As filed with the Securities and Exchange Commission on May 9, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2000

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 Into English)

Hungary

(Jurisdiction of Incorporation or Organization)

Budapest, 1013, Krisztina krt. 55, Hungary

(Address of Principal Executive Offices)

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

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

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

NONE

(Title of Class)

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

NONE

(Title of Class)

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

Ordinary Shares……1,037,358,870,
nominal value HUF 100 per share
(as of December 31, 2000)

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 Ω

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

Item 17 9 Item 18 Ω

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

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PART III

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" refers to Westel Mobil Távközlési Rt.; and the term "Westel 0660" refers to Westel Rádiótelefon Kft. The Company owns 51 percent of each of the Westel companies. In this annual report, the term "Minister" refers to the Minister heading the Prime Minister Office, to whom the rights belonging to the Minister of Transport, Telecommunications and Water Management were transferred as of June 1, 2000.

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.

PART I

ITEM 1 — INDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2 — OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3 — KEY INFORMATION

SELECTED FINANCIAL DATA

This selected consolidated financial and statistical 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 as of and for the years ended December 31, 1996, 1997, 1998, 1999 and 2000 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 30 to the consolidated financial statements.

	Year ended December 31,					
	1996	1997	1998	1999	2000	2000
	HUF	HUF	HUF	HUF	HUF	U.S.$(1)
	(in millions, except per share amounts)					
Consolidated Income Statement Data:						
Amounts in accordance with IAS						
Revenues	196,490	253,948	318,060	384,932	445,945	1,566
Operating profit	52,071	74,054	96,109	121,131	112,871	396
Net income	23,088	36,034	58,337	78,632	68,763	242
Net income per share(2)	22.26	34.74	56.24	75.81	66.29	0.23
Diluted net income per share(2)	22.26	34.74	56.24	75.52	66.02	0.23
Amounts in accordance with U.S. GAAP						
Revenues	190,135	251,197	318,342	385,306	461,537	1,621
Operating profit	45,436	68,331	96,346	121,460	104,701	368
Net income	16,304	30,130	58,564	78,721	63,793	224
Net income per share(2)	15.72	29.05	56.46	75.89	61.50	0.22
Diluted net income per share(2)	15.72	29.05	56.46	75.61	61.25	0.22
Consolidated Balance Sheet Data:						
Amounts in accordance with IAS						
Total assets	420,725	480,611	549,540	647,870	745,509	2,619
Net assets	182,516	225,861	269,380	350,591	427,715	1,502
Capital stock	103,728	103,728	103,728	103,728	103,736	364
Total shareholders' equity	172,642	208,676	257,245	327,579	386,984	1,360
Amounts in accordance with U.S. GAAP						
Total assets	420,933	480,638	549,149	647,239	750,328	2,635
Net assets	170,497	210,642	256,918	338,260	410,238	1,441
Total shareholders' equity	160,623	193,457	244,783	315,248	369,817	1,299

	Year ended December 31,					
	1996	1997	1998	1999	2000	2000
	HUF	HUF	HUF	HUF	HUF	U.S.$(1)
	(in millions, except per share amounts)					
Other data:						
Weighted average number of shares						
Basic ………………………………...	1,037	1,037	1,037	1,037	1,037	3.64
Diluted …………………………………	1,037	1,037	1,037	1,041	1,042	3.66

(1) Translated into U.S. dollars at the official closing rate of the National Bank of Hungary on December 31, 2000 of U.S. dollar 1.00 = HUF 284.73. These translations are unaudited and presented for convenience purposes only. 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.

Dividends

The following table sets forth the dividend paid per Matáv ordinary share for the years 1997, 1998, 1999 and 2000. The table shows the dividend amounts in Hungarian Forints, together with U.S. dollar equivalents, for each of the years indicated.

	Dividend Paid Per Ordinary Share	
	HUF	U.S.$
Year		
1996 ………………………………………………………………………...	n.a.	n.a.
1997 ………………………………………………………………………...	7	0.0344
1998 ………………………………………………………………………...	8	0.0365
1999 ………………………………………………………………………...	9	0.0356
2000 ………………………………………………………………………...	10	0.0351

(1) Translated into U.S. dollars at the official closing rate of the National Bank of Hungary on December 31, 2000 of U.S. dollar 1.00 = HUF 284.73, on December 31, 1999 of U.S. dollar 1.00 = HUF 252.52, on December 31, 1998 of U.S. dollar 1.00 = HUF 219.03 and on December 31, 1997 of U.S. dollar 1.00 = HUF 203.50.

Exchange Rate Information

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 against a basket of foreign currencies. 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. Before May 4, 2001, the National Bank of Hungary had stated 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. On May 4, 2001, the National Bank of Hungary announced that it has widened this intervention band significantly to 15 percent above or below the announced rate. The move was explained as a step towards convergence with the European Union exchange rate regime and as an effective tool to fight inflation. Matáv's exposure to risks from exchange rate fluctuations has increased as a result of this band widening because the National Bank of Hungary is less likely to act to stabilize the value of the Hungarian Forint during periods of exchange rate volatility.

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, 0.4 percent in October 1999 and 0.3 percent in April 2000. In April 2001, the National Bank of Hungary cut the monthly devaluation rate to 0.2 percent.

The following tables set forth, for the periods and dates indicated, the period-end, average, high and low official rates 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.

	Exchange Rates (amounts in HUF/U.S.$)			
	Period-End	**Average (1)**	**High**	**Low**
Year				
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
2000 ………………………………………..	284.73	282.27	318.71	245.57
2000				
October ……………………………...	313.57	307.10	318.71	299.05
November …………………………...	304.97	308.27	314.75	302.52
December …………………………...	284.73	295.41	302.13	283.65
2001				
January..	284.84	282.24	289.70	277.37
February..	288.87	288.13	294.10	281.19
March..	302.79	292.63	302.79	284.14

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

	Exchange Rates (amounts in HUF/DM)			
	Period-End	**Average (1)**	**High**	**Low**
Year				
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 day during the relevant period.

