Magyar Telekom Telecommunications CO Ltd
Form 20-F
May 11, 2005

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As filed with the Securities and Exchange Commission on May 11, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004
Commission file number 1-14720

MAGYAR TELEKOM TÁVKÖZLÉSI RT.

(Exact Name of Registrant as Specified in Its Charter)

MAGYAR TELEKOM TELECOMMUNICATIONS CO. LTD.

(Translation of Registrant's Name Into English)

Hungary

(Jurisdiction of Incorporation or Organization)

Budapest, 1013, Krisztina krt. 55, Hungary

(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act

Title of each class	**Name of each exchange on which registered**
American Depositary Shares, each representing five Ordinary Shares	New York Stock Exchange
Ordinary Shares	New York Stock Exchange*

Securities registered or to be registered pursuant to Section 12(g) of the Act

NONE
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act

NONE
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

Ordinary Shares.....1,042,811,600
nominal value HUF 100 per share
(as of December 31, 2004)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ý NO o

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ý Item 18 o

*Not for trading, but only in connection with the registration of American Depositary Shares.

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PART II

PART III

Certain Defined Terms and Conventions

In this annual report the terms "Magyar Telekom", the "Group", the "Company", "we", "us" and "our" refer to Magyar Telekom Távközlési Rt. and, if applicable, its direct and indirect subsidiaries as a group; the term "Magyar Telekom Rt." refers to Magyar Telekom Távközlési Rt. without its subsidiaries; the term "TMH" refers to T-Mobile Magyarország Távközlési Rt. (formerly known as Westel Mobil Távközlési Rt.); the term "Maktel" refers to Makedonski Telekommunikacii AD and the term "DT" refers to Deutsche Telekom AG.

On May 6, 2005, Magyar Távközlési Rt. ("Matáv") changed its name to Magyar Telekom Távközlési Rt. (Magyar Telekom Telecommunications Co. Ltd.) and its abbreviated name became Magyar Telekom Rt.

In this annual report, the term "Minister" refers to the Minister heading the Ministry of Informatics and Communications (Informatikai és Hírközlési Minisztérium, "IHM"), a ministry of the Hungarian government in charge of regulating the telecommunications industry.

Totals in tables may be affected by rounding. Segment revenue and operating expense figures included in this annual report do not give effect to intersegment eliminations.

Forward-looking Statements May Not Be Accurate

The Company may from time to time make written or oral forward-looking statements. Written forward-looking statements appear in documents the Company files with the Securities and Exchange Commission, including this annual report, reports to shareholders and other communications. The U.S. Private Securities Litigation Reform Act of 1995 contains a safe harbor for forward-looking statements. Factors identified in filings with the Commission may cause actual results to differ materially from a forward-looking statement made by Magyar Telekom or on its behalf. Readers should also consider the information contained in Item 3, "Key Information Risk Factors" and Item 5, "Operating and Financial Review and Prospects", as well as the information contained in the Company's periodic filings with the Securities and Exchange Commission for further discussion of the risks and uncertainties that may cause such differences to occur. The Company's forward-looking statements speak only as of the date they are made, and the Company does not have an obligation to update or revise them, whether as a result of new information, future events or otherwise.

PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3 KEY INFORMATION

SELECTED FINANCIAL DATA

This selected consolidated financial and statistical information should be read together with the consolidated financial statements, including the accompanying notes, included in this annual report. We derived these financial data from our consolidated financial statements as of and for the years ended December 31, 2000, 2001, 2002, 2003 and 2004 and the accompanying notes, which have been audited by PricewaterhouseCoopers Budapest, Hungary ("PwC"). These consolidated financial data are qualified by reference to our consolidated financial statements and accompanying notes, which we have prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS differs from U.S. Generally Accepted Accounting Principles ("GAAP"). For a discussion of the principal differences between IFRS and U.S. GAAP as they relate to us, see Note 36 to the consolidated financial statements.

	Year ended December 31,					
	2000[3]	2001[3]	2002	2003	2004	2004
	HUF	HUF	HUF	HUF	HUF	U.S.$[1]
	(in millions, except per share amounts)					
Consolidated Income Statement Data:						
Amounts in accordance with IFRS						
Revenues	445,945	547,735	590,585	607,252	601,438	3,336
Operating profit	96,091	119,400	122,240	122,064	85,264	473
Net income	66,652	82,560	68,128	57,475	34,641	192
Operating profit per share	92.66	115.14	117.76	117.60	82.14	0.46
Net income per share[2]	64.27	79.59	65.66	55.38	33.38	0.19
Diluted net income per share[2]	63.97	79.59	65.66	55.38	33.38	0.19
Amounts in accordance with U.S. GAAP						
Revenues	461,537	550,900	592,294	610,946	607,599	3,370
Operating profit	90,456	120,144	132,585	132,715	91,839	509
Net income	65,844	82,403	78,619	66,404	39,685	220
Operating profit per share	87.23	115.86	127.73	127.86	88.48	0.49
Net income per share[2]	63.49	79.47	75.77	63.98	38.24	0.21
Diluted net income per share[2]	63.19	79.47	75.77	63.98	38.22	0.21
Consolidated Balance Sheet Data:						
Amounts in accordance with IFRS						
Total assets	954,424	1,104,196	1,077,451	1,058,837	1,029,558	5,711
Net assets	638,509	508,469	575,580	630,384	576,664	3,199
Capital stock	103,736	103,736	104,281	104,281	104,281	578
Total shareholders' equity	637,281	460,300	516,144	560,110	516,567	2,865
Amounts in accordance with U.S. GAAP						
Total assets	965,608	1,118,015	1,099,634	1,090,308	1,077,899	5,979
Net assets	627,397	493,357	570,541	633,783	592,877	3,288
Total shareholders' equity	626,170	448,440	514,664	567,452	534,907	2,967

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(in millions)				
Other data:					
Weighted average number of shares					
Basic	1,037	1,037	1,038	1,038	1,038
Diluted	1,042	1,037	1,038	1,038	1,038

(1) Translated into U.S. dollars at the official exchange rate of the National Bank of Hungary on December 31, 2004 of U.S. dollar 1.00 = HUF 180.29. These translations are unaudited and presented for convenience purposes only.

(2) Net income per share under IFRS and net income per share under U.S. GAAP are calculated by dividing net income by the weighted average number of shares outstanding during each period.

(3) In December 2001, Magyar Telekom Rt. acquired 49 percent of the common shares of TMH and Westel Rádiótelefon Kft. ("Westel 0660") from Deutsche Telekom AG. Magyar Telekom Rt. is controlled by Deutsche Telekom AG so this was a transaction between parties under common control. The financial statements have been restated as if TMH and Westel 0660 were wholly owned subsidiaries of Magyar Telekom since March 23, 2000, the date on which Deutsche Telekom AG acquired 49 percent of TMH and Westel 0660.

Dividends

The following table sets forth the dividend per Magyar Telekom ordinary share for the years 2000, 2001, 2002, 2003 and 2004. The table shows the dividend amounts in Hungarian forints, together with U.S. dollar equivalents, for each of the years indicated.

	Dividend Paid Per Ordinary Share	
	HUF	U.S.$[1]
Year		
2000	10	0.0351
2001	11	0.0394
2002	18	0.0799
2003	70	0.3367
2004	70	0.3883

(1) Translated into U.S. dollars at the official exchange rate of the National Bank of Hungary on December 31, 2004 of U.S. dollar 1.00 = HUF 180.29; December 31, 2003 of U.S. dollar 1.00 = HUF 207.92; December 31, 2002 of U.S. dollar 1.00 = HUF 225.16; on December 31, 2001 of U.S. dollar 1.00 = HUF 279.03 and on December 31, 2000 of U.S. dollar 1.00 = HUF 284.73.

EXCHANGE RATE INFORMATION

The National Bank of Hungary ("NBH") quotes and publishes official exchange rates based on prevailing market rates. The NBH sets the official rate of exchange for the Hungarian forint based on euro. On any given day, the market exchange rate of the Hungarian forint against euro may vary from the official rate of the National Bank of Hungary. Prior to May 4, 2001, the National Bank of Hungary had a policy of intervening in the foreign currency market if the market exchange rate deviates more than 2.25 percent above or below the official rate. On May 4, 2001, the National Bank of Hungary announced that it had widened this intervention band to 15 percent above and below the official rate. This decision was taken as a step toward convergence with the European Union exchange rate regime and as an effective tool against inflation.

As used in this document, "Hungarian forint" or "HUF" mean the lawful currency of Hungary. "EUR", "euro" or "€" mean the single unified currency that was introduced in 11 participating member states of the European Union on January 1, 1999. "U.S. dollar," "USD" or "$"mean the lawful currency of

the United States. Unless otherwise stated, conversion of Hungarian forint into U.S. dollars have been made at the rate of USD 1.00 to HUF 180.29, which was the official rate quoted and published by the National bank of Hungary on December 31, 2004.

The following tables set forth, for the periods and dates indicated, the period-end, average, high and low official rates quoted and published by the National Bank of Hungary for Hungarian forint per U.S.$1.00 and EUR1.00.

	Exchange Rates (amounts in HUF/U.S.$)			
	Period-End	**Average[1]**	**High**	**Low**
Year				
2000	284.73	282.27	318.71	245.57
2001	279.03	286.54	304.06	271.35
2002	225.16	258.00	283.98	225.16
2003	207.92	224.44	237.63	206.61
2004	180.29	202.63	217.24	180.19
2004				
November	185.98	188.88	193.56	185.40
December	180.29	183.42	188.73	180.19
2005				
January	189.15	187.81	190.29	181.43
February	182.59	187.23	191.26	182.59
March	190.81	185.91	192.10	180.58
April	194.86	191.69	194.86	189.44

(1) The average of the exchange rates on each business day during the relevant period.

	Exchange Rates (amounts in HUF/EUR)			
	Period-End	**Average[1]**	**High**	**Low**
Year				
2000	264.94	260.04	265.67	254.47
2001	246.33	256.68	267.29	241.45
2002	235.90	242.97	252.38	235.17
2003	262.23	253.51	272.03	234.69
2004	245.93	251.68	270.00	243.42
2004				
November	246.67	245.32	247.38	243.42
December	245.93	245.90	249.28	244.03
2005				
January	245.70	246.56	248.39	245.22
February	242.13	243.77	245.62	242.13
March	247.18	244.97	248.50	241.42
April	252.66	248.16	252.66	245.95

(1) The average of the exchange rates on each business day during the relevant period.

We will pay any cash dividends in Hungarian forints, and exchange rate fluctuations will affect the U.S. dollar amounts you would receive if you are a holder of American Depository Shares ("ADSs") upon conversion of cash dividends on the shares those ADSs represent. Fluctuations in the exchange rate between the Hungarian forint and the U.S. dollar will also affect the prices of shares and ADSs.

RISK FACTORS

Prior to making any investment decision, you should carefully consider the risks set forth below in addition to other information contained in this annual report. The risks described below are not the only risks we face. Additional risks not currently known to us or risks that we currently regard as immaterial also could have a material adverse effect on our financial condition or results of operations or the trading prices of our securities. This annual report contains certain "forward-looking" statements. These include statements on expectations of our businesses. You will find below and elsewhere in this annual report important factors that could cause our results to differ materially from such forward-looking statements. We disclaim any obligation to update information contained in any forward-looking statement.

Our operations are subject to substantial government regulation, which can result in adverse consequences for our business and results of operations.

The Act XL of 2001 on Communications ("Act on Communications") was approved by the Hungarian Parliament in June 2001 and came into force on December 23, 2001. This act became the basis for the liberalization of the telecommunications market in Hungary.

The Act on Communications was not in full conformity with the new European Union ("EU") Regulatory Framework for Telecommunications. To achieve harmonization of the telecommunications regulatory regime in Hungary to the EU Regulatory Framework as well as to encourage further competition in the market, Act C of 2003 on Electronic Communications ("Act on Electronic Communications") was enacted by the Parliament.

The Act on Electronic Communications primarily deals with the following: Internet regulation, Significant Market Power ("SMP") obligation regulation, carrier selection, costing methodology, number portability regulation and institutional issues. The Act on Electronic Communications came into force on January 1, 2004.

Under the new EU Regulatory Framework and the Act on Electronic Communications, the National Communications Authority ("NCA", Nemzeti Hírközlési Hatóság) was established to identify markets subject to the regulatory framework, or "relevant markets", to carry out market analysis of relevant markets and, if the NCA finds a lack of sufficient competition in such markets, to identify businesses with SMP and impose appropriate obligations or requirements (or amend pre-existing conditions, if any) on such businesses to encourage competition. The market analysis includes a public consultation process with interested parties and, in certain cases, with the European Commission.

The NCA has started this procedure on 18 relevant markets and, by February 2005, has reached its final findings on 8 of these markets, including fixed line retail markets, and mobile wholesale origination and termination markets. The NCA's finding on the fixed line retail markets identified Magyar Telekom as an SMP. The NCA accordingly imposed a price cap on our services in the retail access markets for residential/non-residential customers and required us to allow our fixed line residential/non-residential customers to select other service providers for local and/or national and international calls. The NCA's findings on other markets are expected to be published in the first half of 2005.

We cannot fully anticipate the combined impact of these regulatory developments on our business and results of operations. Our business and results of operations may be adversely affected by these changes.

The liberalization of the fixed line telecommunications market is expected to have an effect on the mobile telecommunications industry as well. On November 4, 2002, the NCA designated, for the first time,

TMH as an SMP in the interconnections market. TMH was obligated to decrease its fixed-to-mobile termination charges by 10 percent, effective September 1, 2003. The TMH's SMP status was reconfirmed on November 6, 2003, in an annual review by the NCA. TMH was required to file a long run incremental cost ("LRIC") based calculation on the fixed-to-mobile termination fees by March 1, 2004. The regulator also established a guideline for the reduction of the termination fees. According to the guideline, the decrease in the termination fees shall not exceed 10 percent even if cost-based prices would require a further reduction. In May 2004, the NCA ordered TMH to reduce its interconnection fees by an average of 8.8 percent. The market analysis procedure under the new EU Regulatory Framework and the Act on Electronic Communications also identified TMH as an SMP in the mobile termination market. This decision was announced on January 24, 2005. It is expected that the level of our fees and interconnection prices may change significantly due to the government regulations in the future and such changes could adversely impact the financial condition and results of operations of TMH.

Under the new regulatory regime in Hungary, two changes, which affected telecommunications customers' ability to retain telephone numbers when switching a carrier, were implemented in 2004. Since January 1, 2004, telecommunications customers are entitled to the geographic number portability, or the ability to retain a telephone number associated with a fixed telephone line when switching a carrier. On May 1, 2004, this portability was extended to include mobile and non-geographic telephone numbers. These changes may result in a larger churn rate among both fixed line and mobile customers, thus negatively affecting our financial condition and results of operations.

See "Item 4 Regulation and Pricing"

We are subject to more intense competition due to the liberalization of the telecommunications sector.

As a result of limited success that the Act on Communications had on the Hungarian telecommunications sector, the Act of Electronic Communications came into force on January 1, 2004 to facilitate further competition and encourage new entrants to the market. Although identities of such new entrants are already known to some degrees, the scope of competition and any adverse effect on our results will depend on a variety of factors that we currently cannot assess with precision and are for the most part not within our control. Among such factors are business strategies and capabilities of potential competitors, prevailing market conditions, the effect of Hungary's accession to the European Union, as well as the effectiveness of our efforts to prepare for new market conditions.

In the mobile communications business, we already face intense competition. As all telecommunications markets have become increasingly saturated, the focus of competition is starting to shift from customer acquisition to customer retention. Significant customer defections could have an adverse effect on results of operations, and customer acquisition and retention expenses are substantial. Due to the increased level of competition, prices for mobile voice telephony have been declining over the past several years and may continue to decline.

We also face intense competition in the market for Internet services, as well as in the data communications markets.

In Macedonia, Maktel's exclusive rights to provide fixed line telecommunications services expired at the end of 2004, as a result of the market liberalization. Competition posed by new entrants may result in downward pressure on Maktel's pricing, sales volume and profitability, which would have an adverse effect on our financial condition and results of operations.

Our ability to sustain revenue growth will depend in part on our ability to increase traffic and offer value added and data services to our customers.

We expect the number of fixed access lines and tariffs for telephony services to decrease as competition in fixed and mobile telephony increases. Our ability to sustain revenue growth will therefore depend on our ability to increase the amount of traffic over existing fixed lines and to increase revenues from value added and data services. We also plan to grow our mobile subscriber base and our related lines of business, such as Internet and cable television, and expand our coverage area. We may not be able to sustain revenue growth, if we are not able to offer attractive and affordable value added services in the future or if our customers do not purchase our services.

We may be unable to adapt to technological changes in the telecommunications market.

The telecommunications industry is characterized by rapidly changing technology with related changes in customer demands and the need for new products and services at competitive prices. Technological developments are also shortening product life cycles and facilitating convergence of various segments of the increasingly global information industry. Our future success will largely depend on our ability to anticipate, invest in and implement new technologies with the levels of service and prices that customers demand. Technological advances may also affect our level of earnings and financial condition by shortening the useful life of some of our assets.

The operation of our businesses depends in part upon the successful deployment of continually evolving mobile communications technologies, which will require significant capital expenditures. There can be no assurance that such technologies will be developed according to anticipated schedules, that they will perform according to expectations, or that they will achieve commercial acceptance. We may be required to make more capital expenditures than we currently expect if suppliers fail to meet anticipated schedules, performance of such technologies fall short of expectations, or commercial success is not achieved.

The effect of technological changes on our businesses cannot be predicted. In addition, it is impossible to predict with any certainty whether the technology selected by us will be the most economic, efficient or capable of attracting customer usage. There can be no assurance that we will be able to develop new products and services that will enable us to compete effectively in the Hungarian telecommunications market.

Developments in the technology and telecommunications sectors have resulted and may result in impairments in the carrying value of certain of our assets.

Developments in the technology and telecommunications sectors, including significant declines in stock prices, market capitalization and credit ratings of market participants may result in impairments of our tangible, intangible or other assets. Future changes in these areas could lead to further impairments at any time. Recognition of impairment of tangible, intangible and financial assets could adversely affect our financial condition and results of operations and might lead to a drop in the trading price of our shares. We review on a regular basis the value of each of our subsidiaries and their assets. The value of goodwill is reviewed annually. In addition to our regular valuations, whenever we identify any indication (due to changes in the economic, regulatory, business or political environments) that goodwill, intangible assets or fixed assets might have been impaired, we consider the necessity of performing certain valuation tests which may result in an impairment charge.

We depend on a limited number of suppliers for equipment and maintenance services.

In each of our operating divisions, there are a limited number of suppliers for required equipment and maintenance services. The failure of these suppliers to meet our equipment and service needs in a timely manner could have a significant effect on our revenues and market position. The construction and operation of our networks and the provision of our services and network infrastructure, especially mobile telecommunications services, are dependent on our ability to obtain adequate supplies of a number of items on a timely and cost-efficient basis. These include handsets and transmission, switching and other network equipment. Significant delays in obtaining such equipment and maintenance services could have a material adverse effect on our business and results of operations.

Our business may be adversely affected by actual or perceived health risks associated with mobile communications technologies.

Media reports have suggested that radio frequency emissions from cellular telephones may be linked to medical conditions such as cancer. In addition, a number of consumer interest groups have requested investigations into claims that digital transmissions from handsets used in connection with digital mobile technologies pose health risks and cause interference with hearing aids and other medical devices. There can be no assurance that the findings of such studies will not have a material effect on our mobile business or will not lead to government regulation. Our ability to install new mobile telecommunications base stations and other infrastructure may also be adversely affected, and related costs may increase, due to regulation or consumer action in response to concerns over health risks and adverse effect on the value of properties adjacent to such facilities. The actual or perceived health risks of mobile communications devices could adversely affect mobile communications service providers, including us, through increased barriers to network development, reduced subscriber growth, reduced network usage per subscriber, threat of product liability lawsuits or reduced availability of external financing to the mobile communications industry.

System failures could result in reduced user traffic and revenue and could harm our reputation.

Our technical infrastructure (including our network infrastructure for fixed network services and mobile telecommunications services) is vulnerable to damage and interruption from information technology failures, power loss, floods, windstorms, fires, intentional wrongdoing and similar events. Unanticipated problems at our facilities, system failures, hardware or software failures or computer viruses could affect the quality of our services and cause service interruptions. Any of these occurrences could result in reduced user traffic and revenue and could harm our reputation.

Loss of key personnel could weaken our business.

Our operations are managed by a small number of directors and key executive officers. The loss of directors or key executive officers could significantly impede our financial, marketing and other plans. We believe that the growth and future success of our business will depend in large part on our continued ability to attract and retain highly skilled and qualified personnel at all levels; however, the competition for qualified personnel in the telecommunications industry is intense. We can give no assurances that we will be able to hire or retain necessary personnel.

Our share price may be volatile, and your ability to sell our shares may be adversely affected due to the relatively illiquid market for Magyar Telekom securities.

The Hungarian equity market is relatively small and illiquid compared to major global markets. As a result of the limitations of the Hungarian equities market and the volatility of the telecommunications sector, the price of Magyar Telekom shares may be relatively volatile and you may have difficulty selling your shares in the event of unfavorable market conditions.

We have a substantial business interest based in Macedonia, where ethnic hostilities and economic pressures could reduce the value of our investment in that region.

We own 100 percent interest in Stonebridge Communications AD ("Stonebridge"), which owns 51 percent interest in Maktel, the formerly state-owned public telecommunications service provider in Macedonia. Maktel became a consolidated subsidiary of Magyar Telekom beginning on January 15, 2001.

Ethnic hostilities, while getting better, continue to pose significant risk to the economy of Macedonia. The negative pressure on the economy could lead to a devaluation of the currency. In case of a devaluation of the Macedonian denar, the value of our interest in Maktel would be reduced and our financial condition and results of operations may be adversely affected.

The value of our investments, results of operations and financial condition could be adversely affected by economic developments in Hungary and other countries.

Our business depends on general economic conditions in Hungary and abroad. There are many factors that influence global and regional economies, which are outside of our control. A cautious or negative business outlook may cause our customers to delay or cancel investment in information technology and telecommunications systems and services, which would adversely affect our revenues directly and, in turn, slow the development of new services and applications that could become future revenue sources.

Fluctuations in the currency exchange rate could have an adverse effect on our results of operations.

We are subject to currency translation risks, mainly relating to the results of our Macedonian operations. Devaluation of the Macedonian denar or appreciation of the Hungarian forint may exert a negative influence on Maktel's results that are converted into HUF. This is mainly a reporting risk, but through the dividend payments it has direct financial (cashflow) effects on us as well.

We are subject to risks resulting from fluctuations in interest rates.

We are subject to risks resulting from fluctuations in interest rates, which can affect costs associated with our interest bearing obligations and certain other payments. Our debt portfolio consists of approximately equal amount of floating rate and fixed rate obligations. The floating rate loans decrease the predictability of our financing costs since interest is always paid according to the current market interest rates. Fixed rate loans also bear risks of fluctuating interest rates as we may have to pay interest at a higher rate on fixed rate loans than the prevailing market interest rate, and we may not be able to refinance at a lower interest rate.

In 2002 and 2003, we refinanced our indebtedness denominated in euro and replaced them with indebtedness in Hungarian forint. As the interest rate volatility associated with the Hungarian forint is much higher than that associated with the euro, we may be exposed to higher interest rate volatility. To mitigate such volatility, our debt portfolio was modified to include approximately equal amount of fixed rate and floating rate indebtedness. However, we cannot guarantee that such strategy will sufficiently decrease our exposure to interest rate volatility. Such volatility may lead to unexpected increase in interest payment obligations, which would adversely affect our financial positions and results of operations.

ITEM 4 INFORMATION ON THE COMPANY

ORGANIZATION

Until May 3, 2005, the legal name of the Company was Magyar Távközlési Rt. and it operated under its commercial name, "Matáv". On May 3, 2005, Magyar Távközlési Rt. was rebranded as Magyar Telekom Távközlési Rt. (Magyar Telekom Telecommunications Co. Ltd.) and its commercial name became Magyar Telekom Rt. Magyar Telekom is a limited liability stock corporation incorporated and operating under the laws of Hungary. Our shares are listed on the Budapest Stock Exchange, and our ADSs are listed on the New York Stock Exchange. Our headquarters are located at 55 Krisztina krt., 1013 Budapest, Hungary. Our telephone numbers are +36-1-458-0000 and +36-1-458-7000. Our agent for service of process in the United States is CT Corporation, 111 Eight Avenue, New York, New York 10011, USA.

