Magyar Telekom Plc.
Form 20-F
March 24, 2011

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**As filed with the Securities and Exchange Commission on March 24, 2011**

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

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# 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, 2010**

**Commission file number 1-14720**

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# MAGYAR TELEKOM TÁVKÖZLÉSI NYILVÁNOSAN MÜKÖDÖ RÉSZVÉNYTÁRSASÁG

(Exact Name of Registrant as Specified in Its Charter)

# MAGYAR TELEKOM TELECOMMUNICATIONS PUBLIC LIMITED COMPANY

(Translation of Registrant's Name into English)

**Hungary**

(Jurisdiction of Incorporation or Organization)

**Budapest, 1013, Krisztina krt. 55, Hungary**

(Address of Principal Executive Offices)

Thomas Stumpf
Accounting and Taxation Director
Magyar Telekom
Budapest, 1013, Krisztina krt. 55, Hungary

+36-1-457-4211
tom.stumpf@telekom.hu
(Name, Telephone, Email and/or Facsimile number and Address of the Company Contact Person)

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 | N/A* |
| Ordinary Shares | Budapest Stock Exchange |

Securities registered or to be registered pursuant to Section 12(g) of the Act: **N/A**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **N/A**

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.....1,042,742,543 nominal value HUF 100 per share (as of December 31, 2010)**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No ý

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing

U.S. GAAP o International Financial Reporting Standards as issued by the International Accounting Standards Board ý Other o

If "Other" has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow. Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

*

On November 2, 2010, the Company filed a Form 25 with respect to the delisting of its American Depository Shares from the New York Stock Exchange. The delisting became effective on November 12, 2010.

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**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 Plc. and, if applicable, its direct and indirect subsidiaries as a group; the term "Magyar Telekom Plc." refers to Magyar Telekom Plc. without its subsidiaries; the term "TMH" refers to the mobile operations of Magyar Telekom Plc.; the term "DT" refers to Deutsche Telekom AG; the term "DT Group" refers to DT and its subsidiaries as a group.

In this annual report, the term "Minister" refers to the Minister of the applicable government ministry then responsible for regulation of the activities of the Company as described below.

Prior to June 1, 2000, the Minister of Transport, Telecommunications and Water Management was in charge of regulating the telecommunications industry. The responsibility was transferred to the Minister heading the Prime Minister Office on June 1, 2000 and to the Minister heading the Ministry of Informatics and Communications on May 27, 2002. On June 1, 2006 the Ministry of Informatics and Communications merged into the Ministry of Economy and Transport. The Ministry of Economy and Transport was divided into two ministries on May 15, 2008, and responsibility for regulating the telecommunications industry was transferred to the Ministry of Transport, Telecommunications and Energy. On December 1, 2008 the Minister heading the Prime Minister Office took over the responsibility for the telecommunications industry in Hungary. On May 29, 2010, this responsibility was transferred to the Ministry of National Development.

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

**Forward-looking Statements**

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. Actual results may 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.

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**Explanation of abbreviations used throughout the report**

| Abbreviation | Term |
|---|---|
| 2G, 3G, 4G | Second/Third/Fourth-generation mobile technology |
| 2Play, 3Play, 4Play | double-play, triple-play, quadruple-play |
| 3Screen | Three Screen (TV, PC and wireless phone) |
| ADS | American Depository Shares |
| ADSL | Asymmetrical Digital Subscriber Line |
| ARPA | Average monthly Revenue per Access |
| ARPU | Average monthly Revenue per User |
| ASP | Application Service Provider |
| ATM | Asynchronous Transfer Mode |
| ATMs | Automatic Teller Machines |
| AVL | Automatic Vehicle Location |
| BRAS | Broadband Remote Access Server |
| CPE | Consumer Premises Equipment |
| CRM | Customer Relationship Management |
| CUG | Closed User Group |
| DOCSIS | Data Over Cable Service Interface Specification |
| DSLAM | Digital Subscriber Line Access Multiplexer |
| DVB-C | Digital Video Broadcasting Cable |
| DVB-S | Digital Video Broadcasting Satellite |
| DVB-T | Digital Video Broadcasting Terrestrial |
| DWDM | Dense Wavelength-Division Multiplexing |
| ED3 | EuroDOCSIS 3.0 technology |
| EDGE | Enhanced Data rates for GSM Evolution |
| EDR | Hungarian Unified Digital Radio Network/Egységes Digitális Rádiótávközlö Rendszer |
| EFM | Ethernet in the First Mile |

| | |
|---|---|
| EPG | Electronic Program Guide |
| ERP | Enterprise Resource Planning |
| F2M | Fixed to Mobile |
| FDC | Fully Distributed Costs |
| FDD | Frequency Division Duplex |
| FL-LRIC | Forward-Looking Long Run Incremental Costs |

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| Abbreviation | Term |
|---|---|
| FMC | Fixed Mobile Convergence |
| FTTH | Fiber to the Home |
| FTTx | Fiber to the x |
| GE | Gigabit Ethernet |
| GIA | Global Internet Access |
| GPON | Gigabit Passive Optical Network |
| GPRS | General Packet Radio Service |
| GPS | Global Positioning System |
| GSM | Global System for Mobile communications |
| HAG | Home Access Gateways |
| HD | High Definition |
| HFC | Hybrid Fiber Coax |
| HSI | High Speed Internet |
| HSDPA | High Speed Downlink Packet Access |
| HSLL | High Speed Leased Lines |
| HSUPA | High Speed Uplink Packet Access |
| HYTAS | Hybrid Telecommunications Access System |
| IC | Interconnection |
| ICT | Information and Communications Technology |
| ILL | Internet Leased Line |
| IMS | IP Multimedia Subsystem |
| IMSI | International Mobile Subscriber Identity |
| IMT | International Mobile Telecommunications 2000 (global standard for 3G) |
| IP | Internet Protocol |
| IPSec | Internet Protocol Security |
| IPTV | Internet Protocol-based TV |
| IP-VPN | Internet Protocol-based Virtual Private Network |

| | |
|---|---|
| ISDN | Integrated Services Digital Network |
| ISP | Internet Service Provider |
| IT | Information Technology |
| IVR | Interactive Voice Response |
| LRIC | Long Run Incremental Costs |
| LTE | Long Term Evolution |

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| Abbreviation | Term |
|---|---|
| LTO | Local Telecommunications Operator |
| MLLNI | Managed Leased Line Network Internet |
| MMDS | Multichannel Multipoint Distribution Service |
| MMS | Multimedia Message Service |
| MNO | Mobile Network Operator |
| MOU | Average monthly Minutes of Use per subscriber |
| MPLS | Multi Protocol Label Switching |
| MSAN | Multi Service Access Node |
| MVNO | Mobile Virtual Network Operator |
| NAS | Network Attached Storage |
| NAT | Network Address Translation |
| NAPA-WINE | Network-Aware P2P-TV Application over Wise Networks |
| NFC | Near Field Communication |
| NGA | Next Generation Access |
| NG EMM | Next Generation Enterprise Marketing Management |
| NGMN | Next Generation Mobile Networks |
| NGN | Next Generation Network |
| NGOSS | Next Generation Operation Support System |
| NMIA | National Media and Infocommunications Authority |
| NT | Network Technology |
| PABX | Private Automated Branch Exchange |
| PATS | Publicly Available Telephone Service |
| PBX | Private Branch Exchange |
| PC | Personal Computer |
| PDH | Plesiochronous Digital Hierarchy |
| PoP | Point of Presence |
| POTS | Plain Old Telephone Service |

| | |
|---|---|
| PSTN | Public Switched Telephone Network |
| QoS | Quality of Service |
| R4 3GPP | Release 4 Third Generation Partnership Project |
| RIO | Reference Interconnection Offer |
| RUO | Reference Unbundling Offer |
| SaaS | Software as a Service |

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| Abbreviation | Term |
|---|---|
| SAC | Subscriber Acquisition Cost |
| Sat TV | Satellite TV |
| SDH | Synchronous Digital Hierarchy |
| SDR | Special Drawing Rights |
| SHDSL | Single-Pair High-Speed Digital Subscriber Line |
| SI | System Integration |
| SIM | Subscriber Identity Module |
| SLA | Service Level Agreement |
| SMB | Small and Medium Businesses |
| SMS | Short Message Service |
| SOHO | Small Office/Home Office |
| SPA | Service Provisioning and Activation |
| TDD | Time Division Duplex |
| TDM | Time Division Multiplex |
| TETRA | Terrestrial Trunked Radio |
| ULL | Unbundled Local Loop |
| UMTS | Universal Mobile Telecommunications System |
| VDSL | Very High Bitrate DSL |
| VoCable | Voice over Cable television |
| VoIP | Voice over Internet Protocol |
| VPN | Virtual Private Network |
| WACC | Weighted Average Cost of Capital |
| WAP | Wireless Application Protocol |
| WiFi | Wireless Fidelity |
| WiMAX | World Interoperability for Microwave Access |
| WLAN | Wireless Local Area Network |
| WLR | Wholesale Line Rental |

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# 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, 2006, 2007, 2008, 2009 and 2010 and the accompanying notes, which have been audited by PricewaterhouseCoopers Könyvvizsgáló és Gazdasági Tanácsadó Kft. ("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") as issued by the International Accounting Standards Board ("IASB").

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2010 |
| | HUF | HUF | HUF | HUF | HUF | U.S.$[1] |
| | (in millions, except per share amounts) | | | | | |
| **Consolidated Comprehensive Income Data:** | | | | | | |
| Amounts in accordance with IFRS | | | | | | |
| Revenues | 671,196 | 676,661 | 673,056 | 643,989 | 609,579 | 2,922 |
| Operating profit | 135,408 | 128,312 | 162,258 | 147,133 | 112,094 | 537 |
| Profit attributable to the owners of the parent | 74,700 | 60,155 | 93,008 | 77,618 | 64,378 | 309 |
| Operating profit per share | 130.16 | 123.25 | 155.83 | 141.31 | 107.65 | 0.52 |
| Basic earnings per share | 71.80 | 57.78 | 89.32 | 74.54 | 61.83 | 0.30 |
| Diluted earnings per share | 71.78 | 57.78 | 89.32 | 74.54 | 61.83 | 0.30 |
| **Consolidated Financial Position Data:** | | | | | | |
| Amounts in accordance with IFRS | | | | | | |
| Total assets | 1,129,282 | 1,133,265 | 1,166,543 | 1,166,377 | 1,109,006 | 5,315 |
| Net assets | 589,372 | 577,898 | 596,547 | 605,420 | 594,712 | 2,850 |
| Common stock | 104,277 | 104,275 | 104,275 | 104,275 | 104,275 | 500 |
| Total Equity of the owners of the parent | 522,722 | 511,681 | 533,946 | 538,480 | 531,512 | 2,547 |

(1) Translated into U.S. dollars at the official exchange rate of the National Bank of Hungary on December 31, 2010 of U.S. dollar 1.00 = HUF 208.65. These translations are unaudited and presented for convenience purposes only.

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| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 |
| | (in millions) | | | | |
| **Other data:** | | | | | |
| Weighted average number of shares | | | | | |
| Basic | 1,040 | 1,041 | 1,041 | 1,041 | 1,041 |
| Diluted | 1,041 | 1,041 | 1,041 | 1,041 | 1,041 |

**Dividends**

The following table sets forth the dividend per Magyar Telekom ordinary share for the years 2006, 2007, 2008, 2009 and 2010. 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** | | |
| 2006 | 70 | 0.3653 |
| 2007 | 74 | 0.4287 |
| 2008 | 74 | 0.3938 |
| 2009 | 74 | 0.3935 |
| 2010[(2)] | 50 | 0.2396 |

(1) Translated into U.S. dollars at the official exchange rate of the National Bank of Hungary on December 31, 2010 of U.S. dollar 1.00 = HUF 208.65, December 31, 2009 of U.S. dollar 1.00 = HUF 188.07, December 31, 2008 of U.S. dollar 1.00 = HUF 187.91, December 31, 2007 of U.S. dollar 1.00 = HUF 172.61 and December 31, 2006 of U.S. dollar 1.00 = 191.62.

(2) The Board of Directors of the Company has proposed a HUF 50 per ordinary share dividend distribution to be approved by the Annual General Meeting of the Company on April 12, 2011.

## EXCHANGE RATE INFORMATION

As used in this document, "Hungarian forint" or "HUF" mean the lawful currency of Hungary. "EUR", "euro" or "€" mean the single unified currency of the European Union ("EU"). "U.S. dollar," "USD" or "$" mean the lawful currency of the United States.

The National Bank of Hungary ("NBH") quotes and publishes official exchange rates of the Hungarian forint for all major currencies based on prevailing market rates. Unless otherwise stated, conversion of Hungarian forint into U.S. dollars have been made at the rate of USD 1.00 to HUF 208.65, which was the official rate quoted and published on December 31, 2010.

On any given day, the market exchange rate of the Hungarian forint against the euro may vary from the official rate of the NBH. Prior to May 4, 2001, the NBH had a policy of intervening in the foreign exchange market, if the market exchange rate of the Hungarian forint against the euro deviated more than 2.25 percent above or below the official rate. On May 4, 2001, the NBH announced that it had widened this intervention band to 15 percent above and below the official rate. The central parity was set at 282.36 HUF/EUR rate. As of February 26, 2008, the NBH terminated the intervention band. The floating exchange rate allows the NBH to focus more effectively on the inflation targets.

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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 NBH for Hungarian forint per U.S. $1.00 and EUR 1.00.

| | Exchange Rates (amounts in HUF/U.S.$) | | | |
|---|---|---|---|---|
| | Period-End | Average[1] | High | Low |
| **Year** | | | | |
| 2006 | 191.62 | 210.51 | 225.01 | 191.02 |
| 2007 | 172.61 | 183.83 | 199.52 | 171.13 |
| 2008 | 187.91 | 171.80 | 218.76 | 144.11 |
| 2009 | 188.07 | 202.26 | 249.29 | 176.67 |
| 2010 | 208.65 | 208.15 | 240.57 | 184.00 |
| 2010 | | | | |
| September | 203.43 | 216.22 | 227.80 | 203.13 |
| October | 197.95 | 197.55 | 201.02 | 193.23 |
| November | 218.76 | 201.88 | 218.76 | 190.78 |
| December | 208.65 | 209.67 | 214.72 | 205.00 |
| 2011 | | | | |
| January | 200.31 | 206.31 | 216.37 | 198.14 |
| February | 197.05 | 198.67 | 201.95 | 194.86 |
| March (through March 23, 2011) | 190.06 | 194.82 | 198.46 | 190.04 |

(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** | | | | |
| 2006 | 252.30 | 264.27 | 282.69 | 249.55 |
| 2007 | 253.35 | 251.31 | 261.17 | 244.96 |
| 2008 | 264.78 | 251.25 | 275.79 | 229.11 |
| 2009 | 270.84 | 280.58 | 316.00 | 264.17 |
| 2010 | 278.75 | 275.41 | 290.03 | 261.60 |
| 2010 | | | | |
| September | 277.33 | 282.25 | 288.78 | 276.12 |
| October | 273.69 | 274.46 | 276.83 | 270.53 |
| November | 284.54 | 275.70 | 284.54 | 270.78 |
| December | 278.75 | 277.47 | 280.60 | 273.43 |
| 2011 | | | | |
| January | 273.30 | 275.45 | 279.40 | 271.93 |
| February | 272.34 | 271.18 | 274.28 | 268.21 |
| March (through March 23, 2011) | 269.66 | 272.15 | 273.92 | 269.66 |

(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 if you are a holder of American Depository Shares ("ADSs") exchange rate fluctuations will affect the U.S. dollar amounts you will receive upon conversion of cash dividends on the shares represented by ADSs. Fluctuations in the exchange rate between the Hungarian forint and the U.S. dollar will also affect the prices of shares and ADSs.

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## 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.

The following discussion contains a number of forward-looking statements. Please refer to the "Forward-Looking Statements" discussion at the front of this Annual Report for cautionary information.

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

The Electronic Communications Act of 2003 ("Electronic Communications Act"), which came into force in January 2004, was enacted by the Hungarian Parliament to achieve harmonization of the telecommunications regulatory regime in Hungary with the New Regulatory Framework ("NRF") of the EU for electronic communications adopted in 2002, and to encourage further competition in the market. The NRF has been subject to review by the EU since 2007. The agreed reforms to the NRF accepted in November 2009 are the result of three years of discussions with stakeholders, national regulators and users. See "Item 4 Regulation New Regulatory Framework (revised)" for a description of the reforms adopted in 2009. Changes to the NRF are required to be implemented by national legislation by May 25, 2011. The NRF review implementation process was launched by the Ministry in October 2010, and Magyar Telekom is providing written input and comments to the Ministry in the course of the consultation process.

The National Media and Infocommunications Authority of Hungary ("NMIA") was officially established on August 11, 2010 to ensure the undisturbed operation, in compliance with applicable legislation, of the media and the markets for electronic communications, postal and information technology services in Hungary in accordance with the Electronic Communications Act and Act I of 1996 on Television Broadcasting, as amended. The new, converged regulator performs the tasks of its predecessors: the National Communications Authority ("NCA") and the National Radio and Television Commission ("NRTC"). According to the official announcement, the purpose of the merger, among others, is cost efficiency, more rational allocation of resources, more cost effective work, avoidance of duplication of work and better cooperation of the supporting activities within a single organizational structure. One of the primary responsibilities of the NMIA is to perform market analysis procedures under which it defines "relevant markets," or markets subject to the regulatory framework. The NMIA analyzes such markets for the level of competition and, if it finds a lack of sufficient competition in such markets, identifies service providers with significant market power ("SMP"), and imposes appropriate regulatory obligations on such providers to encourage competition. The NCA previously carried out a market analysis procedure and reached its final findings on 17 out of 18 relevant markets identified in an applicable decree in 2004. Under these findings, Magyar Telekom was found to have SMP in 13 of the 18 markets (i.e., markets 1-9, 11-13 and 16). By the end of March 2008, the NCA had published SMP resolutions concerning 17 markets out of the 18 in the second round of market analyses. Out of these 17 markets, Magyar Telekom was identified as an operator with SMP in all but four markets. As a result, the NCA imposed various obligations on Magyar Telekom with respect to these markets. See "Item 4 Regulation and Pricing".

The Recommendation of the European Commission on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services (2003/311/EC) ("Recommendation"), the regulation on which the market analysis procedure of the NCA was based, was also reviewed by the EU during 2006 and 2007. This new Recommendation entered into force on December 17, 2007. As a result of the EU review,

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the number of relevant markets decreased from 18 to 7. Magyar Telekom is currently identified as having SMP in all of the 7 remaining markets as well as in all retail markets cancelled from the list of relevant markets. The new Recommendation will become effective in the current round of market analyses by the NMIA, which is expected to be completed in 2011. Until now only two resolutions with respect to market 7/2007 (voice call termination on individual mobile networks) and market 1/2007 (access to public telephone network at a fixed location for residential and non-residential customers) have been published. The extension of the definition of market 11 (unbundling of the local loops) from copper to optical networks by the NMIA makes the extension of the unbundling obligation to Magyar Telekom's new technology (optical) networks easier for the NMIA. This is expected to have an adverse impact on our business results. In 2008, Magyar Telekom launched a widespread optical network deployment program. In the event the NMIA decides to impose regulations on optical networks, it would affect both the wholesale and the retail market. This decision is expected in the first half of 2011.

The Ministry of National Development published the final version of the Infocommunications Strategy currently titled as the "Digital Renewal Action Plan" on December 23, 2010. The Strategy has four priorities (citizens, growing enterprises and employment, effective and secure operating government and infrastructure available for all) and 82 action plans related to them. Some objectives are related to the effective ICT operation of the government, including consolidation and centralization of governmental networks and applications (already implemented in a decree) and the state's role in infrastructure development. The exact details, resource allocation and exact timing of the latter are not yet included in the strategy. The full or partial achievement of these objectives may have direct impact on Magyar Telekom's network solutions and could indirectly affect the Company's operations.

In addition, our businesses in Macedonia and Montenegro are also subject to various regulatory developments. In Montenegro, the additional relevant markets (e.g., trunk segment of leased lines, retail market of publicly available services for local, domestic and international calls, wholesale market on access and origination of calls in public mobile telephone networks) are expected to be defined by the Agency for Electronic Communications and Postal Services ("EKIP") in the first half of 2011 and consequently, the new market analysis may result in additional obligations in the fourth quarter of 2011 or the first quarter of 2012, which may have an impact on the profitability of the company depending on the nature and scope of obligations imposed.

In Macedonia, in particular, the current and possible future SMP status of T-Mobile Macedonia in various markets may lead to additional obligations, such as lower mobile termination rates, national roaming, lower RUO and IC fees, access to ducts and specific network elements, universal service and requirements to publish general conditions and quality parameters of services. The activities of the Agency for Electronic Communications ("AEC") related to retail price control will be enhanced.

The European Commission (the "Commission") has issued a recommendation on mobile termination rates by prescribing detailed cost accounting methodology to be applied over a set timeframe by the national regulatory authorities ("NRAs"). As a result, it is possible that TMH's mobile termination rates will be reduced to a lower level than intended by the NMIA by 2012. The regulation of mobile termination rates at the EU level may lead to interventions by the Macedonian and Montenegrin regulator as well.

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

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

The scope of competition and any adverse effect on our results depend on a variety of factors that we cannot assess with precision and are for the most part not within our control. Among such factors are business strategies and capabilities of new competitors, prevailing market conditions, as well as the

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effectiveness of our efforts to prepare for new market conditions. Specific risks in the fixed line market include continuous downward pressure on tariff levels, loss of customers as a result of unbundled access to the local loop, loss of fixed line customers as a result of introducing "naked" ADSL (i.e., without a subscription for a PSTN line), competition from alternative operators using new technologies (e.g., VoIP, VoCable) and migration to lower priced Internet price plans as a result of speed upgrades. In addition, the declining prices of mobile telecommunications services also lead to the migration of fixed line customers.

