was telecoms equity analyst with Dresdner Kleinwort Wasserstein. He joined Deutsche Telekom Group in 2001 as Senior Director in charge of IPO preparations and investor relations for T-Mobile International. Since April 2002 he was Deutsche Telekom's Senior Executive Vice President responsible for investor relations. He was appointed Chief Financial Officer of Magyar Telekom as of September 20, 2006 and elected member of the Board of Directors on November 6, 2006.

Gerhard Viktor Mischke

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

Frank Odzuck

Born in 1959. He obtained an economics degree in 1983 in Budapest. He has been working in Hungary for over 15 years. He was the managing director of the Hungarian operations of Eduscho and Eduscho-Tchibo for 8 years and later the managing director of Nestlé-Schöller Hungary. Since 2003 he has been the CEO of Zwack Unicum, listed on the Budapest Stock Exchange. The company, producing and marketing a genuine "Hungaricum", is one of the best-known international companies in Hungary. He is a successful businessman, a respected member of the German business community in Hungary. Magyar Telekom's Director since November 6, 2006.

Dr. Ralph Rentschler

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

* Dr. Mihály Patai has resigned from his position effective May 23, 2006.
* Dr. György Surányi has resigned from his position effective October 9, 2006.
* Elek Straub has resigned from his position on December 5, 2006.

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

Dr. László Pap, Chairman
Géza Böhm
Attila Csizmadia
Dr. Ádám Farkas
Dr. János Illéssy
Gellért Kadlót
Dr. Sándor Kerekes
Dr. Thomas Knoll
Konrad Kreuzer
Dr. György Szapáry
György Varju
Péter Vermes

Members of the Remuneration Committee

Michael Günther
Frank Odzuck
Dr. Ralph Rentschler

Members of the Audit Committee

Dr. Ádám Farkas, Chairman
Dr. János Illéssy
Dr. Sándor Kerekes
Dr. László Pap
Dr. György Szapáry

Value-creating growth

Focusing on service excellence,
efficient operations and market expansion

Our strategy

- Focus on value-creating growth
- Group level synergies and integrated operations
- Service quality program for customer satisfaction
- Market leading positions in mobile and web content services
- Strong positions in the IT services market

Harmonized strategic thinking and integrated operations

The basis of the strategic planning of Magyar Telekom is harmonized, Group-level thinking. The strategy of Magyar Telekom rests on three pillars, and its focus is on value-creating growth: service excellence – with focus on broadband products; increasingly efficient integrated operation of the business lines; and expansion growth in the telecom convergent markets and through international acquisitions. The three business lines managing the core activities of the Group – the Wireline, the Mobile and the Corporate Services – promote the achievement of service excellence and efficiency through utilization of the Group synergies and integrated operations, thus creating the conditions for expansion growth. We can only meet properly the challenges of the market by acting as an integral Group. To achieve this we are exploiting the benefits and the synergies offered by our belonging to the Deutsche Telekom Group. It is also our task to take advantage of the benefits offered by our integrated service provider status and to create future growth opportunities based on the provision of integrated telecommunications services. This implies better and fuller service for customers and higher value for shareholders.

Strategic agreement for utilization of the synergies

On the lines of the agreements between T-Com and T-Mobile concluded in 2005, in December 2006 Magyar Telekom and T-Systems Enterprise Services GmbH signed a strategic cooperation and brand use agreement which ensures for Magyar Telekom the exclusive use of the T-Systems brand name in Hungary. Through strengthening this strategic cooperation new synergies have opened for the Magyar Telekom Group within the Deutsche Telekom Group. For T-Systems, harmonized market activity can contribute to the improvement of customer relations and thus enhance the possibility of utilizing the IT market opportunities. As of January 1, 2007 Magyar Telekom increased its stake in T-Systems Hungary by 2% bringing it to 51%. The parties intend to raise Magyar Telekom's share in T-Systems Hungary to 100% by the end of June 2007. T-Systems Hungary focuses on systems integration whose target market is major Hungarian companies and institutions.

Successes of the T-Mobile integration

Magyar Telekom Plc. and T-Mobile Hungary Ltd. merged on March 1, 2006. Through the merger we have created an integrated telecommunications company whose benefits can be felt by our customers, shareholders and employees alike. Through the utilization to the fullest possible extent of the new opportunities offered by integration our customers receive better services and integrated offerings. Several important goals of integration were reached already in 2006, while harmonization following the merger will only bring tangible results in other business activities in the longer term. Our first integrated fixed-mobile offering, the "Oda-Vissza" discount scheme was launched in January 2006. The integration of the Group's shop network is a major success of the utilization of synergies. We have been offering an extended portfolio containing all the products and services of T-Com, T-Mobile, T-Online and T-Kábel in the redesigned T-Pont shops since October 2006. The principal goal of the harmonization of the retail network consisting of 47 units was to make the servicing of customers more efficient. The nationwide integrated T-Pont shop network stands without equal in Hungary's telecommunications market.

Quality for our customers

In early 2006 T-Com launched a two-year program aimed at improving customer relations, which T-Mobile also joined. The goal is to reach the European top league in terms of customer satisfaction and service quality by the end of 2007. Excellent customer service as basic objective also features among the medium-term strategic objectives of the Magyar Telekom Group. The customers could first encounter the public promises of the "Quality for our customers" program, embodying high-standard customer care, in the integrated T-Pont shops in April 2006. The changes in the business environment and the intensifying competition have made it necessary to improve service quality by focusing on customer demand, and this calls for a new, comprehensive and priority treatment of the activities aimed at improving customer experience in addition to the continuous developments implemented so far. An appropriate quality of customer service can only be provided on the basis of a Group-level program implemented on uniform principles. The basic principle of this systematic and consistent work is to service the customers in the simplest and fastest way by satisfying their needs to the greatest possible degree.

Strong positions in mobile multimedia and content development

In December 2006 Magyar Telekom signed contracts on the acquisition of the MobilPress and MFactory companies that provide mobile multimedia and content development services. MobilPress manages, among other things, the t-zones portal, and MFactory is also a player of Hungary's mobile content producer segment. Magyar Telekom has bought 100% of MobilPress and 75% of MFactory with the option to increase its stake in MFactory to 100% from 2009. Thanks to these acquisitions, the Magyar Telekom Group has strengthened its market leading position in the mobile content and value-added services market. In the wake of the new investments we wish to develop a multimedia service center in order to seize the opportunities offered by these dynamically growing segments.
IKO Telekom Media Holding, 50% owned by Magyar Telekom, is one of Hungary's biggest interactive text messaging, mobile content and marketing providers.

Leading position in web content provision

In April 2006 T-Online Hungary signed a contract on the acquisition of iWiW Kft. that manages Hungary's biggest social portal. iWiW ('international Who is Who'), an Internet social site mapping existing friendships and relations online, is the third most popular Hungarian website in terms of visitors. In May T-Online Hungary purchased Adnetwork Kft., a company operating Hungary's biggest online advertisement network. With these steps the Magyar Telekom Group, through T-Online, has become the market leading web content provider. In 2006 T-Online Hungary has strengthened this position by concluding further cooperation agreements with the operators of the SZTAKI online dictionary, the HarmoNet and the Blogter portals.

The goal: market leadership in the IT services market

In 2006 we built strong positions in the growing IT, systems integration and outsourcing markets through acquisitions that fit into the medium-term strategy of the Magyar Telekom Group and enhance its activities. Thanks to the acquisition closed in April 2006 of Dataplex, a company operating in the IT outsourcing services market, we achieved considerable market growth and service portfolio expansion. In September 2006 we closed a transaction through which we acquired the KFKI Group consisting of three companies which are active in the IT services market. The acquisition of the KFKI Group has made the Magyar Telekom Group one of the biggest players of Hungary's IT market. At present, BCN, Integris, the KFKI Group and T-Systems Hungary belong to Magyar Telekom's T-Systems line of business providing corporate and IT services. Following stabilization and the elimination of parallel operations, T-Systems will develop its new service structure by 2008 which it expects will make it the biggest player of Hungary's IT market and the leading system integrator of the country.

Group-level integrated business management system

In March 2006 Magyar Telekom and SAP Hungary signed a contract on the implementation of a new business management system called ERP (enterprise resource planning) which supports the Group's integrated and harmonized processes. Under the contract Magyar Telekom's existing SAP integrated business management system will be replaced by the new system and it will be rolled out to the Group member companies too. The project is Hungary's biggest systems integration investment of the year. It was the integration of T-Mobile that made necessary further unification of the business processes and the related IT systems within the Magyar Telekom Group, so that the new integrated system can support the unified processes of Magyar Telekom from the beginning of 2007. Magyar Telekom's goal is to increase efficiency in the accounting and financial areas through further development of the "shared service" concept.

The "T" brand in South-East Europe

Following the rebranding of Magyar Telekom in 2005, in 2006 we started the implementation of the international "T" brand at the South-East European member companies of the Group in Macedonia and Montenegro. Since June the former MobiMak has been offering its services under the name and brand of T-Mobile Macedonia, while the rebranding of MakTel and its wireline business unit will take place in 2007. In a full-scale rebranding operation carried out in September 2006, Telekom Montenegro changed its name to Crnogorski Telekom and both business units of the company implemented the "T" brand: the unit providing wireline services is now called T-Com Crna Gora, and the mobile unit and subsidiary, formerly called Monet, now operates under the name and brand T-Mobile Crna Gora.

Diversity

Supporting diversity and ensuring equal opportunities for our employees

Human resources

- Equal opportunities for our employees
- Encouraging diversity
- Protecting our employees' health and safety
- Transparent and compulsory regulations of conduct
- Career consulting program

Diversity and equal opportunities

Magyar Telekom has always ensured equal opportunities for its employees, regardless of age, gender, ethnicity, religious and political conviction or sexual orientation. In October 2006 we accepted and published the Diversity Policy which defines the company's obligations and responsibilities for the practical implementation of diversity. The Magyar Telekom Group supports diversity with programs developed specially for the groups with different social backgrounds (broadest possible use of teleworking, part-time work, etc.) and continues to pay special attention to ensuring equal opportunities for its employees in the selection practice, during their career at the company and in everyday work alike. We consciously recognize the diversity of our employees, markets, suppliers, shareholders and our entire society and by adopting a proactive approach to our business environment, we encourage this diversity. We are trying to raise the awareness of our employees to, and discuss with them, the questions, tasks and problems associated with diversity and equal opportunities, also through the programs of our Equal Opportunities Film Club launched in October 2006.

International and national recognition for equal opportunities

Magyar Telekom has won the Diversity Award 2006 international recognition for its efforts to create equal opportunities for its employees. This award is given by Deutsche Telekom every other year to member companies and organizations of the Group. The result of the 2006 competition was announced by the jury of experts in February 2007. The winning application of Magyar Telekom presented 13 projects that promote equal opportunities, including The Cause program, the Donation Line, the Civil Tariff Package and the Digital Bridge program. In recognition of the company's outstanding achievements in providing equal opportunities at the place of work, the high level of its commitment and its professional approach, Magyar Telekom received the Integrating Employer 2006 award of the Municipality of Budapest in the for-profit category. The jury highly appreciated the innovative elements of the system (harmonization of family and job, atypical employment, integration of people with disabilities, alternative training forms) and the company's partnership with the employee representation organizations.

Social Charter

Magyar Telekom adopted its Social Charter in October 2006. In this document the company laid down the principles of its conduct in the social area. In the Social Charter, among other things, the company acknowledges the basic freedoms of organization and collective agreement of the employees and expresses its willingness to cooperate with the legitimate representation bodies of the employees. It supports the development of the skills of the employees, which is the shared interest of the company and the employees, and considers the protection of the health and safety of the employees to be important. One good example for the enforcement of the provisions of the Social Charter is the company's support of parents with small children, and mothers in particular. Employees on temporary leave to raise small children are also eligible for the benefits specified in the collective agreement, they are informed about the professional training possibilities open to them and their return to work is helped with special training.

Code of Conduct

The Code of Conduct of Magyar Telekom entered into force in May 2006 with the approval of the Management Committee. This document, similarly to the codes of conduct in force at Deutsche Telekom and its other international subsidiaries, lays down the ethical and legal norms of the company's everyday operation. The Code is based on the prevailing legal regulations and describes the principles that determine the correct behavior of the employees from a moral and legal aspect and in compliance with the values that have guided the activities of the Group. With the introduction of the Code of Conduct the Deutsche Telekom Group commits itself to comply with the transparent and compulsory regulations in all those countries where it is active, seeking to be a reliable and calculable partner for everyone it has contacts with, including the customers, business partners and employees. Besides the employees of the Magyar Telekom Group the Code of Conduct is also available to our partners on the company's Internet site.