HISTORY AND DEVELOPMENT

Prior to 1990, the Hungarian national postal, telephone and telegraph authority, Magyar Posta, provided all public telephony services in Hungary. As of January 1, 1990, the Hungarian government split Magyar Posta into three distinct entities based on the nature of their operations: postal services, telecommunications and broadcasting. The Hungarian government made Magyar Távközlési Vállalat, the predecessor to Matáv, responsible for telecommunications operations. This entity was transformed on December 31, 1991 into a stock corporation, Magyar Távközlési Rt., or Matáv, then wholly owned by the predecessor of the Állami Privatizációs és Vagyonkezelõ Rt. (the "State Privatization and Holding Company" or the "ÁPV").

MagyarCom GmbH ("MagyarCom"), a holding company in which Deutsche Telekom and Ameritech Corporation ("Ameritech") each held a 50 percent interest, was selected by the Minister in an international tender and subsequently purchased a 30.1 percent stake in Matáv for approximately U.S.$ 875 million on December 22, 1993. The ÁPV contributed U.S.$ 400 million of the purchase price paid by MagyarCom to Matáv to provide it with capital to expand the telephone network.

MagyarCom entered into a concession agreement with the Hungarian government on December 19, 1993. MagyarCom then assigned certain of its rights under the concession agreement to Matáv. On December 22, 1993, Matáv entered into a concession contract (the "Concession Contract") with the Hungarian government, which gave us the exclusive right to provide domestic long distance and international public telephony services throughout Hungary and local public fixed line voice telephony services in 31 of 54 Local Primary Areas for a term of eight years ending December 22, 2001. On May 24, 1994, we obtained the right to provide telephony services in an additional five Local Primary Areas for a term of eight years ending in May 2002.

On December 22, 1995, MagyarCom acquired from the ÁPV an additional 37.2 percent interest for approximately U.S.$ 852 million, raising its stake to 67.3 percent.

In connection with the Company's initial public offering in November 1997, both MagyarCom and the ÁPV collectively sold 272,861,367 shares or 26.31 percent of then outstanding shares. In June 1999, the ÁPV sold its remaining 5.75 percent stake in Matáv in a secondary offering.

On October 8, 1999, SBC Communications Inc. ("SBC") completed its acquisition of Ameritech and thus gained control over Ameritech's 50 percent interest in MagyarCom.

On July 3, 2000, SBC sold its 50 percent ownership in MagyarCom to Deutsche Telekom, making Deutsche Telekom a 100 percent owner of MagyarCom.

As of December 31, 2004, 59.21 percent of Matáv's ordinary shares was held by MagyarCom, 40.32 percent publicly traded and 0.47 percent held as treasury shares. The Hungarian government owns one Series "B" voting preference share to which special rights attach.

On January 20, 2005, Magyar Telekom announced that the Board of Directors had made a decision to rename Matáv to Magyar Telekom. According to the resolution, the official name of the Company changed to Magyar Telekom Távközlési Rt. (Magyar Telekom Telecommunications Co. Ltd.) and its abbreviated name is now Magyar Telekom Rt. The Board of Directors' decision was approved by the shareholders in the Extraordinary General Meeting on February 22, 2005.

On May 6, 2005, the change of the Company's name was registered with the Court of Registry. At the same time, we changed and registered the name of two of our subsidiaries. Axelero, our internet subsidiary, is now named T-Online Hungary Internet Service Provider Co. Ltd. ("T-Online Hungary"). MatávkábelTV, our cable television subsidiary is now named T-Kábel Hungary CableTV Servicing Limited Liability Company ("T-Kábel Hungary").

The renaming is expected to have a positive impact on our results of operations. It is expected to build solid brand awareness and contribute to a new image of the Company. The renaming is also expected to strengthen our competitive position in the Hungarian fixed line market.

For the details on our principal acquisitions during the last three years, see "Item 10 Material contracts".

DESCRIPTION OF BUSINESS AND ITS SEGMENTS

We are the principal provider of fixed line telecommunications services in Hungary, with approximately 2.9 million fixed access lines at December 31, 2004. We are also Hungary's largest mobile telecommunications service provider, with more than 4,032,000 mobile subscribers (including users of prepaid cards) at December 31, 2004. We also hold a 100 percent interest in Stonebridge Communications AD, which controls Maktel, the sole fixed line telecommunications service provider and, through its subsidiary Mobimak, the leading mobile telecommunications operator in Macedonia. Our total consolidated revenues were HUF 601,438 million (U.S.$ 3,336 million), and our total consolidated net income was HUF 34,641 million (U.S.$ 192 million) in 2004.

We are a full-service telecommunications provider operating in two business segments:

Fixed Line Telecommunications Services. Our fixed line telecommunications services consist of local, long distance and international telephony as well as other telecommunications services, including data transmission, cable television and Internet services. Magyar Telekom Rt. had exclusive rights through December 2001 to provide domestic long distance and international public telephony services throughout Hungary and to provide local public fixed line telephony services in 31 of the 54 local primary areas in Hungary. Magyar Telekom Rt. had exclusive rights in five of the 54 local primary areas until May 2002, while its subsidiary, Emitel had exclusive rights in an additional three concession areas through November 2002. Our 36 former local concession areas cover approximately 70 percent of Hungary's geographic area and include Budapest as well as nearly all of other major cities in Hungary. As there is limited competition for public voice telephony services even after the liberalization of the telecommunications market, we are still the dominant voice telephony service provider in these 36 areas. We also provide leased lines, data transmission services and corporate network services, sell telecommunications equipment and offer network construction and maintenance services. We are the market leader for most of these services in Hungary.

The fixed line telecommunications service segment also includes three Macedonian companies. Stonebridge is a holding company through which Magyar Telekom controls Maktel. Telemacedonia is a management company through which Magyar Telekom provides management and consulting services to Maktel, Mobimak and Stonebridge. Maktel is Macedonia's leading fixed line telecommunications company. Its exclusive rights in fixed line telecommunications services expired in December 2004. These exclusive rights included local, national and international long distance public voice services, voice over Internet Protocol ("IP") services, leased lines services and the construction and operation of public voice network services.

Mobile Telecommunications Services. Our mobile telecommunications subsidiary, T-Mobile Hungary, is a leading provider of mobile telecommunications services in Hungary. TMH is one of three Global System for Mobile Telecommunications ("GSM") digital providers in Hungary. Since December 7, 2004, TMH also has rights to operate Third Generation ("3G"), or Universal Mobile Telecommunications System ("UMTS"), mobile telecommunications services. Mobile telecommunications services have contributed significantly to our revenue. The number of TMH's subscribers increased from approximately 2.5 million at the end of 2001 to approximately 4.0 million by the end of 2004.

The mobile telecommunications service segment also includes Mobimak, a leading mobile telecommunications service provider in Macedonia. Mobimak is a fully owned subsidiary of Maktel. The number of Mobimak's subscribers increased from 523,664 at the end of 2003 to 752,462 at the end of 2004.

STRATEGY

Since becoming a listed company in 1997, we have maintained our dominant position in the domestic fixed line business, successfully expanded into mobile and international operations through acquisitions, and continuously produced solid results. To ensure our continuing success, we have launched a Value Creation Program, which consists of three main elements.

- improving operational performance;
- leveraging the group synergies; and
- growth through acquisitions.

The aim of this program is to maintain our Earnings Before Interest, Tax, Depreciation and Amortization ("EBITDA") margin, before restructuring charges, above 40 percent in 2005 and 2006 despite the increasing regulatory and competitive pressure across the group. We aim to generate sustainable results through the following initiatives.

Improving operational performance

Management has developed a comprehensive market-oriented program aimed to improve operational performance in every division. Our primary focus is on fixed line access preservation, broadband growth, mobile profitability improvement, and significant cost reduction. Several specific goals have been established.

- *Preserve the fixed line customer base*: Hungary's fixed line access base has been declining for a number of years. We aim to minimize the erosion of the fixed line customer base through combination of an advertising campaign and introduction of a new range of competitive products. Our fixed line business will continue to maintain our aggressive product launch schedule to improve the value proposition of a Public Switched Telephone Network ("PSTN") subscription. New flat-rate price plans and bundled Internet access products will be offered in the first phase of

the revitalization of the fixed line business. These offerings will be followed by innovative products based on our improving and expanding broadband access platform in the areas of entertainment, content and bundled voice solutions. Fixed line growth initiatives will be launched in Hungary nationwide.

Maintain the continuing growth in Asymmetrical Digital Subscriber Line ("ADSL") penetration: In 2004, we almost doubled Hungary's ADSL access base. As the leading broadband provider in the country, we are committed to maintaining the continuing growth in broadband penetration. ADSL is the keystone of our defense of the fixed line access base. Ongoing promotions, a new differentiated product range and broadband-specific content services are developed to generate strong increases in demand, while strategic pricing should allow optimal subscriber and profit growth. We aim to increase our ADSL customer base to 400,000 by the end of 2006.

Defend the leading position in the mobile market: T-Mobile Hungary is the leading mobile provider in Hungary with a market share of approximately 46 percent. The competition in the mobile market is intense, however, with competitors continuing to market aggressively to gain market share. TMH aims to defend its dominant position with four major initiatives.

Pricing strategy: TMH has established a pricing strategy to respond aggressively to competitors' moves while avoiding unnecessary price reductions.

Customer value management: TMH uses a state-of-the-art customer value management system to track and monitor the value of each customer to us. This is an essential tool to retain customers and target customer segments and sub-segments accurately in a market in near saturation. The level of customer service and proactive sales are differentiated according to the value of our customers, enabling TMH to extract maximum value from its customer base, while optimizing retention and acquisition costs.

Focus on postpaid (contract-based) mobile subscribers: Postpaid subscribers have a higher value than prepaid customers due to higher usage and long-term loyalty commitments. Postpaid subscribers represent nearly 30 percent in TMH's customer base and marketing initiatives (e.g. handset upgrades, loyalty program, etc.) are designed to preserve this customer segment.

International product portfolio: The rebranding of the company allows TMH to access the global product portfolio of T-Mobile. Management will leverage this unique benefit to strengthen our competitive position and to improve the value of our services with innovative offers. A wide range of content-driven non-voice products and attractive roaming schemes will be our first offering to demonstrate the additional benefits of the rebranding to our customers.

Exploit all revenue growth and cost reduction opportunities at Maktel: we have also developed a Value Creation Program for the Maktel Group. The program is expected to improve the attractiveness of our offers and sales execution quality in the fixed line residential business, capturing further growth in the still expanding mobile market and optimizing our cost structure.

Continuous improvement of internal efficiency: we will continue the aggressive internal cost reduction program, which has been underway for several years. A set of specific operational efficiency targets has been set in place. For example, we plan to improve the efficiency of our workforce by increasing the fixed lines per employee ratio to over 500 (a ratio that corresponds to the best practice in Western Europe) by the end of 2006. In addition, the headcount of the existing subsidiaries will be reduced by an average of 17.3 percent. We plan to reduce a larger portion of management positions to further improve efficiency. In addition to organizational measures, management plans to seek further cost savings by leveraging our group-wide synergies in procurement.

Leveraging the group synergies

Our position as an integrated telecom company within DT will allow us to create additional shareholder value by taking advantage of group synergies to reduce costs, capture new revenues and improve our competitive positions.

Following the successful rebranding of Westel to T-Mobile Hungary, on January 20, 2005, the Board of Directors passed a resolution to rebrand Matáv to Magyar Telekom and start marketing our services under the global T-brand structure. With the full introduction of the "T"-brand in Hungary, the brand structure of the Magyar Telekom Group is expected to follow the brand structure of Deutsche Telekom, by introducing such brands in Hungary as T-Com, T-Systems and T-Online. The rebranding is expected to have a positive impact on our operations with a new image and stronger brand awareness among our customers.

Another significant element of synergies with the DT Group is the joint venture of T-Systems Hungary Kft. ("TSH"). TSH forms a stable partnership between Magyar Telekom and T-Systems International ("TSI"), which will bring additional value through expansion in the outsourcing and system integration markets and the capture of additional international carrier traffic. We have an agreement with TSI to provide international network and carrier services in the South-Eastern Europe region through our Points of Presence ("PoPs"). We have already established international PoPs in Romania and Bulgaria. Additional PoPs in Serbia and Ukraine are also planned.

Another step that has been taken to achieve cost savings is the implementation of a group-level financial Shared Service Center ("SSC"). The SSC, in addition to short-term cost savings, will provide us with a strategic opportunity. The primary purposes of the SSC are to provide best-in-industry service to internal customers, improve operational efficiencies and reduce costs associated with non-core activities through group-level headcount reduction. It also allows faster integration of future acquisitions.

Growth through acquisitions

The third element in our Value Creation Program is growth through value-accretive acquisitions. In line with our earlier communications, growth through further value-enhancing acquisitions remains our priority.

We look for acquisition targets, which meet the following criteria:

The target company should be located in the South-Eastern region of Europe;

The target company should have good earnings potential in a growing market;

The transaction cannot be dilutive on EBITDA level;

The target company should be a telecommunications firm with a very strong position in the relevant markets;

We look for majority ownership or at least a controlling stake;

Restructuring potential is advantageous; and

Country and regulatory risk should be at an acceptable level.

Our presence in the region, continuing success in managing mobile providers as well as integrated carriers, and proven ability to manage the regulatory environment and restructure former monopolies to

compete successfully in liberalized markets uniquely position Magyar Telekom to repeat success we achieved in the acquisition of Maktel.

In line with our focus on value-accretive acquisitions, Magyar Telekom acquired a 51.12 percent stake in the Montenegrin Telecommunications Company ("Telekom Montenegro" or "TCG") from the government of Montenegro in March 2005. At the same time, we acquired additional 21.92 percent of TCG's shares from minority shareholders.

We are committed to carry out only those acquisitions that increase the shareholder value. If targets with attractive value-creation opportunities do not emerge, we may further increase our dividend payment while maintaining the net debt ratio between 30 and 40 percent.

OVERVIEW OF MAGYAR TELEKOM'S REVENUES AND PRINCIPAL ACTIVITIES

For the years ended December 31, 2002, 2003 and 2004, our total revenues by business segments were as follows:

	Year ended December 31,			Year ended December 31,
	2002	2003	2004	2004/2003
	(in HUF millions)			(% change)
Revenues				
Hungarian Fixed line	336,306	324,552	301,743	(7.0)
International Fixed line	47,793	49,689	45,184	(9.1)
Total	384,099	374,241	346,927	(7.3)
Less:	(1,122)	(1,552)	(907)	(41.6)
Total revenue of Fixed line segment	382,977	372,689	346,020	(7.2)
Less: inter-segment revenues	(14,756)	(14,034)	(11,846)	(15.6)
Fixed line revenue from external customers	368,221	358,655	334,174	(6.8)
Hungarian Mobile	232,612	254,141	263,023	3.5
International Mobile	29,482	31,575	33,734	6.8
Total	262,094	285,716	296,757	3.9
Less: intra-segment revenues	(19)	(20)	(58)	190.0
Total revenue of Mobile segment	262,075	285,696	296,699	3.9
Less: inter-segment revenues	(39,711)	(37,099)	(29,435)	(20.7)
Mobile revenue from external customers	222,364	248,597	267,264	7.5
Total revenue of the Group	590,585	607,252	601,438	(1.0)

Most of our revenues in 2002, 2003 and 2004 were derived from services provided within Hungary, except for the international fixed line and international mobile revenues, which were mainly derived from services provided in Macedonia.

Our business is not materially affected by seasonal variations.

FIXED LINE TELECOMMUNICATIONS SERVICES SEGMENT

In 2004, our fixed line telecommunications services generated revenues of HUF 346,020 million before intersegment eliminations. Fixed line telecommunications services consist of domestic and international services, leased lines, data transmission, cable television and Internet services, telecommunications equipment sales, construction, maintenance and other services.

Hungarian Fixed Line Operations

Domestic Services

Revenues from domestic fixed line voice telephony consist of:

subscriptions, connections and other charges;

outgoing domestic traffic revenues; and

incoming domestic traffic revenues.

Products and Services

Local and Long Distance Calling Services. We provide local, domestic and international long distance telephony services to our fixed line telephony subscribers and to fixed line telephony subscribers in other Local Telecommunications Operator ("LTO") areas.

Digifon Services. The increased level of digitalization of our exchanges permits us to offer value added digifon services, such as call forwarding and call waiting, to a significant number of our fixed line telephony subscribers. These services help increase fixed line usage as they make busy signals and unanswered calls less common.

Shared Cost/Toll Free Numbers. To enable business customers to better meet the needs of their clients, we have introduced a wide range of "blue" numbers, which are shared cost numbers, and "green" numbers, which are toll free access numbers. In addition, we offer the International Freephone Service ("IFS"), which enables subscribers to maintain one (or more) toll free access number(s) in one or more countries outside Hungary. These access numbers are in the same format as domestic toll free access numbers in those countries. Through this access number, the customers outside Hungary may reach the IFS subscriber free of charge. The costs of international calls are paid by the IFS subscriber. We also offer the Universal International Toll Free Number, which is a single toll free access number that can be used to call our subscribers in Hungary from one or more countries outside Hungary.

Voice-mail. In November 1999, we began to offer a voice-mail service. In August 2000, we enriched the service by introducing call return and call capture functions as part of the basic voice-mail service. In July 2001, we introduced voice-mail Short Message Service ("SMS"), which provides an SMS alert to the mobile handset of the customer each time he or she receives a voice-mail message. These services allow better usage of the network, more comfort in using the phone and decrease the ratio of uncompleted calls. As of December 31, 2004, we had approximately 417,000 voice-mail subscribers.

Fixed SMS. In September 2002, we launched a new messaging service called Fixed SMS. The service first operated within Magyar Telekom Rt.'s network and between Magyar Telekom Rt.'s and TMH's network. From February 1, 2003 this service is also available between Magyar Telekom Rt.'s and Pannon GMS Rt.'s ("Pannon") network.

From a fixed line terminal, short text messages can be sent with an SMS-capable phoneset and SMS termination is available for every subscriber. If the addressee does not have an SMS-capable phoneset, the text message is converted and sent as a voice message. The maximum length of an SMS is 160 characters. The service has other useful functions as well: SMS to fixed fax machines, SMS redirection and multi-SMS transmission. Since April 1, 2004, the fixed SMS service has been available between Magyar Telekom Rt.'s and Emitel's networks.

Integrated Services Digital Network ("ISDN"). ISDN allows a single access line to be used simultaneously for a number of purposes, including voice, data, facsimile and video transmission. ISDN also provides higher quality and faster transmission of signals while increasing the bandwidth capacity of the network. The coverage of ISDN is 95 percent of our network. We offer both basic ISDN access lines with two channels and multiplex ISDN access lines with 30 channels. As of December 31, 2004, we had installed 184,358 ISDN access lines with two channels and 5,221 ISDN access lines with 30 channels, amounting to the total of 525,346 ISDN channels. In 2003, we introduced the Turbo ISDN service. This product provides the highest speed dial-up Internet connection (128 Kbit/s). The Turbo ISDN service extended the life-cycle of the mature ISDN product without any additional investment.

Private Branch Exchange ("PBX") Services. We offer PBX services through one of our subsidiaries, BCN Rendszerház Kft. ("BCN Kft.", formerly Matávcom Kft.). As of December 31, 2004, BCN Kft. had leased and sold approximately 22,000 ports. The vast majority of the leased equipment is digital and meets the demands of developing technologies such as ISDN and digitally enhanced cordless telecommunications.

Calling Cards. In 2003, the Hazaszámlázó Calling Card was introduced for residential customers using the Csevegö and Felezö price plans. The subscribers of the Sokatmondó price plan can purchase the Sokatmondó Calling Card, while the business customers subscribing to the Ritmus price plan can purchase Ritmus Calling Cards. These calling cards allow customers to enjoy the discounts provided by their fixed line price plans when making calls from public payphones in Hungary and abroad.

Directory Assistance. We offer directory inquiry services. We received 29.3 million inquiries relating to domestic and 0.5 million inquiries relating to foreign phone numbers in 2004. The domestic directory assistance database includes all fixed line and postpaid mobile subscribers' data in Hungary. We offer a call completion option to Magyar Telekom Rt. and TMH postpaid subscribers, whereby calls may be connected automatically. Our directory services center performed 5.9 million call completions in 2004. We also offer increasingly popular Directory Assistance-Plus ("DA-Plus") service. DA-Plus offers a wide range of information including Yellow Pages, residential classified advertisements, encyclopedia, dictionary-based information, recipes, poems, as well as telephone numbers, postal, e-mail and website addresses without any quantity restrictions. We started to establish our own proprietary database in 2004. The requested information is not only provided verbally, but by e-mail or fax. The tariff of the service is based on per minute usage. The number of minutes billed by the DA-Plus service was approximately seven million in 2004.

Subscribers

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

	At December 31,		
	2002	2003	2004
Lines in service in Magyar Telekom Rt.'s service areas			
Residential lines	2,055,338	2,012,672	2,015,934
Business lines	282,406	261,642	256,321
Public payphones	33,316	28,799	27,059
Total	2,371,060	2,303,113	2,299,314
ISDN channels	511,326	527,728	525,346
Total	2,882,386	2,830,841	2,824,660
Lines in service in Emitel's service areas	79,460	78,638	77,705
Lines installed per 100 inhabitants in Magyar Telekom Rt.'s service areas	38.4	37.5	37.5
Digital exchange capacity as % of Magyar Telekom Rt.'s total exchange capacity	87.1	89.9	92.9

Our domestic fixed line telephony subscribers can be classified into two categories: residential customers and business customers, which include our customers in the public sector. As of December 31, 2004, 75 percent of our access lines was utilized by our residential customers and 24 percent by our business customers. The remaining one percent of access lines was used for public payphones.

The Hungarian government, through its various institutions and departments, constitutes our largest customer group. We develop separate service packages for each of these institutions and departments, as each of them generally has its own annual budget, particular telecommunications needs and responsibilities. From a strategic perspective, however, we consider the Hungarian government a single customer. We offer most of our largest customers, including the government, discounts for services we provide.

Tariffs

We charge fixed line subscribers a one-time connection fee, monthly subscription charges and call charges based on usage. A call charge contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration. In accordance with the Act LXXXVII of 1990 on Pricing (the "Pricing Act"), as modified by the Act on Electronic Communications, the Minister, together with the Minister of Finance, is responsible for establishing the maximum tariffs for universal services. We may, however, offer services at prices lower than those established by the Minister.

Our one-time connection fee and monthly subscription charge are different for residential and business customers. We do not charge our business and residential customers different traffic tariffs if they use the same price plan. We charge the same tariffs on analog telephone lines and on ISDN lines.

In 2004, we increased the number of price plans to allow customers in different market segments to choose plans that best suit their calling patterns. These price plans also served as a tool to maintain our customer base in the fully liberalized market as those customers who select us as the operator for every traffic direction (local, long distance and international) receive the highest discounts.

We offer the following primary price plans:

Bázis price plan. This price plan is our standard plan without any discount.

Minimál price plan. This price plan was established for residential customers with analog lines who use their phones less often than average users but want to be available for incoming calls and would like to pay lower monthly fees. By the end of 2004, we had over 443,000 customers under this price plan. As a result of change in the regulatory environment, however, we terminated the sales of the Minimál price plan on January 1, 2004. Customers who had subscribed to this price plan prior to December 31, 2003 may maintain their Minimál subscription. However, we will not offer this price plan to new customers. Consequently, for low-usage residential customers, our best product offering is now the Felezö price plan.

Felezö price plan. On February 1, 2003 we launched the Felezö price plan. The Felezö price plan fulfills the conditions of the universal service provision which is obligatory for us by the law. Under this plan, half the monthly fee is applied toward call charges and subscribers can initiate calls without the call set up fee. Calculation of the telephony costs is also easy since the local and the domestic long distance numbers can be called at the same per minute rate. The international, fixed-to-mobile and Internet per minute fees of the price plan are the same as those under the Bázis price plan. As of December 31, 2004, approximately 500,000 subscribers were enrolled in this price plan. From October 1, 2004, the subscribers of the Felezö price plan who meet certain economic criteria are eligible to receive a government subsidy. The government pays HUF 1,000 towards the monthly fee of the Felezö price plan for these customers.

Üzleti Felezö price plan. This price plan was launched on June 1, 2004. The Üzleti Felezö price plan enables business customers to apply half of their monthly fees towards call charges. The price plan does not contain any call set up fee, but traffic fees are charged per minute. As of the end of 2004, over 10,000 customers subscribed to this package.

Csevegö price plan. On December 27, 2001, we launched the first price plan for residential customers that offers increasing discount for longer calls. The discount is 20 percent from the 5th minute and 30 percent from the 10th minute up to the 60th minute of the call. The discount is valid for all calls all day. From June 16, 2003, half the monthly fee can be applied toward Internet usage if customers access the Internet via our Open Internet service. The price plan also contains 20 free fixed SMSs per month. In 2004, it was the second most popular price plan with over 408,000 customers as of December 31, 2004.