The most significant trend in the fixed line market is the increasing share of 2Play or 3Play offers (bundling voice, Internet and television services into one package) which may result in discounts on purchased services for customers. In Hungary, cable penetration is above the European average. From a competition point of view, the unregulated cable television operators may be able to offer more flexible price structures to customers than the regulated market players, such as Magyar Telekom. In the case of increasing price competition, this may narrow our ability to give adequate market responses against the competitors' actions.

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

New market models using Internet-based messaging and communication services may adversely affect both of our fixed line and mobile voice and messaging services. Entry by MVNOs into the mobile telecommunications market may intensify the competition in Hungary. MVNOs are mobile operators that do not own their own spectrum or network infrastructure, and instead buy the use of the spectrum and network infrastructure from traditional mobile operators and provide mobile telecommunications services to consumers based on the purchased capacity. MVNOs are likely to target the lower segment of the market and such development will likely increase price-based competition. Currently there is no regulation in Hungary where incumbents would be obliged to provide regulation based access prices for MVNOs. We do not expect changes in this field.

For example, on November 20, 2009, Vodafone, in cooperation with Magyar Posta, launched a branded reseller mobile service, "Postafon", which is offered by Magyar Posta in several post offices. Telenor has also launched a new mobile service in cooperation with Red Bull (the producer of energy drinks) under the name "Red Bull Mobile". The entry pressure from other interested parties to a 3-player mobile market may increase in the future. If MVNO is hosted by one of our competitors, Magyar Telekom will lose revenue as customers are lost to the MVNO and the tariff level in the Hungarian mobile market may significantly decrease.

The modified GSM Directive UMTS technology to be deployed in the 900 MHz bands was published in the Official Journal of the EU on October 20, 2009, along with the Decision of the European Commission on the technical implementation requirements. The modified Directive entered into force on November 9, 2009 and the Directive was required to be implemented by national legislation by May 9, 2010. There is a possibility for an E-GSM900 spectrum tender in the second quarter of 2011 at the earliest. The tender may further increase the competition in the Hungarian mobile market. On July 1, 2010, during the conference of the Hungarian Association of ICT companies, the Deputy Secretary of State of the Ministry of National Development indicated the possibility of conducting a 450 MHz tender in the near future and this tender is still on the agenda of the NMIA and may possibly take place in 2011. Incumbents are expected to be excluded in the same way as in the tender of 2008.

We also face intense competition in the market for Internet services, as well as in the data communications markets from other fixed line, mobile and cable television service providers. The share of

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Magyar Telekom DSL net additions has declined against competitors' cable Internet offerings. This could adversely affect our further broadband growth prospects and may lead to further tariff erosion.

Competition posed by new entrants in Macedonia and Montenegro may result in a downward pressure on pricing, sales volume and profitability, which would have an adverse effect on our financial condition and results of operations.

**Our ability to meet our revenue targets will depend in part on our ability to offset the declining fixed line voice revenues with data, TV, Internet and SI/IT revenues and our ability to acquire telecommunications companies.**

We expect the number of our fixed access lines and rates for fixed telephone services to decrease. In addition, the growth rate of the Hungarian broadband market is expected to slow down. To mitigate this decrease in fixed line voice revenues, we are now moving from pure fixed line voice offers to integrated 2Play and 3Play packages, which allow us to partially substitute declining voice traffic revenues with content, entertainment and bundled access revenues. In mobile operations in Hungary, market penetration is now saturated, and we expect flat development in the following year. We may not be able to sustain our revenue targets, if we are unsuccessful in offsetting the effect of our declining voice and messaging revenues with new 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 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 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 or potentially requiring their impairment.

NGN (IP Multimedia Subsystem-based network) is the main stream of technical development that gives the general framework for reaching most of our business strategic goals and for transforming the company. Our NGN strategy focuses on overlay NGN. This approach means that the new technology is built in parallel to the existing network, not in substitution or replacement of existing technology, and we build and use the new technology for introducing new services. In addition, we use the NGN for network transformation by migrating our legacy networks to NGN to change the technology and platform to further provide legacy services and features at a lower operational cost level.

We have planned migration to NGN on the basis of recent trends in the telecommunications industry: as vendors allocate resources to develop NGN, they significantly increase legacy system support fees and development costs, we face increasing risk of failures due to aging technology, which may result in revenue loss and stimulate higher churn. The risk of failing to overlay NGN development is that we miss gaining new revenues from broadband-based services and applications as well as integrated, convergent service offerings (3Play, 4Play), while we lose traditional business.

Our Next Generation Fixed Access strategy is to widely deploy FTTH (optical network) and to upgrade our cable networks (coax) to EuroDocsis3.0 technology. The EuroDocsis3.0 technology upgrade was performed in 2010. As described below, due to poor economic conditions in Hungary in 2009 and 2010, the FTTH roll-out did not proceed according to our original strategy in 2010, and we expect the FTTH roll-out will be further delayed in 2011. Many of our competitors have started to invest in deploying a NGA network, which might decrease our market share in High Speed Internet (above 20 Mbit/s) market as well as in other markets (voice, TV) through xPlay offers, and therefore be a threat to the value of our existing network.

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Further, the economic crisis in 2009 and 2010 in Hungary has affected our ability to invest in and deploy new technology. In 2009 and 2010, we could not fulfill the original FTTH roll-out plan due to combined effect of lower funds available for capital expenditures and the weakening of the Hungarian currency as a result of the economic crisis. See " The value of our investments, results of operations and financial condition could be adversely affected by economic developments in Hungary and other countries". In addition, the economic crisis has also affected us from the demand side as customers may not use new products and services developed on our FTTH network to the extent anticipated, which may lead to decline in revenues and have an adverse impact on our results. Management continually assesses and reviews our plans and related capital expenditures with respect to the roll-out of new technology and accordingly, our plans may change as market conditions develop, including amending targets in relation to the FTTH roll-out plan such as the target to connect approximately 360,000 households via optical network solution by the end of 2013. Our original target was to connect 780,000 households by the end of 2013.

After merging the mobile and fixed line technology areas of the Company, in order to improve the efficiency of the customer service function, we intend to unify the IT and CRM systems that support daily business, the sale of new products and the management of customers. If these development processes are drawn out over time and if the various systems continue to operate concurrently for a longer period, this could contribute to more significant churn and a faster decline in our revenues.

Due to the accelerated network development of our competitors in the last few years, our services face competition from broadband products of other service providers. The development of this parallel infrastructure affects the price level and the available penetration of our services as well as the return of our investments.

The operation of our mobile businesses depends in part upon the successful deployment of continually evolving mobile communications technologies, which requires 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.

TMH launched 3G-based services in Hungary in 2005 before any of its competitors. TMH is currently upgrading the network infrastructure to better provide the new generation of services. However, alternative technologies and standards (e.g., WiFi, WiMAX or VoIP) may keep consumers from choosing 3G-based services. These new technologies, especially VoIP, also endanger our voice business. We are not able to predict at the moment which of these competing technologies will be the most widely accepted platform, however we think that HSDPA and HSUPA enabled 3G network, and later the LTE (4G) standard are the most likely candidates. There is a frequency spectrum allocation risk for LTE, because currently there is no frequency spectrum available, on which the LTE service could be launched.

Our subsidiary, Pro-M Professzionális Mobilrádió Zrt. ("Pro-M"), also faces risks resulting from technological changes, since the TETRA technology on which its network is based is evolving according to customer demands. To neutralize this risk, Pro-M needs to keep pace with new developments and apply these to its network, while considering capital expenditure requirements.

The effects 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.

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**The future of our current operational model is subject to currently unforeseeable changes in the future business environment.**

The telecommunications industry is undergoing a major change globally with an effect on the Hungarian market as well. We have considered these market trends including changes in technology, customer requirements, competition and regulation, and accordingly, we have planned our operational restructuring to be in line with these market trends. Our operational model effective from 2008 is based on customer segments and also provides a solid basis to capture long-term growth. We have designed our operational model according to our most current knowledge of market trends and our business needs; however, the future business environment might evolve into currently unforeseen directions that will require us to adjust our operational model.

**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 and financial 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 impairment tests, whenever we identify any indication (including changes in the economic, regulatory, business or political environments) that goodwill, intangible assets or fixed assets may 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 necessary equipment and maintenance services. The failure of these suppliers to meet our equipment and maintenance 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 key 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 mobile telephones are 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 additional government regulations. Our ability to install new mobile telecommunications base stations and other infrastructure may also be adversely affected, and related costs may increase, due to regulations 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.

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

Our technology 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 continuing 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.

**Ongoing government investigations into contracts and activities in Montenegro and Macedonia may result in fines or other sanctions.**

In the course of conducting their audit of the Company's 2005 financial statements, PricewaterhouseCoopers, the Company's auditors, identified two contracts the nature and business purposes of which were not readily apparent to them. In February 2006, the Company's Audit Committee retained White & Case, as its independent legal counsel, to conduct an internal investigation into whether the Company had made payments under those, or other contracts, potentially prohibited by U.S. laws or regulations, including the U.S. Foreign Corrupt Practices Act ("FCPA") or internal Company policy. The Company's Audit Committee also informed the United States Department of Justice ("DOJ"), the United States Securities and Exchange Commission ("SEC") and the Hungarian Financial Supervisory Authority of the internal investigation.

Based on the documentation and other evidence obtained by it, White & Case preliminarily concluded that there was reason to believe that four consulting contracts entered into in 2005 were entered into to serve improper objectives, and further found that during 2006 certain employees had destroyed evidence that was relevant to the investigation. White & Case also identified several contracts at our Macedonian subsidiary that warranted further review. In February 2007, our Board of Directors determined that those contracts should be reviewed and expanded the scope of the internal investigation to cover these additional contracts and any related or similarly questionable contracts or payments.

On December 2, 2009, the Audit Committee provided the Company's Board of Directors with a "Report of Investigation to the Audit Committee of Magyar Telekom Plc." dated November 30, 2009 (the "Final Report"). The Audit Committee indicated that it considers that, with the delivery of the Final Report based on currently available facts, White & Case has completed its independent internal investigation.

The Final Report includes the following findings and conclusions, based upon the evidence available to the Audit Committee and its counsel:

The information obtained by the Audit Committee and its counsel in the course of the investigation "demonstrates intentional misconduct and a lack of commitment to compliance at the most senior levels of Magyar Telekom, TCG, and Makedonski Telekom during the period under investigation."

As previously disclosed, with respect to Montenegrin contracts, there is "insufficient evidence to establish that the approximately EUR 7 million in expenditures made pursuant to four

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consultancy contracts . . . were made for legitimate business purposes", and there is "affirmative evidence that these expenditures served improper purposes." These contracts were not appropriately recorded in the books and records of the Company and its relevant subsidiaries. As previously disclosed, the Company has already reclassified, in the Company's financial statements, the accounting treatment relating to certain of these contracts to more accurately account for these expenditures.

As previously disclosed, there is evidence that certain former employees intentionally destroyed documents relating to activities undertaken in Macedonia by the Company and its affiliates.

Between 2000 and 2006 a small group of former senior executives at the Company and the Company's Macedonian affiliates authorized the expenditure of approximately EUR 24 million through over twenty suspect consultancy, lobbying, and other contracts (including certain contracts between the Company and its subsidiaries on one hand, and affiliates of a Cyprus-based consulting company on the other hand). The Final Report concludes that "the available evidence does not establish that the contracts under which these expenditures were made were legitimate."

"The evidence shows that, contrary to their terms, a number of these contracts were undertaken to obtain specific regulatory and other benefits from the government of Macedonia. The Companies generally received the benefits sought and then made expenditures under one or more of the suspect contracts. There is evidence that the remaining contracts were also illegitimate and created a pool of funds available for purposes other than those stated on the face of the agreements."

In entering into these contracts and approving expenditures under them, the former senior executives knowingly caused, structured, or approved transactions that shared most or all of the following characteristics:

- intentional circumvention of internal controls;
- false and misleading Company documents and records;
- lack of due diligence concerning, and failure to monitor performance of, contractors and agents in circumstances carrying a high risk of corruption;
- lack of evidence of performance; and
- expenditures that were not for the purposes stated in the contracts under which they were made, but rather were intended to obtain benefits for the Companies that could only be conferred by government action.

The Final Report states that "the Investigation did not uncover evidence showing receipt of payments by any Macedonian government officials or political party officials." However, the Audit Committee's counsel did not have access to evidence that would allow it to identify the ultimate beneficiaries of these expenditures.

Nothing in the Final Report implicates any current senior executive or Board member of the Company in connection with any wrongdoing.

As previously disclosed, the Company has taken remedial measures to address issues previously identified by the independent investigation. These measures included steps designed to revise and enhance the Company's internal controls as well as the establishment of the Corporate Compliance Program.

Due to these measures, no modifications to the Corporate Compliance Program were viewed as necessary in response to the Final Report. This conclusion has been discussed with the Audit Committee

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and the Audit Committee has not made recommendations either relating to the Company's compliance program or internal controls.

The Company is continuing to assess the nature and scope of potential legal remedies available to the Company against individuals or entities that may have caused harm to the Company.

As previously announced, the DOJ, the SEC and the Ministry of Interior of the Republic of Macedonia have commenced investigations into certain of the Company's activities that were the subject of the internal investigation. Further, in relation to certain activities that were the subject of the internal investigation, the Hungarian Central Investigating Chief Prosecutor's Office has commenced a criminal investigation into alleged corruption with the intention of violating obligations in international relations and other alleged criminal offenses. In addition, the Montenegrin Supreme State Prosecutor is also investigating the activities of the Company that were the subject of the internal investigation and has requested information from the Company in relation to the relevant contracts. These governmental investigations are continuing, and the Company continues to cooperate with these investigations.

As previously disclosed, the Company, through its external legal counsel, is engaged in discussions with the DOJ and the SEC regarding the possibility of resolving their respective investigations as to the Company through negotiated settlements. The Company has not reached any agreement with either the DOJ or the SEC regarding resolution of their respective investigations, and discussions with both agencies are continuing. We may be unable to reach a negotiated settlement with either agency. Any resolution of the investigations could result in criminal or civil sanctions, including monetary penalties and/or disgorgement, against the Company or its affiliates, which could have a material effect on the Company's financial position, results of operations or cash flows, as well as require additional changes to its business practices and compliance programs. The Company cannot predict or estimate whether or when a resolution of the DOJ or SEC investigations will occur, or the terms, conditions, or other parameters of any such resolution, including the size of any monetary penalties or disgorgement, the final outcome of these investigations, or any impact such resolution may have on its financial statements or results of operations.

**A lawsuit by our minority shareholders may require us to take time-consuming and/or expensive corrective actions.**

As previously disclosed in May 2010, two Hungarian minority shareholders filed a lawsuit against the Company, requesting the Metropolitan Court to render ineffective the resolutions passed by the general meeting on April 7, 2010. These two shareholders have previously brought lawsuits challenging resolutions passed by Magyar Telekom's shareholders at previous general meetings, as previously disclosed by the Company.

On October 29, 2010, the Metropolitan Court announced its first instance judgment rejecting the minority shareholders' claim. This first instance judgment is not final and binding as the plaintiffs submitted an appeal against the judgment.

Magyar Telekom disagrees with the lawsuit initiated by the minority shareholders and will continue to vigorously defend against the claims. We cannot fully exclude that the Company will be required to take other corporate actions in connection with the shareholders' suit described above. Also, we cannot provide any assurance that this matter would not have other adverse effects on the Company that are not currently foreseen.

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

The Hungarian equity market is relatively small and illiquid compared to major global markets. As a result of the limitations of the Hungarian equity market and the volatility of the telecommunications sector

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in general, the price of our shares and ADSs may be relatively volatile and you may have difficulty selling your shares in the event of unfavorable market conditions. Further, effective as of November 12, 2010, the Company's ADSs were delisted from and are no longer traded on the New York Stock Exchange ("NYSE"), which may impact the liquidity of our ADSs.

**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, which are outside of our control that influence global and regional economies. 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 down the development of new services and applications that could become future revenue sources.

In 2009, the global financial crisis led to declining demand, which resulted in declining prices and higher churn rates, both in our consumer and business segments in Hungary. The negative trends experienced in 2009 continued in 2010 as well. We experienced positive signs of recovery in the second half of 2010, but the Hungarian economy is still very fragile. We expect continued pressure on demand for telecommunications services both in the fixed and mobile sectors due to the weak labor market, lower household disposable income, as well as fewer orders from business customers and the public sector. A long term weakness of the Hungarian currency may also negatively affect our customers' disposable income because of the high rate of indebtedness denominated in foreign currencies. Due to the continuing weak economic conditions, the new government has sought to implement cost-savings measures in government spending. Based on a Government resolution, the new government intends to deliver HUF 20 billion of savings related to the 2010 budget for national asset management, which includes IT and telecommunication services. As a result of the requested price allowances in relation to government contracts, we experienced a negative impact on our 2010 revenues and expect that these price allowances will affect our results in the coming years by HUF 5-7 billion. Furthermore, the Government issued a decree which authorized a state-owned company to exclusively provide ICT services for public administration and/or state-owned organizations, institutions and companies. This company is entitled to consolidate the state-owned networks and to make the necessary infrastructure developments. These measures by the Government aiming at, amongst other purposes, cost savings will have a negative impact on our SI/IT revenues; however the actual effect cannot be determined at this time, as the exact timing of contract amendments and network development are not included in the decree. Our subsidiary, Pro-M, also faces risks emerging from government-financed, EDR-based projects that might be affected by the financial situation of Hungary. In addition, our businesses in Macedonia and Montenegro are also affected by similar factors. See "Item 5 Management Overview General" for further explanations of effects of the financial crisis on our 2010 performance and "Item 5 Management Overview Outlook" for our expectations for 2011.

A significant amount of cash of the Group's Macedonian and Montenegrin subsidiaries is held in local banks and in connection with these deposits the counterparty risk may be higher, due to the small number of internationally substantial financial institutions in these countries, however, all of our deposits are covered with bank guarantees issued by banks from the European Union. These amounts are deposited primarily on fixed interest rate terms in order to minimize exposure to market changes that would potentially adversely change the cashflows from these instruments.

We may also experience higher financing costs in the future as higher fluctuations of interest rates seem to be more likely due to the increased volatility in the international capital and money markets after the financial crisis. For additional information about our financial risk management, see Note 3 to the consolidated financial statements.

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**We are subject to unpredictable changes in Hungarian tax regulations.**

In October 2010, the Hungarian government imposed special "crisis" taxes on the telecommunications, energy and retail sectors. The taxes were introduced with a retroactive effect for the fiscal year 2010. The special telecommunications tax is a progressive tax to be calculated on the revenues from electronic telecommunication services. Tax rates are: 0 percent (on revenues below HUF 500 million), 4.5 percent (on revenues between HUF 500 million and HUF 5 billion) and 6.5 percent (on revenues exceeding HUF 5 billion). The total special telecommunications tax paid by the Company in 2010 amounted to HUF 28 billion and the impact on Earnings before Interest, Tax, Depreciation and Amortization ("EBITDA") was HUF 27 billion. Pursuant to the relevant legislation, these special taxes will be in effect until the end of 2012; however, there are indications from the government that these special taxes or other similar taxes affecting the telecommunications sector may be imposed beyond 2012. We are in the process of reviewing how the special telecommunications tax will affect our plans beyond 2010.

On March 14, 2011, the European Commission announced that it had decided to send a request for information to Hungary, in the form of a 'letter of formal notice', thereby opening an infringement procedure against Hungary in relation to the special telecommunications tax. The Commission raised concerns that this tax is incompatible with EU telecommunications rules. Hungary has two months to reply to the request. If the Commission receives no reply, or if the responses presented by the Hungarian Government do not address the Commission's concerns, the Commission may issue a formal request for Hungary to ensure that it complies with EU law on the taxation of telecommunications companies. The Commission may also eventually bring the case before the Court of Justice of the European Communities. The outcome of the infringement procedure, to which the Company and/or its affiliates are not party, is uncertain.

On March 1, 2011 the Hungarian Government announced that as part of its long-term effort to reduce the Hungarian budget deficit it intends to amend existing law that provides for a reduction in corporate tax rates from the current 19 percent to 10 percent starting in 2013. When the law reducing future corporate tax rates was enacted in 2010, the Group recalculated its deferred tax balances, resulting in the reversal of net deferred tax liabilities of HUF 14.5 billion in the 2010 comprehensive income statement. The recent announcement of the intended cancellation of the scheduled reduction of the tax rate from 2013 is expected to cause the recognition of a substantially higher amount of net deferred tax liabilities in 2011 and result in a negative impact on deferred tax expense in 2011 equivalent in magnitude to the positive impact on net deferred tax expense in 2010.

These uncertain and unforeseeable changes to tax legislation in Hungary has had, and in the future may continue to have, as a result of these or similar regulations introduced by the government, a material effect on our results of operations and financial condition.

**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 and Montenegrin operations. Devaluation of the Macedonian denar or appreciation of the Hungarian forint may have a negative impact on Makedonski Telekom's results when converted into HUF. The conversion of Crnogorski Telekom's results into HUF depends on the value of the HUF against the EUR. This is mainly a reporting risk, but through the dividend payments it has direct financial (cashflow) effects on us as well. The recent financial crisis increased the volatility of exchange rate fluctuations, which affect our purchasing costs of goods and services. While the vast majority of our revenues are denominated in the functional currency of the pertinent Group company, part of our operating expenses and capital expenditures are denominated in EUR and USD.

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**We are continuously involved in disputes and litigation with regulators, competitors and other parties. The ultimate outcome of such legal proceedings is generally uncertain. The results of those procedures may have a material adverse effect on our results of operations and financial condition.**

We are subject to numerous risks relating to legal and regulatory proceedings, in which we are currently a party, or which could develop in the future. Litigation and regulatory proceedings are inherently unpredictable. Legal or regulatory proceedings in which we are or could be involved (or settlements thereof), may have a material adverse effect on our results of operations or financial condition. For information concerning material litigation in which we currently are involved, see "Item 8 Financial Information Legal Proceedings." For information concerning our regulatory environment, see "Item 4 Information on the Company Regulation."

