

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 20-F

W REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF
THE SECURITIES EXCHANGE ACT OF 1934

OR

9 ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

for the fiscal year ended December 31, 1999, Commission file number 1-14540

MAGYAR TÁVKÖZLÉSI RT.

(Exact Name of Registrant as specified in its charter)

HUNGARIAN TELECOMMUNICATIONS CO. LTD.

(Translation of Registrant's name in English)

Hungary

(Jurisdiction of Incorporation or Organization)

Budapest, 1013, Krisztina krt. 55, Hungary

(Address of Registrant's Principal Executive Offices)

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

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

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

NONE

(Title of Class)

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

NONE

(Title of Class)

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

Ordinary Shares.....1,037,281,601
(as of December 31, 1999)

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 **9** No **W**

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

Items 17 **W** Item 18 **9**

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

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Certain Defined Terms And Conventions

In this annual report, the terms "MATÁV" and the "Company" refer to MATÁV Rt. and its direct and indirect subsidiaries as a group; the term "Westel 900" refers to Westel 900 GSM Mobil Távközlési Rt.; and the term "Westel 450" refers to Westel Rádiótelefon Kft. The Company owns 51 percent of each of the Westel companies.

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

Forward-looking Statements May Not Be Accurate

The Company may from time to time make written or oral forward-looking statements. Written forward-looking statements appear in documents the Company files with the Securities and Exchange Commission, including this annual report, reports to shareholders and other communications. The U.S. Private Securities Litigation Reform Act of 1995 contains a safe harbor for forward-looking statements. Factors identified in filings with the Commission may cause actual results to differ materially from a forward-looking statement made by MATÁV or on its behalf. 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.

EXCHANGE RATES

The National Bank of Hungary sets the official rate of exchange for Hungarian Forints. Until December 31, 1998, the rate was based on a basket of currencies consisting of 30 percent U.S. dollars and 70 percent Deutsche marks. On January 1, 1999, the National Bank of Hungary replaced the Deutsche mark with the euro to change the currency basket to 30 percent U.S. dollars and 70 percent euros. On January 1, 2000, the National Bank of Hungary removed the U.S. dollars from the basket and based the Hungarian Forint solely on the euro.

On March 12, 1995, the National Bank of Hungary announced a crawling peg system for devaluing the Hungarian Forint. Under the crawling peg devaluation regime, the Hungarian Forint is devalued each day by a fixed percentage rather than intermittently. The National Bank of Hungary determines and announces in advance the monthly rate of devaluation. On any given day, the actual exchange rate of the Hungarian Forint against the basket of currencies may vary from the rate the National Bank of Hungary has announced. The National Bank of Hungary has announced a policy of intervening in the foreign currency market if the actual exchange rate moves more than 2.25 percent above or below the announced rate, and has so intervened in the past.

The National Bank of Hungary has devalued the Hungarian Forint continuously in recent years. The monthly devaluation rate was reduced from 1.2 percent on January 1, 1996 to 1.1 percent in April 1997 and to 1.0 percent in August 1997. Since then, the National Bank of Hungary announced further cuts to the crawling peg, decreasing it to 0.9 percent in January 1998, 0.8 percent in June 1998, 0.7 percent in October 1998, 0.6 percent in January 1999, 0.5 percent in July 1999 and 0.4 percent in October 1999. The National Bank of Hungary announced that the devaluation rate will be reduced to 0.3 percent from April 2000 and is expected to be reduced further to 0.2 percent from January 2001.

The National Bank of Hungary also announced that if inflation decreases to 5 percent the daily devaluation system is expected to be terminated and the intervention band is expected to be widened.

The following tables set forth, for the periods and dates indicated, the period-end, average, high and low official rate set by the National Bank of Hungary for Hungarian Forints per U.S.\$1.00, DM1.00 and EUR1.00, respectively. The Company makes no representation that the Hungarian Forint amounts referred to in this annual report could have been or could be converted into any currency at any particular rate or at all.

Year	Exchange Rates (amounts in HUF/U.S.\$)			
	Period-End	Average (1)	High	Low
1995	139.47	125.69	139.98	107.84
1996	164.93	152.57	165.13	139.21
1997	203.50	186.98	203.92	160.96
1998	219.03	214.45	227.07	203.24
1999	252.52	237.30	252.63	212.31

(1) The average of the exchange rates on each business days during the relevant year.

Year	Exchange Rates (amounts in HUF/DM)			
	Period-End	Average (1)	High	Low
1995	97.38	87.84	97.42	71.42
1996	106.17	101.40	106.40	96.62
1997	113.59	107.75	114.37	102.95
1998	130.65	122.15	132.66	112.95

(1) The average of the exchange rates on each business days during the relevant year.

Year	Exchange Rates (amounts in HUF/EUR)			
	Period-End	Average (1)	High	Low
1999	254.92	252.80	258.86	248.23

(1) The average of the exchange rates on each business days during the relevant year.

The Company will pay any cash dividends in Hungarian Forints, and exchange rate fluctuations will affect the U.S. dollar amounts received by holders of ADSs on conversion of cash dividends on the shares those ADSs represent. Fluctuations in the exchange rate between the Hungarian Forint and the U.S. dollar will also affect the prices of shares and ADSs.

PART I

ITEM 1 — DESCRIPTION OF BUSINESS

Introduction

MATÁV is the principal provider of fixed line telecommunications services in Hungary, with approximately 2.9 million fixed access lines at December 31, 1999. The Company is also Hungary's largest mobile telecommunications service provider, with over 940,000 mobile subscribers (including users of prepaid cards) at December 31, 1999. The Company's total consolidated revenues were HUF 384,932 million and its total consolidated net income was HUF 78,632 million in 1999.

MATÁV is a full-service telecommunications provider:

Fixed Line Telecommunications Services. The Company's fixed line telecommunications services consist of local, long distance, international and other telecommunications services. The Company has exclusive rights through December 2001 to provide domestic long distance and international public telephony services throughout Hungary. The Company also has exclusive rights to provide local public fixed line telephony service in 36 of the 54 local primary areas in Hungary. The Company's exclusive rights in 31 of these areas extend through December 2001 and in five of these areas extend through May 2002. The Minister of Transport, Telecommunications and Water Management (the "Minister") and MATÁV have begun negotiations for a possible earlier termination of MATÁV's exclusive rights. See "— Regulation and Pricing — Fixed Line Concession Contracts." The Company's 36 local concession areas cover approximately 70 percent of Hungary's geographic area. MATÁV's local concession areas include Budapest and nearly all of the other major cities in Hungary. MATÁV also provides leased lines, data transmission services and corporate network services, sells telecommunications equipment and offers network construction and maintenance services. MATÁV is the market leader in Hungary for most of these services.

Mobile Telecommunications Services. Through its two mobile telecommunications subsidiaries, Westel 900 and Westel 450, the Company is a market leader in the provision of mobile telecommunications services in Hungary. Westel 900 currently is one of three GSM digital providers, and Westel 450 is the sole provider of analog mobile telecommunications services, in Hungary. Mobile telecommunications services have contributed significantly to the Company's revenue growth. Revenues from mobile telecommunications services increased from HUF 67,681 million, before intersegment eliminations in 1997 to HUF 117,336 million before intersegment eliminations in 1999, while the number of subscribers more than tripled over the period. In 1999, Westel 900 won one of the new 1800 GSM mobile telecommunications operating licences. A new entrant on the Hungarian digital cellular market started operation in December 1999. The winners of the two additional licences - including Westel 900 - may enter the 1800 GSM market a year later, in December 2000.

During the past three years, MATÁV has continued a substantial investment and restructuring program that has resulted in significant operational and financial benefits. Between 1997 and 1999, MATÁV invested HUF 169 billion in its fixed line telecommunications network, and added over 645,000 fixed access lines and over 103,000 ISDN channels. The Company reduced the fixed line waiting list from approximately 91,000 at December 31, 1996 to approximately 38,000 at December 31, 1999. The Company expects to make total capital expenditures of approximately HUF 150 billion both in 2000 and 2001. The rate of penetration in MATÁV's service areas increased from 28.2 access lines per 100 inhabitants at December 31, 1996 to 38.6 access lines per 100 inhabitants at December 31, 1999. In addition, the level of digitalization of the Company's switching capacity increased from 63.8 percent at December 31, 1996 to 79.0 percent at December 31, 1999. Workforce efficiency increased, with the number of fixed access lines per fixed line employee rising from 136 at December 31, 1996 to 240 at December 31, 1999.

The Company's restructuring and investment program has benefited significantly from the management, marketing, technical, operational and financial expertise provided by its strategic investors, SBC Communications Inc. ("SBC") and Deutsche Telekom AG ("Deutsche Telekom").

Hungary's stable telecommunications regulatory environment has contributed to the Company's growth in recent years. The current regime provides MATÁV with a period of exclusive rights to provide its core telecommunications services. In addition, tariffs for fixed line services are regulated under price cap regimes that permit the Company to rebalance tariffs over time. Since 1994, the Company has been gradually rebalancing tariffs for its fixed line telecommunications services to reflect more closely the underlying costs of these services. In real terms, the Company has been increasing subscription charges and local usage tariffs, while reducing domestic long distance and international tariffs.

MATÁV Rt. and certain of its subsidiaries qualify for a reduction in income tax payable on meeting certain conditions. The reduction in the tax payable amounted to a 100 percent allowance for five years from the date of qualification, and a 60 percent allowance for a further five years. Through 1998, MATÁV Rt. and Westel 900 qualified for the 100 percent allowance. Through 1995, Westel 450 utilized the 100 percent allowance. From January 1, 1999, MATÁV Rt. and Westel 900 are utilizing the reduced allowance of 60 percent for a further five years (effective tax rate of 7.2 percent). Westel 450 has utilized the reduced allowance of 60 percent until December 31, 1999. Management believes that the conditions underlying the reduction in income tax will continue to be met. All other subsidiaries were subject to income tax of 18 percent.

Business Strategy

MATÁV's objective is to be the best Central and Eastern European telecommunications service provider. The Company aims to bring the quality, efficiency and scope of Hungary's telecommunications network and services to the level of modern Western telecommunications companies to serve the interest of MATÁV's customers, investors and employees. MATÁV aims to increase shareholder value by:

- *growing the core business and focusing on the customer;*
- *expanding into new businesses; and*
- *improving productivity and efficiency.*

Growing the core business and focusing on the customer

Growing the Core Business. The Company plans to continue to build its fixed line residential and business customer base by increasing the penetration of fixed access lines and upgrading the access network. In the short run MATÁV plans to continue to focus on installation and sales of additional lines and also upgrades to ISDN for communication intensive applications. The Company believes that it is helping to cultivate Hungarian telephone habits such that Hungarians are increasing the number of calls they make and the amount of time they spend on the telephone. MATÁV also seeks to increase levels of call completion through further penetration of value added services, such as digifon and Voice-mail services.

MATÁV's objective is to remain the dominant mobile services provider and market leader in Hungary by continuing to increase penetration and expanding its service scope through its subsidiaries Westel 900 and Westel 450. Data and Internet applications are expected to sustain mobile usage. MATÁV will also seek to exploit the Group's common infrastructure and network platforms as well as sales and service channels.

The Company believes that revenue from data services will continue to grow more rapidly than revenue from its other businesses. The proliferation of new applications is fueling growth in data services and driving the requirements for more advanced technology and service platforms. MATÁV has experienced increasing demand from businesses for integrated solutions as well as new technologies that deliver increasing operating efficiencies with economies of scale and lower costs. The expected growth in the Internet should also result in increased data revenue as well as growth in local access and usage.

Focusing on the Customer. *MATÁV has established distinct distribution channels designed to meet the needs of its three major customer groups: residential customers, business customers and wholesale service providers. MATÁV continuously seeks to transform itself into a customer-oriented organization that provides its subscribers with consistent "one-stop service", permitting subscribers to handle their business with the Company over the telephone. The Company plans further improvements in customer service and its understanding of sophisticated customer needs. To support these efforts, the Company is focusing on developing its customer-oriented culture and sales capabilities. The Company continually seeks to offer new products and services in response to customers' needs and to enhance its brand identity. The Company's pricing strategy is to provide attractively priced packages of products and services.*

Expanding into new businesses

MATÁV's overall objective is to maximize profits and take advantage of the growth opportunities across Hungary, including LTO territories.

MATÁV plans to concentrate significant resources on developing a business design which is based on Internet Protocol ("IP") and Internet services to adapt to the challenges of the emerging Internet economy and remain competitive with new entrants in the market. MATÁV plans to implement an IP centric development of its network and introduce IP based data communications solutions, such Virtual Private Networks.

MATÁV's objective is to remain the predominant Internet provider in Hungary by increasing penetration into the business and residential customer segments and by exploring expansion into the e-business market. MATÁV operates Origo, the most frequently visited portal in Hungary. Some of the key Internet-related services that MATÁV plans to provide include transaction authentication and authorization services, e-commerce, as well as portal development and management.

In 2000, the Company plans to begin developing and deploying broadband services based on xDSL technology. The viability of cable TV as a broadband access solution will be assessed particularly in LTO areas. The cable TV business line is expected to contribute to the revenues of the Company. In addition, it is also expected to create opportunities for the joint sale of telecommunications and entertainment services.

Improving productivity and efficiency

The Company is increasing productivity and operational efficiency through the ongoing modernization of its telecommunications network and investment in network systems and service platforms. In addition, MATÁV is committed to further headcount reduction through natural attrition, early retirement, centralization and automation. These changes are expected to result in further cost reduction and a more competitive cost structure as part of MATÁV's effort to prepare for a fully competitive environment.

Overview of MATÁV's Revenues

For the year ended December 31, 1999, MATÁV's total revenues by business segment were as follows:

	<u>Year ended December 31,</u>		<u>Year ended</u>
	<u>1998</u>	<u>1999</u>	<u>December 31,</u>
	<i>(in HUF millions)</i>		<i>(% change)</i>
<i>Fixed line telecommunications services segment</i>			
<i>Subscriptions, connections and other charges</i>	55,673	63,413	13.9
.....			
<i>Domestic traffic revenues</i>	108,425	134,071	23.7
.....			
<i>Other usage</i>	26,807	26,999	0.7
<i>International traffic revenues</i>	38,792	43,807	12.9
<i>Other services</i>	27,232	33,940	24.6
<i>Total fixed line segment</i>	<u>256,929</u>	<u>302,230</u>	17.6
<i>Mobile telecommunications services segment</i>	88,142	117,336	33.1
<i>Intersegment eliminations</i>	<u>(27,011)</u>	<u>(34,634)</u>	28.2
<i>Total</i>	<u><u>318,060</u></u>	<u><u>384,932</u></u>	21.0

Fixed Line Telecommunications Services Segment

In 1999, MATÁV's fixed line telecommunications services generated revenues of HUF 302,230 million before intersegment eliminations. Fixed line telecommunications services consist of domestic and international services, leased lines, data transmission related services, telecommunications equipment sales, construction, maintenance and other services. Fixed line telecommunications services do not include sales of mobile telecommunications equipment.

Domestic Services

Domestic fixed line voice telephony, MATÁV's principal business activity, generated revenues of HUF 224,483 million before intersegment eliminations in 1999. Revenues from domestic fixed line voice telephony consist of:

- subscriptions, connections and other charges;
- domestic traffic revenues; and
- other usage.

Products and Services

Local and Long Distance Calling Services. MATÁV provides exclusive local service to its fixed line telephony subscribers in its 36 local concession areas. The Company also has the exclusive right to provide long distance service to customers in all 54 local primary areas of Hungary.

Digifon Services. The improved level of digitalization of its exchanges permits the Company to offer value added digifon services, such as call forwarding and call waiting, to a significant number of its fixed line telephony subscribers. These services contribute to increased fixed line usage by avoiding busy signals or unanswered calls.

Shared Cost/Toll Free Numbers. To enable business customers to better meet the needs of their clients, MATÁV has introduced a wide range of "blue" numbers, which are shared cost numbers, and "green" numbers, through which businesses provide toll-free access for their customers. In 1999, the Company introduced Private Green Numbers, which are targeted at residential users.

Voice-mail. In November 1999, MATÁV launched a new Voice-mail product. MATÁV believes Voice-mail is an attractive new service for subscribers while it simultaneously increases the number of completed calls. The new Voice-mail service generated over 65,000 orders by the end of 1999.

ISDN Services. MATÁV offers ISDN services in Budapest and other major cities in its local concession areas. ISDN allows a single access line simultaneously to be used for a number of purposes, including voice, data, facsimile and video transmission. ISDN also provides higher quality connections with faster transmission of signals while increasing the bandwidth capacity of the network. MATÁV offers both basic ISDN access lines with two channels and multiplex ISDN access lines with 30 channels. MATÁV's ISDN services meet Euro-ISDN requirements. As of December 31, 1999, MATÁV had installed 22,343 ISDN access lines with two channels and 2,326 ISDN access lines with 30 channels, amounting to over 114,400 total ISDN channels.

Private Branch Exchange Services. MATÁV offers private branch exchange services through one of its subsidiaries, MATÁVcom Kft. As of December 31, 1999, MATÁVcom Kft. leased approximately 75,000 ports. The vast majority of the equipment leased is digital and meets the demands of developing technologies such as ISDN and digital enhanced cordless telecommunications. In August, 1999 MATÁVcom extended its activity into LAN services.

Calling Cards. In July 1998, the Company introduced the MATÁV World Card, which allows customers to make calls from any touch tone telephone both domestically and abroad. Customers can pay for the calls in Hungarian Forints as part of their telephone bills. By December 31, 1999, customers had subscribed for over 85,000 World Cards.

Directory Assistance. The Company offers customers directory inquiry services. Since March 1, 1997 the Company introduced a new, high quality directory assistance service, which received over 100 million inquiries by the end of 1999. In May 1999, the service was further developed to offer a call completion option, whereby calls may be connected automatically. In October, 1998 the directory assistance service received an ISO 9002 qualification.

Subscribers

The following table sets forth information regarding total fixed access lines and penetration rates in MATÁV's local concession areas:

	<i>At December 31,</i>		
	<u>1997</u>	<u>1998</u>	<u>1999</u>
<i>Lines in service in MATÁV's local concession areas:</i>			
<i>Residential lines</i>	1,982,186	2,201,366	2,370,579
<i>Business lines</i>	347,737	362,828	378,605
<i>Public payphones</i>	35,468	36,954	36,205
<i>Total</i>	<u>2,365,391</u>	<u>2,601,148</u>	<u>2,785,389</u>
<i>ISDN channels</i>	38,520	70,642	114,466
<i>Total</i>	<u><u>2,403,911</u></u>	<u><u>2,671,790</u></u>	<u><u>2,899,855</u></u>
 <i>Lines installed per 100 inhabitants:</i>			
<i>in MATÁV's local concession areas</i>	31.7	35.4	38.6
<i>Waiting list (in thousands)(1)</i>	23	30	38
<i>Digital exchange capacity as % of MATÁV's total exchange capacity</i>	70.2	75.7	79.0

(1) The waiting list consists of customers whose application for connection to an access line has been outstanding for 60 days or more. Year-end promotions like the one in 1998 and 1999 often generate demand in high density areas which can delay connections.

MATÁV's domestic fixed line telephony subscribers are primarily in two categories: residential customers and business customers. MATÁV includes the government among its business customers. As of December 31, 1999, 81.8 percent of MATÁV's access lines were connected to residential customers and 17.0 percent to business customers. In 1999, residential customers accounted for 46.9 percent and business customers accounted for 49.1 percent of MATÁV's domestic traffic revenues. The remaining 1.2 percent of access lines were connected to public pay phones, which accounted for 4.0 percent of MATÁV's domestic traffic revenues in 1999. MATÁV's top 250 customers account for less than 15 percent of the Company's revenues.

The Hungarian government, through its various institutions and departments, constitutes MATÁV's largest customer group. MATÁV develops separate service packages for each of these institutions and departments, because each generally has its own annual budget, particular telecommunications needs, independent organization and responsibility. From a strategic perspective, however, MATÁV considers the Hungarian government to be a single customer. MATÁV offers its largest customers, including the government, discounts for the services it provides. MATÁV estimates that revenues from the Hungarian government in the aggregate accounted for less than ten percent of its total revenues in 1999. A substantial majority of these revenues were related to services provided under MATÁV's exclusive concession rights.

Traffic

The following table sets forth the total minutes of domestic telephony traffic that MATÁV's fixed line subscribers generated, including calls from the fixed line network to mobile subscribers:

	<i>Year ended December 31,</i>		
	<i>1997</i>	<i>1998</i>	<i>1999</i>
<i>Domestic traffic (in thousands of minutes)</i>	<i>6,977,733</i>	<i>7,758,741</i>	<i>8,632,345</i>

Tariffs

MATÁV charges fixed line subscribers a one-time entrance fee, monthly subscription charges and traffic charges based on usage. MATÁV's tariffs for its fixed line voice telephony services are regulated by the Minister. MATÁV may, however, offer services at prices lower than those established by the Minister.

Until December 31, 1998, traffic charges were based on a fixed-price pulse. Commencing January 1, 1999, the Company introduced a time-based billing system. Under this system, a call charge contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration.

The following table sets forth the Company's domestic fixed line tariffs at January 1 in each of the following years in nominal Hungarian Forints:

	<i>At January 1,(1)</i>			
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
	<i>(HUF, exclusive of VAT)</i>			
<i>Entrance fee:(2)</i>				
<i>Residential</i>	30,000 (3,	27,000	27,000	27,000
<i>Business</i>	90,000 (4,	60,000	60,000	60,000
<i>Standard monthly subscription charge:</i>				
<i>Residential(5)</i>	960	1,100	1,210	1,814
<i>Business</i>	1,050	1,335	1,630	2,440
<i>ISDN entrance fee:</i>				
<i>Basic</i>	180,000	180,000 (6,	125,000	99,000
<i>Multiplex</i>	1,350,000	1,350,000 (6	1,350,000	1,350,000
<i>ISDN standard monthly subscription charge:</i>				
<i>Basic</i>	2,550-3,150	2,550-3,150 (6	3,200-6,400	3,700-6,900
<i>Multiplex</i>	38,250-46,500	38,250-46,500 (6	49,000-63,800	53,400-69,900
<i>Charge for a three minute peak rate call:</i>				
<i>Local</i>	18.00	31.20	31.80 (7	27.60 (7)
.....				
<i>From the fixed line network to mobile subscribers</i>	144.00	176.80	186.60 (7	186.00 (7)
.....				
<i>Domestic long distance:</i>				
<i>Zone 1 (Extended local)</i>	36.00	41.60	33.60 (7	27.60 (7)
<i>Zone 2 (Budapest metropolitan area)(8)</i>	-	41.60	46.20 (7	45.60 (7)
<i>Zone 2 (Near long distance)(9)</i>	99.00	-	-	-
<i>Zone 3 (Long distance)</i>	99.00	104.00	98.40 (7	87.00 (7)

(1) Reflects listed tariffs. From time to time, the Company may offer promotions and discounts from these listed tariffs.

(2) The Company agreed with the Minister to discount entrance fees from those listed by at least 30 percent on average in 1998. There was no similar agreement in 1999.

(3) Effective October 15, 1997, the residential entrance fee was decreased to HUF 27,000.

(4) Effective January 15, 1997, the business entrance fee was decreased to HUF 72,000, and effective October 15, 1997, the business entrance fee was further decreased to HUF 60,000.

(5) Included 20 free pulses until the end of 1998. From January 1, 1999, no usage discount is included in the monthly subscription fee.

(6) From February 1, 1998, the former tariffs changed. The basic entrance fee decreased to HUF 150,000, while the multiplex entrance fee did not change. The basic subscription fees increased to HUF 2,800-5,700, while the multiplex subscription fee increased to HUF 41,900-56,900.

(7) Includes a call set-up charge (HUF 6.60 in 1999, HUF 6.00 in 2000).

(8) This new zone was created in the new tariff regime with effect from January 1, 1998. Prior to January 1, 1998, these calls were included in Zone 1.

(9) As of January 1, 1998, near long distance Zone 2 and Zone 3 were combined into Zone 3.

MATÁV's one-time entrance fee and monthly subscription charge are different for residential and business customers. The Company does not charge its business and residential customers different traffic tariffs. MATÁV charges the same tariffs for voice traffic on fixed telephone lines and on ISDN lines. In 1999, the Company's tariffs for data traffic on ISDN lines were 25 percent higher than for voice traffic. MATÁV decreased this data surcharge to 10 percent on January 1, 2000.

Tariff Rebalancing. Historically, MATÁV, like government-owned operators in other countries, maintained relatively low subscription charges and relatively high tariffs for domestic long distance and international calls. Since 1995, the Company has been gradually rebalancing its tariffs within the constraints of the price cap regime to more closely reflect the underlying costs of services. See "— Regulation and Pricing." MATÁV has already made significant progress in this rebalancing. From December 31, 1997 through December 31, 1999, in real terms the Company increased its monthly subscription charges by 22.4 percent, increased its local tariffs by 18.0 percent, decreased charges for calls from fixed line to mobile telephones by 2.1 percent and decreased domestic long distance tariffs by 12.5 percent.

The Company has accelerated its drive toward tariff rebalancing for 2000 to stimulate usage and to prepare for future competition. The monthly subscription fee increased significantly in both nominal and real terms over 1999. In contrast, usage charges decreased on average in both nominal and real terms against 1999 tariffs.

Public Telephones

As of December 31, 1999, MATÁV operated 36,205 public pay phones, representing a penetration rate of 4.8 per 1,000 inhabitants in MATÁV's concession areas. Approximately 45 percent of these telephones were card operated. The Company plans to continue to increase the ratio of card-operated public pay phones. The traffic tariffs charged for calls from public pay phones are at a slight premium to those charged to fixed line subscribers.

International Telephone Services

The Company has the exclusive right to provide international public telephony services throughout Hungary. International telephone services consist of outgoing and incoming international telephony traffic, including voice, data and switched transit traffic through Hungary. In 1999, outgoing international telephony traffic generated revenues of HUF 21,215 million before intersegment eliminations, and incoming international telephony traffic generated revenues of HUF 22,592 million before intersegment eliminations.

Products and Services

MATÁV provides international calling access to its fixed line telephony subscribers and to subscribers of other local telephone operators and mobile service providers. In 1992, MATÁV introduced Hungary Direct and Country Direct services, which permit customers to charge calls made from abroad to their home phone numbers. In 1997, MATÁV began offering international "green" numbers, which allow businesses to provide toll-free access to their customers. MATÁV also sells international leased lines, including international managed leased lines, and international ISDN, X.400, X.25, telex and telegraph services. International ATM connections were launched with Deutsche Telekom and Teleglobe in 1999 to meet the increasing demand for Internet capacity.

In December, 1999 MATÁV launched an IP based telephone service. With MATÁV's IP Tel Card, calls can be made to any country of the world substantially cheaper than from traditional fixed lines. IP Tel Card customers do not need Internet access, or even a computer.

MATÁV completes international calls terminating in Hungary originated by subscribers of foreign telecommunications operators. The Company also provides such operators with transit traffic services.

Traffic

The following table sets forth information regarding international telephony traffic to and from Hungary, including other local telephone operators' and mobile services' international traffic and transit traffic through Hungary. In addition to international traffic through fixed lines and mobile service providers' the figures also include traffic based on IP technology, but do not include traffic through international leased lines.

	Year ended December 31,					
	1997		1998		1999	
	(millions of minutes, except for percentages and ratios)					
<i>Outgoing traffic:</i>						
Germany and Austria	106.8	37.2 %	109.2	36.9 %	118.5	36.5 %
Neighboring countries other than Austria	44.3	15.4	47.9	16.2	54.5	16.8
United States	14.9	5.2	13.1	4.4	14.1	4.3
United Kingdom	16.8	5.9	17.4	5.9	18.9	5.8
Italy	16.0	5.6	16.8	5.7	18.5	5.7
.....						
All other countries	88.2	30.7	91.9	30.9	100.0	30.9
Total outgoing traffic	287.0	100.0 %	296.3	100.0 %	324.5	100.0 %
.....						
Growth in total outgoing traffic (% per annum)	-	6.1	-	3.2	-	9.5
<i>Incoming traffic:</i>						
Germany and Austria	115.1	35.5 %	128.9	34.4 %	157.6	35.7 %
Neighboring countries other than Austria	33.0	10.2	37.6	10.0	41.5	9.4
United States	30.0	9.2	26.4	7.0	58.2	13.2
United Kingdom	26.3	8.1	42.3	11.3	49.0	11.1
Italy	18.5	5.7	19.6	5.2	18.2	4.1
.....						
All other countries	101.7	31.3	119.7	32.1	116.7	26.5
Total incoming traffic	324.6	100.0 %	374.5	100.0 %	441.2	100.0 %
.....						
Growth in total incoming traffic (% per annum) ...	-	15.4	-	15.4	-	17.8
Ratio of incoming to outgoing traffic	-	1.13	-	1.26	-	1.36
Transit traffic (millions of minutes)	23.7	-	35.5	-	60.9	-

A substantial portion of international traffic in terms of minutes consists of calls to and from Germany, Austria, the United States, the United Kingdom and Italy, which, in the aggregate, accounted for approximately 52 percent of the outgoing traffic and 64 percent of the incoming traffic in 1999. Business customers make a substantial majority of the outgoing international calls carried by MATÁV.

In 1997, 1998 and 1999, growth in incoming traffic outpaced growth in outgoing traffic. The Company believes that outgoing traffic did not increase as rapidly as incoming traffic in part because customers are increasingly using leased lines and private branch exchange services such as call blocking, and in part because dramatic decreases in tariffs charged by foreign service providers increased inbound calls.

Tariffs

Until December 1998, MATÁV's international traffic charges were based on a fixed-price pulse. Commencing January 1, 1999, MATÁV switched to time-based billing. The call charge for an international call, like that for a domestic call, now contains two elements: a call set-up charge, and a traffic charge measured in seconds based on the call's duration.

The following table shows the change since 1997, in nominal Hungarian Forints, in the charge for a three-minute call to

selected destinations:

	<i>At January 1,</i>			
	<u>1997</u>	<u>1998</u>	<u>1999(1)</u>	<u>2000(2)</u>
		<i>(HUF, exclusive of VAT)</i>		
<i>Neighboring countries</i>	216.00	249.60	244.20	222.00
.....				
<i>Other Europe</i>	288.00	332.80	330.60	285.00
<i>United States and Canada</i>	486.00	364.00	339.60	294.00

(1) Includes a call set-up charge of HUF 6.60.

(2) Includes a call set-up charge of HUF 6.00.

Tariff Rebalancing. Since 1995, as part of the rebalancing of its tariffs, MATÁV reduced its international tariffs for outgoing calls moving towards rates that foreign telecommunications service providers charge for calls to Hungary and to take into account the related international accounting rates. From December 31, 1997 through December 31, 1999, MATÁV's international call tariffs fell on average by 13.4 percent in real terms. As part of its ongoing tariff rebalancing, the Company expects to continue to lower its international tariffs to stimulate usage. International tariffs introduced in 1999 and 2000 have decreased on average in both nominal and real terms compared to 1998 and 1999, respectively.

Settlement Arrangements. Under bilateral settlement arrangements, MATÁV pays other carriers for the use of their networks for outgoing international calls and receives payments from other carriers for the use of its network for incoming international calls. In Europe, such settlement arrangements fall under the general auspices of the International Telecommunication Union. Settlement payments, which are generally denominated in special drawing rights, are calculated using a currency basket in which U.S. dollars have the greatest weight.

International Telecommunications Hub

MATÁV believes that Hungary is well located to serve as a telecommunications gateway between Eastern and Western Europe. MATÁV has two state-of-the-art international gateways as well as fiber optic cable connections serving 11 border crossings. These fiber optic cable connections use synchronous digital hierarchy transmission facilities. The Company has X.25 links, which are used for packet switched data transmission with 83 international networks. It also has ISDN connections with 39 international networks and is a member of the Global European Network, a high-capacity integrated network management system providing international leased lines. The Company has been developing tariff packages for transit traffic and in conjunction with Telekom Austria, the Austrian national telecommunications operator, and ROM-TELECOM, the Romanian national telecommunications operator, MATÁV offers the ORIENTRANS tariff for the transmission of traffic between Asia Minor and Western Europe.

Leased Lines

Revenues from leased lines totalled HUF 13,816 million before intersegment eliminations in 1999. MATÁV is the principal provider of leased lines in Hungary.

Leased line service establishes a permanent connection for the 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 partly in Hungary and partly abroad. The Company leases lines to other local telephone operators and mobile service providers, who use such lines as part of their networks. It also leases lines to providers of data services. In addition, the Company leases lines to multi-site business customers who use leased lines to transmit voice and data traffic among their respective sites.

The Company offers a broad variety of standard analog and digital lines for lease, including two-wire and four-wire analog lines and digital lines with capacities from 4.8 Kb/s to 2.0 Mb/s. MATÁV also offers high capacity customized digital lines to other telecommunications providers.

Flex-Com. Since 1996, MATÁV has offered Flex-Com, domestic and international digital leased lines with managed back-up systems that are dedicated to transmitting data. In 1998, the Company launched the Flex-Com NMS (VSN) network management system and ISDN-Flex and Voice-Flex services. In 1999, MATÁV increased its Flex-Com connections from 5,170 to 7,007 lines. In 1999, higher quality (Gold and Silver), secure access, and quick installation (Express, Profi) Flex-Com services were introduced. The Gold and the Silver quality services increase the annual availability to 99.9 percent and 99.7 percent respectively, as compared to the 99.5 percent annual availability of the FLEX-Com basic service. The secure access provides two way subscriber access through separate routes or transmission media at one termination point of the connection. The quick installation services are connected within ten days (Express) or within five days (Profi) as compared to the normal provisioning time (20 days).