Exchange Rates
(amounts in HUF/EUR)

	Period-End	Average (1)	High	Low
Year				
1999 ....……….........	254.92	252.80	258.86	248.23
2000 ....……….........	264.94	260.04	265.67	254.47
2000				
October ……………………………...	263.15	262.98	264.00	262.34
November …………………………...	264.90	264.11	265.02	263.24
December …………………………...	264.94	264.96	265.67	264.50
2001				
January..	265.16	265.01	265.33	264.58
February..	266.14	265.67	266.31	265.27
March...	266.70	266.46	266.75	266.20

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

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.

RISK FACTORS

Prior to making any investment decision, you should carefully consider the risks set forth below in addition to the other information contained in this annual report. This annual report contains certain "forward-looking" statements. These include statements on expectations of Matáv's businesses. You will find below and elsewhere in this annual report important factors that could cause the results of Matáv to differ materially from such forward-looking statements. Matáv disclaims any obligation to update information contained in any forward-looking statement.

Matáv's operations are subject to substantial government regulation, which can result in adverse consequences for the Company's business and results of operations.

Matáv has exclusive rights through December 2001 to provide domestic long distance and international public voice telephony services throughout Hungary. The Company also has exclusive rights through December 2001 and, in five areas, through May 2002, to provide local public fixed line telephony service in 36 of 54 local primary areas in Hungary. Following the expiration of the exclusivity of the concession agreements of Matáv and other local telephone service providers, a draft new Telecommunications Act, which is under preparation, is expected to be the basis for the liberalized telecommunications market in Hungary.

The draft new Telecommunications Act has been approved by the government and is expected to be approved by the Hungarian Parliament in June 2001. It is subject to change until its ratification and is scheduled to enter in force on December 23, 2001. The draft new Telecommunications Act will, among other things, establish a new regime of retail price controls on fixed line voice telephony services, require unbundling of local loops and transparency of cost-based pricing for interconnection services, and establish Matáv as a universal service provider. The Company cannot anticipate the combined impact of these changes on its business and results of operation. Executive orders clarifying the details of the new telecommunications regime will be issued only after the approval of the draft new Telecommunications Act and some of the executive orders might be issued only a short time before the December 23, 2001 deadline. Matáv's business and results of operations may be adversely affected by the new Hungarian telecommunications regulatory regime, and the Company is preparing for market liberalization in a very uncertain regulatory environment. See "Regulation and Pricing -The Draft New Telecommunications Act".

Limitations on Matáv's ability to rebalance its tariff structure could impede the Company's ability to compete effectively.

Matáv is subject to regulatory limitations on its ability to increase prices for fixed line telephone services and to rebalance prices for specific categories of service. Management believes that the Company's domestic and international tariff structure will require continued rebalancing. The current limitations could limit the Company's ability to compete in the provision of public switched voice telephony services following telecommunications market liberalization in Hungary.

Matáv is subject to increased competition due to telecommunications sector liberalization.

Competition in the Hungarian telecommunications sector is increasing as a result of market liberalization measures. After December 23, 2001, other service providers will have the right to compete directly for Matáv's customers across Hungary. Matáv is preparing for the introduction of competition in public switched voice telephony services and already operates in an increasingly competitive environment in non-regulated areas, such as mobile telephony and data transmission.

Management believes that following the liberalization of the Hungarian telecommunications sector, competition in the provision of telecommunications infrastructure as well as in domestic and international telephony services may arise from a variety of new entrants, including telecommunications service providers from other countries and companies currently providing other telecommunications services previously liberalized in Hungary. The exact identity of the new entrants, the scope of increased competition and any adverse effect on the Company's results will depend on a variety of factors that we currently cannot assess with precision and are for the most part not within the Company's control. Among such factors are the business strategies and capabilities of potential competitors, prevailing market conditions at the time competition is permitted, applicable EU and Hungarian regulations with respect to new entrants and the Company, as well as the effectiveness of the Company's efforts to prepare for increased competition. As a result of increasing competition, Matáv may be unable to maintain its market share and sustain the prices it currently charges for telecommunications services, which could have an adverse impact on its financial condition and results of operations.

Matáv's ability to sustain revenue growth will depend in part on increasing traffic and offering value added and data services to its customers.

Although Matáv expects the number of access lines in its concession areas to continue growing as the Hungarian economy develops, it is not likely to grow as rapidly as in prior years. Matáv's ability to sustain revenue growth will therefore depend on increasing the amount of traffic over existing fixed lines and on increasing revenues from value added and data services. Matáv also plans to sustain revenues by growing its mobile subscriber base and expanding its related lines of business, such as Internet and cable television. Matáv may not be able to sustain revenue growth, if it is not able in the future to offer attractive or affordable value added services or if the Company's customers do not purchase its services.

Increased traffic may not fully offset declining tariffs.

Matáv has been implementing broad-based tariff rebalancing designed to foster increased usage of telecommunications services, to align Matáv's tariffs more closely with costs and to increase Matáv's competitiveness in anticipation of market liberalization. In 2000, although subscription fees have increased in real terms, local, domestic long distance and international tariffs have decreased both in nominal and real terms. Increased usage of local, long distance and international telecommunications services may not fully offset the impact of declining tariffs.

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

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

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

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

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

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

Matáv's share price may be volatile and your ability to sell Matáv shares may be adversely affected due to the relatively illiquid market for Matáv securities.

The Hungarian equity market is relatively small and illiquid compared with major global markets. Matáv has by far the largest market capitalization of any company listed in the Budapest Stock Exchange. As a result of the limitations of the Hungarian equities market, the general turmoil in emerging markets beginning in 1998 and the volatility of the telecommunications sector, the price of Matáv shares may be relatively volatile and you may have difficulty selling your shares in the event of unfavorable market conditions.

Matáv expects to face limitations on further extention of its cable television business under the draft new Telecommunications Act, which is scheduled to take effect on December 23, 2001.

The draft new Telecommunications Act, which is expected to be the basis for the telecommunications market in Hungary after December 23, 2001, restricts Matáv from purchasing cable television networks until January 1, 2004 and also restricts the Company from building its own cable television networks in those areas where Matáv or another significant competitor has a telephone network. These expected measures would significantly limit the expansion of Matáv's cable television business.