Kontroll price plan. This is our first price plan with no monthly subscription or call set-up fees for residential customers with analog lines. Subscribers may chose a 30-day card for HUF 3,700, a 60-day card for HUF 7,400, a 90-day card for HUF 10,500, or a 180-day card for HUF 19,500. The card can be refilled during its period of validity or within 10 days after expiry. This price plan is similar to mobile prepaid offers.

Sokatmondó price plan. We launched this price plan on October 1, 2002. As of December 31, 2004, we had approximately 82,000 customers under this price plan. Signing a definite-period pre-selection contract is a precondition for this offer. The elements of the price plan are as follows:

Peak period lasts until 3 p.m. in Magyar Telekom (i.e., non-LTO or non-mobile) directions; and until 6 p.m. in LTO and mobile directions;

30 SMSs free of charge per month (in Magyar Telekom, TMH and Pannon directions);

60 minutes free Internet access (in cooperation with T-Online Hungary); and

Sokatmondó Digifon price plan (with caller identification function).

The subscribers of the Sokatmondó price plan can order the Sokatmondó calling card, with which calls can be originated at the per minute rates of the price plan from our service area and from abroad.

Ritmus price plan. We offer this price plan for residential and business customers who mainly place calls in peak hours. The price plan is available for customers with analog or ISDN lines. Signing a definite-period pre-selection contract is a precondition for this offer. By subscribing to this price plan, customers receive discounted per minute rates.

XL supplementary price plan. On December 3, 2003, we introduced the XL supplementary price plan which may be ordered in addition to the Bázis, Csevegö or Sokatmondó price plan. For a monthly gross fee of HUF 990, customers using the supplementary price plan may make calls without usage fee or call set up charge for local calls up to the first 60 minutes of a call (the discount is only offered for voice calls). As of the end of 2004, over 101,000 subscribers were under this price plan.

XXL supplementary price plan. On September 1, 2004, we introduced the XXL supplementary price plan which may be ordered in addition to the Bázis, Csevegö or Sokatmondó price plan. For a monthly gross fee of HUF 1,750, customers using the supplementary price plan may make calls without usage fee or call set up charge for local and long distance calls in our service areas up to the first 60 minutes of a call. The discount is valid only for voice traffic. As of the end of 2004, approximately 38,000 subscribers were under this price plan.

V8 - Vállalkozói price plan. On November 22, 2004, we introduced the V8 price plan, designed primarily for small business customers. This plan has no additional monthly fee and does not charge any call set up fees. The billing is minute based. The price plan provides over 30 percent discount on the minute fees for every direction compared to the Bázis price plan. As of December 31, 2004, over 3,700 customers were under this price plan.

Magyar Telekom Open Internet service. On June 16, 2003, we launched our Internet service based on per minute pricing. Our Open Internet service offers Internet access for a per-minute fee without any monthly fee, call set up charge or registration fee. The service is available for every Magyar Telekom subscriber. In addition, Csevegö price plan subscribers can apply half of their monthly fee toward this service. The users of our Open Internet service exceeded 90,000 as of the end of 2004. The Open Internet service accounted for 20 percent of the overall increase of the dial-up traffic revenue in 2004. As a result of the extensive marketing campaign launched in December 2004, Magyar Telekom Rt. became the second largest company in the dial-up Internet market.

Public Telephones

As of December 31, 2004, Magyar Telekom Rt. operated 27,059 public payphones, representing a penetration rate of approximately 3.6 per 1,000 inhabitants in Magyar Telekom Rt.'s service areas. The Act on Electronic Communications modified the requirement to provide public telephone stations from one pay station per 500 inhabitants to one pay station per 1,000 inhabitants. The traffic tariffs charged for calls from public payphones are at a premium to those charged to fixed line subscribers.

International Telephone Services

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

Products and Services

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

International toll free service was launched in 1998. This service enables the caller to make international calls free of charge to and from 36 countries, while the call charges are covered by the subscriber of the toll free number. Universal international toll free service was launched in 2003. This service is available from 21 countries and enables the subscribers to be called on a unique universal number free of charge from abroad.

In June 2000, we introduced the international prepaid calling card, "Barangoló", which allows customers to make phone calls, including IP based calls, in approximately 40 countries. This service enables customers to call from touch-tone payphones in Hungary and abroad.

Tariffs

The call charge for an international call contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration. On September 1, 2002, we increased the number of international tariff zones from six to eleven, to better differentiate the rates of the international fixed line and mobile calls. International tariffs decreased on average both in 2003 and 2004 and we expect to continue to lower our international tariffs to stimulate usage.

Settlement Arrangements. Under bilateral settlement arrangements, we pay other carriers for the use of their networks for outgoing international calls and receive payments from other carriers for the use of our network for incoming international calls. In Europe, such settlement arrangements fall under the general auspices of the International Telecommunications Union. Settlement payments, which are generally denominated in Special Drawing Rights ("SDR"), are calculated using a currency basket in which U.S. dollars have the greatest weight. Due to the large exchange rate fluctuations of the SDR caused by the recent volatility of the U.S. dollars, we started to shift our accounting rate agreements to euro-based arrangements. As our important European and North-American partners supported this change, we will continue these efforts in 2005 as well. New international carrier partners prefer to use the euro as a settlement currency.

International Telecommunications Hub

We believe that Hungary is geographically well positioned to serve as a telecommunications gateway between Eastern and Western Europe. We have two state-of-the-art international gateways as well as fiber optic cable connections serving 12 border crossings. These fiber optic cable connections use synchronous digital hierarchy transmission facilities. We have X.25 links, which are used for packet switched data transmission with 83 international networks. We also have ISDN connections with 54 international networks. To increase the utilization of our transmission network, we offer attractive price schedules for dedicated transit services through Hungary. We have launched our own Dense Wavelength-Division Multiplexing ("DWDM") backbone network and are DT's partner in Delivery of Advanced Network Technology to Europe ("DANTE"), which provides 10 Gbit/s transmission path interconnecting Budapest and Vienna and connection to the European research and educational network, GEANT.

To seize the opportunities presented by the liberalization of the telecommunications market in Romania, we established interconnection arrangements with major Romanian alternative service operators and network service providers to offer transit services towards Western Europe. In addition, we use our own point of presence in Austria, which enables us to engage in telephone and Internet business with alternative telecommunications carriers located in Vienna. We are present at the Vienna Internet Exchange (with dedicated circuit for Internet data exchange) and have peering arrangements with approximately 60 Internet Service Providers ("ISPs") there. We have direct Internet peering connections with Serbia and Slovakia and provide high-capacity international Internet transit service ISPs in Ukraine, Bosnia-Herzegovina and Macedonia.

Leased Lines

We are the principal provider of leased lines in Hungary.

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

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

We offer a broad variety of standard analog and digital lines for lease, including two-wire and four-wire analog lines and digital lines with capacities from 64 Kbit/s to 155 Mbit/s. We also offer high capacity customized digital lines to other telecommunications providers.

Flex-Com. Since 1996, we have offered Flex-Com, domestic and international digital leased lines with managed back-up systems that are dedicated to data transmission. In 1998, we launched the Flex-Com Network Management Service (Virtual Switched Network) network management system and ISDN-Flex and Voice-Flex services. In 1999, higher quality (Gold and Silver), secure access, and quick installation (Express, Profi) Flex-Com services were introduced. The Gold and the Silver quality services increase the annual availability to 99.9 percent and 99.7 percent respectively, as compared to the 99.5 percent annual availability of the Flex-Com basic service. The secure access provides two-way subscriber access through separate routes or transmission media at one termination point of the connection. The quick installation services are connected within ten days (Express) or within five days (Profi) as compared to the normal delivery time (20 days). In 2000, we launched two new services. Flex-Com high-speed (E3) access service provides 34 Mbit/s central access for the main site of a large enterprise network. City-Voice service is a version of the Voice-Flex service, which offers hot-line voice and fax communication capabilities on the managed leased line network between two customer premises.

We further widened the range of access options in 2002. We developed and launched the outdoor Flex-Com subscriber access and the Kiloflex P-type subscriber access. The outdoor access facilitates outdoor installation of terminating equipment of lines with maximum 1,984 Kbit/s, focusing on the demands of mobile service providers. In the speed range from 192 Kbit/s to one Mbit/s, Kiloflex P provides a cheaper access than the previous subscriber access.

In 2002, we launched the Service Level Agreement ("SLA") report service of Flex-Com and Frame-Flex, which offers monthly and annual reports of the SLA parameters specified in the customer contracts. The SLA report, as an additional service, shows our customers the monthly and annual fulfillment of the commitments identified in the SLA. The reports are generated automatically to monitor and check regularly the actual service quality. In 2003, we launched the Web SLA service, which provides SLA reports through the Internet.

In 2004, we launched new promotions to defend our market share. For existing wholesale customers, we offered price discounts for further purchases, and for retail customers spare capacities were offered for new connections. Our primary goal is to increase the number of connections to utilize our resources fully.

Despite these efforts, the number of Flex-Com connections decreased from 11,480 as of December 31, 2003 to 10,467 lines as of December 31, 2004.

Frame-Flex. We also use our managed leased line network to offer Frame-Flex, a public frame relay service that is particularly suited to customers who transmit data in bursts, such as connections between local area networks. As of December 31, 2004, we had 585 Frame-Flex connections. In 2000, we introduced LANConnect, a frame relay based managed router service. LANConnect is primarily targeted at small and medium size enterprises allowing them to seamlessly interconnect their Local Area Networks ("LANs"). In 2004, we offered spare capacity promotion for our customers to utilize our resources fully.

High Speed Leased Line ("HSLL"). The HSLL service provides permanent, digital, transparent, point-to-point leased line service between service access points ("SAPs") which meets the European Telecommunications Standards Institute ("ETSI") Open Network Provision ("ONP") specifications. The connections are established by a service provider according to the needs of its customers. Transmission rates provided by the HSLL service are 2, 34 and 140 Mbit/s. In 2001, we enlarged our HSLL services portfolio by offering new rates of 45 and 155 Mbit/s. We increased our HSLL connections to 930 by December 31, 2004 from 522 at December 31, 2003.

As an addition to the High Speed Leased Line portfolio, we introduced a Wavelength Division Multiplexing ("WDM") technology based premium service, Gigalink, which provides an even higher speed (622 Mbit/s) leased line service to business customers and to other service providers. In 2004, we expanded the speed of Gigalink from 2.5 Gbit/s to 10 Gbit/s for the Campus backbone network (a link between universities and academic institutions).

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

Data Transmission and Related Services

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

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

Internet. T-Online Hungary, our fully owned ISP subsidiary, offers Internet services based on dial-up, ADSL technology as well as access through cable television, wireless LAN ("WLAN") and leased line to provide residential and business customers with narrowband or broadband Internet services at affordable prices.

In 2004, T-Online Hungary increased its subscriber base by 26.3 percent to 266,020. T-Online Hungary is the largest Internet service provider in Hungary with an estimated 42 percent market share based on the number of dial-up subscribers. The number of T-Online Hungary's broadband (ADSL, cable television and WLAN) customers has nearly doubled and reached 153,475 as of December 31, 2004 compared to 77,760 a year earlier.

In 2004, the number of Internet users increased dynamically. Internet penetration rate among the population aged 14 and above reached 26 percent in 2004 compared to 22 percent in 2003. By the end of 2004, 15 percent of Hungarian households were connected to the Internet compared to 12 percent at the end of 2003. Similarly, Personal Computer ("PC") penetration rate also improved, providing a basis for further growth potentials. In 2004, 35 percent of the Hungarian households owned a PC compared to 31 percent a year earlier. Approximately 700,000 existing PC households without Internet connection represent a strong basis for further growth. T-Online Hungary is committed to accelerate Internet penetration growth and has invested a significant amount of resources to develop attractive and innovative content, such as [origo] Téka video-on-demand and Zeneáruház (music download).

The accelerated broadband expansion in Hungary will be a basis for further development in contents available on the Internet, further attracting users interested in more content and services. While only 10 percent of narrowband (dial-up) subscribers use the Internet for music download and only 5 percent for video download, 39 and 33 percent of broadband subscribers use the Internet for these purposes, according to T-Online Hungary's consumer researches. Market data shows that an increasing number of households skip the dial-up technology and start to use Internet with broadband straight away.

[origo], the most frequently visited portal in Hungary, has also contributed to the growth of T-Online Hungary. The number of page impressions ("PIs") increased significantly in 2004. This strong growth was a result of introduction of new services and contents, including [origo] Téka and a new Automobile section. T-Online Hungary is committed to the social responsibility and has made [origo] accessible to the blind and near-sighted.

Other important developments concerning T-Online Hungary during 2004 included:

In February 2004, T-Online Hungary launched a new security product, T-Online Hungary Internet Security, with F-Secure as a partner. The software offers various security features including virus protection, firewall, spam filter and parental control;

In April 2004, T-Online Hungary launched a new broadband content portal ([origo] Play), that features videos, music download, online radio and photo gallery;

In June 2004, T-Online Hungary introduced a high bandwidth ADSL product (ADSL Play) for the high-end residential segment;

From June 2004, T-Online Hungary simplified the dial-up "Kombi" package product, offering an easy-to-understand dial-up package. The Kombi product provides 15- or 40-hour dial-up internet access without additional call charge;

In July 2004, T-Online Hungary introduced WLAN equipments packaged with ADSL access products to the residential market;

In November 2004, T-Online Hungary increased the ADSL and CableNet download and upload bandwidths based on Magyar Telekom Rt.'s wholesale broadband offer. The upgrade was available for all existing users as well as new customers;

In December 2004, T-Online Hungary developed a software for families with small children, containing a family-friendly web browser, special content, content-filtering tool (parental control), and online media stream of the popular Minimax TV channel;

In December 2004, T-Online Hungary launched Video-on-Demand ("VoD") service, providing movies on pay-per-view basis to extend the broadband content portal; and

In December 2004, T-Online Hungary opened the new Datacenter room ("Adatpark"), which doubled the capacity of the server co-location service.

Datex-P. We offer Datex-P, a packet-switched data transmission service based on the X.25 protocol. As of December 31, 2004, we had 3,692 Datex-P terminals compared to 3,636 at December 31, 2003. The service provides low to medium speed domestic switched data communications services with international connectivity to business customers. As a result of the proliferation of new technologies, growth in the number of subscribers has stopped. To extend the lifecycle of the product and maintain profitability, network optimization and cost reduction were major objectives in 2003. In 2004, we assessed and commenced migration of customers to other data transmission services. Full service withdrawal is planned for 2007.

rEDInet. This service allows editing of business documents electronically, quickly, accurately and with full security. The technology of the Electronic Data Interchange ("EDI") service is used worldwide. We also provide professional training and consultation services to the users of our rEDInet service. The rEDInet covers more than 80 percent of the traditional EDI market in the Fast Moving Consumer Goods ("FMCG") sector. In recent years the growth of the traditional EDI market has slowed in terms of new participants, but the number and type of transferred messages are growing. Further growth opportunities may appear with introduction of e-invoice solutions and Internet-based services with lower costs. The Internet-based solution allows customers of the Small Office/Home Office ("SOHO") and Small and Medium size Enterprises ("SME") segment without IT background to become a member of the electronic trading community.

Magyar Telekom ADSL. ADSL is a continuous, high-speed Internet access service based on the Asymmetric Digital Subscriber Line ("DSL") technology. The service offers cost efficient broadband Internet access together with telephony service over existing copper wires. We sell these services mainly on a wholesale basis to ISPs, which in turn distribute the services to residential and small business customers. The service has been available in certain parts of Budapest since September 1, 2000. In 2004, this service had significant growth with the number of ADSL connections reaching 203,654 by December 31, 2004 from 103,564 at December 31, 2003.

In 2003 and 2004, we implemented a major infrastructure expansion project to accomplish our Internet market goals. A large amount of investment was used for the roll out of broadband Internet. As a result of these steps, 175 towns were connected to the service in 2003 and over 380 towns by the end of 2004. By December 31, 2004, our ADSL coverage reached 79 percent of our total lines. In our service area, every third Internet user accesses the Internet via ADSL line and an increasing proportion of new residential customers select ADSL as their first Internet access.

To better satisfy customer demand, we increased the maximum download speed of our ADSL accesses at no extra charge in November 2004. As a result, the maximum download bit-rate was increased by one third for the cheapest price plan and doubled for all other price plans at the same prices, terms and conditions. The higher bandwidth contributes to the faster roll out of ADSL and also encourages customers to download enriched broadband content. To support this trend, we introduced new broadband services, such as the [origo] Play service, which offers music download in cooperation with Warner and EMI, and a new video-on-demand service.

Small town ADSL program. The successful "Small town ADSL program", launched in 2003, made ADSL access available in small towns and villages that are often economically less developed. The goal of the "Small town ADSL program" is to identify and serve towns and locations that show a significant interest in ADSL. In the first phase of the program (started on June 23, 2003), prospective users from 42 locations were invited register their requests. The list of towns included in the program is continuously expanding. So far, 279 towns have signed up for the program and the service has been established for 275 of these towns as of the end of 2004.

Volume-dependent ADSL. On December 13, 2004, we started negotiations with our ISP partners to plan for the introduction of a new type of wholesale ADSL. In addition to the current flat-rate wholesale offers, we will enable our ISP partners to use the ADSL service with charges based on the volume of the ADSL user traffic. This new pricing structure enable the ISP partners to offer a much wider choice of services better suited to the end users' requirements.

Magyar Telekom Non-profit Information and Training Center ("NIOK") joint tender (free ADSL access for non-governmental organizations). More than 400 non-governmental organizations have received free ADSL access for one year under our social responsibility program called "Magyar Telekom gives back". We invited applications in November 2004 from non-governmental organizations for this program. Organizations that do not yet have an ADSL line were eligible to apply. The free service is worth about HUF 130,000 for each organization. We have thus committed to contribute more than HUF 50 million to non-governmental organizations. Our aid helps these organizations to perform their tasks more efficiently, publicize their activities to more people and have faster access to the information.

Plug and Play ADSL. Plug and Play ADSL is a package product that includes an ADSL access with multimedia PC, on-site installation and support.

Satellite DSL. Satellite DSL is a broadband Internet connection via satellite. This service can provide a high-quality access to the Internet for customers who live in areas not yet covered by the ADSL service. The Satellite DSL service ensures a broadband Internet connection via satellite in areas where no other broadband Internet access is available. With the help of satellite connections, the service multiplies the download speed of the already existing Internet access up to 768 Kbit/s.

Magyar Telekom EasyNet. On February 21, 2003, we launched our EasyNet product, a wireless broadband Internet solution based on the Wireless Fidelity ("Wi-Fi") technology for public site owners (e.g., hotels, conference centers and restaurants). It does not contain end user authentication, and anyone may take advantage of the broadband Internet service with an appropriate end user device in areas with radio coverage.

Magyar Telekom EasyNet Plusz was launched on August 1, 2003. This service provides significant additional capabilities compared to those offered by Magyar Telekom EasyNet. The most significant feature is the end user identification, as well as the use of prepaid cards, which allow the use of the wireless broadband Internet service. EasyNet Plusz cards are available in three levels of access time (1-hour, 5-hour, 24-hour) and may be used at any time until the expiration of the card. At the end of 2004, there were 62 public hot spot sites in operation (13 hotels, 21 T-Ponts and 28 others).

Magyar Telekom DataLink. In 2004, we launched a new data transmission product. It offers technology independent data transmission between business customers' locations. The customer only needs to define three main parameters, bandwidth, SLA and interface. With the introduction of this service, we can better utilize our spare data transmission capacity. This service provides data connection below 2 Mbit/s, with X.21 or Ethernet interfaces.

IP Connect. In September 2000, we introduced IP Connect service, a complete solution for ISPs providing transport and access facilities to IP traffic. It includes the provision of ports in the service area, required for the subscribers of ISPs to dial-in from analog or ISDN lines. The service also enables leased line access, and ensures that traffic will be forwarded to both domestic and international switches as well as to the domestic switch of a particular ISP. The domestic switch of the ISP is connected to our IP network via a leased line. To maintain our market share and competitive position, a new product offering, called Symmetrical Internet was introduced in 2003, which includes access and IP/Internet service. After the introduction of this new service, many of our customers switched from IP Connect to Symmetrical Internet.

IP Complex Plus. IP Complex Plus is an IP based Virtual Private Network ("IP-VPN") service. IP Complex Plus service is offered to retail and wholesale customers having multiple remote sites. This service enables them to establish data traffic between sites without the need of setting up "point-to-point" connections between two sites. Customers' VPNs are secured since they remain separated from each other. The development of supplementary services, such as ISDN backup, integrated voice/data, ADSL/Single-Pair High-Speed Digital Subscriber Line ("SHDSL") access and dial-up access to IP-VPNs make this product more attractive to a growing number of business customers. In 2004, monthly and online report services were introduced to allow users to check the service quality. In addition, we started the upgrade of the integrated voice and data product.

MultiLAN. Our system integration services are designed primarily for business customers with separately located branch offices. They include the installation of LANs at customer premises and the provision of Wide Area Network ("WAN") services. We provide integrated network management, fault clearance and customer support for the LAN and WAN segments.

Magyar Telekom Háttértár. Magyar Telekom Háttértár product was launched in October 2004. Users of this service can automatically back-up files on their PCs on our background server. If customer's PC crashes and the content of the hard disk cannot be recovered, the back-up files on our server may be accessed.

International data products. We provide signaling links for mobile operators to facilitate international roaming. We also sell international leased lines, including international managed leased lines, international ISDN, X.400, X.25 and telegraph services. The sales of international leased lines are steadily growing, partly due to the introduction of one-stop-shopping agreements, whereby customers can order from and pay for the service at one end-point of the connection, which eliminate the need to deal with multiple service providers. International Internet connectivity was enhanced in 2004 to provide services for Internet service providers. By the end of 2004, the capacity of international Internet connections reached 3 Gbit/s. Since the end of 2003, we no longer provide international telex services.

Fixed Line Telecommunications Equipment Sales

We distribute an extensive range of telecommunications equipment, from individual telephone sets to facsimile terminals, PBXs and complete network systems, through a network of customer service centers. In addition to stand-alone telephone-set sales, we offer various packages combining telephone-sets with telephone lines and price plans.

Cardnet Rt. sells point of sale terminals. BCN Rendszerház Kft. (formerly Matávcom Kft.), our fully owned subsidiary, sells PBX equipment.

We do not manufacture telecommunications equipment but resell and lease equipment manufactured by other companies.

The telecommunications equipment sector is highly competitive and characterized by rapid technological innovation. We believe that the supply and service of telecommunications equipment are integral part of being a full service telecommunications provider and are necessary for the expansion of our customer base. In addition, these activities permit us to ensure that technologically advanced equipment required for new services is available in Hungary.

Other Revenues

Other revenues include cable television, construction and maintenance services and other miscellaneous revenues.

Our cable television ("CATV") group consists of three entities providing various cable television services in Hungary. The asset management holding company of the CATV business is Invested Rt. The most significant company of our CATV group is T-Kábel Hungary, which began providing cable television services on January 1, 1999.

Through network development and acquisitions, our CATV group significantly increased its number of cable television customers during the past four years. The CATV group had approximately 384,000 subscribers as of December 31, 2004, out of which T-Kábel Hungary had 282,000. At December 31, 2003, the CATV group had approximately 362,000 subscribers, out of which T-Kábel Hungary had 263,000. Our CATV group is the second largest cable television provider in Hungary.

T-Kábel Hungary offers 44 television and radio channels in three program packages in its network. As a result of the price based competition in the cable television market in Hungary, especially in Budapest, new customers are often connected with low connection fees. Where the networks allow, our CATV firms in cooperation with ISPs offer broadband Internet services. In most cases, CATV firms provide a network service for ISPs. The number of Internet subscribers through our cable television network was approximately 16,000 on December 31, 2004. T-Kábel Hungary's cable television activities benefit from our long-term relationship with the customers, our thorough market knowledge as well as our strong brand name. Our main goals in this area are to increase market share through further acquisitions, connect additional customers within existing service areas, improve the quality of network and increase Average Revenue Per User ("ARPU").

In 2002, we introduced the Audiofix (Drop Charge) product, which is an Intelligent Network ("IN") premium rate service enabling content providers to offer content services for fixed call rates. The product is mainly used in the media's call-in programs. The product has been very successful due to the introduction of reality shows and other interactive programs on Hungarian television channels.

We construct fixed line telecommunications networks and offer network maintenance services to other telecommunications operators in Hungary. These construction and maintenance services are ancillary to the construction and maintenance of our networks.

We carry out our construction through subcontractors. The majority of construction revenue is derived from optical network construction, network construction related to subscriber connections and project planning. In addition, our fully owned subsidiary, BCN Rendszerház Kft. is also engaged in a full range of network construction activities.