Frame-Flex. MATÁV also uses its managed leased line network to offer Frame-Flex, a public frame relay service that is particularly suited to customers who transmit data in bursts, such as connections between local area networks. At December 31, 1999, MATÁV had 635 Frame-Flex connections.

The Company's leased line customers pay a one-time connection fee based on the type of line leased. Monthly subscription charges vary with the type and length of line leased and, in some cases, with the term of the lease. With the exception of leased lines required for connection with other networks, leased line tariffs are not subject to regulation. As part of the overall rebalancing of its tariffs, MATÁV has reduced its leased line tariffs in real terms over the last few years in response to competition.

Data Transmission and Related Services

Revenues from data transmission and related services totalled HUF 11,464 million before intersegment eliminations in 1999. Data transmission and related services consist primarily of data transmission, telex and network services for business customers, such as financial institutions and insurance companies, and, to a lesser extent, residential customers. The market for data transmission and related services in Hungary is highly competitive. The Company is the leading supplier of data transmission and related services in Hungary.

MATÁV's revenues from data transmission have grown significantly as a result of both the development of the Hungarian economy and the Company's increasingly sophisticated services. Revenues for data transmission grew from HUF 3,699 million in 1997 to HUF 7,781 million in 1999, in each case before intersegment eliminations. MATÁV expects the market for these services to grow with the proliferation of personal computers and increasing consumer needs. MATÁV believes that the ability to offer new data products and services will be critical to competing effectively in the future, particularly with respect to business customers.

Datex-P. MATÁV offers Datex-P, a packet-switched data transmission service based on the X.25 protocol. At December 31, 1999, MATÁV had 3,471 Datex-P terminals. The service provides low to medium speed domestic switched data communication services with international connectivity to business customers.

Internet. Since the introduction of the Company's Internet service, MATÁVNet, in the spring of 1997, the number of subscribers has grown rapidly. By December 31, 1999, MATÁVNet had over 51,000 customers. In 1999, MATÁVNet became the largest content provider in Hungary with a 45 percent market share based on the number of subscribers and continues to strengthen its position as a market leader in Internet services, from connection to e-commerce. This growth was greatly fostered by Origo, the most frequently visited portal site in Hungary with 120,000 sessions per day, and Altavizsla, the only search engine in the Hungarian language. In 1999, MATÁVNet introduced NetQuick, a package available in larger department stores that provides instant Internet access. MATÁVNet also operates the most popular freemail service in Hungary as well as a business news and information service called Business Quarter. In addition, MATÁVNet is one of the country's leading website homepage designers and builders and is in the process of developing business models and applications for e-commerce. To help stimulate demand and promote wider Internet usage, MATÁVNet has begun selling Internet subscriptions packaged with personal computers. For the same purpose, MATÁV has developed discounted local call packages that charge a flat fee per local call during certain hours of the day.

VSAT. MATÁV offers business satellite communications services through its own central station. Satellite services based on

VSAT technology provide a solution for the rapid and reliable completion of data communications by establishing both domestic and international links.

Global Frame Relay and Global X.25. To satisfy the customer need for cost effective worldwide data communication services, the Company has introduced the Global Frame Relay and Global X.25 services as part of an agreement between MATÁV and Global One.

Cable TV and Broadcasting Services. On July 1, 1998, MATÁV established MATÁVkábelTV Kft., for providing cable television services. The subsidiary began providing services on January 1, 1999. MATÁVkábelTV had over 100,000 subscribers as of December 31, 1999. The subsidiary's key responsibilities are marketing and sales. Other members of the MATÁV group provide network provisioning activities such as a terminal station and optical network as well as servicing tasks. MATÁVkábelTV benefits from MATÁV's long term relationship with the customers, its thorough market knowledge as well its strong brand name.

MATÁV owns a 25 percent interest in Magyar RTL Televízió Rt ("MRTL"), a national terrestrial television broadcaster entitled to provide commercial television programs but not to engage in broadcast diffusion or distribution activities. CLT-UFA S.A. owns 49 percent, Grundy International No. 1. B.V. owns 20 percent and Raiffeisen Group owns six percent of MRTL. MRTL has a concession for a period of ten years with an option for a five year extension. The Program Provision Agreement was signed on July 9, 1997, the starting date of the licence. By the last quarter of 1998, MRTL became a market leader in its target age group between 18-49 years. MRTL is investing in film packages with major American distributors as well as in locally produced programs with Hungarian stars. MRTL derives revenue primarily from advertising sales.

rEDInet. The Company also offers rEDInet, an electronic data interchange service. This service facilitates private exchange of internationally standardized electronic documents.

Security Services. On July 5, 1998, MATÁV established MATÁVOR Kft., a wholly owned subsidiary, to provide security monitoring services. MATÁVOR Kft. had approximately 6,500 customers as of December 31, 1999.

MATÁV Corporate Networks. MATÁV has already built corporate private networks for its customers, primarily in the banking, finance, utility and public administration sectors. Based on increased demand and its experience in corporate networking, MATÁV introduced MATÁV Corporate Networks on September 1, 1998. MATÁV Corporate Networks are offered to key accounts as a tailor-made customized service designed to satisfy internal communication needs.

MATÁV provides other data transmission services, including telex and telegraph. In the future, the Company plans to introduce virtual private and intelligent networks to meet the increasingly complex telecommunications needs of its key customers.

Fixed Line Telecommunications Equipment Sales

MATÁV distributes an extensive range of telecommunications equipment, from individual telephone sets to facsimile terminals, private branch exchanges and complete network systems, through a network of customer service centers. CARDNET Rt., in which MATÁV acquired a majority interest in the second half of 1998, sells point of sale terminals. In 1999, sales of fixed line telecommunications equipment generated revenues of HUF 3,030 million before intersegment eliminations. MATÁV does not manufacture telecommunications equipment but rather resells and leases equipment manufactured by other companies.

The telecommunications equipment sector is highly competitive and characterized by rapid technological innovation and intense competition. MATÁV believes that the supply and service of telecommunications equipment is an integral part of being a full service telecommunications provider and is necessary for the expansion of its customer base. In addition, these activities permit MATÁV to ensure that technologically advanced equipment required for new services is available in the Hungarian market.

Construction and Maintenance Services

MATÁV constructs fixed telecommunications networks and offers network maintenance services to other telecommunications operators in Hungary. These construction and maintenance services are ancillary to the construction and maintenance of MATÁV's networks and generated revenues of HUF 5,630 million before intersegment eliminations in 1999.

The Company carries out its construction activity primarily through its wholly owned subsidiary, MATÁVline Kft. The majority of construction revenue is derived from optical network construction, network construction related to subscriber connections and project planning. In April 2000, MATÁV sold MATÁVline Kft. MATÁV intends to utilize open market conditions in its construction of new networks, as there are now a number of construction companies in the Hungarian market.

Mobile Telecommunications Services Segment

In 1999, MATÁV's mobile telecommunications services generated revenues of HUF 117,336 million before intersegment eliminations. MATÁV provides mobile telecommunications services through two subsidiaries, Westel 900 and Westel 450, each of which is 51 percent owned by MATÁV.

Westel 900 provides digital services and Westel 450 provides analog services. At December 31, 1999, Westel 900 and Westel 450 together accounted for an estimated 58 percent of the total Hungarian mobile telephony market in terms of subscribers. The aggregate penetration rate of digital and analog mobile telephone services in Hungary increased from approximately 4.6 percent at December 31, 1996 to approximately 16.2 percent at December 31, 1999. A new entrant into the GSM market started operations in the last quarter of 1999.

Each of the Westel companies operates on a stand-alone basis as required by its concession. Each has its own administrative, financing, billing and collection systems. The companies cooperate with each other in certain areas and provide each other with certain services on an arm's length basis. The Westel companies each provide distribution services for the other's products, and Westel 450 provides system maintenance to Westel 900 on a contract basis. The Westel companies also lease space to each other and from MATÁV Rt. on an arms length basis.

In 1999, the minority owner of Westel 900 and Westel 450, MediaOne International entered into a purchase and sale agreement with Deutsche Telekom. As a result, on October 21, 1999 Deutsche Telekom entered into an agreement to purchase most of MediaOne International's Eastern European portfolio including both Westels' shares and quotas. This purchase transaction was completed in March, 2000.

On October 21, 1999 MATÁV announced that it entered into an agreement with Deutsche Telekom providing MATÁV the option to acquire Deutsche Telekom's 49 percent interest in Westel 450 and Westel 900 for a fixed price of USD 885 million. MATÁV can exercise the option in up to three tranches representing a percentage of not less than 15 percent each at any time for a 15 months period starting on July 1, 2000. The transaction should be closed no earlier than January 1, 2001 and no later than December 31, 2001.

MATÁV also entered into a proxy agreement with Deutsche Telekom. Under this agreement MATÁV represents Deutsche Telekom on completion of its purchase transaction in connection with the management of both Westel 900 and Westel 450, nominating all members of the Supervisory Board except one Deutsche Telekom nominated member and in the case of Westel 900 all Directors of the Board except one Deutsche Telekom nominated director. MATÁV controls the operations of both Westel companies except that Deutsche Telekom is entitled to vote the Westel companies' shares in the following decisions:

- *changes in the capital structure other than on pro-rata basis;*
- *dividend declaration other than on a pro-rata basis;*
- *merger, demerger, spin-off, liquidation;*
- *modification of the constitutive documents;*
- *sale of substantial assets;*
- *issuance of convertible securities other than on a pro-rata basis;*
- *admission of new shareholders;*
- *entry into strategic alliance with any competitor of Deutsche Telekom; and*
- *removal of the Independent Accountant.*

Westel 900

Westel 900 commenced offering GSM digital mobile telecommunications services on March 31, 1994 pursuant to a concession awarded in November 1993. GSM affords high quality digital transmission and is the dominant digital mobile telecommunications standard in Europe. Westel 900 offers basic GSM voice telephony services and a number of complementary services, such as voice mail, call forwarding, short message services and call waiting. Westel 900 also provides GSM-based data and facsimile transmission services as well as mobile Internet services and a number of content services. Westel 900 offers several different packages of services designed for different customer requirements, including a traffic package targeted at low volume residential customers.

The prepaid card of Westel 900, Domino, provided 37 percent of net customer additions in 1999. In 1999, Westel 900 made a number of value added services available to prepaid customers, such as sending short messages (SMS) and caller ID. Prepaid customers (especially young people and security users) are expected to represent the majority of growth potential for 2000.

In 1999, Westel 900 enhanced its value-added services and introduced several new products. In the second half of 1999, Westel 900 presented the new voice over IP based Westel Net-Tel service which enables users to make international calls at lower rates than MATÁV's standard international tariffs. The Mailreader voice e-mail and the Wireless Application Protocol pilot service, a combination of mobile communication and IP technology, were also introduced in 1999. Other new products include the SIM-tool kit and SMS banking.

Westel 900 encourages the loyalty of customers with various programs, such as bonuses on high usage and partner cards with low monthly fees.

As of December 31, 1999, the Westel 900 network covered 98 percent of Hungary's population and 96 percent of its geographic area. The build-out of its mobile network has been substantially completed. Westel 900 has entered into international roaming agreements with 144 operators in 70 countries.

On February 25, 1999 the Ministry of Transport, Telecommunications and Water management (the "Ministry") issued an invitation to tender for the licensing in Hungary of DCS 1800 services, a mobile telecommunications system operating in the 1800 MHz frequency band. The tender was closed on May 7, 1999. In October 1999 an amended concession contract was signed, allowing Westel 900 and its current GSM 900 competitor, Pannon GSM, to start commercial service in the 1800 MHz band for 15 years beginning November 26, 2000. At the same time the Minister also signed a concession contract with V.R.A.M. Rt., the new entrant on the Hungarian digital cellular market, which uses the Vodafone brandname.

Westel 900's principal objectives are to maintain market leadership in the rapidly growing mobile telecommunications market, expand its brand recognition and focus on providing a high quality of customer service.

Subscribers. The number of Westel 900 subscribers has grown significantly over the past three years. The table below sets forth information concerning the number of Westel 900 subscribers at the dates indicated:

	<i>At December 31,</i>		
	<i>1997</i>	<i>1998</i>	<i>1999</i>
Subscribers	362,786	546,554	842,279
Annual growth in subscribers (%)	61.5	50.7	54.1

The rapid increase in the number of Westel 900 subscribers since December 31, 1997 is attributable to a number of factors, including real terms reductions in handset prices and traffic tariffs. Growth also can be attributed to handset discounts, installment purchase plans and aggressive marketing.

Westel 900 estimates that, as of December 31, 1999, it held approximately 55 percent of the Hungarian market for GSM mobile digital services in terms of subscriber base. The Company expects to initiate additional marketing campaigns to stimulate further subscriber growth and to maintain its market share.

Traffic. Westel 900's average traffic per subscriber remains one of the highest in Europe at 200 minutes per month in 1999. Traffic per subscriber has declined over the past few years as the subscriber base has expanded to include lower volume users.

Tariffs. Since January 1998, mobile subscriber tariffs have been unregulated and carriers have had the freedom to set the level of the various tariff elements (i.e. connection fee, subscription charge and traffic charges). Westel 900 charges subscribers a one-time connection fee, monthly subscription charges and time based traffic charges. Customers using prepaid cards do not pay monthly subscription charges. Westel 900 does not charge subscribers for incoming calls, other than calls received while roaming, although it receives payments from other telecommunications service providers for terminating calls on its network. Westel 900 customers currently have more tariff package choices than the customers of the competitive service providers.

Distribution. Westel 900 operates ten sales and service centers in Budapest, 23 elsewhere in Hungary and two mobile showrooms. Westel 900 sales personnel are paid a regular wage plus sales commissions. In addition to distributing products and services through its own sales network, Westel 900 distributes products through master dealers (FOTEX group, Westel 450 and MATÁV) on an agency basis, through large Hungarian retail and distribution chains (Shell, MOL, TESCO, Auchan, Billa, Lapker) and through franchise partners. In total, Westel 900 markets products through almost 1,500 outlets.

Westel 450

Westel 450 is the sole provider of analog mobile telecommunications services in Hungary. Westel 450 commenced operations in 1990 and was the only provider of mobile services in Hungary until the commencement of GSM operations in 1994.

Westel 450 service is based on the NMT standard, which predates digital mobile telephony services, including GSM. In response to competition from GSM operators, Westel 450 took advantage of its lead in geographic coverage to focus on penetration. The Westel 450 network covers over 98 percent of Hungary's geographic area.

At present, Westel 450 has positioned itself as the mobile network offering the most affordable service in Hungary. Unlike the GSM service providers, Westel 450 does not provide international roaming services. However, Westel 450 is well suited for price-conscious customers who do not often travel abroad but require mobility within Hungary.

Subscribers. The table below sets forth the number of Westel 450 subscribers at the dates indicated:

	<i>At December 31,</i>		
	<u>1997</u>	<u>1998</u>	<u>1999</u>
<i>Subscribers</i>	79,099	93,596	97,753
<i>Annual growth in subscribers (%)</i>	9.9	18.3	4.4

In 1998 and 1999, the number of Westel 450 subscribers increased due to active promotional programs and innovative service offers.

Tariffs. Westel 450 charges its subscribers monthly subscription charges and traffic charges for outgoing calls. Westel 450 does not charge subscribers for incoming calls, although it receives payments from other telecommunications service providers for terminating calls on its network. Westel 450 offers a number of different packages of services designed for different customer requirements, including a package for low volume users.

Distribution. Westel 450 markets its services through its own salesforce, through Westel 900 salespersons on an agency basis and through a network of small independent retailers.

Marketing and Distribution

MATÁV's goal is to meet demand while accelerating its ability to create and respond to customers' needs for a broad range of advanced telecommunications services. The Company believes that increasing customer awareness of its products and services and promoting customer loyalty is critical to its future success. MATÁV is reshaping its marketing efforts to be proactive, market and application driven and customer-service oriented. The Company strives to become easily accessible to its customers by presenting "one-stop service."

The Company's customer service activity is managed mainly through call centers. With the nationwide roll-out of the operational support system, the call centers permit subscribers to handle their business with the Company over the telephone. The call centers have assumed most of the functions of the more traditional customer or "walk-in" offices. By the end of 1999, three call centers covering all residential and small business customers were operational.

MATÁV continues to enhance its "local presence" by establishing retail stores where customers can view the various products and services the Company offers and experience features through demonstrations as well as receive full scale customer care. The Company established a total of 23 retail shops across Hungary by the end of 1999, including 17 "MATÁV Pont" shops. MATÁV also operates an agent and dealer network, consisting of 31 dealer shops and approximately 200 agents.

MATÁV's marketing activities focus on four elements:

- products;*
- pricing;*
- promotion;*
- distribution and sales.*

Products. MATÁV's product portfolio is continuously expanding and developing in response to market needs. The Company actively manages its product portfolio by soliciting customer input for new services and innovative package solutions, and eliminating services that are no longer in demand. In addition to traditional voice and data telecommunications services, the Company offers value added services such as ISDN, voice mail, calling cards, managed narrow and broadband data transmission, Internet access and voice over IP.

Pricing. The Company's pricing strategy is to maintain its leading position by providing attractively priced and flexibly packaged combinations of products and services. MATÁV continues to rebalance its subscriber tariffs, preparing for market liberalization. The Company increasingly offers various pricing packages for its fixed line telecommunications services including subscriber packages, which bundle call management services, and calling plans, such as "Favorite Numbers", which allow customers to choose a limited set of telephone numbers, calls to which are charged at discount rates. In January, 2000 a new package was introduced for low users with reduced subscription fees and higher usage tariffs charged after a certain amount of regularly rated calls. In April 2000, another new package was introduced for residential customers especially for Internet users which allows unlimited calls within specified time periods for a flat monthly fee.

Promotion. MATÁV's promotion and advertising is focused on providing information about its various products and services and strengthening its brand image. Advertising is based on market research to identify market trends and customer needs, with active customer involvement in testing products and promotions. The Company has achieved high levels of consumer awareness as a result of its existing advertising campaigns and through the effective use of appropriate media.

Distribution and Sales. The Company manages the following five distribution and sales channels:

- residential customers;*
- business customers, consisting of customers with relatively higher usage and more specialized telecommunications needs, including the Hungarian government;*

- *wholesale providers, consisting of other local telephone operators and mobile service providers;*
- *foreign operators, including those transiting traffic through Hungary; and*
- *public payphone users, including the sale of calling cards.*

MATÁV manages these distribution channels by specially tailored products and services. To provide appropriate incentives to managers, the Company has linked compensation to performance. Similarly, MATÁV has introduced incentive compensation as a component of salespersons' salaries.

Infrastructure and Technology

Over the past three years, MATÁV has invested over HUF 169 billion in its fixed line telecommunications network. Through these investments, MATÁV has sought to rapidly build out and modernize its network to enable the Company to offer a broad portfolio of technologically advanced products and services. MATÁV expects to incur capital expenditures of approximately HUF 150 billion, including approximately HUF 90 billion per year on its fixed line telecommunications network in 2000 and 2001. The Company expects the majority of fixed line expenditures to relate to capacity improvements in the local loop and in systems and service platforms.

Modernization of Switches and Exchanges. The Company has rationalized its switching architecture to increase the operational efficiency of its network. MATÁV has already eliminated one hierarchical level from its switching architecture and plans to reduce the number of its switching sites from over 1,000 in 1999 to below 100 within ten years by consolidating switching platforms into larger centralized switches.

The Company continues to digitalize its local networks. At December 31, 1999, 79.0 percent of MATÁV's exchange capacity was digital, compared to 63.8 percent at December 31, 1996. Each of the MATÁV concession areas is served by at least one digital primary exchange. Digitalization permits a broader range of services, increases capacity and generates cost savings. Digitalization is also a prerequisite for providing ISDN and Internet services. The number of local exchanges capable of providing ISDN services has increased considerably and the number of ISDN channels grew from 11,128 at December 31, 1996 to 114,466 at December 31, 1999. On the basis of the ISDN infrastructure, MATÁV's network supports switched high quality Internet access and X.25 packet switched data transmission for ISDN subscribers.

Expansion of Access Networks. The Company has substantially expanded and modernized its local networks. Over the last three years, MATÁV has added in excess of 645,000 access lines and over 103,000 ISDN channels to the local networks. In 1996, the Company began to employ radio-linked subscriber lines ("radio local loop" or "RLL"). By the beginning of 1999, the Company had created a capacity of over 174,000 and installed over 164,000 radio-linked subscriber lines. Radio local loop provides a cost effective alternative to expansion of conventional fixed line local loops and is well suited to areas where installation of fixed lines is costly or difficult, such as low density areas in the Hungarian countryside. MATÁV's license to operate an analog radio local loop system in the 900 MHz frequency band is scheduled to expire in 2003.

As part of the introduction of the DCS 1800 mobile system, the Ministry has required MATÁV to exit part of its 900 MHz frequency band width before the expiration of its licence. In compliance, MATÁV had removed its analog radio local loop system from Budapest by August 31, 1999. At December 31, 1999 the Company still provides services for approximately 161,000 RLL subscribers. According to an agreement between the Ministry and MATÁV the Company will be compensated for this early withdrawal from the 900 MHz frequency band.

MATÁV uses fiber optic cables in its fixed line local loop networks, serving approximately 165,000 subscribers. The Company installed a substantial portion of the local network fiber optic cable in Budapest, where segments of the old cabling were in poor condition and where MATÁV believes the demand for high capacity and quality transmission will be greatest. At the end of 1999, there are approximately 45,000 installed channels available to connect additional subscribers to the fiber optic local loop networks. MATÁV plans to extend its local fiber optic network both inside and outside Budapest to cover new areas and to increase the number of ISDN subscribers.

Backbone Network. MATÁV has a digital fiber optic national long distance network that connects local primary area networks. The Company has implemented synchronous digital hierarchy systems in both the national long distance and Budapest networks. In addition to cost advantages, synchronous digital hierarchy systems provide an extremely flexible transmission infrastructure with automatic transmission paths. MATÁV installed an additional 224 km of optical cable and synchronous digital hierarchy systems in the long distance network during 1999, increasing both network availability and transmission capacity. As of December 31, 1999, MATÁV had 4,552 km of digital backbone network.

Intelligent Network. MATÁV has implemented an intelligent network platform. The Company launched the first set of Intelligent Network services (shared cost and toll free numbers, Televoting, and Virtual Card Calling) in 1998. In 1999, the services were also deployed to LTO areas and the platform software was recently upgraded. New services, such as Prepaid Card calling and services to support fixed and mobile telecommunications convergence, are under development.

Asynchronous Transfer Mode. MATÁV introduced the first public network in Hungary based on asynchronous transfer mode technology in 1998. Based on this technology, high speed LAN-Flex and Cell-Flex services are provided commercially. LAN-Flex offers local area network interconnection services, while Cell-Flex offers a high-speed data transmission service. Both services provide flexible bandwidth delivery. The Company plans to introduce switched capabilities on this network in 2000 and 2001, to enhance the efficiency of broadband services. MATÁV intends to further develop this network to support other capabilities and services.

International Network. As a result of enhancing and upgrading investments, the Company has eliminated the majority of its analog international connections. MATÁV's international network consists of two state-of-the-art digital gateway exchanges. These gateway exchanges connect MATÁV's domestic network to the global international network providing automatic telephone service with 214 countries. MATÁV has 11 fiber optic connections, one digital microwave link and one satellite earth station available for connections across Hungary's borders. MATÁV has established direct "Common Channel Signaling 7" connections to 40 countries and intends to expand these connections to ten additional countries in 2000. MATÁV has also established international ISDN connections with 30 countries and is scheduled to connect ten additional countries in 2000.

Network Quality. Investment in the network, particularly in modernization initiatives, has led to significant improvements in network quality. For instance, MATÁV has reduced the percentage of faults per main line per year from 23.88 percent in 1997 to 17.07 percent in 1999, and has reduced the call failure rate for local calls from 0.32 percent to 0.09 percent over the same period. The Company has also cut downtime per main line per year from 5.04 hours in 1997 to 2.07 hours in 1999. Modernization, particularly the digitalization and rationalization of MATÁV's switching architecture, has also contributed to increases in the productivity of its employees.

Information Technology

MATÁV has dedicated significant resources to improving its information technology systems. MATÁV believes that the continuing development of these systems is essential to improving customer service and the efficiency and productivity of its employees.

MATÁV's nationwide operational support system integrates the following elements:

- *billing;*
- *automated call collection;*
- *customer service orders; and*
- *technical inventory management.*

This operational support system permits MATÁV to offer itemized billing, bundle products and services in tariff packages and to generate a single bill for customers with multiple locations. Automated call collection maintains accurate customer billing and improves tracking of traffic. Integrated customer service order and technical inventory management enables MATÁV to shorten service installation intervals in areas where the requisite cabling is already in place. The operational support system reduces administrative costs and increases internal productivity. MATÁV implemented the operational support system throughout its entire network as of October 1998. This system has become integrated into the Company's daily operations and is upgraded regularly as required.

MATÁV has embarked on a number of other information technology initiatives designed to monitor and improve the efficiency of its network and increase employee productivity. A switched network operations and management system facilitates the centralized management of stored program controlled switches. This system manages: switches, networks, traffic and signaling.

In 1997, MATÁV began implementing the network repair and provisioning system to improve the quality of its service while reducing costs. The Company plans to implement a Work and Force Management System (WFMS), a new testing system for its network and services, and a new Automatic Call Distributor (ACD) to establish call centers receiving customers' complaints. The deployment of the test system, the ACD and the call centers were completed in second quarter of 1999. The country wide roll out of the WFMS is expected to be completed in 2000.

Competition

Notwithstanding the Company's exclusive rights to provide certain fixed line telecommunications services, approximately one third of the Company's 1999 revenues were derived from areas open to direct competition.

Domestic Fixed Line Telecommunications Services

In its domestic telephony business, the Company is subject to indirect competition from mobile telecommunications providers. Following full liberalization of fixed line voice telephony, a variety of market entrants providing public fixed voice telephony service, either by interconnecting with MATÁV's network or via their own infrastructure, will begin to compete. Existing and potential service providers include other local telephone operators, operators of existing alternative networks, such as public utilities, railways and mobile telecommunications providers, and global alliances of international telecommunications providers.

Significant current and potential competitors in domestic telecommunications services include PanTel, Novacom, Vivendi and Antenna Hungaria. The investors in PanTel include KPN Telecom B.V., MÁV Rt., the Hungarian National Railway Company and KFKI Számítástechnikai Rt. Novacom was founded by the Budapest Electric Works, the German RWE Telliance AG and Telekomunikations Holding Südwest GmbH. Vivendi is an investor in Hungarian local telephone operators. Antenna Hungária is mainly owned by Állami Privatizációs és Vagyonkezelő Rt. (the "ÁPV").

International Telecommunications Services

MATÁV is already subject to indirect competition in the provision of international voice telephony services from by-pass and call-back services, particularly with respect to traffic to the United States and Canada. Although call-back services are technically illegal in Hungary, they are difficult to prevent. Management believes that the historically balanced nature of its international tariffs has limited competition from such services. The Company also faces competition from private networks

connected through leased lines, and companies that lease lines for international data transmission. The Company expects that competition in the provision of international telephony services, which has traditionally been based on price, will increase, particularly with the anticipated full liberalization of public voice telephony. IP telephony also may redirect calls — primarily international calls — from MATÁV's network. IP telephony can be less expensive than traditional telephony service but suffers from low quality. Companies offering IP telephony include Pantel, Novacom and the three digital mobile service providers in Hungary.

Leased Lines and Data Transmission Services

MATÁV competes in the provision of leased lines with various operators. MATÁV's data transmission and related services face significant competitive pressure. A large number of Hungarian companies have established private data networks. Competitors have also established data transmission networks using leased lines and their own switching capacity. Management believes the extent and quality of the Company's network and attractive pricing give it a competitive advantage in the provision of leased lines and data transmission and related services.

MATÁV faces competitive pressure in the provision of Internet services as well. Significant competitors in Internet services include Elender, Datanet and Euroweb. Elender is part of PSINet Group, Datanet is fully owned by Global TeleSystems Group and the majority owner of Euroweb is PanTel.

Mobile Telecommunications Services

The digital mobile telecommunications market in Hungary is highly competitive and is characterized by successive promotional campaigns and price competition. Westel 900 currently competes principally with Pannon GSM and the new entrant on the GSM market, Vodafone. In general, Westel 900 has sought to attract customers through competitive pricing, superior distribution, customer service and discounting handset sales.

Although Westel 450 is the sole provider of analog mobile services, it competes with the digital services of Westel 900, Pannon GSM and Vodafone. To retain subscribers, Westel 450 has maintained lower tariffs and launched an active customer retention campaign. Management believes that Westel 450 will be able to maintain its analog subscriber base because of Westel 450's lower usage costs. The design of analog handsets has improved to the point where advantages associated with digital handsets have been largely eliminated. The factory price of analog handsets is still generally higher than comparable GSM handsets, but promotional campaigns have kept the price to the consumer at or near the price of GSM handsets.

Employees

MATÁV employed 15,377 persons as of December 31, 1999. The following table provides information concerning the number of full-time employees, including full-time equivalents, of MATÁV Rt. and its consolidated subsidiaries:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
<i>MATÁV Rt.:</i>			
Average number of employees	15,217	14,098	12,665
Number of employees at period end	14,771	13,287	12,093
<i>MATÁV Rt. and its consolidated subsidiaries:</i>			
Average number of employees	19,094	17,535	16,034
Number of employees at period end	18,187	16,595	15,377

Workforce Reduction and Redeployment. *Centralization and technological improvements as well as attrition have permitted the Company to reduce the size of its workforce. While overall personnel levels are falling, the number of highly skilled employees is increasing. MATÁV expects to further reduce its number of employees. Access lines per fixed line employee increased from 136 at December 31, 1996 to 240 at December 31, 1999, which brings our goal set in 1997 to achieve 250 access lines per fixed line employees by the end of 2000 well within reach.*

Employee Representation and Labor Relations. *MATÁV Rt. has entered into a collective bargaining agreement with the Hungarian Telecommunications Trade Union. The agreement, which can be terminated by either party with three months' notice, applies to all MATÁV Rt. employees except for the Chief Executive Officer, regardless of their union membership status. Wage terms in the agreement must be renegotiated annually. Under the agreement, employees are generally entitled to specific periods of notice before termination. Furthermore, employees are entitled to a specific amount of severance pay, which depends on the tenure of the employee. Employees are also entitled to welfare benefits as discussed below.*

In addition to the collective bargaining agreement, MATÁV's employees are generally covered by the Hungarian Labor Code, Law XXII of 1992, as amended, which imposes various restrictions on the involuntary termination of employment. The Hungarian Labor Code protects employee interests through two different labor organizations: the Trade Union and the Plant Council. The Trade Union, as the official representative of employee interests in negotiations relating to the terms of employment, has the right to be informed of all corporate measures that may significantly affect the interests of employees and to commence legal action against the Company for employment-related conduct that infringes an employment rule. In addition, the Plant Council directly represents employee interests in dealings with management and decides jointly with the employer on matters involving employee welfare funds and institutions. The Plant Council must be informed in semi-annual reports on issues affecting the Company's economic performance and changes in wages, employment conditions and working hours. The Plant Council must also be consulted regarding corporate measures affecting employees. The Plant Council elects one-third of the members of the Company's Supervisory Board.

MATÁV believes that its relations with its employees are good. MATÁV has not experienced any labor strikes or disruptions since its formation.

Pensions and Benefit Programs. *MATÁV provides employees with discounted telephone services, subsidized meals, commuting expenses, discount holiday facilities and other in-kind benefits. In addition to its statutory contributions to governmental health, retirement and unemployment schemes, MATÁV contributes to the employees' voluntary pension fund and supplementary benefits fund, which provides private pension and health insurance benefits supplementing government pension and health benefits. The Company does not, however, guarantee payment by the benefits fund to its members. In 1999, approximately 90 percent of all employees participated in the pension plan and self-help plans. MATÁV established a health fund in 1998 that had a membership of 8,737 at the end of 1999.*

Share Transfer to Employees of the Company. *In March 1996, the ÁPV, one of the Company's principal shareholders at that time, instituted an employee stock transfer plan for the benefit of MATÁV's employees. Under the plan, the ÁPV sold 27,883,300 shares to an entity set up for the purpose of creating the plan (the "MRP"), which in turn sells the shares it acquires to participating employees. Employees of MATÁV Rt. who had been employed for one year were eligible to participate. A total of*

24,397,000 shares were allocated and sold to participants in first subscription period which ended in September 1996. In the first six months of 1997, an additional 2,502,200 shares were allocated and sold to participants. No further undistributed shares were allocated during any subsequent period.

A fixed purchase price of HUF 118.05 per share was paid by participants on an installment basis, and all installments had been paid by December 31, 1999. Participants may withdraw their shares any time from the MRP and are free to dispose of them.

From June 29, 1998 to July 1, 1998, MATÁV Rt. issued 7 million convertible bearer bonds, known as the "Management Incentive Program Bond" each with a face value of HUF 1. The holder of a bond may convert it into one newly issued MATÁV A series registered common share with a face value of HUF 100, in accordance with the allocation and conversion rules. On July 1, 1998, 4.2 million bonds were allocated to management.

The Bonds may be converted into newly issued MATÁV A series registered common stock over a three year period with one third vesting each year beginning July 1, 1999. Bonds can not be converted after the end of the bond's term. No bonds have been converted as of December 31, 1999. By December 31, 1999, 402 thousand bonds had been forfeited by management.