Matáv has a substantial business interest based in Macedonia, and current ethnic hostilities and related violent conflict could reduce the value of Matáv's investment in that region.

Matáv owns 86.5 percent interest in Stonebridge Communications AD ("Stonebridge"), which owns a 51 percent interest in Macedonian Telecom ("MakTel"), the formerly state owned public telecommunications service provider in Macedonia. MakTel became a consolidated subsidiary of Matáv beginning on January 15, 2001. MakTel's total revenues in 2000 amounted to HUF 54.8 billion, compared with Matáv's total revenues of HUF 445.9 billion for the same period.

Tensions between ethnic Albanian and Slavic populations in Macedonia have recently resulted in sporadic violent confrontations focused primarily along the northern border of the country. Efforts by the United Nations, the North Atlantic Treaty Organization and a number of individual countries to promote peaceful dialogue among parties to the conflict have led to some progress relaxing tensions in the region. The conflict in Macedonia may, however, escalate. If as a result of the conflict some or all of MakTel's fixed assets are damaged or destroyed, MakTel's operational efficiency is reduced or the Macedonian economy is negatively affected, then the value of Matáv's interest in MakTel would be reduced and Matáv's future results of operations may be adversely affected.

Matáv is subject to risks resulting from fluctuations in exchange rates.

Matáv is subject to risks resulting from fluctuations in exchange rates, which can adversely affect costs associated with Matáv's foreign currency denominated debt obligations and certain other payments. Before May 4, 2001, the National Bank of Hungary had a stated policy of intervening in the foreign currency market if the actual Hungarian Forint/Euro exchange rate moved more than 2.25 percent above or below the announced rate. On May 4, 2001, the National Bank of Hungary announced that it has widened this intervention band significantly to 15 percent above or below the announced rate. Our exposure to risks from exchange rate fluctuations has increased as a result of this band widening because the National Bank of Hungary is less likely to act to stabilize the value of the Hungarian Forint during periods of exchange rate volatility. See "Item 11 Quantitative and Qualitative Disclosures about Market Risk."

ITEM 4 — INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT OF THE COMPANY

Organization

Matáv is the principal provider of fixed line telecommunications services in Hungary. Its shares are listed on the Budapest Stock Exchange and the New York Stock Exchange. Matáv's headquarters are located at 55 Krisztina krt., 1013 Budapest, Hungary. Its telephone numbers are 36-1-458-0000 or 36-1-458-7000. Matáv operates under the laws of Hungary. Its U.S. agent for federal securities law purposes is CT Corporation, 111 Eight Avenue, New York, New York, 10011, USA.

Historical Background

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, the predecessor entity to Matáv, became responsible for telecommunications operations. This entity was transformed on December 31, 1991 into a stock corporation, Magyar Távközlési Rt., or Matáv, then wholly owned by the predecessor of the Állami Privatizációs és Vagyonkezelő Rt. (the "State Privatization and Holding Company" or the "ÁPV").

MagyarCom GmbH ("MagyarCom"), a holding company in which Deutsche Telekom AG and Ameritech Corporation ("Ameritech") each held a 50 percent interest, was selected by the Minister in an international tender and subsequently purchased a 30.1 percent stake in Matáv for approximately U.S. dollar 875 million. The ÁPV contributed U.S. dollar 400 million of the purchase price paid by MagyarCom to Matáv to provide it with capital to expand the telephone network. MagyarCom entered into a concession agreement with the Hungarian Government on December 19, 1993. MagyarCom then assigned certain of its rights under the concession agreement to Matáv. On December 22, 1993, Matáv entered into a concession contract with the Hungarian Government, which gives Matáv the exclusive right to provide domestic long distance and international public telephony services throughout Hungary and local public fixed line voice telephony services in 31 of 54 Local Primary Areas for a term of eight years ending December 22, 2001. On May 24, 1994 Matáv obtained the right to provide telephony services in an additional five Local Primary Areas for a term of eight years ending May 25, 2002.

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

On July 3, 2000 SBC sold its 50 percent ownership in MagyarCom to Deutsche Telekom AG, increasing Deutsche Telekom AG's ownership in Matáv to 59.52 percent. The remaining 40.48 percent of Matáv's ordinary shares are publicly traded, and one Series "B" voting preference share to which special rights attach is controlled by the Hungarian Government.

Acquisition of Macedonian Telecom (MakTel)

In December 2000, the Company, on behalf of a consortium, reached agreement with the government of Macedonia to purchase 51 percent of MakTel upon its privatization. The closing of the transaction took place on January 15, 2001 whereby the Company paid EUR 343.3 million on behalf of the consortium in accordance with the acquisition agreement. The 51 percent ownership acquired by Matáv was contributed on January 16, 2001 to a newly established Macedonian acquisition vehicle, Stonebridge.

In accordance with a subscription and shareholders' deed between Matáv, SEEF Holdings Ltd. and CosmoTelco Added Value Services S.A., the latter two acquired a 6.1 percent and a 7.4 percent ownership respectively in Stonebridge reducing Matáv's investment in Stonebridge to EUR 301.5 million. Matáv, consequently, has an 86.5 percent stake in Stonebridge, which owns 51 percent of MakTel, thereby Matáv has an effective ownership interest in MakTel of approximately 44 percent.

MakTel became a consolidated subsidiary of Matáv from January 15, 2001.

The following table sets out summary financial information and statistical data of MakTel for the years ended December 31, 1998, 1999 and 2000. The summary financial information is extracted from audited accounts of MakTel prepared in accordance with IAS.

	For the year ended December 31,			
	1998	**1999**	**2000**	**2000**
	MKD millions	MKD millions	MKD millions	U.S. $ millions
Financial data				
Total revenue	7,379	10,066	12,203	187
Operating profit	2,562	5,166	3,780	58
EBITDA	3,564	6,279	4,998	76
Net income	1,925	3,661	2,839	43
Statistical data				
Total number of subscribers	439,000	471,000	507,000	
Number of mobile subscribers	30,000	48,000	108,000	
Internet subscriptions	3,000	5,000	10,000	
Employees	3,500	3,700	3,700	

(1) Translated into U.S. dollars at the official closing rate of the National Bank of Macedonia on December 31, 2000 of U.S. dollar 1.00 = MKD 65.33

BUSINESS OVERVIEW

Business Summary

Matáv is the principal provider of fixed line telecommunications services in Hungary, with approximately 3.0 million fixed access lines at December 31, 2000. The Company is also Hungary's largest mobile telecommunications service provider, with almost 1,675,000 mobile subscribers (including users of prepaid cards) at December 31, 2000. The Company's total consolidated revenues were HUF 445,945 million and its total consolidated net income was HUF 68,763 million in 2000.