Magyar RTL Televízió Rt. ("M-RTL") is a Hungarian television broadcast company, in which Magyar Telekom has a 25 percent effective share of ownership. M-RTL is entitled to provide commercial television programs but not to engage in broadcast diffusion or distribution activities. M-RTL has a concession for a period of ten years with an option for a five-year extension. The Program Provision Agreement was signed on July 9, 1997, being the starting date of the license. M-RTL operates a channel under a brand name, RTL KLUB.

Since its launch in 1997, RTL KLUB has rapidly established a strong position in Hungary's television market, being the market leader for the last four years. Market share among the targeted age 18-49 audience rose substantially from 1997 to 2004, from 21 percent to 32 percent for the whole day and from

20 percent to 37 percent for the prime-time (between 7 and 11 p.m.). M-RTL has successfully converted its leading audience result into television advertising market share.

RTL KLUB seeks to maintain and increase audience share through investing in local productions, as well as successful internationally licensed programs, and through its continued long-term relationships with major film distributors, including Warner Brothers, Fox, Buena Vista and Columbia. M-RTL is strategically concentrating on sport events, such as Formula One races, Paris-Dakar rally, National League and National Team football matches and boxing. In response to the main competitor's launching of "Big Brother", M-RTL started its own reality show: "Való Világ" (Reality World) in 2002. Due to the success of the program, RTL KLUB broadcasted the second and the third series of this reality show in 2003 and 2004. Való Világ enabled M-RTL to generate increased non-spot (prime-rate audiotext and SMS) revenues and contributed to the development of RTL KLUB brand name.

Macedonian Fixed Line Operations

In December 2000, we, on behalf of a consortium, reached an agreement with the government of Macedonia to purchase 51 percent of Maktel on its privatization. The closing of the transaction took place on January 15, 2001 whereby we paid EUR 343.3 million on behalf of the consortium in accordance with the agreement. The 51 percent ownership acquired by us was contributed to a newly established Macedonian holding company, Stonebridge.

For further details on the Maktel acquisition, see "Item 10 Material contracts".

Maktel is the primary fixed line service provider in Macedonia. Its exclusive rights in fixed line telecommunications services expired in December 2004. These exclusive rights included local, national and international long distance public voice services, voice over IP services, leased line services and building and operating public voice network services. Maktel's objectives for the forthcoming year are to be a leading provider of technology in Macedonia and to provide quality services with attractive prices to prepare for future competition.

For the past three years, Maktel's major operational goals were to digitalize the fixed line network and to increase the number of subscribers. The digitalization rate reached 100 percent by the end of 2003. Maktel had 583,776 analog fixed lines and 42,082 ISDN channels as of December 31, 2004, and fixed line penetration reached 29.0 percent in Macedonia.

Subscribers

The following table sets forth information regarding the total fixed access lines and penetration rates of Maktel:

	At December 31,		
	2002	**2003**	**2004**
Number of fixed lines			
Residential lines	510,837	524,632	524,722
Business lines	58,787	57,353	56,329
Public payphones	2,239	2,729	2,725
Total	571,863	584,714	583,776
ISDN channels	22,350	34,522	42,082
Total	594,213	619,236	625,858
Lines installed per 100 inhabitants in Maktel's service areas	28.0	29.0	29.0
Digital exchange capacity as % of Maktel's total exchange capacity	96.3	100.0	100.0

Maktel has a 75 percent market share in the Macedonian Internet market. The number of Internet subscribers and the time they spend on the Internet are gradually increasing. Maktel provides Internet access via the public switched telephone network, leased lines and ADSL. By the end of 2004, Maktel had 64,944 Internet customers. The growth in the Internet subscribers was fostered by the sale of ADSL service, which had nearly 2,500 subscribers as of December 31, 2004.

Historically, Maktel, like government-owned operators in other countries, maintained relatively low domestic charges and high tariffs for international calls. Since November 1999, Maktel has been gradually rebalancing its tariffs in accordance with its long-term rebalancing strategy. International tariffs are expected to decrease further, bringing them in line with the EU standards after the liberalization. Local tariffs and basic access charges are expected to increase to reflect costs, but Maktel will not seek to exploit the maximum increases allowed by the regulation to keep the rates affordable to its customers.

MOBILE TELECOMMUNICATIONS SERVICES SEGMENT

Our mobile telecommunications services generated revenues of HUF 296,699 million in 2004 before intersegment eliminations.

Hungarian Mobile Operations

Until June 30, 2003, we provided mobile telecommunications services in Hungary through two subsidiaries, TMH and Westel 0660. On June 30, 2003, Westel 0660 ceased to provide analog cellular telecommunications services and was merged into TMH on November 30, 2003. TMH is now the sole subsidiary of Magyar Telekom providing mobile telecommunications services in Hungary.

As of December 31, 2004, TMH accounted for estimated 46.2 percent of the total Hungarian mobile telephony market in terms of subscribers. The penetration rate of mobile telephone services in Hungary increased from 48.7 percent at December 31, 2001 to 86.4 percent at December 31, 2004.

On March 22, 2004, our Board of Directors took the decision to rebrand Westel Mobil Távközlési Rt. ("Westel") to T-Mobile Hungary. The official name of Westel has changed to T-Mobile Hungary Telecommunications Co. Ltd. (in Hungarian: T-Mobile Magyarország Távközlési Rt.) from May 3, 2004.

TMH and T-Mobile International (the mobile telecommunications division of DT) have acted in close cooperation for a number of years. The cooperation both in the area of procurement and development of new technologies and services allows TMH to offer its customers a wider range of services and equipment for more competitive prices. The rebranding was an important step in cultivation of the service synergy potentials between TMH and the T-Mobile Group. T-Mobile International is one of the largest international groups of mobile operators and is the only mobile communications company providing a seamless transatlantic service to its customers.

TMH's rebranding will allow TMH to offer valuable services under a revitalized corporate image. We believe that TMH's closer affiliation with T-Mobile International will allow it to provide its subscribers a whole new range of innovative products and services, including access to services provided by other T-Mobile branded carriers operating in other countries.

Immediately after the rebranding, TMH announced its intention to join FreeMove, the largest mobile alliance in the world founded by T-Mobile International, Orange, the Telefonica group and TIM. The objective of the alliance is to offer seamless mobile services to its customers through favorable international roaming pricing, coordination of services, joint terminal procurement and other cooperative measures.

We received favorable responses from the public for our TV commercials, marketing materials and corporate images featuring the new brand name. In addition, the T-Mobile brand became well-known in Hungary in a shorter period than we originally expected. According to the survey carried out by GFK Hungária, the aided brand awareness has reached 100 percent by November 2004 only six months following the rebranding.

Westel, the predecessor of TMH, commenced offering commercial GSM digital mobile telecommunications services on March 31, 1994, pursuant to a concession awarded in November 1993. GSM affords high quality digital transmission and is the dominant digital mobile telecommunications standard in Europe.

TMH offers basic GSM voice telephony services and a number of value added services for retail and corporate customers. TMH launched General Packet Radio Service ("GPRS") in 2001, Multimedia Message Service ("MMS"), Video Streaming, Mobilbank and mobile purchase in 2002, Enhanced Data rates for GSM Evolution ("EDGE"), WhoCalled, WLAN in 2003 and several new value added services, such as Koktél Multimedia Service Packages and Melody in 2004.

In 2004, TMH continued to enhance its value added services, introduced several new products, increased the penetration and usage of the existing products and extended the access of some of its domestic products abroad:

International roaming service was available for TMH subscribers in 319 networks in 144 countries as of December 31, 2004, of which 106 networks in 53 countries were available for prepaid customers and 76 GPRS networks in 41 countries for postpaid customers.

In 2004, TMH further developed its SMS service by launching packages of 15, 25 and 80 SMSs for customer segments with different SMS usage patterns. SMS penetration and usage remained stable during the year.

In line with the increase in the number of MMS-capable handsets in the market, TMH experienced a strong boost in MMS penetration and traffic. The number of mobile-originated MMSs in 2004 was more than four times the amount in 2003.

The scale of TMH's GPRS portfolio spans from Wireless Application Protocol ("WAP") Start (users pay only traffic fee) through service packages with daily or monthly fee with bundled traffic to GPRS300 (300 Mbyte WAP or Net traffic included in monthly fee). TMH has reached more than 10 percent of its postpaid customer base with GPRS service and expects further increase in GPRS penetration and traffic.

In September 2004, TMH introduced KoktélMini and KoktélMaxi, two multimedia packages with bundled SMS, MMS, GPRS traffic, mail notification SMSs, contentSMS and contentMMS subscription (the latter two only for postpaid customers) for a monthly fee. These packages soon became very popular among the customers.

On September 1, 2004, TMH launched "Melody", a service that allows subscribers to set virtually-downloaded sound bites (e.g., music) as ringback-tones (i.e., the ringing sound a caller hears before the call is answered) for their mobile phones. Melody was one of the most successful non-voice products introduced in 2004.

TMH strengthened its content services in 2004. TMH's customers can register their interest to several content SMS and MMS categories like news, sports, weather, entertainment and horoscope. TMH's t-zones WAP portal (introduced in June 2004) offers a large quantity of its proprietary and third-party content, including news, chat and other downloadable content (logos, ring-tones, Java games, etc.). The popularity of this portal grew continuously during 2004 and the daily average number of visitors reached 40,000 to 45,000. Premium-service SMS traffic was quite substantial in 2004 as well: TMH launched a new range of access numbers for premium-price SMS and voice services.

In 2004, TMH significantly widened the range of products that can be purchased via WAP or by SMS. Using mobile purchase service, customers can buy various products and services offered by TMH and third-party vendors. We expect to see strong growth in sales of products such as cinema ticket, parking, DVD, CD, flower and travel insurance.

In 2004, TMH introduced a new generation of its mobile banking service, Multibank, which allows customers to manage their bank account and pay their utility bills with their mobile phone. A superior level of security and flexibility are the main characteristics of the service.

For corporate customers TMH offers a full range of telecommunication services. The most important new service launched in 2004 for corporate clients was TeleMátrix, a complex Virtual Private Network ("VPN") solution with customer self-care on the web.

Electronic top-up services are available at many Automated Teller Machines ("ATMs"), petrol stations, Internet-banks, Telebanks and Mobilbank. In 2004, TMH increased the number of electronic top-up outlets by more than 40 percent. In addition, since 2004, customers can also top-up their accounts by sending an SMS with the required top-up amount and the monthly bill they wish the amount to be charged to. The amount of electronic top-up significantly increased during 2004.

TMH encourages customer loyalty with various incentive programs. Until September 2004, Gold Cards were awarded to customers based on the length of service, and bonus points were awarded to these cardholders based on the level of usage. The points could be redeemed for various products and services in retail stores, through the Internet and call centers. Certain products and services could be acquired by combining points with cash. Loyalty points earned after August 2003 had a validity period of 24 months.

In 2004, TMH made a progress in implementing a more focused customer retention program in line with its strategic efforts in the field of Customer Relationship Management ("CRM"). In September 2004, a revamped customer loyalty program targeting both the prepaid and the postpaid segment was introduced. A multi-level program differentiates customers based on the number of loyalty points calculated from their invoiced amount, incoming minutes and their contract duration, offering a complex set of service benefits. TMH's loyalty program manages differentiated customer service in the case of handset upgrade program, custom-made tariff offerings and a point collection program for postpaid customers both at its outlets and through call centers. Top-tier customers (i.e., Platinum and Gold Card holders) can access priority services and various discounts. T-Mobile Hungary plans to continue to maintain its retention effort in future as well.

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

	At December 31,		
	2002	**2003**	**2004**
Number of subscribers			
Postpaid subscribers	850,615	982,460	1,163,483
Prepaid subscribers	2,552,173	2,783,814	2,868,562
Total	3,402,788	3,766,274	4,032,045
Average monthly Minutes of Use ("MOU") per subscriber	118	114	115
Churn ratio (%)	14.7	19.8	15.9
Average monthly Revenue per User in HUF			
Postpaid subscribers	13,032	12,806	11,828
Prepaid subscribers	2,904	2,684	2,380
Total subscribers	5,732	5,261	4,945

The increase in the number of TMH subscribers since December 31, 2002 is attributable to a number of factors, including reductions in handset prices and traffic tariffs in real terms. Growth can be also attributed to installment purchase plans and aggressive marketing.

According to NCA sources, as of December 31, 2004, TMH served approximately 46.2 percent of the GSM mobile digital services market in Hungary in terms of subscriber base. TMH expects to initiate additional retention and acquisition marketing campaigns to stimulate further subscriber growth and to maintain its market leadership.

Number Portability. On May 1, 2004, the NCA introduced Mobile Number Portability ("MNP") to promote competition in the Hungarian mobile market. Mobile Number Portability, however, has not had a significant impact on the mobile market. T-Mobile has successfully managed challenges posed by MNP, as the number of those customers who changed mobile service provider in connection with MNP has been below the expected level and the migration has not led to an increase in the churn level.

Traffic. TMH's average traffic per subscriber is comparable to other European countries at 115 minutes per month in 2004. Average traffic per subscriber has declined over the past few years as the subscriber base has expanded to include lower-volume users. During 2003, SMS traffic showed a large increase: 623 million SMS were sent by TMH users compared to 586 million in 2002. In 2004, 637 million SMS were sent by TMH users.

Tariffs. Since January 1998, mobile subscriber tariffs have been deregulated, and carriers have had the freedom to set the level of various tariff elements (i.e., connection fee, subscription charge and traffic charges).

TMH charges subscribers a one-time connection fee, monthly subscription charges, event charges and time-based traffic charges. Customers using prepaid cards do not pay monthly subscription charges. TMH does not charge subscribers for incoming calls, other than calls received while roaming. TMH receives payments from other telecommunications service providers for terminating calls on its network. During 2004, mobile service providers developed a number of price plans. TMH maintained the widest selection in price plans and successfully introduced new tariff solutions and allowances, to acquire new subscribers and increase loyalty.

In 2004, TMH introduced new price plans covering some of its business segments:

Profi was introduced to target the SOHO and SME segments. The aim was to gain new customers, retain existing ones and respond to competitors' actions. It has a modular structure: discounts are available on SMS and non-voice services as well as on calls terminating in different networks (discounts towards a specific fixed line prefix, calls terminating in own network etc.).

Komplett was created to better serve the varying interests of SOHO and SME segments, while enabling more simple communication of business price plans in the media.

In June 2004, TMH launched a fully customizable and flexible price plan named *Mátrix* for its largest customers. The customer may specify and set the value of each tariff element one by one, independently from one another. The new price plan makes it easier for us to provide services that better satisfy divergent needs of our corporate customers.

Macedonian Mobile Operations

Our Macedonian mobile operations, Mobimak, experienced a significant growth in 2004.

Mobimak is the leading mobile operator in Macedonia, dedicated to provide up-to-date technologies and advanced service offerings, commensurate to the highest technological and service standard of the T-Mobile group.

By the end of 2004, Mobimak expanded its customer base from 523,664 at the end of 2003 to 752,462 customers, despite the competitive market environment. The principal activities of Mobimak's operations are digital mobile telephony services based on GSM technology and non-voice services such SMS, MMS and GPRS. We also provide GSM phase2+ data and facsimile transmission services, mobile Internet and a number of other content services. The Macedonian market is very price sensitive. We offer various promotions and incentives to encourage use of our services.

In 2003, Mobimak introduced the GPRS service. In 2004, Mobimak continued enhancing its value added service portfolio, and introduced various new products:

Mobimak now offers international roaming service for its subscribers on 193 networks in 87 countries, while on 28 networks in 20 countries in Customized Application for Mobile network Enhanced Logic ("CAMEL") arrangement for prepaid customers. International roaming for GPRS is available for all customers on 22 networks in 17 countries.

In parallel with the deployment of core GPRS network, Mobimak has also developed GPRS services that provide additional services and content. In addition to WAP, MMS, content SMS and premium-rate SMS services, customers can now download MMS content and Java-games.

At the end of 2004, Mobimak soft-launched the EDGE carrier, which supplements GPRS services with higher data transfer speed and capacity. The service is currently available in certain parts of Skopje.

The number of Mobimak customers has grown significantly over the past three years. The table below sets forth information concerning the number of Mobimak subscribers at the dates indicated:

	At December 31,		
	2002	**2003**	**2004**
Number of subscribers			
Postpaid subscribers	92,281	98,923	118,862
Prepaid subscribers	274,067	424,741	633,600
Total	366,348	523,664	752,462
Average monthly Minutes of Use per subscriber	118	84	66
Average monthly Revenue per User in HUF	6,855	5,264	3,804

The number of mobile subscribers increased by 43.7 percent from 523,664 at the end of 2003 to 752,462 subscribers at the end of 2004. The 228,798 net additions achieved in 2004 was predominantly from the prepaid price plan, which represents 91.3 percent of total net customer additions.

The increase in the number of Mobimak subscribers in the last three years is attributable to a number of factors, including reductions in handset prices and call traffic prices in real terms. Growth can be also attributed to aggressive marketing and installment purchase plans.

As of December 31, 2004, Mobimak accounted for estimated 76 percent of the total Macedonian mobile telephony market in terms of subscribers. The mobile penetration rate grew significantly, from 29 percent at the end of 2003 to 49 percent at the end of 2004.

Mobimak's business is affected by seasonal factors, with a general increase in roaming revenues during the third calendar quarter of the year due to the summer holidays and increased sales of products and services during the fourth quarter due to Christmas purchases.

Revenues from voice services constitute the largest portion of the Mobimak's turnover, and, consequently, the company is undertaking a wide range of activities to encourage growth in usage of these services. Average traffic per subscriber per month in minutes has declined from 118 at the end of 2002 to 84 at the end of 2003 and to 66 at the end of 2004 as the subscriber base has expanded to include lower-volume user segments. Data services during 2004 showed a large increase: 147 million SMS were sent in 2004 compared to 114 million in 2003.

Dependence on Patents, Licenses, Customers, Industrial, Commercial and Financial Contracts

We do not believe that we are dependent on any patent or other intellectual property right, on any individual third party customer or on any industrial, commercial or financial contract. Similar to other fixed line and mobile operators, we require telecommunications licenses from the governments of Hungary and Macedonia, the two countries in which we operate.

MARKETING AND DISTRIBUTION

Hungarian Fixed Line Operations

While the Hungarian telecommunications market became fully liberalized on December 23, 2001, the liberalization process started years earlier in data communications, international voice and Internet services. The advent of new competitors coupled and with the mass proliferation of mobile devices led to the saturation in the traditional voice business and strong competition in the business communication market. The high mobile penetration rate is due to the fact that the mobile phone is viewed as a substitute, rather than a complement to fixed telephones because of the relatively low level of disposable income in Hungary.

Having the largest market share makes us vulnerable to losing a large number of customers to other fixed line operators and, particularly, to mobile operators. To avoid a downward spiral of falling prices and decreasing market share, we changed our strategy to counter competitive price plans of our fixed line competitors as well as the increasing mobile plan offerings of the mobile vendors.

In 2004, there were significant positive changes in our market position. We managed to achieve a decrease in the rate of customer churn despite the increasing price based competition in the mobile market. Thanks to our new customized price plans, usage per line remained at the same level in 2004 as compared to 2003 in the residential segment. Internet usage increased dramatically due to the launch of the free dial-up Internet service and the strong ADSL campaign by the end of 2004, the number of ADSL lines exceeded 200,000 as compared to approximately 100,000 at the end of 2003.

Our fixed line marketing strategy is based on four key objectives:

- Strengthening the role of the fixed line service;
- Reducing churn;
- Boosting broadband penetration; and
- Developing a new image of fixed line telephony by offering customized solutions for each segment and identifying business development alternatives.

Strengthening the role of the fixed line service

In 2004, competition from our fixed line competitors became more intense due to certain regulatory changes, the increased usage of call-by-call service and the decrease in interconnection fees. Customers have access to services of other service providers either by signing a separate service contract with them for a predefined call-direction (pre-selection) or by dialing a pre-fix number before each call (call-by-call). With the launch of several optional calling plans ("OCPs"), we are paying increasing attention to market-based product enhancement that requires less capital investment and leads to more customer satisfaction than technology-focused product innovation. Based on our analytical marketing tools, we have redesigned our price plans to match the calling patterns of various customer segments to reinforce the concept that the mobile telephone is not a substitute, but a complement to the fixed line.

Reducing churn

PSTN churn is generated by a) customers' requests, b) lines terminated due to non-payment and c) ISDN service orders. As broadband access services (e.g., ADSL) have become increasingly available in recent years and customers become more aware of its availability, migration to ISDN slowed down from the level observed in 2000.

The number of service terminations due to customer requests decreased by 23 percent in 2004 compared to 2003 thanks to our customer retention efforts. To minimize the cancellation of lines, we continued customer acquisition and retention programs started in 2003.

We developed a churn barometer, which indicates whether a customer is likely to terminate the fixed line service in the near future. We started using the churn barometer in April 2004. We proactively contact customers showing signs of churn and offer them the best price plan for their calling patterns.

We also conduct a survey on customer satisfaction. In addition, a new CRM system was put into operation in 2004 to improve our customer service.

Boosting broadband penetration

We consider the promotion of Internet usage in Hungary one of our priorities now and in the near future. Our main objectives are to establish and spread a more developed Internet culture, to foster communication, to promote the opportunities offered by the Internet and to reach and support customer segments with a lower level of disposable income.

Magyar Telekom Open Internet is our free dial-up Internet service, which gives additional value to the fixed line and has successfully stimulated fixed line usage. After its launch in July 2003, the service quickly became popular. By the end of 2004, over 90,000 customers had used Magyar Telekom Open Internet.

Magyar Telekom Rt. and T-Online Hungary are organizing a free Internet Training Program as part of the "Mindentudás Egyeteme" (Omniscience University) which is sponsored by us and is the most popular scientific forum in Hungary.

The broadband access market is growing dynamically in Hungary. We are the largest service provider in this market. Within our service area, the dominant technology is ADSL, while the use of cable modem is growing rapidly as well. We sell ADSL products mainly on a wholesale basis. In the broadband market other types of broadband access are not very significant at the moment, although cable modem service offered by cable television service providers is becoming increasingly competitive.

We had more than 200,000 ADSL lines at the end of 2004 as compared to approximately 100,000 lines at the end of 2003.

Developing a new image of fixed line telephony by offering customized solutions for each segment and identifying business development alternatives

Segmentation at Residential Lines of Business ("T-LoB"). In addition to the residential segment, T-LoB also serves micro-, small and medium size corporate customer segments. For these segments, targeted, cost effective product developments and communication methods have been implemented. In 2004, several segment specific programs were launched or continued from 2003:

We started pre-installing telephone lines in selected new residential developments;

We introduced services for customers having access to other telephony operators. Pre-selection services "Csevegö Partner" and "Ritmus Partner" were introduced for residential and business customers, respectively. In addition, call-by-call services, "1515 Elöhívó" for residential and "Ritmus 100 Elöhívó" for business customers, were introduced;

XL and XXL supplementary price plans were the main drivers of usage changes in 2004; and

For business customers, "Üzleti felezö" price plan was introduced.

Segmentation at Business Lines of Business ("B-LoB"). The business customer base served by B-LoB comprises large and medium size corporate customers.

In 2004, the corporate telephony market served by B-LoB experienced significant challenges due to the stronger competition from mobile telecommunications service providers and the development of the IP technology. Corporate customers are seeking ways to minimize their telecommunications spending. Intensified demand for integrated offers has developed and we plan to leverage our position as the sole integrated provider to benefit from this trend.

B-LoB also intends to exploit LAN business opportunities that can preserve both voice and data traffic revenues. To better handle and integrate market information, the business development, marketing and strategy functions were harmonized. We believe that providing a high quality solution with knowledgeable sales people, who can communicate the value of our products and services to our customers, is critical to attracting and retaining customers. Therefore, in addition to simplifying its sales channels, B-LoB has re-segmented them based on annual revenue and public sector criteria. In addition, a product development department was established to handle specific business customer's needs for products and related consulting services.

B-LoB sells its products and resells certain third-party products directly to customers through dedicated account managers. We also invested in various programs to enhance the selling skills of account managers. By strengthening the customer service department, B-LoB has also significantly and effectively expanded its points of sales.

With simplified and extended sales channels B-LoB can more effectively exploit new business opportunities and retain its customer base.

B-LoB Product Development

The traditional telecommunication functions are now an element in system integration efforts of many of our customers. An integrated solution has the ability to run complex customer-side applications containing multiple devices and telecommunication network elements. We develop products and services based on specific customer needs.

In 2004, the following services were developed:

E-learning. This service offers high-level electronic remote training and is able to transmit presentations to remote audiences. E-learning offers our customers cost- and time-efficient knowledge sharing.