The conversion price of the Bonds is the Hungarian Forint equivalent of U.S.\$5.75 per bond, calculated based on the middle U.S.\$/HUF exchange rate quoted by the Hungarian Central Bank on the day of conversion, less the face value of the Bond, but not less than the initial public offering price of HUF 730 per share.

Compensation cost is not recognized in these financial statements for the fair value or the intrinsic value of the bonds granted.

REGULATION AND PRICING

Overview

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

Telecommunications Act

Pursuant to the Telecommunications Act, national telecommunications policy is developed by the Hungarian government and approved by the Hungarian parliament. The Minister is responsible for, among other things:

- *supervising the telecommunications sector;*
- *drafting national telecommunications policy proposals and procedures;*
- *coordinating state activities relating to telecommunications;*
- *designating primary service areas;*
- *awarding concessions; and*
- *setting, in agreement with the Minister of Finance, tariffs for concessionary services.*

The Telecommunications Act sets forth that the following services can be provided only by a concession company or by an enterprise formed for this purpose by, or with the majority participation of, the Hungarian state:

- *public fixed line voice telephone network services;*
- *public mobile telephone services;*
- *nationwide public paging services; and*
- *national and regional television and radio broadcasts.*

The Ministry has discretion to determine the number, scope and exclusivity of concessions granted.

Other public telecommunications services and activities do not require a concession, but are subject to various licensing and frequency assignment requirements designed to ensure operational security, undisturbed cooperation between networks and data protection. These liberalized services include:

- *certain satellite services;*
- *public switched data transmission services;*
- *leased line services;*
- *value added services; and*
- *the establishment and operation of special purpose or closed user group networks.*

Under the Telecommunications Act, a concession holder may engage in activities functionally related to its concession. In addition, the Concessions Act requires that the concession holder be dissolved upon termination of its concession. Notwithstanding this requirement, MATÁV believes that if its concession rights were terminated, arrangements could be made to enable MATÁV to engage in non-concessionary activities.

At the national and regional level, the Budapesti Hírközlési Felügyelet (the "Budapest Telecommunications Inspectorate") and, at the local level, regional telecommunications authorities ("Regional Inspectorates" and, together with the Budapest Telecommunications Inspectorate, the "Inspectorates") are responsible for licensing. The activities of the Inspectorates are supervised by the Telecommunications General Inspectorate, a central budgetary organization established in 1993 under the control of the Ministry. The Inspectorates supervise the telecommunications service providers, issue required

telecommunications service licenses and interconnection permits and monitor compliance with licenses and permits. In addition, the Budapest Telecommunications Inspectorate is responsible for allocating frequencies and frequency bands.

The Hungarian government has also established the National Telecommunications and Informatics Council, which advises it on managing frequency use and on the telecommunications and information services sectors.

Fixed Line Concession Contracts

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

MagyarCom then assigned certain of its rights to MATÁV. On December 22, 1993, MATÁV entered into a concession contract (the "Concession Contract") with the Minister. The Concession Contract gives MATÁV the exclusive right to provide domestic long distance and international public fixed line voice telephony services throughout Hungary and local public fixed line voice telephony services in 29 Local Primary Areas for a term of eight years ending December 22, 2001. The concession has a total duration of 25 years and may be further extended by agreement with the Minister for another 12 and one-half years.

In September 1993, the Minister issued a second competitive tender for the exclusive right to provide local public fixed line voice telephony services in the remaining 25 of the 54 Local Primary Areas. MATÁV obtained the right to provide services directly in seven of those areas by being the successful bidder in respect of five areas, and the default provider in two areas where there was no successful bidder. MATÁV also obtained the right to provide services indirectly in an additional three areas through joint ventures. With respect to the five areas where it was the successful bidder, MATÁV's rights are governed by separate concession contracts. Rights to service the remaining 15 areas were distributed among 12 local telephone operators ("LTOs").

The Minister agreed in the Concession Contract that until December 22, 2001, it will use its best efforts to prevent changes in the decrees relating to interconnection, tariffs or other telecommunications matters which would have a material adverse impact on MATÁV.

MATÁV must pay concession fees with respect to its national concession and each of its local concessions equal to 0.1 percent of its total annual gross revenues generated and received from public telephone services. In its Debrecen Local Primary Area, MATÁV must pay 3.3 percent, in its Szentendre Local Primary Area 2.0 percent and in its Székesfehérvár Local Primary Area 4.0 percent.

Service Provision Requirements. The Telecommunications Act generally requires each public telephone service provider, including MATÁV, to enter into subscriber contracts and provide connections to the public network to all subscribers within its Local Primary Area. If the service provider does not connect a subscriber within the required period, it must pay to the subscriber liquidated damages equal to one third of the monthly subscriber's fee for each day of the delay. MATÁV paid HUF 373 million in 1997, HUF 70 million in 1998 and HUF 46 million in 1999 in respect of these penalties. The rights and obligations of the public telephone service providers and the subscribers are regulated under the Government Decree 243/1997 (XII.20) on the Telecommunication Subscriber Contracts, which came into force on January 1, 1998.

Under the fixed line concession contracts, in each of its Local Primary Areas, MATÁV must also meet requests of subscribers for public telephone services within certain time limits. The Company must meet 90 percent of the requests of subscribers within six months, and 98 percent within 12 months. In 1999, MATÁV met these requirements in all of its Local Primary Areas.

Minimum Service Requirements. MATÁV also must provide the following minimum services in its Local Primary Areas during its eight-year exclusivity periods:

- access to local public emergency services free of charge with a uniform national telephone number;

- *printed directories for each Local Primary Area;*
- *directory information service at a reasonable charge approved by the Minister; and*
- *directory information to other foreign or domestic operators of telecommunications networks and to other companies publishing directories at a reasonable charge.*

The Company understands that the Minister is considering implementing some form of "universal service" obligation, which might include a defined minimum service to be provided to all users at an affordable price. Under comparable regulations in the European Union, the universal service obligation includes the provision of voice telephone service via a fixed connection, which also allows for the operation of a fax and modem, operator assistance, emergency and directory inquiry services and public telephones.

Development Targets. In the four Local Primary Areas covered by separate concession contracts, annual development targets were established for fixed access lines with penalties including fines and a possible reduction in the term of MATÁV's exclusivity period if targets were not met. These annual development targets required MATÁV, subject to there having been sufficient demand, to increase the number of installed access lines by 15.5 percent per year through 1999. MATÁV satisfied or exceeded these annual development targets.

Service Quality Requirements. The fixed line concession contracts also establish annual quality of service targets through the year 2002 based upon percentage of call completions, dial tone delays, customer service call response times and number of billing complaints. MATÁV did not meet all of its quality of service targets in 1997 and incurred penalties of HUF 80.3 million. In 1998 and 1999, MATÁV met all of its quality of service requirements.

The Company has always agreed with the Ministry on the penalties charged for the failure to meet quality of service targets. In addition, the targets originally established in the fixed line concession contracts have been adjusted twice, on an agreed basis, to more closely reflect international and European standards.

The Company may not meet its annual development targets and quality of service targets in the future. Measures that could be taken against the Company in the future as a result of failing to meet these targets may have a material adverse impact on the Company's business, financial condition or results of operations.

Cross-subsidy Prohibition. MATÁV may not subsidize its non-concessionary telecommunications services or the sale of telecommunications and computer equipment with revenues from its concessionary telephone services. The Company must also maintain separate accounts for expenses and revenues associated with the provision of concessionary telephone services.

Domestic Goods and Services. The fixed line concession contracts require MATÁV to use specified percentages of Hungarian goods and services in providing concessionary telephone services. MATÁV is currently satisfying these requirements.

Provider of Last Resort. If the Minister terminates a local concession or an LTO ceases to provide telephone service in any Local Primary Area, within 30 days following notice from the Minister, MATÁV must provide such service on reasonable agreed terms and conditions, including reasonable funding by the Ministry, until a new concession is awarded to MATÁV or another service provider.

Non-concessionary Services. Under the Telecommunications Act and the Concession Contract, MATÁV may provide telecommunications services not requiring a concession, including leased line services and value added services. These activities are not subject to concession fees.

Modification and Termination of Concessions. Under the Telecommunications Act, the Minister may periodically review the provisions of the fixed line concession contracts in the interest of national defense, public security, consumer interest, economic development and the fulfillment of Hungary's international agreements. The Minister's conclusions must be supported by evidence and, subject to a reconciliation procedure, the Minister may unilaterally modify such provisions. In such event, MATÁV may be entitled to compensation. The Minister has not exercised his authority to modify unilaterally any provisions of the fixed line concession contracts.

The fixed line concession contracts may be terminated at any time with the consent of both the Minister and MATÁV. Following notice and a hearing, the Minister may unilaterally terminate any or all rights granted under a concession contract, in its entirety or with respect to a specified service or geographic area, if:

- MATÁV repeatedly and willfully violates material provisions of the concession contract, and, after having received notice of such violations from the Minister, refuses to take the appropriate steps to correct such violations in a timely manner;*
- MATÁV unreasonably fails to allow authorized telecommunications service providers to interconnect with its public telephone network, or MATÁV fails, after having received notice thereof from the Minister, to pay fees and penalties provided for in a concession contract; or*
- liquidation or bankruptcy proceedings are instituted against MATÁV, or MATÁV makes a general assignment for the benefit of its creditors.*

Upon termination of the Concession Contract, MATÁV must be dissolved pursuant to the Concession Act. Pursuant to the Company's amended Articles of Association, upon dissolution of the Company without a successor, the Hungarian state as the holder of the Series "B" Share has the right to purchase all or any part of the assets of the Company, including shares of subsidiaries or affiliates, for a price equal to the appraised value of the assets as determined by an independent appraiser or the auditor of the Company. See "Control of Registrant."

The Minister has begun negotiations with MATÁV and the LTOs regarding the possible early introduction of liberalization in the market for public fixed line voice telephony services. The negotiations could result in MATÁV's exclusive rights to provide its concessionary services expiring before December 2001 or, in the case of five Local Primary Areas, May 2002.

Change of Control. Under the Concession Contract, the Minister must give consent to any transfer which would result in a person or persons acting in concert acquiring more than 10 percent of MATÁV's outstanding shares over a two-year period. The Minister's consent may not be withheld if the proposed transferee is a financially, legally and professionally sound strategic or financial investor that is well regarded and deemed to be prominent in its particular field by the international marketplace. In other cases, the Minister must consider the documents and information presented to him and may not unreasonably withhold his consent.

The prior consent of the Minister is not required in certain cases, including transfers to underwriters in offerings and changes of control confined to Deutsche Telekom, SBC and their affiliates.

Mobile Concession Contracts

Hungary was the first country in Central and Eastern Europe to introduce public mobile telecommunications services. In 1993, the Minister awarded two concessions to provide nationwide cellular telephone services using the digital GSM 900 standard: one to Westel 900 and the other to Pannon GSM Rt. Westel 450 began providing analog mobile radio telephone service in October 1990 with an exclusive license, and in 1994 entered into an exclusive concession contract with the Minister.

Westel 900

Under the concession contract, dated November 4, 1993, as amended (the "900 Concession Contract"), between the Minister and Westel 900, Westel 900 has the right for 15 years from that date to provide public GSM mobile telephony services. Westel 900 is authorized to provide GSM service in the 906 to 914 and 951 to 959 MHz frequency ranges in Hungary. The parties may agree to extend the Westel 900 concession for a period of seven and one-half years.

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

Vodafone brand name. The shareholders of V.R.A.M. Rt. include Vodafone Airtouch Plc (50.1 percent), RWE Telliance AG (19.9 percent), Antenna Hungária (20 percent), and Magyar Posta (10 percent). Both Westel 900 and Pannon GSM are obliged to provide national roaming services to Vodafone customers until 2002.

By 2003 the three digital carriers will have the same spectrum resources allocated to them both on the 900 and the 1800 MHz band. The Minister has agreed not to issue a new tender or otherwise license a new carrier for such services on these bands within the time frame of the licence agreement.

Westel 900 has to pay HUF 11 billion concession fee adjusted to the movement of the HUF/U.S.\$ exchange rate. The first installment of the concession fee, HUF 2,750 million was paid eight days after the modification of the concession agreement (November 1999). The second installment of HUF 2,750 million plus exchange difference is due eight days after the commencement of 1800 MHz service (expected in November 2000). The remaining HUF 5,500 million plus exchange difference due in connection with the concession fee is expected to be paid proportionally (1/9th of the remaining fee will be paid on every additional 1 MHz of spectrum received). Westel 900 will also pay annual installments of USD 1 million after the commencement of the 1800 MHz service (expected from November 2000).

Required Fees. In accordance with the Concession Agreement, the frequency fee payable to the Ministry consists of two parts: a frequency reservation fee and a frequency usage fee. Westel 900 must pay the Hungarian government a frequency reservation fee of HUF 256 million per year for the nationwide reservation of one 8 MHz duplex frequency band (40 GSM duplex radio channel). This fee decreases in proportion to the percentage of the nationwide coverage of the service. Westel 900 must also pay a frequency usage fee of HUF 200,000 per year for each GSM duplex channel and base station with a radio license.

Tariffs. Commencing January 1, 1998, Westel 900's subscriber charges ceased to be regulated under the Pricing Act or ministerial decree and consequently ceased to be subject to the price cap regime which earlier applied.

Roaming Agreements. Westel 900 may sign roaming agreements with other public mobile telecommunications service providers outside of Hungary in accordance with the provisions of the Telecommunications Act and the GSM Association, which deals with the digital mobile cellular telecommunications system.

Interconnection. Westel 900 may use fixed links and equipment jointly with other providers if this does not reduce or inhibit competition. If Westel 900 receives a request for interconnection from another public telephony service provider, it is obliged to enter into an interconnection contract as provided by Section 7 of the Telecommunications Act. For as long as MATÁV has the exclusive right to provide domestic and international long distance telephony services, Westel 900 is required to use lines leased from MATÁV to connect with the fixed line network. Westel 900 is required to use MATÁV's international gateway for mobile international calls.

Domestic Goods and Services. Westel 900 must use specified percentages of Hungarian goods and services. Westel 900 currently satisfies these requirements.

Non-concessionary Services. Westel 900 is entitled to pursue the following non-concessionary activities without obtaining any further license:

- other telecommunications services;*
- trade, repair and maintenance related to media and computer technology;*
- computer applications services;*
- measurement and security technology services;*
- general technical development services;*
- telecommunications research and development;*
- organization, development and general construction activity related to investment programs and building maintenance;
and*
- telecommunications and other training courses.*

Westel 900 may not sell mobile subscriber equipment that is manufactured by a company in which Westel 900 has an interest.

Termination. The Minister notified Westel 900 that for each of 1997, 1998 and 1999 it had met its concession obligations. If an event of default occurs under the 900 Concession Contract, the Minister may issue a cure notice to Westel 900. Westel 900 would then have 90 days to agree with the Minister on a plan of action for curing the default. If Westel 900 does not reach an agreement with the Minister or if Westel 900 does not cure the default within an agreed period of between three to six months, the Minister may issue a notice terminating the 900 Concession Contract. Upon termination of the 900 Concession Contract, Westel 900 would be dissolved under the Concessions Act.

Westel 450

Pursuant to the concession contract, dated June 24, 1994 (the "450 Concession Contract"), between the Minister and Westel 450, Westel 450 has the right for 15 years from October 15, 1990 to provide public NMT 450 mobile telephony services in the 450 to 470 MHz frequency range in Hungary. The parties may agree to extend the Westel 450 concession for a period of seven and one-half years.

Required Fees. Westel 450 currently pays frequency reservation fees to the Telecommunications General Inspectorate of HUF 7.4 million per year for the 3.66 MHz duplex frequency range and HUF 20,000 per year for each 20 KHz duplex radio channel and base station with a radio license.

Tariffs. Commencing January 1, 1998, Westel 450's subscriber charges ceased to be regulated under the Pricing Act or ministerial decree and consequently ceased to be subject to the price cap regime which earlier applied.

Interconnection. Westel 450 may use fixed links and equipment jointly with other providers if this does not reduce or inhibit competition. If Westel 450 receives a request for interconnection from another public purpose telephony service provider, it is obliged to enter into an interconnection contract as provided by Section 7 of the Telecommunications Act. For as long as MATÁV has the exclusive right to provide domestic and international long distance telephony services, Westel 450 is required to use lines leased from MATÁV to connect with the fixed line network. Westel 450 is required to use MATÁV's international gateway for mobile international calls.

Domestic Goods and Services. Westel 450 must use specified percentages of Hungarian goods and services. Westel 450 is currently satisfying these requirements.

Non-concessionary Services. Westel 450 is entitled to pursue the following non-concessionary activities without obtaining any further license:

- other telecommunications services;*
- trade, repair and maintenance related to media and computer technology;*
- computer applications services;*
- measurement and security technology services;*
- general technical development services;*
- telecommunications research and development;*
- organization, development and general construction activity related to investment programs and building maintenance; and*
- telecommunications and other training courses.*

Westel 450 may not sell mobile subscriber equipment that is manufactured by a company in which Westel 450 has an interest.

Termination. The Minister may terminate all or part of the 450 Concession Contract, if Westel 450 does not fulfill its obligations under the contract. The Minister is also entitled to terminate the 450 Concession Contract in the case of intentional and repeated violations of the contract. Termination could result from, among other things, Westel 450's failure to meet quality requirements or to pay fees, or its refusal to satisfy an interconnection request of a telecommunications service provider. In addition, the Minister may terminate the contract if liquidation proceedings are instituted against Westel 450 or if Westel 450's inability to satisfy the claims of its creditors adversely affects its ability to fulfill its concession obligations. Upon termination of the 450 Concession Contract, Westel 450 would be dissolved under the Concessions Act. The Minister notified Westel 450 that for each of 1997, 1998 and 1999 it had met its concession obligations.

Interconnection

The Telecommunications Act requires public telephone service providers to provide interconnection to other public telecommunications networks and requires as a prerequisite to any interconnection a written network contract.

As a result of amendment of the Telecommunications Act, since July 28, 1999 network contracts can be concluded not only for interconnection of networks but also a public telecommunications service provider may allow use of its telecommunications network by a third party with the aim of providing services.

The Telecommunications Act further requires service providers, including MATÁV, to meet technical and operating standards and regulations and to cooperate to permit unified network operation through interconnection.

The Minister may issue decrees regarding signalling, traffic routing, synchronization, numbering and points of interconnection. Government Decree 158/1993 (XI.11) on the Interconnection of Telephone Networks, the Licensing of their Cooperation and Network Contracts (the "Interconnection Decree") sets forth the rules and procedures for interconnection of public networks and special purpose telecommunications networks for closed user groups. The Interconnection Decree prohibits a public telephone network from interconnecting with a network that is not covered by either a concession or a service license.

Connection of a special purpose network to a public network or another special purpose network requires an additional interconnection license issued by the Budapest Telecommunications Inspectorate. The license for connection to a public network may be granted subject to conditions ensuring, among other things, that the special purpose network is not used to provide services to third parties. With limited exceptions, operators of special purpose networks are permitted to interconnect for services other than public switched voice if they have an interconnection license issued by the Budapest Telecommunications Inspectorate or when such operators are affiliated.

In the case of network contracts related to the provision of local public telephone services, the deadline for signing the network contract is three months, and the deadline for the interconnection is six months, from the date interconnection was requested. In other cases, the deadline for signing the network contract is six months and for interconnection is one year. If the parties do not enter into a network contract before the deadline, the competent Regional Inspectorate, at the request of the entity seeking interconnection, will establish the terms of interconnection.

On the basis of the network contract, the user must pay the network provider a one-time connection fee, a monthly subscription fee, a usage fee and, if applicable, fees for leased lines. In the case of MATÁV and the Westel companies, these fees are determined pursuant to tariff decrees issued by the Minister in agreement with the Minister of Finance and in accordance with the Pricing Act. Under the Concession Contract, MATÁV must generally bear the costs of physical interconnection.

Telecommunications Service Licensing Requirements

According to the Telecommunications Act, the provision of certain telecommunications services that do not require a concession is subject to service licenses, which are granted by the Inspectorates. Pursuant to Government Decree 48/1997 (III.14) on the Licensing of Certain Telecommunications Services, a service license granted by the Budapest Telecommunications Inspectorate, in the case of nationwide and regional services, or a Regional Inspectorate, in the case of local services, is required for most liberalized telecommunications services. Certain additional non-public services may be provided subject to compliance with reporting requirements.

A service license may be issued following submission to the relevant Inspectorate of an application setting forth, among other things, the proposed service and the terms on which it will be offered and the applicant's legal and technical qualifications. A service license may be issued for a term of ten years and may be extended, upon request, for successive additional terms of five years each. Entities such as MATÁV, which hold a concession for public telecommunications services, may provide the services listed in the service license decree, other than cable broadcasting, subject to compliance with reporting requirements 30 days prior to the commencement of service. Service licenses may not be transferred or assigned, except in the event of a legal succession.

Licensing and Allocation of Frequencies

The Minister sets fees for frequency use by decree in agreement with the Minister of Finance. Act LXII of 1993 on Frequency Management (the "Frequency Act") sets forth additional licensing procedures for the allocation of frequencies, and Act I of 1996 on Radio and Television Broadcasting (the "Media Act") governs the broadcasting industry generally. The Frequency Act, which came into force on July 1, 1993, regulates the rights and obligations of the users of frequencies, the management of frequencies and interference protection.

Frequency assignments must conform with the National Frequency Range Distribution Chart, which lays out the entire spectrum and the purpose and availability of frequency bands. MATÁV's frequencies are generally valid for periods of one to five years. The frequency assignments for the radio local loop system are valid through November 2003. However, MATÁV, removed its radio local loop system from Budapest during 1999. See "Infrastructure and Technology — Expansion of Access Networks."

If a telecommunications service provider wishes to provide services that require a frequency assignment and appropriate frequencies are available, the Telecommunications General Inspectorate must hold a public auction or drawing. A public auction is held if the number of available frequencies is not sufficient to satisfy all requests. A drawing is held if the number of available frequencies is sufficient to satisfy requests but the frequencies have differing qualitative characteristics.

Rights of Way

Under the Telecommunications Act, public telecommunications service providers are entitled to use the waterways, canals, natural lakes, beds of natural lakes and airspace of Hungary and, upon prior notification of the owner, to install telecommunications equipment on private property and to enter private property where telecommunications equipment is located for maintenance and fault elimination purposes. Further rights of use may be established on antennas and in utility tunnels. The public telecommunications service provider must enter into a contract with the property owner setting forth the conditions for the common use of the property. Owners of real property are also obliged to remove obstructions to public telecommunications networks. Owners of real property may claim compensation for the nuisance suffered as a result of entry onto their property.

Upon request, the competent Inspectorates may establish easements in favor of a public telecommunications service provider on real property for the purposes of placing telecommunications equipment, telephone lines and antennas. MATÁV is seeking easements over a substantial number of real properties on which such equipment has been installed by it or its predecessors. The Inspectorates must certify in writing that, for technical reasons, there is no other alternative for placing such devices. If the placement of telecommunications equipment prevents or materially hinders use of real property, the owner may request the purchase or expropriation of the property after seeking an opinion from the Inspectorate.

Competition Law Restrictions

The Concession Contract prohibits MATÁV from using any dominant position in the market for public voice telephone services to gain an unfair or anticompetitive advantage in the provision of services or products.

Under the Competition Act, a market participant is considered to be in a dominant position if, among other things, it may 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.

The Concession Contract specifically prohibits several practices. MATÁV may not unjustly or unreasonably discriminate between, or extend unjust or unreasonable preferences to, similarly situated licensed operators or subscribers, including its affiliates. The rates and terms pursuant to which MATÁV uses the public telephone network for providing its own services must be the same as those which it offers to other providers. MATÁV may supply terminal equipment to customers, but may not make the purchase or lease of such equipment a condition to obtaining any public telephone service or include the charge or fee for such equipment as part of the rates, fees or charges for any public telephone service.

The Competition Act generally prohibits abuse of a dominant position, including, among other things:

- *establishing purchase or sale prices unfairly in business relations, including the application of general contractual conditions, obtaining unjustified advantages in any manner or forcing another party to accept disadvantageous terms;*
- *restricting production, distribution or technical development to the detriment of the consumer;*
- *refusing without any justification to establish or maintain appropriate business relations;*
- *establishing prices at a level much lower than those of its competitors to force competitors out of or to prevent them from entering a market;*
- *hindering competitors from entering a market in any other unjustified manner; or*
- *creating an unduly disadvantageous market situation for competitors.*

EU Association Agreement and European Directives

In December 1991, Hungary signed an association agreement (the "Association Agreement") with the members of the European Union. The Association Agreement was enacted into law in Hungary on January 4, 1994, and in April of that year Hungary applied for full membership in the European Union. On July 17, 1997, the European Commission recommended that Hungary be named as one of six countries then invited to begin negotiations for membership.

The Association Agreement provides for the harmonization of Hungarian legislation, including telecommunications and other legislation, with that of European Union member states. Hungary and the members of the European Union have agreed to:

- *exchange information regarding telecommunications policy statements, and technical and other information;*
- *organize seminars, workshops and conferences;*
- *provide training and advisory services;*
- *transfer technologies;*
- *carry out mutual projects;*

- promulgate European standards, certificate systems and regulations; and
- advance new communication methods, services and equipment.

European institutions have enacted numerous directives providing for an open and seamless telecommunications market within and among EU member states through liberalization and harmonization of member states' laws.

The seminal liberalization directive was adopted on June 28, 1990. It provided for the progressive liberalization of telecommunications services other than voice telephony, mobile telecommunications, telex and satellite communications. Other directives were thereafter adopted to liberalize satellite telecommunications services other than public fixed line voice services in October 1994, services provided over cable television networks in October 1995 and mobile services in January 1996. To complete the liberalization process, a March 13, 1996 directive (1) requires the full liberalization, as of July 1, 1996, of the use of alternative infrastructures, such as telecommunications infrastructures of railways, for the provision of all telecommunications services other than voice telephony and (2) provides for complete liberalization of voice telephony and the provision of public telecommunications infrastructure as of January 1, 1998. The European institutions have also adopted or is considering a number of directives relating to harmonization of national licensing laws, technical interfaces and tariff principles.

Management expects that as Hungary moves closer to EU membership the Hungarian parliament will enact additional legislation with a view to bringing Hungary's regulatory regime into compliance with European directives. As in the case of other EU member states, Hungary may benefit from certain transitional arrangements for a period after obtaining EU membership.

World Trade Organization Telecommunications Agreement

In February 1997, 69 governments, including Hungary, made multilateral commitments as part of the World Trade Organization Telecommunications Agreement to liberalize the market for basic and certain other telecommunications services. The 69 signatories were required to ratify the accord by November 30, 1997. Hungary ratified the agreement, which took effect January 1, 1998, with a reservation postponing liberalization of the telecommunications market in Hungary.

Hungary's commitment under the World Trade Organization Telecommunications Agreement includes liberalization of data, telex/telegraph, fax, leased circuits, satellite services, and public voice services by January 1, 2003 for international and domestic long distance calls and by January 1, 2004 for local calls. Public land mobile services may be limited to one operator for NMT 450 MHz and two operators for GSM until January 1, 2004. In spite of this agreement, Hungary admitted a third GSM operator, Vodafone, into the market in 1999.

Broadcasting and Transmission

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

National and regional television and radio broadcasting or broadcast "distribution" to local operators generally require concessions under the Telecommunications Act and may be carried out on the basis of a program distribution contract in accordance with the Media Act between the NRTB and the distributor. Frequencies are assigned under the terms of the Frequency Act. Entities registered as program distributors are permitted to transmit the broadcasts of third parties to subscribers through a cable transmission network.

MATÁV may not directly obtain any broadcast rights until December 31, 2002. The Media Act restricts MATÁV's further expansion in the program distribution sector. Under the Media Act, a party holding a controlling share in a program distributor, including a cable television company, may not acquire a controlling share in another program distributor. The Media Act defines a "controlling interest" in any entity to include a more than 25 percent economic or voting interest in the entity or

contractual or other arrangements giving the holder a controlling influence over the entity. See "Legal Proceedings — Other."

In its 1999 amendments to the Telecommunications Act, the Hungarian Parliament approved restrictions on infrastructure relating to program distribution. As a result MATÁV Rt. and its subsidiary MATÁVkábelTV Kft., which was founded with the aim of providing program distribution services, could not establish, lease or acquire disposal rights over any cable network suitable for program distribution parallel to MATÁV Rt.'s public telecommunications network, except in settlements with populations below 30,000. One of the leading insurance companies in Hungary, Hungária Biztosító Rt. has subsequently purchased 25 percent of shares and 75 percent of voting rights in MATÁVkábelTV Kft., which may continue to engage in program distribution.

Pricing

Regulatory Framework

In accordance with the Pricing Act, the Minister, acting in agreement with the Minister of Finance, is responsible for setting maximum tariffs for concessionary telephony services, interconnection tariffs and tariffs for leased lines used for concessionary telephony services. Tariff regulation in Hungary is based on the price-cap method.

Fixed Line Tariffs. In 1998, MATÁV Rt.'s fixed line tariffs were regulated by Decree 31/1997 (XII.20) on charges for public telephone services (the "1998 Fixed Line Tariff Decree"). The 1998 Fixed Line Tariff Decree was amended by Decree 31/1998 (XII.23) KHVM (the "1999 Fixed Line Tariff Decree"), which was subsequently amended by Decree 1/2000 (I.18) KHVM (the "2000 Fixed Line Tariff Decree"). The 2000 Fixed Line Tariff Decree establishes new public fixed line telephone service charges to be applied from February 1, 2000.

Entrance Fees. One-time entrance fees are regulated by Decree 11/1995 (VII.12) KHVM on the One-Time Access Fee Payable for Establishment of Public Telephone Service Access Points (the "Connection Fee Decree"). The Connection Fee Decree was amended by Decree 19/1997 (X.11) KHVM (the "Entrance Fee Decree").

Interconnection Fees. Interconnection fees are regulated by Decree 1/1998 (I.12) on sharing revenues related to concession telecommunications services, tariffs of leased line services used for providing concessionary telecommunications services and tariff accounting (the "1998 Interconnection Decree"), as amended by Decree 6/1999 (II.19) KHVM issued in February 1999 (the "1999 Interconnection Decree"). This decree was subsequently amended by Decree 8/2000 (III.29) KHVM (the "2000 Interconnection Decree").

Fixed Line Tariffs

Tariffs for fixed line telephony services consist of a one-time entrance fee, monthly subscription fees and usage charges.

Entrance Fees

Entrance fees are based upon costs of installation and the general development of MATÁV's network. Prior to October 15, 1997, regulations provided for limited refund rights if a subscriber terminated its contract. MATÁV recorded a reserve for refunds based on the historical level of requests, although the level of refunds requested were not significant.

As of October 15, 1997, the Entrance Fee Decree eliminated the refund rights of a subscriber for a new connection to the fixed line network and allowed MATÁV to recognize the full entrance fee as revenue upon connection. The Entrance Fee Decree gives service providers the right to collect an additional fee for providing connections in rural areas, if the entrance fee does not cover the direct costs of the service provider. Entrance fees as well as subscription charges, but not usage charges, are differentiated by customer type: business and residential. MATÁV may provide discounts from the published charges, but may not exceed any published charge.

Subscription Fees and Usage Charges

Fixed line subscription fees and usage charges are regulated under an aggregate price cap. In 1999, the aggregate price cap was set by reference to the September to September consumer price index and was then adjusted to permit rebalancing to gradually reduce the subsidy to fixed line subscription fees and local usage charges from long distance and international charges. In 1999, the aggregate price cap was 10.5 percent.

In 2000, the aggregate price cap is set by reference to the forward-looking consumer price index as forecasted by the Government in the Budget Act for 2000. After taking into account a two percent productivity factor to which MATÁV Rt. is subject, MATÁV Rt.'s aggregate price cap for tariff increases in 2000 under the principles set forth in the 2000 Fixed Line Tariff Decree is four percent. At the same time the 2000 Fixed Line Tariff Decree limits the residential consumer telephony price index - measured by the Central Statistical Office - to be six percent, equal to the forecasted forward-looking consumer price index. Should the real October to October consumer price index exceed the Government forecast (six percent) by at least 2 percent, the aggregate price cap for 2001 can be increased by two-thirds of the difference as compensation. Should the real August

residential consumer telephony price index exceed the permitted level (six percent), the tariffs have to be decreased in order to fulfill the price index requirement.

The following table sets forth changes in public fixed line subscription fees and usage charges for 2000 as established under the 2000 Fixed Line Tariff Decree.

<u>Basket</u>	<u>Percentage Change</u>
Subscription fees	49.88%
.....	
Local and Zone 1 and Zone 2 (Budapest metropolitan area) charges	(12.27%)
.....	
Zone 3 and international charges	(10.55%)
.....	

Although MATÁV Rt. fixes local and national usage charges separately for each of three time periods, it does not differentiate international charges by time of day. Domestic and international long distance charges are uniform throughout the country. The 1999 Fixed Line Tariff Decree also introduced time-based billing. Under this system, the usage charge is composed of a call set-up and a second-based usage charge. In 1999, the call set-up charge was HUF 6.60 per call (in 2000, it is HUF 6.00 per call), exclusive of VAT, and is independent of the tariff zone or time period of the call.

Fixed Interconnection Fees

Fees for national and international calls are shared by the service providers involved through interconnection fees based on usage. MATÁV Rt., as the exclusive provider of national and international long distance services, pays an interconnection fee to other service providers for origination and/or termination of a call.