For the security of employment

In September 2006 several national authorities, interest representation organizations and major companies signed a partnership agreement in an effort to eliminate the negative phenomena of the labor market. The signatories – including Magyar Telekom – of the charter called 'Partnership for the security of employment' committed themselves to refraining from all forms of illegal employment. They agreed to devote increased care to the contracts aimed at hiring labor and when making such contracts with other employers they will avoid any provisions which could be used to violate the rights of employees. They also agreed that in market competition they will not violate the labor regulations or the labor safety requirements and will not apply pricing which does not cover the wages and wage taxes of the employees.

Career consulting for employees

With the introduction of career consulting in October 2006 Magyar Telekom implemented an initiative previously unknown to Hungarian companies. The program provides information and advice for the employees to develop a realistic self-valuation and recognize their opportunities. The company also provides the professional training needed for personal development and advance of the employees, access to relevant information and also gives the employees an opportunity to freely apply for any vacancy inside the Group. The employees must see clearly what they themselves can do for their own advance. Through the consulting service the employees receive information that helps them select the training or development opportunities best suited to their needs and also a list of vacancies both at the Magyar Telekom Group and at Deutsche Telekom. There is also practical information on how the selection is done, how to prepare for the job interviews, etc. Also a part of the career consulting service is interactive personal consulting by consultants with an extensive professional background and familiar with human resource and psychology issues.

E-learning and distance learning

E-learning, this advanced form of distance learning supported by infocommunications tools, plays a decisive role in Internet-based professional training. Magyar Telekom participates with innovative solutions which it offers on an ongoing basis and in a trendsetting manner, primarily in the field of faster and more efficient further training of its employees. Besides education, e-learning technology can also be used to efficiently support data and opinion collection through online questionnaires. The materials of the training programs and the e-learning infrastructure as service environment are available on the Internet, so the complex e-learning solution of Magyar Telekom offers a competitive alternative for businesses and individuals alike.

Starting Block program turns ten

In an effort to involve new knowledge, Magyar Telekom has initiated the Starting Block (Rajtkő) trainee program in 1995, and it turned ten years old in October 2006. The trainee program accepts 20 fresh graduates each year, and the five-month training period they spend at the different units helps the development of employees through work experiences. Magyar Telekom also successfully operates the Compass (Iránytű) and the Mentor programs which help the new entrants to become familiar with their new working environment as quickly as possible, as well as the Performance Management system which is used to assess the competence and knowledge of the employees and identify areas in need of improvement.

Giving back

Responsibility, support and donations for the benefit of communities

Corporate social responsibility

- Top place on the national CSR list
- Donations from employees, customers and TV viewers
- With Internet for equal opportunities in communications
- Support to culture, education, sports and leisure
- T-house: new dimensions of communications

Continuing success program: Magyar Telekom Gives Back

Magyar Telekom has become one of the major sponsors of the civil society in the past decade.
In October 2006, at the decision of the jury of experts appointed by Figyelő TOP 200, Magyar Telekom received the Corporate Donor of the Year Award. Also in October the list of Hungarian companies assuming the most corporate social responsibility was published for the first time on the basis of a comparative survey. Magyar Telekom earned the top place on the Accountability Rating Hungary 2006 list. Our supports have been gathered since 2004 in a unified, transparent system by the Magyar Telekom Gives Back program. On the decisions of the board of trustees of the program, 161 non-profit and civil associations, foundations and organizations were supported by donations totaling HUF 103 million in 2006. Our key support areas include the treatment with cardiovascular diseases and cancer. We are paying special attention to addressing the health and social problems of children, to environment protection and to supporting initiatives aimed at reducing the digital divide. The employees of Magyar Telekom are contributing individual donations to the company's own. Magyar Telekom supplements their offerings for the civil society with specific amounts. Over the past five years our employees supported the efforts of selected organizations with the donation of over HUF 50 million. In December 2006 the Magyar Telekom Group employees also offered their Christmas gift money to a civil organization. The employees decided through intranet voting that they would donate the sum of around HUF 3 million as a special Christmas gift to the "Hope for Children with Leukemia" foundation which supports the treatment of infant leukemia.

The human call number

The subscribers of the Magyar Telekom Group are given the opportunity to donate HUF 100 with each call made to the 1788 Donation Line and thus support six different non-profit organizations each year. The Donation Line is a simple and transparent link between donor and recipient. This initiative, unique in Europe, greatly simplifies the donation mechanism. From 2002 till the end of 2006, 28 non-profit organizations received a total amount of HUF 180 million support through the Donation Line.

The Cause – everyone's cause

At Christmas 2005 viewers of Viasat3 television were offered the opportunity to vote support to the work of four foundations by calling the 1771 Charity Number in the framework of a "real" reality show initiated and financed by Magyar Telekom. In addition to Magyar Telekom's donation of HUF 16 million, these organizations also received the proceeds from the calls made by our customers. In June and December 2006 this fund-raising campaign continued in the form of a TV2 channel program series under the title of "The Cause". Each series presented the work of four civil organizations in a half-hour documentary. The charitable civil organizations working for the solution of social problems and the "causes" eligible for the support were selected by an independent jury through applications. In June, the HUF 5 million donation went to the Magic Lamp Foundation which realizes the dreams of children suffering from serious diseases while in December to the Foundling dog shelter. These organizations also received the proceeds of the charitable calls by the vote of the television viewers. The organizations that received fewer votes were each given HUF 1 million donation by the company. The series continues in 2007.

Digital Bridge for the disadvantaged in terms of communications

In 2006 in the framework of the Digital Bridge program launched in 2004, Magyar Telekom experts visited about 70 small localities and helped the residents learn how to use the worldwide web. Also under the Digital Bridge initiative the company launched the community site called Egálnet – With Internet for Equal Opportunities (www.egalnet.hu) whose goal is to support the establishment of relations between the organizations that help disadvantaged groups. The affected groups include all those civil and local government agencies that help disadvantaged persons and groups. Communications handicaps present a growing problem as in the absence of communication opportunities the groups in need are not able to manifest themselves. Magyar Telekom offers assistance in this respect with the free services of Egálnet. The website wizard helps them make their own website and Magyar Telekom provides storage space and the management of these sites. Through the site the communities can raise the awareness of the public to their work, they can intensify their communication activities and the services offered on the community site, such as forum, customer service, news, etc., help the registered users establish relations with one another.

Environment protection and sustainability

In June 2006 the Management Committee of the Magyar Telekom Group adopted the Group's new environmental policy which, after the rebranding, presents in a new form the environmental philosophy and the main relevant aims accepted as obligations by the Magyar Telekom Group, which have been harmonized with the environmental targets of Deutsche Telekom. The Magyar Telekom Group participates actively in the Hungarian and international sustainability and environment protection forums and events, including also the European workgroup which is preparing the harmonization of the IT and communications industry with social, economic and environmental interests. The environment-conscious approach plays an important role in our everyday operations too: our company was the first in Hungary to introduce selective waste collection. We treat as top priority the use of recycled paper and – by making the fullest use of the possibilities offered by electronic communications – the reduction of our paper demand.

Home of the future, technology of the present

The T-house established by Magyar Telekom in cooperation with Siemens and the House of the Future exhibition hall, opened in March 2006 in Budapest. In the T-house Magyar Telekom presents its future-oriented services and the new dimensions of communications, which thus become tangible for the visitors. The member companies of the Group pooled their knowledge to come up with advanced communications services that make our everyday life simpler, more comfortable and more enjoyable. The high-tech wireline and mobile broadband services presented in the T-house (such as IP telephony, video phone, 3G mobile communications) are already available and within a few years they are expected to reach a large number of people and become part of our everyday life.

Culture and education

Magyar Telekom is one of the leading supporters of Hungarian cultural life and we have been keeping this position for years as, for example, chief sponsor of Bartók Rádió, supporter of the Magyar Telekom Symphony Orchestra or sponsor of the highly successful concert series running at the Academy of Music under the title The Piano. For its traditional Christmas raypaintig exhibition Magyar Telekom selected a new location in the second half of December 2006 – in the centre of Budapest. The special outdoor event was accompanied by music, leisure and children's programs. Hundreds of thousands of people could enjoy the extraordinary spectacle when crossing one of the central squares of Budapest, and also use the free wireless HotSpot Internet access. With the support of the raypainting exhibitions we express our commitment to sponsoring the art of public places, as one form of contemporary art.
The University of All Knowledge, a joint venture of Magyar Telekom and the Hungarian Academy of Sciences launched in 2002, has continued its successful journey in the fields of education and the dissemination of knowledge. After the 8th semester which ended in June 2006, a new and upgraded University welcomed audiences from week to week. The television viewer rating of the programs held in a new location has improved considerably. The 150th lecture in the University of All Knowledge series was held in December 2006. The first 130 lectures are already available on DVDs which education and cultural institutions have received in support of their work. In February 2007 the lecture series reached a new milestone, the 10th semester. Magyar Telekom continued to sponsor in 2006 too the Puskás Tivadar Secondary School of Telecommunications, a key institution for the training of telecom specialists, as well as the Post and Telecommunications Museum, Hungary's unique collection of the history of industry.

T-Com: sports and leisure

Besides easing the social problems we attach high importance to giving back to the local communities, also by the strengthening of the community spirit and social cohesion through mass sports events and leisure programs. The T-Com Vivicitta runs that mobilize thousands of people each year were organized in four cities in the spring of 2006. The T-Com Children's Island designed for young families and children had tens of thousands of children and their adult relative visitors in June-July 2006, who were treated to diverse entertaining programs and creative and playing opportunities.

T-Mobile: sports and music

As the leading mobile service provider, for many years T-Mobile has been one of the major partners of Hungarian sport. 2006 was an outstanding year in this area as Hungary organized European championships in swimming, kayaking and canoeing, and pentathlon, and T-Mobile contributed to the organization both as sponsor and as communications partner. In spring 2006 it gave its name as sponsor to the T-Mobile Top Marathon mountain bike events held at four places in the country. In 2006 T-Mobile continued to provide support and mobile communications opportunities to the classical music events of the Budapest Spring Festival and the Autumn Festival, outstanding in Europe. In the frame of T-Mobile International's music program the second event of the Electronic Beats festival series was held in Budapest in June 2006. Thanks to the cooperation of T-Mobile International and Robbie Williams, in July the world star's fans could also watch his Budapest concert on their 3G sets and access exclusive music content on their mobile phones.

Accelerating

Increased bandwidth, new products and one-stop servicing for the satisfaction of our customers

Wireline services

- Nearly 3.4 million fixed lines in 3 countries
- Broadband: rapid increase in connections, speed and coverage
- Traffic-enhancing flat-rate packages
- T-Home TV promises new experience
- Integrated nationwide retail network

Successful customer retention in the wireline market

The restructuring of the wireline market continued in 2006. Competition in the Hungarian wireline segment became even sharper because the cable television providers have also come out with telephone services. Under the combined impact of strong mobile substitution and number portability, Magyar Telekom's lines have seen a decrease of 4% year-on-year. Retention of its lines and halting its customer churn are high on our priority list. Thanks to our customer retention programs comprising a proactive approach, favorable offerings and targeted contacting of our customers, we managed to reduce our line churn. In addition, we are intensifying our line sales efforts.

Broadband: dynamic expansion, faster speed

Expansion of the broadband wireline connections was a priority target in 2006 too. At the end of 2006 the number of broadband connections of the Magyar Telekom Group (predominantly ADSL and cable television) reached 572 thousand, which meant a 60% increase year-on-year. In 2006 we had 513 thousand ADSL lines. As a result of continuous growth, at the end of 2006 the ADSL service was available in 1050 localities in the Magyar Telekom service area which means that in terms of the overall population we increased coverage to 87.5%. Magyar Telekom significantly raised the speed limits of its ADSL service by launching in June 2006 the ADSL2+ service, with which it doubled the earlier maximum download speed.

Flat-rate, broadband and integrated residential tariff packages

An outstanding achievement in 2006 was that long-distance minute traffic in our residential market grew significantly by 22.6% and local minute traffic by 10.7%. The key driver of this growth was the broad range of flat-rate packages which offer customers unlimited phone usage. Thanks to Favorit Non-Stop and Favorit Non-Stop Plus launched in February 2006 and the packages available with broadband Internet access (T-DSL Favorit, T-DSL Favorit Non-stop) the number of Favorit users grew significantly and reached 550 thousand by the end of 2006. At the end of 2006 over 83% of the fixed telephone lines serviced by Magyar Telekom belonged to one or other of the discount tariff packages. T-Online's and T-Kábel's broadband product portfolio grew from April with ADSL Netperc and ADSL Light providing time-based Internet access, while Kábelnet Light is targeting beginner Internet users.