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## ITEM 4 INFORMATION ON THE COMPANY

### ORGANIZATION

Magyar Telekom Távközlési Nyilvánosan Müködö Részvénytársaság (in English, Magyar Telekom Telecommunications Public Limited Company) is a limited liability stock corporation incorporated and operating under the laws of Hungary. We operate under a commercial name, Magyar Telekom Nyrt. or Magyar Telekom Plc. Our shares are listed on the Budapest Stock Exchange, and our ADSs were listed on the NYSE until November 12, 2010, on which date the delisting of our ADSs from the NYSE became effective and our ADSs are no longer traded on the NYSE. 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 Eighth 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 telephone services in Hungary. On 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 responsible for telecommunications operations. This entity was transformed on December 31, 1991 into a stock corporation, Magyar Távközlési Rt. ("Matáv") then wholly owned by the predecessor of Állami Privatizációs és Vagyonkezelö Rt. ("State Privatization and Holding Company" or "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. 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 telephone services throughout Hungary and local public fixed line voice telephone services in 31 of 54 Local Primary Areas for a term of eight years ending on December 22, 2001. On May 24, 1994, we obtained the right to provide telephone 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 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 ÁPV collectively sold 272,861,367 shares or 26.31 percent of then outstanding shares. In June 1999, 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.

### DESCRIPTION OF BUSINESS AND ITS SEGMENTS

We are the principal provider of fixed line telecommunications services in Hungary, with approximately 1.9 million fixed voice access lines as of December 31, 2010. We are also Hungary's largest mobile telecommunications services provider, with more than 5.2 million mobile subscribers (including users of prepaid cards) as of December 31, 2010.

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Magyar Telekom established its current management structure in Hungary based on customer segments that require different technology and marketing strategies, and support functions. The Group's key operating segments in Hungary are: Consumer Services Business Unit, Business Services Business Unit, Group Headquarters and Technology Business Unit. The Media Business Unit, a separate operating segment in 2008 and 2009 (which was not a reportable segment for accounting purposes due to its relatively small size), was reported to the Management Committee as part of the Group Headquarters in 2010. In addition, the Group also has operations in Macedonia and Montenegro, which represent two additional reporting segments.

The Consumer Services Business Unit ("CBU") operates in Hungary, providing mobile, fixed line telecommunications and TV distribution services (including marketing, sales and customer relations activities) to residential and small business telecommunications customers in Hungary, with several million customers mainly under the T-Mobile and T-Home brands.

The Business Services Business Unit ("BBU") operates in Hungary, providing mobile and fixed line telecommunications, info-communications and system integration services (including marketing, sales and customer relations activities) mainly under the T-Systems and T-Mobile brands to key business partners (large corporate and public sector customers), as well as SMBs.

The Group Headquarters ("Headquarters") is responsible for providing wholesale mobile and fixed line services and also includes the operations of the Media Business Unit, considered as a separate operating segment in 2008 and 2009 in Hungary. Headquarters also performs strategic and cross-divisional management and support functions including Procurement, Treasury, Real estate, Accounting, Tax, Legal, Internal Audit and similar shared services and other central functions of the Group's management. Headquarters is also responsible for the Group's points of presence in Bulgaria, Romania and Ukraine, providing wholesale services to local companies and operators.

The Technology Business Unit ("Technology") is responsible for the operations and development of the mobile, fixed line and cable TV network, as well as IT management in Hungary.

The Group also has full-scale mobile and fixed line telecommunications operations in Macedonia and Montenegro, which represent two additional reporting segments of the Group. We hold a 100 percent interest in Stonebridge Communications AD, which controls Makedonski Telekom, the leading fixed line telecommunications services provider and, through its subsidiary T-Mobile Macedonia, the leading mobile telecommunications operator in Macedonia. We also hold a 76.53 percent ownership in Crnogorski Telekom, the principal fixed line telecommunications services provider and, through its subsidiary T-Mobile Crna Gora, the second largest mobile telecommunications operator in Montenegro.

We have not made any significant acquisitions between 2008 and 2010. For the investments in capital expenditures between 2008 and 2010 by our reportable segments, see Note 32.1.1 to the Consolidated Financial Statements. For the discussion of our major infrastructure developments, see "Item 4 Information on the Company Infrastructure and Technology."

## STRATEGY

As a result of our strategy, Magyar Telekom has maintained a leading position in its Hungarian fixed line, mobile, Internet and data businesses in 2010.

The telecommunications industry is undergoing a major change globally. Worldwide trends are driving towards an integrated telecommunications, information, media and entertainment market. The economic crisis has also led to restructuring between market segments.

We expect that the traditional telecommunications market will no longer deliver sizeable revenue growth in Hungary. The fixed voice market as a major revenue and profit source is declining; mobile is no longer able to compensate this decline. However, we expect that new core segments, especially mobile broadband, broadcasting and IT services will deliver sizable revenue growth in the coming years. The fixed market is characterized by 3Play bundles, with TV services becoming a driver and core element of service

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offerings, while the mobile market is driven by fierce competition in broadband. An increasing technology platform-based competition can be observed in the domestic market, and our competitors are extensively deploying next-generation countrywide fixed and mobile networks. The battle for customer contact has pushed prices down. This slower development in the telecommunications market is likely to lead to consolidation between market players to increase economies of scale and enable growth.

Our Corporate Strategy was designed in order to address these global and local market challenges and better exploit our position as an integrated telecommunications operator with a full range of services. Our Corporate Strategy FIX, TRANSFORM, INNOVATE enables us to exploit and develop our extended customer base, significantly improve efficiency and capture growth opportunities. The strategic objective in the short/mid-term is to fix critical factors within the core business (simplified and focused lean operation, lower cost structure, end-to-end responsibilities) and to further strengthen our positions in core connectivity segments (voice, mobile broadband, TV) that will enable us to shift resources and priorities towards focused innovation and expansion.

Our new growth areas support conscious revenue restructuring, i.e., our growth in our new core segments, such as broadband, broadcasting, IT and content services, is expected to gradually compensate for lower revenues from traditional telecommunications, while non-core areas, such as energy, e-health, finance, and insurance services, support customer retention and the maintenance of high-margin revenues.

In order to continue our transformation to become a cost-efficient integrated services company in an extended market of telecommunications and related industries, we have set our strategic priorities as follows:

1. *Slow down voice churn*

   To retain customers of the highest margin segments

   To secure the largest profit pool for future investments

2. *Reach competitive cost structure*

   To reach competitive cost base

   Improve Return on Capital Employed ("ROCE"), Operating Expenses to Sales and Capital Expenditures to EBITDA ratios

3. *Secure market leader position in broadband*

   To secure broadband access leadership as basis for all future services

   To stabilize revenue market share and increase share of high-margin revenues

4. *Achieve market leader position on the TV market*

   To increase TV customer volumes as means to retain high-margin voice and broadband customers

   To increase number of services per customer (3/4Play)

5. *Stabilize revenues*

To transform our revenues into a sustainable mix

To reverse declining revenue trends, thus easing pressure on cost side

To further monetize infrastructure with high-margin revenues

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## OVERVIEW OF MAGYAR TELEKOM'S REVENUES AND PRINCIPAL ACTIVITIES

For the years ended December 31, 2008, 2009 and 2010, our total revenues by business segment were as follows:

| | Year ended December 31, | | | Year ended December 31, |
|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2010/2009 |
| | (in HUF millions) | | | (% change) |
| **Revenues** | | | | |
| Total CBU revenues | 341,563 | 322,336 | 314,773 | (2.3) |
| Less: CBU revenues from other segments | (38,655) | (33,849) | (30,066) | 11.2 |
| CBU revenues from external customers | 302,908 | 288,487 | 284,707 | (1.3) |
| Total BBU revenues | 179,174 | 170,989 | 159,271 | (6.9) |
| Less: BBU revenues from other segments | (16,833) | (18,861) | (15,683) | 16.8 |
| BBU revenues from external customers | 162,341 | 152,128 | 143,588 | (5.6) |
| Total Headquarters revenues | 163,905 | 143,776 | 123,013 | (14.4) |
| Less: Headquarters revenues from other segments | (70,945) | (62,258) | (53,184) | 14.6 |
| Headquarters revenues from external customers | 92,960 | 81,518 | 69,829 | (14.3) |
| Total Technology revenues | 11,370 | 10,556 | 8,287 | (21.5) |
| Less: Technology revenues from other segments | (7,877) | (7,599) | (7,142) | 6.0 |
| Technology revenues from external customers | 3,493 | 2,957 | 1,145 | (61.3) |
| Total Macedonia revenues | 76,097 | 82,312 | 77,598 | (5.7) |
| Less: Macedonia revenues from other segments | (285) | (214) | (134) | 37.4 |
| Macedonia revenues from external customers | 75,812 | 82,098 | 77,464 | (5.6) |
| Total Montenegro revenues | 33,148 | 34,442 | 32,874 | (4.6) |
| Less: Montenegro revenues from other segments | (105) | (51) | (44) | 13.7 |
| Montenegro revenues from external customers | 33,043 | 34,391 | 32,830 | (4.5) |
| All other (net) | 2,416 | 2,426 | 1 | (100.0) |
| Total consolidated revenue of the segments | 672,973 | 644,005 | 609,564 | (5.3) |
| Measurement differences to Group revenue | 83 | (16) | 15 | n.a. |
| Total revenues of the Group | 673,056 | 643,989 | 609,579 | (5.3) |

In addition to the segments described above, there are a few small foreign subsidiaries not belonging to any segment for financial reporting purposes and are not reported separately due to their small size. These operations are included in "All other" in the reconciliation of the reportable segments' totals to the Group totals.

Our business is not materially affected by seasonal variations.

### CONSUMER SERVICES BUSINESS UNIT (CBU)

The operations of CBU consist of fixed line and mobile voice retail services, fixed line and mobile Internet services, data transmission, pay TV, telecommunications equipment sales, as well as other services. The most important "other services" are: energy retail business, mobile purchase (buying opportunity based on SMS) and insurance business. These services are often provided in cooperation with other companies.

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CBU provides services for residential and SOHO customers. CBU offers home-related telecommunications services under the T-Home brand and mobile communications services under the T-Mobile brand.

**Fixed Line Services**

***Voice Retail Services***

*Subscribers*

The following table sets forth information regarding the key voice operating statistical figures of CBU, including PSTN, VoIP and VoCable lines:

| | At December 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2010** |
| Voice services | | | |
| Total voice access | 1,921,486 | 1,740,619 | 1,587,192 |
| Payphone | 16,274 | 14,788 | 11,897 |
| Total outgoing traffic (thousand minutes) | 3,550,076 | 3,135,892 | 2,762,690 |
| Blended MOU (outgoing) | 151 | 159 | 160 |
| Blended ARPA (HUF) | 3,650 | 3,630 | 3,427 |

*Products and Services*

*Local, Domestic and International Long Distance Telephone Services.* We provide local, domestic and international long distance telephone services for our fixed line subscribers. We send and receive all our international voice and switched transit traffic to and from Deutsche Telekom. The agreement with Deutsche Telekom guarantees us international telephone services revenues and profits and allows for cost reductions due to this synergy with the parent company.

*Directory Assistance.* We offer directory inquiry services. The domestic directory assistance database includes all fixed line and postpaid mobile subscribers' data in Hungary. We offer a call completion option to subscribers, whereby calls may be connected automatically.

*Digital Home.* Based on our Digital Home concept, we started to sell a complete portfolio of devices, including e-books, Network-attached Media Storage, Media Streamer and Xbox video game consoles to gain new broadband subscribers. Since November 2010, simultaneously with the world premier of Xbox Live, T-Home started to offer the Xbox online gaming service. As a brand new service in our Digital Home portfolio, the Otthonörzö ("Home Security") service was launched in January 2010. With the help of a wireless radio communication channel and fixed line broadband Internet technology, our clients can monitor their home through their mobile devices.

*Fees and Charges*

We charge fixed line subscribers a one-time connection fee, monthly subscription charges and traffic charges based on usage. Traffic charge is measured in minutes in residential price plans while either in seconds or in minutes in business price plans, depending on the specific plan.

Our one-time connection fee and monthly subscription charges are different for residential and business customers. There are different price plans for residential and business customers as well.

*Residential price plans*

Our T-Home brand (introduced in September 2008) offers fixed line voice, Internet and pay television services independently of underlying technology. 3Play (when the three services, such as fixed

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line voice, Internet and TV, are bundled and offered in a single package) is the focus of the portfolio and of the communication, but the elements can also be purchased separately or in any combination with certain limitations. The more services to which a customer subscribes, the more T-Home discounts are available. If two or three basic services are subscribed to, the customer is granted the "T-Home Double Discount" or the "T-Home Triple Discount," respectively.

Our voice portfolio offers the same plans at the same price on all platforms (PSTN, VoIP and VoCable). T-Home Double Discount or T-Home Triple Discount is offered to customers in all of our residential price plans. We continue to offer flat rate price plans. Flat rate price plans are transparent and easy to budget, and are designed to reduce the erosion of our fixed line business. Customers of flat rate price plans can use our network for domestic calls periods for a fixed monthly fee.

*Small business price plans*

The T-Home discount structure, introduced in 2008, is also available for SOHO customers. The T-Home SOHO discount includes flat rate voice price plans designed for business customers, aiming to further increase our flat price plan penetration.

***Internet Services***

The following table sets forth information regarding Internet products of CBU:

| | At December 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2010** |
| Internet products | | | |
| Retail DSL market share (%)[1] | 54 | 58 | 63 |
| Cable broadband market share (%)[1] | 18 | 19 | 20 |
| Number of retail DSL customers | 404,878 | 435,558 | 462,566 |
| Number of cable broadband customers | 127,683 | 152,878 | 181,056 |
| Number of fiber optic connections | 0 | 7,247 | 19,109 |
| Total retail broadband customers | 532,561 | 595,683 | 662,731 |
| Blended broadband ARPU (HUF) | 5,103 | 4,427 | 3,944 |

(1) Data relates to Magyar Telekom Plc. The figures are our estimates and are based on the number of subscribers in the market.

T-Home provides broadband Internet services for residential and SOHO customers through three different technologies such as copper (ADSL, VDSL), coax network (Cable Internet) and GPON (Optical Internet). The prices and bandwidths offered on these technologies are harmonized as far as possible.

The prices of Internet services depend on the bandwidth (and traffic limit) and the number of other T-Home services (telephone and TV) subscribed (T-Home Double or Triple Discount). There are different Internet packages for residential and SOHO customers.

*ADSL.* ADSL is a continuous, high-speed Internet access service based on the Asymmetric DSL technology. The service offers cost-efficient broadband Internet access over existing copper wires. In addition, we offer Naked ADSL, an ADSL service over existing copper wires without a telephony service. We offer 1/5/15 Mbit/s download bandwidth packages.

*VDSL.* In 2010, we offered VDSL service in more than 90 cities, reaching 145,000 households. We offer two special services on this technology in addition to the normal ADSL services: up to 25 Mbit/s Internet access and HD channels on IPTV.

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*Cable Internet.* We also provide cable Internet by using cable television infrastructure. After the continuous development of our cable network, we offer ED3 technology almost on all of our cable networks. At the end of 2010, ED3 services were available in approximately 589,000 households. We offer 5 and 15 Mbit/s maximum download speeds in the whole network and we also offer 25/50/80 Mbit/s maximum download speeds in ED3 service.

*Optical Internet.* After the introduction of our optical Internet portfolio on GPON network in April 2009, we continued our FTTx network roll-out program in 2010 as well. We offer optical Internet packages with 5/15/$^{25}$/$_{50}$ Mbit/s maximum download speeds. GPON services are available in approximately 227,000 households.

*T-Home HSI portfolio.* Through VDSL, ED3 and GPON technologies, we were able to provide HSI packages with 25/50/80 Mbit/s maximum download bandwidth in about 961,000 households by the end of 2010.

***TV***

The following table sets forth information regarding the key TV operational statistical figures of CBU:

| | At December 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2010** |
| TV services | | | |
| Number of cable TV customers | 422,936 | 406,841 | 370,212 |
| Number of satellite TV customers | 5,338 | 156,142 | 254,188 |
| Number of IPTV customers | 28,496 | 67,430 | 124,374 |
| Total TV customers | 456,770 | 630,413 | 748,774 |
| Blended TV ARPU (HUF) | 3,537 | 3,280 | 2,949 |

T-Home offers pay TV services on three different TV platforms: on cable (T-Home analogue and digital cable TV), on IP (IPTV) and on satellite (Sat TV). The prices of cable TV and IPTV have been harmonized, while Sat TV is available for a slightly lower monthly fee. The prices of TV services depend on the number of channels (package type) and the number of T-Home services subscribed by the customer (T-Home Double or Triple Discount).

*IPTV.* IPTV service was introduced in 2006. Since the launch of IPTV over ED3, the sale of IPTV services has been dynamically increasing and the number of IPTV connections reached more than 124,000 by end of 2010. IPTV allows broadcasts to be seen on a television set with a set-top-box over copper, ED3 or optical network. The product line offers various interactive contents, such as time-shift function, EPG on screen, recording on the hard disc built in the set-top-box, web EPG service, video on demand service and picture-in-picture. In 2010, we continued to increase the coverage of this service by developing our networks. T-Home IPTV is available in more than 1,600,000 households in Hungary.

*Cable TV.* With the integration of T-Kábel, analogue and digital cable TV products have become an integral part of the harmonized T-Home TV portfolio. The growth in the number of cable TV subscribers slowed down in 2008 and the number of customers began to decrease in 2009, as a result of growing competition and also due to the saturation and development of the market, as well as the continuous migration towards more improved platforms (e.g., IPTV). We have sought to offset our Cable TV churn with network and customer acquisitions.

*Sat TV.* We launched satellite TV service (T-Home Sat TV) in 2008. By entering the Sat TV market we became a nation-wide TV service provider. The sale of our Sat TV service increased rapidly and the number of Sat TV customers reached more than 254,000 by the end of 2010. With the introduction of the

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DVB-S service, we are able to provide 3Play bundled services (TV, Internet, voice) in 78 percent of the country.

We have reached one of our main strategic objectives by becoming the number one 3Play service provider in Hungary (based on number of customers) under the T-Home brand, which strengthens and broadens our customer base (less churn sensitivity).

***Fixed Line Telecommunications Equipment Sales***

We distribute an extensive range of telecommunications equipment, from individual telephone sets to modems, HAGs, set-top-boxes, TVs and complete network systems, through a network of customer service centers and our technical unit. In addition to stand-alone telephone-set sales, we offer various price plans combining voice, Internet and TV services together with a wide range of device portfolio supporting service packages (e.g., phones, routers, TVs, etc.). We also continually research new device solutions (e.g., media streamer, gaming consoles, ePAD) in order to offer and to build a high-level Digital Home for our customers.

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 elements of a full service telecommunications provider and are necessary for the expansion of our customer base. In addition, these activities allow us to ensure that technologically advanced equipment required for new services is available in Hungary.

***Other Revenues***

Other fixed line revenues include construction, maintenance, rental, customer care services, revenues from retail energy trade and other miscellaneous revenues.

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**Mobile Services**

*Subscribers*

The table below sets forth information concerning the key mobile operating statistical figures of CBU at the dates indicated:

| | At December 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2010** |
| Mobile penetration (%)[1] | 121.8 | 117.7 | 120.2 |
| Mobile SIM market share (%)[2] | 43.9 | 43.4 | 43.4 |
| Number of customers | 4,648,323 | 4,343,672 | 4,416,312 |
| Postpaid share in the customer base (%) | 29.1 | 35.2 | 39.0 |
| MOU | 127 | 126 | 138 |
| | | | |
| ARPU (HUF) | 3,397 | 3,164 | 3,239 |
| Postpaid | 7,265 | 6,454 | 5,956 |
| Prepaid | 1,862 | 1,670 | 1,635 |
| | | | |
| Overall churn rate (%) | 16.9 | 27.5 | 21.0 |
| Postpaid (%) | 12.1 | 15.1 | 15.9 |
| Prepaid (%) | 18.8 | 33.1 | 24.0 |
| Ratio of non-voice revenues in ARPU (%) | 15.2 | 16.7 | 18.6 |
| Average SAC per gross add (HUF) | 6,813 | 7,680 | 6,570 |
| Number of mobile broadband subscriptions | 182,687 | 326,384 | 488,867 |
| Mobile broadband market share (%)[2] | 53.4 | 45.9 | 47.8 |
| Population-based indoor 3G coverage[2] | n.a. | 65.4 | 65.4 |

(1) Data relates to the mobile penetration in Hungary, including customers of all three service providers.

(2) Data relates to Magyar Telekom Plc., figures published by NMIA.

On December 31, 2010, we accounted for 43.4 percent of the total Hungarian mobile market in terms of subscribers based on the number of active SIM cards and 44.8 percent in terms of total number of active SIM cards generating traffic in the previous three months as published by NMIA.

We were the first mobile operator to launch HSDPA service in Hungary in 2006. The outdoor mobile broadband coverage based on population reached about 75.2 percent by the end of 2010. We have managed to maintain our market leader position in the mobile Internet market. At the end of 2010, we had a market share of 47.8 percent based on the number of subscriptions and 43.1 percent based on the number of subscriptions with data transfers according to information published by NMIA.

Despite the difficult economic circumstances in 2010, we were able to increase the number of our mobile subscribers with attractive price plans. The number of mobile broadband subscriptions increased and at the end of 2010, we had 488,867 subscribers representing a 49.8 percent increase in comparison with the previous year.

*Churn policy.* Generally, a contract customer is churned either after voluntary termination upon the lapse of his contracted loyalty period or after forced contract termination due to the customer's failure to fulfill payment obligations. In the absence of re-charging, a prepaid customer is considered to be churned after a period of 12 to 15 months depending on the amount charged on the prepaid card.