Under the 1999 Interconnection Decree, local service providers were entitled to retain an average of HUF 7.50/minute for the termination and HUF 7.50/minute plus HUF 8.78/minute as auxiliary fee for the origination of all domestic long distance and international calls. In 2000, a local service provider is entitled to the following interconnection fees if the call is originated in its area:

	<u>peak</u>	<u>discounted</u> (HUF/minute)	<u>night</u>
National long distance	15.95	6.90	5.30
International	36.00	36.00	36.00

In 2000, a local service provider is entitled to the following interconnection fees if the call is terminated in its area:

	<u>peak</u>	<u>discounted</u> (HUF/minute)	<u>night</u>
National long distance	8.50	5.50	5.50
International	18.00	18.00	18.00

In the case of calls within the Zone 2 Budapest metropolitan area, a different interconnection regime applies both in 1999 and 2000. MATÁV Rt., as the exclusive provider of long distance services, is entitled to receive 20 percent of the average of the Zone 1 fees. The terminating local operator, including MATÁV Rt. where it is the local service provider, is entitled to receive 50 percent of the difference between the average of the Zone 2 fees and 20 percent of the average of the Zone 1 fees.

Under the 2000 Interconnection Decree, MATÁV Rt. must pay HUF 8.16/call to the local service provider for any calls made to MATÁV Rt.'s domestic or international directory assistance.

Leased Line Fees

Tariffs for leased lines required for concessionary activities are subject to the Pricing Act under the price cap regime and are regulated by ministerial decrees. All other leased line tariffs are unregulated. The regulation is uniform for MATÁV and the LTOs. The public telephony service provider can charge a one-time connection fee and a monthly rental fee. These fees may be raised each year by a maximum amount currently calculated by multiplying the existing fees by the increase in the forward-looking consumer price index (in 2000 by six percent).

Mobile Tariffs

Local Mobile Interconnection Fee in 1999 and 2000

In 1999, in the case of a mobile call originating or terminating in a fixed network, the local service provider received a flat interconnect fee of HUF 7.50/minute. In 2000, the local operator receives an interconnect fee of HUF 10.31/minute for originating a mobile call from the fixed network and HUF 4.80/minute for terminating a mobile call in the fixed network.

Long Distance Mobile Interconnection Fee in 1999 and 2000

As the exclusive provider of national long distance services, MATÁV Rt. received a long distance mobile interconnection fee of HUF 3.89/minute in 1999 for forwarding any kind of domestic call initiated or terminated in the network of a mobile service provider. In 2000, MATÁV Rt. receives a HUF 2.00/minute interconnection fee for transiting national long distance calls originated or terminated by a mobile service provider. MATÁV Rt. receives the same amount for transiting calls both originated and terminated by a mobile service provider.

International Mobile Interconnection Fee in 1999 and 2000

Under the 1999 Interconnection Decree, for outgoing international calls originated by mobile customers, MATÁV Rt. received its international tariffs less HUF 16.63/minute. MATÁV Rt. paid a fixed fee of HUF 16.63/minute to a mobile operator for terminating international calls in the mobile network. In 2000, MATÁV Rt. is entitled to receive an amount equal to the regular fixed line international tariff minus HUF 16.63/minute for international calls originating from a mobile network. MATÁV Rt. must pay a fixed fee of HUF 18.00/minute to a mobile operator for terminating international calls in the mobile network.

ITEM 2 — DESCRIPTION OF PROPERTY

As of December 31, 1999, MATÁV's property, plant and equipment had a total net book value of HUF 512,700 million.

MATÁV has one of the largest real estate portfolios in Hungary with an aggregate net book value at December 31, 1999 of HUF 68,546 million. The Company uses substantially all of these properties for telecommunications installations, computer installations, research centers, service outlets and offices. MATÁV also rents several properties.

Due to the consolidation of various operations, the conversion to digital switches and ongoing staff reductions, MATÁV anticipates that a substantial portion of its owned and leased properties will not be necessary to its core business in the future. Consequently, the Company reduced its net real estate occupancy costs by terminating all of its real estate lease contracts in 1999. The Company intends to sell or rent its surplus owned properties.

In the fourth quarter of 1999, the operations of MATÁV's total real estate portfolio was outsourced to Trammell Crow-Wallis.

The aggregate net book value of MATÁV's technical equipment and machinery at December 31, 1999 was HUF 371,264 million.

ITEM 3 — LEGAL PROCEEDINGS

Public Procurement

In 1998, MATÁV solicited bids to procure public telephone booths. In so doing, it limited potential bidders to manufacturers selling specific products. A losing bidder brought suit against MATÁV, alleging that it was injured as a result of the limitation MATÁV placed on the group of potential bidders. The Public Procurement Arbitration Committee invalidated the tender and ordered MATÁV to issue a new tender. MATÁV's appeal of the decision to the Metropolitan Court was unsuccessful. Consequently, MATÁV issued a new tender.

Other

MATÁV holds a 25 percent interest in Magyar RTL. A tenderor, IRISZ TV, not awarded a broadcasting contract by the NRTB brought an action against the NRTB, Magyar RTL and MTM SBS Televízió Rt. ("MTM") in the Municipal Court of Budapest alleging that the selection by the NRTB of the winning tenderor did not comply with the applicable tender rules. The Municipal Court rejected the plaintiff's claim. On appeal, the Supreme Court reversed the Municipal Court's decision on the grounds that the NRTB, acting as an administrative authority, had failed to comply with the applicable rules. According to the Supreme Court's decision, the NRTB was obliged to terminate the contract made with Magyar RTL. The NRTB did not terminate the contract and suspended its administrative procedure relating to the termination. Following this suspension, IRISZ brought a suit against the NRTB alleging that the suspension was illegal.

The NRTB filed a claim in the Constitutional Court alleging that the provision of the Media Act requiring it to terminate a civil law contract while acting as an administrative authority was unconstitutional. In addition, the NRTB, Magyar RTL and MTM requested an extraordinary review of the Supreme Court's decision.

In March 2000, IRISZ TV repealed its extraordinary review and withdrew its complaints, which has been accepted by the defendants and the Supreme Court terminated the suit. In the same verdict the Supreme Court overruled the verdicts of the court of first instance and court of appeal. The case is now settled and poses no further threat to the licence of Magyar RTL.

MATÁVkábelTV Kft. acquired a number of cable television networks between June 1999 and February 2000, of which the acquisitions of cable television networks purchased from Local Governments of Tata, Pomáz-Tinnye-Piliscsaba, Solymár, Esztergom and Dunakeszi are subject to the authorization of the Office of Economic Competition Council. MATÁV has initiated procedures to obtain such authorization.

ITEM 4 — CONTROL OF REGISTRANT

Prior to 1990, the Hungarian national postal, telephone and telegraph authority, Magyar Posta, provided all public telephony services in Hungary. As of January 1, 1990, the Hungarian government split Magyar Posta into three distinct entities along the lines of its three main areas of operation: postal services, telecommunications and broadcasting. Magyar Távközlési Vállalat, MATÁV's predecessor, became responsible for telecommunications operations. This entity was transformed on December 31, 1991 into a stock corporation, wholly owned by the ÁPV.

The issued share capital of the Company is HUF 103,728,170,000, consisting of 1,037,281,600 Series "A" ordinary shares and one Series "B" voting preference share. All Series "A" ordinary shares have a nominal value of HUF 100 and the Series "B" Share has a nominal value of HUF 10,000. The holder of the Series "B" Share enjoys certain preferential voting and other rights described below.

MagyarCom purchased a 30.1 percent interest in MATÁV from the ÁPV on December 22, 1993. On December 22, 1995, MagyarCom acquired from the ÁPV an additional 37.2 percent interest for approximately U.S.\$852 million, raising its stake to 67.3 percent. In connection with the Company's initial public offering, both MagyarCom and the ÁPV collectively sold 272,861,367 shares. In June 1999, the ÁPV sold its remaining 5.75% stake in MATÁV during a secondary offering. The total number of shares sold was 60,096,515, out of which MagyarCom sold 581,319 shares in connection with a greenshoe option. Information concerning MATÁV's ownership structure as of December 31, 1999 is set out in the following table:

<u>Shareholder</u>	<u>Number of shares</u>	<u>Percentage of share capital</u>
MagyarCom	617,478,081	59.53%
Publicly traded	419,803,519	40.47%
	1,037,281,600	100.00%
Holder of Series "B" Shares(1)	1	
	1,037,281,601	

(1) Par value of Series "B" Share is HUF 10,000.

See note 23 to the consolidated financial statements for information about certain related-party transactions between the Company and its principal shareholders.

MagyarCom. MagyarCom is owned by SBC and Deutsche Telekom. Deutsche Telekom is Europe's largest telecommunications services provider in terms of revenues, and operates one of the most technologically advanced telecommunications networks in the world.

Except for one director nominated and elected by the holder of the Series "B" Share, MagyarCom has the power to cause the election of the entire Board of Directors at the general meeting of shareholders. MagyarCom therefore controls MATÁV.

SBC and Deutsche Telekom manage and operate MagyarCom jointly. In the event of protracted disagreement, Deutsche Telekom would have the deciding vote, except with regard to certain fundamental matters, including the sale by MagyarCom of any shares. There have not been any disagreements that have caused Deutsche Telekom to cast its deciding vote. Decisions by MagyarCom relating to dividends to be paid by MATÁV require the approval of both SBC and Deutsche Telekom. SBC and Deutsche Telekom have granted each other a right of first refusal over their holdings in MagyarCom and the right to participate on equal terms in any sale of their MagyarCom shares to a third party.

Each of SBC and Deutsche Telekom currently owns 50 percent of MagyarCom stock. Deutsche Telekom has granted SBC an option to put to Deutsche Telekom up to 100 percent of its holdings in MagyarCom at:

- a price per share equal to the public market price of the corresponding MATÁV shares at each time the put is exercised;

plus

- in connection with SBC's initial exercise of its put, a one-time payment of U.S.\$60 million.

The minimum number of MagyarCom shares that SBC may put to Deutsche Telekom in any exercise is the least of:

- 750,000 shares;
- a number of shares sufficient for the aggregate put price to be not less than U.S.\$150 million; and
- the entire remaining amount of SBC's MagyarCom holdings subject to the put, provided that not less than 1,000,000 MagyarCom shares may be put to Deutsche Telekom upon initial exercise.

If the initial exercise of the put is with respect to less than 1,929,782 MagyarCom shares, Deutsche Telekom may require SBC to sell to Deutsche Telekom an additional number of MagyarCom shares up to that amount at the put price. Upon the acquisition by Deutsche Telekom of MagyarCom shares pursuant to the put or the right of first refusal, Deutsche Telekom would have the right to appoint the majority of the directors to MagyarCom's board, and SBC's representation on the MATÁV Executive Committee could be reduced to correspond with the reduction in its ownership interest.

The Company believes that it benefits greatly from the management and technical resources brought to it by SBC and Deutsche Telekom. There is a service agreement in force between MagyarCom Services Kft., a Hungarian company jointly owned by Deutsche Telekom and SBC, and the Company pursuant to which MagyarCom Services provides management and consultancy services to the Company at fees approximating cost. The total fees charged for such services amounted to HUF 2,903 million in 1997, HUF 3,135 million in 1998 and HUF 2,152 million in 1999.

The Hungarian State. The Hungarian state has significant influence over MATÁV's activities as the holder of the Series "B" Share through the Ministry, as the regulator of the Hungarian telecommunications sector and as MATÁV's largest customer. Ownership of the Series "B" Share gives the Hungarian state, through the Minister, certain special rights in the election of one member of each of the Board of Directors and the Supervisory Board and the right to require the Ministry's consent for certain other decisions taken at the general shareholders' meeting. The Hungarian state, acting through the Ministry and various regulatory bodies under its supervision, also exercises regulatory control over MATÁV's telecommunications activities. See "Regulation and Pricing."

Shareholders' Agreement. MATÁV, MagyarCom and the Minister are parties to a shareholders' agreement, dated September 26, 1997 (the "Minister Shareholders' Agreement"). Pursuant to the Minister Shareholders' Agreement, MagyarCom has agreed, among other things, to restrict transfers by it of 10 percent or more of the voting stock of MATÁV to any person or persons acting in concert (except for (i) a new concessionaire, (ii) an internationally recognized underwriter acquiring the shares for the exclusive purpose of distributing such shares in a public offering or (iii) other transferees after the consent of the Minister has been obtained). In particular, the recipient of such a transfer must be a financially, legally and professionally sound strategic or financial investor that is well regarded and deemed to be prominent in its particular field by the international marketplace. In addition, MagyarCom has agreed to procure that any such transferee will undertake to abide by a similar transfer restriction. MagyarCom has also agreed to exercise its rights as a shareholder, insofar as it lawfully may, to ensure that the majority of MATÁV's management level employees and officers continues to be composed of Hungarian citizens. In his capacity as holder of the Series "B" Share, the Minister has agreed to attend all MATÁV shareholder meetings at which his attendance is necessary to constitute a quorum for the transaction of business.

Series "B" Share

The Hungarian state owns the Series B Share. Only the Minister or his legal successor may exercise rights attached to the Series "B" Share. Except as described below, the Series "B" Share has the same rights as the ordinary shares. The holder of the Series "B" Share is entitled:

1. to nominate one member of the Board of Directors and one member of the Supervisory Board and effectively to elect, remove or replace these members;

2. *if the Company's registered capital is increased, a new class of shares is issued or the rights attached to a particular class of shares change, to require the Articles of Association to be amended so that the voting rights of the Series "B" Share will be sufficient to nominate, elect or remove the Series "B" director or Supervisory Board member;*
3. *to inspect the shareholders' register and the books maintained by a depository of the Company's shares approved by the Company, and to request copies of the register or books;*
4. *if the Company dissolves without a successor company, to purchase all or part of the Company's assets, including shares of subsidiaries or affiliates, for a price equal to the appraised fair market value of such assets;*
5. *to request from the Board of Directors detailed information about a material fact significantly affecting the Company's financial position; and*
6. *to request that the Company audit or investigate any issue or prepare reports or provide information on issues within the scope of activities of the Company's auditor or the Supervisory Board pursuant to law or the Articles of Association.*

The holder of the Series "B" Share must be present, in person or by proxy, for a quorum, and its approval is required to pass shareholders' resolutions related to any:

1. *increase and decrease of the Company's registered capital;*
2. *change of rights attached to any class of shares, including any amendment to the rights of the Series "B" Share or the creation of a new class of shares with rights superior or equal to the rights or adversely affecting the rights of the Series "B" Share, or any amendment to the rights attached to any existing class of shares that would grant them rights superior or equal to the rights attached to the Series "B" Share;*
3. *merger into or consolidation with another business entity, de-merger, transformation into another form of business association and termination of the Company without a legal successor;*
4. *transfer, creation or encumbrance of a valuable right that enables the Company to operate its local concessions;*
5. *election or removal of the Series "B" director or Supervisory Board member;*
6. *conversion of a type of shares by means of replacing or stamping them;*
7. *transfer of all or a substantial part of the assets of the Company that would render the Company incapable of performing its obligations under the national concession;*
8. *amendment to the Articles of Association which would impair the rights of the holder of the Series "B" Share, including authorizing the Board of Directors to increase the Company's registered capital;*
9. *issuance of convertible bonds or bonds conferring preemptive rights; and*
10. *decisions on significant transfers of shares.*

The Minister issued a statement to MagyarCom on September 29, 1997 in which he confirmed his intention to vote the Series "B" Share on matters set out in items 1. to 3. of the previous paragraph in favor of decisions that do not adversely affect the national security of the Republic of Hungary, impair the rights attached to the Series "B" Share as provided in the Articles of Association or impair the Company's ability to perform its obligations under the Concession Contract in any substantial respect. The Minister declared his intention not to vote in favor of any decision that would result in an existing or new class or type of shares being granted rights superior or equal to, or otherwise adversely affecting, the rights of the Series "B" Share. The Minister agreed to use reasonable efforts to ensure that any successor to the Series "B" Share will issue a letter to MagyarCom including the same terms as the Minister's statement.

Transfer of Shares

The holder of the Series "B" Share and other shareholders holding at least a simple majority of the shares must generally approve a transfer of shares that would result in a person or group of persons holding ten percent or more of the outstanding voting stock of the Company. The consent of the holder of the Series "B" Share is also required to transfer shares if the transferee would acquire more than 49.9 percent of the outstanding voting stock of the Company.

Although amendments to the Hungarian Companies Act that took effect on June 16, 1998 generally do not allow restrictions on transfers of public companies' shares, the restrictions discussed above are also contained in MATÁV's Concession Contract as required by the Concession Act. The Company believes that the inconsistency between its Articles of Association and Concession Contract, on the one hand, and the Hungarian Companies Act, on the other, is likely to be resolved either by the inclusion of a specific authorization for the transfer restrictions in the new Telecommunications Act or an amendment to the existing Telecommunications Act, or by the Minister, as the holder of the Series "B" Share, approving an amendment to MATÁV's Articles of Association removing these restrictions.

In registering a transfer of shares, the registrar may request evidence that the shares were transferred in accordance with the Articles of Association. If the Company establishes that the transfer occurred in violation of the Articles of Association or if the transferee refuses to produce the necessary evidence, the Company may refuse to register the transfer. The Board of Directors may invalidate registrations based on untrue, false or misleading statements. Only shareholders registered in the Company's register may exercise shareholder rights vis-a-vis the Company or transfer shares. A registered shareholder must notify the Company within eight days of any transfers of its shares or it will be liable for liquidated damages.

ITEM 5 — NATURE OF THE TRADING MARKET

In November 1997, shareholders of MATÁV completed a Hungarian and international initial public offering of shares. MATÁV shares were listed in the "A" category of the Budapest Stock Exchange, and MATÁV ADSs, each representing five ordinary shares, were listed on the New York Stock Exchange. The total number of shares sold in the initial public offering was 272,861,367, or 26.31 percent of the total outstanding shares, for an aggregate offering price of over U.S.\$1.0 billion. The offer price was HUF 730 per share and U.S.\$18.65 per ADS.

In June 1999, the ÁPV sold its remaining 5.75% stake in MATÁV during a secondary offering. The total number of shares sold was 60,096,515, out of which MagyarCom sold 581,319 shares in connection with a greenshoe option. The offer price was HUF 1,273 per share and U.S.\$26.50 per ADS.

The ADSs are eligible for quotation and trading on SEAQ International.

Trading on the New York Stock Exchange

The table below sets forth the high and low closing sales prices for the ADSs on the New York Stock Exchange for the periods indicated, as reported on the New York Stock Exchange composite tape:

	<i>Price per ADS</i>	
	<i>High</i>	<i>Low</i>
	(U.S.\$)	
1997		
<i>Fourth Quarter (from November 14)</i>	26.37	18.65
1998		
<i>First Quarter</i>	31.12	22.94
<i>Second Quarter</i>	33.25	27.43
<i>Third Quarter</i>	32.69	19.00
<i>Fourth Quarter</i>	30.06	19.94
1999		
<i>First Quarter</i>	34.00	24.94
<i>Second Quarter</i>	29.75	26.37
<i>Third Quarter</i>	31.25	26.75
<i>Fourth Quarter</i>	36.50	26.06

Trading on the Budapest Stock Exchange

The table below sets forth the high and low closing sales prices for the shares on the Budapest Stock Exchange for the periods indicated, as reported by the Budapest Stock Exchange:

	Price per Share	
	High	Low
	(HUF)	
1997		
Fourth Quarter (from November 14).....	1,084	730
1998		
First Quarter	1,315	927
.....		
Second Quarter	1,411	1,157
Third Quarter	1,395	891
Fourth Quarter	1,270	859
1999		
First Quarter	1,379	1,150
.....		
Second Quarter	1,406	1,250
Third Quarter	1,507	1,306
Fourth Quarter	1,791	1,220
.....		

The Hungarian securities market is supervised by the Hungarian State Monetary and Capital Market Supervisory Board, which oversees the activities of the Budapest Stock Exchange and brokers and dealers. The principal statute governing the securities market is Act CXI of 1996 on the Issue and Offering of Securities, Investment Services and the Stock Exchange, which regulates, among other things, company disclosure obligations and insider trading.

The Budapest Stock Exchange, an independent and self-regulated non-profit organization, reopened on June 21, 1990 after having been closed for 42 years. Although it has grown significantly since reopening, it remains small compared to most Western stock exchanges, with an equity market capitalization of approximately HUF 7,306 billion at December 29, 1999. Average daily trading in equity securities on the Budapest Stock Exchange increased from approximately HUF 66 million in 1993 to approximately HUF 13,725 million in 1999.

There are three categories of equity securities on the Budapest Stock Exchange: "A," "B" and "C." A company whose shares are to be admitted to the "A" category must meet the following requirements:

- the company must have published audited financial statements for three full fiscal years showing a profit for the third full fiscal year;
- the aggregate market value of the shares to be listed may not be less than HUF 10 billion;
- the public must hold either (A) 25 percent of the shares, with an aggregate market value of at least HUF 4 billion or (B) shares with an aggregate market value of at least HUF 10 billion;
- at least 1,000 individuals or entities must hold the shares; and
- the shares must be in registered form.

Trading in shares listed on the Budapest Stock Exchange must be executed through the facilities of the listed Budapest Stock Exchange. Over-the-counter trading in shares by brokers is not permitted.

Trades on the Budapest Stock Exchange are effected by means of automatic matching computerized trading systems. The Budapest Stock Exchange settles securities trades through the facilities of Központi Elszámolóház és Értéktár Rt. ("KELER"). Purchasers have securities allocated to their account within the clearing system on the fifth day following the trade date, and remit the purchase price of the securities to the Budapest Stock Exchange through their accounts at KEKER at such time for on-payment to sellers. Securities certificates can be withdrawn from the clearing system on the sixth day following the trade date. Sellers of securities are required to lodge securities certificates representing the securities sold four days after the trade date.

Companies whose shares are included in the "A" category are required to file periodic reports with the Budapest Stock Exchange, including consolidated financial statements on a quarterly basis and annual audited consolidated financial statements. In addition, a company must report any information of which it becomes aware relating to changes that have occurred or will occur in the company's business, results of operations or financial condition, which affect, directly or indirectly, the value of the listed securities or the yield thereon to the Budapest Stock Exchange no later than 10:00 a.m. the following business day.

The Budapest Stock Exchange Index was first introduced in 1991 and was officially recognized by the Board of the Budapest Stock Exchange under the name "BUX" on January 1, 1995. The composition of the BUX is periodically restructured to reflect the development of the Budapest Stock Exchange and as of April 1, 1999 included 18 companies. Criteria for choosing the underlying stocks for the BUX are based on liquidity and market segment representation. Until October 1, 1999, weightings for the BUX reflected the market capitalizations of its constituent companies and were adjusted for changes in share capital. The constituent companies are updated in September and March each year. On April 1, 1998, MATÁV was added to the list of companies included in the BUX at HUF 1,297 per share and with a 15.44 percent weighting.

As of October 1, 1999, in the calculation of the BUX a free float capitalization based weighting has been adopted. As a result, MATÁV received the highest weighting of 25.46 percent.

The table below shows the quarterly closing value and period high and low closing prices for the BUX for each of the periods indicated:

	<i>BUX(1)</i>		
	<i>Closing Value</i>	<i>High</i>	<i>Low</i>
1997			
<i>First Quarter</i>	5,414	5,815	4,291
.....			
<i>Second Quarter</i>	6,795	6,795	5,301
.....			
<i>Third Quarter</i>	7,693	8,484	6,754
<i>Fourth Quarter</i>	7,999	8,107	5,561
1998			
<i>First Quarter</i>	8,656	8,691	8,597
.....			
<i>Second Quarter</i>	7,806	7,866	7,802
.....			
<i>Third Quarter</i>	4,571	4,674	4,556
<i>Fourth Quarter</i>	6,308	6,343	6,294
1999			
<i>First Quarter</i>	5,490	6,946	5,130
.....			
<i>Second Quarter</i>	6,486	6,646	5,479
.....			
<i>Third Quarter</i>	6,747	7,626	6,548
<i>Fourth Quarter</i>	8,819	8,921	6,182
.....			

Source: Budapest Stock Exchange

(1) Calculated from a base of 1,000 set on January 1, 1992.

**ITEM 6 — EXCHANGE CONTROLS AND OTHER LIMITATIONS
AFFECTING SECURITY HOLDERS**

The investment by foreigners in Hungarian securities is regulated by Act XXIV of 1988 on Foreign Investments, as amended (the "Foreign Investment Act") and Act XCV of 1995 on Foreign Exchange, as amended (the "Forex Act") and implementing decrees. The Foreign Investment Act and the Forex Act regulate foreign investment in Hungarian equities. In addition, the Forex Act regulates foreign investment in Hungarian debt instruments and flows of cash. The regulations in these acts do not restrict foreigners from investing in registered shares issued by Hungarian companies, nor do they restrict the total number of shares foreigners may own. In addition, foreigners may establish wholly owned subsidiaries in Hungary to acquire all the shares of a Hungarian company.

Shares held by foreign investors may be sold without restrictions to other foreigners or Hungarian persons. Foreign investors may deposit proceeds from sales to Hungarian persons in a convertible Hungarian Forint account, the balance of which may be converted into foreign currency and repatriated without restriction, subject to withholding tax rules, or may be paid into a foreign currency account of the foreigner in Hungary or abroad. Similarly, foreign investors may convert dividends paid by Hungarian companies into foreign currency and repatriate the proceeds, subject to withholding tax rules. If a foreign shareholder does not wish to repatriate sale proceeds or dividend payments, it may elect to receive and deposit such payments in Hungarian Forints into a convertible HUF-denominated account established with any commercial bank in Hungary. Such accounts will accrue interest in Hungarian Forints. The balance remains freely convertible into foreign currency and may subsequently be repatriated or reinvested in Hungary.

The Forex Act regulates the conversion of Hungarian Forints into foreign currencies and transactions between foreigners and Hungarian persons which require a foreign exchange license issued by the National Bank of Hungary. No foreign exchange license is required for any of the following acts:

- to repatriate dividends or proceeds from the sale of shares;*
- to hold shares in Hungarian companies;*
- to deposit shares with either a Hungarian or foreign depository;*
- to exercise shareholders' rights; or*
- to sell shares in Hungarian companies.*

ITEM 7 — TAXATION

Hungarian Taxation of Nonresident Holders of Securities

The following is a summary of the Hungarian tax considerations relevant to an investment in ADSs or shares by a holder who is not a citizen or resident of Hungary, is not a corporation, partnership or other entity organized under Hungarian law, and does not hold ADSs or shares in connection with the conduct of a business in Hungary through a permanent establishment (a "non-resident holder").

The summary of Hungarian tax considerations set out below is based on Hungarian laws in force at the date of this annual report, including double tax treaties currently in force, and is subject to changes in such laws or treaties occurring after this date.

Dividends

Dividends paid to non-resident holders are subject to a general withholding tax of 20 percent unless the provisions of a relevant double tax treaty apply or, in the case of dividends paid to non-resident business entities, the dividends are reinvested in Hungarian companies.

Hungary has entered into a number of tax treaties which provide for a reduced rate of dividend withholding tax. For example, the treaty relating to the avoidance of double taxation concluded between the United States and Hungary (the "U.S.-Hungary treaty") generally reduces Hungarian withholding tax to 15 percent if the beneficial owner of the dividends is resident in the United States. For the purposes of applying the provisions of the relevant double tax treaty, a "beneficial owner" of a dividend is the foreign organization or foreign recipient of the dividend which declares the dividend in its income tax returns for the purposes of computing its own tax liability in its country of residence. A "recipient" of a dividend is a foreign organization or foreign recipient of Hungarian income to whom the dividend is paid.

In the application of benefits generally available under double tax treaties which Hungary has concluded the country of residence of the "beneficial owner" and not the "recipient" will determine the availability of double tax treaty benefits.

In practice, to obtain the benefits of reduced withholding tax rates under a relevant double tax treaty, a non-resident holder of securities must file a refund claim with the Hungarian tax authorities and provide official certification from the tax authorities of its home country that the holder is eligible for benefits under the relevant double tax treaty. In addition, the holder must provide a statement issued by the payer which shows that tax has been withheld and a declaration that the non-resident holder is the "beneficial owner" of the income, and the amount received will be treated as income in the country of residency. Forms may be obtained from, and filings shall be sent to, APEH Észak-budapesti Igazgatósága, 1139 Budapest, Petneházy u 6-8, PO Box 45.

Hungarian law provides procedures that would allow the Company to withhold tax from dividends at applicable treaty rates provided it satisfies certain requirements. The Company intends to explore the feasibility of implementing such procedures. In this respect, the depository has agreed to use reasonable efforts, in cooperation with the Company, to make and maintain arrangements enabling security holders to obtain available treaty benefits.

Capital Gains Tax

Gain derived by non-resident business entities from the sale or other disposition of ADSs or shares is not subject to tax in Hungary.

Capital gains derived by non-resident individuals from the sale or other disposition of ADSs or shares are subject to a withholding tax at a rate of 20 percent if the buyer is a Hungarian business entity or a broker registered in Hungary. However, an applicable tax treaty can preempt this rule. For instance, the U.S.-Hungary treaty provides that capital gains realized by a qualifying resident of the United States, as evidenced by a certificate of tax residency from the Internal Revenue Service, will be exempt from Hungarian taxation.

Transfer Tax

The sale or other disposition of ADSs or shares is not subject to Hungarian transfer tax.

Stamp Duty

The sale or exchange of ADSs or shares is not subject to stamp duty in Hungary.

Hungarian Taxation of Resident Holders of Securities

Dividends Paid to Resident Entities

Dividends paid to resident entities in Hungary are not subject to withholding tax. These payments are treated as income of the recipient for accounting purposes but not for taxation purposes.

Dividends Paid to Resident Individuals

Under the Hungarian personal income tax legislation, dividends paid to resident individuals are in general subject to a withholding tax of 20 percent.

Capital Gains Tax/Transfer Tax/Stamp Duty

Capital gains derived by a Hungarian company from the sale of shares are part of the normal profit before taxation. The standard corporate tax rate is 18 percent.

Capital gains derived by an individual resident in Hungary are in general subject to personal income tax at a rate of 20 percent.

There is no transfer tax or stamp duty on sale of shares in Hungary.

United States Taxation

The following is a summary of the United States federal income tax considerations that are likely to be material to the purchase, ownership and disposition of ADSs or shares by a holder that is a resident of the United States for purposes of, and is fully entitled to benefits under, the income tax treaty between the United States and Hungary (a "U.S. holder").

The summary is based on laws, regulations, rulings and decisions in effect on the date of this document, all of which are subject to change. This summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular investor's decision to purchase ADSs or shares. In particular, the summary deals only with U.S. holders that will hold shares or ADSs as capital assets, and does not address the tax considerations relevant to investors that are subject to special tax rules, such as banks; insurance companies; securities dealers; persons holding shares as part of an integrated investment, including a "straddle" comprised of an ADS or share and one or more other positions; and persons that have a functional currency other than the U.S. dollar.

A holder will generally be entitled to benefits under the U.S.-Hungary Treaty, and therefore will be a U.S. holder, if it:

- is an individual U.S. resident, a U.S. corporation, or a partnership, estate, or trust to the extent its income is subject to taxation in the United States as the income of a U.S. resident, either in its hands or in the hands of its partners or beneficiaries;*
- is not also a resident of Hungary for Hungarian tax purposes; and*
- does not hold ADSs or shares in connection with the conduct of business in Hungary through a permanent establishment or the performance of personal services in Hungary through a fixed base.*

Prospective investors should consult their own advisers regarding the tax consequences of holding ADSs or shares in light of their particular circumstances, including, in particular, the effect of any state, local or other national laws.

In general, for U.S. federal income tax purposes, beneficial owners of ADSs will be treated as the owners of the shares represented by those ADSs.

Dividends

The gross amount of dividends received by a U.S. holder, including amounts withheld in respect of Hungarian withholding tax, will generally be subject to U.S. federal income taxation as foreign source dividend income, and will not be eligible for the dividends received deduction allowed to corporations. Dividends paid in Hungarian Forint will be includible in the income of U.S. holders in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of receipt by the holder or, in the case of ADSs, the custodian. If such dividends are converted into U.S. dollars on the date of receipt, U.S. holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. holder may be required to recognize foreign currency gain or loss upon its receipt of a refund of Hungarian withholding tax to the extent the U.S. dollar value of the refund differs from the U.S. dollar equivalent of the refund amount on the date of receipt of the underlying dividend.

Hungarian withholding tax at the 15 percent rate provided under the U.S.-Hungary Treaty will be treated as a foreign income tax. Subject to generally applicable limitations, foreign income taxes may, at the election of the holder, be claimed as credits against a U.S. holder's U.S. federal income tax liability, or may be deducted in computing taxable income. Credits generally will not be available to U.S. holders for Hungarian withholding taxes in excess of the 15 percent treaty rate. Foreign tax credits generally will not be allowed for withholding taxes imposed in respect of certain short-term or hedged positions in securities or in respect of arrangements in which a U.S. holder's expected economic profit, after non-U.S. taxes, is insubstantial. U.S. holders should consult their own advisers concerning the implications of these rules in light of their particular circumstances.

Distributions to U.S. holders of additional shares with respect to ADSs or shares that are made as part of a pro rata distribution to all shareholders of the Company generally will not be subject to U.S. federal income tax.

Capital Gains

Gains realized by U.S. holders on the sale or other disposition of ADSs or shares generally will be subject to U.S. federal income taxation as capital gains. Deposits and withdrawals of shares by U.S. holders in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

Gain or loss recognized by a U.S. holder that holds ADSs or shares as capital assets will be capital gain or loss. The distinction between capital gain or loss and ordinary income or loss is important for purposes of the limitations on a U.S. holder's ability to offset capital losses against ordinary income and because individual holders may be entitled to a preferential tax rate on capital gains realized with respect to ADSs or shares held for more than one year. The preferential tax rate is generally 20 percent.