Magyar Telekom's first integrated wireline-mobile offering, the Oda-Vissza discount scheme was launched in January 2006 in the spirit of integration.

New business tariff packages

In 2006, too, we introduced customized offers for our small and medium-size business customers and further developed the efficiency of customer service. Besides introducing the Grátisz 100 tariff package, which gives our customers 100 minutes of free calls a month from April 2006, we also made more favorable the minute rates of the Grátisz 500 package which we have been offering since 2005. The choice of business packages available with broadband Internet access, or ADSL, expanded further last year. The T-DSL Eco 500 package launched in January, was followed in October by the T-DSL Profi Grátisz and the T-DSL Partner package offered for the business customers of the partner carriers.

New offers in the competitors' areas

The services of T-Com are available in the entire territory of the country, also in the competitors' service areas. In 2006 we further expanded the choice of our tariff packages in the service areas of Invitel, Hungarotel and Monortel. 87% of our customers in these areas are using preselection packages, which means they are making their calls by using T-Com. In 2006, we introduced for our residential customers the Hangadó and Harmónia discount offerings of low minute rates and the Favorit Nonstop Plusz package which offers zero HUF wireline minutes in peak hours. From September 2006 , the Favorit Partner Plusz is available to those customers of Invitel, Hungarotel and Monortel who use T-Com's telephone service via preselection. From February 2006 the residential and business broadband products of T-Online are also available in the whole territory of the country.

T-Home TV: a new era of television

In November 2006 T-Online Hungary, in cooperation with T-Com, became the first to launch the IP television (IPTV) service, under the name of T-Home TV. The digital service available through broadband Internet connection promises a revolutionary new experience compared to traditional television, moreover it uses the existing television set, no computer is needed, simply an IPTV reception unit (set top box) and a remote control. Besides outstanding picture and voice quality, T-Home TV also offers

many new content services, including online digital video rental, program recording, electronic program listing, program stopping, child lock, delay, rewind and "picture in picture" function, billing and package information display and [freemail] message reading. T-Home TV has been launched in Budapest and five other cities with plans to cover all the major cities in the country in 2007.

Successful acquisitions enlarge online product portfolio

In April 2006 T-Online Hungary signed a contract to purchase iWiW Kft. that operates the country's biggest social site. The iWiW ('international Who is Who') site, which maps existing friendships and relations online and offers many other services, is available in 16 languages. As a result of development carried out by T-Online, by the end of January 2007 the number of registered users of the site reached 1.7 million from 640 thousand in April 2006, which makes iWiW the third most popular Hungarian website. In May 2006 T-Online Hungary purchased Adnetwork Kft., the biggest Hungarian online advertising service company. Adnetwork's advertising network reaches about 2.3 million users monthly. These steps have made T-Online the market leader in web content provision.

[origo]: new records, services and contents

Thanks to steadily growing contents, the number of visitors to Hungary's leading portal group, the [origo] portfolio sites comprising [origo], [freemail], T-Online.hu and G-portal, has seen continuous increase. It reached one million visitors a day in April 2006, as first among the Hungarian portal sites, and by the fourth quarter it had a stable daily 1.2 million visitors. On the Lakáskassza (Home Saving Fund) site of [origo], launched in April 2006, visitors can also make home savings contracts. The [origo] clickbank services have also been widened: from June credit cards can be requested via the Internet. In August T-Online launched a new free video sharing site of its own development called Videa, on which anyone can place videos and comments. In June another feature was added to the [origo] portfolio, a blog service called Blogter.hu. On the basis of the relevant cooperation agreements of T-Online, from October the HarmoNet.hu site with new features has been added to the services offered by [origo] as well as the most popular free online dictionary. The new [origo] search engine called OK.hu was launched in December.

Special services and enhanced business development

In addition to Internet access, from 2005 T-Com has also been offering its customers various supplementary services helping in the use of their computer and the Internet. The T-Com Superservice helps solve any computer or Internet problem quickly over the telephone, the Internet or on the spot. The service was available in 12 Hungarian cities at the end of 2006. The T-Com Magentanár program, launched in March 2006, gives users customized Internet training in locations appointed by themselves, for the time being in the area of Budapest. The T-Com Egészségvonal (Health Line) service, available from April 2006, offers its users the assistance of qualified nurses in their home, via video connection working with a wireline telephone and a television set. In July, the Hungarian Chamber of Physicians issued for its members new chip ID cards, supplied by T-Com and T-Online. The chip cards simplify the work of doctors and can also be enabled for electronic signature and prescription writing.

Integrated T-Pont shop network, quality in customer relations

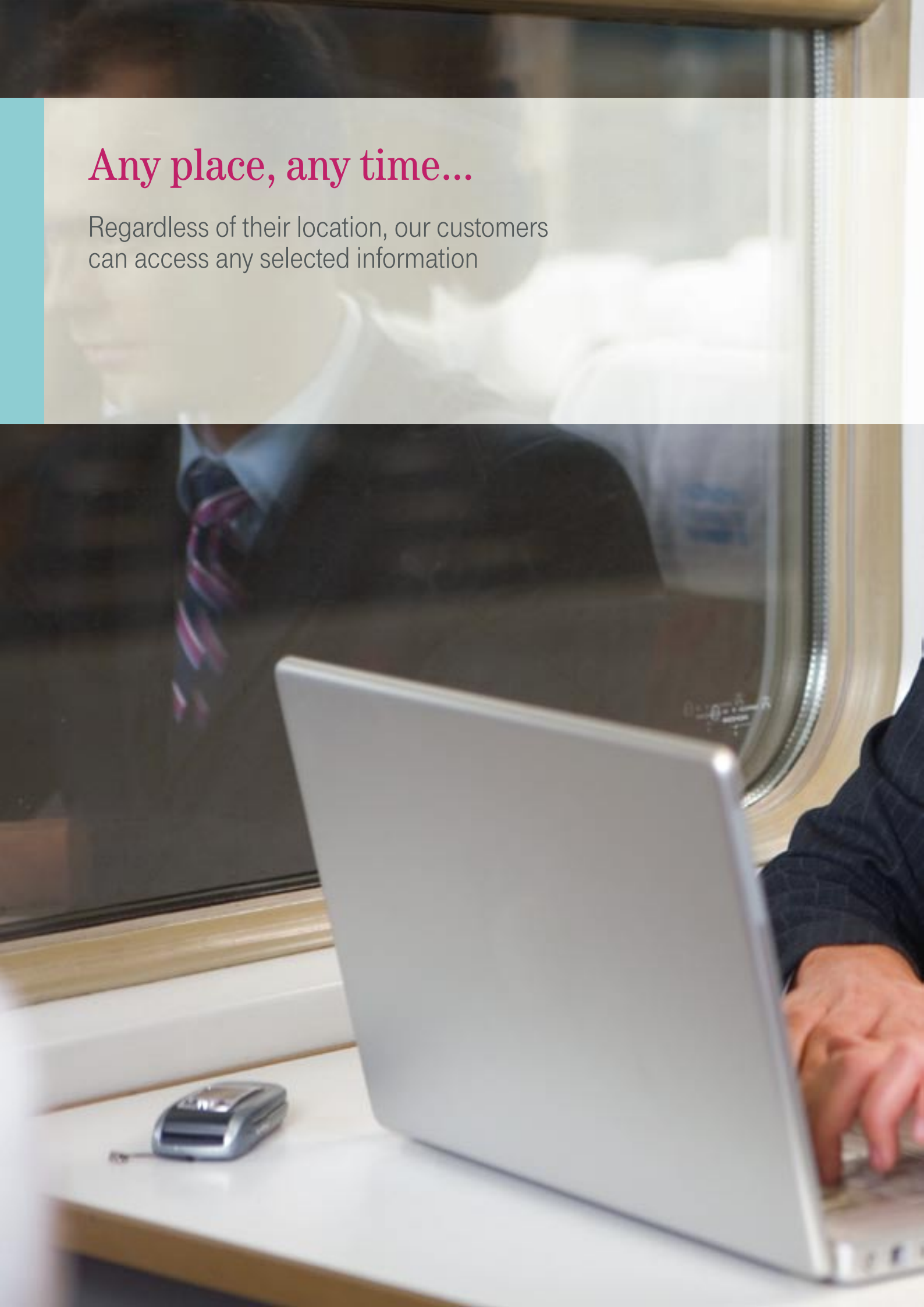
Magyar Telekom completed the upgrade of its integrated T-Pont shop network in October 2006. The redesigned T-Pont shops, renewed in looks and activities alike, offer in the same place all the products and services of T-Com, T-Mobile, T-Online and T-Kábel. The purpose of harmonization of the T-Pont network consisting of 47 integrated shops, which is unmatched in Hungary's telecommunications market, was to make the servicing of customers more efficient. The T-Pont shop network provides a considerable competitive edge for the Magyar Telekom Group. The "Quality for our Customers" program implemented in 2006 was outstanding in terms of improving customer satisfaction. This comprehensive service quality improvement program guarantees the high standard of customer relations, the continuous improvement and maintenance of the competitiveness of our services. It was in the integrated T-Pont shops that customers could first encounter the public promises of the program which makes high-standard customer care an everyday practice. Another new achievement which mainly tourists coming to Hungary can appreciate is that from July 2006 T-Com's public payphones also accept euro coins besides the forint.

T-Kábel: expanding digital portfolio

At the end of 2006 the Magyar Telekom Group had over 414 thousand cable television subscribers. Despite growing competition T-Kábel Hungary has managed to retain its place as the country's second biggest program distributor. With a pace of growth exceeding that of the preceding years, by the end of 2006 the number of subscribers to Kábelnet Internet access, which is being marketed by T-Online, approached 58 thousand. Since December 2005 T-Kábel has been offering thematic digital television minipackages which contain several channels. With the service packages launched in December 2006 the entire analog content has become available also in digital picture and voice quality, which helps digital television become a mass product. T-Kábel was the first among the big cable television providers to digitize almost its entire basic offering. For the time being the new program packages are available in Budapest and its metropolitan area; the regional expansion of the digital offer is expected in 2007.

International wireline segment

In Macedonia, MakTel had 517 thousand fixed lines at the end of 2006. The annual 7.5% churn rate is attributed primarily to mobile substitution. The number of Internet subscribers has increased substantially by 37% to 126 thousand, and the dynamic, 111% growth of ADSL connections shows a promising trend. Telekom Montenegro has been operating under the name of Crnogorski Telekom since September 2006, and in the full-scale rebranding the wireline business unit has taken the name of T-Com Crna Gora. While keeping the number of fixed lines practically stable at 195 thousand, the company succeeded in increasing the number of its Internet subscribers by 21% and ADSL connections have started fast growth. In Romania, Combridge entered the residential and business telephone markets as the first alternative operator in February 2006, offering its favorably priced call-by-call services under the EUfonika brand.



Any place, any time...

Regardless of their location, our customers can access any selected information

Mobile services

- More than 5.7 million mobile customers in 3 countries
- The real mobile broadband – HSDPA
- Mobile multimedia over 3G: video phone, mobile TV
- Web'n'walk: mobile Internet at any location
- Entering the notebook market

T-Mobile's most successful year ever

T-Mobile has closed the most successful year of its history with more than 4.4 million subscribers and a net customer growth of 5.7% year-on-year. In 2006 Hungary's biggest mobile operator retained its stable market leading position in an increasingly saturated mobile market with 99 subscriptions for every 100 citizens. On the basis of the number of customers T-Mobile's market share was 44.5% at the end of 2006. In a sharp competition T-Mobile acquired in 2006 the biggest number of new customers in terms of SIM cards in use, 262 thousand in all. Contract subscribers have grown continuously and postpaid customers approached 35% of the subscriber base. T-Mobile has strengthened its leadership in innovation by offering several novelties and the customers responded well to its value-added services, new tariff packages, discount minute and set offerings, as well as the mobile broadband that includes HSDPA which T-Mobile is the first and only mobile operator to offer. The launch of integrated products, the growing demand for mobile commerce, mobile Internet and multimedia services (MMS, video phone, mobile television) and the establishment of uniform T-Pont shops have all played an important role in the 2006 successes. Mobile data communication is also having an ever more decisive role in customer growth.