Matáv is a full-service telecommunications provider operating in two business segments:

Fixed Line Telecommunications Services. The Company's fixed line telecommunications services consist of local, long distance, international and other telecommunications services, including data transmission, cable television and Internet 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 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 and Westel 0660, the Company is a market leader in the provision of mobile telecommunications services in Hungary. Westel currently is one of three GSM digital providers and Westel 0660 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 88,142 million, before intersegment eliminations in 1998 to HUF 159,345 million before intersegment eliminations in 2000, while the number of subscribers almost tripled over the period. In 1999, Westel won one of the new 1800 GSM mobile telecommunications operating licenses. One new entrant in the Hungarian digital cellular market started operation in December 1999 offering GSM services. The winners of the two other 1800 GSM licenses - including Westel - entered the 1800 GSM market 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 1998 and 2000, Matáv invested over HUF 170 billion in its fixed line telecommunications network, and added over 294,000 fixed access lines and over 267,000 ISDN channels. The Company expects to make total capital expenditures of approximately HUF 340 billion between 2001 and 2003. The rate of penetration in Matáv's service areas increased from 31.7 access lines per 100 inhabitants at December 31, 1997 to 39.5 access lines per 100 inhabitants at December 31, 2000. In addition, the level of digitalization of the Company's switching capacity increased from 70.2 percent at December 31, 1997 to 85.1 percent at December 31, 2000. Workforce efficiency increased, with the number of fixed access lines per fixed line employee rising from 163 at December 31, 1997 to 264 at December 31, 2000.

Business Strategy

Matáv's strategy is aimed at maintaining the leading position in the Hungarian market for fixed line voice telephony and mobile telecommunications while simultaneously building on and expanding the scope of its investments, particularly in mobile telecommunications and other telecommunications segments where Matáv sees the greatest growth potential. Matáv will seek to maximize profits and cash flows from its existing core fixed line and mobile telecommunications businesses to help fund such development and expansion of its business. Matáv will also seek to exploit new market opportunities through geographical expansion, both domestic and international.

As part of Matáv's strategy, and with the aim of supporting Matáv's ability to enhance profitability and increase shareholder value, in 2001, the Company began to reorganize its operations into the following lines of business: fixed line mass market, mobile services, Internet and data/business solutions.

Fixed Line Services Segment

Fixed Line Mass Market

Fixed line telecommunications is Matáv's most established core business. Fixed line voice telephony services in particular continues to be the Company's most significant revenue contributor, representing approximately 60 percent of Matáv's total revenues in 2000.

Matáv plans to further increase subscriber lines and upgrade existing lines to ISDN. Matáv is also working to increase average minutes of use per subscriber by increasing call completions, in part through further penetration of value added services. Matáv also seeks to capture additional market share of the expected growth in demand for broadband services and fixed line data services. Matáv believes that revenue from data services in particular will continue to grow more rapidly than revenue from its other fixed line operations. Data services growth is expected to be driven by increased use of the Internet, increased demand for integrated business solutions and the development of more efficient and cost-effective data communications technologies.

In an effort to maximize cash flow and profit from the fixed line business, Matáv is working to streamline its fixed line operations and reduce related operating costs. The primary elements of this process include:

- implementing cost reduction plans to reduce administrative overhead;
- improving operating efficiencies; and
- eliminating unproductive assets.

Matáv also believes that improving customer satisfaction and retaining existing fixed line customers are important aspects of the fixed line strategy, particularly in light of increasing competition in the fixed line business as Matáv's exclusive rights expire at the end of 2001.

Matáv will seek to become the leading wholesale provider in the Hungarian wholesale market for fixed line telecommunications services and benefit from what is expected to be a growing number of potential wholesale customers. In addition to providing the mandatory interconnection services required under Hungarian law, Matáv seeks to expand wholesale operations into areas the Company believes will be profitable, such as Internet protocol ("IP") telephony. Matáv expects to approach wholesale customers with tailored solutions providing comprehensive packages of telecommunications services.

Data/Business Solutions

Matáv aims to offer comprehensive business services, providing end-to-end managed customer networks with desktop environments supported by information technology partners. Matáv’s existing product portfolio includes Private Branch Exchange ("PBX"), Local Area Network ("LAN"), Wide Area Network ("WAN") and LAN-WAN integration solutions. Matáv will seek to expand this portfolio and related know-how to include integration of voice, data and other business solutions. Matáv is able to offer its key accounts all fixed line network solutions supplemented with mobile products.

Internet

Matáv is the leading Internet service provider ("ISP") in the Hungarian consumer market through its subsidiary, Matávnet Rt. ("Matávnet"), which also operates [origo], one of the most visited portals in the country. Matáv seeks to maintain its leading access and content provider position in the consumer market and intends to become the market leader ISP in Hungary in the corporate market as well. The Company's Internet strategy objectives include:

- increasing Internet penetration and customer acquisition;
- maintaining the Company's leading position as a mass market Internet service provider;
- becoming a leading Internet service provider for mobile phone users through Westel's mobile ISP service; and
- improving Matáv's market position as a provider of Internet services to business customers.

Matáv seeks to achieve its objectives by providing technically advanced broadband access products at affordable prices. In addition, Matávnet plans to differentiate itself from its competitors in the dial-up business by improving technical reliability of the network and level of customer care by a new billing system and improved call center.

Matáv will exploit Matávnet's portal, [origo], one of Hungary's most visited Internet portals. By offering improved content for both mobile and fixed line users, the Company expects to increase the loyalty of Matávnet's customer base. Matáv plans to expand its current horizontal portal design by adding a vertical portal dimension to and integrating e-business modules with the [origo] portal.