U.S. Information Reporting and Backup Withholding

Dividends on ADSs or shares, and payments of the proceeds of a sale of ADSs or shares, paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting, and may be subject to backup withholding at a 31 percent rate, unless the holder (1) is a corporation or other exempt recipient or (2) provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. Holders that are not U.S. persons generally are not subject to information reporting or backup withholding. However, such a holder may be required to provide a certification to establish its non-U.S. status in connection with payments received within the United States or through U.S.-related financial intermediaries.

ITEM 8 — SELECTED CONSOLIDATED FINANCIAL AND STATISTICAL DATA

This selected consolidated financial and statistical data should be read together with the consolidated financial statements, including the accompanying notes, included in this annual report. MATÁV derived the financial data from MATÁV's consolidated financial statements and the accompanying notes, which PricewaterhouseCoopers Könyvvizsgáló és Gazdasági Tanácsadó Kft., MATÁV's independent accountants, have audited. This consolidated financial data is qualified by reference to MATÁV's consolidated financial statements and accompanying notes, which the Company has prepared in accordance with International Accounting Standards ("IAS"). IAS differs from U.S. GAAP. For a discussion of the principal differences between IAS and U.S. GAAP as they relate to the Company, see Note 26 to the consolidated financial statements.

	Year ended December 31,					
	1995	1996	1997	1998	1999	1999
	HUF	HUF	HUF	HUF	HUF	U.S.\$(1)
<i>(in millions, except per share/ADS amounts)</i>						
Consolidated Income Statement Data:						
Amounts in accordance with IAS						
Revenues	143,321	196,490	253,948	318,060	384,932	1,524
Employee-related expenses	(25,305)	(30,714)	(37,799)	(46,902)	(57,168)	(226)
.....						
Depreciation and amortization	(30,514)	(35,233)	(40,668)	(53,554)	(62,145)	(246)
Payments to other network operators	(16,432)	(22,209)	(27,226)	(35,965)	(44,184)	(175)
.....						
Cost of telecommunications equipment sales	(11,219)	(11,897)	(14,268)	(17,175)	(22,392)	(89)
Other operating expenses	(29,183)	(44,366)	(59,933)	(68,355)	(77,912)	(309)
Total operating expenses	<u>(112,653)</u>	<u>(144,419)</u>	<u>(179,894)</u>	<u>(221,951)</u>	<u>(263,801)</u>	<u>(1,045)</u>
Operating profit	30,668	52,071	74,054	96,109	121,131	479
Net interest and other charges	(29,389)	(24,673)	(29,865)	(28,795)	(22,133)	(88)
.....						
Share of associates' results before income tax	(221)	141	(238)	302	1,428	6
Profit before income tax	1,058	27,539	43,951	67,616	100,426	397
Income tax (expense) benefit.....	556	(791)	(303)	1,267	(6,911)	(27)
Profit after income tax	1,614	26,748	43,648	68,883	93,515	370
Minority interest	(1,898)	(3,660)	(7,614)	(10,546)	(14,883)	(59)
Profit (loss) before extraordinary item ..	(284)	23,088	36,034	58,337	78,632	311
Extraordinary item	4,877	-	-	-	-	-
Net income	<u>4,593</u>	<u>23,088</u>	<u>36,034</u>	<u>58,337</u>	<u>78,632</u>	<u>311</u>
Net income per share(2)	4.43	22.26	34.74	56.24	75.81	0.30
Diluted net income per share(2)	4.43	22.26	34.74	56.24	75.52	0.30
Ratios and other financial data:						
Operating margin %(3)	21.4	26.5	29.2	30.2	31.5	31.5
Net income margin %(4)	3.2	11.8	14.2	18.3	20.4	20.4
EBITDA(5)	61,182	87,304	114,722	149,663	183,276	725.8
Net income per ADS(6)	22.14	111.29	173.69	281.20	379.05	1.50
Amounts in accordance with U.S. GAAP(7)						
Net income	423	16,304	30,130	58,564	78,721	312
Basic earnings per share(2)	0.41	15.72	29.05	56.46	75.89	0.30
Basic earnings per ADS(6)	2.04	78.59	145.24	282.30	379.45	1.50
Diluted earnings per share(2).....	0.41	15.72	29.05	56.46	75.61	0.30
Diluted earnings per ADS(6).....	2.04	78.59	145.24	282.30	378.05	1.50

<i>At December 31,</i>					
<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
<i>HUF</i>	<i>HUF</i>	<i>HUF</i>	<i>HUF</i>	<i>HUF</i>	<i>U.S.\$(1)</i>

(in millions, except per share amounts)

Consolidated Balance Sheet Data:

Amounts in accordance with IAS

Assets:

<i>Current assets</i>	54,719	54,640	64,258	64,666	86,522	343
.....						
<i>Fixed assets(8)</i>	314,054	360,615	412,801	479,474	555,099	2,198
<i>Other non current assets(9)</i>	7,268	5,470	3,552	5,400	6,249	25
Total assets	<u>376,041</u>	<u>420,725</u>	<u>480,611</u>	<u>549,540</u>	<u>647,870</u>	<u>2,566</u>

Liabilities and shareholders' equity:

<i>Current liabilities</i>	70,076	83,260	87,376	104,227	115,359	458
<i>Non current liabilities(9)</i>	149,903	154,949	167,374	175,933	181,920	720
<i>Minority interest</i>	6,508	9,874	17,185	12,135	23,012	91
<i>Total shareholders' equity(9)</i>	149,554	172,642	208,676	257,245	327,579	1,297
Total liabilities and shareholders' equity	<u>376,041</u>	<u>420,725</u>	<u>480,611</u>	<u>549,540</u>	<u>647,870</u>	<u>2,566</u>

Amounts in accordance with U.S. GAAP(7)

<i>Total assets</i>	376,156	420,933	480,638	549,149	647,239	2,563
<i>Non current liabilities</i>	158,033	168,059	182,363	187,633	173,611	688
<i>Shareholders' equity</i>	144,077	160,623	193,457	244,783	315,248	1,248

Consolidated Cash Flow Data:

Amounts in accordance with IAS

<i>Net cash flows from operating activities</i>	47,422	74,749	90,029	135,499	138,465	548
<i>Net cash flows from investing activities</i>	(76,069)	(77,185)	(92,398)	(114,357)	(126,460)	(501)
<i>Net cash flows from financing activities</i>	12,603	(4,641)	3,985	(26,788)	(9,034)	(35)
 <i>Capital expenditures</i>	 (85,651)	 (87,552)	 (94,786)	 (116,283)	 (127,678)	 (505)
.....						
<i>Cash dividends declared per share</i>	n.a.	n.a.	7	8	9	0.04
.....						

	<i>Year ended December 31,</i>				
	<i>1995</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>
Statistical Data:					
<i>Average number of connected access lines(10):</i>					
<i>Residential</i>	<i>1,375,579</i>	<i>1,605,475</i>	<i>1,886,338</i>	<i>2,080,997</i>	<i>2,271,249</i>
<i>Business</i>	<i>328,413</i>	<i>329,229</i>	<i>342,404</i>	<i>355,004</i>	<i>371,823</i>
<i>Public payphones</i>	<i>31,503</i>	<i>32,550</i>	<i>34,799</i>	<i>36,242</i>	<i>35,987</i>
<i>Total</i>	<u><i>1,735,495</i></u>	<u><i>1,967,254</i></u>	<u><i>2,263,541</i></u>	<u><i>2,472,243</i></u>	<u><i>2,679,059</i></u>
<i>Average number of ISDN channels(11)</i>	<i>720</i>	<i>6,284</i>	<i>23,414</i>	<i>52,434</i>	<i>88,125</i>
<i>Average number of mobile telephone subscribers(12):</i>					
<i>Westel 900</i>	<i>88,768</i>	<i>167,709</i>	<i>306,612</i>	<i>450,945</i>	<i>686,973</i>
<i>Westel 450</i>	<i>64,938</i>	<i>70,140</i>	<i>76,426</i>	<i>86,348</i>	<i>96,934</i>
<i>Total</i>	<u><i>153,706</i></u>	<u><i>237,849</i></u>	<u><i>383,038</i></u>	<u><i>537,293</i></u>	<u><i>783,907</i></u>
<i>Domestic traffic (thousands of minutes)(13)</i>	<i>n.a.</i>	<i>n.a.</i>	<i>6,977,733</i>	<i>7,758,741</i>	<i>8,632,345</i>
<i>Outgoing international traffic (millions of minutes)(14)</i>	<i>247.0</i>	<i>270.6</i>	<i>287.0</i>	<i>296.3</i>	<i>324.5</i>
<i>Incoming international traffic (millions of minutes)(15)</i>	<i>245.5</i>	<i>281.2</i>	<i>324.6</i>	<i>374.5</i>	<i>441.2</i>
<i>Ratio of incoming international traffic to outgoing international traffic(14)(15)</i>	<i>0.99</i>	<i>1.04</i>	<i>1.13</i>	<i>1.26</i>	<i>1.36</i>
<i>Number of fixed line employees(16)</i>	<i>17,183</i>	<i>15,833</i>	<i>14,771</i>	<i>13,287</i>	<i>12,093</i>
<i>Number of access lines per employee(16)(17)</i>	<i>110</i>	<i>136</i>	<i>163</i>	<i>201</i>	<i>240</i>
<i>Penetration per 100 inhabitants(18)</i>	<i>24</i>	<i>28</i>	<i>32</i>	<i>35</i>	<i>39</i>

(1) Translated into U.S. dollars at the official closing rate of the National Bank of Hungary on December 31, 1999 of U.S. dollar 1.00 = HUF 252.52.

(2) Net income per share under IAS and earnings per share under U.S. GAAP are calculated by dividing net income by the weighted average number of shares outstanding during each period. The weighted average numbers of shares used in calculating net income per share and earnings per share was 1,037 million for the years ended December 31, 1995, 1996, 1997, 1998 and 1999. The weighted average number of shares used in calculating diluted earnings per share is 1,041 million for the year ended December 31, 1999.

(3) Operating margin is the ratio of operating profit to revenues expressed as a percentage.

(4) Net income margin is the ratio of net income to revenues expressed as a percentage.

(5) EBITDA represents earnings before extraordinary items, minority interest, share of associates' results before income tax, net interest and other charges, income tax, depreciation and amortization. EBITDA is not intended to represent cash flow from operations under IAS or U.S. GAAP and should not be considered as an alternative to net income as an indicator of MATÁV's operating performance or to cash flows as a measure of liquidity. MATÁV believes that EBITDA is a standard measure commonly reported and widely used by analysts, investors and other interested parties in the telecommunications industry. Accordingly, this information has been disclosed to permit a more complete comparative analysis of MATÁV's operating performance relative to other companies in its industry.

(6) Each ADS represents five shares.

(7) Under IAS, Westel 900 and Westel 450 are consolidated. Under U.S. GAAP, however, the Company believes that although it holds 51 percent of Westel 900 and Westel 450, the ownership rights of the minority shareholder may be considered participatory in nature and would preclude consolidation under U.S. GAAP. For purposes of the reconciliation to U.S. GAAP, both companies were accounted for using the equity method. There is, however, no difference in net income or shareholders' equity under U.S. GAAP as a result. See Note 26 to the consolidated financial statements.

(8) Fixed assets include intangible assets, which include concession costs, software, leasehold interests and goodwill, less accumulated amortization.

(9) The Company has adopted IAS 19 "Employee Benefits" (revised 1997), as reflected in opening retained earnings of 1998.

(10) Average number of access lines in all of the local primary areas serviced by MATÁV over the periods indicated.

(11) Average number of ISDN channels over the periods indicated.

(12) Average number of subscribers over the periods indicated.

- (13) Due to the differences in measurement techniques, minute data prior to 1997 is not available.
- (14) Based on actual traffic data from international gateway exchanges. Outgoing international traffic includes all Hungary-originated calls, including those calls placed by subscribers of MATÁV, other LTOs and mobile providers.
- (15) Based on data from the settlement process with international carriers. Incoming international traffic includes all Hungary-terminated calls, including those calls terminating with subscribers of MATÁV, other LTOs and mobile providers. It does not include transit traffic.
- (16) Based on the number of employees at the end of the periods indicated, not including employees of MATÁV's subsidiaries. The number of employees of MATÁV, including all consolidated subsidiaries, at year end was 21,687 in 1995, 19,848 in 1996, 18,187 in 1997, 16,595 in 1998 and 15,377 in 1999.
- (17) Based on the number of employees, not including employees of MATÁV's subsidiaries, and the number of access lines, including for these purposes, ISDN channels, at the end of the periods indicated in all of the local primary areas serviced by MATÁV. Each ISDN channel is counted as one access line.
- (18) Based on the number of access lines at the relevant period end in MATÁV's 36 local concession areas. Each ISDN channel is counted as one access line.

DIVIDEND POLICY

The shareholders have approved the payment of cash dividends of HUF 9,335 million, equal to HUF 9 per share, from the Company's consolidated net income for 1999. This amount corresponds to 12 percent of 1999 net income. The record date for payment of the dividends is May 25, 2000.

Under Hungarian law, the Company is permitted to pay annual dividends out of profits and profit reserves, determined on the basis of the annual unconsolidated accounts prepared in accordance with Hungarian Accounting Regulations, following a declaration at the annual general meeting of shareholders. Prior to the approval of the annual unconsolidated accounts, the Company's shareholders at the general meeting may also declare a dividend advance on the basis of an interim accounting. Under Hungarian law, the general meeting of shareholders may decide to declare a higher or lower dividend than that recommended by the Board of Directors, provided the Company's shareholders' equity under Hungarian Accounting Standards would remain positive following the dividend. The general meeting of shareholders may also decide not to declare a dividend, even if the Board of Directors recommends one. The Company distributes dividends to holders of shares duly registered in the shareholders' register as the legal owners of shares on the date determined by the general meeting to be the dividend record date.

The determination of whether to pay dividends, and of the amount of dividends paid, depends upon, among other things, the Company's earnings, financial condition and cash requirements, applicable restrictions on the payment of dividends under Hungarian law and any other factors the Board of Directors may consider relevant. As of December 31, 1999, the profit reserves available for distribution were approximately HUF 173,000 million.

The Company will declare any cash dividends in Hungarian Forints. In the case of shares represented by ADSs, the cash dividends are paid to the depository and converted into and paid in U.S. dollars at the prevailing rate of exchange, net of conversion expenses of the depository and applicable Hungarian withholding tax. Fluctuations in exchange rates will affect the amount of dividends that ADS holders receive. Dividends paid to non-Hungarian holders, including U.S. holders, of shares or ADSs may be converted into foreign currency and repatriated, subject to Hungarian withholding tax.

ITEM 9 — MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read together with the consolidated financial statements, including the accompanying notes, included in this annual report. The consolidated financial statements and the accompanying notes have been prepared in accordance with IAS. IAS differs in certain respects from U.S. GAAP. For a discussion of the principal differences between IAS and U.S. GAAP as they relate to the Company, see Note 26 to the consolidated financial statements. Revenues and operating expenses discussed under "— Results of Operations — By Segment" do not reflect intersegment eliminations.

MATÁV's results of operations and its medium-term prospects should be considered in light of a number of rapid and fundamental changes occurring in both the Company and the environment in which it operates:

- **Market Liberalization.** *In 1999, approximately two thirds of MATÁV's revenues were derived from areas in which the Company had exclusive rights and was subject to limited indirect competition. The Company's exclusive rights to provide long distance service throughout Hungary end in December 2001. Its exclusive rights to provide fixed line local service in 31 local concession areas end in December 2001 and in its five local concession areas end in May 2002. In addition, the Minister and MATÁV have begun negotiations for a possible earlier termination of MATÁV's exclusive rights. In such event, the Company would be subject to competition throughout its business earlier than currently provided for in the concession.*
- **Tariff Rebalancing.** *MATÁV has been implementing broad-based tariff reform designed to foster increased usage of telecommunications services, to align its tariffs more closely with costs and to increase its competitiveness in anticipation of market liberalization. In 2000, local, domestic long distance and international tariffs have decreased in both nominal and real terms, while subscription charges have significantly increased in both nominal and real terms. The Company expects that the impact of decreasing local, long distance and international tariffs is likely to be offset, in part, by an increase in usage of local, long distance and international telecommunications services.*
- **Interconnection Fees.** *Through 1997, interconnection fees were based on a revenue-sharing model under which the Company, as the long distance service provider, was generally able to collect two thirds of the total interconnection fee. Commencing in 1998, the new interconnection decree moved towards a more cost-based formula. In 1999, interconnection fees paid by MATÁV increased and the amount MATÁV receives from other local telephone operators for terminating calls decreased. In 2000, interconnection fees paid by MATÁV for domestic calls have decreased, while interconnection fees paid by MATÁV for international calls have further increased. MATÁV expects that cost-based interconnection fees will be introduced in the near future.*
- **Taxation.** *The Company benefits from reduced corporate income tax. Neither MATÁV Rt. nor Westel 900 paid corporate income tax from 1994 through 1998. From 1999, for a five year period, both companies are entitled to a 60 percent reduction in the amount of tax payable, resulting in an effective tax rate of 7.2 percent. Westel 450 utilized a similar 60 percent tax reduction until January 1, 2000.*
- **Inflation.** *Annual inflation in Hungary, as measured by changes in the consumer price index, averaged 18.3 percent in 1997, 14.3 percent in 1998 and 10.0 percent in 1999. The nominal increase in MATÁV's revenues over this period derives largely from the effects of inflation and corresponding adjustments in tariffs, although many of MATÁV's tariffs have fallen in real terms and are beginning to decline in nominal terms. The increase in nominal terms of many of the Company's costs is also attributable to inflation. MATÁV has not adjusted its financial statements for inflation, because the Company believes that Hungary does not have the characteristics of a hyperinflationary economy.*
- **Devaluation.** *In recent years, the Hungarian Forint has been subject to significant devaluation. The Hungarian Forint is devalued by a fixed monthly percentage against a currency basket. Devaluation can result in both realized and unrealized foreign exchange losses relating to non-Hungarian Forint denominated liabilities. These losses are included in net interest and other charges relating to the Company's foreign currency denominated indebtedness.*

Results of Operations — Total

Total Revenues

MATÁV's total revenues grew by 51.6 percent from HUF 253,948 million in 1997 to HUF 384,932 million in 1999. Increases in revenues from fixed line telecommunications services have been driven by increases in tariffs, growth in the net number of access lines, increases in aggregate usage and the introduction of new products and services. Revenues from mobile telecommunications services grew by 71.8 percent from 1997 through 1999 driven by a rapid increase in the mobile subscriber base.

Total Operating Expenses

The Company's total operating expenses increased by 46.6 percent from HUF 179,894 million in 1997 to HUF 263,801 million in 1999. MATÁV's total operating expenses have, however, declined as a percentage of total revenues from 70.8 percent in 1997 to 68.5 percent in 1999. Depreciation and amortization and employee-related expenses are MATÁV's most significant operating expenses. Depreciation and amortization increased throughout the period as a result of MATÁV's ongoing investment in its networks. Depreciation and amortization as a percentage of total revenues increased slightly from 16.0 percent in 1997 to 16.1 percent in 1999. Employee-related expenses increased throughout the period as the effect of average wage increases in nominal terms has more than offset the effect of reductions in the number of employees. Other operating expenses as a percentage of total revenues decreased from 23.6 percent in 1997 to 20.2 percent in 1999 due to efficiency improvements.

Total Operating Profit

The Company's total operating profit grew by 63.6 percent from HUF 74,054 million in 1997 to HUF 121,131 million in 1999, as total revenues grew at a faster rate than total operating expenses.

Results of Operations — By Segment

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

	Year ended December 31,		
	1997	1998	1999
	(in HUF millions)		
Revenues:			
Fixed line	206,096	256,929	302,230
Mobile	67,681	88,142	117,336
Intersegment eliminations(1)	(19,829)	(27,011)	(34,634)
Total	253,948	318,060	384,932
Operating expenses:			
Fixed line	151,304	186,409	216,759
Mobile	48,419	62,553	81,676
Intersegment eliminations(1)	(19,829)	(27,011)	(34,634)
Total	179,894	221,951	263,801
Operating profit:			
Fixed line	54,792	70,520	85,471
Mobile	19,262	25,589	35,660
Total	74,054	96,109	121,131

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

Fixed Line Telecommunications Segment

MATÁV's fixed line telecommunications segment includes local, domestic and international long distance telephone services as well as value added digifon services such as call waiting, itemized billing and telephone and private branch exchange equipment rental. This segment also consists of leased line and data transmission services, equipment sales, construction, maintenance and other services.

Revenues

The following table sets forth information regarding revenues for the fixed line telecommunications segment:

	Year ended December 31,			Year ended December 31,	
	1997	1998	1999	1998/1997	1999/1998
	(in HUF millions)			(% change)	
Revenues:					
Subscriptions, connections and other charges	41,479	55,673	63,413	34.2	13.9
Domestic traffic revenues	85,319	108,425	134,071	27.1	23.7
Other usage	19,911	26,807	26,999	34.6	0.7
International traffic revenues	35,748	38,792	43,807	8.5	12.9
.....					
Other services	23,639	27,232	33,940	15.2	24.6
Total	206,096	256,929	302,230	24.7	17.6

Subscriptions, Connections and Other Charges. Revenues from subscriptions, connections and other charges consist of

revenues from monthly subscription fees, entrance fees, fees for digifon services and rental charges for telephones and private branch exchanges. Revenues from subscriptions, connections and other charges are principally a function of the number and mix of residential, business and ISDN access lines and corresponding charges.

Revenues from subscriptions, connections and other charges increased in both 1998 and 1999 principally as a result of nominal increases in standard monthly subscription fees and the rapid increase in access lines as well as increases in usage of digifon services and telephone and private branch exchange rentals.

Monthly subscription fees increased in nominal terms by 16.7 percent in 1998 and 31.8 percent in 1999.

Entrance fees for business customers remained constant in nominal terms from July 20, 1995 through the end of 1996 and fell by 20 percent in nominal terms with effect from January 15, 1997. On October 15, 1997, the business entrance fee was further decreased by approximately 17 percent. Entrance fees for residential customers fell by ten percent on October 15, 1997.

For entrance fees charged prior to October 15, 1997, the capital contribution portion of the fee was treated as deferred revenue and credited to revenue over the period the related assets are depreciated. The portion of the entrance fee covering non-capitalized expenses was recognized as revenue upon connection. After October 15, 1997, the entire entrance fee is recorded as revenue upon connection reflecting the change in related legislation, which eliminated refunds and the advanced development of the network.

The growth in access lines has been a significant driver in the growth of subscriptions, connections and other charges. The table below sets forth information regarding average access lines in MATÁV's local concession areas.

	Year ended December 31,			Year ended December 31,	
	1997	1998	1999	1998/1997	1999/1998
				(% change)	
Average access lines:					
Residential	1,886,338	2,080,997	2,271,249	10.3	9.1
Business	342,404	355,004	371,823	3.7	4.7
Public payphones	34,799	36,242	35,987	4.1	(0.7)
.....					
Total	2,263,541	2,472,243	2,679,059	9.2	8.4
ISDN channels	23,414	52,434	88,125	123.9	68.1
Total	2,286,955	2,524,677	2,767,184	10.4	9.6

The increase in access lines throughout the period reflects the rapid build out of MATÁV's network. The majority of this increase related to residential lines. The number of ISDN channels, used primarily by business customers, is currently small but has grown rapidly since the introduction of ISDN in Hungary in November 1995.

Domestic Traffic Revenues. Domestic traffic revenues consist of traffic charges for local and domestic long distance calls placed by MATÁV's subscribers. Domestic traffic revenues are a function of tariffs, the total number of telephone calls, the distribution of call duration, the time of day and the mix between more costly domestic long distance calls and less expensive local calls.

Domestic traffic revenues increased throughout the period principally as a result of the rapid increase in access lines and nominal increases in tariffs. The effects of tariff and access line increases were mitigated by the fact that the majority of new access lines were connected to low-volume residential customers.

From 1997 through 1999, MATÁV increased its local tariffs by an average of 48.4 percent in nominal terms and 18.0 percent in real terms. Over the same period, MATÁV increased its tariffs for calls from fixed line to mobile telephones by an average of 23.1 percent in nominal terms and decreased by an average of 2.1 percent in real terms. MATÁV's domestic long distance tariffs increased by an average of 10.0 percent in nominal terms and decreased by an average of 12.5 percent in real terms over this period.

Other Usage. Revenues from other usage include amounts related to domestic and international long distance services that MATÁV provides to customers in non-MATÁV Local Primary Areas or to mobile customers. Revenues from other usage increased in both 1998 and 1999 mainly as a result of growth in the volume of traffic.

International Traffic Revenues. Revenues from international traffic consist of revenues from outgoing and incoming international services. The following table sets forth information concerning international traffic revenues and outgoing and incoming international traffic:

	Year ended December 31,			Year ended	
	1997	1998	1999	December 31,	
	(in HUF millions, except traffic figures)			1998/1997	1999/1998
				(% change)	
Revenues:					
Outgoing international traffic revenue(1) ..	19,118	20,897	21,215	9.3	1.5
Incoming international traffic revenue(2) ..	16,630	17,895	22,592	7.6	26.2
	<u>35,748</u>	<u>38,792</u>	<u>43,807</u>	8.5	12.9
Traffic in thousand of minutes:					
Outgoing international(3)	187,862	188,412	192,356	0.3	2.1
Incoming international(4)	324,623	374,546	441,193	15.4	17.8

(1) Excludes revenues from calls placed by subscribers of other local telephone operators and mobile service providers. MATÁV's revenues relating to these calls are included in revenues from other usage.

(2) Includes revenues from calls terminating with subscribers of MATÁV, other local telephone operators and mobile service providers, transit traffic via Hungary and other international services.

(3) Excludes calls placed by subscribers of other local telephone operators and mobile service providers. MATÁV's revenues relating to these calls are included in revenues from other usage.

(4) Includes calls terminating with subscribers of MATÁV, other local telephone operators and mobile service providers. Does not include transit traffic via Hungary.

Revenues from outgoing international traffic are a function of tariffs and the number, duration and mix of calls to destinations outside Hungary placed by MATÁV's fixed line subscribers. Revenues from outgoing international traffic increased in 1998 principally as a result of a 10.2 percent increase in tariffs. In 1999, revenues from outgoing international traffic increased as a result of increased number of access lines, partly offset by a tariff decrease of 1.2 percent. The Company believes that the increase in outgoing minutes has been limited by the relatively high number of international calls placed by mobile subscribers, the rapid growth of private leased lines and PBX's with call blocking capability.

Revenues from incoming international traffic consist of amounts paid by foreign carriers for the use of MATÁV's network to carry calls placed by their customers. Revenues from incoming international traffic increased in 1998 and 1999 principally as a result of the increase in international incoming traffic and the continuing devaluation of the Hungarian Forint against special drawing rights, in which international settlement payments between telecommunications providers are generally denominated. The Hungarian Forint depreciated against the special drawing rights 13.5 percent in 1998 and 11.4 percent in 1999. The positive effect of the devaluation of the Hungarian Forint and the increase in incoming traffic more than offset the continuing decline in international settlement rates, which fell by an average of 16.4 percent in 1998 and 12.2 percent in 1999.

Other Services. Revenues from other services consist of revenues from leased lines, data transmission and related services, telecommunications equipment sales and construction, maintenance and other.

The following table sets forth data relating to revenues from other services:

	Year ended December 31,			Year ended	
	1997	1998	1999	December 31,	
				1998/1997	1999/1998

	(in HUF millions)			(% change)	
<i>Other services:</i>					
<i>Leased lines</i>	7,607	10,493	13,816	37.9	31.7
<i>Data transmission and related services</i>	5,264	8,121	11,464	54.3	41.2
.....					
<i>Telecommunications equipment sales</i>	2,094	3,230	3,030	54.3	(6.2)
<i>Construction, maintenance and other</i>	8,674	5,388	5,630	(37.9)	4.5
	<u>23,639</u>	<u>27,232</u>	<u>33,940</u>	15.2	24.6

Revenues from other services increased in both 1998 and 1999 principally as a result of the growth in demand for sophisticated transmission services such as managed leased lines, ISDN-based data transmission services and Internet services.

Operating Expenses

Operating expenses consist of employee-related expenses, depreciation and amortization and other operating expenses. The following table sets forth information regarding operating expenses:

	Year ended December 31,			Year ended December 31,	
	1997	1998	1999	1998/1997	1999/1998
	(in HUF millions)			(% change)	
<i>Operating expenses:</i>					
<i>Employee-related expenses</i>	31,950	39,253	46,419	22.9	18.3
.....					
<i>Depreciation and amortization</i>	32,824	44,044	49,873	34.2	13.2
<i>Other operating expenses</i>	86,530	103,112	120,467	19.2	16.8
	<u>151,304</u>	<u>186,409</u>	<u>216,759</u>	23.2	16.3

Employee-related Expenses. *Employee-related expenses consist of wages and salaries, social security and other expenses. Employee-related expenses increased in 1998 and 1999 due to wage increases and an increase in the relative proportion of higher paid skilled and managerial employees, partly offset by a reduction in headcount. The official wage increase was 9.5 percent in April 1998 and 15.0 percent in April 1999 for MATÁV Rt.'s employees. Required social security contributions and bonus, welfare and pension payments rose in line with wages.*

The average number of employees in the fixed line telecommunications segment decreased by 1,725 employees or 9.7 percent in 1998 and by 1,621 employees or 10.1 percent in 1999 as a result of natural attrition, improved efficiency and streamlining of the organizational structure.

Depreciation and Amortization. *Depreciation and amortization expenses increased in both 1998 and 1999 as a result of continued investment in MATÁV's fixed line telecommunications network. Over the period, depreciation and amortization as a percentage of revenues declined despite the Company's significant capital expenditure program. After a review of the useful lives of its assets, the Company extended the lives of certain switches and operating systems with gross book value of HUF 16,088 million. This resulted in a decrease in depreciation expense of HUF 1,181 million.*

Other Operating Expenses. *Other operating expenses consist of payments to other network operators, cost of telecommunications equipment sales and other expenses. The majority of the increases in other operating expenses in both 1998 and 1999 related to materials and maintenance, frequency and service fees, legal and other consulting fees, marketing fees and provisions. In addition, during 1997, the Company incurred expenses of approximately HUF 1,600 million related to its initial public offering.*

Operating Profit

The following table sets forth information concerning operating profit and operating margin for the fixed line

telecommunications segment:

	<i>Year ended December 31,</i>			<i>Year ended December 31,</i>	
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1998/1997</u>	<u>1999/1998</u>
					<i>(% change)</i>
<i>Operating profit (in HUF millions)</i>	54,792	70,520	85,471	28.7	21.2
<i>Operating margin (percent)(1)</i>	26.6	27.4	28.3	<i>n.a.</i>	<i>n.a.</i>

(1) Operating margin is the ratio of operating profit to revenue, expressed as a percentage.

Operating profit and operating margin grew in both 1998 and 1999 principally as a result of growing revenues from domestic telecommunications services as well as operating efficiencies that led to lower rates of growth in operating expenses.

Mobile Telecommunications Segment

Revenues

Revenues from the mobile telecommunications segment consist of one-time connection fees, monthly subscription and value added service charges, traffic charges and equipment sales. Revenues increased in 1998 and 1999 principally as a result of rapid growth in the number of subscribers.

The following table provides information concerning subscribers of mobile telecommunications services and monthly usage of the network:

	Year ended December 31,			Year ended December 31,	
	1997	1998	1999	1998/1997	1999/1998
				(% change)	
<i>Average number of subscribers:</i>					
Westel 900	306,612	450,945	686,973	47.1	52.3
Westel 450	76,426	86,348	96,934	13.0	12.3
<i>Average monthly usage per:</i>					
Westel 900 subscriber (minutes)	250	221	200	(11.6)	(9.5)
Westel 450 subscriber (minutes)	243	205	179	(15.6)	(12.7)

Westel 900's revenues from mobile telecommunications services increased from 1997 through 1999, primarily as a consequence of the continued growth in the Westel 900 subscriber base as well as nominal increases in average mobile tariffs. The average number of Westel 900 subscribers grew by 52.3 percent in 1999. The effects of subscriber-base growth and tariff increases were partially offset by declines in average monthly minutes per subscriber, which management believes reflected the growth of the overall mobile telecommunications market to include more low-volume users, and the increased availability of, and improvements in, fixed line network services.

Westel 450's revenues from mobile telecommunications services increased in 1998 and 1999 compared to 1997 and 1998. The increase in both years was primarily attributable to the growing number of subscribers and increase in tariffs, which was partially offset by lower usage.

Operating Expenses

Operating expenses consist of employee-related expenses, depreciation and amortization and other operating expenses. The following table sets forth information regarding operating expenses for the mobile telecommunications segment:

	Year ended December 31,			Year ended December 31,	
	1997	1998	1999	1998/1997	1999/1998
	(in HUF millions)			(% change)	
<i>Operating expenses:</i>					
Employee-related expenses	5,849	7,649	10,749	30.8	40.5
Depreciation and amortization	7,844	9,510	12,272	21.2	29.0
Other operating expenses	34,726	45,394	58,655	30.7	29.2
	<u>48,419</u>	<u>62,553</u>	<u>81,676</u>	29.2	30.6

Employee-related Expenses. Employee-related expenses increased in 1998 and 1999 principally as a result of higher workforce levels and nominal increases in wages. The average number of mobile employees grew by 166 or 12.7 percent in 1998 and by 120 or 8.2 percent in 1999, principally as a result of increased sales and service personnel to accommodate the expanded subscriber base.