Successful integration

One of the key targets of 2006 was successfully reached when T-Mobile integrated into Magyar Telekom's organization structure while improving efficiency and the standard of customer services. T-Mobile has been fulfilling its obligations and commitments and providing seamless services to its customers in unchanged form as a Magyar Telekom line of business since March 2006. T-Com and T-Mobile implemented their first integrated fixed-mobile offer called Oda-Vissza discount in January. This new type of package offers Magyar Telekom Group customers discount calls between mobile and fixed networks. The upgraded integrated package has been available with even more favorable conditions under the name of Oda-Vissza Plusz since December 2006. The uniform T-Pont shop network, completed by October 2006, enhances the efficiency and success of customer servicing and sales. T-Mobile's service and set offerings are presented together with the products and services of the other "T" brands in this integrated shop network unique in the Hungarian market.

Mobile Internet and real mobile broadband: 3G and HSDPA

T-Mobile considers the expansion of mobile Internet and mobile data communication a decisive market trend so in May 2006 it launched, ahead of its competitors, its superfast mobile Internet service commonly referred to as HSDPA (High Speed Downlink Packet Access). This modern technology enables fast data download on the 3rd generation (3G) mobile network, which T-Mobile launched, also as first, in August 2005. Thanks to HSDPA, besides the 3G services (e.g. video phone, mobile television) already at the end of last year T-Mobile subscribers could also use the Internet with up to 3 Mbps download speed or send even large e-mail messages. Mobile broadband can be used for computer Internet access, to download video files and make continuous video transmission, as well as to make video telephone calls outdoors with the help of a portable computer. At present the HSDPA can be used everywhere where 3G network is available. By the end of 2006 the broadband mobile network was available to about 30% of the population and fast expansion of coverage continues in 2007. The successful spread of the mobile Internet is playing an increasing role in customer growth, as evidenced by the fact that the number of mobile Internet users soared by 55% in 2006.

New combined tariff packages and offers

The T-Mobile Kaméleon tariff package launched in April 2006 offers more transparent basic fees and minute, SMS and MMS rates which customers can freely combine. The Kaméleon package is special in the Hungarian market because the rates can be combined optionally to suit the user's needs and usage habits. The rates also provide room for many individual combination options because they also comprise wireline, SMS and MMS discounts in addition to mobile fees. Under a cooperation scheme between T-Mobile and Budapest Bank (GE Money Bank), from May customers can avail themselves of a new-type T-Mobile MasterCard Standard credit card that can be used with the mobile phone. T-Mobile is the first in the Hungarian mobile market to offer a full solution for broadband mobile Internet usage. Under this offering customers can also buy a notebook on an interest-free loan with low upfront payment if they order a mobile Internet package with a net card. With its campaign aimed at stimulating mobile Internet use T-Mobile has entered the notebook market, and thanks to its combined offering it has also become an

important player there. It is an indication of the upward trend of data communication that by the end of 2006 T-Mobile sold nearly 6,000 broadband Internet packages comprising notebook and netcard.

Expanding WLAN and roaming

T-Mobile, which also leads the market of wireless accesses (WLAN), implemented major expansion of its WLAN network in 2006 to offer fast wireless Internet access to hundreds of thousands of people who did not previously have such connection. T-Mobile's Internet Fix service, available since April 2006, offers flat-rate wireless Internet access to the inhabitants of small localities where broadband connection was not available previously. Internet Fix is a special version of T-Mobile HotSpot. Its advantage is that high-speed Internet access is available for a monthly flat-rate at the given address, and if the user requires the service provider will also install and monitor the necessary devices. Internet Fix, available to everyone also without T-Mobile or mobile phone subscription, already offered broadband Internet access to the inhabitants of 120 localities in December. T-Mobile is traditionally market leader in international mobile roaming: at the end of 2006 its contracted subscribers could use 373 GSM mobile networks of 173 countries and could send MMS messages from 162 networks. At the end of 2006 3G roaming was possible in 24 European countries and in 18 partner networks. In 2006 T-Mobile customers could access the HotSpot service in over 8,000 T-Mobile WLAN access points in Hungary and in 6 other countries.

The whole web on the mobile phone: web'n'walk

In June 2006 T-Mobile implemented a new mobile data communication service called web'n'walk. Besides T-Mobile's own web'n'walk portal the users of the service can access the Internet on their mobile phone. The subscribers of the web'n'walk mobile Internet packages can access the whole web regardless of their location, i.e. with the help of a special mobile browser they can reach any selected web site, surf and send e-mails. This service also gives Internet experience to users who do not have a computer and home Internet access. In future web'n'walk will be the key feature of T-Mobile's mobile Internet services.

Innovations in mobile commerce

In 2006, T-Mobile customers made 800 thousand online purchases of products and services with the help of their mobile phone. Since March T-Mobile customers can also buy 4-day motorway stickers with their mobile phone. With this fast and comfortable service subscribers can avail themselves of modern, 21st century services. From June coach tickets can also be purchased with T-Mobile mobile phones for selected domestic and international services of Volánbusz. From December T-Mobile customers can place SMS advertisements in the leading advertising papers. The mobile operator itself is also selling the products of its business partners to its own customers under the Mobile Purchase service. Besides downloading digital products such as operator logos, ringtones, games, screen images and information services, since 2003 customers also have the opportunity to buy other products (CDs, videos, books, tickets, etc.).

My T-Mobile: Internet services in one place

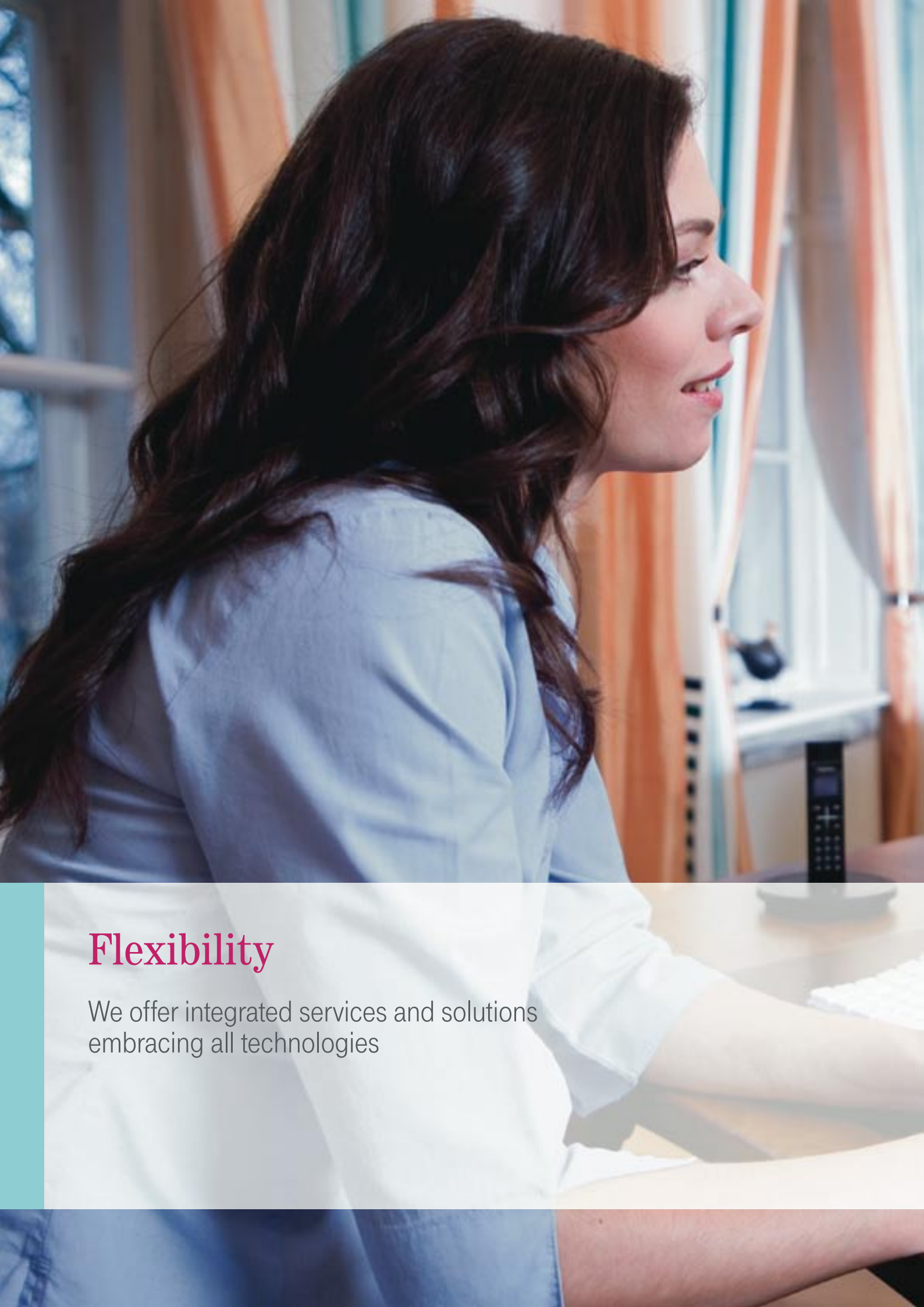
T-Mobile launched its My T-Mobile online service in December 2005. The customer can reach the multitude of functions the service provider offers on its website through a transparent and user-friendly system. Users can, among other things, obtain information on their online purchase orders in the T-Mobile Webshop, query the balance and call list of their m-commerce, SMS and MMS messages, modify the tariff packages they subscribe to and pay their bills. With the WebSMS service they can send SMS messages via the Internet. The self-service Internet customer service is a useful feature because it gives users the opportunity to buy and activate services and tariff packages or cash in their Connection loyalty program bonus points.

Nationwide EDR system completed

Pro-M Zrt., a Magyar Telekom member company successfully completed the nationwide construction and technical testing of the EDR (uniform digital radio communication system) network by the end of January 2007 deadline. The system using the Tetra standard satisfies the requirements specified for European emergency networks. It offers secure voice and data communication with the help of mobile radio sets and base stations and enables the communication of all emergency services (police, ambulance, firefighters, border guards, disaster services, etc.) on a single network in the entire territory of the country. The Magyar Telekom Group won the government's contract for the construction and operation of the nationwide EDR network in October 2005. The first milestone of the system, the Budapest network, was commissioned in April 2006. With the completion of the entire system one of the most up-to-date and extensive emergency radio systems of Europe has been put in place in Hungary.

International mobile services

Since June 2006 the former MobiMak has been offering its services in Macedonia under the name and brand of T-Mobile Macedonia. In 2006, T-Mobile Macedonia's customer base increased by 7.7% and reached nearly 945 thousand. Thus T-Mobile Macedonia controls 66.5% of the two-player Macedonian mobile market, which a third operator is expected to enter in 2007. In Montenegro, following the rebranding in September 2006, the former Monet mobile subsidiary now provides services under the name and brand of T-Mobile Crna Gora and operates also as a business unit of Crnogorski Telekom. With an outstanding growth of more than 59%, T-Mobile Crna Gora has increased the number of its customers to nearly 332 thousand, which gives it 41% share of the two-player local mobile market.



Flexibility

We offer integrated services and solutions embracing all technologies

Corporate services

- T-Systems: a decisive market player in IT and systems integration
- New consolidated subsidiaries, expanding product portfolio
- Integrated relationship management
- Managed infocommunications services
- Electronic bill management

Telecommunications, information technology, systems integration

As a result of massive internal development and extensive acquisitions the Magyar Telekom Group developed strong positions in the IT market too from 2003, in line with the global trend of convergence of telecommunications and information technology. The Group, through its line of business operating under the T-Systems brand, has become a decisive player of Hungary's IT and systems integration markets. The T-Systems brand represents extensive information and communication technology (ICT), outsourcing and systems integration potential, capacity and competence, in possession of which T-Systems provides comprehensive services for 3,000 strategic, public administration and key corporate customers in Hungary.
T-Systems offers to its business partners the full competence of the Magyar Telekom Group. This common knowledge is used to satisfy our partners' infocommunication needs with a uniquely wide scope of turnkey solutions. With its business flexibility and the seamless operation of its customized infocommunications services T-Systems efficiently supports the activities of its customers, helping them to concentrate on their core business, which favorably influences their efficiency, competitiveness and market image.

Successful IT acquisitions – the goal is market leadership

In September 2006 Magyar Telekom closed the transaction with which it acquired the KFKI Group that is operating on the Hungarian IT services market. Among the three KFKI Group companies integrated in the operations of T-Systems, both ICON, which offers IT security services, and IQSys, an application and software development company, represent new product portfolio. At the same time, the third KFKI Group company KFKI-LNX and the existing subsidiary BCN pursue complementary activities in terms of network and systems integration and customer base.
This transaction has clearly placed T-Systems in the top league of Hungarian IT providers.
The utilization of the new competencies and synergies holds out growth opportunity through the expansion of the market and the customer base. The number of member companies consolidated under the T-Systems brand further increased after Magyar Telekom raised its stake to majority (51%) in T-Systems Hungary in January 2007 under an agreement signed with T-Systems Enterprise Services in December 2006. According to the intentions of the owners Magyar Telekom may raise its stake to 100% in the first half of 2007. The agreement ensures for Magyar Telekom the exclusive use of the T-Systems brand name in Hungary.
From March 2006 T-Systems provides for its customers the server hosting service of T-Online Hungary affiliate Dataplex. Following the finalization of its structure planned for 2008, T-Systems wants to become the biggest player of Hungary's IT market and the country's leading systems integrator.