*Traffic.* The average monthly traffic per CBU mobile subscriber was 138 minutes in 2010. The usage increased as a result of free or discounted usage in closed user groups.

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***Mobile voice services***

*Voice postpaid services*

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

We charge subscribers a one-time connection fee, monthly subscription charges, event charges and time-based traffic charges. We do not charge subscribers for incoming calls, other than calls received while roaming. We receive payments from other telecommunications service providers for terminating calls on our network. We maintained a wide range of price plans in 2010 to remain competitive and develop loyalty.

For the small enterprise segment (SOHO customers), CBU offers several price plans providing favorable calls within the user group and other specific services. Customers can manage their user groups and connecting services via web-based application called Telematrix.

We introduced a shareable business tariff called Etalon Team in June 2010. For a single monthly fee, this product can be used by several employees of a small business company as a shareable usage pool.

Customized employee discounts are gaining considerable market share in the Hungarian mobile market, concentrating mainly on large multinational companies and the government segment. Since the bills of these subscriptions are paid by individuals (and not their employers), this group of customers belongs to the CBU customer base.

*Voice prepaid services*

Customers using prepaid cards do not pay monthly subscription charges, but certain price plans do include monthly recurring fees.

Electronic top-up services are available at many ATMs, petrol stations, Internet banks, Telebanks, Mobilbanks, on public Internet sites, in post offices, newsagent network, T-Mobile franchise and wholesale partners. The estimated share of electronic top-up in our total top-up remained stable, at above 90 percent at the end of 2010.

*Roaming services*

International roaming services are available both for our prepaid and postpaid subscribers. The number of networks and countries where they can make and receive voice calls, send and receive data or SMS is increasing continuously. Since 2007, EU roaming regulations have been in place for roaming voice tariffs for retail customers. The regulation was extended for further three years to retail voice and SMS tariffs as well in 2009.

***Mobile non-voice services***

In 2010, we continued to enhance our non-voice services portfolio, introduced several new products, increased the penetration and usage of existing products and extended access to some of our domestic products abroad:

The increase in the usage of our mobile Internet services played an important role in 2010. The number of subscribers for this service rose by 49.8 percent in 2010.

In December 2010, Origo, our fully owned media subsidiary, launched a new mobile version of [origo], Hungary's most visited online portal with a very strong brand. Origo mobile replaced "t-zones" and "web'n'walk" as the default mobile home page for all T-Mobile subscribers and it is also available to the subscribers of other service providers. We believe this service will boost the traffic of the default T-Mobile portal significantly and generate mobile advertisement revenues.

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We continued to broaden our mobile-related insurance portfolio in 2010, which is available for our postpaid mobile customers by calling our customer service center. We doubled the number of subscribers for family insurance products and in 2010, we successfully introduced two new services (handset insurance for new devices and travel insurance service for subscribers in mobile roaming situation). Revenues from insurance services grew by 87 percent in 2010.

In 2010, we extended the Mobile TV streaming service for iPhone users in order to gain more subscribers and revenue.

Purchases via mobile phones continued to grow in 2010, transaction figures grew by 57 percent and revenues by 27 percent. The main driver of growth in 2010 was the parking service (i.e., when parking tickets can be purchased via mobile phones using SMS or IVR channel). Other popular products purchased by mobile phones are lottery tickets and highway fees, but further smaller partners were also integrated (e.g., travel insurance). In the future, we see potential for the purchase of public and rail transportation tickets by mobile phone.

AkcióNekem.hu ("OffersForMe.hu") is a webpage, which was launched to build up a mobile marketing database in September 2010. We expect the usage of this database to bring new revenue streams from the advertisers and also to support CRM activities. Mobile subscribers may register for this database for free and receive regular promotional offers, third party advertisements and discount notices. Subscribers have the option to add thematic filters to their profiles and to limit the number of messages per week they are willing to receive.

We offer free navigation software for iPhone in cooperation with NAVIGON AG with the aim of increasing customer loyalty and iPhone 4 sales volumes in our highest ARPU-generating mobile customer segment. Immediately on the day of launch in August 2010, the T-Mobile branded application became the No.1 downloaded application in the AppStore accessible for Hungarian customers. The positive customer feedback and the activation rate reflect that the project holds extremely high brand-building value.

***Mobile equipment and activation***

We distribute an extensive range of mobile device products, such as terminals, accessories, notebooks, netbooks, ePads, data products, SIM cards and vouchers.

We focus on both acquisition and retention, offering several favorable packages to our customers, such as the interest-free installment option for almost all mobile handsets and notebooks, or in case of our existing customers, the popular loyalty offers with more favorable prices and conditions.

We offer combined mobile service (voice, Internet and TV) and device offers to our customers, finely-tuning the eventualities of existing mobile services, together with supportive devices.

The best example of this is the successful introduction of iPhone 3G in 2008, iPhone 3GS in 2009 and iPhone 4 in 2010 for the Hungarian market exclusively by T-Mobile. iPhone can also be bought bundled with iPhone-specific price plans (ikon 200, ikon 400 and ikon 600), which help to fully exploit iPhone's multimedia capabilities. We also have a wide range of Android-, Windows Phone 7- and Symbian-based smartphone portfolio. The related terminals are offered with the MediaMánia price plans. Among the operating systems, Android became increasingly popular and due to the wide selection of smartphone devices with MediaMánia tariffs, T-Mobile was able to increase its smartphone penetration in 2010.

We sell mobile equipment manufactured by other companies.

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*T-Home and T-Mobile integrated offers*

Since we are the only integrated (fixed-mobile) telecommunications service provider in the Hungarian market we continue to leverage the opportunity of FMC.

*T-Home/T-Mobile integrated broadband offer.* This offer provides fixed line and mobile Internet together at a discounted price. The purpose of the promotion is to retain fixed line and mobile customers with a competitive offer and to sell mobile Internet as a complementary service for them.

*FamilyFriend Option.* This option offers flat rate voice traffic to those customers who subscribed to the FamilyFriend Option between their T-Home fixed and T-Mobile postpaid and prepaid numbers. In 2010, we added VoIP technology to fixed lines.

*The Connection Program.* The joint loyalty program of T-Home and T-Mobile offers the opportunity to collect loyalty points for use of fixed line and mobile services, as well as several favorable discounts.

*Paletta.* As part of our integrated company strategy, we introduced a fixed-mobile price plan in June 2010, which was aided with a full advertising campaign in September. This price plan offers mobile and fixed voice, fixed Internet and TV services to residential customers in a single package at a discounted price. The offer is available in two price plans, targeting mid- and advanced-user segments offering a very unique service in the Hungarian market.

*Kombi business discount.* As another element of our integrated company strategy, we introduced a fixed-mobile offers for small businesses in February 2010. This price plan offers mobile voice, fixed voice and fixed Internet plus an optional mobile broadband to small business customers at a discounted price.

**BUSINESS SERVICES BUSINESS UNIT (BBU)**

The operations of BBU consist of fixed line and mobile voice retail services, Internet services, data transmission, SI/IT services, TV, telecommunications equipment sales, as well as other services.

**Fixed line services**

***Voice Retail Services***

*Subscribers*

The following table sets forth information regarding the key voice operating statistical figures of BBU:

| | At December 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2010** |
| Voice services | | | |
| Business PSTN lines | 110,389 | 100,172 | 86,439 |
| Managed leased lines (Flex-Com connections) | 6,037 | 4,745 | 3,454 |
| ISDN channels | 288,338 | 270,466 | 236,706 |
| Total lines | 404,764 | 375,383 | 326,599 |

| | | | |
|---|---|---|---|
| Total outgoing traffic (thousand minutes) | 798,157 | 656,372 | 557,319 |
| MOU (outgoing) | 191 | 178 | 176 |
| ARPU (HUF) | 5,457 | 5,162 | 4,880 |

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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.

Due to the continuing weak economic conditions, the new government has sought to implement cost-savings measures in government spending. Based on a Government resolution, the new government intends to deliver HUF 20 billion of savings related to the 2010 budget for national asset management, which includes IT and telecommunication services. As a result of the requested price allowances in relation to government contracts, we had a negative impact on our 2010 revenues and expect that these price allowances will affect our results in the coming years by HUF 5-7 billion.

*Fees and Charges*

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. Traffic charge is either measured in seconds based on the call's duration, or in minutes, depending on call plans.

*Business price plans*

We target business customers with flat rate price plans, which are transparent and easy to budget. These are designed to reduce the erosion of our fixed line business, and to provide an opportunity for the reacquisition of traffic that we have lost due to pre-selection. Customers of flat rate price plans can use our network for local and domestic long distance calls for a fixed monthly fee. We also offer flat rate price plans with options for mobile and international calls.

Beginning in 2009, we also offer flat rate price plans to our largest key customers. To prevent customer churn, we use these price plans as a retention tool for our fixed line and mobile voice services customers.

For SMBs, we extended the existing business flat rate portfolio and launched a fixed-mobile CUG bundled product to retain fixed line traffic in the business segment.

*Services*

*Local, Domestic and International Long Distance Telephone Services.* We provide local, domestic and international long distance telephone services to our fixed line subscribers.

*IP-based Voice Services.* We provide integrated voice, Internet and corporate data packages at very attractive prices for our SMB segment within the fixed line portfolio.

*Shared Cost/Toll Free Numbers.* The reverse charged numbers ("blue" and "green") are primarily used by business customers leveraging the service benefits in the course of their business operations. The customer base and the usage volume of this service are stable. In line with international regulations, we ensure the international availability of reverse charged numbers both from fixed line and mobile networks.

*PBX Services.* We offer virtual PBX services via VoIP providing internal voice and data integrated business networks for the small and medium business segment.

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***Internet Services***

The following table sets forth information regarding the Internet customers of BBU:

| | At December 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2010** |
| Internet services | | | |
| Number of leased line Internet subscribers | 617 | 558 | 564 |
| Number of retail DSL customers | 31,805 | 32,358 | 30,192 |
| Retail DSL ARPU (HUF) | 13,743 | 12,712 | 10,485 |

We offer our business customers Internet services based on ADSL technology as well as access through cable, WLAN and leased lines. BBU provides ADSL service on PSTN lines named BDSL. Packages without traffic limits are available with four different download speeds: 5, 10, 15 and 25 Mbit/s.

*Bundled ADSL ("T-DSL").* BBU also offers voice and Internet bundles (T-DSL) targeting primarily small and medium business customers. In 2009, we have reshaped our T-DSL portfolio with new bandwidth packages (5, 10, 15 and 25 Mbit/s download speeds) and more value added services. T-DSL price plans contain telephone line services with voice and Internet access and value added services such as virus protection and domain name.

*T-HotSpot.* HotSpot is a WiFi technology-based wireless broadband Internet solution for public site Internet services (i.e., hotels, conference centers, restaurants). By the end of 2008, former T-Com and T-Mobile HotSpots have been consolidated; therefore the whole T-HotSpot network can be now used under the same terms and conditions.

*MLLN Internet Access.* MLLNI provides transport and access facilities to IP traffic and it is offered mainly to our largest business customers. The product includes domestic and international peering and leased line access, by which the domestic end-point of the customer is connected to our IP network with symmetrical upload and download link. With the growing penetration of xDSL-based broadband access technology and the aggressive pricing in the customer segment, we will derive less revenue from our MLLNI services.

***Data Transmission and Related Services***

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 offer a broad variety of standard analogue and digital lines for lease, including two-wire and four-wire analogue lines and digital lines with capacities from 64 Kbit/s to 10 Gbit/s. We also offer high capacity customized digital lines to other telecommunications providers.

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

*Flex-Com.* We offer Flex-Com, domestic and international digital leased lines with managed back-up systems that are dedicated to data transmission. The number of Flex-Com connections has been decreasing as customers choose leased line services based on the high speed FTTx technologies within

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100 Mbit/s and 10 Gbit/s speed ranges (e.g., Gigalink) or choose network facilities with higher values from our product portfolio (e.g., IP Complex Plus, MultiFlex).

*Magyar Telekom DataLink.* In 2004, we launched a data transmission product that offers technology-independent data transmission between business customers' locations. The customer only needs to define three main parameters: bandwidth, SLA and interface. This service provides data connection below 2 Mbit/s, with X.21 or Ethernet interfaces. With the introduction of this service, we can better utilize our spare data transmission capacity and also offer other high-value network facilities to our customers (e.g., IP Complex Plus, MultiFlex).

*MultiFlex.* In 2007, we launched a new MultiFlex service. It is an Ethernet-level virtual private network service on our Ethernet-aggregation and MPLS-backbone network, where access may be provided through multiplying copper pairs, optical fiber, or micro, which enables connections to our customers with a speed up to 1 Gbit/s. We provide proactive fault repair and SLA report, and our partners can access the report via our VIP portal website. In 2009, we launched a few new service options, such as Redundancy and Measurement-based SLA options. By the end of 2010, we had more than 200 contracted customers.

*Datex-P.* We offer Datex-P, a packet-switched data transmission service based on the X.25 (e.g., X.1, X.28, X.32) protocol. The service provides low speed (up to 128 Kbit/s) 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. Between 2003 and 2005, our major objectives were to extend the lifecycle of the product, maintain profitability, optimize the network and reduce costs. In 2005, we assessed and commenced migration of customers to other data transmission services, which is still ongoing. The churned customers can choose up-to-date and high-value network facilities from our product portfolio (e.g., IP Complex Plus, MultiFlex).

*IP Complex Plus.* IP Complex Plus is an IP-VPN service. IP Complex Plus service is offered to retail and wholesale customers having multiple remote sites. This service enables them to establish secure data traffic between sites without the need of setting up "point-to-point" connections between two sites. The development of supplementary services, such as ISDN back-up, integrated voice/data, ADSL/SHDSL access and dial-up access to IP-VPNs make this product more attractive to a growing number of business customers. In addition to the current function of integrated voice/data service, we provide number portability for our IP Complex Plus customers. Using this new service, customers can use their existing phone numbers within their private network as well. In 2007, we extended our portfolio with new access technologies based on Ethernet network, which enable our customers to connect to the IP network with a speed up to 1 Gbit/s. In 2009, we launched the HSDPA mobile backup option to improve the reliability of data transmission. Furthermore, we allow wired connections to the domestic customer VPN from Romania and Bulgaria.

*Telepresence.* Telepresence is an entirely new generation of video conferencing services that is offered to our corporate customers. It creates a unique live, face-to-face communication experience over the network. Telepresence uses powerful integrations to our IP Complex Plus network enabling highest quality (1080p, low latency, spatial audio) video and audio connections, which provide users with simplicity in call scheduling and launching, as well as reliability. It manages real time applications such as voice and video at the lowest possible bandwidth. This allows customers to keep costs down, and use their network investments to maximum advantage. We also use Telepresence for our own company purposes with several sites in Hungary, which are connected by IP-VPN with other Deutsche Telekom subsidiaries in Skopje, Podgorica and Frankfurt.

*Távszámla.* In 2005, we launched our electronic bill presentment and payment product (Távszámla). Távszámla provides certified invoices in PDF format with electronic signatures and time stamps complying with relevant legal regulations. This service is perfectly suitable for public utilities to reduce paper-based bills and significantly reduce their billing costs. In addition to our own services, the bills of various public

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utilities (e.g., gas, electricity) are also available through Távszámla. At the end of 2010, the registered users of Távszámla exceeded 97,000.

***System Integration and Information Technology***

BBU has a prominent competitive advantage in providing complex ICT services in the Hungarian market, since it also owns the necessary telecommunications infrastructure. As a result of our clear strategy to dominate the Hungarian ICT services market and the acquisitions completed between 2006 and 2009, our company became the market leader providing combined IT and telecommunications services. In the spring of 2009, we acquired ISH, an IT services vendor with a significant client base in the healthcare sector. On February 28, 2011, we completed the purchase of Daten-Kontrol Kft., which develops, installs and operates IT applications from two sites in Budapest and Pécs.

*Outsourcing services*

*ICT Outsourcing*

Our ICT Outsourcing services offer transfer of assets, customized hardware configuration, customized SLA and processes for mainly large enterprise companies and public institutions. We select the billing and settlement solutions that best suit the goals of our partners (e.g., solutions based on users, infrastructure elements, service tickets and combinations of these factors).

*Managed Services*

Our managed services represent complex IT infrastructure services including both the necessary network equipment and the related services for a monthly service charge. As a managed infrastructure service, we provide Managed LAN, Managed Voice, Managed Desktop, Managed Security, and Managed Printer services for our mid-market business customers.

*Managed LAN.* With the Managed LAN Service, we offer construction, continuous operation and management of companies' computer networks (LAN). The service includes continuous monitoring of active devices in local networks and proactive fault repair. With this service we offer our customers a one-stop service provision for a foreseeable transparent monthly service charge.

*Managed Voice.* Our Managed Voice Service offers the construction and operation of a complete integrated voice and data communication system. In addition to all functions of conventional telephone systems, the Managed Voice Service includes an IP-based voice transmission (telephone) system with numerous comfort features. The system is fully based on and is integrated into the data network of the company's headquarters and its sites so there is no need for an additional internal telephone network at the headquarters or at the sites.

*Managed Desktop.* Our Managed Desktop Service is a solution for companies to outsource their IT infrastructure operations. With this service, we assume the overall management (including continuous monitoring) of client workstations (computers) and connected devices, i.e., printers and other peripherals. The service also includes professional consulting, procurement of the necessary PC and notebook configurations, installation of the necessary software environment and, when requested, its modification.

*Managed Security.* Our Managed Security Service offers protection of the IT infrastructure through local or centralized monitoring, construction and operation of an IT protection system.

*Managed Printer.* Our Managed Printer Service includes design, installation and operation of companies' entire printer pool, the devices needed for printer operations, their replacement and continuous monitoring.

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*Compleo*

BBU offers to SMBs office communications infrastructure services in one package, containing modern IT and telecommunications tools. Components of the T-Systems Compleo service package include:

- Telecommunications access and usage, i.e., integrated broadband, voice and Internet service for each site;
- IT network (LAN) and equipment, i.e., telephone sets and PABX functionality;
- Internet security;
- Service Desk and monitoring service; and
- Secure above-Internet (IPSec-VPN-based) data communication options between the sites.

This service package can be tailored to the very needs of the SMBs' business.

*Infrastructure-hosting & co-location services*

We provide hosting and co-location services, which offer full-scale solutions for data storage and at the same time allow clients to monitor servers during any period of the day, and take immediate action if necessary. Our hosting and co-location services include all the functions associated with servers, starting from locality- or server-based co-location through server leases to the provision of replacement computers, and provision of value added services.

*ASP, SaaS services*

We provide ASP/SaaS services to local governments, medium sized companies and SMBs. These services enable us to bundle telecommunications and IT services. We developed the Virtualoso product to enter the SMB market with standardized ASP Services, while we plan to provide from 2011 customized ASP solutions for local governments and ERP/CRM applications in SaaS model for mid-market customers. We provide the following types of Virtualoso services:

- Virtualoso eMail (Microsoft Exchange functions);
- Virtualoso Meeting (teleconference, virtual meeting room and joint online work);
- Virtualoso Server (rent of server capacity);
- Virtualoso WorkPlace (online application for storing and sharing documents);
- Virtualoso BackUp (archiving data from own server or PC in a safe data park);
- Virtualoso BlackBerry (safe e-mail communication with automatic synchronization and device management);

Virtualoso VoiceCenter (virtual PBX); and

Virtualoso SMS (user friendly web interface to manage and send large number of messages).

*Application Development and Operation*

Our subsidiary, IQSYS provides IT application development, management and system integration services mainly for large enterprises and public institutions. In addition to these traditional markets, IQSYS has an increasing focus on the SMB sector as well. We deliver complex, custom-tailored solutions covering the full application lifecycle. Our services range from business and IT consulting, through the implementation of application packages (ERP, CRM, other sector specific applications, business intelligence solutions), custom application development and system integration to the delivery of the

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required tools and the operation of the applications. Our offering is complete with application services as well as outsourced IT and business workflow services.

*Infrastructure*

Our subsidiary, KFKI provides large enterprises and public institutions with various infrastructure solutions and IT operation services. Beside these large business partners, KFKI also handles customers from the SMB sector. KFKI implements, supports and operates unified communication solutions, intelligent building solutions, network integration solutions, IT security infrastructure, IT service management and system administration solutions as well as computer systems. KFKI also provides consulting services in the areas of IT security, IT operation and IT investments. We outsource not only IT equipment, but human resources ("HR") as well. Our IT operation services range from operation by our expert delegated to the client on a long-term basis to installation, repair, maintenance, planning, consulting, operation and upgrading in any part of the country.

**Mobile operations**

*Subscribers*

The table below sets forth information concerning the key mobile operating statistical figures of BBU at the dates indicated:

| | At December 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2010** |
| Mobile operations | | | |
| Number of customers | 713,469 | 775,912 | 792,106 |
| Overall churn rate (%) | 5.8 | 8.0 | 8.2 |
| MOU | 325 | 336 | 340 |
| ARPU (HUF) | 7,655 | 6,458 | 5,926 |
| Number of mobile broadband subscriptions | 81,339 | 102,161 | 135,583 |
| Ratio of non-voice revenues in ARPU (%) | 20.2 | 23.6 | 26.3 |
| Average SAC per gross add (HUF) | 9,092 | 8,280 | 6,030 |

***Mobile voice services***

We provide the same voice retail services to our corporate customers that we offer to our residential market.

***Mobile non-voice services***

In addition to the services we offer to our residential customers, we developed the following products for our corporate clients:

*Telematrix.* Telematrix is a web-based tool available for our customers to manage their entire mobile fleet (cost and asset management, service activation and deactivation) on their own. We continually develop the Telematrix platform, which we consider a major competitive advantage enabling us to maintain our market leader position in the corporate mobile market.

*Corporate Internet and Intranet Service (APNCA).* APNCA is a Virtual Private Network service with optional Internet access based on mobile network. APNCA service is offered to corporate customers having multiple mobile endpoints. This service enables them to establish secure data traffic between the mobile end point and the customer's main office.