Depreciation and Amortization. Depreciation and amortization increased in both 1998 and 1999. These increases were primarily attributable to increases in property, plant and equipment and investment in the mobile network.

Other Operating Expenses. Other operating expenses increased in both 1998 and 1999 principally due to increases in payments to other network operators, cost of equipment sales, marketing expenses and frequency fees.

Operating Profit

The following table sets forth information concerning operating profit and operating margin for the mobile telecommunications segment:

	Year ended December 31,			Year ended December 31,	
	1997	1998	1999	1998/1997	1999/1998
				(% change)	
Operating profit (in HUF millions)	19,262	25,589	35,660	32.8	39.4
Operating margin (percent)(1)	28.5	29.0	30.4	n.a.	n.a.

(1) Operating margin is the ratio of operating profit to revenue, expressed as a percentage.

Operating profit and operating margin grew in both 1998 and 1999 principally as a result of growing revenues from mobile telecommunications services.

Net Interest and Other Charges — Total

The following table sets forth information concerning net interest and other charges:

	Year ended December 31,			Year ended December 31,	
	1997	1998	1999	1998/1997	1999/1998
	(in HUF millions)			(% change)	
<i>Interest expense:</i>					
Hungarian Forint loans	8,303	11,720	11,112	41.2	(5.2)
Foreign currency loans	7,171	6,134	6,182	(14.5)	0.8
.....					
Finance leases	261	192	47	(26.4)	(75.5)
.....					
Foreign exchange loss - net	16,090	12,378	6,289	(23.1)	(49.2)
Commissions and other bank charges	1,230	1,311	1,941	6.6	48.1
Total interest payable and other charges	33,055	31,735	25,571	(4.0)	(19.4)
.....					
Interest capitalized	(966)	(895)	(541)	(7.3)	(39.6)
Interest and other financial income	(2,224)	(2,045)	(2,897)	(8.0)	41.7
.....					
	<u>29,865</u>	<u>28,795</u>	<u>22,133</u>	(3.6)	(23.1)

Net interest and other charges decreased in 1998 compared to 1997 primarily as a consequence of decreases in net foreign exchange loss and in interest expense related to MATÁV's foreign currency denominated loans, partly offset by an increase in interest expense relating to Hungarian Forint loans. Net foreign exchange loss and interest expense related to MATÁV's foreign currency denominated loans decreased in 1998 as a result of a 5.3 percent decrease in the average level of foreign currency denominated loans, the decreasing average interest rate of those loans and the decreasing rate of devaluation of the Hungarian Forint. Interest expense related to MATÁV's Hungarian Forint denominated loans increased in 1998 primarily as a result of a 39.6 percent increase in the average level of those loans.

Net interest and other charges decreased in 1999 compared to 1998 primarily as a result of a decrease in net foreign exchange loss. Net foreign exchange loss decreased in 1999 due to the reduced rate of monthly devaluation and better performance of the Hungarian Forint within the intervention band in relation to the currency basket. In shifting the loan portfolio to Hungarian Forint denominated loans MATÁV also benefited from decreasing Hungarian Forint interest rates.

See Item 9A for certain quantitative and qualitative information about financial instruments.

Income Tax — Total

The following table sets forth information concerning income tax expense incurred by the Company:

	<i>Year ended December 31,</i>			<i>Year ended</i>	
	<i>December 31,</i>			<i>December 31,</i>	
	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>1998/1997</i>	<i>1999/1998</i>
	<i>(in HUF millions)</i>			<i>(% change)</i>	
Income tax expense /(benefit).....	303	(1,267)	6,911	(518.2)	(645.5)

The Company and certain of its subsidiaries qualify for a reduction in income tax payable on meeting certain conditions. The reduction in the tax payable amounted to a 100 percent allowance for five years from the date of qualification, and a 60 percent allowance for a further five years. Through 1998, MATÁV Rt. and Westel 900 qualified for the 100 percent allowance. Through 1995, Westel 450 utilized the 100 percent allowance. From January 1, 1999, MATÁV Rt. and Westel 900 are utilizing the reduced allowance of 60 percent for a further five years (effective tax rate of 7.2 percent). From January 1, 1996, Westel 450 has utilized the reduced allowance of 60 percent until December 31, 1999. Management believes that the conditions underlying the reduction in income tax will continue to be met. All other subsidiaries were subject to income tax of 18 percent.

The conditions for entitlement to the reduced corporate income tax include (1) that one half of the company's annual revenues originate from public telecommunications services; (2) that the company's initial share capital exceeds HUF 50 million; and (3) that at least 30 percent of the company's initial share capital is held by non-Hungarians.

Differences in timing between tax regulations and financial reporting generate deferred tax assets and liabilities in the consolidated financial statements. The Company records these temporary differences according to the liability method in the current period.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. MATÁV has tax losses of HUF 2,312 million to carry forward against future taxable income, which have not been recognized in these financial statements due to uncertainty of their recoverability. Tax losses of HUF 339 million expire in 2002, HUF 674 million expire in 2003 and HUF 1,299 million expire in 2004.

Liquidity and Capital Resources

The following table sets forth information concerning the Company's cash flows:

	<i>Year ended December 31,</i>		
	<i>1997</i>	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>		
<i>Net cash flows:</i>			
<i>from operating activities</i>	90,029	135,499	138,465
<i>from investing activities</i>	(92,398)	(114,357)	(126,460)
<i>from financing activities</i>	3,985	(26,788)	(9,034)
<i>Change in cash and cash equivalents</i>	1,616	(5,646)	2,971
<i>Cash and cash equivalents, beginning of period</i>	7,643	9,259	3,613
.....			
<i>Cash and cash equivalents, end of period</i>	9,259	3,613	6,584
.....			

Net Cash Flows from Operating Activities. *MATÁV's primary source of liquidity is cash flows from operating activities.*

Net cash flows from operating activities increased by HUF 45,470 million in 1998 compared to 1997, primarily due to an increase in operating profit of HUF 22,055 million and the effect of a higher level of depreciation and amortization expense of fixed assets, which increased by HUF 12,886 million. In 1998, the change in receivables increased by HUF 12,313 million, which led to a corresponding decrease in net cash flows from operating activities. In 1998, the change in payables increased by HUF 22,013 million, which led to a corresponding increase in net cash flows from operating activities.

Net cash flows from operating activities increased by HUF 2,966 million in 1999 compared to 1998, primarily due to an increase in operating profit of HUF 25,022 million and the effect of a higher charge for depreciation and amortization of fixed assets, which increased by HUF 8,591 million. In 1999, the change in receivables increased by HUF 906 million and the change in payables decreased by HUF 15,671 million, which led to a corresponding decrease in net cash flows from operating activities. Net income tax paid also increased by HUF 7,550 million in 1999 compared to 1998.

Net Cash Flows from Investing Activities. *Net cash flows from investing activities are primarily driven by capital expenditures, movements in other financial assets and purchase of investments. Capital expenditures were HUF 94,786 million in 1997, HUF 116,283 million in 1998 and HUF 127,678 million in 1999. Movements in other financial assets in 1998 represented a cash inflow of HUF 6,638 million from sale of government bonds. Movements in other financial assets in 1999 represented a cash outflow of HUF 2,458 million from purchase of government bonds. Purchase of investments increased by HUF 7,644 million in 1998 compared to 1997 primarily as a result of the repurchase by Westel 900 of its shares.*

Net Cash Flows from Financing Activities. *Net cash flows from financing activities are primarily driven by the Company's borrowing activities. MATÁV received net proceeds from loans of HUF 5,471 million in 1997, made net repayments of HUF 8,954 million in 1998 and received net proceeds from loans of HUF 2,268 million in 1999. Net cash flows from financing activities decreased in 1998 principally as a result of a HUF 16,581 million increase in dividends paid. Net cash flows from financing activities increased in 1999 compared to 1998 principally as a result of a HUF 6,250 million decrease in dividends paid.*

Net Working Capital. *The Company's current liabilities generally exceed its current assets, because the Company, in keeping with its aim of maintaining low levels of working capital, has negotiated longer repayment terms. As a result, payables have a longer term than receivables. Accordingly, although the Company's current liabilities exceeded current assets at December 31, 1997, 1998 and 1999, it was capable of meeting payables as they fell due from its positive operating cash flow. In addition, MATÁV has built up and maintains a significant level of undrawn committed credit facilities which it uses, when necessary, to meet current liabilities as they fall due.*

At December 31, 1999, the Company had undrawn committed short-term credit facilities of approximately HUF 8,314 million

and undrawn committed long-term credit facilities of approximately HUF 85,546 million. Undrawn committed long term credit facilities of HUF 54,464 million expire in 2001, HUF 25,332 million expire in 2002, HUF 700 million expire in 2005 and HUF 5,050 million have no specified expiration date. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin. There are pledges on assets for loans totaling HUF 9,726 million.

Indebtedness. The Company's total indebtedness analyzed by currency is as follows:

	<i>At December 31,</i>	
	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>	
<i>Hungarian Forint</i>	70,649	93,988
.....		
<i>Deutsche mark</i>	52,590	42,779
<i>U.S. dollar</i>	29,122	24,006
<i>Swiss franc</i>	6,776	4,812
<i>Dutch guilder</i>	5,261	5,047
.....		
<i>Other</i>	<u>8,073</u>	<u>11,887</u>
	<u>172,471</u>	<u>182,519</u>

HUF 17,804 million of indebtedness is scheduled for repayment in 2000, HUF 68,893 million is scheduled for repayment in 2001 and HUF 23,477 million is scheduled for repayment in 2002. MATÁV expects scheduled repayments of indebtedness and possible prepayments to be financed primarily from cash flows from operating activities and from undrawn committed credit facilities.

As of December 31, 1999, approximately 72 percent of the Company's indebtedness bore interest at variable rates. The Company's Hungarian Forint denominated floating rate indebtedness is subject to interest rates between 14.4 percent and 18.9 percent based on various reference rates, including BUBOR and the rate quoted by the National Bank of Hungary. The Company's foreign currency denominated floating rate indebtedness is subject to interest rates between 3.7 percent and 7.2 percent, with rates generally based on LIBOR plus a margin. A substantial majority of the Company's fixed rate indebtedness is foreign currency denominated and bears an average interest rate of 6.7 percent.

MATÁV issued a domestic floating rate note of HUF 10 billion with a maturity of five years and a domestic fixed rate bond of HUF 5 billion with a maturity of one year in March 1998. The interest rate on the floating rate note is 50 basis points above the average rate in the three auctions of the six-month Hungarian Treasury bill prior to the relevant interest period. The fixed rate bond has been repaid.

MATÁV's operating revenues and expenses are denominated almost entirely in Hungarian Forints. Amounts payable to and receivable from other international carriers, which are denominated in a basket of currencies known as special drawing rights, are netted against one another and settled primarily in U.S. dollars and Deutsche marks. Capital expenditures are denominated partly in foreign currencies, principally U.S. dollars and Deutsche marks.

Several of the Company's loan agreements contain covenant restrictions, including financial ratio requirements. At December 31, 1999, the Company was in compliance with these requirements. These restrictions do not significantly affect the liquidity of the Company.

Capital Expenditures

The Company's capital expenditures totalled HUF 94,786 million in 1997, HUF 116,283 million in 1998 and HUF 127,678 million in 1999. Capital expenditures included expenditures for (1) the fixed line network, including network operations systems, (2) mobile telecommunications and (3) new products, corporate infrastructure and other assets.

Capital expenditures for the fixed line network accounted for 57 percent of total capital expenditures in 1997, 48 percent of total capital expenditures in 1998 and 43 percent of total capital expenditures in 1999. Capital expenditures for mobile telecommunications totalled 15 percent of total capital expenditures in 1997, 16 percent of total capital expenditures in 1998 and 25 percent of total capital expenditures in 1999. The remainder of capital expenditures for this period related to investment in infrastructure. Expenditures on information technology increased from approximately three percent in 1997 to approximately five percent in 1999.

The Company expects capital expenditures relating to its existing lines of business to be approximately HUF 150 billion both in 2000 and 2001. The Company expects that expenditures for the fixed line network will be 45 percent in 2000 and 43 percent in 2001 of total capital expenditures, and that expenditures for mobile telecommunications will be 29 percent of total capital expenditures in 2000 and then decline. Mobile capital expenditures in 2000 include the DCS 1800 licence fee. Other capital expenditures are expected to increase from 32 percent in 1999 to 36 percent in 2001. Expenditures related to information technology are expected to remain about four percent of total capital expenditures in 2000 and 2001.

The Company expects to be able to finance capital expenditures over the next several years from net cash flows from operations and from borrowings. The Company's actual future capital expenditures will depend on a variety of factors, such as the development of its business and of the Hungarian economy and whether MATÁV enters into any new lines of business. As a result, the Company's actual future capital expenditures may be significantly different.

Implementation of the Euro

The euro's implementation impacts MATÁV in two ways: (1) through debt denominated in Deutsche marks, French francs, Dutch guilders and ECUs and (2) through capital expenditures payable in foreign currencies of European Monetary Union member countries. Since January 1, 1999, new contracts with EU-based suppliers and new loans made with EU-based institutions have been denominated in euros. With respect to contracts and loans in place prior to January 1, 1999, the Company has the right during the euro transition period, which ends January 1, 2002, either to pay in the currency of the contract or to convert these contracts into euro terms. The Company will evaluate its contracts on a case-by-case basis to determine whether it is advantageous to convert agreements to euros before the end of the transition period. After January 1, 2002, all agreements made with reference to national currencies of European Monetary Union member countries will automatically refer to the euro. MATÁV believes that the implementation of the euro should not have a material effect on the Company.

Reconciliation to U.S. GAAP

The following table reconciles net income and shareholders' equity under IAS to U.S. GAAP for the periods indicated:

	Year ended December 31,		
	1997	1998	1999
	(in HUF millions)		
Net income:			
IAS	36,034	58,337	78,632
U.S. GAAP	30,130	58,564	78,721
Shareholders' equity:			
IAS	208,676	257,245	327,579
U.S. GAAP	193,457	244,783	315,248

Reconciling adjustments relate principally to the different treatment under U.S. GAAP of deferred revenue, post-retirement benefits, management incentive plan bonds and the employee stock purchase plan. See Note 26 to the consolidated financial statements.

Under U.S. GAAP, revenue relating to investment contribution and entrance fees is recognized as any related potential refund obligation is extinguished. This accounting treatment emphasizes the legal nature of the potential refund obligation and creates a timing difference between the ongoing expense recognition and the delayed revenue recognition. This interpretation is expected to result in a lump sum revenue recognition of deferred fees by approximately HUF 19 billion in June 2000.

Under IAS, Westel 900 and Westel 450 are consolidated. Under U.S. GAAP, however, the Company believes that although it holds 51 percent of Westel 900 and Westel 450, the ownership rights of the minority shareholder may be considered participatory in nature and would preclude consolidation for purposes of the reconciliation to U.S. GAAP. Accordingly, under U.S. GAAP, both companies were accounted for using the equity method. There is, however, no difference in net income or shareholders' equity under U.S. GAAP as a result. See Note 26 to the consolidated financial statements.

Additional disclosures required for IAS — Recent Accounting Pronouncements

The following IAS standards were not required to be implemented in 1999. The adoption of these standards are not expected to have a material impact on the Company's consolidated financial statements.

IAS 22 (revised) "Business Combinations"

IAS 35 "Discontinuing Operations"

IAS 36 "Impairment of Assets"

IAS 37 "Provisions, Contingent Liabilities and Contingent Assets"

IAS 38 "Intangible Assets"

IAS 39 "Financial Instruments Recognition and Measurement"

Additional disclosures required for U.S. GAAP — Recent Accounting Pronouncements

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" is effective for financial periods beginning after June 15, 1999. Upon initial application all derivatives are required to be recognized in the balance sheet as either assets or liabilities and measured at fair value. In addition, all hedging relationships must be designated, documented and reassessed. The Company is currently evaluating the effect that SFAS No. 133 will have on its consolidated financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," (SAB 101) which provides additional guidance in applying generally accepted accounting

principles. In certain cases, SAB 101 requires upfront fees be deferred and recognized over the expected period of performance. We are assessing the types of transactions that may be affected by this Bulletin. Its impact on the consolidated financial statements is not yet known.

ITEM 9A — QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk Sensitive Instruments

MATÁV is exposed to interest and foreign exchange rate risk associated with its debt and anticipated transactions. MATÁV has no significant concentrations of credit risk. The functional accounting currency of MATÁV is the Hungarian Forint, therefore MATÁV's objective is to minimize the level of its financial risk in Hungarian Forint terms.

MATÁV's major financial market risk exposure is in interest rate fluctuations. This is due to the fact that changing interest rates in the U.S. and Western-Europe affect the fair value of fixed rate debt. To control interest rate risk, a combination of fixed and floating rate debt is used within the foreign currency and Hungarian Forint portfolios. In the case of foreign debt, MATÁV maintains a balance between fixed rate and variable rate debt. Mainly floating rate instruments are used in the case of Hungarian Forint debt due to decreasing interest rates.

MATÁV is exposed to foreign exchange risk related to foreign currency debt and foreign exchange payments (i.e. international third party telecommunications carriers and capital expenditure). To reduce foreign exchange risk, MATÁV's debt portfolio guidelines limit the individual classes of currencies in the debt portfolio. MATÁV is increasing the proportion of its borrowings in Hungarian Forint as the Hungarian capital market develops. Most of MATÁV's foreign exchange debt portfolio is adjusted to the same mix as the official basket of foreign currencies used by the National Bank of Hungary to devalue the Hungarian Forint and to determine official exchange rates. Matching the composition of MATÁV's foreign debt portfolio to the basket of currencies used by the National Bank of Hungary in its regulation of the Hungarian Forint minimizes the foreign exchange cross currency risk.

In 1998 and 1999 MATÁV occasionally entered into derivative contracts for hedging purposes. These foreign currency forward contracts and swap arrangements were taken to reduce the exchange rate risk of debt repayments or to adjust the currency structure of the debt portfolio to match that used by the National Bank of Hungary in its management of the Hungarian Forint. Using derivatives to change the debt portfolio's composition serves to reduce cross currency risk.

Included in bank loans are U.S. dollars denominated loans amounting to HUF 5,878 million and subject to interest based on a fixed rate of 7.05%. These loans are the subject of a cross currency interest rate swap arrangement which entitles the Company to receive U.S. dollars interest and principal payments at fixed rates and obliges it to pay euro interest and principal repayments at floating rates of the EURIBOR rate plus a margin of 0.66%. The euro principal payments are fixed at a rate of 1 euro = 1.0777 U.S. dollars. The timing and amount of the U.S. dollars payments to be received exactly matches the underlying payment obligations on the U.S. dollars loan. The Company accounts for interest and foreign exchange movements on these loans at the euro rate.

Effective January 3, 2000, an additional HUF 6,082 million in U.S. dollars denominated loans subject to interest based on a fixed rate of 6.56%, are the subject of a cross currency swap agreement. This swap agreement entitles the Company to receive U.S. dollars interest and principal payments at fixed rates and obliges it to pay euro interest and principal payments at fixed rates of 5.17%. Euro principal payments will be determined according to the euro equivalent of the U.S. dollars principal payments using the average of the USD/EUR spot rates between October 27, 1999 and December 22, 1999. The timing and amount of the U.S. dollars payments to be received will exactly match the underlying payment obligations of the U.S. dollars loans.

Derivative instruments are limited to foreign currency forward contracts and swap agreements that are not recognized in the financial statements on inception. In the case of foreign currency forward contracts, any increase or decrease in the amount required to settle the liability is off-set by a corresponding movement in the value of the forward exchange contract. Gains and losses on derivative positions are booked against the gain or loss on the related underlying positions being hedged. In 1999, losses of HUF 515 million was recognized in the statements of income related to foreign currency forward contracts. As of December 31, 1999, MATÁV held foreign currency forward contracts covering DEM 226 million and U.S.\$30 million.

The financial asset portfolio is relatively small compared to the debt portfolio of MATÁV and includes only short term, marketable securities with active secondary markets to ensure liquidity. MATÁV mitigates credit risk by investing only in high quality securities. As of December 31, 1999, MATÁV's cash balance included HUF denominated cash equivalent instruments

with a value of HUF 3,740 million at an average fixed interest rate of 11.6 percent and HUF 2,844 million in variable rate instruments with an average interest rate of 8.4 percent. Financial investments of HUF 3,732 million were held in fixed rate instruments at an average interest rate of 13.5 percent. The net carrying amounts of financial assets including cash, investments, receivables and payables and finance lease obligations reflect reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

The following table is a summary of MATÁV's market sensitive debt instruments, including fair value calculated using the discounted cash flow method. Average rates disclosed represent the weighted average rates of fixed rate and variable rate portfolios at period end. The book values of variable rate loans and borrowings approximate their fair values as shown below at December 31, 1999.

	<i>Maturities</i>						<i>Total</i>	<i>Fair value</i>
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>after 2004</u>		
	<i>(in HUF millions, except percentages)</i>							
<i>Bank loans (HUF denominated)</i>								
<i>Fixed rate</i>	83	0	0	0	12,500	0	12,583	13,898
<i>Average interest rate</i>	16.00%				11.75%			
<i>Variable rate</i>	13,166	12,000	18,885	12,125	5,125	6,375	67,676	67,676
<i>Average interest rate</i>	14.80%	14.94%	14.84%	14.62%	14.71%	14.66%		
<i>Total</i>	<u>13,249</u>	<u>12,000</u>	<u>18,885</u>	<u>12,125</u>	<u>17,625</u>	<u>6,375</u>	<u>80,259</u>	<u>81,574</u>
<i>Bank loans (foreign currency denominated)</i>								
<i>Fixed rate</i>	3,935	3,935	3,935	3,935	3,935	16,485	36,160	39,475
<i>Average interest rate</i>	6.61%	6.61%	6.61%	6.61%	6.61%	6.79%		
<i>Variable rate</i>	1	52,370	0	0	0	0	52,371	52,371
<i>Average interest rate</i>	17.5%	4.57%						
<i>Total</i>	<u>3,936</u>	<u>56,305</u>	<u>3,935</u>	<u>3,935</u>	<u>3,935</u>	<u>16,485</u>	<u>88,531</u>	<u>91,846</u>
<i>Total bank loans</i>	<u>17,185</u>	<u>68,305</u>	<u>22,820</u>	<u>16,060</u>	<u>21,560</u>	<u>22,860</u>	<u>168,790</u>	<u>173,420</u>
<i>Bonds and bills of exchange (HUF denominated)</i>								
<i>Fixed rate</i>	87	0	4	0	0	0	91	90
<i>Average interest rate</i>	8.86%		10.00%					
<i>Variable rate</i>	0	0	0	10,000	0	0	10,000	10,000
<i>Average interest rate</i>				14.62%				
<i>Total</i>	<u>87</u>	<u>0</u>	<u>4</u>	<u>10,000</u>	<u>0</u>	<u>0</u>	<u>10,091</u>	<u>10,090</u>

ITEM 10 — DIRECTORS AND OFFICERS OF REGISTRANT

Board of Directors

Under Hungarian law, the Board of Directors is responsible for the Company's management and decides on matters other than those that must be determined by shareholders. The Board of Directors is required to report to the shareholders at the annual general meeting of the shareholders and quarterly to the Supervisory Board on the business administration, state of the assets and business policy of the Company.

Pursuant to the Company's amended Articles of Association, the Board of Directors consists of a minimum of six and a maximum of 11 members elected at the annual general meeting of the shareholders for a term of one year. The Hungarian state, as holder of the Series "B" share, is entitled to nominate one member of the Company's Board of Directors. MagyarCom has the power to cause the election of all other members of the Board of Directors at the general meeting of shareholders.

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

The current members of the Board of Directors, their principal occupations and the years of their original election are as follows:

<u>Name</u>	<u>Principal Occupation</u>	<u>Member since</u>
Elek Straub	Chairman and Chief Executive Officer of MATÁV	1995
.....		
Timothy J. Cawley	President of SBC International	1998
William J. Edwards	Member of Executive Committee of MATÁV	1998
Moritz Gerke	Senior Executive Director for Central Europe, Eastern Europe and the Middle East at Deutsche Telekom	1996
Franz X. Hiergeist	Executive Director, Domestic Networks, Planning and Systems at Deutsche Telekom	1994
Dr. Zsolt Lajer *.....	Lawyer	1999
Dr. Mark von Lillienkiold	Member of Executive Committee of MATÁV	1996
Dr. Mihály Patai	Chairman and Chief Executive of Hungária Biztosító	1998
.....		
Dr. Károly Szász	Chief Executive Officer of Konzumbank	1999
A. Vernon Weaver	Former U.S. Representative to the European Union	1999

* Representative of the holder of the Series "B" Share.

Board of Directors' Biographies

Elek Straub. Mr. Straub was appointed a Director in 1995. Mr. Straub has served as Chairman of the Board of Directors since January 1996. He served as the Head of the IT Department of the Ministry of Labor from 1970 through 1980. From 1980 through 1990 he was first the Head and later the Vice President of the IT Division of the Central Statistical Office of the Hungarian government. From 1990 to 1995, he was the General Manager of IBM Hungary. In 1995 he joined MATÁV. Mr. Straub became a member of the Operating Committee in 1995 and Chairman of the Executive Committee in 1996.

Timothy J. Cawley. Mr. Cawley joined Ameritech Inc. in 1993 as Vice President, Marketing of Small Business Services. He became President of Small Business Services in 1995 which generated U.S.\$1.4 billion annual revenue. From 1997 to 1998 he served as President of European Operations and was responsible for U.S.\$5 billion in investments in Denmark, Belgium, Hungary, Norway and Germany. Since 1998, he has served as President of Ameritech International.

William J. Edwards. *Mr. Edwards has over 25 years of business management experience in the telecommunications and business equipment industries. He joined Ameritech in 1984 and served nine years as Vice President of Radio Frequency Services. In 1994 and 1995 he was Vice President, Corporate Strategy responsible for transforming Ameritech's product management structure.*

Moritz Gerke. *Mr. Gerke was appointed a Director in 1996. He acted as Project Manager and Marketing Manager at Hewlett-Packard GmbH from 1982 through 1990. Between 1991 and 1995, he worked for Marcam Corp., serving first as Managing Director and later as General Manager. From 1995 to 1997 he was the Director responsible for International Business and Joint Ventures at Deutsche Telekom. Since 1998, he has been the Senior Executive Director for Central Europe, Eastern Europe and the Middle East at Deutsche Telekom.*

Franz X. Hiergeist. *Mr. Hiergeist was appointed a Director in 1994. He began his professional career in 1968 at Deutsche Bundespost Telecommunications Engineering Center in the field of satellite communications and long term studies. In 1976 he became responsible for telephone services and operations and national satellite projects at the Ministry of Posts and Telecommunications in Bonn. He currently serves as Executive Director of Domestic Networks, Planning and Systems at the Deutsche Telekom General Directorate.*

Dr. Zsolt Lajer. *Dr. Lajer started his career as a civil servant, then he joined the State Bank Supervision, and later he became Chief Legal Counsel of Commerzbank (Budapest). Currently, he works as a lawyer and regularly contributes to numerous legal journals. He is a member of the German-Hungarian Lawyers' Association, the Banking Commission of ICC Hungary, the International Bar Association's Banking Law Committee, a founder and a member of the presidium of the Swiss-Hungarian Lawyers' Association. The Ministry of Transport, Communications and Water Management nominated him as Member of MATÁV Ltd.'s Board of Directors.*

Dr. Mark von Lillienkiold. *Dr. von Lillienkiold was appointed a Director in 1996. He began his professional career in 1977 at Bayer, where he held positions including Director, Finance Director and Board Member of various subsidiaries in several countries. From 1986 through 1991, he was employed at a subsidiary of the BAT Group, where he served as Finance Manager from 1986 through 1988 and Finance Director and Board Member from 1988 through 1991. From 1991 through 1993, he worked for two affiliates of Banco Latino/Lauria Group as Vice President of Finance. He joined Deutsche Telekom in 1994 as Executive of International Finance. Currently serving as an Executive Officer, he has been a member of the Operating Committee since 1994 and a member of the Executive Committee since 1996.*

Dr. Mihály Patai. *Dr. Patai started to work at the National Bank of Hungary in 1976, and joined the Financial Research Institute in 1978. Between 1982 and 1988 he served at the Ministry of Finance, Department of International Finances. He became Chairman of the Board at General Banking and Trust Company Ltd. In 1988, he joined the World Bank, Washington DC, then worked as Bank and IFC alternate executive director. In 1993 he became managing director of Kereskedelmi Bank Rt. in charge of International and Foreign Exchange Operations. In 1996 he became Chairman and CEO at Budapest Investment International Inc. He has been Chairman of the Board and CEO of Hungária Biztosító since 1996.*

Dr. Károly Szász. *Dr. Szász started his career at TESCO Foreign Trade Company in 1981. He joined the Central European International Bank Ltd. (CIB) in 1984, and served in positions of increasing responsibilities. In 1995, he became Director of the Corporate Business Unit of the Hungarian Foreign Trade Bank Ltd., and also served as Member on the Board of this bank. He became Director of the Corporate Business Unit at CIB in 1996. He became CEO of HypoVereinsbank Hungária Ltd. in 1998, and CEO of Konzumbank in 1999. ÁPV Rt. nominated him as Member of MATÁV Ltd.'s Board of Directors.*

A. Vernon Weaver. *Mr. Weaver built up his successful career during his 32 years with Stephens Group and Stephens Inc., an investment banking firm of Little Rock, Arkansas. He supervised this firm's operations in Europe and, as President and CEO of Stephens Overseas Services, he directed financial institutions in Indonesia, Singapore and Hong Kong. He also served as President of Union Life Insurance of Little Rock from 1964 through 1977, and as Administrator of the U.S. Small Business Administration from 1977 through 1981. He was Assistant to the Chairman of the Board of Stephens Group and Stephens Inc. in 1996, when he was nominated U.S. Representative to the European Union.*

Executive Committee

Pursuant to the Company's amended Articles of Association, the Board of Directors has established an Executive Committee,

which is empowered to carry out the day-to-day operations in accordance with the annual business plan. The Executive Committee is also empowered to transfer its rights to the Company's executive officers, and, with the exception of the Chief Executive Officer, to appoint or dismiss executive officers, define their remuneration and perform other activities assigned to it by the Board of Directors. The Executive Committee consists of three members, who are members of the Board of Directors. The current members of the Executive Committee are Elek Straub, William J. Edwards and Dr. Mark von Lillienkiold.

Supervisory Board

The Supervisory Board is responsible for supervising the administration and control of the Company and for assuring that the Company meets Hungarian legal requirements and the provisions set out in its own governing instruments. The Supervisory Board reviews every significant report delivered at the general meeting of the shareholders, proposals by the Board of Directors, the financial statements, and proposals regarding profit distribution. The Supervisory Board also prepares a report on these topics for the general meeting of shareholders at which the annual report is discussed.

Pursuant to the Articles of Association, the Supervisory Board consists of nine members elected by the shareholders for terms of one year each. The Works Council nominates one third of the Supervisory Board members in accordance with the rules set out to guide the election of employee members. The holder of the Series "B" share has the right to nominate one member of the Supervisory Board. Meetings of the Supervisory Board require a quorum of six members.

The current members of the Supervisory Board, their principal occupation and the years of their original election are as follows:

<u>Name</u>	<u>Principal Occupation</u>	<u>Member since</u>
Dr. Csaba Csapodi	Ministry of Transport, Telecommunications and Water Management, Head of Development Division	1998
David A. Dohnalek *.....	Assistant Treasurer, Ameritech International	1998
Paul B. Grosse	Senior Director, International Business Development, Deutsche Telekom	1998
Dr. Horst D. Laubscher	Senior Executive Director, International Finance, M & A, Deutsche Telekom	1996
Dr. László Pap	Budapest University of Technology, Dean, Professor, Head of Department	1997
Joe Rosen	Director of Finance, SBC International	1998
József Szabó	President of the Work Council, West Hungary Technical Directorate	1999
György Varjú	President of the Work Council, Budapest Technical Directorate	1999
Péter Vermes	Chairman of MATÁV's Works Council	1997

* Mr. Dohnalek resigned from his position on January 27, 2000. His successor is not appointed yet.

Indemnification of the Board of Directors and Supervisory Board

Pursuant to the Company's amended Articles of Association, to the extent permitted by law, the Company is required to indemnify each current and former member of the Board of Directors and the Supervisory Board in certain circumstances. Generally, if such an individual is liable for certain costs or damages in connection with his board position and has acted in good faith, then the Company must indemnify him. The Company may maintain insurance on behalf of any person who is or was a member of the Board of Directors or the Supervisory Board against any liability asserted against him and incurred by him in any such capacity, whether or not the Company would have the right to indemnify him against such liability.