Mobile Services Segment

Matáv considers mobile telecommunications services to be one of its most important sources of potential future growth. Matáv believes that mobile telecommunications penetration in Hungary will continue to increase, and the Company expects that by the end of 2001 mobile penetration in Hungary will surpass the current 40 percent penetration for fixed line services. Growth in mobile telecommunications services should also be enhanced by increased traffic from data and Internet services as related mobile services are further developed.

Matáv's objective is to remain the leading mobile telecommunications services provider offering the premium quality services in Hungary. To achieve this aim, Matáv seeks to offer customers the latest mobile technologies on the market, a wide range of value added services and high quality customer service. Matáv's mobile telecommunications services business is further supported by the Company's ability to offer mobile customers comprehensive telecommunications packages that can include services from Matáv's other lines of business.

Geographic Expansion

Matáv plans to seek new opportunities through both domestic and international expansion of its business. Domestically, particularly as current exclusive rights of LTOs expire, Matáv will seek to compete across Hungary for the provision of fixed line and other telecommunications services. Through international expansion, Matáv aims to:

- exploit core competencies and enter new growth markets for telecommunications services;
- leverage Deutsche Telekom AG's global network and service activities;
- create regional network capacity; and
- selectively consider acquisitions and joint venture opportunities.

Investments and Portfolio Management

Matáv considers investment and portfolio management strategy to be key to the Company's goal of enhancing profitability in the rapidly evolving telecommunications sector. Matáv must constantly assess its new investments and existing business interests in light of their potential to generate future returns and enhance Matáv's market position.

Matáv uses the following criteria in assessing new investments and its existing portfolio of business assets:

- growth potential;
- return on capital;
- strategic value, particularly for positioning Matáv in emerging growth areas of telecommunications technology;
- synergies with Matáv's existing telecommunications businesses and assets; and
- efficiencies from economies of scale.

Overview of Matáv's Revenues

For the years ended December 31, 1998, 1999 and 2000, Matáv's total revenues by business segment were as follows:

	Year ended December 31,			Year ended December 31,
	1998	1999	2000	2000/1999
		(in HUF millions)		(% change)
Fixed line telecommunications services segment				
Subscriptions, connections and other charges.	55,673	63,413	83,243	31.3
Domestic traffic revenues	108,425	134,071	129,517	(3.4)
Other usage	26,807	26,999	26,679	(1.2)
International traffic revenues	38,792	43,807	41,432	(5.4)
Leased lines	10,493	13,816	16,453	19.1
Data transmission and related services	5,357	7,781	11,949	53.6
Telecommunications equipment sales	3,230	3,030	4,810	58.7
Construction, maintenance and other	8,152	9,313	12,197	31.0
Total fixed line segment	256,929	302,230	326,280	8.0
Mobile telecommunications services segment....	88,142	117,336	159,345	35.8
Intersegment eliminations	(27,011)	(34,634)	(39,680)	14.6
Total	318,060	384,932	445,945	15.9

Fixed Line Telecommunications Service Segment

In 2000, Matáv's fixed line telecommunications services generated revenues of HUF 326,280 million before intersegment eliminations. Fixed line telecommunications services consist of domestic and international services, leased lines, data transmission, cable television and Internet services, telecommunications equipment sales, construction, maintenance and other services.

Domestic Services

Domestic fixed line voice telephony, Matáv's principal business activity, generated revenues of HUF 239,439 million in 2000, HUF 224,483 million in 1999 and HUF 190,905 million in 1998, in each case before intersegment eliminations.

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. In 2000 we increased the number of Voice-mail subscribers to 275,000. In August 2000 Matáv enriched the service by introducing call return and call capture functions as part of the basic voice-mail service. This allows better usage of the network, more comfort in using the phone and decreases the ratio of uncompleted calls.

ISDN Services. Matáv offers ISDN services in Budapest and other major cities in its local concession areas. ISDN allows a single access line to be used simultaneously for a number of purposes, including voice, data, facsimile and video transmission. ISDN also provides higher quality 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. As of December 31, 2000, Matáv had installed 95,641 ISDN access lines with two channels and 3,820 ISDN access lines with 30 channels, amounting to 305,882 total ISDN channels.

PBX Services. Matáv offers PBX services through one of its subsidiaries, Matávcom Kft. As of December 31, 2000, Matávcom Kft. leased and sold 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 Kft. 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, 2000, customers had subscribed to over 98,000 World Cards.

Directory Assistance. The Company offers customers directory inquiry services. On March 1, 1997, the Company introduced a new, high quality directory assistance service, which received over 140 million inquiries by the end of 2000. In May 1999, the service was further developed to offer a call completion option, whereby calls may be connected automatically. From October 1, 2000, the directory assistance database has been extended to include the Westel mobile customer's database.

Subscribers

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

	At December 31,		
	1998	**1999**	**2000**
Lines in service in Matáv's local concession areas:			
Residential lines	2,201,366	2,370,579	2,296,351
Business lines	362,828	378,605	326,503
Public payphones	36,954	36,205	36,774
Total	2,601,148	2,785,389	2,659,628
ISDN channels	70,642	114,466	305,882
Total	2,671,790	2,899,855	2,965,510
Lines installed per 100 inhabitants:			
in Matáv's local concession areas	35.4	38.6	39.5
Waiting list (in thousands)(1)	30	38	19
Digital exchange capacity as % of Matáv's total exchange capacity	75.7	79.0	85.1

(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, 2000, 79.1 percent of Matáv's access lines were connected to residential customers and 19.7 percent to business customers. The remaining 1.2 percent of access lines was connected to public pay phones. Matáv's top 400 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 five percent of its total revenues in 2000. 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:

	Year ended December 31,		
	1998	**1999**	**2000**
Domestic traffic (in thousands of minutes)	7,758,741	8,632,345	9,692,678

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 in each of the years indicated in nominal Hungarian Forints. Tariff changes were effective from January 1 in 1998 and 1999. In 2000 and 2001, tariff changes were effective from February 1 for analog lines and from January 1 for ISDN lines.