Key partners – exclusive service

T-Systems keeps contacts with its key business partners through a key customer service in order to provide fast and efficient services for them and personal account management. In a high-standard one-stop service approach it responds to the identified needs of its customers with customized, integrated infomation and communication technology solutions.

Relationship management

Integration and presentation of Group-level services plays a key role in the business strategy of the Magyar Telekom Group. With this in sight we have created the Relationship management teams which ensure Group-level servicing of our business customers. The teams consist of the account managers and experts of T-Systems, T-Mobile and T-Online and carry out their duties under the supervision of a relationship manager, thus integrating in one efficient expert team the contact points of the Magyar Telekom Group.
With the unified expertise and competence we can develop the most efficient possible service and solution combinations, which give our key customers a tangible competitive edge. At present, T-Systems is the only company in the Hungarian ICT market to offer such broad range of integrated problem solutions embracing all technologies.

Establishment of the Electronic Governmental Backbone Network

T-Systems won a tender invited by the Prime Minister's Office in 2005 which gave it contracts for the establishment of the Electronic Governmental Backbone Network (EKG). As part of the project T-Systems has also created the conditions for the government agencies to access the EKG and use its central services. The connection of the institutions and the services available on the EKG unfolded in full in 2006. The EKG ensures possibilities for the public administration institutions which were not available to them earlier, or not at the required level of security.

It thus creates the foundations for the secure use of the electronic applications, the modernization of the external and internal communication of the institutions, the introduction and rollout of e-administration and, last but not least, naturally also for the rationalization of the costs of the affected areas.

Managed service portfolio

T-Systems was the first to introduce in Hungary – in possession of extensive international experience and support – managed infocommunications services. Given the fact that they are monthly flat-rated services, these complex solutions eminently lend themselves to advance planning, and with their use the infocommunications costs of the companies can be substantially reduced. One outstanding advantage of the managed services is remotely managed security and service quality guaranteed by T-Systems. T-Systems recommends its managed services to medium-size and large businesses, which can thus leave some elements of infocommunication to an external provider and concentrate on their core business. The service portfolio consists of three elements. The IP-based Managed Voice service, which was launched as first of the integrated services in 2005, is mainly beneficial for companies with several sites and large telephone traffic. The Managed WAN-LAN service means both WAN and LAN remote management by T-Systems as well as the procurement, operation, remote monitoring and servicing of the required equipment. The Managed Security service ensures, besides safe operation of the elements mentioned, the security of the company's internal network.

Strengthening positions in the ICT outsourcing market

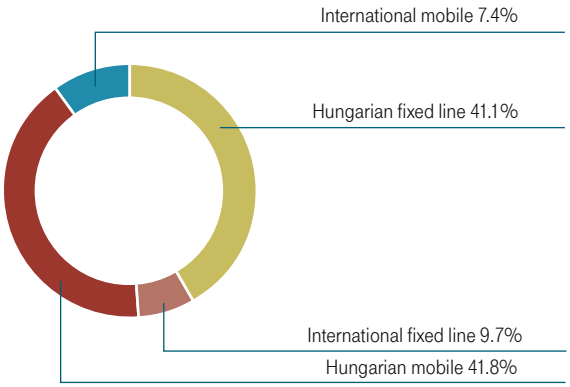
T-Systems is the first to offer in the Hungarian infocommunications market integrated ICT outsourcing services from one hand. This service comprises the entire telecommunications and IT infrastructure of the partner companies, including voice and data communication, PABX solutions, LAN and IP telephony. T-Systems relies on an extensive array of international experience and proven procedures in providing the ICT outsourcing services. It relies on this knowledge, which it adapts to the Hungarian conditions, to provide the outsourcing services first launched in 2003.

E-bill – electronic bill presentation and payment

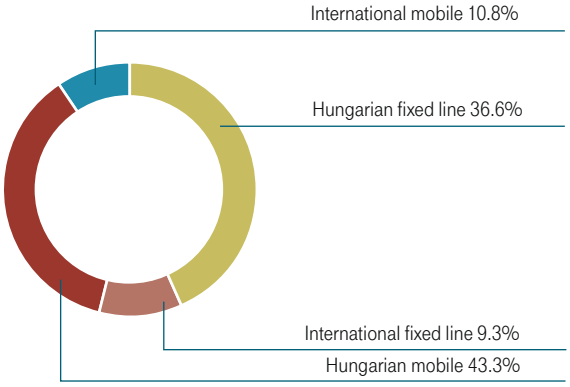
T-Systems was the first in Hungary to introduce the electronic bill presentation and payment service, the e-bill, under the name Távszámla. The underlying idea was to present users electronic bills, via the Internet, instead of sending them in hard copy. The users can view and manage their e-bill on the same website at home or in office. All that is needed to use the e-bill is a PC with Internet access, successful registration and ordering of the electronic bill at the service provider, and bills can be viewed and paid electronically. The content of the service is being continuously expanded: at present the service bills of T-Com, T-Kábel, T-Online and T-Mobile are available in electronic form.

Management report for the 2006 financial year

Revenue breakdown before internal eliminations



Reported EBITDA breakdown



Highlights

- Total revenues of Magyar Telekom Group increased by 9.1% to HUF 671.2 bn, primarily driven by higher mobile, Internet, and system integration & IT-related revenues. The TETRA (Terrestrial Trunked Radio network) revenues of Pro-M and the consolidation impact of the acquired companies also supported top line growth during 2006. (Total revenues were equivalent to EUR 2.5 bn using the 2006 average HUF/EUR exchange rate of 264.27.)
- Group EBITDA grew slightly by 0.9%, amounting to HUF 258.6 bn with an EBITDA margin of 38.5%. Group EBITDA excluding investigation-related costs (HUF 4.1 bn) was HUF 262.7 bn with an EBITDA margin of 39.1%.
- Magyar Telekom has voluntarily changed its accounting policy with regard to the classification of the local tax. Accordingly, this tax charge has been reclassified to the income tax line of the profit and loss statement instead of other operating expenses. Local tax amounted to HUF 8.4 bn in 2005 and HUF 8.5 bn in 2006.
- External revenues from fixed line services increased by 4.5% to HUF 343.9 bn. The positive trend in Internet and system integration & IT-related revenues offset the decline in outgoing traffic revenues. EBITDA amounted to HUF 118.7 bn and the EBITDA margin on external revenues was 34.5%.
- External revenues from mobile services increased by 14.5% to HUF 327.3 bn. This improvement was primarily driven by higher voice revenues and the positive contribution from the TETRA project. EBITDA amounted to HUF 139.9 bn with the EBITDA margin on external revenues reaching 42.8%.
- Gross additions to tangible and intangible assets were HUF 90.9 bn. The portion relating to the fixed line segment reached HUF 49.7 bn with mobile at HUF 41.2 bn. Within the mobile segment, HUF 9.4 bn was spent on UMTS-related investments.

Fixed line segment: Growth in broadband and SI/IT services

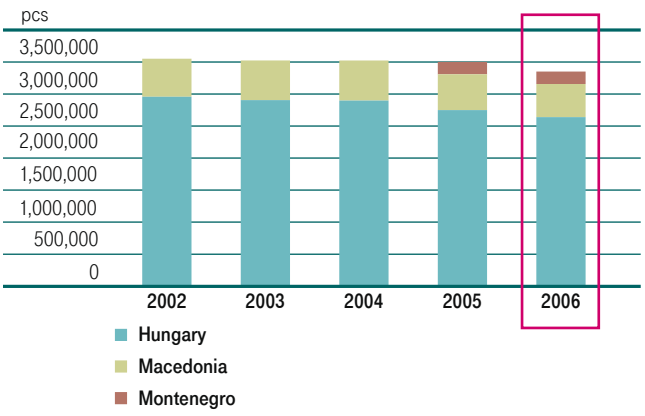
Total external fixed line revenues increased by 4.5% to HUF 343.9 bn as the negative trend in line and outgoing traffic was offset by stronger Internet and SI/IT related revenues. The impressive performance of the international subsidiaries was driven by efficiency improvements, while results in forint terms were also supported by favorable FX movements. Segment EBITDA declined by 5.9% to HUF 118.7 bn, resulting in a margin of 34.5% on external revenues.

By the end of 2006, the total number of Hungarian fixed lines decreased by 4.0% to 2.6 million with a 34.2% fixed line penetration in Magyar Telekom's service area. The decline is due to strong mobile substitution and number portability. The number of broadband connections increased to 572.2 thousand implying growth of close to 60% over end-2005. The number of Internet subscribers increased by 30% to 427.0 thousand, reflecting the strong growth in broadband connections.

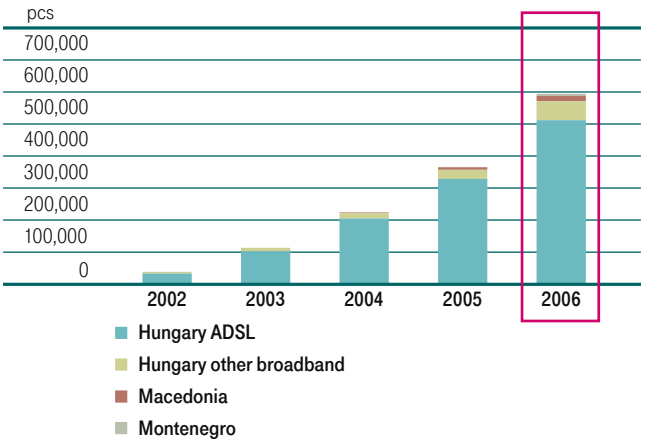
The total number of MakTel's lines decreased by 7.5% to 517.1 thousand lines in 2006, while fixed line penetration declined to 23.9%. The number of broadband connections more than doubled reaching 16,462 compared to 7,798 a year ago.

Montenegrin fixed line penetration increased slightly to 31.4% by the end of 2006 with 194.5 thousand lines installed. The number of broadband connections grew significantly to 6,639 from 1,085 a year ago.

Total number of fixed lines



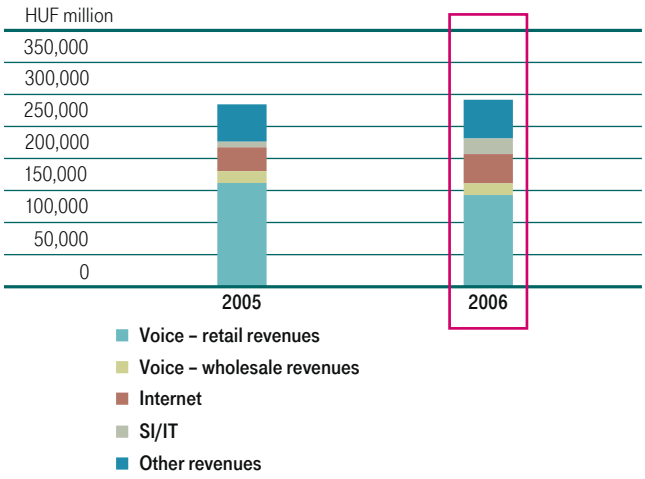
Total number of broadband connections



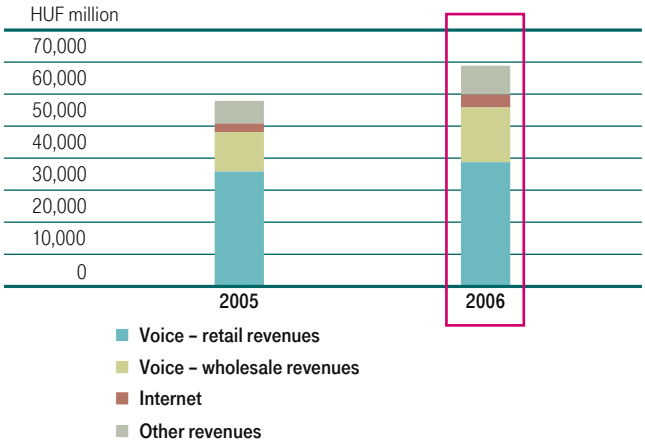
Hungarian fixed line operations: Successful initiatives increasing revenues

Revenues before elimination grew to HUF 292.2 bn in 2006, a 2.5% increase on the previous year. Retail voice revenues declined by 11.6% to HUF 143.4 bn as the slight growth in subscription revenues could not compensate for the considerable decline in traffic revenues. Although fixed-to-mobile minutes fell due to strong mobile substitution, local and domestic long distance traffic both increased thanks to the positive effect of flat-rate packages on usage. Nevertheless, discounts and bundled minutes provided in our packages contributed to the traffic revenue decline. At the same time, system integration & IT revenues nearly tripled to HUF 24.4 bn, partially supported by the consolidation impact of KFKI. Internet revenues increased by 23.0% to HUF 45.8 bn as decreasing contribution from dial-up revenues was counterbalanced by the significant rise in the number of installed ADSL lines. Meanwhile, the number of cable television customers reached 414.3 thousand, contributing to other revenue growth.