Executive Officers

The current executive officers of MATÁV, their current positions and the years of their appointment are as follows:

<u>Name</u>	<u>Position</u>	<u>Year of Appointment</u>
Elek Straub	Chairman and Chief Executive Officer	1996
László Bodnár	Chief Logistics Officer	1999
John Brady	Chief Financial Officer	1999
William J. Edwards	Executive Officer	1998
Ottó Gecser	Chief Marketing Officer	1996
Dr. Mark von Lillienkiold	Executive Officer	1994
Manfred Ohl	Chief Technical Officer	1999
Dr. Tamás Pásztory	Chief Human Resources and Legal Officer	1996

Executive Officers' and Chief Officers' Biographies

Elek Straub, *Chairman and Chief Executive Officer. See biography above.*

László Bodnár, *Chief Logistics Officer. Mr. Bodnár was appointed MATÁV's Chief Logistics Officer on March 16, 1999. His key assignment is coordination of MATÁV's IT activities. He joined the Miskolc Post Directorate in 1971, and served in posts of increasing responsibilities. He was Director of the Sopron Post Directorate in 1989-1990, and Head of the Sopron Telecommunications Directorate from 1990 until 1999. In 1998 and 1999 he supervised the modernization of MATÁV's organization. From January 1, 1999 he served as Director of the West Hungary Technical Directorate.*

John Brady, *Chief Financial Officer. Mr. Brady was appointed MATÁV's Chief Financial Officer on June 1, 1999. He worked for Xerox and Pepsi Cola between 1975 and 1985 in the financial and planning fields. He filled several positions at MCI Inc. From 1993, he directed the market research unit, then the domestic strategy division, and acted as Director responsible for planning. He became financial officer of the Domestic Long-distance Calls Business Unit at Ameritech in 1993. Then he was appointed Vice President of TeleDenmark, a subsidiary of SBC-Ameritech in Europe.*

William J. Edwards, *Executive Officer. See biography above.*

Ottó Gecser, *Chief Marketing Officer. In December 1996, Mr. Gecser joined MATÁV as Chief Marketing Officer. He worked for Marubeni Corp., a Japanese trading house, as a sales representative in the Mechanical Engineering Department from 1980 through 1988, and in 1988 he was appointed Hungarian Director of Marubeni Hungary Kft. From 1989 to 1992, he served as Senior Vice President and COO for Fujifilm Hungary Kft. In 1992, he joined the Fotex Group as Senior Deputy CEO and was responsible for coordinating the operation of the companies held by the Fotex Group and coordinating the launching of new products for the Fotex Group.*

Dr. Mark von Lillienkiold, *Executive Officer. See biography above.*

Manfred Ohl, *Chief Technical Officer. Deutsche Telekom appointed Mr. Ohl Chief Technical Officer of MATÁV in November 1998. He was Head of the Technical and Network Business Unit in Frankfurt am Main, which is a business unit serving the telecommunications demand of international companies. During the construction of the telecommunications infrastructure in the new federal states of Germany, Mr. Ohl worked for the Headquarters and was responsible for turn-key cable network construction. Then Mr. Ohl was responsible for reconciliation of the Business Plan with the investment demand for network infrastructure in the area of Deutsche Telekom, and for central coordination of investments.*

Dr. Tamás Pásztor, *Chief Human Resources and Legal Officer. Dr. Pásztor has been the Executive Director of the Human Resources Branch since MATÁV's establishment. He was appointed Deputy Chief Officer of MATÁV in July 1995 and Chief Human Resources and Legal Officer of MATÁV in February 1996. He is responsible for MATÁV's operational and organizational development activity. He joined MATÁV's predecessor in 1969 and since 1980 has been in various positions in the human resources area.*

ITEM 11 — COMPENSATION OF DIRECTORS AND OFFICERS

For the year ended December 31, 1999, the aggregate compensation of the Board of Directors was HUF 13.8 million.

For the year ended December 31, 1999, the aggregate compensation of the members of the Supervisory Board was HUF 9.5 million.

For the year ended December 31, 1999, the aggregate compensation of the Executive Officers was HUF 218.3 million.

ITEM 12 — OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT OR SUBSIDIARIES

In its meeting on April 28, 1998, the general meeting of the shareholders approved a conditional capital increase of MATÁV Rt. to facilitate the flotation of convertible bonds and authorized the Board of Directors to carry out the flotation.

From June 29, 1998 to July 1, 1998, MATÁV Rt. issued through a public offering 7,000,000 convertible bearer bonds with a nominal value of HUF 1 each. Each bond may be converted into one ordinary share. The bonds bear interest at the rate of 10 percent. Unless previously converted, the bonds pay principal and interest at maturity. The bonds mature on June 30, 2002.

The objective of issuing the convertible bonds was to establish a closer tie between the interests of shareholders and management in the performance of the Company. Senior and corporate level middle managers having at least three years continuous tenure with the Company or one of its wholly owned subsidiaries were entitled to subscribe for the bonds. The maximum number of bonds that may be allocated to each employee is as follows:

- Chief Executive Officer: 140,000 bonds;*
- Executive Committee members and Chief Officers: 65,000 bonds per individual;*
- Executive Directors, Directors of mid-level units, and top managers of consolidated subsidiaries wholly owned by MATÁV Rt.: 32,000 bonds per individual; and*
- Heads of Department at the headquarters and Deputy Directors of mid-level units: 21,000 bonds per individual.*

On July 1, 1998, 4.2 million bonds were allocated to management. 2.8 million bonds remained unallocated.

One third of the bonds may be converted into ordinary shares in each year from July 1, 1999 until maturity. The Bonds cannot be converted after maturity.

The conversion price of the bonds is the Hungarian Forint equivalent of U.S.\$5.75 per bond, calculated based on the middle U.S. dollar/Hungarian Forint exchange rate quoted by the National Bank of Hungary on the day of conversion, less the nominal value of the bond, but not less than the initial public offering price of HUF 730 per share. The general meeting of the shareholders determined and approved the conversion price, which is based on MATÁV's average share price on the Budapest Stock Exchange converted into U.S. dollars on May 29, 1998 using the currency exchange rate of the National Bank of Hungary.

Total compensation expense of HUF 143 million will be recognized over the three year vesting period. The amount amortized from July 1, 1998 to December 31, 1998 is HUF 24 million. The amount amortized in 1999 of HUF 42 million reflects the same amortization as in 1998, but reduced due to the forfeit of 402,000 bonds by managers.

ITEM 13 — INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS

Not applicable.

PART II

ITEM 14 - DESCRIPTION OF SECURITIES TO BE REGISTERED

Not applicable.

PART III

ITEM 15 — DEFAULTS UPON SENIOR SECURITIES

Not applicable.

**ITEM 16 — CHANGES IN SECURITIES AND CHANGES IN SECURITY
FOR REGISTERED SECURITIES**

Not applicable.

PART IV

ITEM 17 - FINANCIAL STATEMENTS

Not applicable.

ITEM 18 - FINANCIAL STATEMENTS

See Item 19 for a list of financial statements filed under Item 18.

ITEM 19 — FINANCIAL STATEMENTS AND EXHIBITS

MAGYAR TÁVKÖZLÉSI RT.

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INDEPENDENT ACCOUNTANT'S REPORT TO THE BOARD OF DIRECTORS OF

MAGYAR TÁVKÖZLÉSI RT.

We have audited the accompanying consolidated balance sheets of Magyar Távközlési Rt. ("MATÁV") as of December 31, 1998 and 1999, and the related consolidated statements of income, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of MATÁV's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. Generally Accepted Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of MATÁV as of December 31, 1998 and 1999, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1999 in accordance with International Accounting Standards.

Application of accounting principles generally accepted in the United States of America would have affected shareholders' equity as of December 31, 1998 and 1999 and net income for each of the years in the three year period ended December 31, 1999 to the extent summarized in Note 26 to the consolidated financial statements.

PricewaterhouseCoopers
Könyvvizsgáló és Gazdasági Tanácsadó Kft.

Budapest
February 23, 2000

MAGYAR TÁVKÖZLÉSI RT.
CONSOLIDATED BALANCE SHEETS

	<i>Notes</i>	<i>At December 31,</i>		
		<i>HUF</i>		<i>U.S.\$</i>
		<i>1998</i>	<i>1999</i>	<i>1999</i>
		<i>(in millions)</i>		<i>(unaudited)</i>
ASSETS				
Current assets				
Cash and cash equivalents	4	3,613	6,584	26
Financial investments	5	1,274	3,732	15
Receivables	6	51,662	66,667	264
Inventories	7	8,117	9,539	38
Total current assets		<u>64,666</u>	<u>86,522</u>	<u>343</u>
Fixed assets				
Property, plant and equipment	8	449,664	512,700	2,030
Intangible assets	9	24,781	33,007	131
Associates and other long term investments		5,029	9,392	37
Other non-current assets	10	5,400	6,249	25
Total non-current assets		<u>484,874</u>	<u>561,348</u>	<u>2,223</u>
Total assets		<u>549,540</u>	<u>647,870</u>	<u>2,566</u>
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Loans and other borrowings	11	19,311	17,804	71
Trade and other payables	13	74,956	87,945	348
Deferred revenue	14	5,638	4,685	19
Provision for liabilities and charges	15	4,322	4,925	20
Total current liabilities		<u>104,227</u>	<u>115,359</u>	<u>458</u>
Non current liabilities				
Loans and other borrowings	11	153,160	164,715	652
Deferred revenue	14	18,260	13,606	54
Provision for liabilities and charges	15	4,513	3,599	14
Total non current liabilities		<u>175,933</u>	<u>181,920</u>	<u>720</u>
Minority interests	16	12,135	23,012	91
Shareholders' equity				
Common stock.....		103,728	103,728	411
Additional paid in capital		22,834	22,834	90
Retained earnings		130,683	201,017	796
Total shareholders' equity		<u>257,245</u>	<u>327,579</u>	<u>1,297</u>
Total liabilities and shareholders' equity		<u>549,540</u>	<u>647,870</u>	<u>2,566</u>

These consolidated financial statements were accepted for the Board of Directors on February 23, 2000 and signed on their behalf by:

Elek Straub
Chairman and Chief Executive Officer

John Brady
Chief Financial Officer

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

MAGYAR TÁVKÖZLÉSI RT.

CONSOLIDATED INCOME STATEMENTS

	Notes	For the year ended December 31,			U.S.\$
		HUF			1999
		1997	1998	1999	(unaudited)
(in millions, except per share amounts)					
Revenues	17	253,948	318,060	384,932	1,524
Employee-related expenses		(37,799)	(46,902)	(57,168)	(226)
Depreciation and amortization		(40,668)	(53,554)	(62,145)	(246)
.....					
Payments to other network operators		(27,226)	(35,965)	(44,184)	(175)
Cost of telecommunications equipment sales		(14,268)	(17,175)	(22,392)	(89)
Other operating expenses		(59,933)	(68,355)	(77,912)	(309)
Total operating expenses		(179,894)	(221,951)	(263,801)	(1,045)
Operating profit		74,054	96,109	121,131	479
Net interest and other charges	18	(29,865)	(28,795)	(22,133)	(88)
Share of associates' results before income tax		(238)	302	1,428	6
.....					
Profit before income tax		43,951	67,616	100,426	397
Income tax (expense) / benefit	19	(303)	1,267	(6,911)	(27)
Profit after income tax		43,648	68,883	93,515	370
Minority interest	16	(7,614)	(10,546)	(14,883)	(59)
Net income		<u>36,034</u>	<u>58,337</u>	<u>78,632</u>	<u>311</u>
Basic earnings per share					
Net income per share		34.74	56.24	75.81	0.30
Weighted average common stock outstanding		1,037	1,037	1,037	1,037
Diluted earnings per share					
Net income per share		34.74	56.24	75.52	0.30
Weighted average common stock outstanding		1,037	1,037	1,041	1,041

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

MAGYAR TÁVKÖZLÉSI RT.

CONSOLIDATED CASH FLOW STATEMENTS

	For the year ended December 31,			U.S.\$
	HUF			1999
	1997	1998	1999	(unaudited)
	(in millions)			
Cash flow from operating activities				
Operating profit	74,054	96,109	121,131	479
Depreciation and amortization	40,668	53,554	62,145	246
Change in payables	(1,172)	20,841	5,170	20
Change in inventory	(295)	(806)	(1,302)	(5)
Change in receivables	(4,091)	(16,404)	(17,310)	(68)
Receipt of new customer fees	7,023	7,266	5,765	23
Amortization of deferred revenue	(6,207)	(5,886)	(5,607)	(22)
Other cashflows from operations	(2,488)	(2,351)	(4,215)	(17)
Cash generated from operations	107,492	152,323	165,777	656
Interest paid	(15,735)	(15,225)	(17,533)	(69)
Commissions and bank charges	(1,230)	(1,311)	(1,941)	(8)
Net income tax paid	(498)	(288)	(7,838)	(31)
Net cash flows from operating activities	90,029	135,499	138,465	548
Cash flows from investing activities				
Capital expenditures on tangible and intangible assets	(94,786)	(116,283)	(127,678)	(505)
Purchase of investments	(1,960)	(9,604)	(3,551)	(14)
Interest received	3,190	2,045	2,897	11
Dividends received	0	410	526	2
Movement in other financial assets	(7,370)	6,638	(2,458)	(10)
Proceeds from sale of fixed assets	1,097	2,437	3,804	15
Net cash flows utilized in investing activities before extraordinary items	(99,829)	(114,357)	(126,460)	(501)
Extraordinary proceeds	7,431	0	0	0
Net cash flows from investing activities	(92,398)	(114,357)	(126,460)	(501)
Cash flows from financing activities				
Dividends paid to shareholders and minority interest	(1,187)	(17,768)	(11,518)	(46)
Proceeds from loans and other borrowings	284,807	179,060	245,544	973
Repayment of loans and other borrowings	(279,336)	(188,014)	(243,276)	(963)
Other	(299)	(66)	216	1
Net cash flows utilized in financing activities	3,985	(26,788)	(9,034)	(35)
Change in cash and cash equivalents	1,616	(5,646)	2,971	12
Cash and cash equivalents, beginning of year	7,643	9,259	3,613	14
Cash and cash equivalents, end of year	9,259	3,613	6,584	26

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

MAGYAR TÁVKÖZLÉSI RT.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	<i>Shares of common stock (1)</i>	<i>Common stock</i>	<i>Additional Paid-in capital</i>	<i>Retained earnings</i>	<i>Total shareholders' equity</i>
	<i>(in HUF millions, except share amounts)</i>				
Balance at 1 January 1997	1,037,281,600	103,728	22,834	46,080	172,642
<i>Net income</i>				36,034	36,034
Balance at 1 January 1998 (3).....	<u>1,037,281,600</u>	<u>103,728</u>	<u>22,834</u>	<u>82,114</u>	<u>208,676</u>
<i>Effect of adopting IAS 19</i> <i>- revised 1997 (net of deferred tax) (2) ...</i>				(2,506)	(2,506)
As restated	<u>1,037,281,600</u>	<u>103,728</u>	<u>22,834</u>	<u>79,608</u>	<u>206,170</u>
<i>Dividend</i>				(7,262)	(7,262)
<i>Net income</i>				58,337	58,337
Balance at January 1, 1999 (3).....	<u>1,037,281,600</u>	<u>103,728</u>	<u>22,834</u>	<u>130,683</u>	<u>257,245</u>
<i>Dividend</i>				(8,298)	(8,298)
<i>Net income</i>				78,632	78,632
Balance at December 31, 1999	<u>1,037,281,600</u>	<u>103,728</u>	<u>22,834</u>	<u>201,017</u>	<u>327,579</u>

- (1) In addition to the 1,037,281,600 common shares, total shareholders' equity includes one Series "B" preference share at the nominal value of HUF 10,000. This share is held by the Ministry of Transport, Telecommunications and Water Management and bestows certain rights on its owner, including access to information, and the appointment of a Director. This share may only be held by the Government or its nominee. The Company has been authorized to issue 7 million ordinary shares for the purpose of fulfilling its obligation in connection with any conversion of the management incentive program bonds described in Note 20.
- (2) The Company adopted IAS 19 "Employee Benefits" (revised 1997) and has recognized the cumulative effect of the change in accounting directly in equity for the liability of HUF 2,914 million net of deferred tax of HUF 408 million as determined by actuarial valuation at January 1, 1998 (see note 21).
- (3) The distributable reserves of the Company under Hungarian law at December 31, 1998 and 1999 amounted to approximately HUF 130,000 million and HUF 173,000 million, respectively.

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

1 Principal activities

Magyar Távközlési Rt. (the "Company" or "MATÁV Rt.") with its subsidiaries form the "Group" or "MATÁV". The Group is the principal supplier of telecommunications services in Hungary. MATÁV is a full-service telecommunications provider. The Company has exclusive rights through December 2001 to provide domestic long distance and international public telephony services throughout Hungary. Of the 54 local concession areas, the Company has exclusive rights to provide local public fixed line telephony service in 36 areas, 31 of which extend through December 2001 and five through May 2002. MATÁV is Hungary's largest mobile telecommunications provider. In addition, the Company provides leased lines, data transmission services and corporate network services, cable television services, security monitoring services and sells and leases telecommunications equipment.

2 Basis of presentation

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

The consolidated financial statements have been prepared under the historical cost convention and in compliance with International Accounting Standards ("IAS"). IAS 19 "Employee Benefits" (revised 1997) was adopted in 1998. The Company recognized the cumulative effect of the change in accounting under IAS 19 directly in equity for the liability prior to January 1, 1998.

The consolidated financial statements are shown in millions of Hungarian Forints ("HUF"). For the convenience of the reader, the consolidated financial statements for the year 1999 are also presented in millions of U.S. dollars ("USD") translated at a rate of HUF 252.52 to USD 1.00 (the official rate of the National Bank of Hungary at December 31, 1999). These translations are unaudited. The effect of inflation is significant (1997: 18.3%, 1998: 14.3%, 1999: 10.0%) and should be considered in evaluating the financial position, results of operations and cash flows of the Group.

The preparation of financial statements in conformity with IAS requires management to make estimates and assumptions that affect the amounts reported in the financial statements and notes thereto. Actual results could differ from those estimates.

3 Statement of accounting policies

(a) Principles of consolidation

The consolidated financial statements include the financial statements of the Company, its majority owned subsidiaries and the subsidiaries over which the Company has effective control. Intercompany balances and transactions have been eliminated in the consolidation.

Associated companies (companies for which the Company is able to demonstrate significant influence but not control) and joint ventures are accounted for in the consolidated financial statements using the equity method of accounting.

(b) Impairment of non-current assets

The Group regularly reviews its non-current assets, including property, plant and equipment, intangible assets and associates and other long term investments for permanent diminution in value. Where there has been a permanent diminution in value, it is recognized as an expense in the period in which the diminution is identified.

(c) Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation, except for certain assets which were revalued at incorporation. Cost in the case of the outside plant, comprises all expenditures including the cabling within customers' premises and interest on related loans. When assets are retired or disposed of, the cost and accumulated depreciation are removed from the accounts and any related gain or loss is recognized in the consolidated income statement. Maintenance and repairs are charged to expense when incurred.

Depreciation is calculated on a straight line basis from the time the assets are deployed over their remaining useful lives. The Group regularly reviews these lives for consistency with current development plans and advances in technology.

The useful lives assigned are as follows:

Buildings	10 - 50 years
Duct, cable and other outside plant	25 - 38 years
Telephone exchanges	7 - 15 years
Other fixed assets	3 - 12 years

(d) Intangible assets

Costs associated with developing internal computer software that has a probable benefit exceeding the cost beyond one year, are recognized as an intangible asset. Expenditures which enhance and extend the benefits of computer software programs beyond their original specifications and lives is recognized as a capital improvement and added to the original cost of the software.

Costs associated with the maintenance of existing computer software programs and for modifications for the Year 2000 are expensed as incurred.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary/associated undertaking at the date of acquisition. Goodwill on acquisitions is reported in the balance sheet as an intangible asset and is amortized using the straight-line method over its estimated useful life.

Intangible assets are amortized over their respective economic lives. Such assets are stated at cost less amortization on a straight line basis over the following periods:

<i>Concession costs</i>	<i>8 - 25 years</i>
<i>Software</i>	<i>5 years</i>
<i>Leasehold interests</i>	<i>6 years</i>
<i>Goodwill on purchase of subsidiaries</i>	<i>5 - 20 years</i>

(e) Leased assets

Lessor

Assets leased out under operating leases are included in property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar fixed assets. Rental income is recognized on a straight-line basis over the lease term.

Lessee

Leases of property, plant and equipment where the Group assumes substantially all the benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the estimated present value of the underlying lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other payables and loans and other borrowings. The interest element of the finance charge is charged to the income statement over the lease period. The property, plant and equipment acquired under finance lease contracts is depreciated over the useful life of the asset.

Costs in respect of operating leases are charged to the consolidated income statement on a straight line basis over the lease term.

(f) Inventories

Inventories are stated at the lower of acquisition cost or net realizable value. Acquisition cost is calculated on a weighted average basis.

(g) Receivables

Receivables are stated at expected net realizable value, after provision for doubtful accounts. Amounts due and receivable from other network operators are shown net where a right of set-off exists and the amounts are settled on a net basis.

(h) Cash and cash equivalents

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

(i) Deferred revenue

A portion of fees charged to customers upon connection to the fixed line network prior to October 15, 1997 represented contributions to the cost of network construction. The capital contribution element of such fees was deferred and amortized to revenue over the life of the related assets. Legislation was enacted effective October 15, 1997 eliminating refunds of such fees and signaling the removal of any capital contribution element of future customer fees.

The Group's accounting policies for customer fees are:

(i) Connection fees

Connection fees are treated as deferred revenue and credited to revenue in the consolidated income statement over the period the related assets are depreciated.

(ii) Investment contribution fees

Prior to July 1995, investment contribution fees were held as a provision for liabilities and charges due to their indefinite legal refundability. Following the introduction of new legislation in July 1995, investment contribution fees are refundable only until June 1, 2000. As the legislation removed the indefinite refundability provision, investment contributions net of a provision to cover future repayments on termination of services are treated as deferred revenue and are credited to revenue in the consolidated income statements over the period the related assets are depreciated.

(iii) Entrance fees

Beginning in July 1995, entrance fees replaced both connection fees and investment contribution fees. For entrance fees charged prior to October 15, 1997, the capital contribution portion of the fee was treated as deferred revenue and credited to revenue over the period the related assets are depreciated. The portion of the entrance fee covering non-capitalized expenses was recognized as revenue upon connection. After October 15, 1997, the entire entrance fee is recorded as revenue upon connection reflecting the change in related legislation and the advanced development of the network.

(j) Revenues

Revenues for all services, shown net of VAT and discounts and after eliminated sales within the Group, are recognized when products and services are provided. A proportion of the revenue received is paid to other operators for the use of their networks, where appropriate. These revenues and costs are stated gross in these consolidated financial statements. Revenues earned from connecting subscribers to the mobile network are recognized upon service activation.

(k) Operating expenses

Research and development and advertising costs of HUF 8,534 million are expensed as incurred.

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

(l) Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into HUF at the exchange rates at the balance sheet date and exchange gains and losses are recognized immediately. Gains and losses that arise on foreign currency transactions and financing activities are included under net interest and other charges.

(m) Borrowing costs

Borrowing costs are recognized as an expense as incurred net of interest capitalized. Interest on general borrowings is capitalized as part of the cost of the relevant fixed asset up to the date of commissioning and is then amortized over the period the asset is depreciated.

(n) Income tax

Deferred tax is provided, using the liability method, for all temporary differences arising between tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used to determine deferred income tax.

The principal temporary differences arise from depreciation on property, plant and equipment, provisions for post retirement benefits, deferred revenue, provisions for receivables, inventory, liabilities and charges, government loans and tax losses carried forward. The net deferred tax asset is included in "Non current assets."

(o) Earnings per share

Basic earnings per share is calculated by dividing income for the period by the weighted average number of common shares outstanding. Diluted earnings per share is calculated by the treasury stock method.

(p) Pensions and other post-retirement benefits

The Company adopted IAS 19 "Employee Benefits" (revised 1997) in 1998 and recognized the cumulative effect of the change in accounting directly in equity for the liability at January 1, 1998. Some group companies provide post-retirement meal and other benefits to their retirees. Under IAS 19 the expected costs of these benefits are accrued over the period of employment using a single actuarial method not tied to the funding of the plan. The valuation of these obligations has been carried out using the projected unit cost method.

Payments to defined contribution pension plans are recognized as expense in the period in which they become due. Payments amounted to HUF 826 million, HUF 1,272 million and HUF 1,616 million for the years ended December 31, 1997, 1998, and 1999, respectively. The Group also makes a payment to a supplementary defined contribution pension plan.

(q) Financial Instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, trade creditors, leases and borrowings. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

Exchange gains and losses and hedging costs arising on contracts entered into as hedges are recognized in the income statement in the same period as the exchange differences on the items covered by the hedge transactions. Gains and losses on contracts which are no longer designated as hedged are included in the income statement.

4 Cash and cash equivalents

Substantially all cash and cash equivalents are denominated in Hungarian Forint and concentrations of credit risk are limited as MATÁV places its cash with substantial credit institutions.

5 Financial investments

Financial investments consist primarily of treasury instruments with maturities of three to twelve months.

6 Receivables

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Domestic trade receivables</i>	54,856	67,342
.....		
<i>Foreign trade receivables</i>	3,799	4,999
.....		
<i>Other receivables</i>	3,166	3,975
<i>Advances paid for current assets</i>	864	424
<i>Associates</i>	336	305
<i>Prepayment on 1800 MHz bandwidth concession</i>	0	2,750
<i>Other prepayments and accrued income</i>	1,139	1,849
	<u>64,160</u>	<u>81,644</u>
<i>Less allowances for doubtful accounts</i>	<u>(12,498)</u>	<u>(14,977)</u>
	<u>51,662</u>	<u>66,667</u>

Concentrations of credit risk relating to trade receivables are limited due to the large number of customers comprising the Group's customer base and their dispersion across many different industries and geographic areas. The allowance for doubtful accounts and changes therein for 1998 and 1999 are as follows:

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Allowance, beginning of period</i>	(8,519)	(12,498)
<i>Charged to expense</i>	(6,247)	(7,298)
<i>Written off</i>	2,268	4,819
<i>Allowance, end of period</i>	<u>(12,498)</u>	<u>(14,977)</u>

7 Inventories

	<i>At December 31,</i>	
	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>	
<i>Cables, wires and other inventory</i>	3,619	3,534
<i>Inventory for resale</i>	5,170	6,557
<i>Subtotal</i>	<u>8,789</u>	<u>10,091</u>
<i>Less allowances for obsolete inventory</i>	(672)	(552)
	<u>8,117</u>	<u>9,539</u>

8 Property, plant and equipment

	<u>Land</u>	<u>Buildings</u>	<u>Duct, cable and other outside plant</u>	<u>Telephone exchanges</u>	<u>Other fixed assets</u>	<u>Capital work in progress</u>	<u>Total</u>
	<i>(in HUF millions)</i>						
Cost							
<i>January 1, 1999</i>	3,766	61,197	171,583	271,594	58,596	33,171	599,907
<i>Additions</i>	53	14,784	18,083	71,010	19,808	(2,160)	121,578
<i>Disposals</i>	(55)	(1,238)	(1,095)	(6,767)	(2,211)	0	(11,366)
<i>December 31, 1999</i>	<u>3,764</u>	<u>74,743</u>	<u>188,571</u>	<u>335,837</u>	<u>76,193</u>	<u>31,011</u>	<u>710,119</u>
Depreciation							
<i>January 1, 1999</i>		7,918	31,147	86,303	24,875		150,243
<i>Charge for the year</i>		2,241	7,104	34,986	12,027		56,358
<i>Disposals</i>		(198)	(721)	(6,733)	(1,530)		(9,182)
<i>December 31, 1999</i>		<u>9,961</u>	<u>37,530</u>	<u>114,556</u>	<u>35,372</u>		<u>197,419</u>
Net book value							
<i>December 31, 1999</i>	<u>3,764</u>	<u>64,782</u>	<u>151,041</u>	<u>221,281</u>	<u>40,821</u>	<u>31,011</u>	<u>512,700</u>
Net book value							
<i>December 31, 1998</i>	<u>3,766</u>	<u>53,279</u>	<u>140,436</u>	<u>185,291</u>	<u>33,721</u>	<u>33,171</u>	<u>449,664</u>

Additions to capital work in progress are shown net of transfers to assets in service.

Included in additions to fixed assets at 31 December 1999 are assets subject to finance leases capitalized with a gross book value of HUF 1,144 million and net book value of HUF 952 million.

9 Intangible assets

	<i>At December 31,</i>	
	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>	
Concession costs	6,790	6,790
Software	20,437	30,246
Leasehold interests	4,737	5,885
Goodwill	4,333	6,379
	<u>36,297</u>	<u>49,300</u>
Accumulated amortization	<u>(11,516)</u>	<u>(16,293)</u>
	<u>24,781</u>	<u>33,007</u>

10 Other non current assets

	<i>At December 31,</i>	
	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>	
Net deferred tax asset (note 19)	2,547	3,379
Assets held for disposal	913	589
Other non current assets	<u>1,940</u>	<u>2,281</u>
	<u>5,400</u>	<u>6,249</u>

11 Loans and other borrowings

	<i>Notes</i>	<i>At December 31,</i>	
		<u>1998</u>	<u>1999</u>
		<i>(in HUF millions)</i>	
Bank	(a)	152,800	168,790
Bonds and bills of exchange	(b)	17,123	10,091
Government	(c)	2,488	2,113
Finance leases		60	1,525
.....		<u>172,471</u>	<u>182,519</u>

At December 31, 1999, principal repayments fall due in:

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<i>after</i> <u>2004</u>	<u>Total</u>
Total	<u>17,804</u>	<u>68,893</u>	<u>23,477</u>	<u>26,821</u>	<u>21,995</u>	<u>23,529</u>	<u>182,519</u>

The effective borrowings costs (total interest payable and other charges) for MATÁV's loans and borrowings were 20.9%, 18.6% and 14.4% for the years ended 1997, 1998, and 1999, respectively. The weighted average interest rate on short-term borrowings (denominated in Hungarian Forints and foreign currencies) was 14.4% in 1998 and 12.7% in 1999.

(a) Bank loans analyzed by currency are as follows:

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Hungarian Forint</i>	<i>50,981</i>	<i>80,259</i>
.....		
<i>Deutsche Mark</i>	<i>52,590</i>	<i>42,779</i>
<i>U.S. Dollar</i>	<i>29,119</i>	<i>24,006</i>
<i>Other</i>	<i>20,110</i>	<i>21,746</i>
	<u><i>152,800</i></u>	<u><i>168,790</i></u>

Bank loans of HUF 120,047 million at December 31, 1999 were subject to variable interest rates. Variable rate loans raised in Hungarian Forint are subject to interest rates between 14.4% and 17.3% and are based on various rates, including BUBOR (Budapest Interbank Offered Rate), yield of treasury bill and the rate quoted by the National Bank of Hungary. Funds raised in foreign currency with variable rates are subject to interest rates between 3.7% and 7.2% generally based on LIBOR plus a margin. The remaining foreign currency bank loans were subject to fixed interest rates between 4.6% and 8.6%. The bank loans have maturities ranging from 2000 to 2011.

Included in bank loans are loans from the World Bank and the European Investment Bank (collectively known as "IFI's") totaling HUF 42,093 million and HUF 49,908 million at December 31, 1998 and 1999, respectively. The majority of these loans are taken in foreign currency which are subject to rates of between 4.6% and 8.6% with maturities ranging from 2005 to 2011.

Included in bank loans are USD denominated loans amounting to HUF 5,878 million and subject to interest based on a fixed rate of 7.05%. These loans are the subject of a cross currency interest rate swap arrangement which entitles the Company to receive USD interest and principal payments at fixed rates and obliges it to pay Euro interest and principal repayments at floating rates of the EURIBOR rate plus a margin of 0.66%. The Euro principal payments are fixed at a rate of 1 Euro = 1.0777USD. The timing and amount of the USD payments to be received exactly matches the underlying payment obligations on the USD loan. The Company accounts for interest and foreign exchange movements on these loans at the Euro rate.

Effective January 3, 2000, an additional HUF 6,082 million in USD denominated loans subject to interest based on a fixed rate of 6.56%, are the subject of a cross currency swap agreement. This swap agreement entitles the Company to receive USD interest and principal payments at fixed rates and obliges it to pay Euro interest and principal payments at fixed rates of 5.17%. Euro principal payments will be determined according to the Euro equivalent of the USD principal payments using the average of the USD/EUR spot rates between October 27, 1999 and December 22, 1999. The timing and amount of the USD payments to be received will exactly match the underlying payment obligations of the USD loans.

Loans totaling HUF 31,429 million and HUF 20,857 million at December 31, 1998 and 1999 are roll-over loans which can be prepaid at any time and may be drawn down in one to six month rolling periods. However, the facility under which the loans are provided have final repayment dates falling due after one year and are, therefore, classified as long-term.

Group loan agreements contain covenant restrictions which, among other things, require maintenance of certain financial ratios. Breach of those covenants would make HUF 125,778 million due and payable in 30 days if not remedied. At December 31, 1999, the Group was in compliance with these financial ratio requirements, the most restrictive was a debt to equity ratio of 1.2.

(b) On March 24, 1998, the Company completed two domestic bond offerings. Five year bonds with a total amount of HUF 10 billion were sold with interest payable semiannually at an interest rate of 50 basis points over the average yield of the last three auctions of 6 month Hungarian Treasury Bills. A one year bond offering in the total amount of HUF 5 billion was fully subscribed with interest payable on maturity at a rate of 19.67%. This bond matured and was repaid on March 26, 1999.

(c) The interest-free Government loan is repayable in equal annual installments through 2007. The Government loan is denominated in Hungarian Forint.

At December 31, 1999, the Company had undrawn committed short-term credit facilities of approximately HUF 8,314 million and undrawn committed long-term credit facilities of approximately HUF 85,546 million. Undrawn committed long term credit facilities of HUF 54,464 million expire in 2001, HUF 25,332 million expire in 2002, HUF 700 million expire in 2005 and HUF 5,050 million have no specified expiration date. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin. There are pledges on assets for loans totaling HUF 9,726 million.

12 Quantitative and Qualitative Information about Financial Instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, trade creditors, leases and borrowings. The Company and Group are also parties to financial instruments that reduce exposure to fluctuations in foreign currency exchange.