E-hospital. This service was developed for hospitals and healthcare institutions. We provide various telecommunications services, turn-key security systems for buildings, other operational electronic systems (e.g., nurse call system, video surveillance system) as well as Information Technology ("IT") (software and hardware) support.

Security service. Our security service helps lower the risk of crime and other casualty losses. We offer automatic fire alarm, electronic burglar and intruder alarm, video camera surveillance systems, door access and working time registration systems. This plan also includes data security, from protection of local systems to an entire network.

E-government. This service, developed for public institutions, provides physical infrastructure, WAN/LAN set-up, and customized applications for the front and back office activities.

Our presence in the service areas of other LTOs

The liberalization of the Hungarian telecommunications market enabled us to enter into geographical areas formerly served by LTOs, such as Invitel, Hungarotel, HTCC and Monortel. To provide competitive service offerings, we increased our presence in areas originally serviced by other LTOs with special focus on voice services.

Since the liberalization, customers can freely choose their telecommunications service provider. There are two types of carrier selection: pre-selection and call-by-call. In Hungary, carrier pre-selection is widely used by the corporate segment.

In addition to Szeged, where we started our operation based on our own network in October 2003, we reached several other new locations in 2004 offering voice, data and value added services with fixed line or wireless access. Since September 15, 2004, Magyar Telekom, in line with the deregulation, has offered local and long-distance call services in service areas of Invitel, HTCC and Monortel. The enhancement of our network infrastructure is based on the customer demand, future business opportunities and thorough financial analyses.

Focus on SME segment

As the telecommunications and IT needs of our corporate customers increasingly call for standardized management and service, we now offer integrated telecommunications solutions, which fully meet their variable needs. For successful sales of these solutions, we must be aware of corporate processes and business characteristics of our SME customers. To provide high quality service to these customers, we place a strong emphasis on the segmentation of the SME customer base by industries. In line with this, we aim to develop an organizational structure that ensures effective information gathering on customers as well as the fulfillment of their individual, integrated telecommunications requirements. In the sales department, the sector-based, rather than region-based, distribution has been given a more prominent role and, as a result, customer service is now carried out in teams. For the fulfillment of individual needs, we combine our existing product portfolio with products of our partner companies to best meet both the telecommunications and IT needs of the SME customers.

Distribution

Our T-LoB has seven retail sales channels to ensure total market coverage for our over two million residential and business customers.

The nationwide sales network with approximately 160 agents and 100 value added resellers serves as a basis for proactive sales of the product and service portfolio of Magyar Telekom Rt. and our ISP subsidiary, T-Online Hungary, in the residential and SME markets. Our dealer network also provides tailor-made services and can offer complete telecommunications solutions (e.g., voice, data, PBX, router) to business customers. In 2004, the indirect sales channels achieved remarkable results in data communications products and services (DSL, Flex-com, IP) sales.

The T-Pont retail network reaches all Magyar Telekom areas in Hungary. We also operate customer contact points in the LTO areas as well. In this key retail network, all of our services are available, including various types of T-Online Hungary Internet access, TMH mobile prepaid products and cable TV services of T-Kábel Hungary.

Magyar Telekom Rt. served about 1.2 million customers in 2004 through its retail stores. We also have 57 T- Pont Franchise Network stores that help in retail distribution. TeleSales activity increased in 2004 and has played a key role in the sales of several price plans. The Internet store of Magyar Telekom, ePont, showed remarkable results as the number of visitors doubled in 2004.

Macedonian Fixed Line Operations

Although the Macedonian telecommunications market was not fully liberalized until January 1, 2005, our fixed line telecommunications business already faced strong competition in 2004, driven mainly by mobile substitution, Internet competition and illegal Voice over Internet Protocol ("VoIP") and wireless data transmission providers. We expect competition to intensify in 2005.

Fixed line voice services face competition mainly from mobile prepaid services that allow very strict cost control for subscribers in the Macedonian market, where the majority of the customers have very limited disposable income.

The competition among mobile operators is driving down prices of the mobile services and is also reducing the difference between the values of fixed and mobile services for the average consumer. Intensive marketing activities of mobile competitors decrease the consumer perception of this difference, and thereby enhance the perceived value of mobile communications. This trend led to a moderate decrease in the active customer base of Maktel in 2004, mainly due to the increased number of non-paying customers.

During the second half of 2004, Maktel turned more intensively towards broadband services, such as ADSL, to enhance the value of fixed lines. The number of ADSL lines exceeded 2,400 by the end of 2004 and is expected to grow at an accelerated rate in 2005. Other data services (e.g., leased lines and IP-VPNs), which also increased in 2004, are expected to grow further as well.

Maktel's marketing strategy in the first year of market liberalization is based on the following key objectives:

- Preserving the number of fixed lines;
- Promoting broadband services to enhance the value of fixed lines;
- Developing a new image of fixed line telephony by offering customized solutions for each segment and identifying business development alternatives.

Hungarian Mobile Operations

In 2004, the Hungarian mobile market reached a 86.4 percent penetration level, which is comparable to the average level in Western European countries. The mobile market development slightly slowed down as compared to previous years. The Hungarian mobile market is highly competitive and dominated by three carriers: TMH, Pannon and Vodafone Magyarország Rt. ("Vodafone"). Due to the very high penetration level, our focus has moved from acquisition to retention.

2004 was a very successful year for TMH in all of our strategic areas:

- Maintain the market leader position;
- Customer Relationship Management;
- Increase non-voice usage; and
- Manage the rebranding successfully.

Maintain the market leader position

TMH now has over four million subscribers and closed the year with 46.2 percent market share (in terms of the number of subscribers). We have the leading position both in the consumer and the business segment.

To maintain our leading position, several price plans were launched both in the consumer and the business segment. In the case of postpaid users, "Relax" flat rate price plan was launched. This plan generated migration from the prepaid segment to the postpaid segment, and it had retention effect within the postpaid customer base. To maintain the leading position in the business segment, especially in SOHO, new competitive price plans "Profi" and "Komplett" were launched to better meet the needs of our customers.

Customer Relationship Management

2004 was a very successful year in terms of churn level. Due to our retention programs and active campaigns, the year end churn level was significantly lower than planned.

TMH launched its revamped loyalty program, Kapcsolat Gold Card Program, for its postpaid users as well as many of our prepaid users. The program offers attractive benefits such as:

- mobile handset upgrade;
- special tariff and non-voice offers; and
- collection of points which can be redeemed for products and services.

The sales structure showed positive changes and reflects our strategic focus. Ratio of postpaid sales had increased and the migration from prepaid to postpaid nearly doubled.

We also introduced a new customer data system company-wide, which allows all of our employees dealing with our customers to access the same customer database. This allows TMH to offer targeted and tailored solutions to different customer segments.

Increase non-voice usage

The non-voice products were very successful in 2004. In the consumer segment, the SMS, MMS and GPRS-WAP usage significantly increased. Several tailor-made segment-specific non-voice products and services were launched both in consumer and business segment.

Manage the rebranding successfully

TMH successfully managed its brandname change from Westel to TMH. During the rebranding period, all the distribution network and electronic channels were rebranded. By the end of 2004, the new brand has achieved high awareness and a positive image.

Distribution

TMH has a strong direct distribution network consisting of 28 Building Value stores and 9 Economy stores. Building Value stores provide full-scale sales, customer service and repair service to customers while Economy stores focus primarily on sales. 11 stores are located in Budapest and the other 26 are in regional centers. All of these stores were refurbished during the TMH rebranding period in 2004. There is also a department dedicated to major accounts. This department consists of 79 sales representatives and serves major accounts on a segment basis. Our customers can also purchase TMH products on our on-line shop.

In addition to the direct sales channels, TMH also distributes its products and services through indirect sales partners. In 2004, TMH had 222 full-scale indirect outlets nationwide. In addition, TMH has 26 MultiMedia ("MM") partners. The role of these MM partners is to give special info-communication support for our customers and concentrate on the sales of value added and complex IT-mobile solutions. TMH also sells its prepaid products (e.g., prepaid SIM, plastic top-up card, on-line top-up) through major Hungarian retail channels. TMH has a strong relationship with retailers (e.g., Tesco, Cora, MediaMarkt, Metro, Shell, Mol and OMW) which sell prepaid Subscriber Identity Module ("SIM") cards at 89 outlets and provide prepaid top-up opportunities at 6,395 outlets. On-line top-up opportunities are available at 3,469 outlets nationwide.

Macedonian Mobile Operations

To maintain the trust and confidence of over 750,000 customers and to better meet their communication needs, Mobimak has introduced three postpaid price plans for residential customers, three postpaid price plans for business customers and three prepaid price plans adapted to the needs of these various groups of customers.

Marketing based on customer data is widely used to build strong customer relationships. Loyalty schemes are also increasingly used to improve customer satisfaction and customer churn rate.

Mobimak distribution network consists of direct and indirect sales outlets bearing our corporate image. Mobimak has a network of 22 directly owned shops and also possesses a network of over 2,200 indirect Points of Sales ("PoS") managed by authorized dealers throughout the country. Mobimak distribution network offers high quality services and a broad spectrum of handset and accessory products.

COMPETITION

Hungarian Fixed Line Operations

In 2004, despite the increased competition from other carriers, we managed to retain our leading position in the voice services market. The largest competitors, Invitel and Tele2, lack the ability to cover the entire telecommunications value chain or to benefit from cross-segment synergies. We are the only integrated service provider in the market with full telecommunication product offerings.

Domestic and International Fixed Line Telecommunications Services

Until the end of 2002, our fixed line operations were mainly subject to indirect competition from mobile telecommunications providers. In addition, following the full liberalization of fixed line voice telephony, a variety of market entrants providing public fixed voice telephony service, either by interconnecting with our network or through their own infrastructure, could begin to compete. Existing and potential service providers include other LTOs, operators of existing alternative networks, such as

public utilities, railways and mobile telecommunications providers and global alliances of international telecommunications providers.

In 2004, the mobile carriers remained our key competitors for domestic calls. Mobile penetration reached 86.4 percent by the end of 2004, which not only led to intense competition in the mobile telecommunications market, but also affected the fixed line telephony market. Due to high penetration, mobile carriers target the residential and business customers with more and more competitive packages and lower prices in an effort to win fixed line customers.

Tele2, the most aggressive competitor, entered the Hungarian market in 2004. Tele2 mainly focuses on the residential market. It competes on the basis of a simple and low pricing structure as well as aggressive marketing. However, as Tele2 failed to win the 3G mobile frequency tender, it will not be able to provide mobile telecommunications services in the near future.

In the first years of liberalization, LTOs and alternative service providers concentrated their efforts on business customers in the areas of long distance and international calls. In 2004, they started to target residential customers as well. Alternatives are present in the residential market, such as prepaid calling cards for international long distance calls.

Despite increased competition, we successfully kept our leading position in domestic telephony and had an approximately 80 percent market share in terms of access lines in Hungary as of December 31, 2004.

In our geographic service areas, a number of carriers (Tele2, GTS Datanet, eTel, Invitel, PanTel, British Telecom and Monortel) offered pre-selection and call-by-call services in 2004 and were able to attract some of our customers. We also offer similar price plans and are successful in attracting new customers from LTO areas.

The introduction of number portability did not result in the expected increase in competition in 2004.

In 2004, cable TV providers also entered the voice market. Their "triple-play" offer contains voice, Internet and cable TV services from the same provider, which is likely to have an impact on competition in 2005.

In the Internet market, we were able to achieve our goals along with the intense increase of ADSL subscriptions. Our Open Internet service had a market-enhancing effect on the declining dial-up Internet market.

Leased Lines and Data Transmission Services

In the continuously expanding Hungarian leased line and data transmission market, we retained our leading position in 2004 in terms of market share. Our key competitors are alternative telecommunications carriers (GTS-Datanet, PanTel), that offer products and services primarily based on fixed line and microwave leased line technologies. The data transmission market also featured other cheaper technologies, such as IP.

The Internet market in Hungary is dominated by a few large ISPs, although several dozen Internet providers are registered. In 2004, the main trend in the Internet market was the rapid growth of broadband services. The number of broadband Internet access increased by about 100 percent as compared to 2003. Nearly 60 percent of Internet access provided by T-Online Hungary is through broadband (ADSL, cable

television or W-LAN). T-Online Hungary, our fully owned subsidiary, is the market leader with an estimated 42 percent market share based on the number of dial-up subscribers. Its key competitors are the Internet affiliates of the alternative telecommunications service providers and UPC, a company offering broadband access through cables used for cable television.

Macedonian Fixed Line Operations

Under the Concession Contract with the government of the Republic of Macedonia, Maktel had the exclusive rights to provide fixed voice telephony services until December 31, 2004.

Domestic and International Fixed Line Telecommunications Services

In 2004, Maktel's fixed line business faced indirect competition from mobile operators in domestic traffic and, to a limited extent, in international traffic from unlawful VoIP providers (such VoIP services are currently prohibited in Macedonia).

The liberalization of fixed line voice telephony, which started on January 1, 2005, may bring a number of new entrants providing public fixed voice telephony services, which may lead to competition in both international and long distance voice services.

Leased Lines and Data Transmission Services

With respect to the Macedonian leased line and data transmission market, Maktel had the exclusive rights to provide these services until the end of 2004. The only exception was the internet market, which has been liberalized since 1998. In addition to Maktel, there are three major ISPs: Onnet, MOL and UNet. Maktel is the market leader with an approximately 75 percent market share based on the number of Internet dial-up minutes and is the sole provider of ADSL.

Hungarian Mobile Operations

In 2004, the Hungarian mobile telecommunications market was characterized by intense competition, driven by new services, lower prices and aggressive marketing. Competition was stronger than ever in the mobile segment and the focus on acquisition was replaced by focus on retention. As the market began to saturate, new services and lower tariffs were offered and aggressive marketing campaigns were conducted. The mobile penetration rate further increased in 2004, reaching 86.4 percent by the end of the year. Despite the intense competition, TMH retained its market leading position with a 46.2 percent market share based on the number of subscribers.

The competitors of TMH are Pannon GSM and Vodafone. Vodafone continued its intensive and aggressive marketing campaigns and reached a 19.9 percent market share in terms of the number of subscribers by the end of 2004. Vodafone was able to leverage its global brand and added a large number of customers. Pannon GSM on the other hand was not able to halt its declining market share. As a result, it had the smallest net customer additions, lost approximately 2 percent of subscriber market share and ended the year with a 33.9 percent subscriber market share.

Non-voice and content services are playing an increasingly important role in mobile offerings. All providers strengthened their non-voice services in 2004.

Macedonian Mobile Operations

Competition in mobile communications is generally intense and conducted on the basis of price, subscription options, subsidized handsets, coverage, range of services offered, innovation and quality of service. The second largest mobile provider in the country, Cosmofon, began commercial operation in June 2003. Its marketing and advertising efforts are aggressive with low and competitive handset prices, attractive price plans, broad array of advertising and indirect channels of sales with three main dealers.

According to Mobimak's estimates, Cosmofon had approximately 85,000 customers at the end of 2003 and reached approximately 243,000 customers by the end of 2004, representing a 24 percent market share. Cosmofon's subscriber base is mainly prepaid. Cosmofon has been increasingly targeting Mobimak's residential and business contract customers.

In this intensive competitive environment, Mobimak plans to maintain and expand its market share through improved productivity, efficiency measures and maintenance of existing customer relations to avoid the escalation of competition on prices.

REGULATION AND PRICING

Development of the Telecommunications Regulatory Regime in Hungary

The regulatory regime governing telecommunications services in Hungary has been substantially revised since 1990, when the former state postal, telephone and telegraph authority, Magyar Posta, was divided into three distinct operations. Act LXXII of 1992 on Telecommunications, as amended (the "Telecommunications Act"), established the general regulatory framework for the Hungarian telecommunications sector. The Telecommunications Act provided for the promulgation of additional decrees by the Hungarian government and the Ministry. The telecommunications market has been also governed by other legislation that is not specific to telecommunications, including, among others, Act XVI of 1991 on Concessions, as amended (the "Concessions Act"), the Pricing Act and Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practice (the "Competition Act").

In 1993, the Minister divided Hungary into 54 local primary geographic areas ("Local Primary Areas") for local public fixed line voice telephony service. In August 1993, the Minister issued an international tender for the right to provide international and domestic long distance telephone services throughout Hungary and to provide local public fixed line voice telephony services in 29 of the 54 Local Primary Areas, including Budapest. The Minister selected MagyarCom, our parent holding company, as the winning bidder in the tender.

MagyarCom then assigned certain of its rights to Magyar Telekom. On December 22, 1993, we entered into the Concession Contract with the Minister. The Concession Contract gave us the exclusive right to provide domestic long distance and international public fixed line voice telephony services throughout Hungary and local public fixed line voice telephony services in 29 Local Primary Areas for a term of eight years ending on December 22, 2001.

In September 1993, the Minister issued a second competitive tender for the exclusive right to provide local public fixed line voice telephony services in the remaining 25 of the 54 Local Primary Areas. We obtained the right to provide services directly in seven of those areas by successfully bidding on five areas and by virtue of being the default provider in two areas where there was no successful bidder. We also obtained the right to provide services indirectly in additional three areas through a joint venture. With respect to the five areas where we were the successful bidder, our rights were governed by separate

concession contracts. Rights to service the remaining 15 areas were distributed among 12 local telephone operators.

In 2000, the government broke up the Ministry of Transport, Telecommunications and Water to establish the Ministry of Transport and Water Management and the Telecommunications Government Commissioner's Office, which was a part of the Prime Minister's Office and bore the sole responsibility for all matters related to telecommunications. The rights of the Prime Minister's Office were transferred as of May 27, 2002 to the Ministry of Informatics and Communications.

The regulation of the Hungarian telecommunications market was fundamentally changed on December 23, 2001, when the Act on Communications came into force. The Act on Communications superseded the Telecommunications Act on December 23, 2001. The Act on Communications provided the main legal framework for the liberalized market until the end of 2003, and it provided for the promulgation of additional (governmental and ministerial) decrees.

On January 28, 2002, the Minister and Magyar Telekom concluded the Contract on Universal Service Provision. According to this contract, the national concession was terminated on January 31, 2002, while in the five local areas (Debrecen, Nyíregyháza, Szentendre, Székesfehérvár and Szolnok) the local concessions were terminated on May 24, 2002.

Limited amount of competition that resulted from the Act on Communications and harmonization of the Hungarian law to EU standards required by the accession of Hungary to EU led the modification of the regulatory regime governing the telecommunications sector. Act C of 2003 on Electronic Communications, the latest regulations on the telecommunications sector, came into effect on January 1, 2004 and Act on Communications was superseded at that time. In line with the authorization of Act C of 2003 on Electronic Communications, several executive decrees were issued as well.

On June 30, 2004, the Minister and Magyar Telekom concluded a modified Contract on Universal Service Provision, which is in line with the new regulation.

The Act on Electronic Communications and the Contract on Universal Service Provision

The Act on Electronic Communications was approved by the Parliament on November 24, 2003 and came into effect on January 1, 2004. The primary goals of the new act are:

to further improve the electronic communications infrastructure;

to provide consumers with reliable and safe electronic communications services of high quality at the lowest possible prices;

to promote efficient competition in the electronic communications market regardless of the technology applied; and

to comply with the legislation of the European Community.

The Act on Electronic Communications has fundamentally changed the authority structure of the liberalized telecommunications market. The National Communications Authority was established as the supreme supervisory body. The NCA operates in a close cooperation with the Competition Office and the General Inspectorate for Consumer Protection. One member of the NCA represents the interest of consumers in the telecommunications sector. In addition to the NCA, Permanent Court of Arbitration for Communications ("CAC") was also established.

Set forth below is a brief summary of certain provisions of the Act on Electronic Communications.

Universal Service. According to the Act on Electronic Communications, universal services are basic communications services that should be available to all customers at an affordable price. Universal services include access to fixed line voice telephony services of regulated minimum quality enabling access to Internet services at a regulated minimum speed, a regulated density of public payphones, a public register of subscribers, national domestic inquiry service as well as cost-free call-barring and emergency calls. Access to voice services at an affordable price is guaranteed partly through the selection of universal service providers (the Minister shall appoint the most efficient service provider) and partly by introducing a subsidy granted to disabled or low-income users from the state budget.

According to Article 5 of Government Decree 345/2004 (XII. 22.), the service provider is obliged to certify and attest that it meets the quality requirements set out in the obligatory standards described in various laws, authority licenses and contractual conditions of the company. Magyar Telekom Rt. was granted the certificate first on August 27, 2001 for its concession telephony services. During the fall of 2002, Magyar Telekom Rt. had Mátrix Kft. to certify its universal and publicly available telecommunications services as well. The certifying organization issued the certificate on our compliance on December 16, 2002. This certificate is valid until November 10, 2005 subject to ongoing reviews every six months.

Ministerial Decree 8/2004 (IV.20.) IHM regulates detailed conditions and technical requirements of the universal services. Universal service providers are entitled to compensation for their net avoidable costs, except for the costs incurred from discount price plans offered to residential subscribers. Ministerial Decree 7/2004 (IV.20.) IHM establishes detailed rules used to calculate the net avoidable costs. The compensation is available for universal service providers from the Universal Electronic Communications Support Fund.

We became a universal service provider as a result of the universal service contract between Magyar Telekom and the Minister signed on January 28, 2002. Our Fixed Lines Concession Contracts were superseded by the Contract on Universal Service Provision and the national concession (which included the international and domestic long distance as well as the local concessions) in 31 primary areas was terminated on January 31, 2002, while the local concessions in the remaining five concession areas were terminated on May 24, 2002. In the Contract on Universal Service Provision, the Minister acknowledged that Magyar Telekom Rt. fully complied with all of its obligations during the concession period.

We duly paid the concession fee relating to the first month of 2002 for the nationwide concession and relating to the period up to May 24, 2002 for the five primary areas. The Minister has no outstanding claims against us. Upon the termination of its concession contract in its three primary areas on November 1, 2002, our subsidiary, Emitel also concluded the contract on universal service provision with the Minister.

Based on the new regulation under the Act on Electronic Communications, the Minister of Communications can appoint the most efficient bidder(s) as universal service provider(s). On June 30, 2004, the Minister appointed us as the universal service provider in our former concession area and the Minister and Magyar Telekom concluded a modified Contract on Universal Service Provision. The former contract was modified since the Act on Electronic Communications has changed the rules on universal service and required the modification of existing contracts. The new contract is valid until December 31, 2008 and can be extended for additional four years.

Subscriber Contracts. The service providers must establish general terms and conditions as well as subscriber contracts to be entered into with subscribers. The Act on Electronic Communications contains the general rules of agreements between subscribers and telecommunications service providers for

telecommunications services. The ministerial Decree 16/2003 (XII.27.) on "Telecommunications Subscriber Contract" contains other important rules relating to subscriber contracts. In subscriber contracts, parties can modify the provisions of the Act on Electronic Communications only if they are more favorable to the subscribers. The service providers already operating in the market were obliged to amend their existing terms and conditions as well as subscribers contracts in accordance with the Act on Electronic Communications and Ministerial Decree 16/2003 (XII.27.)

The general terms and conditions of subscriber contracts must contain, among other things, the process of concluding and amending subscriber contracts, the quality of the telecommunications service, conditions for restriction of the service, the fault-repair service and the method for handling subscriber complaints. The individual subscriber contract must contain personal data of the subscriber.

Significant Market Power Regulation. According to the Act on Electronic Communications, all service providers that were designated as an SMP in 2003 would remain SMPs in the interim period until the first market analysis and SMP designation under the EU standards, which were required to take place by September 1, 2004. These service providers are required to comply with regulations prescribed for the interim period by the Act on Electronic Communications and the related executive decrees. Until the end of the interim period, the NCA will determine the markets, analyze these markets, designate SMPs on each market and impose certain obligations on each SMP. Obligations of SMP operators may include transparency, equal treatment, accounting separation, publishing reference offers for interconnection, access and bundling services (which must be offered on cost-based prices).

We have been designated as an SMP on the telephony and leased lines market by the regulator at the end of 2003. In the first quarter of 2004, the NCA requested service providers to provide extensive operating data for market assessment and identification of operators with SMP. Although we are submitting the requested information in several phases, we consider that this request had no legal basis and initiated a court procedure to challenge this request.

At the end of 2004, analysis of 16 out of 18 markets has been initiated by the NCA. Analysis on 8 of these markets have been completed so far on markets 1 to 6 (fixed line retail markets) and 15 to 16 (mobile wholesale origination and termination). The results of analysis on fixed line retail markets have identified us as an SMP and imposed a price cap on our services in the retail access markets for residential/non-residential customers and required us to allow our fixed line residential/non-residential customers to select other services providers for local and/or national and international calls. The rest of the resolutions is being finalized and is expected to be published in the first half of 2005.