*Bulk SMS.* Bulk SMS service enables corporate customers to contact a large number of customers, employees or business partners in a simple way. The service provides easy and fast sending, receiving and management of SMSs in bulk and is a new way to acquire or retain customers and send advertisements.

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*BlackBerry Enterprise services.* Using a special mobile device, the BlackBerry Enterprise Service enables users to access their corporate mailing systems. The service provides comprehensive on-line access to various functions, including incoming electronic mails, calendar, corporate address book and tasks.

*Fleet management.* Fleet management is a position tracking service based on GSM/GPS systems.

Our subsidiary, Pro-M provides TETRA services for public safety and security agencies in Hungary.

Due to continuous network developments, the outdoor mobile radio coverage of EDR is more than 99 percent, based on a countrywide average. EDR services have been available since 2006 for public safety and security agencies, such as e-learning and the AVL system that serves police action control, or new mobile units extending TETRA services.

Providing EDR services for a new range of users is a possibility for Pro-M after having finished negotiations concerning the related processes with the responsible Minister.

Pro-M realizes service revenues from providing EDR telecommunications services for various public safety (emergency) and law enforcement bodies based on the EDR contract. The agreement is valid until 2015. The EDR contract was modified in 2010 as EDR service fees were lowered for 2010 and 2011 due to the fact that the Central Office for Administrative and Electronic Public Services at the Prime Minister's Office was required to fulfill cost cutting requirements to comply with the saving measures introduced by the Hungarian government.

**HEADQUARTERS**

Headquarters is responsible for:

(i) wholesale services;

(ii) headquarters functions (management and support);

(iii) shared services (back-office and non-core shared services within the company);

(iv) our PoPs in South-Eastern Europe;

(v) media business unit and new business developments.

**Wholesale services**

Our wholesale unit represents a separate line of business operating independently from our retail businesses. The wholesale activities focus on three strategic objectives:

(i) enabling retail activities;

(ii) complement retail activities; and

(iii) strengthen our regional presence.

To enable our retail businesses, we have bilateral interconnection and roaming agreements with national and international network operators. Furthermore, we purchase services from other telecommunications operators ensuring nationwide coverage for our retail services.

In the domestic telecommunications market, we face strong competition in both the retail and wholesale levels. In most service markets, the parallel use of wholesale and retail sales channels in a complementary way can ensure reaching the optimum financial results. In addition, our wholesale business increases utilization of the existing network capacities.

In order to offset the decreasing revenue potential of the traditional domestic wholesale markets, we are looking for opportunities to expand our regional presence especially in South-Eastern Europe. We intend to strengthen our market position in this region through our regional subsidiaries (PoPs).

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***Customers***

*Alternative domestic fixed network and service providers*

ISPs, ASPs and cable TV operators belong to this wholesale partner group, consisting of approximately 200 partners in 2010. Most Internet service providers and cable TV service providers are further expanding their traditional service portfolios and become 2Play or 3Play (and in certain cases even 4Play) service providers through intensive up-sell strategies. In response to this demand, we provide commercial-based and regulated wholesale solutions to these partners enabling them to sell 2Play or 3Play packages. We offer to this segment end-user access (xDSL, unbundled local loop and leased lines), backbone capacity (low and high speed leased lines on several technologies), infrastructure-based services (duct rental), interconnection and network access services (transit) as well as complex network and service platform solutions (IPTV and VoIP). The market demands are gradually shifting to all IP-based technologies regarding both the backbone capacity and the end-user access. Furthermore, the domestic wholesale market is undergoing significant market consolidation, especially in the cable TV market.

*MNOs*

We have two partners belonging to this wholesale segment. Typical services sold to these partners include interconnection-based services, network access-based services (e.g., international and domestic transit, value-added services) and capacity sales (TDM and IP-based leased lines). Their demands particularly focus on interconnection services, however we make efforts to increase the portion of commercial services in our sales.

*International data telecommunications providers*

We sell international low and high speed leased lines, transit circuits, IP/Internet connections, other managed data communication services and backbone capacity to approximately 50 international wholesale partners and purchase such services from approximately 50 international partners for our retail activities. Our international partners, which are typically simultaneous buyers and suppliers, are significant wholesalers in Europe, including Deutsche Telekom, Telekom Austria, Interoute and T-Systems International. We expect that the dynamic growth of the IP-based services will be able to offset the decline of the low-speed data communications services in the future.

*Premium rate segment (Third party wholesale market)*

In the third party wholesale market, we have 74 contracted content provider partners, the largest of which also act as aggregators. Dominant partners have leading roles in media and mobile marketing market support (e.g., suppliers of commercial TV channels, mobile marketing campaign organizers). Due to the characteristics of the market we offer premium and normal rate interactive services and solutions, allowing content providers to access mobile and fixed line customers.

*Roaming and international voice partners*

International roaming service was available for our subscribers on 433 networks in 188 countries as of December 31, 2010, of which 243 networks in 125 countries were available for prepaid customers. As of December 31, 2010, customers could use 270 GPRS networks in 124 countries. Since January 1, 2008, we send and receive all our international voice and switched transit traffic to and from Deutsche Telekom. The agreement with Deutsche Telekom guarantees us international telephone services revenues and profits and allows for cost reductions due to this synergy with the parent company.

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***Wholesale product lines***

*Regulated services*

Regulated, domestic traffic services primarily consist of call origination and termination services. In the call origination and termination market, we are an SMP service provider and therefore obliged to submit RIO. We have 28 bilateral interconnection agreements for providing regulated services. We are also obliged to provide number portability for fixed line numbers based on RIO as well as local loop unbundling based on RUO.

*Broadband services*

We sell wholesale ADSL service to ISPs, which enable them to offer integrated broadband Internet services combining access and IP transport to their retail customers under their own brands. At the end of 2010, we had contractual relationships with 19 ISPs. Due to the strong competition caused by alternative broadband technologies (mobile broadband and cablenet), the number of wholesale ADSL connections decreased to 130,965 at the end of December 2010, from 161,270 at the end of 2009. We expect further decreases in the number of wholesale ADSL connections in 2011.

*TV services*

As one of the first providers in Europe, we launched a wholesale IPTV product in the middle of 2009 enabling ISPs to provide own branded IPTV service to their ADSL customers. We had nine wholesale IPTV partners at December 31, 2010. The number of wholesale IPTV subscribers reached 975 at December 31, 2010. The Hungarian TV market is highly competitive driven by different technologies such as analogue broadcasting, analogue cable TV, DVB-T, DVB-S, DVB-C.

*Data and IP service*

We offer an extended data and IP service portfolio to wholesale partners. It consists of managed leased lines on different technologies (TDM, Ethernet, ATM, SDH). These connections are available on access and backbone network levels as well. BBU is responsible for product management of most of these products and our Headquarters unit sells them to wholesale partners. We are responsible for the development and life-cycle management of two services within the wholesale data and IP service portfolio.

Our Symmetrical Internet, which combines IP transport, Internet peering and leased line access, was designed especially for ISPs. This product was introduced in 2003 to maintain our competitive position in the Internet leased line market. In 2009, we extended the domestic Symmetrical Internet portfolio to the international market involving Magyar Telekom's, Deutsche Telekom's and Telekom Austria's IP MPLS platforms. We experienced significant growth in sales in this market in 2010.

Our HSLL service also plays a significant role in wholesale sales providing high speed (from 2 Mbit/s to 155 Mbit/s), high reliability leased line connections between service access points. Our Gigalink service provides high capacity (from 155 Mbit/s to 10 Gbit/s) connections for large volume data transmission. The market demands have been gradually moving towards Ethernet-based solutions. As a result, the HSLL users gradually started migrate to Ethernet in 2010.

*Infrastructure service*

We share our physical infrastructure (ducts, poles, equipment housing) on a commercial basis. Our partners are mostly cable TV companies. We had 23 partners at December 31, 2010. We have to face competition in this market particularly within major cities and regarding backbone relations.

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*Interactive mobile service*

There are two major lines of interactive messaging services: premium and normal rate. Both service groups are available on the following service channels: voice, SMS, MMS. Due to the evolution of business models and technologies, the premium rate services are operated in a harmonized market among the mobile operators (except premium voice), contrary to the normal rate competitive market. Harmonization in premium rate services is necessary to ensure countrywide access required by the characteristics of the market. In case of normal rate services and premium rate voice there is a heavy competition among mobile operators for increasing market share (especially from mobile marketing revenues). Appearance of new alternative solutions (e.g., mobile payment, IPTV) and the direction of media and mobile marketing development strongly influence the opportunities in this market. We expect the demand for such services to increase in the future.

**Headquarters functions**

*General*

Headquarters performs strategic and cross-divisional management functions for the Group. Headquarters functions include those performed by many of our central departments, such as legal, regulatory, strategy, HR, communication, investor relations, treasury, security, internal audit and compliance.

*Principal Activities*

Our strategy area is responsible for determination of new lines of business, to scout new products, technologies and services, to acquire access to them on our behalf and to handle the portfolio of our international subsidiaries.

Our treasury team is primarily responsible for cash management, investments in securities, leasing arrangements and the refinancing of indebtedness through a variety of financial arrangements, including, among other things, bank loans and other credit arrangements. Furthermore, this unit is responsible for the issuance of debt in international capital markets, the handling of payments and clearing transactions, foreign exchange and hedging, as well as mergers and acquisitions ("M&A") activities.

Our legal department represents us in legal disputes, creates and approves our contracts and regulations and performs due diligence activities with our treasury team on potential acquisition targets.

**Shared services**

*General*

Operating functions not directly related to the core businesses of our operating segments are considered shared services functions. Shared services include, among others, the management and servicing of our real estate portfolio, fleet management, procurement, HR administration and accounting.

*Principal Activities*

The real estate unit, based on revenues, is the largest shared service within Headquarters. The real estate unit is responsible for managing our real estate portfolio, renting commercial real estate and providing facility management services for the Group, primarily in Hungary. In addition, this unit is also responsible for the operation, management and servicing of our radio transmission sites, such as our radio towers and transmitter masts in Hungary (primarily used in mobile, radio and satellite communications, as well as for television broadcasting).

Our real estate operations are conducted partly through STRABAG Property and Facility Services Zrt. and partly by our own property organization.

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Our fleet management is conducted through MKB Eurolízing Zrt., which provides fleet management and mobility services, with approximately 2,650 vehicles provided to the Group companies and affiliates within Hungary.

Central procurement handles purchasing activities, calls for tenders, signs and controls contracts and it is responsible for all related procurement procedures.

**Our Points of Presence in South-Eastern Europe**

The Headquarters segment also includes the activities of Magyar Telekom in certain countries in South-Eastern Europe. Magyar Telekom provides international network and carrier services in South-Eastern Europe through PoPs. We entered the Romanian market in July 2004, the Bulgarian market in September 2004, and the Ukrainian market in August 2005 to offer various wholesale services. Capitalizing on our experience in these markets, we have entered the retail market segment in Romania with a full service portfolio.

**Media unit and new business developments**

The Headquarters segment is also comprised of content, media and other non-access services; it is also responsible for new business developments and the coordination of innovative activities.

In line with our strategy of capturing new revenue sources in business areas in which we can build on our existing capabilities, we have decided to enter the retail energy market, via the resale of natural gas and electricity, leveraging off the extensive sales networks that we already have in place. It is anticipated that participation in the retail electricity and gas market will enable us to retain existing, and win new, telecommunications customers with attractive energy offers. We expect that such electricity and gas offers will help support additional sales and services provided to existing customers, as well as possible upgrades to existing services.

The liberalization of the Hungarian electricity and gas market was completed in July 2009, enabling us to enter into agreements with a wholesale provider for the supply of sufficient electricity and gas volumes. We sell electricity and gas to our existing customer base as a bundled product supplementing the telecommunication services offered.

We launched electricity and gas retail offers for a targeted segment of residential and business customers from among our existing customers from April 2010 to test customer perception and acceptance. After this initial phase, we have provided services from May 2010 in a limited service area. Based upon our experiences in this limited service area, we will assess the possibility of becoming a nationwide energy service provider in 2012.

**TECHNOLOGY**

Technology is a central supporting unit for the business units of the Company. It is responsible for the development and operations of the mobile and fixed networks as well as IT.

Technology derives its revenues mainly from:

(i) internal services to other segments of the Company regarding NTs, service development and IT;

(ii) network maintenance and consulting services to subsidiaries; and

(iii) network construction and maintenance services to external parties.

Technology in its current form was established in 2008 and became a central technology unit serving the Company's business units as internal clients. Currently it employs approximately 1,900 professionals. On the IT side, two directorates (IT Architecture and Development, and IT Operations) were established after a merger of the IT organizational units of former T-Mobile, T-Com and T-Online. On the network

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technology side, mobile and fixed network areas were initially kept separate because processes differed significantly.

In 2010, a substantial organizational change took place in Technology: the mobile and fixed network technology areas merged. This merger, referred to as "TU 2.0", provides opportunities for exploiting synergy effects by the following steps:

- fully integrate fixed and mobile network technology areas;
- consolidate processes, eliminate functional redundancies;
- clarify functional responsibilities, between and within IT and NT; and
- centralize all service development tasks and organizations.

The first phase of the TU 2.0 project ended at January 1, 2010, when the new organizational structure was established. During the second phase in the first half 2010, we started the harmonization and merger of fixed line and mobile processes, made modifications to adjust operations to the new organizational structure and developed the detailed rules of operations. According to the new organizational structure, all network development-related functions have been consolidated in the NT Plan and Build unit. At the same time, all operations related tasks, both fixed and mobile, have been consolidated in the NT Operations unit. An important change is that all technology-related service development tasks are centralized in one Service Development unit. These three NT areas work under the leadership of the NT Chief Technical Officer.

Besides the NT and IT directorates, a separate directorate is responsible for setting strategic goals and objectives for Technology and ensuring the strategic harmonization with the rest of the Company. This organization is also responsible for the governance of Technology as a whole, including reporting, process and risk management, quality management and business alignment (including demand management).

Technology maintains direct relationships with the respective technology units of DT. DT maintains supervision of major strategic activities. In 2010, DT established its European region and defined common regional strategic goals for both NT and IT areas. Regional collaborations focus on standardization to exploit volume effect of technology procurements and cost savings derived from maintenance. As an example, IT application retirement, procurement and GPON testing will be coordinated among the EU Group affiliates.

Technology also performs extensive Research and Development ("R&D") activities. Particularly in co-operation with Hungarian universities, 43 research projects have been completed in 2010 to identify future opportunities of telecommunications services and technology innovations.

In 2010, the most important NT developments included the following:

- We continued the fiber roll-out according to the Company's fixed-access strategy: designed and deployed FTTH (based on GPON technology) covering 227,000 homes by the end of 2010. In addition, Technology finalized ED3.0 upgrade on Magyar Telekom's HFC network, enabling high-speed Internet connection on cable TV infrastructure.
- We continued the roll-out of mobile broadband connectivity. By end of 2010, 75 percent of the population was covered by 3G (UMTS/HSDPA) and 91 percent of the population was covered by EDGE Packet Switched Data Service. Data traffic on our mobile network has constantly increased (by 43 percent in 2010). Capacity to support these increases is assured by the continued development of our network.
- We continued designing NGMN focusing on access domain (including pilots of LTE) and core network elements. The LTE pilot was successfully executed, and its results have been evaluated.

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The replacement of legacy PSTN (Austrian Digital System) switches that had reached the end of their life-cycle has been completed in order to reduce maintenance costs at telephone central offices.

According to the long-term voice strategy, Technology, together with marketing areas, designed and started an all-IP pilot at Budaörs Hytas area, where GPON roll-out has been done previously. The migration is still in progress.

As one of the first operators in the world, we introduced IPTV services on EuroDOCSIS 3.0 platform, covering almost 589,000 households.

As for the IT strategy, we successfully carried out several substantial developments in 2010, including:

We continued the strategic CRM & Billing IT landscape consolidation program to simplify processes, reduce parallel developments, reduce time-to-market, and decrease IT cost. The implementation will continue in 2011 and 2012.

We launched a thorough program to transform our IT area to increase efficiency and effectiveness. To increase business agility and time-to-market we have reengineered many IT processes (e.g., end-to-end testing and release management) and introduced several new processes, such as a business alignment office (including demand management), metrics and problem management.

To support our new energy service line, we introduced a new energy-billing system.

As an international roll-out, we implemented our SAP system (all major modules) at our subsidiary in Montenegro and provide them SAP services.

We have introduced an any-place unified business communication system for our internal workforce to make soft phone, video conferencing, chat (instant messaging) and document sharing functions available company-wide.

We increased the service quality and efficiency of IT operations and consolidated our different legacy service desks into a new unified one. We replaced the infrastructure platform for our prepaid mobile service as well.

Based on the internal success of our identity and access management (IAM) application, we have started to roll out the unified solution to our national and international subsidiaries.

**MACEDONIA**

**Fixed line services**

Makedonski Telekom is the primary fixed line service provider in Macedonia. Makedonski Telekom provides traditional fixed line telecommunications services and content services within the scope of the fixed line network, broadband services and integrated solutions, including IPTV. In addition, the product portfolio of Makedonski Telekom includes IP-based services, data transmission, sale and lease of equipment and system integration services.

In May 2008, Makedonski Telekom introduced the T-Home brand.

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The following table sets forth information regarding the fixed line operation of Makedonski Telekom:

| | At December 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2010 |
| Number of revenue generating fixed lines | | | |
| Residential lines | 356,082 | 305,806 | 281,436 |
| Business lines | 34,864 | 31,443 | 29,255 |
| Payphone | 1,692 | 1,218 | 889 |
| Total | 392,638 | 338,467 | 311,580 |
| ISDN channels | 38,598 | 34,766 | 32,328 |
| Total | 431,236 | 373,233 | 343,908 |
| Number of retail DSL customers | 81,858 | 109,617 | 130,127 |
| Number of wholesale DSL access | 17,008 | 18,751 | 21,091 |
| Total DSL access | 98,866 | 128,368 | 151,218 |
| Retail DSL market share (estimated) (%) | 81 | 83 | 84 |
| Number of dial-up customers | 5,910 | 1,813 | 633 |
| Number of leased line customers | 129 | 228 | 301 |
| Number of IPTV customers | 1,952 | 14,150 | 30,123 |

Beginning in June 2008, Makedonski Telekom also offers VoIP-based services (Call Comfort, Office Comfort and Office Comfort+ packages). VoIP product portfolio was extended in September 2008 when Call & Surf packages were launched on the market for the residential segment.

Makedonski Telekom launched IPTV in November 2008 and offers TV sets as well in its sales network. In March 2009 and April 2009, respectively, the 'Call & Surf Start' 2Play package and the '3 Max Start' 3Play package were introduced in the Macedonian fixed line market. The '2Max' package (fixed line and TV) was introduced in November 2009.

Makedonski Telekom introduced FTTH service in December 2009. Call & Surf Optic, Office Complete Optic and 3Play Optic packages were introduced on the Macedonian fixed line market.

Makedonski Telekom offers end-to-end solutions for its business customers, including a complete portfolio of fixed line products and services, as well as SI solutions.

**Mobile services**

T-Mobile Macedonia is the leading provider of mobile telecommunications services in Macedonia. The principal activities of T-Mobile Macedonia's operations are digital mobile telephone services and non-voice services such as SMS, MMS and GPRS based on GSM and UMTS technology.

T-Mobile Macedonia had a customer base of 1,295,285 at the end of 2010, compared to 1,381,094 at the end of 2009. It represents an estimated market share of 51.3 percent in the Macedonian mobile telecommunications market at the end of 2010 as opposed to 56.4 percent at December 31, 2009 (based on the number of total SIM cards). The mobile market penetration in Macedonia is 122.8 percent, which shows the

trend of individuals owning multiple SIM cards. As a result of the market saturation, we especially focus on retaining customers to protect our market share. The AEC uses the market share calculation method based on the total number of active SIM cards which were used in the previous three months.

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The table below sets forth information concerning the key operational statistical figures of T-Mobile Macedonia at the dates indicated:

| | At December 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2010 |
| Number of subscribers | | | |
| Postpaid subscribers | 360,706 | 419,148 | 418,083 |
| Prepaid subscribers | 1,018,485 | 961,946 | 877,202 |
| Total subscribers | 1,379,191 | 1,381,094 | 1,295,285 |
| MOU | 111 | 121 | 135 |
| ARPU (HUF) | 2,586 | 2,678 | 2,690 |
| Mobile penetration in Macedonia (%)[1] | 110.5 | 116.1 | 122.8 |
| T-Mobile Macedonia's market share (%)[1] | 59.4 | 56.4 | 51.3 |

(1) Data estimated by T-Mobile Macedonia based on internal analysis of competition.

The decrease in the number of T-Mobile Macedonia subscribers in 2010 was due to aggressive pricing offers by competitors. The pricing offers were accompanied by strong marketing campaigns focusing on very low price levels.

The Macedonian mobile market was characterized by highly competitive campaigns and offers in 2010. Due to the increased competitiveness and in order to prevent churn and encourage usage, T-Mobile Macedonia launched various campaigns, price plans and additional services specially designed to meet subscribers' needs with focus on value instead of price. These offers are targeting different customer segments.

In 2010, T-Mobile Macedonia introduced several products that differentiate T-Mobile Macedonia in the mobile market and provide additional value for the customers.

T-Mobile Macedonia is continuously working on creating market demand for mobile Internet and stimulating mobile data usage via device/data price plans.

T-Mobile Macedonia introduced its first 4Play bundled product, Family Max which is a joint offer containing fixed line and mobile telephony, high speed ADSL Internet and IPTV for one monthly subscription fee.

**MONTENEGRO**

**Fixed line services**

We have a 76.53 percent interest in Crnogorski Telekom. Crnogorski Telekom is the principal fixed line service provider in Montenegro. Its exclusive rights in fixed line telecommunications services expired in December 2003. Crnogorski Telekom provides a wide range of retail and wholesale telecommunications services at domestic and international level (e.g., voice services, broadband access, IPTV services, leased line circuits, data transmission).