	1998	1999	2000	2001
	(HUF, exclusive of VAT) (1)			
Entrance fee: (2)				
Residential	27,000	27,000	27,000	27,000
Business	60,000	60,000	60,000	60,000
Standard monthly subscription charge:				
Residential (3)	1,100	1,210	1,814	2,308
Business	1,335	1,630	2,440	3,100
ISDN entrance fee:				
Basic	180,000 (4	125,000	99,000	60,000
Multiplex	1,350,000 (4	1,350,000	1,350,000	990,000
ISDN standard monthly subscription charge:				
Basic	2,550-3,150 (4	3,200-6,400	3,700-6,900	3,900-6,900
Multiplex	38,250-46,500 (4	49,000-63,800	53,400-69,900	57,600-75,500
Charge for a three minute peak rate call:				
Local	31.2	31.8 (5)	27.6 (5)	25.4 (5)
From the fixed line network to mobile subscribers	176.8	186.6 (5)	186.0 (5)	183.8 (5)
Domestic long distance:				
Zone 1 (Extended local)	41.6	33.6 (5)	27.6 (5)	25.4 (5)
Zone 2 (Budapest metropolitan area)(6)	41.6	46.2 (5)	45.6 (5)	48.8 (5)
Zone 3 (Long distance)	104.0	98.4 (5)	87.0 (5)	75.8 (5)

(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 and 2000.

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

(4) 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.

(5) Includes a call set-up charge (HUF 6.6 in 1999, HUF 6.0 in 2000 and HUF 3.8 in 2001).

(6) 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.

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 and eliminated it on January 1, 2001.

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, 1998 through December 31, 2000, in real terms the Company increased its monthly subscription charges by 63.6 percent, decreased its local tariffs by 13.7 percent, decreased charges for calls from fixed line to mobile telephones by 11.2 percent and decreased domestic long distance tariffs by 28.9 percent.

The Company has accelerated its drive toward tariff rebalancing for 2000 and 2001 to stimulate usage and to prepare for future competition. The monthly subscription fee increased in 2000 and 2001 significantly in both nominal and real terms over prior year's fee. In contrast, usage charges decreased on average in both nominal and real terms in 2000 and 2001.

Public Telephones

As of December 31, 2000, Matáv operated 36,774 public pay phones, representing a penetration rate of 4.9 per 1,000 inhabitants in Matáv's concession areas. Approximately 48 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.

Acquisition of Emitel

Matáv Rt. has been a 50% owner of Emitel since its establishment and treated Emitel as an associated company in its consolidated financial statements. On December 31, 2000, Matáv Rt. agreed with Aphrodite BV, the owner of the other 50% stake that it will purchase the remaining 50% stake. The change of ownership is conditional on the approval of the Minister responsible for telecommunications in Hungary as well as on the approval of the Hungarian Competition Office, which could be several months. The price will be determined when the transaction is finalized and will be partially dependent on the operations of Emitel, but it shall not be less than USD 46.5 million.

International Telephone Services

International telephone services comprise inbound and outbound traffic, including voice and data communications as well as switched transit. The Company has the exclusive right to provide international direct dialing service in Hungary until December 2001. International telephone services consist of outgoing and incoming international telephony traffic, including voice, data and switched transit traffic through Hungary. In 2000, outgoing international telephony traffic generated revenues of HUF 17,490 million before intersegment eliminations, and incoming international telephony traffic generated revenues of HUF 23,942 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. The Company provides signaling links for mobile operators to facilitate international roaming. Matáv also sells international leased lines, including international managed leased lines, and international ISDN, X.400, X.25, telex and telegraph services. The sales of international leased lines are steadily growing, partly due to the introduction of one-stop-shopping agreements. International Internet connectivity was enhanced in 2000 in order to provide services for Internet service providers.

In June 2000 Matáv introduced the international pre-paid calling card, "Barangoló", which enables customers to make phone calls, including IP based calls, in 40 countries of the world. This service enables customers to call from touch-tone payphones in Hungary and abroad until the card expires. Until the end of 2000 approximately 30,000 Barangoló cards have been purchased.

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,					
	1998		**1999**		**2000**	
	(millions of minutes, except for percentages and ratios)					
Outgoing traffic:						
Germany and Austria	109.2	36.9 %	118.5	36.5 %	125.1	36.9 %
Neighboring countries other than Austria	47.9	16.2 %	54.5	16.8 %	58.3	17.2 %
United States	13.1	4.4 %	14.1	4.3 %	14.1	4.2 %
United Kingdom	17.4	5.9 %	18.9	5.8 %	17.8	5.3 %
Italy	16.8	5.7 %	18.5	5.7 %	19.2	5.7 %
All other countries	91.9	30.9 %	100.0	30.9 %	104.2	30.8 %
Total outgoing traffic	296.3	100.0 %	324.5	100.0 %	338.7	100.0 %
Growth in total outgoing traffic (% per annum)	-	3.2	-	9.5	-	4.4
Incoming traffic:						
Germany and Austria	128.9	34.4 %	157.6	35.7 %	149.2	31.4 %
Neighboring countries other than Austria	37.6	10.0 %	41.5	9.4 %	43.7	9.2 %
United States	26.4	7.0 %	58.2	13.2 %	55.8	11.8 %
United Kingdom	42.3	11.3 %	49.0	11.1 %	74.4	15.7 %
Italy	19.6	5.2 %	18.2	4.1 %	19.0	4.0 %
All other countries	119.7	32.1 %	116.7	26.5 %	132.3	27.9 %
Total incoming traffic	374.5	100.0 %	441.2	100.0 %	474.4	100.0 %
Growth in total incoming traffic (% per annum)	-	15.4	-	17.8	-	7.5
Ratio of incoming to outgoing traffic	-	1.26	-	1.36	-	1.4
Transit traffic (millions of minutes)	35.5	-	60.9	-	80.7	-

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 63 percent of the incoming traffic in 2000. Business customers make a substantial majority of the outgoing international calls carried by Matáv.

In 1998, 1999 and 2000, 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.