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

Our regulated access prices currently include an access deficit, i.e., our subscription fees do not cover the costs of access. According to the Pricing Act and the relating ministerial decrees (3/2002 (I.21.) MeHVM and 4/2002 (I.26.) MeHVM), the access deficit should be eliminated. Decree 3/2002 (I.21.) MeHVM deals with the access deficit problem by allowing an annual increase in subscription fees of universal price plans above the annual inflation rate.

Local Loop and Bit-stream Unbundling. According to the Act on Electronic Communications and Government Decree 277/2003. (XII.24) on "The detailed rules of procedures related to the reference offers and networking contracts", designated SMP operators providing unbundled access or broadband access are obliged to unbundle local loops and prepare reference offers for unbundled local loops (whether

fully or partially unbundled) and bit-stream access and to provide these services when there is a request for them by other telecommunications service providers.

The SMPs may refuse the request 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.

Interconnection. According to the Act on Electronic Communications and Government Decree 277/2003 (XII. 24), SMPs are obliged to prepare reference offers for interconnection and to provide these services upon the reference offer when there is a request for them by other telecommunications service providers.

According to the Government Decree 277/2003 (XII. 24), the SMPs are obliged to enter into agreements for access to their networks when requested by another service provider. If the provider is obliged to prepare a reference interconnection offer, this offer must be in line with the reference offer. The NCA has authority to arbitrate in disputed cases and may establish provisional arrangements. The reference offer of the SMPs must be approved by the NCA.

Carrier Selection. According to the Act on Electronic Communications, voice telephony customers have the right to select different service providers for each call directions. The implementing regulation was released in Government Decree 73/2004 (IV.15) in April 2004.

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

Telecommunications Service Licensing Requirements. According to the Act on Electronic Communications, the provision of communications services shall be notified to the Communications Regional Office for registration no later than 30 days prior to the commencement of service.

All service providers that have obtained the right to provide communications services before the Act on Electronic Communications became effective may continue to provide such services.

Licensing and Allocation of Frequencies. With the exception of a program receiver device, radio equipment, radio stations and radio communication networks may be operated with a radio license. A radio license may be issued exclusively on the basis of a valid frequency assignment license, with the exception of cases specified by law. Radio equipment, radio stations, radio networks and radio communications systems may be installed with a frequency assignment license, with the exception of cases specified by law. Payment of fees is required for the reservation and authorized use of the frequencies assigned for civil purposes, reservation of identifiers and use of the assigned identifiers.

Magyar Telekom Rt. pays a frequency license fee on the basis of Decree 6/1997 (IV.22) KHVM on "Frequency Reservation and Usage Fee" and Government Decree 120/1998 (VI.17.) on "Rules of Payment of Frequency Reservation and Usage Fee". Additional rules related to frequency usage include Government Decree 284/2002 (XII.21.) on "Specification of the National Frequency Allocation Table" and Government Decree 11/2003 (I.30.) on "Rules of the Auction and Tender to Obtain the Frequency Usage License".

Magyar Telekom Rt. pays a number usage fee for call numbers used by the Company, according to Decree 19/2001 (X.31.) MeHVM on "Fees of Engaging the Number and Address Fields Necessary for the Provision of Public Telephony Services".

Frequency assignments must conform to the National Frequency Range Distribution Chart, which lays out the entire spectrum and the purpose and availability of frequency bands. Our frequencies are generally valid for periods of one to five years. The frequency assignment for the Radio Local Loop system ("RLL") was valid through November 2003. According to the contract concluded with the Ministry on November 4, 2003, we have already finished the replacement of RLLs.

Rights of Way. According to the Act on Electronic Communications, communications service providers are entitled upon prior notification to the owner to install telecommunications equipment on private property and to enter private property where communications facilities (equipment, cables, antennas) are located for maintenance and fault elimination purposes. The public telecommunications service provider must enter into a contract with the property owner setting forth conditions for the common use of the property. The property owners are also obliged to remove obstructions to public telecommunications networks. The property owners have the right to claim compensation for nuisance suffered as a result of entry into their property.

Upon request, the competent inspectorate may establish easements in favor of a public telecommunications service provider on real property for the purposes of placing communications facilities. We are seeking easements over a substantial number of real properties on which we or our predecessors installed such facilities. If the placement of telecommunications equipment prevents or materially hinders the use of real property, the owner may request purchase or expropriation of the property after seeking an opinion from the Inspectorate. The party that orders construction (installation) of communications structures shall restore the initial conditions of the environment after the completion of construction works. If the communications structure installed by the service provider provides for the customer residing or staying in the direct proximity of the structure better than average service or additional services, the service provider may not demand compensation for it.

Mobile Concession Contracts

Hungary was the first country in Central and Eastern Europe to introduce public mobile telecommunications services. Westel 0660 began providing analog mobile radiotelephone service in October 1990 with an exclusive license and entered into an exclusive concession contract with the Minister in 1994. In 1993, the Minister awarded two concessions to provide nationwide cellular telephone services using the digital GSM 900 standard: one to TMH and the other to Pannon.

Under the Concession Contract, dated November 4, 1993, as amended (the "900 Concession Contract"), between the Minister and TMH, TMH has the right for 15 years to provide public GSM mobile telephony services. TMH is authorized to provide GSM service in the 906 to 914 and 951 to 959 MHz frequency bands in Hungary.

The parties may agree to extend the TMH concession for an additional period of seven and half years.

On February 25, 1999, the Ministry issued an invitation to tender for concessions for the DCS 1800 services in Hungary, a mobile telecommunications system operating in the 1800 MHz frequency band. The tender was closed on May 7, 1999. On October 7, 1999, an amended 900 Concession Contract was signed, allowing TMH and its GSM 900 competitor, Pannon, to start commercial service in the 1800 MHz band for 15 years beginning November 26, 2000. At that time, the Minister also signed a concession contract with V.R.A.M. Rt., the new entrant on the Hungarian digital cellular market, which uses the Vodafone brand name.

TMH, simultaneously with Pannon, started commercial operation in the 1800 MHz band on November 16, 2000. Upon request by Vodafone, the national roaming agreement between TMH and Vodafone was terminated effective November 30, 2000, whereby TMH was released from the obligation to provide Vodafone with domestic roaming services on a nationwide basis. Effective December 6, 2002 Pannon terminated its national roaming agreement with Vodafone. As Vodafone had no remedy available for such unilateral decision, it was forced to speed up its network roll out campaign to close the coverage gap vis-á-vis its competitors.

By virtue of the amendment to the Concession Contract in 1999, by the end of 2003, the three digital mobile telecommunications service providers had the same spectrum resources allocated to them both on the 900 and the 1800 MHz bands.

TMH was required to pay a HUF 11 billion concession fee, adjusted for changes in the HUF/USD exchange rate. The first installment of the concession fee, HUF 2,750 million was paid eight days after the modification of the 900 Concession Contract (November 1999). The second installment of HUF 2,750 million, adjusted for changes in the HUF/USD exchange rate, was paid eight days after the commencement of 1800 MHz service (November 16, 2000). The third installment of HUF 1,830 million, adjusted for the changes in the HUF/USD exchange rate, was paid on November 30, 2002. The last installment of the concession fee, HUF 3,670 million, adjusted for the changes in the HUF/USD exchange rate, was paid on December 31, 2003. TMH also pays an annual concession fee of USD 1 million since the commencement of the 1800 MHz service.

Frequency Fees. In accordance with the 900 Concession Contract, the frequency fee payable to the Ministry consists of two parts: a frequency reservation fee and a frequency usage fee. TMH paid the Hungarian government a frequency reservation fee of HUF 256 million per year for the nationwide reservation of one 8 MHz duplex frequency band (40 GSM duplex radio channel) in respect of the 900 MHz frequency band. This fee decreased in proportion to the percentage of the nationwide coverage of the service. TMH must also pay a frequency usage fee of HUF 200,000 per year for each GSM duplex channel and base station with a radio license. Pursuant to a regulatory decree passed in December 2002, the former payment obligation, in respect of the frequency reservation fee, has been revoked. TMH also had frequency fee payment obligations for channels allocated in the 1800 MHz band.

In 2003, based on a fairly complex calculation methodology set out in the Concession Contract, TMH paid HUF 90 million for the right to use the 9 MHz frequency band, plus HUF 130 million for the actual use of channels within that band. Both amounts were adjusted for the changes in the HUF/USD exchange rate. In 2004, TMH paid HUF 150 million for the right to use the 15 MHz frequency band, plus HUF 117.5 million for the actual use of channels within that band as well as HUF 3,080 million for frequency usage in the 900 MHz band, adjusted for the changes in the HUF/USD exchange rate. In addition, TMH paid HUF 542 million in 2003 and HUF 543 million in 2004 for the right to use microwave frequencies.

Tariffs. Commencing January 1, 1998, TMH's subscriber charges ceased to be regulated under the Pricing Act or ministerial decree and consequently ceased to be subject to the previously applicable price cap regime.

Roaming Agreements. TMH may sign roaming agreements with other public mobile telecommunications service operators outside of Hungary in accordance with the rules of the GSM Association, an association of GSM operators and associated members.

Market assessment, SMP designation process, and interconnection. See "Item 4 Pricing"

Termination. The NCA has notified TMH that for the years 2002 and 2003 it had met its concession obligations. TMH also met its concession obligations for 2004, for which notification from the NCA is expected in October 2005. If an event of default occurs under the 900 Concession Contract, the NCA may

issue a cure notice to TMH. T-Mobile Hungary would then have 90 days to agree with the NCA on a plan of action for curing the default. If TMH does not reach an agreement with the NCA or if TMH does not cure any such default within an agreed period of between three to six months, the NCA may issue a notice terminating the 900 Concession Contract. Upon termination of the 900 Concession Contract, TMH would be dissolved under the Concessions Act.

UMTS. On December 7, 2004, the NCA awarded T-Mobile Hungary the exclusive right to use the frequency blocks of 1920-1935 / 2110-2125 MHz Frequency Division Duplex ("FDD") and 1915-1920 MHZ Time Division Duplex ("TDD") for the deployment and operation of an International Mobile Telecommunications ("IMT")2000/UMTS mobile telecommunications system (3G system). The duration of the frequency usage right is 15 years (until 2019) with an option to extend it for another 7.5 years.

The right was awarded after a tender process that started on September 1, 2004 and concluded on December 7, 2004. TMH applied for all three frequency blocks ("A", "B" and"C") separately and won the usage right of frequency block "A". The right to use the frequencies vested upon payment of the first installment of the license fee on December 27, 2004.

T-Mobile Hungary is obliged by the term of the license decree to start commercial 3G service within 12 months after the entry into force of the license within the inner city of Budapest. It is also obliged to reach 30 percent of the Hungarian population within 36 months after the entry into force of the license.

The license fee for UMTS was set at HUF 17,000 million plus reclaimable Value-Added Tax ("VAT") payable in three installments starting in 2004 through to the end of 2005. In addition to the purchase price of the license, T-Mobile Hungary capitalized expenses incurred in connection with the acquisition process of the license. Accordingly, the total capitalized amount is HUF 17,073 million.

The UMTS license right will be amortized on a straight-line basis over 15 years from the time of the commencement of the commercial service.

Competition Law Restrictions

The Act on Electronic Communications and the Contract on Universal Service Provision in line with the Competition Act prohibit us from abusing of our dominant position in the market for public voice telephone services.

Under the Competition Act, a market participant is considered to be in a dominant position if, among other things, it is able to pursue economic activities substantially independent of other market participants, i.e., without the need to consider the market behavior of its competitors, suppliers, customers and other business partners.

Under the Act on Electronic Communications and the Competition Act, the service provider with an SMP status shall provide services to other telecommunications service providers on the same commercial terms, and these terms may not be less favorable than those offered to other service providers controlled by it or controlling it.

According to the Contract on Universal Service Provision, we are obliged to treat similar subscribers in a reasonably similar manner and to refrain from effecting discrimination and/or unjustified advantage with respect to conditions and fees of universal service provision.

Hungary and the European Union

Hungary joined the European Union on May 1, 2004 and became a member state without transitional provisions.

In the field of telecommunications, the regulatory environment in Hungary was required to be harmonized with relevant EU Directives in 2004. The legal harmonization could be achieved by transposition of the EU New Regulatory Framework ("NRF").

The NRF was approved by the Commission in 2002, with the requirement that all member states adopt the legislative matters under their national legislation. According to the NRF, when implementing its measures, the national governments must take its unique national situation into consideration.

The NRF consists of a general framework directive and specific directives concerning:

- access to and interconnection of electronic communications networks;
- mandatory minimum service standards for all users ("universal service") and users' rights;
- authorization and licensing regimes;
- data protection and privacy; and
- decision on a regulatory framework for radio spectrum policy in the EU.

The new regulatory framework, in particular:

- Sets out the rights, responsibilities, decision-making powers and procedures of the National Regulatory Authorities ("NRAs") and the EU Commission. This includes the NRAs' obligation to submit to the Commission and the NRAs of other EU member states the draft regulatory measures that they intend to implement with respect to market definition and significant market power and the EU Commission's power to require NRAs to withdraw such drafts, if the EU Commission considers that such measures may create a barrier to the single European market or is incompatible with EU law.
- Identifies specific policy objectives that NRAs must achieve in carrying out their responsibilities (namely, to promote an open and competitive European market for communications services, to promote the interests of European citizens and to consolidate the EU's internal market in a converging technological environment).
- Provides that operators with significant market power in relevant communications markets will be subject to obligations set out in the directives on universal service and access.

The European Commission issued a recommendation on relevant product and services markets in February 2003. The recommendation identifies markets with certain characteristics that may justify imposition of regulatory obligations.

The EU Commission Recommendation relates, among others, to:

- the retail markets for access to the public telephone network at fixed location and publicly available local and/or national telephone services (both separately for residential and non-residential customers);
- the wholesale markets for call origination as well as call termination and transit in the fixed public telephone network;

unbundled access to the local loop; and

wholesale broadband access.

In the area of mobile communications, the framework directive deals with:

the wholesale market for access and call origination on public mobile telephone networks;

markets for call termination on individual public mobile telephone networks; and

the national wholesale market for international roaming services on public mobile telephone networks.

The EU Commission will regularly carry out a review of the recommendation on relevant markets.

Implementation of NRF in the member states is overseen by the European Regulators Group ("ERG"), which issues analyses and recommendations. The ERG is a newly established body composed of representatives of NRAs, which will play an important role in assisting the Commission in harmonizing the application of the new EU regulatory framework.

Due to the market development, the Commission initiated a revision of the Universal Service Directive, which will begin in 2005 under the supervision of EU Information Society ("EU INFSO"). It will initially focus on the revision of the scope of universal service and then on the revision of the definition of relevant markets. The Committee will address the revision of the NRF from 2006.

Hungary accomplished the implementation of the NRF and achieved legal harmonization of its legislation with the EU in the field of communications with the enactment of the Act C of 2003 on Electronic Communications and the adoption of certain implementation decrees in 2004.

According to the NRF, the NRAs are to assess the markets annually to follow and forecast the level of competition in the market. In Hungary, the market analysis procedure, the specification of relevant markets and the designation of SMP service providers in the relevant markets were initiated in the spring of 2004 on the basis of the NRF principles in the Act and is expected to be completed in the first half of 2005.

We have been an active member of the European Telecommunications Network Operators' Association ("ETNO"). We have also opened a representation office in Brussels on March 1, 2004. This office represents us on EU regulatory matters affecting Hungary at various forums, public hearings and official reconciliations and aims to establish active liaisons with other EU member states.

Broadcasting and Transmission

Broadcasting and transmission are governed by Act I of 1996 on Radio and Television Broadcasting ("Media Act"), Act LXII of 1993 on Frequency Management ("the Frequency Act"), Act on Electronic Communications and the Concessions Act. Under the Media Act, the National Radio and Television Board (the "NRTB") has the primary authority for issuing tenders for broadcasting contracts and registering broadcasters and transmitters.

National and regional television and radio broadcasting or broadcast "distribution" to local operators generally required concessions under the Telecommunications Act and could be carried out on the basis of a program distribution contract in accordance with the Media Act between the NRTB and the distributor. The Act on Electronic Communications does not change the existing regulation. Frequencies are assigned

under the terms of the Frequency Act. Entities registered as program distributors are permitted to transmit broadcasts of third parties to subscribers through a cable transmission network.

The restriction under the Media Act on our further expansion in the program distribution sector was lifted on January 1, 2004. Accordingly, we are now free to increase our ownership interest in any program distributor, including cable television companies, despite our existing controlling interest in one cable television company. The Media Act defines a "controlling interest" in any entity to include a more than 25 percent economic or voting interest or contractual or other arrangements giving the holder a controlling influence over the entity.

Development of the Telecommunications Regulatory Regime in Macedonia, the Fixed Line and Mobile Services Concession Contracts

The Telecommunications Act was enacted in 1996 by the Parliament of the Republic of Macedonia. This act was amended in 1998 within the privatization process, and subsequently in 2000, 2002 and 2004. The Telecommunications Act has been superseded by the Law on Electronic Communications ("ECL") enacted on March 5, 2005. Under the ECL, National Regulatory Agency (the "Agency"), a regulatory authority responsible for implementation of the ECL and the liberalization and competition within the telecommunications industry, was established.

Under the Telecommunications Act, the Minister of Transport and Communications, on December 22, 2000, issued a concession to Maktel ("Maktel Concession Contract"), under which Maktel was granted the exclusive right until December 31, 2004 to provide fixed line voice telephony services and to construct, lease, own, develop, maintain and operate fixed line public telecommunications networks.

In addition, the Minister of Transport and Communications issued a concession to Mobimak ("Concession Agreement") on June 5, 2001, which granted Mobimak the right:

to provide the following Mobile Public Telephony Services throughout the entire territory of the Republic of Macedonia and between places within the Republic of Macedonia and places outside of the Republic of Macedonia:

Analog Mobile Telephony Services

DCS-1800 Mobile Telephony Services

GSM Mobile Telephony Services

to construct, lease, own, develop, maintain and operate Mobile Public Telecommunications Networks.

The Concession Agreement is valid until December 31, 2018, and can be renewed for an additional 20 years without a tender.

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.

Universal Service. Under the ECL, the universal services include:

connection to the public telephone network and access to publicly available telephone services at a fixed location at a reasonable request of the user, enabling users to make and receive local, national and international calls, facsimile communications and transfer of data at the minimum rate of 2,400 bit/s;

providing access to directory enquiry services to all telephone subscribers in the Republic of Macedonia;

access to public payphones;

providing end users with special needs equivalent access to and use of publicly available telephone services.

Maktel's obligation to provide the universal services is subject to and contingent on the Agency's formulation and implementation of related rules, which must take place no later than 2 years after the enactment of the ECL.

Retail Prices. Prices of mobile services may be freely set by operators and providers. Prices for services provided by a monopoly (i.e., fixed line voice telephony services prior to December 31, 2004) must be based on costs.

Thirteen services provided by Maktel are regulated by the Maktel Concession Contract. Tariff regulation and maximum allowed tariff changes of these regulated services are based on the price cap method. Maktel is undergoing a rebalancing process of the regulated tariffs, which is planned to continue in the near future.

The Agency, based on market analysis, may impose price regulation on SMPs in a retail market.

Local Loop and Bit-stream Unbundling. As an SMP, Maktel is obliged to unbundle its local loops and to provide reference offers for unbundled access to the local loops within six months from the day of the ECL's enactment. Maktel has no obligation to provide bit-stream unbundling.

Interconnection. With the liberalization of the market and the ECL, Maktel is obliged to prepare reference interconnection offer within 30 days of the commencement of operations of the Agency, which is expected to take place within 60 days of the enactment of the ECL. All operators are obliged to respond to requests for interconnection to its public communications network to the networks of other operators. Currently Maktel has interconnection agreements with two mobile operators in the voice services market, Mobimak and Cosmofon. Mobimak has interconnection agreement with Cosmofon as well.

Carrier Selection. Maktel has the obligation to enable its subscribers to access publicly available telephone services of any interconnected operator.

Number Portability. Maktel and Mobimak, as operators of publicly available telephone services, must enable their subscribers to retain their non-geographic or geographic numbers when changing telecommunications operators. The number portability is scheduled to be fully implemented no later than two years after the enactment of the ECL.

Telecommunications Service Licensing Requirements. Based on the ECL, operators and service providers are obliged to notify the Agency in writing prior to the commencement of construction and/or use of public electronic communications networks and/or provision of publicly available electronic communications services, alteration or cessation of the provision of public communications networks or services.

Licensing and Allocation of Frequencies. The current licenses for radio frequencies were granted under the Maktel Concession Contract and the assignment of new radiofrequencies now must be approved by the Agency.

Under the Concession Agreement, Mobimak has the exclusive license to use bandwidth of 25MHz in GSM 900 band and is entitled to operate all radio stations it reasonably requires to provide Mobile Public

Telephony Services. Mobimak's use of these frequencies is subject to terms and conditions set forth in the Concession Agreement and to payment of fees associated therewith. No additional authority, application, tender or auction is required for Mobimak to use the assigned GSM 900 frequencies. No other operators (whether licensed or otherwise) may be assigned or may make use of the radio frequencies spectrum assigned to Mobimak's exclusive use.

Under the ECL, there is possibility of reassignment of already assigned frequency bands, if there is public interest that can not be satisfied in any other way, or, if necessary, for efficient spectrum use.

Frequency Fee. The frequency fee is payable to the Telecommunications Directorate. The current annual fee for bandwidth of 1 MHz in GSM 900 and GSM 1800 band is 90,000 EUR and 60,000 EUR, respectively.

Rights of Way. The public telecommunications operators have the rights of way over public and private property necessary for establishment of public telecommunications networks. The public telecommunications operators are obliged to take measures necessary to avoid unnecessary damage to the property used. The related regulations prescribed in the ELC shall be adopted within six months from the day of its enactment.

Interconnection. Mobimak is obliged to provide roaming services for its subscribers with other GSM networks compatible for roaming in and outside the country. The roaming service is provided through roaming agreements with other providers of GSM mobile telephone services or public mobile telecommunications service operators.

Macedonia and the European Union

The Republic of Macedonia signed the Stabilization and Association Agreement with the European Union and its Member States on April 9, 2001. The Macedonian Parliament ratified the Agreement on April 12, 2001, reaffirming the strategic interest and the political commitment for integration with the European Union. The Stabilization and Association Agreement has been ratified and in force since April 1, 2004.

The Stabilization and Association Agreement requires harmonization of Macedonian telecommunications laws with that of the EU and its member states.

PRICING

Hungarian Fixed Line Operations

Connection Fees

Connection fees are determined based on costs of installation and development of our network. Decree 3/2002 (I.21.) MeHVM on "Charges for Voice Telephony Services Provided by Companies with Significant Market Power and Tariff Packages Related to Universal Services" ("the 2002 Fixed Line Tariff Decree") gives service providers the right to collect an additional fee of up to 50 percent of the costs incurred for providing connections in rural areas, if the connection fee does not cover the direct costs of the service provider. Connection fees and subscription charges, but not usage charges, are different for our business and residential customers. We may apply discounts to the published charges but are not allowed to exceed any published charge.

Subscription Fees and Usage Charges

Under the Pricing Act, as modified by the Act on Electronic Communications, the Minister, together with the Minister of Finance, is responsible for establishing the maximum tariffs for universal services. Tariff regulation in Hungary is currently based on the price cap method in case of universal services. According to the draft SMP decrees concerning residential and business access markets, a different type of price cap will apply to subscription fees of various price plans.

Since February 1, 2002, fixed line tariffs and connection fees have been regulated by the 2002 Fixed Line Tariff Decree. This decree has been modified to limit the scope of the price regulation to the maximum tariffs of universal services.

The 2002 Fixed Line Tariff Decree established rules relating to the price regulation for the 3 year period ending in December 2004. The Decree established the price cap formula, under which our annual price cap was calculated by reducing the forward-looking Consumer Price Index ("CPI") by the three percent productivity factor. The draft SMP resolution concerning residential and business access markets extends the applicability of price cap to all subscription fees. The draft resolution provides that the maximum aggregate price increase of the subscription fees cannot be higher than the forward-looking CPI.

On January 1, 2004, we set new prices for our services. To better reflect the market conditions, we maintained our residential subscription fees, while analog and ISDN business subscription fees were moderately increased, thus resulting in an average subscription fee increase of one percent. Both peak and off-peak local minute fees were increased by 5.7 percent each. However, as the call set-up charge was not changed, the increase in the average price index for local usage was five percent, below the ceiling of six percent established by the price cap rules. No other usage fees were changed. In 2005, we increased the subscription fee of some of our residential price plans by 5.6 percent, while including additional value added services (e.g., call waiting) and discounts free of charge for those price plans.