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The following table sets forth information regarding the fixed line operation of Crnogorski Telekom:

| | At December 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2010 |
| Number of revenue generating fixed lines | | | |
| Residential lines | 144,897 | 140,591 | 137,156 |
| Business lines | 18,532 | 18,241 | 17,476 |
| Total | 163,429 | 158,832 | 154,632 |
| ISDN channels | 18,806 | 18,058 | 17,052 |
| Total | 182,235 | 176,890 | 171,684 |
| Number of retail DSL customers | 38,956 | 54,983 | 68,540 |
| Number of dial-up customers | 17,455 | 5,184 | 1,160 |
| Number of leased line customers | 188 | 191 | 193 |
| Number of IPTV customers | 17,531 | 29,612 | 40,042 |

Crnogorski Telekom is the sole provider of ADSL in Montenegro, although competitors offer broadband access through WiMAX access. Internet access is provided via the public switched telephone network, leased lines and ADSL. We experienced strong dial-up to ADSL substitution during the last three years. In 2010, the number of ADSL subscribers at Crnogorski Telekom surpassed 68,000.

Similarly to other fixed line service providers before privatization, Crnogorski Telekom maintained relatively low domestic charges and high charges for international calls. In September 2007, Crnogorski Telekom rebalanced the fixed line voice tariffs adopted by EKIP. International charges have decreased both in residential and in business segment, while local charges and subscription fees have increased in the residential segment.

Crnogorski Telekom introduced its IPTV service, called Extra TV on November 30, 2007. In 2008, the IPTV system was upgraded to support an increased number of customers and to improve service quality. In 2010, Crnogorski Telekom reached market leadership in the Pay TV segment with over 32 percent market share in the number of customers based on EKIP reports.

In 2010, the main focus of our sales activities in Montenegro was to increase broadband data penetration including Extra TV (IPTV) and ADSL sales. In September 2009, Crnogorski Telekom introduced its 3Play offer with great success. In October 2010, the company introduced its first fixed-mobile integrated solution combining voice, data and Extra TV into one offer for Montenegrin families.

**Mobile services**

T-Mobile Crna Gora is the second largest mobile operator in Montenegro with 37.0 percent mobile market share according to the data published by EKIP. Since its inception in 2000, it offers innovative and advanced services to the Montenegrin market and has been experiencing dynamic growth.

The main activities of T-Mobile Crna Gora's operations are digital mobile telephone services and non-voice services, such as SMS and MMS based on the GSM, UMTS, GPRS, EDGE and HSDPA technologies. T-Mobile Crna Gora actively employs various promotions and incentives to encourage use of its services. In addition to a variety of service packages, T-Mobile Crna Gora offers WAP, MMS, content SMS and premium-rate SMS services. In 2007, T-Mobile Crna Gora started the development of a new 3G network, and extended its service portfolio with web'n'walk and mobile Internet, in order to meet the growing needs of mobile customers in an increasingly demanding and competitive Montenegrin mobile market.

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The table below summarizes the key operational statistical figures of T-Mobile Crna Gora:

| | At December 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2010 |
| Number of subscribers | | | |
| Postpaid subscribers | 89,070 | 104,095 | 109,982 |
| Prepaid subscribers[1] | 417,449 | 427,362 | 354,057 |
| Total subscribers | 506,519 | 531,457 | 464,039 |
| MOU | 105 | 96 | 105 |
| ARPU (HUF) | 2,886 | 2,459 | 2,430 |
| Mobile penetration in Montenegro (%)[1] | 185.6 | 208.7 | 199.5 |
| T-Mobile Crna Gora's market share (%)[1] | 36.1 | 36.7 | 37.0 |

(1) Data published by EKIP based on the total number of active subscribers in the previous three months.

T-Mobile Crna Gora's operations, customer base and revenues are significantly affected by seasonal factors. In 2007, the entrance of a third mobile operator, Mtel, significantly increased the competition in the Montenegrin mobile market.

In May 2009, prepaid mobile offers were introduced for the youth segment which significantly contributed to the increase in the number of prepaid customers. On the other hand, the increase was also attributable to higher prepaid and postpaid sales due to special offers during the tourist season.

## DISTRIBUTION AND SALES

### CBU

Magyar Telekom had 48 direct shops (T-Points) at the end of 2010. All shops provide full scale of sales and customer care related services in the entire T-Home and T-Mobile consumer product portfolio. Besides sales activity, cross-selling, up-selling and customer retention are the main activities in focus at T-Points. In 2010, the major challenge is to further enhance the service level within our sales channel in order to better meet customer expectations and to dedicate more time to the customer.

In Magyar Telekom's distribution, the exclusive indirect partner network plays an important role with its 206 shops. In 2010, 14 shops were integrated resulting in a total of 136 shops selling the T-Mobile and T-Home product portfolio.

We have a strong focus on mobile and fixed line broadband sales and we have further developed cooperation with Internet and IT equipment retailers. With our retail partners, the number of outlets selling our broadband services increased to 139 in 2010.

We also sell our prepaid products (e.g., prepaid SIM packages, plastic top-up cards, on-line top-up) through major Hungarian retail channels. Prepaid products are available at 242 sales points nationwide.

We have reorganized our door-to-door agent network to fully align it with our strategic goals in order to leverage the potential of high speed Internet technologies. The number of agents has been continuously increasing with focus on quality and sales capabilities. Telesales channels are also transformed to fully support both acquisition and retention objectives primarily regarding T-Home services.

### BBU

***Enterprise***

We deliver a high service level to our Enterprise customers with full dedication to not only client management, but also technical support and service desk level support. In 2009, approximately 70 key

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account managers handled approximately 2,800 large enterprises in governmental accounts, industrial accounts, commercial accounts, utility and media accounts and financial accounts. The largest multinational companies are being served at the DT Group level by a separate team in order to assure utmost attention to their cross-border needs.

In 2008, we launched the "Top30" project, in the framework of which we handle top customers of BBU and our subsidiaries KFKI and IQSYS in an integrated way. As BBU offers traditional telecommunications (fixed and mobile data and voice) services as well as IT services to its customers, a special team is dedicated to handle companywide info-communications, managed services and outsourcing projects both in the sales and implementation phases.

***SMB***

In 2008, we established dedicated customer services within the SMB segment, i.e., all of the approximately 46,000 SMB customers are managed by dedicated T-Systems sales managers. Our SMB account managers are responsible for 25 percent of our customer base in terms of account and sales targets, while the other part is being managed through our indirect partners. Our own account managers and our indirect partners offer the whole T-Systems and T-Mobile portfolio, which includes IT, voice, data and complex services as well. In our sales activity, both our own account managers and our indirect network play an important role, where the indirect network has exclusivity with Magyar Telekom.

In 2008, the main focus was on integrated offers, selling at least two different types of services to customers at the same time. In 2009, we focused to grow further in IT and application services within our SMB customer base.

***Changes in the sales structure from January 1, 2010***

In line with Magyar Telekom's long term ICT strategy and based on our 18 months experience of the new operational model introduced on January 1, 2008, we decided to take further steps to change our service and sales culture and to achieve an even more simplified operation in order to further improve our customers' experience. The basis for the new sales model was the re-segmentation of our customer group. We have segmented our customers based on their joint IT and telecommunications potential and their service expectations. At the same time, we harmonized and re-consolidated our front- and back office service structure, our supporting IT and other processes. As a consequence of all these arrangements, we serve our business customers according to the following structure as of January 1, 2010.

*Enterprise.* We have established a joint ICT sales force in KFKI and will move all enterprise sales and presales tasks there. 60 account managers serve 400 groups of customers, which include approximately 2,000 very large and large enterprises invariably in governmental accounts, industrial accounts, commercial accounts, utility and media accounts and financial accounts. There is no change compared to previous years' practice for large multinational companies who are being served at the DT Group level by a separate team.

*Mid Market.* Approximately 3,350 medium size business entities (including public institutions and governmental sector) are handled by approximately 50 account managers within BBU.

*SMB/Indirect channel.* Approximately 25,600 small businesses are served by our approximately 90 contracted indirect partners countrywide.

Furthermore, approximately 12,000 very small and micro businesses are served by CBU, where SOHO companies have been handled both in terms of service and customer care.

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**Macedonia**

Makedonski Telekom and T-Mobile Macedonia have developed different sales channels in order to serve customers from different segments. These channels include:

- direct sales channels, such as own retail network, direct agents and key account managers;
- indirect sales channel based on indirect master dealers with their network of own shops, partner shops and free lancers;
- on-line sales channel; and
- call center which performs telesales.

The main sales channel is the Makedonski Telekom and T-Mobile Macedonia shop network. There are 46 active joint shops (43 shops and three kiosks). From October 1, 2010, all shops offer complete product portfolio of T-Home and T-Mobile under the same conditions and customer service level. A new retail DT concept was introduced in four shops in 2010. One of the shops was also redesigned as a "café and shop", in addition to the one opened on January 23, 2009.

Another channel of the distribution network of Makedonski Telekom and T-Mobile Macedonia is the dealers' cooperation. Currently the network consists of 11 master dealers with 105 shops as T-Mobile Macedonia partners and 15 master dealers with 116 shops as Makedonski Telekom partners. The majority of the master dealers' shops are joint shops, offering the full portfolio of sales activities, except for cash collection. Postpaid and prepaid packages of T-Mobile Macedonia (with or without handsets) are available in all dealers' shops. Prepaid vouchers are also available in more than 6,500 kiosks. In addition, some of the kiosks also sell T-Mobile Macedonia prepaid packages without handsets.

A part of the Makedonski Telekom product portfolio (e.g., telephone sets, photo equipment, computers, printers, network equipment) is available to the customers by installment payments through their telephone bill.

In 2010, direct agents put strong emphasis on sale of FTTH products for residential and SOHO/SMB customers and sale of telecommunications and Internet services under customized ICT solutions and data services especially for the SMB segment. In addition, T-Mobile Macedonia is using subsidized handsets and high quality service as strong tools for customer retention and churn prevention both in the residential and business segments.

**Montenegro**

Crnogorski Telekom has developed different sales channels in order to provide the best services for residential and business customers. Business customers are served by key account managers taking care of the top 400 clients and SMB coordinators who are in charge of the SMB and SOHO segments. Top clients are divided by branches (e.g., banks, hotels, large manufacturers, government) and small companies are divided by regions.

There are 12 own T-Centers accompanied by a network of 12 exclusive partner shops which use a similar design to the own shops. Both types of outlets provide a permanent portfolio of handsets and the full range of services for new and existing customers.

Other sales channels include web shop, door-to-door and telesales. In October 2010, a business telesales channel was introduced in order to cover SMB and SOHO segments not covered by SMB coordinators.

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## COMPETITION

### CBU

***Fixed line services***

We face strong competition in all areas of our fixed line operations including voice, Internet and broadcasting services. Direct competitors include other LTOs, mobile telecommunications providers, Internet service providers, alternative service providers and broadcasting service providers.

There is a continuous concentration of market players in the telecommunications market in Hungary. In November 2010, Invitel announced that they acquired Fibernet (the fourth biggest cable service provider in Hungary) and then sold one-third of its cable TV network to UPC, another cable operator. Many small cable companies were also acquired or merged.

*Voice*

In 2010, the main reasons for fixed line churn continued to be mobile substitution, cable competition and the effects of the economic crisis.

In our service areas, some service providers (the largest one of which is Invitel) offer pre-selection and call-by-call services and were able to attract some of our customers. However, we responded to this challenge with competitive flat rate voice packages to regain the traffic generated by customers.

The value of stand-alone fixed voice service continued to decrease for our customers as cable competitors continued to offer VoIP services at very low prices. Cable operators are providing voice services as an add-on to their pay TV offers especially if they are bundled with fixed Internet and/or pay TV service. There is a clear trend of customer demand for 2/3Play bundles for discounted prices. Our largest competitors based on customer numbers are UPC and Digi but we also have to face strong competition from mid-sized and small cable operators in many regions in Hungary.

*Internet*

Cable operators (e.g., UPC, Fibernet, Digi), alternative service providers based on ULL (e.g., GTS Datanet, EnterNet), mobile service providers and other ISPs are our competitors in the fixed Internet market. We kept our leading position in a continuously, but slowly growing retail Internet market.

A technology shift from ADSL to cable Internet and mobile broadband has continued in the broadband market because in the case of cable Internet higher bandwidth is available at lower prices. Mobile Internet plays an increasingly important role, representing more than 40 percent of total Internet subscriptions in 2010. However, a large number of customers use mobile Internet as a complementary service along with fixed line technologies.

ULL services have only marginal shares in the broadband market.

*TV*

The growth of pay TV penetration and the trend of digitalization continued in the television market in 2010.

The market growth was primarily driven by DVB-S technology and T-Home has played an important part in that growth as we acquired the largest number of new DVB-S customers. UPC, the largest service provider in the pay TV market, lost a significant number of subscribers as well as market share during 2010 as their DVB-S subscriber base has not grown and their traditional cable operation was challenged by Digi. Digi's focus shifted from DVB-S to their cable operations and they acquired some small service providers to gain more customers.

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Cable operators are slowly, but consistently, migrating their customers from analogue to digital cable platforms (DVB-C). In addition, smaller operators also launched digital cable services. In the pay TV market, several ISPs and alternative telecommunications service providers (e.g., Invitel, EnterNet) offer IPTV services. DVB-T television service offered by Antenna Hungária Zrt. is available from December 2008. Its network coverage based on population exceeded approximately 95 percent by the end of 2010. Antenna Hungária Zrt. offers a few channels for a very low subscription fee under the brand MindigTV.

***Mobile Services***

In 2010, the Hungarian mobile telecommunications market was characterized by intense competition, driven by new broadband services and decreasing tariff levels. Penetration growth in 2010 was very moderate compared to the previous years indicating that the mobile SIM market reached its saturation.

We continued to focus on customer retention and the development of mobile broadband services and increased our emphasis on fixed-mobile integrated services.

Despite the intense competition, on December 31, 2010, we accounted for 43.4 percent share of the total Hungarian mobile market in terms of subscribers and 44.8 percent in terms of total number of active SIM cards generating traffic in the previous three months according to data published by NMIA.

The direct competitors of T-Mobile Hungary are Telenor and Vodafone.

Vodafone, the third mobile network operator in Hungary by SIM market share, continued to focus on customer acquisitions (especially in the field of mobile broadband) supported by attractive tariff offers and marketing campaigns. Vodafone's SIM market share slightly increased to 22.8 percent by the end of 2010 based on the data published by NMIA.

In April 2010, Vodafone set up a partnership with Invitel in order to develop and launch a new product called Vodafone SmartOffice, designed for small businesses. They have also been engaged in a wholesale agreement with Netfone since July 2010, allowing cable service providers to sell Vodafone's mobile Internet.

In order to follow its parent company's innovation strategy Pannon was rebranded to Telenor in May 2010. The company kept a clear retention and community focus, and maintained its second position in the voice market. At the same time, they pushed mobile broadband and advertised Telenor as the company covering the most settlements (towns and villages) in Hungary. In addition, their already existing Djuice brand was separated from Telenor and relaunched in April 2010, as the first real second brand in the mobile market. Djuice is targeting youth under 26 years with a relatively new concept and a very simple and transparent product portfolio. As part of their multibrand strategy, Telenor established an exclusive partnership with Red Bull and launched a new brand under the name of Red Bull Mobile. Its service portfolio includes competitive tariffs and complete packages with some of the latest handsets. Telenor continued their partnership with Invitel, which sells Telenor's mobile broadband subscriptions bundled with their ADSL packages under the name of Net&Go. By the end of 2010, Telenor's SIM market share slightly decreased to 32.4 percent based on the data published by NMIA.

Mobile Internet penetration reached 13.1 percent at the end of 2010. The number of active mobile Internet users constantly grew during the year. Despite intense mobile Internet competition, we are market leaders when considering both total and active customer numbers, with 47.8 percent and 48.6 percent market share, respectively, according to data published by NMIA.

**BBU**

In 2010, our main competitors in the telecommunications market were Invitel, GTS, Telenor and Vodafone. In order to minimize the effect of the economic downturn in 2010, BBU focused on cross selling activities by providing integrated, managed network services, systems integration and outsourcing services.

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Focusing on complex customers' needs, BBU provided consulting surveys for its large projects. With its wide range of telecommunications and IT services, BBU positioned itself as a general ICT solution provider for the corporate segment.

We divide the IT market into two segments according to the type of services: IT Infrastructure and IT Applications. Nevertheless, due to the economic crisis, IT Outsourcing services (as a new business model for customers to improve the efficiency in their IT spending) became the most required service type both in the infrastructure and the application solutions. Hosting services became more and more popular among SMBs in 2010.

Our main competitors in the IT Infrastructure services are Getronics, Synergon, HP-EDS, S&T Unitis and IBM. Our main competitors in the IT Application Development services are SAP, NESS, IDOM2000, Oracle and Alerant, while in the IT Application Integration services Synergon, IBM, HP-EDS and Accenture. In case of infrastructure hosting services, our main competitors are Invitel, Interware and HP-EDS; while in the application hosting, our main competitors are Hostlogic, Unisys and Nexon. Our goal in this highly competitive market is to keep our leading position in the IT services market by achieving a larger growth rate than the average, to win significant projects and to use a new business model in the SMB sector (i.e., standardized products via economies of scale).

**Headquarters Wholesale Services**

We face increasing competition regarding most of our non- or semi-regulated wholesale services. Our main competitors already have their own backbone telecommunications infrastructures with spare capacities, which enable them to provide services in the market of long-distance data-transmission connections at favorable prices, causing a continuous migration towards the more cost-effective IP-based solutions.

The dynamically improving alternative mobile and cable broadband networks and services challenge our fixed broadband market position (infrastructure-based competition), especially our copper network-based wholesale solutions (wholesale ADSL, IPTV, voice). Furthermore, our competitors are driving the roll-out of NGA networks, which provide them a technological advantage in offering 2Play and 3Play retail services against the ISPs' retail services based on our wholesale products.

The Hungarian mobile broadband market is open for the entrance of MVNOs. Vodafone signed long-term strategic wholesale agreements with Btel and Netfone in July 2010 and with Externet in October 2010, regarding mobile Internet services. The agreements enable MVNOs to provide mobile broadband services under their own brand and MVNOs can contract directly with subscribers.

Our main competitors in the domestic wholesale market are GTS Hungary, Invitel, British Telecom, MVM and Netfone.

In the third party wholesale market we face strong competitors (Telenor and Vodafone) regarding normal rate services and premium rate voice services.

There is also intense competition in the market for international wholesale services. The worldwide development of alternative, cost-efficient technologies is also characteristic in our region. As a consequence, the leased line market share of the less than 2 Mbit/s bandwidth MLLN product is continuously decreasing, while that of high-speed leased lines is increasing. The preference for integrated solutions and new technologies generate IP and Ethernet network demand.

Those providers that possess a global network have a competitive edge in the market of international connections because they can keep the prices relatively low.

Our main competitors in the international wholesale markets are Interroute, Pantel, Telekom Austria, GTS, TeliaSonera and British Telecom.

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**Macedonia**

***Fixed line services***

*Voice*

Makedonski Telekom faces competition from other fixed line and mobile service providers. The major fixed line competitors of Makedonski Telekom are ONE and the cable operators.

Cosmofon launched fixed line voice services in June 2008 over its GSM network, and in August 2008 it started to offer services based on 3G technology. In March 2009, Telekom Slovenije purchased 100 percent of the shares of Cosmofon and became owner of two major competitors, Cosmofon and OnNet. They launched their first joint offer in July 2009, consisting of fixed line voice and Internet broadband services. In November 2009, they were re-branded as ONE. While ONE is our main competitor in the retail fixed line market, they are also one of our most important partners in providing wholesale fixed line and ADSL services.

In September 2008, number portability was introduced as a main service for opening the market for competitors. The fixed line numbers were primarily ported from Makedonski Telekom's network to competitors' networks, mainly into ONE's network.

Both major cable TV operators, CableTel and Telekabel, as well as several smaller cable TV operators have offered fixed line voice services since the last quarter of 2008.

*Internet*

In the fixed line broadband market, there are three major service providers in addition to Makedonski Telekom: ONE, CableTel and Telekabel. Makedonski Telekom continues to be the market leader both in terms of customer numbers and revenue market share based on latest available market report of the AEC (end of third quarter of 2010). It faces competition mainly from cable TV operators' cable broadband Internet, offered to cable TV customers through their own networks and from broadband services through Makedonski Telekom's wholesale ADSL offer. ONE also started to offer mobile broadband Internet access, through its 3G network, from September 2008.

*TV*

In November 2008, Makedonski Telekom entered the TV market by offering 3Play services: TV, Internet and voice bundles. Cable providers also offer similar services. On April 25, 2009, the AEC granted radiofrequencies for digital TV services through DVB-T to Telekom Slovenije, and its commercial operations started in November 2009, under the new brand ONE.

In December 2009, ONE introduced a new bundled offer in the market for 3Play packages containing fixed line, fixed broadband Internet and digital TV.

***Mobile Services***

The Macedonian mobile communications market currently has two GSM operators with UMTS licenses (T-Mobile Macedonia and ONE) and only one GSM operator (VIP).

According to our estimates, as at December 31, 2010, T-Mobile Macedonia had a customer market share of approximately 51.3 percent, ONE 29.7 percent, and VIP 19.0 percent. The mobile penetration rate increased to 122.8 percent by the end of 2010, due to strong and intense competition on the basis of prices, subscription options, subsidized handsets, range of services offered, innovation and quality of service.

According to information from the AEC published on November 11, 2010 and analyses on the Market for services for access and call origination in the public mobile communication networks (Market

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15), World Teleconnect International Macedonia d.o.o has entered the market as MVNO, with 100,000 numbers assigned to it for provision of mobile phone services.