The Group is exposed to interest and foreign exchange rate risk associated with its debt and anticipated transactions. The Group has no significant concentrations of credit risk. The functional accounting currency of MATÁV is the Hungarian Forint, therefore the Group's objective is to minimize the level of its financial risk in Hungarian Forint terms.

The Group's major financial market risk exposure is in interest rate fluctuations. This is due to the fact that changing interest rates in the U.S. and Western-Europe affect the fair value of fixed rate debt. To control interest rate risk, a combination of fixed and floating rate debt is used within the foreign currency and HUF portfolios. In the case of foreign debt, the Group maintains a balance between fixed rate and variable rate debt. Mainly floating rate instruments are used in the case of Hungarian Forint debt due to decreasing interest rates.

The Group is exposed to foreign exchange risk related to foreign currency debt and foreign exchange payments (ie. international third party telecommunications carriers and capital expenditure). To reduce foreign exchange risk, the Group's debt portfolio guidelines limit the individual classes of currencies in the debt portfolio. The Group is increasing the proportion of its borrowings in Hungarian Forint as the Hungarian capital market develops. Most of the Group's foreign exchange debt portfolio is adjusted to the same mix as the official basket of foreign currencies used by the National Bank of Hungary to devalue the Forint and to determine official exchange rates. Matching the composition of the Group's foreign debt portfolio to the basket of currencies used by the National Bank of Hungary in its regulation of the Hungarian Forint minimizes the foreign exchange cross currency risk.

In 1998 and 1999 the Group occasionally entered into derivative contracts for hedging purposes. These foreign currency forward contracts and swap arrangements were taken to reduce the exchange rate risk of debt repayments or to adjust the currency structure of the debt portfolio to match that used by the National Bank of Hungary in its management of the Hungarian Forint. Using derivatives to change the debt portfolio's composition serves to reduce cross currency risk.

Derivative instruments are limited to foreign currency forward contracts and swap agreements that are not recognized in the financial statements on inception. In the case of foreign currency forward contracts, any increase or decrease in the amount required to settle the liability is off-set by a corresponding movement in the value of the forward exchange contract. Gains and losses on derivative positions are booked against the gain or loss on the related underlying positions being hedged. In 1999, losses of HUF 515 million was recognized in the statements of income related to foreign currency forward contracts. As of December 31, 1999, the Group held foreign currency forward contracts covering DEM 226 million and USD 30 million.

The financial asset portfolio is relatively small compared to the debt portfolio of the Group and includes only short term, marketable securities with active secondary markets to ensure liquidity. The Group mitigates credit risk by investing only in high quality securities. As of December 31, 1999, the Group's cash balance included HUF denominated cash equivalent instruments with a value of HUF 3,740 million at an average fixed interest rate of 11.6% and HUF 2,844 million in variable rate instruments with an average interest rate of 8.4%. Financial investments of HUF 3,732 million were held in fixed rate instruments at an average interest rate of 13.5%. The net carrying amounts of financial assets including cash, investments, receivables and payables and finance lease obligations reflect reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

The following table is a summary of the Group's market sensitive debt instruments, including fair value calculated using the discounted cash flow method. Average rates disclosed represent the weighted average rates of fixed rate and variable rate portfolios at period end. The book values of variable rate loans and borrowings approximate their fair values as shown below at December 31, 1999.

	<i>Maturities</i>						<i>Total</i>	<i>Fair value</i>
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>after 2004</u>		
	<i>(in HUF millions, except percentages)</i>							
<i>Bank loans (HUF denominated)</i>								
<i>Fixed rate</i>	83	0	0	0	12,500	0	12,583	13,898
<i>Average interest rate</i>	16.00%				11.75%			
<i>Variable rate</i>	13,166	12,000	18,885	12,125	5,125	6,375	67,676	67,676
<i>Average interest rate</i>	14.80%	14.94%	14.84%	14.62%	14.71%	14.66%		
<i>Total</i>	<u>13,249</u>	<u>12,000</u>	<u>18,885</u>	<u>12,125</u>	<u>17,625</u>	<u>6,375</u>	<u>80,259</u>	<u>81,574</u>
<i>Bank loans (foreign currency denominated)</i>								
<i>Fixed rate</i>	3,935	3,935	3,935	3,935	3,935	16,485	36,160	39,475
<i>Average interest rate</i>	6.61%	6.61%	6.61%	6.61%	6.61%	6.79%		
<i>Variable rate</i>	1	52,370	0	0	0	0	52,371	52,371
<i>Average interest rate</i>	17.5%	4.57%						
<i>Total</i>	<u>3,936</u>	<u>56,305</u>	<u>3,935</u>	<u>3,935</u>	<u>3,935</u>	<u>16,485</u>	<u>88,531</u>	<u>91,846</u>
<i>Total bank loans</i>	<u>17,185</u>	<u>68,305</u>	<u>22,820</u>	<u>16,060</u>	<u>21,560</u>	<u>22,860</u>	<u>168,790</u>	<u>173,420</u>
<i>Bonds and bills of exchange (HUF denominated)</i>								
<i>Fixed rate</i>	87	0	4	0	0	0	91	90
<i>Average interest rate</i>	8.86%		10.00%					
<i>Variable rate</i>	0	0	0	10,000	0	0	10,000	10,000
<i>Average interest rate</i>				14.62%				
<i>Total</i>	<u>87</u>	<u>0</u>	<u>4</u>	<u>10,000</u>	<u>0</u>	<u>0</u>	<u>10,091</u>	<u>10,090</u>

13 Trade and other payables

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Domestic trade payables</i>	36,525	48,576
.....		
<i>Foreign trade payables</i>	5,574	9,284
.....		
<i>Amounts owed to related parties</i>	2,548	833
<i>Taxation and social security</i>	5,139	6,659
<i>Accrued expenses</i>	10,171	9,220
<i>Amounts received in advance</i>	1,587	1,450
<i>Salaries and wages</i>	3,093	4,288
<i>Payables to associates</i>	131	66
<i>Dividends payable to minority interest holders</i>	1,309	2,314
<i>Other payables</i>	8,879	5,255
	<u>74,956</u>	<u>87,945</u>

14 Deferred revenue

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Beginning of period</i>	29,774	23,898
<i>Amortization</i>	(5,876)	(5,607)
<i>End of period</i>	<u>23,898</u>	<u>18,291</u>
<i>Amount to be recognized within one year</i>	5,638	4,685

15 Provision for liabilities and charges

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Severance</i>	3,623	3,076
<i>Investment contribution fees</i>	1,183	643
<i>Post-retirement benefits</i>	3,230	3,549
<i>Other</i>	799	1,256
	<u>8,835</u>	<u>8,524</u>

The provision for severance relates to the employee termination benefit payable in 2000 in accordance with the agreement made with employee representatives. The provision for investment contribution fees recognizes the amount that the Company estimates will be refunded prior to June 2000, the point in time when legal refundability ceases. The bulk of non-current provisions relate to post-retirement benefits which is explained in note 21.

16 Minority interests

In cases where subsidiaries are not wholly owned by MATÁV the consolidated balance sheets and income statements reflect the share of investment and results held by third parties.

	<i>For the year ended December 31,</i>		
	<u>1997</u>	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>		
<i>Beginning of period</i>	9,874	17,185	12,135
<i>Movement in capital contributed by minority interest</i>	(296)	(4,409)	216
<i>Share of results for the year</i>	7,614	10,546	14,883
<i>Dividends paid/payable to minority shareholders</i>	(7)	(11,187)	(4,222)
<i>End of period</i>	<u>17,185</u>	<u>12,135</u>	<u>23,012</u>

17 Revenues

	<i>For the year ended December 31,</i>		
	<u>1997</u>	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>		
<i>Domestic telecommunications services:</i>			
<i>Subscriptions, connections and other charges</i>	41,649	55,728	63,191
<i>Domestic traffic revenue</i>	85,319	108,425	134,071
<i>Other usage</i>	14,936	19,964	18,743
<i>International traffic revenues</i>	35,748	38,792	43,807
<i>Mobile telecommunications services</i>	48,159	61,677	82,746
<i>Other services</i>	28,137	33,474	42,374
	<u>253,948</u>	<u>318,060</u>	<u>384,932</u>

Telephone tariffs are regulated through a price cap by the Ministry of Transport, Telecommunications and Water Management (the "Ministry"). There can be no certainty with regard to future regulatory developments.

18 Net interest and other charges

	<i>For the year ended December 31,</i>		
	<u>1997</u>	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>		
<i>Interest expense:</i>			
Hungarian Forint loans	8,303	11,720	11,112
Foreign currency loans	7,171	6,134	6,182
Finance leases	261	192	47
Net foreign exchange losses	16,090	12,378	6,289
Commissions and other bank charges	1,230	1,311	1,941
<i>Total interest expense and other charges</i>	<u>33,055</u>	<u>31,735</u>	<u>25,571</u>
<i>Interest capitalized</i>	(966)	(895)	(541)
<i>Interest and other financial income</i>	<u>(2,224)</u>	<u>(2,045)</u>	<u>(2,897)</u>
	<u>29,865</u>	<u>28,795</u>	<u>22,133</u>

19 Income tax

	<i>For the year ended December 31,</i>		
	<u>1997</u>	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>		
<i>Income tax charge on the profit for the year</i>	(262)	(324)	(7,646)
<i>Deferred income taxes</i>	(9)	1,631	832
<i>Income tax on the Group's share of the results of associates</i>	(32)	(40)	(97)
<i>Income tax (expense) / benefit</i>	<u>(303)</u>	<u>1,267</u>	<u>(6,911)</u>

The Company and certain of its subsidiaries qualify for a reduction in income tax payable on meeting certain conditions. The reduction in the tax payable amounted to a 100% allowance for five years from the date of qualification, and a 60% allowance for a further five years. Through 1998, Matáv Rt. and Westel 900 qualified for the 100% allowance. Through 1995, Westel Radiótelefon Kft. ("Westel 450") utilized the 100% allowance. From January 1, 1999, Matáv Rt. and Westel 900 are utilizing the reduced allowance of 60% for a further five years (effective tax rate of 7.2%). Westel 450 has utilized the reduced allowance of 60% until December 31, 1999. Management believes that the conditions underlying the reduction in income tax will continue to be met. All other subsidiaries were subject to income tax of 18%.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. The Group has tax losses of HUF 2,312 million to carry forward against future taxable income, which have not been recognized in these financial statements due to uncertainty of their recoverability. Tax losses of HUF 339 million expire in 2002, HUF 674 million expire in 2003 and HUF 1,299 million expire in 2004.

The Company's deferred tax balances are as follows.

	<i>At December 31,</i>	
	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>	
<i>Deferred tax assets</i>		
<i>Net operating loss carryforward</i>	478	391
<i>Deferred income</i>	1,161	1,060
<i>Loans and other borrowings</i>	232	294
<i>Post retirement benefits</i>	485	568
<i>Provisions for receivables and inventory</i>	832	1,059
<i>Provisions for liabilities and charges</i>	0	385
<i>Deferred tax liabilities - Property, plant and equipment</i>	(641)	(378)
<i>Net deferred tax asset</i>	<u>2,547</u>	<u>3,379</u>

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

	<i>For the year ended December 31,</i>		
	<u>1997</u>	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>		
<i>IAS profit before income tax</i>	43,951	67,616	100,426
<i>Tax at 18%</i>	(7,911)	(12,171)	(18,077)
<i>Effect of reduced tax rates</i>	8,411	12,211	9,932
<i>Tax on items not subject to tax</i>	1,137	3,840	2,534
<i>Tax on non deductible expenses</i>	(1,916)	(1,005)	(1,582)
<i>Temporary differences reversing at different rates</i>	8	(1,568)	379
<i>Income tax benefit / (expense) (before associates)</i>	(271)	1,307	(6,814)
<i>Share of associates tax expense</i>	(32)	(40)	(97)
<i>Income tax (expense) / benefit</i>	<u>(303)</u>	<u>1,267</u>	<u>(6,911)</u>

Items not subject to income tax consist primarily of amortization of investment contribution fees and connection fees.

20 Convertible bonds — Management Incentive Plan

From June 29, 1998 to July 1, 1998, MATÁV Rt. issued 7 million convertible bearer bonds, known as the "Management Incentive Program Bond" each with a face value of HUF 1. The holder of a bond may convert it into one newly issued MATÁV A series registered common share with a face value of HUF 100, in accordance with the allocation and conversion rules. On July 1, 1998, 4.2 million bonds were allocated to management.

The Bonds may be converted into newly issued MATÁV A series registered common stock over a three year period with one third vesting each year beginning July 1, 1999. Bonds can not be converted after the end of the bond's term. No bonds have been converted as of December 31, 1999. By December 31, 1999, 402 thousand bonds had been forfeited by management.

The conversion price of the Bonds is the Hungarian Forint equivalent of USD 5.75 per bond, calculated based on the middle USD/HUF exchange rate quoted by the Hungarian Central Bank on the day of conversion, less the face value of the Bond, but not less than the initial public offering price of HUF 730 per share.

Compensation cost is not recognized in these financial statements for the fair value or the intrinsic value of the bonds granted.

21 Post-retirement benefits

Under IAS 19 "Employee Benefits (revised 1997), the Company records expense for post-retirement benefits in the period in which they are earned.

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Benefits earned during the year</i>	90	83
<i>Interest cost on projected benefit obligation</i>	369	373
<i>Post-retirement benefit costs</i>	459	456

The present value of the Company's obligations included in the consolidated balance sheet at December 31, 1999 are as follows:

	<i>At December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Estimated present value of defined benefit obligations</i>		
<i>Retirees and dependents</i>	1,825	1,853
<i>Active plan participants</i>	1,123	797
<i>Accumulated post-retirement benefit obligation</i>	2,948	2,650
<i>Prior year service cost not yet recognized</i>	0	235
<i>Unrecognized net gain from change in assumptions</i>	282	664
<i>Accrued post-retirement benefit cost included in Provisions for liabilities and charges</i>	3,230	3,549

The amount of the accrual was determined using actuarial principles and using the following assumptions:

	<i>For the year ended</i>	
	<i>December 31,</i>	
	<i>1998</i>	<i>1999</i>
	<i>(in HUF millions)</i>	
<i>Discount rate</i>	13%	10%
<i>Weighted average projected growth rate of per-capita benefit costs</i>	10%	10%

The movement in the liability recognized in the balance sheet is summarized in the following table.

	<u>1998</u>	<u>1999</u>
	<i>(in HUF millions)</i>	
At the beginning of the year	0	3,230
the effect of adopting IAS 19 (revised)	<u>2,914</u>	<u>0</u>
	2,914	3,230
Post-retirement benefit costs	459	456
Benefits paid	<u>(143)</u>	<u>(137)</u>
Accrued post-retirement benefit cost included in Provisions for liabilities and charges	<u>3,230</u>	<u>3,549</u>

22 Commitments

(a) Lease commitments

Where the Company is Lessee

Operating lease commitments were mainly in respect of the lease of buildings, network and other telecommunications facilities. Future minimum lease payments under capital and operating leases at December 31, 1999 are as follows:

	<u>Capital Leases</u>	<u>Operating Leases</u>
Year		
2000	431	1,311
2001	453	913
2002	489	862
2003	542	847
2004	162	660
Thereafter	<u>0</u>	<u>514</u>
Total minimum lease payments	2,077	5,107
Less: amounts representing interest and executory costs	<u>(552)</u>	
Present value of net minimum lease payments	1,525	
Less: capital lease obligations included in short-term debt	<u>233</u>	
Long-term capital lease obligations	<u>1,292</u>	

Where the Company is lessor

Operating lease commitments where the Company is lessor relate primarily to the leasing of PBX equipment.

<i>Year</i>	<i>Operating Leases</i>
<i>2000</i>	<i>4,062</i>
<i>2001</i>	<i>3,313</i>
<i>2002</i>	<i>1,429</i>
<i>2003</i>	<i>1,168</i>
<i>2004</i>	<i>884</i>
<i>Thereafter</i>	<i>636</i>
<i>Total minimum lease payments</i>	<u><u><i>11,492</i></u></u>

(b) Purchase commitments

As of December 31, 1998 and 1999, capital and other expenditures amounting to HUF 8.6 billion and HUF 18.6 billion, respectively, principally relating to the telecommunications network, had been committed to under contractual arrangements, with the majority of payments due within one year. In addition, commitments for expenditure on the 1800 MHz bandwidth concession for Westel 900 amounts to HUF 9.1 billion.

(c) M-RTL

MATÁV Rt. acquired a 25% share in M-RTL, a television broadcasting company in 1997. MATÁV Rt. committed to provide M-RTL with equity and debt financing. At December 31, 1999 MATÁV Rt. has outstanding commitments of approximately DEM 4 million to provide further funds to M-RTL.

23 Related party transactions

The Company is majority owned by MagyarCom (59.58%), which is a consortium of Deutsche Telekom AG and SBC Inc. Following a tender in 1993, MagyarCom was awarded the national concession license to operate all long distance and international services, as well as local services in 36 primary areas. The rights and obligations under the concession were assigned to the Company. Under a service agreement, MagyarCom Services Kft., a Hungarian company jointly owned by Deutsche Telekom and SBC provides the Company with management and consultancy services. The total service fees charged in 1997, 1998 and 1999 amounted to HUF 2,903 million, HUF 3,135 million and HUF 2,152 million, respectively.

Westel 450 and Westel 900 use consulting and other technical services provided by MediaOne International, which owns 49% of Westel 450 and 49% of Westel 900 as of December 31, 1999. Costs incurred relating to these services amounted to HUF 93 million in 1997, HUF 93 million in 1998 and HUF 161 million in 1999. Westel 450 and Westel 900 had outstanding dividends payable to Media One of HUF 2,314 million as at December 31, 1999.

The Group provides services to Government departments and businesses.

Hunsat is a joint venture founded by MATÁV (50%) and Antenna Hungária Rt. The revenues of Hunsat include membership fees paid by the establishing owners and subsidies received from an international space communications organization. Costs incurred by the Group including payment of these membership fees amounted to HUF 301 million in 1997, HUF 281 million in 1998 and HUF 301 million in 1999. Any profits made by Hunsat are repaid to the joint venture partners.

Emitel is a Local Telephone Operator (“LTO”) that is 50% owned by MATÁV. Revenues and costs relating to Emitel are included within revenues from other usage and payment to other network operators, respectively. The revenues received from Emitel in 1997, 1998 and 1999 were HUF 1,406 million, HUF 1,720 million and HUF 1,285 million, respectively.

On November 15, 1999, 75% of KabelKomplex was sold to an employee for HUF 103 million which represented the book value of MATÁV's investment in that stake. HUF 1 million was paid on signing the contract with HUF 51 million due in June 2000 and HUF 51 million due in June 2001.

24 Principal investees

At December 31, 1999 the principal operating associates, joint ventures and subsidiaries of the Group, which are all incorporated in Hungary, were as follows:

<i>Associates / Joint ventures</i>	Group interest in capital	Activity
Hunsat Magyar Űrtávközlési Koordinációs Egyesülés	50%	VSAT satellite communications
EMITEL Távközlési Rt.	50%	Local telecommunications operator
Magyar RTL Televízió Rt.	25%	Television broadcast company

<i>Subsidiaries</i>	Group interest in capital	Activity
Balatel Telekommunikációs Szolgáltató Rt.	96.63%	Local telecommunications operator
CARDNET	72.00%	Point-of-sale terminal supplier
Egertel	61.45%	Local telecommunications operator
Első Pesti Telefontársaság Rt.	95.73%	Local telecommunications operator
Inteltrade Kereskedelmi Rt.	83.33%	Foreign trade activities
InvesTel Rt.	100.00%	Group finance company
MATÁVcom Kft.	100.00%	PBX supplier
MATÁVkábelTV Kft.	75.00%	Cable television operator
MATÁVline Kft.	100.00%	Network construction company
MATÁVÖR Kft.	99.00%	Security monitoring company
MATAVNet Kft.	100.00%	Hungarian language internet content server
Westel Rádiótelefon Kft.	51.00% (a)	Cellular telephone services
Westel 900 GSM Mobil Távközlési Rt.	51.00% (a)	GSM digital cellular telephone services

(a) In October 1999, Deutsche Telekom agreed to terms to purchase Media One International's interests in mobile operations in Central and Eastern Europe including Westel 900 and Westel 450. MATÁV has been granted a fifteen month option to purchase the 49% holdings in Westel 900 and Westel 450 from Deutsche Telekom for USD 885 million, the same price agreed between Deutsche Telekom and Media One International.

25 Segmental reporting

MATÁV has two operating segments, fixed line telecommunications and mobile telecommunications. The fixed line telecommunications segment provides local telephony in MATÁV's 36 local primary areas, domestic and international long distance services on a nationwide basis as well as related services such as leased lines, data transmission, PBX, corporate networks, internet and security monitoring. The mobile segment consists of services provided by Westel 450 and Westel 900. Westel 450 provides analog services in the 450 mHz frequency bandwidth and Westel 900 provides digital services in the 900 mHz frequency bandwidth. Services provided between MATÁV, Westel 450 and Westel 900 are made on an arms-length basis. Westel 450 and Westel 900 each provide distribution for the other's products. Both Westel 450 and Westel 900 lease space at base stations to each other and from MATÁV on a contract basis.

The following table presents a summary of operating results of the MATÁV Group by segment for the years ended December 31, 1997, 1998 and 1999. The segments presented below are substantially consistent with the format used by the Company's Executive Committee and management.

For the year ended December 31,		
1997	1998	1999

(in HUF millions)

Revenues			
Fixed line	206,096	256,929	302,230
Mobile	67,681	88,142	117,336
Intersegment elimination	<u>(19,829)</u>	<u>(27,011)</u>	<u>(34,634)</u>
Total	<u>253,948</u>	<u>318,060</u>	<u>384,932</u>
Depreciation and amortization			
Fixed line	32,824	44,044	49,873
Mobile	<u>7,844</u>	<u>9,510</u>	<u>12,272</u>
Total	<u>40,668</u>	<u>53,554</u>	<u>62,145</u>
Operating profit			
Fixed line	54,792	70,520	85,471
Mobile	<u>19,262</u>	<u>25,589</u>	<u>35,660</u>
Total	<u>74,054</u>	<u>96,109</u>	<u>121,131</u>
Assets			
Fixed line	411,351	478,136	543,148
Mobile	76,077	82,038	114,494
Intersegment elimination	<u>(6,817)</u>	<u>(10,634)</u>	<u>(9,772)</u>
Total	<u>480,611</u>	<u>549,540</u>	<u>647,870</u>
Capital expenditures			
Fixed line	79,552	97,729	94,063
Mobile	<u>15,234</u>	<u>18,554</u>	<u>33,615</u>
Total	<u>94,786</u>	<u>116,283</u>	<u>127,678</u>
Liabilities			
Fixed line	203,808	230,771	236,107
Mobile	53,348	55,612	66,533
Intersegment elimination	<u>(2,406)</u>	<u>(6,223)</u>	<u>(5,361)</u>
Total	<u>254,750</u>	<u>280,160</u>	<u>297,279</u>

Basis of Intersegment pricing. *Intersegment pricing between mobile and fixed line is based upon rates as regulated and set out by the Minister of Transport, Telecommunications and Water Management.*

Geographic Information. *MATÁV's two segments operate exclusively in Hungary and MATÁV does not analyze results on a more detailed level based on geographic areas within Hungary.*

26 Reconciliation to U.S. GAAP

The Group's consolidated financial statements are prepared in accordance with International Accounting Standards, which differ in certain respects from U.S. GAAP. The principal differences between IAS and U.S. GAAP are presented below, together with explanations of the adjustments that affect consolidated net income for each of the three years in the period ended December 31, 1999 and total shareholders' equity as of December 31, 1998 and 1999.

	Notes	For the year ended December 31,		
		1997	1998	1999
		(in HUF millions, except per share amounts)		
Net income under IAS		36,034	58,337	78,632
Adjustments for U.S. GAAP:				
Deferred revenue	(a)	(2,751)	282	374
Employee stock purchase plan	(b)	(2,704)	0	0
Post-retirement benefits	(c)	(268)	(21)	(3)
Management Incentive Plan Bonds	(d)	0	(24)	(42)
Deferred income tax on U.S. GAAP adjustments		(181)	(10)	(240)
Net income under U.S. GAAP		<u>30,130</u>	<u>58,564</u>	<u>78,721</u>
Basic earnings per share under U.S. GAAP		29.05	56.46	75.89
Diluted earnings per share under U.S. GAAP		29.05	56.46	75.61

	Notes	At December 31,	
		1998	1999
		(in HUF millions)	
Shareholders' equity under IAS		257,245	327,579
Adjustments for U.S. GAAP:			
Deferred revenue	(a)	(12,695)	(12,321)
Post-retirement benefits	(c)	624	621
Deferred income tax on U.S. GAAP adjustments		(391)	(631)
Shareholders' equity under U.S. GAAP		<u>244,783</u>	<u>315,248</u>

(a) Deferred revenue

A portion of fees charged to customers upon connection to the fixed line network prior to October 15, 1997 represented contributions to the cost of network construction. The capital contribution element of such fees was deferred and amortized to revenue over the life of the related assets. Legislation was enacted effective October 15, 1997 signaling the removal of any capital contribution element of future customer fees, enabling them to be recognized in full upon connection. This legislation also eliminated refunds of such fees.

Investment contribution and entrance fees for fixed line connections prior to October 15, 1997, included a right of refund. Prior to July 1995, investment contribution fees were fully refundable (upon termination of service) for an indefinite period. Legislation enacted in July 1995 established a fixed date on June 1, 2000 for the termination of the refund period for all investment contribution fees and replaced investment contribution fees with "entrance fees". As provided by such legislation, entrance fees are refundable (upon termination of services) for a five year period only, with the refundable amount declining by 20 percent each year. The Minister for Transport, Telecommunications and Water Management together with the Finance Minister issued a joint declaration making entrance fees for all fixed line connections made after October 15, 1997 non-refundable. The Group records a provision for expected refunds based on historical results.

The Group has looked to FASB Statement of Financial Accounting Concepts No. 5, and Statement of Financial Accounting Standard (SFAS) No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities". The Company has interpreted these pronouncements to require that revenue relating to investment contribution and entrance fees is recognized after any potential refund obligation is extinguished. This accounting treatment emphasizes the legal nature of the potential refund obligation and creates a timing difference between the ongoing expense recognition and the revenue recognition. This interpretation is expected to result in a lump sum revenue recognition of deferred fees by approximately HUF 19 billion in June 2000.

(b) Employee stock purchase plan

In March 1996, the ÁPV instituted an employee stock purchase plan (the "MRP Plan") for the benefit of certain of MATÁV's employees. Under the MRP Plan, the ÁPV transferred 27,883,300 shares to the entity set up for the purpose of creating the plan (the "MRP"), which in turn sells the shares it acquires to participating employees. Employees of MATÁV Rt. and its wholly owned subsidiaries who have been employed for more than one year are eligible to participate. After the initial subscription period ended in September 1996, 24,397,000 shares were allocated to participants with an additional 2,502,200 shares allocated in 1997. The MRP decides on a quarterly basis whether to make any of the remaining unallocated shares available to participants. Shares are allocated ratably to each eligible participant up to the amount subscribed. Under the MRP Plan, employees purchase shares at HUF 118.05 (the fixed purchase price determined by the MRP in accordance with the Hungarian Privatization Law), resulting in a discount to the market price at the date of initial subscription. Because there was not a liquid trading market for the shares allocated prior to the global offering, the market price for purposes of determining the discount to be recorded as compensation expense was estimated based on the quotations of Hungarian stock brokerages.

Following the initial allocation to participants, 15 percent of the purchase price was due upon initial allocation of shares and the remainder was payable in 36 monthly installments through September 1999. For subsequent allocations of shares, 15 percent of the purchase price and the installment payments for the period from October 1996 through the allocation date were due immediately and the remainder of the purchase price was payable in monthly installments through September 1999. Prepayments were not permitted.

The MRP's Board of Directors held a general meeting of plan participants in December 1997 to amend the plan and eliminate the prepayment restriction enabling participants to take title to all shares when fully paid. The modified plan allows participants to make full payment for their subscription rights no sooner than 180 days after the Company's November 1997 initial public offering. In addition, participants can freely trade their subscription rights with other participants of the MRP at any time within the 180 days enabling participants to realize the full value of their allocated shares at any time prior to the expiration of 180 days with no requirement for continued service.

The MRP retains title to all shares until the date on which the subscription rights of participants are fully paid. Until the time that title to the shares passes to the participants, all dividends paid in respect of allocated and unallocated shares held by the MRP accrue to the MRP plan. The Company makes no contributions to the MRP Plan.

There is no authoritative guidance under IAS for employee stock based compensation involving a grant from a major shareowner. Under U.S. GAAP, the Company records the discount (measured as the difference between the estimated market price and the purchase price of the shares allocated, as of the allocation date) as compensation expense over the applicable installment period. With the modification of the MRP plan allowing prepayment and transfer of subscription rights, the remaining unamortized balance was fully amortized in 1997.

The gross amount of compensation relating to allocations made at the date of initial subscription was HUF 2,023 million with an additional HUF 923 million relating to shares allocated in 1997. The estimated aggregate market value of the 1,000,000 unallocated shares at December 31, 1999 was HUF 1.7 billion in excess of the aggregate fixed purchase price.

(c) Post-retirement benefits

IAS 19 is substantially similar to SFAS 106. The difference in net income of HUF 21 million in 1998 and HUF 3 million in 1999 and in shareholder's equity of HUF 624 million in 1998 and HUF 621 million in 1999 is due to the difference in the year of adoption of SFAS 106 versus IAS 19. IAS 19 was adopted in 1998, whereas for the U.S. GAAP reconciliation, SFAS 106 was adopted in previous years. The difference in shareholders equity in 1998 of HUF 624 million reflects the HUF 645 million "Unrecognized net loss from past experience" per U.S. GAAP.

(d) Convertible bonds — The Management Incentive Program

Compensation expense is calculated on convertible bonds granted under the "Management Incentive Plan" and disclosed in the U.S. GAAP income statement adjustments in accordance with APB 25. Total compensation expense is based on the difference between the exercise price and the market price on the grant date. The exercise price in Hungarian Forint on the grant date was HUF 1,262 (USD 5.75 converted into Hungarian Forints at the middle exchange rate as of the grant date, 219.42 HUF/USD). The closing market price on the grant date was HUF 1,296. Total compensation expense of HUF 143 million will be recognized over the three year vesting period. The amount amortized from July 1, 1998 to December 31, 1998 is HUF 24 million. The amount amortized in 1999 reflects the same amortization as in 1998, but reduced due to the forfeit of 402,000 bonds by managers.

In 1995, the FASB issued SFAS 123, "Accounting for Stock-Based Compensation." This pronouncement requires MATÁV to calculate the value of the stock options at the date of grant using an option pricing model. MATÁV has elected to apply the "pro forma disclosure only" option permitted under SFAS 123, instead of recording a charge to operation estimated using the Black Scholes method, as shown below:

	<u>1998</u>	<u>1999</u>
Net income as reported (HUF million)	58,564	78,721
Net income pro forma (HUF million)	58,158	78,002
Earning per share as reported (HUF)	56.46	75.89
Earning per share pro forma (HUF)	56.07	75.20

Our assumptions used in the pricing model and resulting fair values were as follows:

Risk free rate	17.3% for 1 year maturity
Expected dividend yield	0.54%
Expected option life (in years)	3
Expected stock volatility	40%
Grant date value	HUF 580

Consolidation of Westel 450 and Westel 900

The consolidated financial statements, prepared in accordance with IAS, include the accounts of Westel 450 and Westel 900 as consolidated subsidiaries. Under IAS, a parent company must consolidate all enterprises which it controls. The definition of control involves the power to govern the financial and operating policies of an enterprise and the ability to obtain benefits from its activities.

Under U.S. GAAP, there is a presumption that consolidation is usually necessary for a fair presentation when one of the enterprises in the group directly or indirectly has a controlling financial interest in another enterprise. U.S. GAAP places emphasis on majority ownership rather than on control. Under U.S. GAAP, the Company believes that while it holds 51% of Westel 900 and Westel 450, the ownership rights of the other shareholder may be considered participatory in nature and would preclude consolidation under U.S. GAAP. Under U.S. GAAP, these investments were accounted for using the equity method.

Net income and shareholders' equity, as reported under IAS, are not affected by this different accounting method under U.S. GAAP. Summary financial information for each of these investments is as follows:

	<u>Westel 900</u>		<u>Westel 450</u>	
	<u>At December 31,</u>		<u>At December 31,</u>	
	<u>1998</u>	<u>1999</u>	<u>1998</u>	<u>1999</u>
	(in HUF millions)			
Current assets	17,424	28,055	4,148	4,886
Fixed assets	48,817	70,529	8,576	8,897
Current liabilities	(12,755)	(17,021)	(1,605)	(6,549)
Non current liabilities	<u>(33,624)</u>	<u>(37,341)</u>	<u>(8,143)</u>	<u>(6,249)</u>
Shareholders' equity	<u>19,862</u>	<u>44,222</u>	<u>2,976</u>	<u>985</u>

27 Additional disclosures required for U.S. GAAP — recent accounting pronouncements

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" is effective for financial periods beginning after June 15, 1999. Upon initial application all derivatives are required to be recognized in the balance sheet as either assets or liabilities and measured at fair value. In addition, all hedging relationships must be designated, documented and reassessed. The Company is currently evaluating the effect that SFAS No. 133 will have on its consolidated financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," (SAB 101) which provides additional guidance in applying generally accepted accounting principles. In certain cases, SAB 101 requires upfront fees be deferred and recognized over the expected period of performance. We are assessing the types of transactions that may be affected by this Bulletin. Its impact on the consolidated financial statements is not yet known.