Tariffs for PSTN access to the Internet

Since January 1, 2004, retail tariffs for PSTN access to the Internet are no longer regulated. Since 2002, however, a part of the charge billed to the customer 30 percent in peak time and 10 percent in off-peak time must be transferred to ISPs. In case of flat rate Internet access, 13 percent of the fee must be transferred to ISPs. This type of revenue sharing remains in operation under the Act on Electronic Communications. Since January 1, 2004, Internet call origination and Flat Rate Internet Access Call Origination ("FRIACO") services are part of the Reference Interconnection Offer ("RIO") and the prices of these services are also regulated within the scope of the reference interconnection offer (tariffs approved by the NCA).

On July 1, 2004, we introduced wholesale "bulk minute" packages. These packages allow ISPs to buy 10,000-minute units of wholesale Internet traffic for prices as low as HUF 2.45 per minute for peak and HUF 1.37 per minute for off-peak.

Leased Line Fees

After our concession ended in the area of leased lines required for interconnection, the leased lines market became unregulated in 2002. On the leased line market, however, we have been declared as an SMP both in 2002 and 2003. As a result, we filed a RIO containing leased line interconnection services first in October 2002, then in August 2003 and in January 2004. The NCA accepted the first RIO containing a minimum set of leased line interconnection services in June 2003.

Leased line interconnection services in the RIO currently include leased lines with 2 Mbit/s bandwidth differentiated by their length: local (0-25 km), regional (26-50 km) and national (51-100 km). The prices of these services are also based on the LRIC methodology.

The NCA has published an SMP draft resolution on the wholesale leased line market. In case of the leased line transit market, we were not identified as an SMP (no operator has been identified as such). However, we have been identified as the only SMP operator in the wholesale leased line termination market in the entire country, not just in our service area. The NCA established a retail-minus type tariff regulation for us in this market. However, the exact procedure and method of this future regulation is not yet known. In the retail-minus type tariff regulation, the wholesale prices are determined based on the retail prices.

Regulated Wholesale Prices

Since December 23, 2001, the interconnection tariffs are no longer regulated on an itemized basis but as part of the reference interconnection offer. Since January 1, 2004, local bitstream access as a new service must be offered as part of the Reference Offer for the Unbundling of the Local Loop ("RUO") and its prices are regulated within its scope. According to the Act on Electronic Communications, in the interim period, until the first market analysis procedure is carried out toward setting the new solutions, the SMP operators are obliged to use the LRIC methodology for calculating the cost-based prices of the RIO services (interconnection tariffs) and the Fully Distributed Costs ("FDC") methodology for calculating prices of RUO services. The LRIC and the FDC methodologies are regulated by the Ministerial Decree 18/2003 (XII.27.) IHM on cost calculation of electronic telecommunications services. The cost-based unbundling and interconnection tariffs must be approved by the NCA. The reference offers must contain approved tariffs.

The NCA has published its draft SMP resolution on the wholesale broadband market, and identified Magyar Telekom Rt., as well as all other LTOs, as SMPs. As is the case with the wholesale leased line termination market, retail-minus type regulation has been established for the wholesale broadband market. According to the draft resolution, the NCA intends to transform the local bitstream access service currently provided by us into a nationwide bitstream access service and base its tariff regulation on retail-minus type tariffs. The local bitstream access service currently exists in the RUO on a cost-based price.

We are obliged to include, in addition to other services that are already part of the RIO and RUO, Internet call origination and FRIACO in our RIO and local bitstream access in our RUO.

The RIO and RUO complying with these regulations have been submitted to the regulator on January 15, 2004. The NCA approved both the RIO and the RUO on June 14, 2004 and on July 29, 2004, respectively. New interconnection fees approved by the NCA are set out in the table below. According to the resolution, new fees have been applied since June 15, 2004.

Interconnection services *	**peak HUF/min**	**off-peak HUF/min**
Local origination	2.42	1.27
Regional origination	3.48	1.82
National origination	4.87	2.56
Local termination	2.07	1.09
Regional termination	3.09	1.63
National termination	4.42	2.32

Internet Interconnection services *	peak HUF/min	off-peak HUF/min
Local origination	2.18	1.14
Regional origination	3.13	1.64
FRIACO	260,258 HUF/month/2 Mbit/s	

* *exclusive of VAT*

All former network interconnection contracts with LTOs and mobile operators have been modified to RIO based network contracts in 2003. These agreements will be modified bilaterally when the NCA approves a new RIO.

Other wholesale prices

The Act on Electronic Communications provides that network access fees be set in a controlled way under objective criteria, based on the principals of transparency and non-discrimination. Starting January 1, 2004, the cost of wholesale access services must be calculated based on LRIC and the prices of these services must be submitted to the NCA for approval, even if the service provider is not obliged to make a reference offer for the service.

Network access and interconnection agreements between Magyar Telekom and ISPs

We sign network access contracts with ISPs to secure access to services provided by ISPs for our subscribers. In addition to the network access contracts, ISPs may sign interconnection contracts with us. If ISPs choose an operator other than us, such operator must sign an interconnection agreement with us to ensure access to the services of these ISPs for our subscribers. The conditions applied in the access contracts must be in line with legal requirements and terms and conditions of the existing subscriber contracts.

Reverse charging agreements between Magyar Telekom and ISPs

In November 2001, we started to enter into reverse charging agreements with a number of ISPs. Under these agreements, customers remit payment for Internet services to the ISPs instead of directly to us. This scheme allows ISPs to offer various price plans based on their customers' needs.

"Price squeeze" (predatory pricing) issues

According to the Act on Electronic Communications, SMP service providers must avoid price squeeze when establishing prices of network services. When service providers reduce their end user prices, they are also obliged to appropriately reduce their prices specified in their reference offers. This provision only apply if the price reduction may affect more than 10 percent of subscribers of the service subject to the price reduction, or the impact of the price reduction exceeds five percent of net sales of the service subject to the price reduction.

If the regulatory authority identifies price squeeze, the NCA examines whether the price of the network service is in line with the incurred costs. If the network prices are cost-based, the NCA refers the case to the Competition Authority. If the network prices are not cost-based, the NCA determines the minimum mandatory margin between the price of the network service and the end user service and/or orders the service provider to modify the reference offer.

Hungarian Mobile Operations

Market assessment, SMP designation process and interconnection

Upon request for interconnection (to provide either network access or network interconnection) from another telecommunications operator, TMH is required under the Act on Electronic Communications and Government Decree 277/2003 (XII.24.) to provide such services, if such request is justified on both technical and economic grounds and provision of such services is not impossible due to the limitation of resources.

See "Item 8 Legal proceedings" for developments on TMH's SMP designation process and interconnection tariffs.

Macedonian Fixed Line and Mobile Operations

The Agency may impose obligations for cost-based pricing and price control on SMPs in a relevant market. The price of services designated as universal services must be equal throughout the country.

The regulatory framework for the tariff regulation is provided in the Concession Contract. Change in the price of the basket of regulated services is determined annually by the price cap method.

Tariffs for PSTN access to the Internet. The tariffs for PSTN access to the Internet are currently not regulated. Wholesale Internet dial-up offers have been submitted to the ISPs in Macedonia.

Leased Line Fees. Leased lines pricing is part of the aggregate price cap regulation.

Regulated wholesale prices. Under the ECL, the Agency may order an SMP to set prices for specific types of interconnection and/or access to local loops on the basis of costs and features and capabilities included in cost accounting systems. The current interconnection fees between Maktel and the two mobile operators, and between two mobile operators themselves, are determined based on interconnection agreements.

"Price squeeze" (predatory pricing) issues. Prohibition of predatory pricing is provided in the Law on Protection of Competition, according to which a market participant must not abuse its dominant position by imposing, directly or indirectly, unfair purchase or selling prices or other unfair trading conditions.

ORGANIZATIONAL STRUCTURE

MagyarCom, which is fully owned by Deutsche Telekom, owns 59.21 percent of the Magyar Telekom ordinary shares.

As of December 31, 2004, the principal operating associates, joint ventures and subsidiaries of the Company were as follows:

Operating partners / Joint ventures	Group interest in capital	Activity
Hunsat Rt.	50.00%	Satellite telecommunications
Magyar RTL Televízió Rt.	25.00%	Television broadcast company
T-Systems Hungary Kft. (TSH).	49.00%	Systems integration for business customers

Subsidiaries	Group interest in capital	Activity
Incorporated in Hungary:		
T-Online Magyarország Rt.	100.00%	Internet service and content provider
BCN Rendszerház Kft.	100.00%	Solutions for business customers
Emitel Rt.	100.00%	Local telecommunications operator
InvesTel Rt.	100.00%	Cable TV holding
T-Kábel Magyarország Kft.	100.00%	Cable TV operator
T-Mobile Magyarország Távközlési Rt.	100.00%	Mobile telecommunications service provider
Incorporated in Macedonia:		
Makedonski Telekommunikacii AD (Maktel)	51.00%	Fixed line telecommunications services
Mobimak AD	51.00%	Mobile telecommunications service provider
Telemacedonia AD	100.00%	Management consulting
Stonebridge AD	100.00%	Holding company

PROPERTY, PLANTS AND EQUIPMENT

Hungarian Fixed Line Operations

We have one of the largest real estate holdings in Hungary. We use substantially all of these properties for telecommunications installations, computer installations, research centers, service outlets and offices.

Due to the consolidation of various operations, the conversion to digital switches and ongoing staff reductions, we anticipate that a substantial portion of our owned and leased properties will not be necessary for our core business in the future. We intend to sell or rent our surplus properties.

In the fourth quarter of 1999, the operations of Magyar Telekom Rt.'s real estate holdings were outsourced to Trammell Crow-Wallis, a real estate management and consulting company. On January 1, 2003, our real estate development, investment and area management operations were outsourced to Trammell Crow-Wallis as well.

We intend to rely fully on outside providers of facility and real estate management services in the medium-term. We are accordingly developing a new service-based contract structure and intend to terminate all our remaining in-house real estate management functions. Our aim is to secure reliable facility and real estate services at the needed quality level and at prices that allow flexible management of our changing real estate portfolio and reduction of real estate management expenses.

To implement these objectives, we founded Telit Rt., a fully owned real estate management subsidiary in the second half of 2004. On February 1, 2005, we sold Telit Rt. to DeTe Immobilien (a fully-owned Deutsche Telekom subsidiary) for EUR 2.1 million. Telit Rt. will provide real estate services to Magyar Telekom Rt. based on a long-term service contract effective February 1, 2005. This new contract will allow us to further strengthen the relationship with the DT Group and at the same time reduce our costs. A small strategic real estate management unit will remain in Magyar Telekom.

Our equipment and machinery primarily consists of switches, communication towers, and other telecommunications equipment.

Hungarian Mobile Operations

Significant part of TMH's property, plants and equipment ("PPE") consists of assets necessary for the GSM network operation, such as transmission equipment, switches and radio units on the base stations.

In the following years, we expect that the proportion of the UMTS related assets will increase in TMH's PPE, in line with the obligation of the license decree.

Other significant part of the non-current assets of TMH consists of intangible assets, which include the GSM and UMTS concession fee.

Macedonian Fixed Line and Mobile Operations

Maktel's and Mobimak's properties are used for telecommunications equipment installations, call center, IT installations, outlets services, administrative offices and warehouses. Maktel also has several operating lease contracts as a leasee for stores and a small number of offices.

Maktel plans to outsource its real estate management operations to a third party starting in the first half of 2005.

Maktel's and Mobimak's equipment mainly consists of switches, base stations, communication towers and other telecommunication equipment.

INFRASTRUCTURE AND TECHNOLOGY

Hungarian Fixed Line Operations

Expansion of Access Networks. At the end of 2000, we began to offer our broadband Internet access services, based on the ADSL and Asynchronous Transfer Mode ("ATM") technologies. We selected Ethernet based Digital Subscriber Line Access Multiplexers ("DSLAMs") in 2004 to provide a more cost effective ADSL solution together with the ATM technology already in use. The ADSL transmission system provides high-speed digital access to any data network over existing copper wires without interruption of Plain Old Telephone System ("POTS") and ISDN2 services with the data speed of 384 and 512 Kbit/s and 1, 1.5 and 3 Mbit/s. In 2004, we continued the national roll out of the ADSL technology. At the end of 2004, over 200,000 customers were using ADSL lines for connection to the Internet. By the end of 2004, our infrastructure allowed up to 1.9 million of our analog and ISDN2 subscribers to have access to the ADSL service. This represents coverage of 383 towns and 78 percent of the population in our service area.

Wireless solutions. In 2003, we introduced the WLAN technology in the access network for hot spot applications. By the end of 2004, 158 hot spot sites were in operation. With this technology, we can provide Internet access service in public areas to customers requiring temporary Internet access (e.g., conference centers, exhibitions, airports, hotels). Since the end of 2004, T-Mobile Hungary's WLAN users and Magyar Telekom Rt.'s WLAN users can use hot spot sites operated by either entity. In 2005, we plan to increase the number of domestic roaming partners to allow our users to use other wireless service providers' network infrastructure.

We use fiber optic cables for our fixed line local loop networks for approximately 160,000 customers as of the end of 2004. We installed a substantial amount of the local network fiber optic cable in Budapest, where segments of the old cable were in poor condition and where we believe the demand for high capacity and high quality transmission will be the greatest (e.g., shopping malls, industrial parks). We plan to extend our local fiber optic network both inside and outside Budapest to cover new demands in existing areas. We provide broadband services in areas of optical access as well.

We have been selectively applying radio technology in our local loops since 1996. The system was initially analog, but since 1999, we have been replacing it with fixed GSM. We use the fixed GSM technology primarily for customers in rural areas without fixed line network access and, on an interim basis, to meet demands that cannot be satisfied immediately with the existing fixed line infrastructure. At the end of 2004, approximately 93,470 subscriber lines were based on the radio technology.

CityNet. CityNet is an overlay network for large cities that connects our nodes and key business customers with optical cables. It provides customers with access to our business communications services. This network typically provides ISDN30, Managed Leased Line Network ("MLLN") and HSLL services. HSLL customer end points are provided with transmission speed of 2 Mbit/s to 2.5 Gbit/s.

Backbone Network. We have a digital fiber optic national long-distance network that connects local primary area networks. We have implemented DWDM technology and SDH systems in both the national long distance and Budapest networks. The countrywide DWDM backbone network, installed in 2001, provides high capacity (maximum 24 times 10 Gbit/s) in the most important nodes of Hungary, as well as in

international directions. In addition to cost advantages, Synchronous Digital Hierarchy ("SDH") systems provide a flexible transmission infrastructure with automatic transmission paths. We introduced a new generation of the SDH system that, besides increasing network availability and transmission capacity, enables new services, such as data (e.g., Ethernet) transmission. In 2004, the increase in the capacity of the backbone network served the growing demand of IP core network and HSLL. The HSLL is mainly provided for mobile operators. Since we have a robust optical backbone network, we do not intend to expand it to a significant extent. As of December 31, 2004, we had approximately 4,500 kilometer of backbone optical cable network.

Internet Core Network. Since 2000, we have been providing Internet access and IP-VPN services on the same IP/MPLS platform. The network was initially based on MPLS over ATM technology. Since 2002, a major capacity upgrade has been in progress to support the expansion of broadband access, mainly ADSL. This included a migration from the ATM-based to the pure router-based Multi Protocol Label Switching ("MPLS") technology by the end of 2003, deploying Gigabit Switch Routers that utilize the transport capacities of the WDM platform. The network has several access options (dial-up, leased line, broadband DSL, CATV) with PoPs in each primary area in Hungary. Available services include IP-VPN (scalable interconnection for corporate sites with Integrated Voice and Data option), IPSec and xDSL to VPNs, Virtual Private Dial-up Network and wholesale Internet services for ISPs. In 2004, we continued to upgrade the transport capacity of the smaller IP nodes using Gigabit Ethernet technology, to scale broadband aggregation capacities further in the future. IPv6 protocol support and backbone Quality of Service ("QoS") capabilities are also considered in the medium-term. In 2004, we undertook significant geographical extension of the IP network, and this development will continue in 2005 as well.

Asynchronous Transfer Mode. We introduced in 1999 the first public network based on the ATM technology in Hungary, with which we provide high speed LAN-Flex, Cell-Flex and WAN-Flex services. LAN-Flex offers LAN interconnection service, while Cell-Flex offers a high-speed data transmission service. Both services provide flexible bandwidth delivery. In addition, WAN-Flex service provides 2 Mbit/s Time Division Multiplexing ("TDM") link to connect PBXs of subscribers. ATM is also the connectivity network that concentrates xDSL traffic towards the IP backbone. Since 2003, we have been using cost effective ATM concentrators and subscriber units.

Managed Leased Line Network. We established our n*64 Kbit/s speed digital managed telecommunications network in 1996. This continuously growing network provides a platform for the managed leased line services (Flex-Com), frame relay services (Frame-Flex) and leased line access for the IP-VPN services as well as the X.25 (Datex-P) service. MLLN is a homogeneous, very reliable network managed by a central management system. The MLLN platform provides practically full coverage for business customers in our areas. In 2005, we plan to introduce cost efficient MLLN access offerings.

Intelligent Network. We launched the first set of IN services in 1998, including shared cost and toll free numbers, televoting and virtual card calling. In 2000, we introduced prepaid card calling services. In 2001, new features were added to the prepaid application and a new price plan was introduced for residential customers. Recharging of fixed line prepaid cards can be done at automated bank machines. The popularity of intelligent network services required a roll out of service switching functions to most of our digital exchanges. In 2002, we introduced new services such as Audiofix to support increasingly popular media games. We upgraded the existing Freephone Number services by user-specific routing trees. In 2004, we further improved existing services to better meet customers' demands. To develop new IN-based services and to enhance and expand the existing services in line with customer needs, we started preparing for the platform modernization.

Modernization of Switches and Exchanges. We have rationalized our switching architecture to increase the operational efficiency of our network. Due to the migration towards more complex services, the ratio of old type exchanges has been diminishing. The preparations for the liberalized telecommunications market included major upgrading of our PSTN/ISDN platform. As a result of this

development, our subscribers can now use the telecommunications network of other operators to make local, national and international calls, and our network can be also accessed by subscribers of other operators for similar calls. To fulfill regulatory requirements, we modified our network to support Service Provider Number Portability for fixed numbers. Preparation for Location Portability is also underway.

We continue to digitalize our local networks. At December 31, 2004, 92.9 percent of our exchange capacity was digital, compared to 85.4 percent at December 31, 2001. Each of our service areas is served by a digital primary exchange. Digitalization permits us to provide a broader range of services and generates operational cost savings. Digitalization is also a prerequisite for providing ISDN services. The number of local exchanges capable of providing ISDN services has increased and the number of ISDN channels grew from 448,396 at December 31, 2001 to 525,346 at December 31, 2004. On the basis of the ISDN infrastructure, our network supports circuit switched high-quality Internet access and packet switched data transmission for ISDN subscribers. Under our current network development plan, we plan to replace all analog switches with digital ones by the end of 2005.

Fixed SMS. In 2002, we introduced the SMS for our fixed line customers. During 2003, new features were added to this service, and the SMS links with major mobile providers were established. The public payphones have been upgraded with the SMS capability. In 2004, we started preparing for the introduction of MMS for our fixed line customers.

Prepaid card based applications. We developed proprietary public Internet terminals (with features such as VoIP, SMS, e-mail, printing capability, camera, etc.), which also provide telephony functions.

Network Quality. Investment in the network, particularly in its modernization, has led to significant improvements in the network quality. Modernization, particularly the digitalization and rationalization of our switching architecture, has also contributed to an increase in the productivity of our employees.

Information Technology. We have dedicated a significant amount of resources to improve our information technology systems. We believe that the continuing development of these systems is essential to improving customer service and the efficiency and productivity of our employees.

Our nationwide operational support system integrates the following elements:

- billing;
- automated call collection;
- network traffic management;
- workforce and workflow management;
- element, network and service management (configuration, alarm management, SLA management); and
- process controlled technical inventories.

This operational support system permits us to offer itemized billing, to bundle products and services in price plans and to generate a single bill for customers with multiple locations. Automated call collection maintains customer billing information and improves tracking of traffic. Network traffic management facilitates reduction of traffic (and revenue) losses caused by unexpected traffic surges or technical outages by maintaining the optimal service level.

We have embarked on a number of other information technology initiatives designed to monitor and improve the efficiency of our network and the employee productivity. A switched network operation and management system facilitates the centralized management of services, switches, network and signaling.

We implemented a Work and Force Management System ("WFMS"), a new testing system for our access network and for POTS, ISDN, Managed Leased Line, High Speed Leased Line, IP based and ADSL services, and a new Automatic Call Distributor ("ACD") to field customers' calls efficiently to call centers. The nationwide roll out of the WFMS was completed in 2000. The workflow supporting the provision and fault clearance of the Managed Leased Line, High Speed Leased Line and IP based services has been successfully implemented in 2003. Our WFMS system has been awarded a Silver Award (2nd prize) by Workflow Management Coalition ("WfMC"), Giga Information Group and WARIA in the "Global Awards for Excellence in Workflow Europe" category in 2003.

We introduced a new integrated technical inventory platform (Xng) to support activities of network resources and capacity management, off-line and on-line (Internet based) SLA report services for managed leased line and the IP based services. We completed the upgrade of our IT systems to facilitate the number portability required by the Act on Electronic Communications.

Macedonian Fixed Line Operations

Maktel endeavors to maintain its network at a high technological level to offer and provide a wide range of products and services that will satisfy customers' demands.

Modernization of Switches and Exchanges. The PSTN/ISDN network in the Republic of Macedonia has been fully digitalized since the end of 2003. To consolidate the network and increase operational efficiency, Maktel is restructuring its switching architecture and decreasing the number of hosts. The liberalization of the telecommunications market required Maktel to perform a substantial upgrade of the PSTN/ISDN platform. With the upgrade, switching systems are now able to support carrier selection and pre-selection functions and certain preconditions for the implementation of number portability have been also established.

Voice-mail Platform. As a result of the introduction of voice-mail services in July 2004, Maktel expects a decrease in the number of uncompleted calls, which will lead to additional revenues.

Signaling Monitoring System. Monitoring of the signaling network is a key for achieving significant improvement of the service quality and decreasing operational costs.

Intelligent Network Platform. During 2004, to enrich its service portfolio, Maktel implemented the IN platform in the network. The following services have been introduced so far: toll-free number, split charging, televoting, prepaid cards and prepaid telephony.

Access Network. The existing copper-wire network is a good basis for introduction of broadband services based on the DSL technologies. At the end of 2003, Maktel introduced broadband Internet access services based on the ADSL technology. Optical cables in the access network are used for connection of key business customers. The implementation of Metro Ethernet has already started with deployment of customized Metro Ethernet solution in Skopje.

Very Small Aperture Terminals ("VSAT"). VSAT technology was introduced in 2002 to provide telephone connections in rural areas without GSM coverage.

Managed Leased Line Network. Maktel uses a central management system to coordinate its homogenous and reliable MLLN. It is built on three levels, each one connected to the existing transport SDH/Plesiochronous Digital Hierarchy ("PDH") network. The platform offers a wide range of services to business customers, such as leased line access for IP-VPN services, Frame Relay services and X.25.

Backbone Network. Maktel's primary area networks are connected to the fiber optic national long distance network. The SDH technology has been implemented in the backbone network, in the

transmission networks in Skopje and other cities in the country. The total length of the backbone optical cable network was about 1,200 kilometer at the end of 2004.

IP Network. The core of the IP Backbone network is built on the Gigabit Switch Routers ("GSR") platform. The core is connected to the global Internet network through two main Internet Gateways. Available services include IP VPN, ADSL, Dial-up Internet access and wholesale Internet services for ISPs.

Data packet switched network. The data packet switched network, called MAKPAK, has nodes in the largest cities in Macedonia. MAKPAK offers four basic services: Dial-up X.28 access over PSTN, Direct X.28 asynchronous access, Direct X.25 access and Frame Relay access.

Information Technology. In the past few years, Maktel has modernized its information technology systems. Maktel considers continuous development and introduction of new integrated IT systems essential for implementation and improvement of customer services and employee productivity.

Hungarian Mobile Operations

GSM network. TMH operates a nationwide GSM public digital mobile network in the 900 MHz band with 8 MHz duplex spectrum since 1994 and in the 1800 MHz band with 6 MHz duplex spectrum since 1999 and in the 1800 MHz band with a total of 15 MHz duplex spectrum since January 2004. To guarantee the best possible service quality for our customers, we are dedicated to the continuing network roll out to meet traffic and coverage demands.

Coverage. In 2002, our focus was on improvement of indoor signal reception, which resulted in 10 percent improvement, and on completing the full radio coverage of the subway system in Budapest. In 2003, coverage of villages with population between 1,000 and 10,000 was increased substantially from 80 percent at the end of 2002 to 91.6 percent at the end of 2003. By December 31, 2004, this level was further raised to 97 percent. The deep indoor coverage was raised up to 97 percent in Budapest and 96 percent in cities over 100,000 inhabitants in 2004.