**Montenegro**

Crnogorski Telekom faces competition mainly from mobile service providers, and, to a lesser extent, from other fixed line services and cable TV providers.

In 2007, a new mobile and fixed line operator entered the Montenegrin telecommunications market: Mtel, the third mobile operator and one of the licensed operators for development and exploitation of WiMAX-based network.

By the end of 2009, ten licenses for VoIP operators were issued as well. They are able to offer outgoing call services to our customers through carrier selection and freephone service.

Nine MMDS and cable TV licenses were awarded at the beginning of 2007. Some of the cable operators have declared their intention to provide Internet and telephony services. MMDS and satellite operators, who were able to start first with service provisioning and who are not dependant on our infrastructure, are currently market leaders in the cable TV segment.

Stronger competition has been developing in the wholesale segment as well. It is expected that significant players like Telekom Serbia, National Broadcasting Company and Electricity Company will enter the Internet and data wholesale business after significant investments in their communications infrastructure have been realized by 2011.

In 2010, Promonte, the incumbent mobile operator, was rebranded to Telenor, in line with its Norwegian parent company.

In the Montenegrin mobile market, T-Mobile Crna Gora had a market share of 37.0 percent, Telenor had a market share of 39.6 percent, while Mtel had a market share of 23.4 percent in terms of number of active subscribers at the end of 2010 according to the data published by EKIP. T-Mobile Crna Gora is the market leader in the postpaid segment.

In November 2006, EKIP issued a tender for two 3G licenses as well as a tender for a mixed 2G-3G license for a third mobile operator. In the first quarter of 2007, T-Mobile Crna Gora and Promonte (Telenor) were awarded with one 3G license each and Mtel won the combined 2G-3G license. T-Mobile Crna Gora launched 3G services in June 2007. Promonte (Telenor) and Mtel offer 3G services as well.

As in other countries, competition in mobile services is intense and driven by pricing, subscription options, subsidized handsets, coverage, as well as quality and portfolio of services offered. Our competitors' marketing and advertising activities are aggressive.

## 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, and/or register our services at the governments of Hungary, Macedonia, Montenegro, Romania and the Ukraine, the countries in which we provide telecommunications services.

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## REGULATION

### Overview

Our operations, as well as those of our subsidiaries and affiliates, are subject to sector-specific telecommunications regulations and general competition law, as well as a variety of other regulations. The extent to which telecommunications regulations apply to us depends largely on the nature of our activities in a particular country, with the conduct of traditional fixed-line telephony services usually being subject to the most extensive regulation. Regulations can have a very direct and material effect on our overall business, particularly in jurisdictions that favor regulatory intervention.

### The EU Regulatory Framework

In 2002, the European Union adopted several legislative measures, which included a general framework directive and four specific directives regarding the following topics (collectively constituting the "EU Framework"):

- 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;
- data retention; and
- decision on a regulatory framework for radio spectrum policy in the EU.

The NRF, in particular:

- sets out the rights, responsibilities, decision-making powers and procedures of the NRAs and the European Commission;
- identifies specific policy objectives that NRAs must achieve in carrying out their responsibilities; and
- provides that operators with SMP in relevant communications markets can be subject to obligations set out in the directives on universal service and access.

Since Hungary joined the European Union on May 1, 2004, our operations have been subject to the EU Framework on telecommunications regulation. EU Member States are required to enact EU legislation in their domestic law and to take EU legislation into account when applying domestic law. Hungary fully implemented the NRF with the enactment of the Electronic Communications Act and fully implemented decrees in 2004.

In each EU Member State, an NRA is responsible for enforcing the national telecommunications laws that are based on the EU Framework. NRAs generally have significant powers under their relevant telecommunications acts, including the authority to impose network access and interconnection obligations, and to approve or review the charges and general business terms and conditions of providers with SMP. In general, a company can be considered to have SMP if its share of a particular market exceeds 40 percent. Market share is determined based on

revenue, number of subscribers, usage volume figures or a combination of these depending on the particular market. NRAs also have the authority to assign wireless spectrum and supervise frequencies.

The European Commission supervises the NRAs and formally and informally influences their decisions in order to ensure the harmonized application of the EU Framework throughout the European Union. Companies can challenge decisions of the relevant NRA before national courts. Such legal

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proceedings can lead to a decision by the European Court of Justice, which is the ultimate authority on the correct application of EU legislation.

**New Regulatory Framework (revised)**

The entire NRF has been subject to a review since 2007 by the EU. The European Commission issued proposals to amend the current framework, which had to be accepted by the European Parliament and the Council of Ministers before coming into force. These proposals did not include any deregulation efforts.

The amendments to the NRF were adopted on November 24, 2009 by the European Parliament; changes to the framework have to be implemented through national law by May 25, 2011. The NRF Review implementation process was launched by the Ministry in October 2010 and we are providing written input and comments in the course of the consultation process.

The main changes introduced by the amendments to the NRF are the following:

The prime objective of the new framework is to promote investments in new infrastructure based on the following measures:

Risk sharing ('risk-diversification') to split investment risk between investor and access seeker;

Regulatory measures to allow regional segmentation of national markets;

NRAs have the authority to apply the "common and symmetrical use of passive infrastructure" obligation to all operators, who have the right to install facilities on, over or under public or private property; and

New remedy of functional separation available for national regulators only under exceptional circumstances and as last resort.

Establishment of a Body of European Regulators for Electronic Communications ("BEREC"): BEREC is supported by a small administrative office and it will replace the existing European Regulators Group ("ERG").

New procedure to harmonize remedies: NRAs have to notify a draft decision on remedial measures to the European Commission, other NRAs and the BEREC. The opinion of BEREC has also been taken into account when adopting a final decision. The new harmonization rules enable the European Commission to adopt further harmonization measures in the form of recommendations or binding decisions when differences in the regulatory approaches of NRAs are found.

Consumer protection: extension of consumer protection rules, such as transparency of consumer contracts (provision of information), consumer contracts must not exceed 24 months, personal data protection and number portability deadlines.

Universal service obligation:

Universal service obligation for providing network access has been separated from the universal service obligation to provide services and the member states can decide what constitutes a "functional Internet access";

Member states shall designate one or more company to provide "equivalent" services for disabled people;

Member states shall empower NRAs to require service providers to provide tariff information on premium rate services immediately prior to a call.

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Spectrum management:

- More emphasis on a member state's cooperation in the strategic planning and harmonization of spectrum usage;
- The implementation of technology and service neutrality principles on new spectrum licenses;
- Removing restrictions on existing spectrum licenses;
- NRAs should make secondary spectrum trading and leasing possible, but they should take action against possible market distortion;
- More emphasis on general licenses than on individual ones.

Net neutrality:

- NRA can set minimum quality of service levels for network transmission to promote net neutrality;
- Consumers should be informed of traffic management techniques, impact on quality of service and any other limitations; however no requirements are imposed on ISP to monitor content;
- Procedural safeguards on restriction of Internet users' access in case of copyright infringement.

**Special Requirements Applicable to Providers with SMP**

The most significant impact on our business stems from the EU Framework's special requirements are applicable to providers with SMP. Obligations in relation to network access, price setting, separate accounting for interconnection services, publication, and non-discrimination can be imposed on those operators that are designated by the relevant NRA as having SMP in an electronic communications market. Such determinations are based on EU guidelines and EU competition case law.

In particular, the NRA may subject providers with SMP, and their affiliates, to the following rules and obligations:

- The prior approval or retroactive review of charges, insofar as such charges and conditions relate to a market in which the provider holds SMP.
- The obligation to offer other companies unbundled special network access (including interconnection) as well as access to certain services and facilities on a non-discriminatory basis.

In addition, providers with SMP can be obliged to maintain separated accounting systems with regard to access services. This obligation is intended to allow for transparency with respect to various telecommunications services in order to prevent, among other things, the cross-subsidization of services. In this regard, the NRA may specify the structure of a provider's internal accounting for particular telecommunications services, which can increase costs of compliance.

Under the EU Framework, the European Commission periodically issues a market recommendation, which is a list of telecommunications markets that it considers susceptible to sector-specific regulation. NRAs must take this list of markets into account when defining the markets that are to be analyzed for the existence of competitive restraints. If an NRA finds that a market is not competitive, it establishes which providers have SMP in this market and may impose certain measures prescribed by statute.

In February 2003, the European Commission issued its first recommendation, which related to the retail markets for fixed line public telephone service and leased lines, as well as the wholesale markets for the ULL, fixed network interconnection, leased lines, broadband access, mobile voice call termination,

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mobile access and call origination, international roaming, and broadcasting transmission services. Current and future market analyses by NRAs have to consider a new recommendation of the European Commission effective as of December 17, 2007. This new version reduced the number of markets to be reviewed from 18 to 7. In particular, most retail markets have been removed from the list of markets that are susceptible to telecommunications regulation. However, the most important retail market relating to the retail access of the fixed telephone network remains subject to such regulation. Further, some wholesale markets are now described in a broader manner (e.g., market for local loop unbundling is no longer restricted to metallic loops). At the moment it is difficult to predict whether these broader definitions lead to an expansion or a reduction of regulation. The new market recommendation also relates to wholesale markets for call origination of fixed telephone networks, call termination of individual fixed networks, broadband access, terminating segments of leased lines and voice call termination on individual mobile networks. However, it will be possible for NRAs to analyze and regulate further markets, if (a) high and non-transitory entry barriers are present in this market, (b) a market structure does not tend towards effective competition within the relevant time horizon taking into account the state of competition behind the barriers of entry, or (c) competition law alone is insufficient to adequately address the market failures concerned. All NRA market analyses are subject to the supervision of the European Commission and can be challenged if the European Commission does not agree with the NRA's findings.

In addition to the European Commission's recommendation, there is a separate EU regulation on unbundled access to the local loop, which became effective in January 2001. It contains the obligations to provide full unbundled access to copper-paired wire lines, as well as unbundled access to the high-frequency spectrum of those lines (line-sharing). Since each member state has specifically addressed local loop unbundling by individual regulatory measures under the framework, the new EU proposals to amend the regulatory framework as described below provide for the termination of the separate EU regulation on local loop unbundling.

On May 7, 2009 the European Commission introduced a recommendation on fixed and mobile termination rates by prescribing detailed cost accounting methodology to be applied over a set timeframe by the NRAs. EU members are required to implement the recommendation and develop mobile and fixed termination rate cost models by December 31, 2012, as described in the recommendation in details. As a result of the costing methodology that imposes the use of a pure FL-LRIC model, the EU hopes to reduce termination rates by 70 percent within three years. The recommendation shall be reviewed after four years, i.e. in May 2013.

**Roaming**

On February 20, 2006, the European Commission announced that, in light of the inability of NRAs to impose regulatory remedies, it had begun to work on a regulation on international voice roaming charges. On June 30, 2007, an EU regulation entered into force which regulates international roaming tariffs for wholesale and retail customers on the basis of a capped pricing system. After a review of roaming prices development, the European Commission published the stricter Roaming Regulation II on June 29, 2009. See "Item 4 Pricing Roaming Agreements and Tariffs". The EU will reevaluate its Roaming Regulation II in 2011 and implement further regulatory remedies and requirements if the European Commission finds that necessary, but this is not expected earlier than the summer of 2012.

In December 2010, BEREC published the "International Mobile Roaming Regulation report" from available roaming data. The amended Roaming Regulation (EC) 544/2009 expires on June 30, 2012. The Commission must complete its review and report on the effectiveness of that regulation to the European Parliament and Council by no later than June 30, 2011. For that reason, the European Commission launched a public consultation to examine retail and wholesale roaming developments, future trends and possibilities. Opinions had to be sent by February 11, 2011. Any new regulatory remedies are expected not to take effect earlier than summer of 2012.

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**Legislative Developments in the EU**

*NGA Recommendation.* The European Commission adopted the final version of its NGA recommendation on September 20, 2010.

The recommendation aims to promote a consistent approach to regulated access to NGA networks imposed by NRAs on operators designated as having SMP on market 4 (wholesale network infrastructure access at a fixed location) and market 5 (wholesale broadband access). In particular, the recommendation seeks to avoid distortions of the single market and provide legal assurance to operators investing in NGA.

The recommendation focuses on FTTx technologies including cable TV's ED3, however, ED3 is not mentioned with respect to remedies (e.g., access obligations, infrastructure sharing and transparency with cost orientation in wholesale pricing). Wireless and mobile technologies are not included in the scope of the recommendation.

The approach proposed by the European Commission aims at driving infrastructure-based competition where it is possible and efficient, while ensuring a seamless migration from copper to fiber-based networks.

The EU proposes extended regulation on NGA, which means that a full set of passive (e.g., facility and infrastructure sharing or access like duct sharing) and active (e.g., wholesale broadband access) remedies can be introduced at the same time to provide the possibility for alternative operators to choose and to enter at any level of the SMP's network. The emphasis is on access to civil engineering infrastructure (duct, pole, manhole, other physical asset sharing and designing newly built facilities so as to allow partners deploying their fibers), access to FTTH terminating segment (in house wiring) and fiber unbundling. Bit stream access is a possible further obligation.

The recommendation proposes cost-based prices for all obligations. A favorable change to the previous draft recommendation is that long-term access pricing (period discounts) may be acceptable if the discounts only reflect the reduction of risk for the investor, judged over an appropriate timeframe and there is no margin squeeze. Volume discounts may be acceptable if the discounts are calculated over a relevant area (as designated by the NRA) and apply equally to all access seekers willing to buy at the same volume, only reflect the reduction of risk for the investor are judged over an appropriate timeframe and there is no margin squeeze. Further, geographic segmentation has to be considered by the NRA (only wired substitution is mentioned in this respect).

*Amendment of the GSM Directive.* On October 20, 2009 the Council Directive 2009/114/EC amending the Council Directive 87/372/EEC ("GSM Directive") and removing the restriction on use of the 900 MHz spectrum exclusively for GSM services; and the complementary Commission Decision setting out the technical parameters that enable the co-existence of GSM and UMTS systems in the 900 MHz and 1800 MHz bands were published in the Official Journal of the European Union. The new rules enable the use of the 900/1800 MHz frequencies for UMTS and more advanced wireless technologies alongside today's GSM services.

Member States were required to implement the amended GSM directive through national law by May 9, 2010. The same implementation deadline was set for opening up the 900 MHz and the 1800 MHz bands for UMTS services. Member States were also required to review the existing spectrum assignments in these bands in order to avoid competition distortions.

Hungary did not meet the implementation deadline of May 9, 2010. Issuing a letter of formal notice, the European Commission started an infringement procedure against Hungary on September 20, 2010, on the basis that Hungary has not taken measures to adapt the revised GSM Directive. The European Commission can initiate a case in the European Court, which can oblige Hungary to comply with the implementation or it can impose fines.

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*Consultation on universal service principles in e-communications.* Public consultation on the second review of the universal service principles was held in 2010. Current EU rules on universal service obligations for telecommunications service providers date from 2002 and guarantee that all Europeans have access to public telephone networks and to basic telecommunications services. The aim of the consultation was to review if these rules and definitions on universal services need to be updated for the digital age, and in particular if they should be extended to cover broadband access. However, the public consultation was closed in May 2010 and no European Commission opinion or proposal has been published to date.

**Competition Law**

The European Union's competition rules have the force of law in all EU Member States. The main principles of the EU competition rules are set forth in Articles 101 and 102 of the Treaty on the Functioning of the European Union ("TFEU") and in the EU Merger Regulation (the "Merger Regulation"). In general, the TFEU prohibits "concerted practices" and all agreements that may affect trade between Member States and which restrict, or are intended to restrict, competition within the EU, and prohibits any abuse of a dominant position within the common market of the EU, or any substantial part of it, that may affect trade between Member States. The European Commission enforces these rules in cooperation with the national competition authorities, which may also directly enforce the competition rules of the TFEU. In addition, the national courts have jurisdiction over alleged violations of EU competition law.

The Merger Regulation requires that all mergers, acquisitions and joint ventures involving participants meeting certain turnover thresholds are to be submitted to the European Commission for review, rather than to the national competition authorities. Under the amended Merger Regulation, concentrations will be prohibited if they significantly impede effective competition in the common European market, or a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.

In addition, all EU Member States (and other jurisdictions in which we operate) have legislation in place, which is substantially similar to the EU competition rules. Thus, in markets where we are dominant, our ability to practice business freely and to establish our own prices can be restricted. Moreover, our opportunities to cooperate with other companies, or to enhance our business by fully or partially acquiring other businesses, can also be limited.

**The Telecommunications Regulatory Regime in Hungary**

The telecommunications industry has been governed by:

Act C of 2003 on Electronic Communications (the "Electronic Communications Act");

Act LXXXVII of 1990 on Pricing (the "Pricing Act"); and

Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practice (the "Competition Act").

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

The Electronic Communications Act came into effect on January 1, 2004. Under the Act, the NCA, the supreme supervisory body, and the Permanent Court of Arbitration for Communications ("CAC") were established.

*Establishment of the new regulatory authority.* The National Media and Infocommunications Authority of Hungary ("NMIA") was officially established on August 11, 2010 to ensure the undisturbed operation, in compliance with pertaining legislation in force, of the media and the markets for electronic

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communications, postal and information technology services in Hungary in accordance with Act C of 2003 and Act I of 1996 on Television Broadcasting. The new, converged regulator performs the tasks of its predecessors: the NCA and the NRTC. The aims of the merger are: cost efficiency, more rational allocation of resources, avoidance of duplication of work and better cooperation of the supporting activities within a single organizational structure.

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

*Universal Service.* The Electronic Communications Act provides that universal services are basic communications services that should be available to all at an affordable price. Universal services include access to fixed line voice telephone services of certain quality enabling access to Internet services, a regulated density of public payphones, a public directory of telephone users, national domestic Directory Assistance service as well as free calls to emergency services. Access to voice services at an affordable price is affected by designation of universal service providers (the Minister shall appoint the most efficient service provider).

We were designated as a universal service provider and entered into a universal service contract with the Minister. The contract was valid until December 31, 2008. The necessary modifications of the telecommunications law and the concerning government and ministerial decrees entered into force in the first half of 2010. The new legislation provides more favorable conditions in line with market changes than the earlier regime. The main modification includes a 'last resort' access obligation, easing the obligation to maintain public payphones and modification of the financing scheme.

Based on discussions between the Ministry and operators, we signed a "pre-contract" with the Ministry on December 30, 2009, which included future conditions for providing universal services and an agreement to sign a final contract with the same conditions by March 31, 2010. However, after lengthy discussions, no universal service contract was signed between the Ministry and operators due to the late submission of bylaws. Further negotiations with the Ministry of National Development have started, and if we were to enter into a new contract, it would be based on the relevant modified government and ministerial decrees which contain more favorable conditions then the previous legislation.

*Subscriber Contracts.* Service providers must establish General Terms of Contracts for providing publicly available electronic communication services. The subscriber contract consists of the General Terms of Contracts and the individual subscriber contract. The Electronic Communications Act provides general rules of agreements between subscribers and telecommunications services 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 deviate from the provisions of the Electronic Communications Act and the General Terms of Contracts only if they are more favorable to the subscribers.

The general terms and conditions of subscriber contracts must contain, among other things, the procedure for terminating 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.

*Local Loop and Bit-stream Unbundling.* According to the Electronic Communications Act and Government Decree 277/2003, (XII.24.) on "The detailed rules of procedures related to the reference offers and networking contracts", operators with SMP 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. Currently these rules apply only for copper pair local loops; optical fiber access networks are not included.

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Providers with SMP may refuse the request for unbundling only if:

there are technical barriers or the unbundling would put an unfair burden on the obliged service provider; and

providing access to the local loop or bit-stream access would endanger the unity of the provider's network.

Unbundling has not become significant in the Hungarian market so far mostly due to the already existing infrastructure-based competition. As a result, unbundling has only led to a moderate loss of our market share to date.

*Interconnection.* According to the Electronic Communications Act and Government Decree 277/2003 (XII. 24.), providers with SMP 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.), providers with SMP 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 legal regulations about the reference offer. The NMIA has authority to arbitrate in disputed cases and may establish provisional arrangements. The reference offer of the providers with SMP must be approved by the NMIA.

*Carrier Selection.* According to the Electronic Communications Act, our fixed voice telephone 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. Consecutive market analysis decisions have confirmed this obligation.

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

*Licensing and Allocation of Frequencies.* With the exception of radio receiver device, radio equipment, radio stations and radio communication networks may be operated on the basis of a general or exclusive radio license. A radio license may be issued exclusively on the basis of a valid frequency assignment license, with certain exceptions. Radio equipment, radio stations, radio networks and radio communications systems may be installed with a frequency assignment license, with certain exceptions. Payment of fees is required for reservation and usage of frequencies assigned for civil purposes, reservation of identifiers and use of the assigned identifiers. In the case of terrestrial public mobile communications there is no frequency reservation fee, there is only a frequency usage fee.

Frequency assignments must conform to the National Table of Frequency Allocations, which lays out the entire spectrum and the purpose and availability of frequency bands.

*Rights of Way.* According to the Electronic Communications Act, communications service providers are entitled with prior notice to enter private property where communications facilities (equipment, cables, antennas) are located for maintenance and repair. 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.

*Data Retention.* The Data Retention Directive of the European Union was implemented in Hungary by an amendment to the Electronic Communications Act that entered into force on March 15, 2008. According to the law, Magyar Telekom has to retain data on the following:

unsuccessful calls, call forwarding and call routing data location identifying on fixed phone;

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call forwarding and call routing data, unsuccessful calls, mobile Internet and other data (e.g., IMSI, location identifying, cell identifier) on mobile phone;

user ID, IP-address, e-mail and Internet telephony on Internet services.

Data retention period was reduced from three years to one year (in case of criminal data requests) and to six months (in case of unsuccessful calls).