Hungarian fixed line revenues



International fixed line revenues



EBITDA of the segment amounted to HUF 94.5 bn, positively impacted by the reclassification of the local business tax. EBITDA margin was 32.4%. Excluding the HUF 4.1bn cost of the investigation which was accounted for within the Headquarter costs, EBITDA was HUF 98.6 bn, with an EBITDA margin of 33.8%.

International fixed line operations: Impressive efficiency improvements

Revenues before elimination grew by 18.9% to HUF 69.0 bn in 2006, reflecting the positive exchange rate movements, the full year consolidation impact of the Montenegrin subsidiary, and the increasing role of the wholesale point of presence and alternative operations which contributed HUF 4.8 bn to Group revenues. EBITDA increased to HUF 24.2 bn with an EBITDA margin of 35.1%.

MakTel's fixed line revenues grew by 4.6% to HUF 44.2 bn owing to the favorable foreign exchange movement. The increasing wholesale voice and Internet revenues could not counterbalance the 2.4% decline in retail voice revenues driven by the lower customer base, the increasing role of mobile substitution, as well as competition from alternative operators. By the end of 2006, MakTel concluded reference interconnect offers with two alternative operators. EBITDA increased by 11.0% to HUF 19.8 bn with the EBITDA margin rising to 44.8%.

Montenegrin fixed line operations contributed HUF 19.9 bn to Group revenues in 2006 owing to strong voice revenue performance, as well as the increasing role of Internet revenues. EBITDA amounted to HUF 4.7 bn. The full integration of the fixed and mobile operations in Montenegro gives scope for headcount reduction of more than 20% during 2007. As a result, HUF 2.5 bn was accounted as accruals for severance payments in 2006.

Mobile segment: Increasing contribution to Group revenues

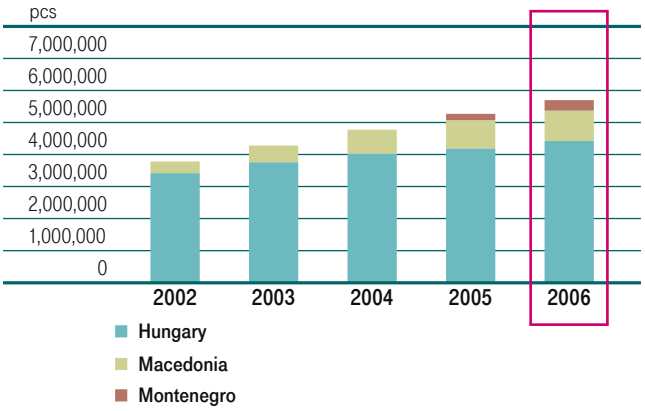
External revenues of the mobile segment increased by 14.5% in 2006 to HUF 327.3 bn. EBITDA grew by 7.4% and amounted to HUF 139.9 bn, while the EBITDA margin was 42.8%. Improvement in the segment performance is attributable to the full consolidation impact of T-Mobile Crna Gora, as well as the positive contribution from the TETRA project.

Hungarian mobile penetration increased to 99.0% by the end of 2006 with T-Mobile maintaining its clear market leadership position with 44.5% market share. As a result of the high penetration, the focus is gradually shifting from customer acquisition to retention. The average acquisition cost per subscriber (SIM card cost, sales related equipment subsidy and agent fee less connection fee) decreased further by 11.7% to HUF 6,234, despite the higher ratio of postpaid sales. Ratio of postpaid subscribers in the total customer base was 34.9% at the end of 2006, compared to 31.6% a year ago. T-Mobile Hungary's subscriber base increased by 5.7% to 4.4 million.

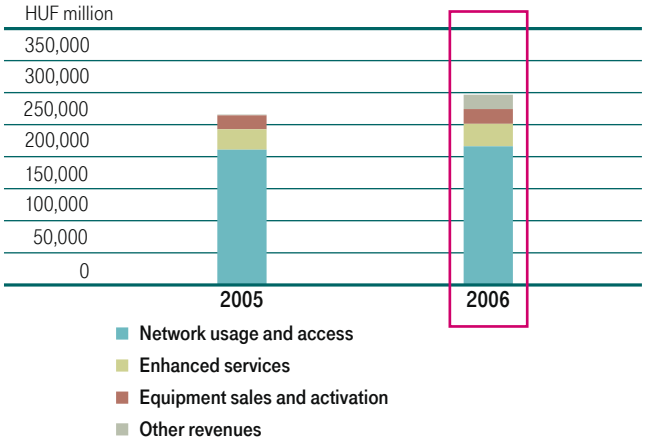
Both the Macedonian and Montenegrin mobile subsidiaries have been rebranded to T-Mobile in the course of 2006, supporting their market positions. T-Mobile Macedonia maintained its leading position with 66.5% market share at the end of 2006. The revenue-generating customer base of the company grew by 7.7% to 944.5 thousand and the proportion of postpaid customers increased to 18.8% from 15.9% a year earlier. Having reached 68.3% at the end of the year, mobile penetration boom has started to slow down.

In Montenegro, the penetration showed signs of seasonal fluctuation within the year, driven by the summer holiday season. Nevertheless, the figure stood at 129.8% at the end of 2006 as T-Mobile Crna Gora extended the availability of SIM cards, in line with other market offers. Consequently, the number of customers increased sharply by 59.4% to 331.6 thousand. The market share of T-Mobile Crna Gora was 41.2% at the end of 2006.

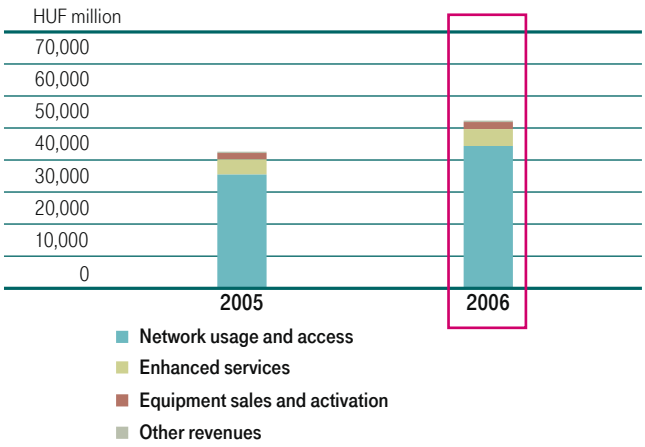
Number of mobile customers



Hungarian mobile revenues



International mobile revenues



Hungarian mobile operations: Clear market leadership maintained

Hungarian mobile revenues before elimination grew by 11.6% to HUF 297.2 bn in 2006. While traffic and access revenues increased by 2.5% to HUF 216.7 bn, the usage of value-added services rose significantly, supported by the expansion of 3G and HSDPA service coverage. As a consequence, revenue from enhanced services grew by 10.1% to HUF 35.1 bn. TETRA-related revenues contributed HUF 2.2 bn to network usage and access revenues, and HUF 18.0 bn to other revenues. Although the introduction of new, flat-rate packages generated higher usage, the discounts and bundled free minutes offered, as well as the extensive use of closed user group offers, resulted in a slight erosion of ARPU (monthly average revenue per user) to HUF 4,800, compared to HUF 4,832 in 2005. MOU (monthly average minutes of use per subscriber) grew to 142 in 2006, from 127 a year earlier.
EBITDA increased by 2.7% to HUF 112.0 bn, while EBITDA margin was 37.7%. The decline in the margin from 2005 is due to higher equipment sales costs related to the TETRA project.

International mobile operations: Strong revenue and EBITDA growth

International mobile revenues grew by 22.7% to HUF 52.4 bn in 2006 due to the strong performance of both companies, helped by the favorable exchange rate effect. EBITDA was HUF 27.9 bn with an EBITDA margin of 53.3%.

T-Mobile Macedonia revenues increased by 15.0% to HUF 39.0 bn thanks to the increasing customer base and usage, partly offset by the continuously decreasing tariffs. Consequently, while MOU grew by 14.3% to 72, ARPU increased by 4.6% to HUF 3,206 in 2006. EBITDA amounted to HUF 21.9 bn with an EBITDA margin of 56.1%.

T-Mobile Crna Gora contributed HUF 13.4 bn to revenues in 2006. The significant increase in revenues over 2005 is primarily due to the consolidation effect and the strong increase in traffic revenues. MOU remained stable at 127 and ARPU grew by 3.0% to HUF 3,858. Both figures were negatively affected by the extended availability of SIM cards introduced in the last quarter of 2006. EBITDA was HUF 6.0 bn with an EBITDA margin of 44.8%.

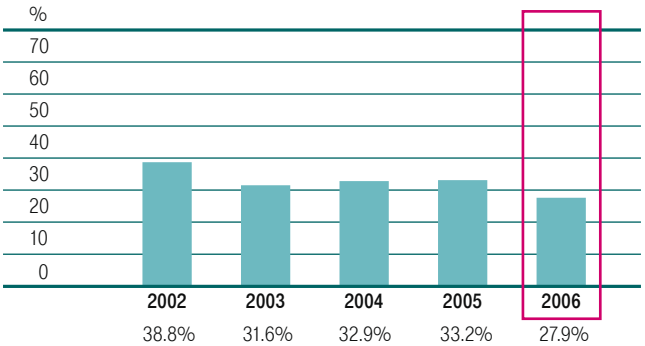
Cash flow generation

Dividends after 2005 results paid in January 2007

In 2006, net cash from operating activities fell by 6.8% to HUF 187.6 bn. The slight growth in EBITDA was offset by the increased working capital requirement, due to the TETRA project, and by the higher income tax paid, driven by the decrease in corporate tax receivable. Net cash utilized in investing activities decreased by 7.1% to HUF 122.3 bn, driven by lower capital expenditure on tangible and intangible assets and higher proceeds from real estate disposals, as well as the sale of financial assets. In 2006, the purchase of subsidiaries and business units included the acquisitions of MakTel treasury shares, KFKI, Dataplex and Orbitel. Net cash flows from financing activities reflect the absence of a dividend payment in 2006.

Consequently, net debt decreased by HUF 67.4 bn in 2006 to HUF 229.2 bn by the end of the year, and the net debt ratio (net debt to net debt plus total equity) fell to 27.9% (33.2% at end-December 2005). Though the Company has not paid dividends for 2005 earnings in 2006, shareholders' equity reflects the dividend decision of the EGM held on December 21, 2006.

Net debt to total capital ratio



Consolidated financial statements

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

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INDEPENDENT AUDITOR'S REPORT
(Free translation)

To the Shareholders and Board of Directors of Magyar Telekom Nyrt.

We have audited the accompanying consolidated financial statements of Magyar Telekom Nyrt. ("the Company"), which comprise the consolidated balance sheet as of 31 December 2006 (in which the balance sheet total is HUF 1,131,595 million and the profit attributable to the equity holders of the Company is HUF 75,453 million) the consolidated income statement, consolidated statement of changes in equity, and the consolidated cash flow statement, for the year then ended and the notes to the financial statements including a summary of the main accounting policies as well as other disclosures.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to assess whether or not the accounting information disclosed in the business report is consistent with that contained in the consolidated financial statements. We conducted our audit in accordance with Hungarian and International Standards on Auditing and with applicable laws and regulations in force in Hungary. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the

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circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Our work in respect of the business report was limited to checking it within the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company.

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

Opinion

During our work we have audited the components and disclosures along with the underlying accounting records and supporting documentation in the consolidated financial statements of Magyar Telekom Nyrt. in accordance with Hungarian and International Standards on Auditing and, on the basis of our audit work, we have gained sufficient and appropriate evidence that the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. In our opinion, the accompanying financial statements give a true and fair view of the financial position of Magyar Telekom Nyrt. as of 31 December 2006, and of the results of its operation for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU. The business report is consistent with the disclosures in the financial statements.