Matáv met several challenges relating to international telephone traffic during the year 2000. Despite the increasing competition in the international transit market Matáv carried a considerable amount of switched transit traffic between Western and Central/Eastern Europe. International transit traffic has increased compared to the previous years' figure. Matáv's international switched transit service has provided a real back-up gateway to reach this part of the continent. The voice over IP service providers have offered lower rates for terminating international telephone traffic in Hungary, and as a result Matáv has lost some incoming international telephone traffic in 2000. In order to minimize the loss of revenue from international telephone traffic and to create new revenue streams, a revised settlement rate policy has been put into practice. This policy aims at safeguarding traffic volumes by systematically reducing settlement rates.

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 1998, in nominal Hungarian Forints, in the charge for a three-minute call to selected destinations. Tariff changes were effective from January 1 in 1998 and 1999. In 2000 and 2001, tariff changes were effective from February 1 for analog lines and from January 1 for ISDN lines.

	1998	**1999(1)**	**2000(1)**	**2001(1)**
		(HUF, exclusive of VAT) (1)		
Neighboring countries	249.6	244.2	222.0	219.8
Other Europe	332.8	330.6	285.0	228.8
United States and Canada	364.0	339.6	294.0	228.8

(1) Includes a call set-up charge (HUF 6.6 in 1999, HUF 6.0 in 2000 and HUF 3.8 in 2001).

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, 1998 through December 31, 2000, Matáv's international call tariffs fell on average by 28.2 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 2000 and 2001 have decreased on average in both nominal and real terms compared to 1999 and 2000, 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 ("SDR"), 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 45 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. Matáv has established its own point of presence in Austria which enables the Company to engage in telephone and Internet business with alternate telecommunications carriers located in Vienna.

Leased Lines

Revenues from leased lines totaled HUF 16,453 million in 2000, HUF 13,816 million in 1999 and HUF 10,493 million in 1998, in each case before intersegment eliminations. 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 Network Management Service (Virtual Switched Network) network management system and ISDN-Flex and Voice-Flex services. In 1999, higher quality (Gold and Silver), secure access, and quick installation (Express, Profi) Flex-Com services were introduced. The Gold and the Silver quality services increase the annual availability to 99.9 percent and 99.7 percent respectively, as compared to the 99.5 percent annual availability of the Flex-Com basic service. The secure access provides two way subscriber access through separate routes or transmission media at one termination point of the connection. The quick installation services are connected within ten days (Express) or within five days (Profi) as compared to the normal provisioning time (20 days). In 2000, Matáv launched two new services. Flex-Com high-speed (E3) access service provides 34Mb/s central access for the main site of a large enterprise network. City-Voice service, a version of the Voice-Flex service offers hot-line voice and fax communication capabilities on the managed leased line network between two customer premises. In 2000, Matáv increased the number of its Flex-Com connections from 7,007 to 8,920 lines.

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, 2000, Matáv had 892 Frame-Flex connections. In 2000, Matáv introduced LANConnect, a frame relay based managed router service. LANConnect is primarily targeted at small and medium size enterprises allowing them to seamlessly interconnect their local area networks (LANs).

High Speed Leased Line ("HSLL"). The service provides permanent, digital, transparent, point-to-point leased line service between service access points (SAPs) which meet the ETSI ONP (Open Network Provision) specifications. The connections are established by the service provider according to the needs of its customers. Transmission rates provided by the HSLL service are 2, 34 and 140 Mbit/s. In 2000, Matáv increased its HSLL connections from 4 to 27.

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 amounted to HUF 11,949 million in 2000, HUF 7,781 million in 1999 and HUF 5,357 million in 1998, in each case before intersegment eliminations. Data transmission and related services consist primarily of data transmission and network services for business customers, such as financial institutions and insurance companies, and, to a lesser extent, residential customers. The market for data transmission and related services in Hungary is highly competitive. 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. 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, 2000, Matáv had 3,950 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 in the spring of 1997, the number of subscribers has grown rapidly. By December 31, 2000, Matávnet, Matáv's fully owned ISP subsidiary had over 95,700 customers. Matávnet is the largest Internet service provider in Hungary with an estimated 48 percent market share based on the number of subscribers and continues to strengthen its position as a market leader in Internet services, from access to e-commerce. This growth was greatly fostered by [origo], one of the most frequently visited portal sites in Hungary with 340,000 sessions per day in the last quarter of 2000, and Altavizsla, one of the most well known search engines 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 with over half a million registered users 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. In 2001, Matávnet began to offer Internet packages based on Asymmetrical Digital Subscriber Line ("ADSL") technology as well as access through cable television, to provide residential customers with broadband, fast Internet service at affordable prices. For business users, Matávnet offers Internet access through leased line and ADSL connections as well as webEDI (Electronic Data Interchange) services. Matávnet has four subsidiaries, including Fokuszonline Rt., which operates a book selling website and Marketline Rt., which operates an electronic market between companies. Matávnet is one of the founders of iStart Center that provides informatics resources for young Internet enterprises.

To help stimulate demand and promote wider Internet usage, Matáv has discount 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.

Cable TV and Broadcasting Services. On July 1, 1998, Matáv established MatávkábelTV Kft. ("MatávkábelTV"), for providing cable television services. The subsidiary began providing services on January 1, 1999. In 2000, MatávkábelTV became a subsidiary of InvesTel Rt., which is a subsidiary of Matáv. Through network development and acquisitions, MatávkábelTV significantly increased its number of cable television customers in 2000 and maintained its second position in the market despite the increasing competition. The Company had approximately 267,000 subscribers as of December 31, 2000. MatávkábelTV offers 36 television and 10 radio channels in 3 program packages in its network. The cable television market in Hungary is characterized by strong price competition, especially in Budapest, where cable operators often connect new customers without entrance fees. MatávkábelTV started to test Internet provision through the cable television network in Budapest. The Company's cable television activities benefit from Matáv's long term relationship with the customers, its thorough market knowledge as well its strong brand name. The main goal in this area is to increase market share through further acquisitions, further connections in the already acquired areas and network reconstruction.

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, Pearson Netherlands 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 license. MRTL operates a channel under brand name RTL KLUB. The television advertising market in Hungary recorded significant growth in 2000. Terrestrial television, especially RTL KLUB, was the main beneficiary of the closure of TV3, a major competing channel, although new cable channels were launched on the market at the end of 2000.