**SMP Regulation**

On April 24, 2004 the Minister issued Decree No. 16/2004 (IV.24.) on the basic principles of market definition, market analysis and identification of service providers having significant market power. The Decree implemented the recommendation of the European Commission (2003/311/EC) and accordingly listed the following 18 relevant product and service markets within the electronic telecommunications sector susceptible to ex ante regulation:

Retail level:

1. Access to the public telephone network at a fixed location for residential customers.
2. Access to the public telephone network at a fixed location for non-residential customers.
3. Publicly available local and/or national telephone services provided at a fixed location for residential customers.
4. Publicly available international telephone services provided at a fixed location for residential customers.
5. Publicly available local and/or national telephone services provided at a fixed location for non-residential customers.
6. Publicly available international telephone services provided at a fixed location for non-residential customers.
7. The minimum set of leased lines.

Wholesale level:

8. Call origination on the public telephone network provided at a fixed location.
9. Call termination on individual public telephone networks provided at a fixed location.
10. Transit services in the fixed public telephone network.
11. Wholesale unbundled access (including shared access) to metallic loops and sub-loops for the purpose of providing broadband and voice services.
12.

Wholesale broadband access.

13. Wholesale terminating segments of leased lines.

14. Wholesale trunk segments of leased lines.

15. Access and call origination on public mobile telephone networks.

16. Voice call termination on individual mobile networks.

17. The wholesale national market for international roaming on public mobile networks.

18. Broadcasting transmission services, to deliver broadcast content to end users.

The NCA accomplished two rounds of market analysis. In the second round, obligations were only slightly modified as compared to those imposed in the first round, by having more detailed rules apply to our provision of services. The results of the analysis on fixed line retail markets identified Magyar Telekom as having SMP and imposed a price cap on retail access market services (market 1 and 2) for residential and non-residential customers. In addition, it required Magyar Telekom to allow fixed line residential and non-residential customers to select other service providers for local and/or national and international calls

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(markets 3-6) and obliged Magyar Telekom to provide the minimum set of leased lines (market 7). On the wholesale markets, the NCA imposed the obligations of transparency (markets 8-9, 11-13), accounting separation (markets 8-9, 11-13), access and interconnection obligations (markets 8-9, 11-13), various obligations regarding cost-based prices and price control (markets 8-9, 11-13) and non-discrimination (markets 12-13). It also imposed an obligation to offer wholesale naked ADSL at regulated prices. The market analysis procedure identified TMH as having SMP in the mobile termination market (market 16) and imposed the obligations of transparency, accounting separation, access/interconnection and cost-based prices and price control.

The third round of analysis of the 18 relevant product and service markets started in 2008. So far, only the decision on the mobile termination market and on the public telephone access market 7 and market 1 (in accordance with the new EU Recommendation on relevant markets) have been adopted. On market 7, the NMIA maintained the obligations of transparency, accounting separation, access/interconnection, cost-based prices and price control, as well as extended the so-called 'Glide Path' regulation (i.e., gradual decreases in termination rates) until the end of 2010. On market 1, the NMIA maintained the obligations of access, non discrimination, prohibition of unjustifiable excessive prices (price cap regulation), carrier selection and carrier pre-selection. Furthermore, NMIA significantly extended the scope of technologies included in its market definition, with wireless local loop, home zone services for mobile operators, wired and wireless broadband access, leased lines and FTTH included in the market definition.

The aforementioned Minister Decree No. 16/2004 (IV.24.) was amended in October 2009 and implemented the revised recommendation of the EU that entered into force on December 17, 2007. As a result, retail call markets (market 3-6) and the minimum set of leased lines became deregulated as well as wholesale markets for transit services in the fixed telephone network, wholesale trunk segments of leased lines, access and call origination on public mobile telephone networks and broadcasting transmission services to deliver broadcast content to end users. The new Decree (8/2009 MeHVM) has become effective already in the current (third) round of market analysis by the NMIA. Current relevant product and service markets are:

1. Access to the public telephone network at a fixed location for residential and non-residential customers;
2. Call origination on the public telephone network provided at a fixed location;
3. Call termination on individual public telephone networks provided at a fixed location;
4. Wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location;
5. Wholesale broadband access;
6. Wholesale terminating segments of leased lines; and
7. Voice call termination on individual mobile networks.

In the course of the third round market analysis of the relevant markets, new SMP resolutions are expected in 2011.

**Mobile Concession Contracts**

Under the 900 MHz Concession Contract, dated November 4, 1993, between the Minister and TMH, TMH was granted the right to provide public GSM 900 mobile telephone services for 15 years, with a possibility of 7.5 years license duration prolongation without a tender.

On October 7, 1999, an amended and integrated GSM 900/DCS 1800 MHz Concession Contract was signed, allowing TMH to start public mobile telephone service in the 1800 MHz band for 15 years beginning November 26, 2000. By virtue of the integrated Concession Contract in 1999, by the end of 2003, the three digital mobile telecommunications service providers had the same spectrum resources assigned

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to them both on the 900 and the 1800 MHz bands. The DCS 1800 license of TMH will expire in 2014, but may be prolonged without a tender for a 7.5 year period. TMH pays an annual concession fee of USD 1 million.

On November 8, 2007, TMH signed the renewed 900/1800 MHz Concession Contract along with the Cooperation Agreement with the Minister. The new Concession Contract prolonged the duration of the TMH's 900 MHz frequency usage right until May 4, 2016. TMH paid HUF 10 billion for the 900 MHz license prolongation and committed to a HUF 20 billion additional mobile broadband investment obligation in the underdeveloped regions of the country in the timeframe of 2008-2009. By the end of 2009, TMH met his investment obligation set in the Cooperation Agreement.

**Licenses for exclusive frequency usage rights**

On December 7, 2004, the NCA awarded TMH the exclusive right to use the frequency blocks of 1920-1935/2110-2125 MHz FDD and 1915-1920 MHz TDD for deployment and operation of 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 for another 7.5 years. The right to use the frequencies vested upon payment of the first installment of the license fee on December 27, 2004.

TMH was obliged by the term of the license decree to start commercial IMT-2000/UMTS service in the inner city of Budapest within 12 months after the license had entered into force. This obligation was met. TMH was also obliged to expand the coverage to 30 percent of the Hungarian population within 36 months after the license came into effect. In December 2006, we fulfilled the population coverage target of the IMT-2000/UMTS license.

The license fee for IMT-2000/UMTS was HUF 17,000 million plus reclaimable VAT, payable by the end of 2005. In addition to the license fee, TMH capitalized expenses incurred in connection with the acquisition process of the license. The total amount capitalized was HUF 17,073 million. The IMT-2000/UMTS license right is amortized on a straight-line basis over 15 years from the time of the commencement of the commercial service on August 26, 2005 to the end of the initial license period.

On April 30, 2009, we won the spectrum tender for the 26 GHz "D" spectrum block. On May 18, 2009, we asked for the frequency assignment decision from the NCA, which was received on July 10, 2009. The total amount capitalized was HUF 510 million.

The Company is also subject to various regulatory requirements with respect to the fees it may charge for its services, as well as fees it is required to pay to the applicable regulators in relation to the services it provides. See "Item 5 Tabular disclosure of contractual obligations".

**Legislative developments in Hungary**

*Implementation of the revised NRF.* EU Member States are required to implement the new telecommunications framework within 18 months upon its publication in the Official Journal of the European Union. The new telecommunications framework was published on December 18, 2009 in the Official Journal of the EU. The Regulation establishing BEREC need not be implemented; it will enter into force throughout the EU upon its publication. Whether the regulatory framework will increase or decrease the regulatory burden on us will depend on the manner in which revised directives are implemented in the EU Member States and the way the revised regulatory framework will be applied by the respective NRA. Changes to the NRF are required to be implemented through national legislation by May 25, 2011. The NRF Review implementation process was launched by the Ministry in October 2010 and Magyar Telekom has provided, and will continue to provide, written input and comments in the course of the consultation process.

*Spectrum.* In conjunction with the implementation of the modified GSM Directive, a "public consultation-like" process started on November 24, 2009, organized by the Minister, which was followed by

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a second consultation meeting on January 21, 2010. The new Government, which came into power in June 2010 is evaluating the different implementation options.

Although official decisions have not been made public, the 900 MHz tender-auction could be further delayed in 2011 due to the unfavorable financial conditions of the operators created by the special tax on the telecommunications sector.

It is likely that in the process of implementing 2008/477/EC Decision, a comparative or competitive bidding process for the 2.6 GHz spectrum blocks will take place in 2011. The 2.6 GHz band is the core frequency band in Europe for LTE, which meets the NGMN.

The ministerial decree on frequency fee has been under revision. The new band fee concept is expected to revise the current usage proportional frequency usage calculation. The timing of the new regulation is not known.

*NGA.* The Hungarian NRA published its draft resolutions on wholesale (physical) network infrastructure access market (market 4) and wholesale broadband access market (market 5) in December 2010. The draft resolutions maintain all previous obligations and impose new ones. The drafts contain all obligations listed in the EC Recommendation. Market 4 changes include: extension of the obligation to next generation networks, duct sharing, dark fiber and access to backhaul services. Cable networks are taken into account as substitutes of ADSL, however, no obligations are imposed on them. Market 5 changes include: extension of the obligation on next generation networks, duct sharing, access to backhaul services and migration rules. The cable networks are expected to be part of market 5 as well because of their high fixed broadband market share in Hungary. No detailed geographical segment analysis (concerning sub-markets) was carried out by NMIA.

*Implementation of EU Recommendation on termination rates.* We assume that the NMIA will implement the Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in Hungary in 2011. As our fixed and mobile IC models calculate with a higher cost base than it is allowed in the Recommendation, the implementation would result in a strong decrease in fixed and mobile termination rates over a three-year glide path. However, since we have nearly symmetric IC traffic, the effect of the Recommendation on our (fixed and mobile) net IC balance (IC expenses and IC revenues) is expected to be near to neutral. On March 11, 2011, the NMIA published its draft resolution on Market 7/2007 (Voice call termination on individual mobile networks). According to the draft resolution, the earlier obligations have not changed, but the termination rates are expected to be lower. The draft resolution includes the details of the LRIC bottom-up model. We will provide comments on the draft resolution to the NMIA.

*Interconnection fees.* On February 24, 2011, the NMIA published its draft resolution on Market 2/2007 and 3/2007. The earlier obligations were not changed, but it is possible that some new obligations will be imposed, such as maximum interconnection fees of VoIP or making the interconnection fees on our cable network part of Magyar Telekom RIO. We will provide comments on the draft resolution to the NMIA.

**Competition Law Restrictions**

The Electronic Communications Act and the Competition Act prohibit us from the abuse of our dominant position in the markets where we are in a dominant position.

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 Electronic Communications Act and the Competition Act, service providers with SMP are required to provide services to other telecommunications service providers on the same commercial terms,

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and these terms may not be less favorable than those offered to other service providers controlled by it or controlling it.

**The Telecommunications Regulatory Regime in Macedonia**

For a description of the telecommunications regulatory regime in Macedonia, see Notes 1.3.2 and 1.3.5 to the Consolidated Financial Statements.

**The Telecommunications Regulatory Regime in Montenegro**

For a description of the telecommunications regulatory regime in Montenegro, see Notes 1.3.3 and 1.3.6 to the Consolidated Financial Statements.

**Broadcasting and Transmission**

Program distribution activities are governed by the rules of Act LXXIV of 2007 on Program Distribution and Digital Switchover ("Program Distribution Act") and Electronic Communications Act. In October 2010 (as a result of the Act LXXXII of 2010), a new authority, the NMIA was established, merging the former National Radio and Television Commission (supervising broadcasting) and the former National Communications Authority (supervising electronic communications).

The NMIA accepts and reviews the notifications received for the provision of services, including program distribution and transmission services, in compliance with legal requirements, registers the services and service providers under its supervisory authority, and determines the obligatory technical and operational conditions in order to preserve integrity of the communications network. Entities registered as program distributors are permitted to transmit broadcasts by third parties to subscribers through a cable transmission network or via any other means (e.g., satellite, IPTV).

In December 2010, a New Media Law was adopted (Act CLXXXV of 2010 on Media Services and Mass Media), implementing the Audiovisual Media Services Directive. The law came into force on January 1, 2011, and imposes certain additional burdens and obligations to our organizations dealing with media.

**PRICING**

*Fixed Line Subscription Fees and Usage Charges*

There used to be two types of price cap regulation, however the price cap for universal services (3 percent for CPI) is no longer in effect from April 22, 2010. On the other hand, the price cap regulation deriving from the SMP resolution on market 1 (residential and business access markets) is still in effect and applies to subscription fees of various price plans. The resolutions provide that the maximum aggregate price increase of the subscription fees  business and residential separately  cannot be higher than the CPI for the current year. This implies that a price check can only be carried out after the year the price cap relates to has ended.

*Leased Line Fees*

In 2005, we were identified as the only operator with SMP in Hungary on the retail market of a minimum set of leased lines (defined as analogue lines in standard and special quality and digital lines between 64 Kbit/s and 2,048 Kbit/s) and were obliged to provide the minimum set of leased lines. The new resolution published on January 31, 2008 did not change our obligation.

*"Price Squeeze" (Predatory Pricing) Issues*

Under the Electronic Communications Act, service providers with SMP are prohibited from pricing retail network services below their wholesale prices. When service providers reduce their end user prices and it causes a "price squeeze", they are obliged to proportionally reduce

their wholesale prices in their reference offers. This provision only applies if the price reduction affects more than ten percent of

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subscribers for the service, or the impact of the price reduction exceeds five percent of net sales of the service.

If the regulatory authority identifies a price squeeze, the NMIA examines whether the price of the network service is in line with the incurred costs. If the network prices are cost-based, the NMIA refers the case to the Competition Authority. If the network prices are not cost-based, the NMIA 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. In practice, however, only the National Competition Authority has carried out price squeeze tests so far.

*Fixed Line Regulated Wholesale Prices*

Magyar Telekom is currently identified as having SMP in all 7 regulated markets.

In the first round of market analysis, we have been identified as an operator with SMP in the voice termination and origination market and the wholesale market on unbundling of copper loops, along with all other LTOs. These SMP resolutions included obligations to submit RIO and RUO to the NCA. The NCA also adopted cost-based pricing rules, based on LRIC for the RIO and FDC for the RUO. Revised SMP resolutions for the voice termination and origination markets, as well as the wholesale market of unbundling of copper loops were published at the end of 2007. The major change in the revised resolution on the wholesale market of unbundling of copper loops is that the tariffs for RUO should be determined by LRIC method as opposed to the FDC method used before. As ordered by the new SMP resolutions, new RIO and RUO were submitted in February 2008. They were approved in July and September 2008, respectively, with a retroactive effect from April 26, 2008. On July 2, 2008, we submitted the joint RIO and RUO with Emitel as a consequence of the merger of Emitel and Magyar Telekom Plc. in October 2007. These recent reference offers were approved on March 26, 2009.

The draft of the new SMP resolution regarding the wholesale (physical) network infrastructure access (market 4) was published in December 2010 and contains broadening remedies on passive network elements, such as ducts, in-house wiring, and NGA optical (GPON) networks.

Magyar Telekom is designated as SMP operator in the wholesale broadband access market (market 5). The "retail-minus" pricing rule is in effect for the wholesale broadband market of nationwide bit-stream access service (including naked bit-stream access), requiring us to provide services at prices lower than retail prices according to a certain margin. The margin applied in the retail minus formula is determined by a fixed amount, instead of on the basis of a percentage (the more common standard internationally). The local bit-stream access service is currently cost-based. The draft of the new SMP resolution regarding the wholesale broadband access market, including the retail minus methodology, was published in December 2010.

Once the drafts are finalized, we will have to submit the first versions of our new reference offers for interconnection and unbundling, most likely in the first half of 2011.

The wholesale leased line termination market consists of i) the wholesale leased line access market and ii) the wholesale market of terminating segment of the leased lines. In 2005, we were identified as the only operator with SMP in Hungary in the wholesale market of terminating segments of leased lines. For the wholesale leased line termination market, the SMP resolution has adopted the "retail minus" pricing rule, requiring us to provide all wholesale leased line access services at prices approximately 33 percent lower than the listed retail prices. We are also required to provide all services identified in the resolution on a national basis. We have complied with this new regulation by reducing our wholesale leased line access prices by the set amount. A regulation published on January 31, 2008 provides for regulation of leased lines up to and including the bandwidth of 2 Mbit/s, as opposed to only those below 2 Mbit/s, and that the "retail minus" pricing rule set at 33 percent in the prior resolution is now 29 percent up to 128 Kbit/s and 28 percent thereafter. The "retail minus" pricing rule is not set in the SMP resolution, but is determined after the NCA examined the data submitted by us as a result of the obligation in the SMP resolution.

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Final SMP resolutions are expected to be published in 2011.

*Fixed Line Other Wholesale Prices*

The Electronic Communications Act provides that network access fees are to be set based on a number of objective criteria, with transparency and without discrimination.

*Network Access and Interconnection Agreements between Magyar Telekom and ISPs*

We enter into network access agreements with ISPs to secure access to services provided by ISPs for our subscribers. In addition to the network access agreements, we may enter into interconnection agreements with ISPs. The terms and conditions for the network access agreements must be in line with the terms and conditions of the existing subscriber contracts.

*Mobile Market Assessment, SMP Designation Process and Interconnection*

Upon request for interconnection (to provide either network access or network interconnection) from another telecommunications operator, Magyar Telekom is required under the Electronic Communications Act and a related decree to provide such services, if such request is reasonable on both technical and economic grounds and provision of such services is not impossible due to the limitation of resources.

*Mobile Retail fees*

*Fees and Charges.* Magyar Telekom's subscriber charges are not subject to regulation under the Pricing Act or any other regulation.

*Mobile Wholesale fees*

*Termination fees.* In the first round of market analysis, the NCA identified all three mobile operators as having SMP on the voice call termination of individual mobile networks and set asymmetrical termination rates for them. TMH, being the operator with the highest market share, was obliged to apply the lowest rate. In the second round of market analysis, the NCA set a glide-path for the following three years that envisaged gradual reductions in termination rates as a result of which asymmetrical termination rates became symmetrical on January 1, 2009. The revised resolution published in December 2008 confirmed the charging of symmetrical termination rates by the three mobile network operators and set a new glide-path envisaging further reductions by December 2010. The harmonization of termination rates introduced on January 1, 2009 in accordance with the NCA's decision has had and continues to have a positive effect on our company even though, as a result of the new EU recommendation of May 7, 2009 on termination rates, it is possible that TMH termination rates will be reduced to a lower level than intended by the NMIA by 2012.

*Roaming Agreements and Tariffs.* TMH may sign roaming agreements with other public mobile telecommunications service operators outside Hungary in accordance with the rules of the GSM Association, an association of GSM operators and associated members. The Roaming Regulation (of the European Parliament and of the Council No. 717/2007/EC) applied specific caps on wholesale and retail international roaming voice charges and set transparency requirements for the provision of roaming tariffs to end users. Text messaging and data communications were not covered immediately but are subject to regulatory monitoring. The regulation came into effect on June 30, 2007 but new retail charges (Eurotariff) were applicable from September 30, 2007. As a consequence, our mobile operations in the European Union had to lower their wholesale and retail roaming tariffs, which negatively affected our revenues. On the basis of a price schedule mandated by this EU regulation, further reductions of wholesale and retail roaming prices took place in mid-2008 and in mid-2009. Furthermore, the EU regulation mandated the introduction of additional transparency measures requiring us to make additional investments.

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In 2008 and 2009, the European Commission reviewed the development of roaming prices. As a result, voice telephony roaming price caps have been extended for a further two years until the end of June 2012. Roaming Regulation II mandates per second billing after the first 30 seconds of a call, regulates SMS wholesale and retail prices as well as wholesale data roaming prices and has prescribed further transparency rules including a cut-off limit system, which was introduced on March 1, 2010. This system requires us to limit data roaming traffic (unless further usage is explicitly allowed by the customer) in order to avoid unexpectedly high invoices. The amended Regulation was published on June 29, 2009. As a consequence, our mobile operations in the European Union had to lower their wholesale and retail roaming SMS tariffs, which have negatively affected our revenues. However, since roaming data services constitute an emerging market, revenues from this segment continue to increase despite regulation.

## ORGANIZATIONAL STRUCTURE

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

For a list of principal operating subsidiaries and associates of the Company as of December 31, 2010, see Note 2.2 to the consolidated financial statements.

## PROPERTY, PLANT AND EQUIPMENT

The real estate portfolio of the Company had a book value of HUF 104,129 million at December 31, 2010. Approximately 77 percent of this amount relates to properties of Magyar Telekom Plc.

We have one of the largest real estate holdings in Hungary. We use substantially all of these properties for telecommunications installations, offices, warehouses, garages and shops. Our equipment and machinery primarily consist of switches, communication towers and other telecommunications equipment.

The number of sites used by Magyar Telekom Plc. is approximately 2,500, out of which approximately 22 percent are owned by the Company, 40 percent jointly owned and 38 percent leased. These figures include the sites used for telecommunications towers and antennas, but do not include the number of base stations. We have 3,435 base stations, of which five percent are owned by Magyar Telekom Plc. and 95 percent are leased from other telecommunications operators or other third parties.

The total area of properties used by Magyar Telekom Plc. as of December 31, 2010 was approximately 621,000 $m^2$. The majority of sites used in our operations are smaller than 100 $m^2$. Approximately 39 percent of the total area is used to house telecommunications equipment and other technical devices. The largest site is our headquarters building located at Krisztina krt. 55 in Budapest, with floor space of over 30,000 $m^2$.

In order to increase the utilization of real estates and increase efficiency, we sell or rent our surplus properties. For more details on property, plant and equipment, see Note 12 to the consolidated financial statements.

We have financed and continue to finance our capital expenditures from cash generated from operating activities. Any excess cash is primarily used to repay loans.

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## INFRASTRUCTURE AND TECHNOLOGY

### Hungary

The following table provides information on the length of the copper and fiber optic cables contained in Magyar Telekom Plc.'s access, backbone and rural area networks in Hungary at December 31, 2010, and each of the two prior years in kilometers (not including the network of T-Kábel):

| | At December 31, |
|---|---|