Budapest, March 22, 2007

Nick Kos
Partner
PricewaterhouseCoopers Kft.
1077 Budapest, Wesselényi u. 16.
License Number: 001464

Szabados Szilvia
Statutory auditor
Licence number: 005314

Consolidated balance sheets

	Notes	At December 31, 2005 as restated (Note 2.1)	2006	2006 (unaudited – Note 2.1)
		(in HUF millions)		(million USD)
ASSETS				
Current assets				
Cash and cash equivalents	6	46,060	77,840	406
Other financial assets	7	1,817	2,692	14
Trade and other receivables	8	95,956	104,016	543
Current income tax receivable	9	1,679	6,735	35
Inventories	10	8,414	10,460	54
Assets held for disposal	11	2,302	6,825	36
Total current assets		156,228	208,568	1,088
Non current assets				
Property, plant and equipment – net	12	580,736	550,900	2,875
Intangible assets – net	13	319,797	331,740	1,731
Investments in associates	14	5,020	5,771	30
Deferred tax assets	9	14,966	9,575	50
Other non current assets	15	6,201	25,041	131
Total non current assets		926,720	923,027	4,817
Total assets		**1,082,948**	**1,131,595**	**5,905**
LIABILITIES				
Current liabilities				
Loans from related parties	16	74,648	74,000	386
Loans and other borrowings – third party	17	43,602	29,605	155
Trade and other payables	18	119,464	200,589	1,047
Current income tax payable	9	1,472	1,736	9
Deferred revenue	19	918	234	1
Provision for liabilities and charges	20	6,817	8,414	44
Total current liabilities		246,921	314,578	1,642
Non current liabilities				
Loans from related parties	16	212,000	185,432	968
Loans and other borrowings – third party	17	14,215	20,697	108
Deferred revenue	19	267	170	1
Deferred tax liabilities	9	3,189	5,647	29
Provision for liabilities and charges	20	3,141	3,344	17
Other non current liabilities	18	5,521	8,560	45
Total non current liabilities		238,333	223,850	1,168
Total liabilities		**485,254**	**538,428**	**2,810**
EQUITY				
Shareholders' equity				
Common stock		104,281	104,277	544
Additional paid in capital		27,382	27,380	143
Treasury stock		(1,926)	(1,504)	(8)
Cumulative translation adjustment		(420)	(1,474)	(8)
Revaluation reserve for available for sale financial assets – net of tax		149	-	-
Reserve for equity settled share based transactions		119	49	-
Retained earnings		397,982	397,311	2,074
Total shareholders' equity		527,567	526,039	2,745
Minority interests		70,127	67,128	350
Total equity		597,694	593,167	3,095
Total liabilities and equity		**1,082,948**	**1,131,595**	**5,905**

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

Christopher Mattheisen
Chairman and Chief Executive Officer

Thilo Kusch
Chief Financial Officer

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

Consolidated income statements

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

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

Consolidated cashflow statements

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

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

Consolidated statements of changes in equity

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

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

Consolidated statements of changes in equity (continued)

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

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

Consolidated statements of changes in equity (notes)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements

1 General Information

1.1 About the Company

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

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

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

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

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

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

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

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

1.2 Investigation into certain consultancy contracts

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

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

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

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

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

1.3 Public service concession and license arrangements

Hungarian Fixed line

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

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

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

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

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

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

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

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

Macedonian Fixed line

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

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

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

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

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

Montenegrin Fixed line

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

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

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

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

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

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

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

The State Union of Serbia and Montenegro had been negotiating a Stabilization and Association Agreement with the EU. It was expected that the agreement would be very similar to the agreements signed with Croatia and Macedonia requiring the harmonization of the telecommunications regulations with the regulatory framework of the EU. In the case of Montenegro the expected amendment of the 2000 Law will achieve most of that goal. As Montenegro became an independent state in 2006, the country will have to restart negotiations about

a Stabilization and Association Agreement of its own, however, this will expectedly have no impact on the telecommunications section of the document.

Hungarian Mobile

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

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

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

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

On December 7, 2004, T-Mobile H obtained the exclusive right of use of certain frequency blocks for the deployment and operation of an IMT2000/UMTS mobile telecommunications system (3G system). The duration of the frequency usage right is 15 years (until December 7, 2019) with an option to extend it for another 7.5 years. T-Mobile H was obliged by the term of the license decree to start commercial 3G service within 12 months after the acquisition of the license within the inner city of Budapest, which was met. It is also obliged to reach a population-wide coverage of 30% within 36 months of license acquisition. As of August 26, 2005 T-Mobile H had started to provide 3G service and has been operating it in compliance with the license conditions.

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

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

Macedonian Mobile

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

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

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

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

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

Montenegrin Mobile

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

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

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

No obligation for number portability is in force.

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

2 Summary of significant accounting policies

2.1 Basis of preparation

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

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

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

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

– IAS 39 (Amendment), The Fair Value Option

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

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

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

– IFRIC 4, Determining whether an Arrangement contains a Lease

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

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

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

– IAS 19 (Amendment), Employee Benefits
– IAS 21 (Amendment), The Effects of Changes in Foreign Exchange Rates;
– IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
– IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts;
– IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
– IFRS 6, Exploration for and Evaluation of Mineral Resources;

– IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds.
– IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment;

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

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

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

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

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

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

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

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

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

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

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

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

2.1.5 Revenue recognition

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

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

2.1.6 Taxes

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

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

2.1.7 Summary of impacts on the income statement

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

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

2.2 Consolidation

(a) Subsidiaries

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

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

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

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

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

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

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

(b) Associates and joint ventures

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

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

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

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

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

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

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

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

2.3 Foreign currency translation

2.3.1 Functional and presentation currency

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

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

2.3.2 Transactions and balances

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

2.3.3 Group companies

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

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

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

2.4 Cash and cash equivalents

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

2.5 Financial assets

The Group classifies its financial assets in the following categories:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2.6 Derivative financial instruments and hedging activities

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

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

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

2.7 Trade and other receivables

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

2.8 Inventories

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

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

2.9 Assets held for disposal

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

2.10 Property, plant and equipment (PPE)

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

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

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

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

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

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

Maintenance and repairs are charged to expense when incurred.

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

The useful lives assigned are as follows:

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

2.11 Intangible assets

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

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

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

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

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

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

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

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

2.12 Impairment of PPE and intangible assets

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

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

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

See also Note 4.

2.13 Loans and other borrowings

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

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

2.14 Trade and other payables

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

2.15 Provisions

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

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

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

2.16 Treasury stock

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

2.17 Revenues

Revenue is primarily derived from services provided to Magyar Telekom's customer subscribers and other third parties using Magyar Telekom's telecommunications network, and equipment sales. Revenues for all services and equipment sales (Notes 21 and 22) are shown net of VAT, discounts and after eliminating sales within the Group, and are recognized when the amount of the revenue can be reliably

measured, it is probable that future economic benefits will flow to the Group and specific criteria are met for the provision of each of the Group's services described below.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2.17.2 Mobile service revenues

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

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

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

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

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

2.18 Employee benefits

(a) Short term employee benefits

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

(b) Pensions

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

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

(c) Share based compensation

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

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

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

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

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

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

2.19 Research and Marketing expenses

Research as well as marketing costs are expensed as incurred.

2.20 Borrowing costs

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

The weighted average interest rate on borrowings is calculated using the average amount of loans and other borrowings during the year and the interest expense charged. As the Group does not incur significant amounts of additional borrowing costs, the weighted average interest rate equals the effective borrowing costs.

2.21 Income taxes

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

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

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

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

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

2.22 Leases

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

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

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

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

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

2.23 Earnings per share

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

2.24 Dividends

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

2.25 Segment reporting

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

2.26 Comparative information

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

3 Financial risk management

3.1 Financial risk factors

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

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

3.1.1 Market risk

(a) Foreign exchange risk

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

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

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

(b) Cashflow and fair value interest rate risk

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

3.1.2 Credit risk

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

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

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

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

3.1.3 Liquidity risk

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

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

3.2 Capital risk management

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

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

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

3.3 Fair value estimation

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

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

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

4 Critical accounting estimates and judgments

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

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

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

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

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

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

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

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

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

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

5 Business combinations

5.1 Acquisitions in 2006

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

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

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

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

5.1.2 Dataplex

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

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

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

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

5.1.3 KFKI Group

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

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

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

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

5.1.4 iWiW, Adnetwork, MFactory

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

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

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

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

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

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

5.1.5 MakTel – own shares

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

5.1.6 MobilPress

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

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

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

5.2 Acquisitions in 2005

5.2.1 Crnogorski Telekom (CGT)

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

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

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

(in HUF millions)	Total	Net assets included in the Fixed line segment on first consolidation	Net assets included in the Mobile segment on first consolidation
Purchase price of ownership acquired	34,954		
Additional costs directly attributable to the business combination	973		
Consideration paid	35,927		
Fair value of net assets acquired	30,805		
Goodwill	5,122	-	5,122
Fair value of net assets acquired:			
Cash	1,866	-	-
Receivables	7,678	6,442	1,236
Income tax receivable	339	-	-
Inventory	609	426	183
Property, plant and equipment	28,687	22,495	6,192
Intangible assets	9,958	3,700	6,258
Other non current assets	1,080	1,080	-
Trade and other payables	(3,917)	(3,148)	(769)
Loans and other borrowings	(3,290)	-	-
Provisions	(1,951)	(1,914)	(37)
Net deferred tax liability	(807)	-	-
	40,252	29,081	13,063
Minority interests	(9,447)		
Total	30,805		

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

5.3 Pro forma information on business combinations

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

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

5.4 Disposal of Cardnet in 2006

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

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

6 Cash and cash equivalents

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

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

7 Other financial assets

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

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

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

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

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

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

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

8 Trade and other receivables

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

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

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

9 Income tax

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

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

9.1 Tax rate reconciliation

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

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

(a) Impact of different tax rates

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

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

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

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

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

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

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

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

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

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

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

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

9.2 Deferred taxes

Magyar Telekom's deferred tax balances are as follows:

	Balance at December 31, 2004	Income statement effect	Other move-ments	Balance at December 31, 2005	Income statement effect	Other move-ments	Balance at December 31, 2006
				(in HUF millions)			
Deferred tax assets and (liabilities)							
Investment tax credits	6,849	741	3,066	10,656	856	2,788	14,300
Net operating loss carry-forward	3,721	2,354	1	6,076	(4,859)	-	1,217
Investments in subsidiaries	(1,334)	434	-	(900)	(300)	-	(1,200)
Withholding tax	-	-	-	-	(2,034)	-	(2,034)
Other financial assets	(140)	43	121	24	(350)	19	(307)
Impairment of receivables, inventory	3,464	264	-	3,728	(678)	-	3,050
Property, plant and equipment and intangible assets	(4,795)	(1,918)	(852)	(7,565)	(88)	(1,388)	(9,041)
Goodwill	-	(1,864)	-	(1,864)	(2,262)	-	(4,126)
Trade and other payables	81	23	-	104	259	-	363
Loans and other borrowings	205	(49)	-	156	123	-	279
Deferred revenue	380	(223)	-	157	(157)	-	-
Provisions for liabilities and charges	2,816	(1,611)	-	1,205	222	-	1,427
Total net deferred tax assets	11,247	(1,806)	2,336	11,777	(9,268)	1,419	3,928
Add back: deferred tax liability	1,280			3,189			5,647
Deferred tax assets	**12,527**			**14,966**			**9,575**
Items included in other movements							
Investment tax credit recognized against cost of PPE			5,373			3,109	
Utilization of investment tax credit			(2,307)			(321)	
Change in accounting policy – embedded derivatives			140			-	
AFS financial assets – valuation differences recognized directly in equity			(19)			19	
Currency translation adjustment arising on consolidation			(44)			(29)	
Arising on business combinations			(807)			(1,359)	
			2,336			1,419	

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

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

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

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

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

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

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

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

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

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

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

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

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

10 Inventories

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

11 Assets held for disposal

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

12 Property, plant and equipment – net

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

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

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

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

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

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

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

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

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

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

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

13 Intangible assets – net

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

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

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

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

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

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

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

14 Investments in associates

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

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

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

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

15 Other non current assets

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

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

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

16 Loans from related parties

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

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

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

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

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

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

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

17 Loans and other borrowings – third party

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

(a) Bank loans

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

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

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

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

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

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

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

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

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

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

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

(c) Credit facilities and pledges
At December 31, 2006, Magyar Telekom had un-drawn committed credit facilities of HUF 91,864 million. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin depending on the currency and institution providing the facilities.