Modernization programs. Hardware modernization and software upgrade programs are regularly carried out. Major projects we undertook recently were replacement of the central processor unit in mobile switching centers in 2003, upgrading of the base station controller hardware in 2004, and a three-year microwave transmission swap program we started in 2003.

Business continuity planning. TMH pays particular attention to developing disaster tolerant solutions to ensure service and business continuity. We introduced in 2004 a new feature called Home Location Register ("HLR") redundancy in the core network to safeguard our subscriber database and keep it functional in the event of a disaster. In case of a complete outage of a mobile switching center or a base station controller, a special proprietary software helps the Network Operation Center rapidly reorganize network resources to minimize service loss.

Packet switched data services: GPRS and EDGE. General Packet Radio Service was introduced by TMH in March 2001, for the first time in Hungary. GPRS provides a continuous seamless connection and higher data rates. At the end of 2003, commercial EDGE service was launched in approximately 23 percent of Budapest area. Data rates of EDGE could be three times higher than that of GPRS. In 2004, the EDGE development project was continued, resulting in 91 percent area coverage of Budapest by the end of the year. TMH and Ericsson successfully demonstrated the high-speed mobile data rate of the EDGE technology in June 2004. TMH's commercial network configuration currently supports peak data rates of around 100 Kbit/s.

Universal Mobile Telecommunications System: In October 2003, TMH became the first operator in Hungary to support video calls on its own UMTS test network in cooperation with Siemens Mobile, Ericsson and Nortel Networks. The 3G network enables besides rapid data transmission and video telephony more comprehensive and interesting contents than before, including, in addition to image and text, the faster transmission of high quality multimedia materials. The pilot network providing UMTS coverage at four different points in Budapest was tested by engineers by the end of 2003.

In December 2004, TMH was awarded a 3G service license and was granted the use of 15 MHz duplex and 5 MHz unpaired 3G spectrum until 2019. In the vendor selection procedure, TMH chose Ericsson Hungary to deliver its UMTS radio access network.

Information Technology. TMH's operations are supported extensively by IT solutions. A great number of closely integrated application systems are used in sales, customer service, collection, service provisioning, call data processing (mediation) and charging, fraud management, billing, handset logistics, interconnect billing, general ledger reporting and electronic document archiving.

A postpaid customer care and billing system ("JAZZ") was put into operation in 1998, after a two-year-long in-house code development. JAZZ is a three-tier client-server architecture system, integrated with Oracle Financials Enterprise Resource Planning ("ERP") system, with self care systems, like Integrated Voice Response ("IVR"), Internet, Web commerce and SMS. In 2004, JAZZ was integrated with Amdocs Clarify Customer Relationship Management system based on Tibco Enterprise Application Integration platform.

TMH's prepaid service relies on our proprietary application system called Domino. In Domino operations environment, telecommunications network nodes, like Mobile services Switching Centers ("MSC") or IN node, are interworking with IT server clusters, IVRs and protocol converters.

TMH operates proprietary Data Warehouse ("DWH"), which provides management and endorsers with business reports and marketing and finance analysts with detailed subscriber, traffic and business information for on-line interactive analysis. DWH is playing a major role in customer segmentation and customer life-cycle value calculation.

Macedonian Mobile Operations

Network development. During its eight years of operation, Mobimak has built a high quality and high capacity network that meets the requirements and needs of its growing subscriber base. The Radio Access Network consists of 483 base stations installed on 337 sites, 2,624 transceiver units, 123 mini-link transmission hops, and 90 repeaters. The Core Network and Supporting Systems consist of 4 Base Station Controllers ("BSC") and 3 Mobile Services Switching centers installed on 3 different sites. In addition, stand-alone HLR, Prepaid node, SMS/Voice Mailbox Service ("VMS")/MMS nodes and Compact GPRS Support Node ("CGSN") are fully operational. The entire network is centrally controlled and monitored by Operation and Support System ("OSS") located in Skopje.

Information Technology. Our rating and billing platforms provide enhanced services for the entire prepaid and postpaid customer base. Having implemented systems from market leaders in this area, we are capable of providing fast, accurate and flexible rating and billing features for our customers. In addition, comprehensive solutions for promotions, discounts and incentives provide extensive flexibility for tailored offerings and customer satisfaction.

Mobimak uses DWH for reporting and analysis of marketing and financial results.

We have implemented a variety of value added service platforms (e.g., SMS, MMS, WAP) that satisfy different needs of our customers.

M-payment and e-payment services are becoming increasingly popular. We are embarking on a new field of mobile-phone-based financial services to our customers in cooperation with banks and financial institutions.

ENVIRONMENT PROTECTION

Due to the nature of our business, our operations do not adversely affect the environment to any significant degree, however, we are paying close attention to environmental protection.

Our commitment for environmental protection first led to our signing of the Environmental Charter of the ETNO in 1998, which was replaced by a more extensive commitment, Sustainability Charter, in 2004. As a member of ETNO Sustainability Working Group, we hosted the first European Conference on Telecommunications and Sustainability in Budapest.

To mitigate or minimize adverse effects to the environment and to improve the environmental performance on a continual basis in areas of operations with the greatest risk, ISO 14001 environmental management systems were implemented in the following areas: mobile, network management, network services, telecommunications development, real estate management, procurement and transportation.

To inform interested parties, we have been publishing Annual Environmental Reports since 2000. We have annually presented our performance in this area at the group-level starting in 2002. In 2004, we published our first Annual Sustainability Report including economic, social and environmental procedures and results. The report was prepared using the 2002 Global Reporting Initiative ("GRI") sustainability reporting guidelines, and has been verified by an independent body. These reports can be accessed on our website.

In 2004, our sustainability report won the second prize in the Central European Environmental Reporting Award. The jury included a representative of the Environmental Department of the European Bank for Reconstruction and Development ("EBRD"), an external expert of the World Business Council for Sustainability Development, a lecturer from the Central European University, a representative of the Central European Centre for Environment Protection and an environmental journalist for HVG.

Since 1998, we have annually organized Environmental Round Table Discussions to present our environmental achievements, as well as to learn about challenges facing other participating parties and to answer their questions. Among the parties participating in these forums are the Communications Authority, the Ministry of Environment and Water Management, the Environmental Protection and Nature Conservation Authority, Directorates of National Parks, non-governmental organizations for environmental protection and nature conservation, various research institutes as well as Magyar Telekom Rt. and its subsidiaries. In 2004, DT also joined this event and gave a presentation on environmental, nature conservation and sustainability issues.

One of the main adverse environmental effects of our operations is our electricity consumption primarily for the operation of telecommunications equipment, and to a lesser extent, for the operation of buildings. To reduce consumption, we launched pilot programs modeling the best practices of other European telecommunications companies. We have also launched a pilot program aimed to use more renewable resources.

We have also taken considerable steps to reduce fuel consumption of vehicles, for example, by making employees aware of alternative communication methods (such as audio and video conferences) to reduce the number of business trips for internal purposes.

In addition to our commitment to reduce paper consumption, we started to use recycled paper in our offices in 2004.

Underground fuel tanks for diesel generators, which ensure the continuity of our services, pose a potential risk to the soil and the underground waters. To mitigate this risk, we have set up a program to double-wall those tanks to ensure compliance with applicable laws and to prevent possible pollution.

Magyar Telekom, like other telecommunications service providers, collects and administers wastes in compliance with relevant regulations. We then transfer them to licensed companies for further handling and destruction, while making an effort to reutilize (recycle) as much of these wastes as possible. The aim is to process and recycle valuable metal, plastic and electronic wastes from outdated devices, which are large in quantity due to the ever shortening life-cycle of telecommunications technologies. In 2004, we developed a software to meet the requirement of a new regulation, which requires daily monitoring of wastes at more than 80 sites of the Company.

TMH considers important the effect of electromagnetic radiation on the environment. The growth of the number of mobile telephone subscribers requires expansion of the network and the base stations. For example, a new base station must be installed for every 1,000-1,500 new subscribers. When planning its new facilities, TMH complies with the MSZ 16260-86 standard that specifies the maximum emission permissible in the vicinity of the base stations. We assign special importance to the location of antennas as regulated by the MSZ/T-17200-9 standard. Before installing a base station or an antenna tower, we consult with affected parties (residents, local municipalities, independent organisations) and, whenever possible, we take their demands into consideration.

ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read together with the consolidated financial statements, including the accompanying notes, included in this annual report. The consolidated financial statements, the accompanying notes as well as the discussion of results presented below have been prepared in accordance with IFRS. IFRS differs in certain respects from U.S. GAAP. For a discussion of the principal differences between IFRS and U.S. GAAP as they relate to us, see Note 36 to the consolidated financial statements. Revenues and operating expenses discussed under " Results of Operations By Segment" do not reflect intrasegment and intersegment eliminations. Our results of operations and medium-term prospects should be considered in light of a number of rapid and fundamental changes occurring in both the company and the environment in which we operate:

Market Liberalization. Our exclusive rights to provide fixed line domestic and international long distance service throughout Hungary ended in December 2001. Our exclusive rights to provide fixed line local service in 31 local concession areas ended in December 2001 and in five local concession areas ended in May 2002. Emitel, our fully owned subsidiary, had exclusive rights in an additional three concession areas through November 2002.

Interconnection Fees. From December 23, 2001, the fixed line interconnection tariffs are no longer regulated by the itemized price regulation but according to the cost calculation methodology. The cost-based unbundling and interconnection tariffs must be approved by the CAC. In November 2002, the CAC designated TMH as an SMP in the national interconnection market and TMH also had to file its cost calculation methodology and relevant cost/tariff data based on the mandatory LRIC model. See "Item 4 Regulation and Pricing".

Taxation. We had benefited from reduced corporate income tax. Until the end of 1998, Magyar Telekom Rt. and TMH qualified for a 100 percent allowance. From January 1, 1999 to the end of 2003, Magyar Telekom Rt. was able to benefit from a reduced allowance of 60 percent (resulting in an effective tax rate of 7.2 percent). As a result of our acquisition of the remaining 49 percent of TMH, foreign ownership fell below 30 percent and TMH lost its 60 percent allowance as of December 21, 2001. All other Hungarian subsidiaries were subject to income tax of 18 percent, while the Macedonian companies are subject to income tax of 15 percent. In December 2003, the Hungarian Parliament enacted a new tax law under which the corporate tax rate was reduced from 18 percent to 16 percent effective January 2004.

As a result of a tax credit relating to broadband asset investments, Magyar Telekom Rt. is entitled to a total corporate tax reduction of HUF 6,849 million (HUF 3,879 million from 2004 and HUF 2,970 million from 2003), which can be used by Magyar Telekom Rt. in the years 2003-2008, of which we used HUF 33 million in 2003. As the recoverability of these tax credits was uncertain in 2003, no deferred tax asset was recognized in 2003. Due to the change of the assessment of the recoverability, we recognized a deferred tax asset of HUF 6,849 million in 2004. As these investment tax credits are governmental grants in essence, we recognized the deferred tax asset against the cost of the related investment.

Inflation. Annual inflation in Hungary, as measured by changes in the consumer price index, was 5.3 percent in 2002, 4.7 percent in 2003 and 6.8 percent in 2004. The nominal increase in our revenues in 2003 compared to 2002 is partly due to the effects of inflation and corresponding adjustments in tariffs, although many of our tariffs have fallen in real terms and are beginning to decline in nominal terms as well. Inflation is also a contributing factor to the increase in nominal terms of many of our costs.

Effect of Foreign Currency Fluctuations. We are subject to risks resulting from fluctuations in exchange rates, which can adversely affect costs associated with our foreign currency denominated debt obligations and certain other payments. Our exposure to risks from exchange rate fluctuations on the

one hand have increased as a result of the National Bank of Hungary's policy change (extended intervention band), while on the other hand decreased because of the continuous hedging of the foreign denominated elements of the debt portfolio.

By the beginning of 2004, however, we significantly reduced our foreign exchange risk as a result of the elimination of the foreign exchange denominated loans from the portfolio. See "Item 11 Quantitative and Qualitative Disclosures about Market Risk". In addition, depreciation of the Macedonian denar and strengthening of the Hungarian forint may exert a negative influence on Maktel's results that are converted into HUF, thereby lowering our results. This is mainly a reporting risk, but through the dividend payments, it has direct financial (cashflow) effects as well.

OPERATING RESULTS

Results of Operations Total

Basis of presentation

We determine segments primarily based on products and services that are subject to risks and returns different from those of other businesses. We have changed our segment disclosure as a result of the change in our management and reporting structure. The segment disclosures for previous years have been amended to facilitate comparability with the disclosure for 2004. The primary segments are now based on the business lines (fixed line and mobile operations), which include both Hungarian and Macedonian activities. Reported segments are consistent with information used by management for internal reporting and monitoring purposes. In addition, our secondary format for reporting segment information is geographical segments.

Total Revenues

Our total revenues grew by 2.8 percent from HUF 590,585 million in 2002 to HUF 607,252 million in 2003. Increases in revenues were mainly due to higher revenues from mobile telecommunications services, which grew by 11.8 percent from 2002 to 2003 driven by a rapid increase in the mobile subscriber base. The higher leased lines and data transmission revenues also contributed to the growth, which was partly offset by lower revenues from the fixed line telecommunications services. Our total revenues decreased by one percent to HUF 601,438 million in 2004 compared to 2003. This decrease primarily resulted from lower revenues from the fixed line telecommunications services due to lower tariffs and decline in the interconnection traffic in 2004.

Total Operating Expenses

Our total operating expenses increased by 6.4 percent from 2003 to 2004. Operating expenses amounted to HUF 485,188 million in 2003 and HUF 516,174 million in 2004. Our total operating expenses as a percentage of total revenues increased from 79.9 percent in 2003 to 85.8 percent in 2004.

Depreciation and amortization and employee-related expenses are our most significant operating expenses.

Depreciation and amortization increased by 4.6 percent in 2003 and 7.3 percent in 2004 as a result of our ongoing investment in our networks. On January 1, 2003, May 31, 2003, and January 1, 2004, we revised the useful lives of certain tangible fixed assets, which resulted in an increase to the depreciation

charge of HUF 5,099 million for 2003 and HUF 177 million for 2004. These assets included buildings, network items, exchanges, assets of operation and service supporting systems, vehicles and computers in 2003, and included servers, software licenses, billing systems, transmission technical equipment and public phones in 2004. The useful lives of these assets were revised as part of a regular practice in line with the requirements of IFRS, and have been changed to reflect technological changes since the initial estimate of useful lives. The increase is also a result of the increase in impairment losses charged to tangible and intangible fixed assets in 2004, as compared to 2003. The HUF 1,344 million impairment losses charged in 2003 mostly related to real estate held for disposal, certain IT equipment and customer relationship management software.

The HUF 5,355 million impairment losses charged to tangible assets in 2004 mainly relate to MLLN node equipment and operational system, Data Termination Unit ("DTU"), Fibre Optic Multiplexer ("FMUX"), High Speed Subscriber's Facilities.

On March 22, 2004, our Board of Directors decided to rebrand the Hungarian mobile subsidiary from Westel to T-Mobile Hungary. As a result of the decision, the carrying value of the capitalized Westel brand name was impaired and then de-recognized as the rebranding was completed by June 5, 2004. This resulted in a HUF 4,426 million additional impairment loss for the year.

Employee-related expenses decreased by 1.5 percent from 2002 to 2003 primarily reflecting the lower amount of net provision for severance. The total payment made in relation to employee termination in 2003 amounted to HUF 9,200 million, of which HUF 8,099 million was charged against the provision for liabilities and charges as at December 31, 2002, while the rest was recognized as employee-related expense in 2003. The 24.5 percent increase of employee-related expenses in 2004 compared to 2003 reflects the higher severance expenses. Employee-related expenses in 2004 include HUF 20.7 billion restructuring charges and additional employee benefits relating to future terminations. The total payment made in relation to employee termination in 2004 amounted to HUF 7,549 million, of which HUF 1,570 million was charged against the provision for liabilities and charges as at December 31, 2003, while the rest was recognized as employee-related expense in 2004. The provision for severance as at December 31, 2004 relates to the employee termination in 2005 and 2006 in accordance with the agreement reached between us and the Trade Union in September 2004. The number of employees affected by the headcount reduction in 2005 and 2006 is approximately 1,900 and includes mostly network and back office personnel. In addition, employee-related expenses increased throughout the period as a result of increases in the average wage in nominal terms.

Other operating expenses include materials, maintenance, marketing, service fees, outsourcing expenses, energy and consultancy. Other operating expenses increased by 6.0 percent in 2003 compared to 2002 mainly as a result of higher agency commissions and fees paid for subcontracted services at Magyar Telekom Rt., TMH and cable television companies. Other operating expenses decreased by 2.2 percent in 2004 compared to 2003. In 2004, our contribution to the Universal Electronic Communications Support Fund ended and this largely decreased our operating expenses. This decrease was partly offset by higher marketing expenses mainly at Magyar Telekom Rt. relating to intensive advertising of new products and price plans as well as higher consulting fees. In 2004, other operating expenses include the costs incurred in relation to the change of Westel's brand name into TMH as well as HUF 5,920 million other income, which is the compensation received from DT for the loss of value incurred in the discontinuation of the Westel brand name.

Total Operating Profit

Our total operating profit decreased by 0.1 percent from HUF 122,240 million in 2002 to HUF 122,064 million in 2003, as the increase in total revenues was lower than the increase in operating expenses. Our total operating profit decreased by 30.1 percent from HUF 122,064 million in 2003 to HUF 85,264 million in 2004 due to the lower revenues and increased operating expenses.

Outlook

In line with our strategy for 2005, we intend to focus on improvement of organic performance, exploiting integration and group synergies and capturing acquisition-driven growth opportunities. In 2005, we plan to produce solid results for our shareholders based on operational improvements in every division. We intend to accomplish our financial and operating objectives by, among other things, increasing consolidated net revenues and operating efficiencies. Accordingly, we intend to invest in areas of our business that we believe offer the best potential for sustainable and profitable growth.

The following discussion provides a brief explanation of our outlook for 2005:

Revenues

Based on our current outlook and current market and regulatory conditions, we expect low single-digit revenue growth in 2005 and 2006. However, each segment is affected by its unique business environment, and we are subject to circumstances and events that are yet unforeseen or beyond our control. The following reflects our current expectations with respect to our segmental plans and initiatives for 2005:

Fixed line segment

Key operational goals of the fixed line segment are the stabilization of fixed line customer base and the continuation of radical boost in ADSL penetration. We expect continued gradual decline in fixed line voice revenues due to continued usage decrease and fixed line unit price erosion driven by mobile substitution and the increased competition in the fixed line market, including competition from PSTN resellers and VoIP or Voice over CATV ("VoCATV") providers. To offset the decreasing revenue stream from fixed line voice services, we intend to increase net revenues through our broadband and innovation initiatives. These are intended to stimulate additional growth potential by taking advantage of higher demand for broadband access as well as to encourage the development of attractive and innovative new services. Additionally, we intend to improve the quality of our products and services to enhance customer retention. Our goal is to support the migration of customers to higher-priced access lines and price plans and to achieve stable net revenues.

Mobile segment

We expect continuing growth in net revenues at T-Mobile Hungary and Mobimak as well. Market penetration in Hungary is now close to the saturation level and we expect weaker growth rates due to a smaller number of potential new subscribers. This trend is partly offset by the migration of prepaid customers to postpaid packages, future growth potential of voice and data services usage and migration to higher-value services, which is supported by the expected launch of UMTS services. In the Macedonian market, we expect that the subscriber growth will continue in 2005 and will drive the net revenue growth.

Expenses

In line with our strategy, we expect continuing improvements in internal efficiency in all segments thanks to our aggressive internal cost reduction program, which has been underway for several years.

We expect that our personnel expenses will be considerably lower in 2005 as compared to 2004, due to significant headcount reduction expenses recorded in the fourth quarter of 2004. We intend to achieve significant improvement in workforce efficiency and reach the fixed line-to-employee ratio above 500 by the end of 2006 at Magyar Telekom Rt.

In 2005, depreciation and amortization expenses are expected to be significantly lower than in 2004, because of the elimination of goodwill amortization due to a change in IFRS accounting principles (IFRS 3).

Gross additions to tangible and intangible assets

Over the past three years, we have sought to rapidly build out and modernize our network to enable ourselves to offer a broad portfolio of technologically advanced products and services. We aim to reduce the gross additions to tangible and intangible assets to sales ratio to below 15 percent from 2005 excluding potential acquisitions and UMTS spending. We expect an increasing proportion of gross additions to relate to high-growth areas in the fixed line segment, such as Internet and data transmissions, while our mobile segment will focus on a dynamic roll-out of the UMTS infrastructure.

Other factors

We expect that in 2005, our core business units will be able to continue to generate strong free cash flow. However, there are some significant elements that can have negative effects on the free cash flow in 2005. As a result of the headcount reduction program, significant part of the severance payments will occur in 2005. Payment of the second and the third tranche of the UMTS license fee and the higher capital expenditure utilization of UMTS network deployment in the mobile segment will also influence the free cash flow negatively. Despite these effects we expect to generate solid positive free cash flow in 2005.

In line with our focus on value-accretive acquisitions, Magyar Telekom acquired a 51.12 percent stake in the Montenegrin Telecommunications Company ("Telekom Montenegro" or "TCG") from the government of Montenegro in March 2005. At the same time, we acquired an additional 21.92 percent of TCG's shares from minority shareholders.

Revenue and EBITDA margin targets

We expect to achieve low single-digit revenue growth and an EBITDA margin above 40 percent (excluding restructuring charges and possible acquisitions) in 2005.

Results of Operations By Segment

The following table sets forth revenues, operating expenses and operating profit by segment:

	Year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Revenues			
Hungarian Fixed line	336,306	324,552	301,743
International Fixed line	47,793	49,689	45,184
Total	384,099	374,241	346,927
Less: intra-segment revenues	(1,122)	(1,552)	(907)
Total revenue of Fixed line segment	382,977	372,689	346,020
Less: inter-segment revenues[(1)]	(14,756)	(14,034)	(11,846)
Fixed line revenue from external customers	368,221	358,655	334,174
Hungarian Mobile	232,612	254,141	263,023
International Mobile	29,482	31,575	33,734
Total	262,094	285,716	296,757
Less: Intra-segment revenues	(19)	(20)	(58)
Total revenue of Mobile segment	262,075	285,696	296,699
Less: inter-segment revenues[(1)]	(39,711)	(37,099)	(29,435)
Mobile revenue from external customers	222,364	248,597	267,264
Total revenue of the Group	590,585	607,252	601,438
Operating expenses			
Hungarian Fixed line	292,640	280,462	288,682
International Fixed Line	32,657	37,924	38,156
Total	325,297	318,386	326,838
Less: intra-segment expenses	(1,122)	(1,552)	(907)
Total operating expenses of Fixed line segment	324,175	316,834	325,931
Hungarian Mobile	180,222	199,111	206,895
International Mobile	18,434	20,396	24,687
Total	198,656	219,507	231,582
Less: intra-segment expenses	(19)	(20)	(58)
Total operating expenses of Mobile segment	198,637	219,487	231,524
Less: inter-segment expenses[(1)]	(54,467)	(51,133)	(41,281)

	Year ended December 31,		
Total operating expenses of the Group	468,345	485,188	516,174

	Year ended December 31,		
	2002	2003	2004
	(in HUF millions)		
Operating profit			
Hungarian Fixed line	43,666	44,090	13,061
International Fixed line	15,136	11,765	7,028
Fixed line segment	58,802	55,855	20,089
Hungarian Mobile	52,390	55,030	56,128
International Mobile	11,048	11,179	9,047
Mobile segment	63,438	66,209	65,175
Total operating profit of the Group	122,240	122,064	85,264

(1) Intersegment eliminations include primarily interconnection fees between the fixed line and mobile networks.

Fixed Line Telecommunications Segment

The fixed line segment includes Magyar Telekom Rt. and its consolidated subsidiaries, other than Mobimak, TMH and Westel 0660.

Our fixed line telecommunications segment includes local, domestic and international long distance telephone services as well as value added digifon services such as call waiting, itemized billing and telephone and private branch exchange equipment rental. This segment also consists of revenues from related services, such as leased lines, data transmission, Internet, equipment sales and cable television.

Hungarian Fixed Line Operations

Hungarian fixed line operations include Magyar Telekom Rt. and its consolidated subsidiaries, other than Maktel, Stonebridge, Telemacedonia, Mobimak, TMH and Westel 0660.

The following table sets forth information regarding Hungarian fixed line revenues:

	Year ended December 31,