18 Trade and other payables

(a) Current liabilities

	At December 31,	
	2005	2006
	(in HUF millions)	
Domestic trade payables	58,292	59,526
Foreign trade payables	5,919	7,486
Salaries and wages	8,794	7,222
Other taxes and social security	12,190	13,162
Amounts received in advance	6,861	6,603
Accrued expenses and prepayments received	6,587	9,965
Accrued interest to DTIF	6,198	3,756
Accrued interest to third parties	461	298
Amounts owed to DT Group companies	3,567	6,207
Payable to associates	694	1,287
Dividend payable to MagyarCom GmbH	-	45,074
Dividends payable to others	77	31,091
Other payables	9,824	8,912
	119,464	**200,589**

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

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

(b) Non current liabilities

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

19 Deferred revenue

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

20 Provision for liabilities and charges

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

(a) Severance

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

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

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

(b) Customer loyalty

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

(c) Legal cases

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

(d) Other provisions

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

21 Revenues – fixed line services

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

22 Revenues – mobile services

	For the year ended December 31,		
	2004	2005	2006
	(in HUF millions)		
Voice	207,636	225,003	240,285
Non voice	30,047	36,539	40,258
Equipment and activation	25,369	23,472	25,280
Other revenues	1,757	834	21,507
Total Mobile revenues	**264,809**	**285,848**	**327,330**

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

23 Employee related expenses

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

24 Share-based compensation

(a) Management share option plan

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

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

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

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

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

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

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

(b) The former CEO's share option plan

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

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

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

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

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

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

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

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

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

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

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

25 Other operating expenses

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

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

26 Other operating income

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

27 Finance expenses

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

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

28 Finance income

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

29 Cash generated from operations

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

30 Purchase of property, plant and equipment and intangible assets

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

31 Purchase of subsidiaries and business units

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

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

32 Segment information

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

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

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

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

(a) Primary reporting format

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

	For the year ended December 31,		
	2004	2005	2006
		(in HUF millions)	
Revenues			
Fixed line – Hungary	298,707	284,985	292,193
Fixed line – Foreign operations	45,693	57,983	68,953
	344,400	342,968	361,146
Less: intra-segment revenue	(1,271)	(2,284)	(3,569)
Total revenue of Fixed line segment	343,129	340,684	357,577
Less: revenue from Mobile segment	(11,146)	(11,478)	(13,711)
Fixed line revenue from external customers	331,983	329,206	343,866
Mobile – Hungary	260,568	266,217	297,209
Mobile – Foreign operations	33,734	42,693	52,399
	294,302	308,910	349,608
Intra-segment revenue	(58)	(27)	(42)
Total revenue of Mobile segment	294,244	308,883	349,566
Less: revenue from Fixed line segment	(29,435)	(23,035)	(22,236)
Mobile revenue from external customers	264,809	285,848	327,330
Total revenue of the Group	**596,792**	**615,054**	**671,196**
Depreciation and amortization			
Amortization of goodwill – Hungary	1,601	-	-
Amortization of goodwill – Foreign operations	684	-	-
Impairment of tangible and intangible assets	5,355	316	2,457
Other depreciation and amortization	74,021	71,579	72,617
Fixed line segment	81,661	71,895	75,074
Amortization of goodwill – Hungary	9,540	-	-
Amortization of goodwill – Foreign operations	2,051	-	-
Impairment of tangible and intangible assets	4,426	75	616
Other depreciation and amortization	39,988	42,716	46,559
Mobile segment	56,005	42,791	47,175
Total depreciation and amortization of the Group	**137,666**	**114,686**	**122,249**
Segment results (Operating profit)			
Fixed line – Hungary	17,941	45,269	32,128
Share of associates' profits – (Hungary)	1,896	330	703
Fixed line – Foreign operations	7,024	8,961	11,492
Fixed line segment	26,861	54,560	44,323
Mobile – Hungary	59,707	75,219	75,677
Mobile – Foreign operations	9,047	12,305	17,095
Mobile segment	68,754	87,524	92,772
Less: Share of associates' profits	(1,896)	(330)	(703)
Total operating profit of the Group	**93,719**	**141,754**	**136,391**

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

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

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

(b) Secondary reporting format

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

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

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

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

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

33 Commitments

(a) Finance lease – Group as lessee

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

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

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

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

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

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

(b) Operating lease – Group as lessee

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

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

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

(c) Finance lease – Group as lessor

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

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

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

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

(d) Operating lease – Group as lessor

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

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

(e) Purchase commitments for tangible assets

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

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

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

34 Contingencies

Mobile termination charges in Hungary

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

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

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

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

35 Related party transactions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Group does not provide loans to its key management.

36 Events after the balance sheet date

Employee termination disputes in Montenegro

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

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

Reconciliation to U.S. GAAP (unaudited)

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

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

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

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

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

(a) Revenue recognition

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

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

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

(b) Asset retirement obligation

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

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

(c) Employee expenses

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

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

(d) Interest capitalized

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

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

(e) Derivatives and other financial assets

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

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

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

(f) Other income (rebranding)

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

(g) Purchase price allocation (business combinations)

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

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

(h) Goodwill

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

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

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

(i) Tax

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

(j) Minority interest

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

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

Financial Calendar 2007

April 26, 2007	Annual General Meeting
May 10, 2007 *	Release of 2007 1st quarter results
August 9, 2007 *	Release of 2007 1st half results
November 8, 2007 *	Release of 2007 1st nine months results

*planned date

Forward-looking statements

This Annual Report contains forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. These statements are based on current plans, estimates and projections, and therefore you should not place undue reliance on them. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of them in light of new information or future events.

Forward-looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Such factors are described in, among other things, our Annual Report on Form 20-F for the year ended December 31, 2005 filed with the U.S. Securities and Exchange Commission.

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Mailing address: 1541 Budapest, Hungary
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E-mail: investor.relations@telekom.hu

Magyar Telekom stock ticker symbol

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

Stock registration

Keler Zrt.
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Stock trading information

Budapest Stock Exchange, Information Center
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Phone: (+36 1) 429 6636, 429 6637
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Internet: www.bse.hu

ADR trading information

JP Morgan, Morgan Guaranty Trust Company
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Magyar Telekom 8129/2007

Magyar Telekom Group: financial highlights

	2005 HUF million	2006 HUF million	Change (%)
Total revenues	615,054	671,196	9.1
EBITDA*	256,440	258,640	0.9
Operating profit	141,754	136,391	(3.8)
Net income	78,415	75,453	(3.8)
Number of employees (closing)	11,919	12,341	3.5
No. of shares (millions)	1,043	1,043	0.0
Basic earnings per share (HUF)	75.5	72.5	(4.0)
Total assets	1,082,948	1,131,595	4.5
Long term debt	226,215	206,129	(8.9)
Net debt	296,588	229,202	(22.7)
Total shareholders' equity	527,567	526,039	(0.3)
Net debt to total equity and net debt	33.2%	27.9%	n.a.
Gross additions to property, plant and equipment and intangible fixed assets	103,587	96,790	(6.6)
EBITDA margin	41.7%	38.5%	n.a.
Operating margin	23.0%	20.3%	n.a.
Net income margin	12.7%	11.2%	n.a.
ROA	7.4%	6.8%	n.a.
HUF/EUR (year end)	252.73	252.30	(0.2)
HUF/EUR (average)	248.05	264.27	6.5
HUF/USD (year end)	213.58	191.62	(10.3)
HUF/USD (average)	199.66	210.51	5.4

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

Key shareholders as of December 31, 2006

The Hungarian State	Holder of the Golden Share
MagyarCom Holding GmbH (owned by Deutsche Telekom AG)	59.21%
Publicly held	40.61%
Treasury shares	0.18%

Magyar Telekom Group: summary of operating statistics

Hungarian fixed line operations	Dec. 31, 2005	Dec. 31, 2006	Change (%)
Fixed line penetration (Magyar Telekom service area, per 100 inhabitants)	35.6%	34.2%	n.a.
Digitalization of exchanges with ISDN	100.0%	100.0%	n.a.
Number of closing lines [1]			
Residential	1,981,876	1,902,011	(4.0)
Business	248,955	236,019	(5.2)
Payphone	22,112	20,517	(7.2)
ISDN channels	500,696	485,290	(3.1)
Total lines	2,753,639	2,643,837	(4.0)
Data products			
ADSL lines [1]	329,314	512,810	55.7
Number of Internet subscribers			
Dial-up	80,938	31,401	(61.2)
Leased line	751	656	(12.6)
DSL	218,954	336,181	53.5
W-LAN	1,467	1,175	(19.9)
CATV	26,425	57,587	117.9
Internet subscribers	328,535	427,000	30.0
Market share in the dial-up market (estimated)	42%	39%	n.a.
Managed leased lines (Flex-Com connections) [1]	10,289	9,165	(10.9)
Cable television customers	403,631	414,286	2.6
Total broadband Internet access [2]	357,957	572,228	59.9

Hungarian mobile operations	Dec. 31, 2005	Dec. 31, 2006	Change (%)
Mobile penetration	92.4%	99.0%	n.a.
Market share of T-Mobile Hungary	45.0%	44.5%	n.a.
Number of customers (RPC)	4,193,855	4,431,136	5.7
Postpaid share in the RPC base	31.6%	34.9%	n.a.
MOU (Minutes of Usage per User/Month)	127	142	11.8
ARPU (Average Traffic Revenue per User/ Month)	4,832	4,800	(0.7)
Postpaid ARPU	10,838	9,849	(9.1)
Prepaid ARPU	2,239	2,300	2.7
Enhanced services within ARPU	621	667	7.4
Average acquisition cost (SAC) per customer	7,062	6,234	(11.7)

International fixed line operations	Dec. 31, 2005	Dec. 31, 2006	Change (%)
Macedonian fixed line penetration	26.0%	23.9%	n.a.
Number of closing lines			
Residential	467,559	430,082	(8.0)
Business	48,252	42,780	(11.3)
Payphone	2,063	2,087	1.2
ISDN channels	41,262	42,200	2.3
Total Macedonian lines	559,136	517,149	(7.5)
Data products (Macedonia)			
ADSL lines	7,798	16,462	111.1
Number of Internet subscribers			
Dial-up	83,930	109,096	30.0
Leased line	137	141	2.9
DSL	7,798	16,462	111.1
Internet subscribers	91,865	125,699	36.8
Market share in the dial-up market (estimated)	81%	94%	n.a.
Montenegrin fixed line penetration	31.2%	31.4%	n.a.
Number of closing lines			
PSTN lines	175,122	173,248	(1.1)
ISDN channels	18,750	21,288	13.5
Total Montenegrin lines	193,872	194,536	0.3
Data products (Montenegro)			
ADSL lines	1,085	6,639	511.9
Number of Internet subscribers			
Prepaid	25,594	25,669	0.3
Leased line	117	121	3.4
DSL	1,085	6,639	511.9
Internet subscribers	26,796	32,429	21.0
Market share in the dial-up market (estimated)	96%	98%	n.a.

International mobile operations	Dec. 31, 2005	Dec. 31, 2006	Change (%)
Macedonian mobile penetration	**61.3%**	**68.3%**	**n.a.**
Market share of T-Mobile Macedonia	69.2%	66.5%	n.a.
Number of customers (RPC)	877,142	944,530	7.7
Postpaid share in the RPC base	15.9%	18.8%	n.a.
MOU	63	72	14.3
ARPU	3,065	3,206	4.6
Montenegrin mobile penetration	**78.6%**	**129.8%**	**n.a.**
Market share of T-Mobile Crna Gora	42.7%	41.2%	n.a.
Number of customers (RPC)[3]	208,094	331,616	59.4
Postpaid share in the RPC base	15.0%	14.6%	n.a.
MOU	127	127	0.0
ARPU	3,745	3,858	3.0

[1] Magyar Telekom Plc. and Emitel (100% owned by Magyar Telekom Plc.).
[2] Includes ADSL lines operated by Magyar Telekom Plc. and Emitel plus T-Online Hungary's broadband customers (other than the ADSL purchased from Magyar Telekom Plc.).
[3] In October 2006, prepaid voucher lifecycle was extended from 3 to 11 months in Montenegro, resulting in increase in the number of prepaid RPC.

Magyar Telekom Group: international presence

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

Declaration of responsibility

We the undersigned declare that to the best of our knowledge all data and information in the attached annual report are true and correct and the report does not omit any material information necessary for investors to make an informed judgement of Magyar Telekom. We acknowledge that, based on the order of the Capital Markets Act, Magyar Telekom, as an issuer, is responsible for any damage caused by its failure to make a regular or extraordinary announcement or by any misleading announcement made.

Christopher Mattheisen
Chairman and Chief Executive Officer

Thilo Kusch
Chief Financial Officer

Budapest, April 26, 2007