Since its launch in 1997, RTL KLUB has rapidly established a strong position in Hungary's television market. Market share among the targeted age 18-49 audience rose substantially from 1997 to 2000, from 20.7 percent to 33.2 percent, as did advertising market share, which had increased to approximately 48 percent by 2000 based on RTL KLUB estimates. RTL KLUB seeks to maintain and increase audience share through investing in local productions, including successful internationally licensed programs, and through its continued long term relationships with major film distributors, including Warner Brothers, Buena Vista and Fox.

Since the establishment of the channel the RTL KLUB brand name has become the second strongest on the Hungarian market, according to Young & Rubicam, Brand Asset Valuation, 2000. RTL KLUB believes this to be the result of its consistent and unique programming policy and communication strategy. In 2000 RTL KLUB became profitable for the first time on an annual basis.

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 Matávőr Kft., a wholly owned subsidiary, to provide security-monitoring services. Matávőr Kft. had 11,687 customers as of December 31, 2000.

In 2000 Matáv developed special service platforms for different segments of the telecommunications market. One of them is the IP service package targeting ISP's. Apart from serving massive residential demands cost-effectively, it is also suited for providing higher quality services to business customers.

Matáv introduced the following data communications and value-added services in 2000:

Matáv ADSL. ADSL is an ATM and ADSL technology based broadband access product developed for continuous, high speed Internet connection. The service bundles cost efficient broadband Internet access with telephony service over existing copper wires. Matáv sells these services on a wholesale basis to ISPs, which in turn distribute the services to residential and small business customers. The service has been available in certain parts of Budapest since September 1, 2000 and its coverage is rapidly expanding.

IP Connect. In September 2000 Matáv introduced IP Connect service. This service is a complete solution for ISPs providing transport and access facilities to IP traffic. It includes the provision of ports in the service area, required for the subscribers of ISPs to dial-in from PSTN/ISDN networks. The service also enables leased line access and it ensures that traffic will be forwarded to both domestic and international switches as well as to the domestic switch of a particular ISP. The domestic switch of the ISP is connected to Matáv's IP network via leased line.

IP Complex. IP Complex is an IP based Virtual Private Network ("IP-VPN") service. IP Complex service is offered to retail and wholesale customers having multiple remote sites. This service enables them to establish data traffic between sites without the need of setting up "point-to-point" connections between two sites, thus establishing an IP-based Virtual Private Network. Customers' VPNs are secured since they remain separated from each other.

MultiLAN. Matáv's system integration services are primarily targeted at business customers with separately located branch offices. It includes the installation of LANs at customer premises and the provisioning of WAN services. Matáv provides integrated network management, fault clearance and customer support for the LAN and WAN segments.

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. Sales of fixed line telecommunications equipment generated revenues of HUF 4,810 million in 2000, HUF 3,030 million in 1999 and HUF 3,230 million in 1998, in each case 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, Maintenance and Other 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 12,197 million in 2000, HUF 9,313 million in 1999 and HUF 8,152 million in 1998, in each case before intersegment eliminations.

The Company carried out its construction activity primarily through its wholly owned subsidiary, Matávline Kft., which was sold in April 2000. Since then, Matáv carries out its construction through subcontractors. The majority of construction revenue is derived from optical network construction, network construction related to subscriber connections and project planning. In addition, Matáv's fully owned subsidiary, MatávCom is also engaged in complete network construction activities.

Mobile Telecommunications Service Segment

Matáv's mobile telecommunications services generated revenues of HUF 159,345 million in 2000, HUF 117,336 million in 1999 and HUF 88,142 million in 1998, in each case before intersegment eliminations. Matáv provides mobile telecommunications services through two subsidiaries, Westel and Westel 0660, each of which is 51 percent owned by Matáv.

Westel provides digital services and Westel 0660 provides analog services. At December 31, 2000, Westel and Westel 0660 together accounted for an estimated 54 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 7.0 percent at December 31, 1997 to 30.8 percent at December 31, 2000.

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 provide each other, on a contract basis, with distribution services for the other's products, and Westel 0660 provides system maintenance to Westel also on a contract basis. The Westel companies also lease property to each other and from Matáv Rt. on an arms length basis.

In 1999, the minority owner of Westel and Westel 0660, MediaOne International, entered into a purchase and sale agreement with Deutsche Telekom AG. As a result, on October 21, 1999 Deutsche Telekom AG entered into an agreement to purchase MediaOne International B.V. and MediaOne International's 49 percent interest in Westel 0660. MediaOne International B.V. holds a 49 percent interest in Westel. This transaction was completed in March 2000.

On October 21, 1999, Matáv announced that it had entered into an agreement with Deutsche Telekom AG providing Matáv the option to acquire Deutsche Telekom AG’s 49 percent interests in Westel and Westel 0660 for a fixed price of U.S. dollar 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. Because full exercise of the option would adversely affect Westel's preferred income tax status, Matáv is discussing with Deutsche Telekom AG the possibility of exercising the option in respect of only 19 percent of Westel shares. This would require modifications to the original contract. The option's expiration date may also be extended.

Matáv also entered into a proxy agreement with Deutsche Telekom AG. Under this agreement Matáv represents Deutsche Telekom AG in connection with the management of both Westel and Westel 0660, nominating all members of the Supervisory Board except one Deutsche Telekom AG nominated member and in the case of Westel all directors except one Deutsche Telekom AG nominated director. Matáv controls the operations of both Westel companies except that Deutsche Telekom AG is entitled to vote the Westel companies’ shares in the following decisions:

- changes in the capital structure other than on a 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 AG; and
- removal of the independent accountant.

Westel

Westel 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. During 2000, Westel (formerly known as Westel 900) was rebranded as a service provider on both 900 and 1800 MHz bands. Westel offers basic GSM voice telephony services and a number of value added services, such as voice mail, call forwarding, short message services, call waiting, conference call and caller ID. Westel also provides GSM-based data and facsimile transmission services as well as SimToolKit applications, mobile Internet services and a number of content services. Westel offers several different packages of services designed for different customer requirements, including different traffic packages targeted at low volume residential customers and higher volume business and governmental customers.

The prepaid card of Westel, Domino, provided 86 percent of net customer additions in 2000. Having introduced the short message service for prepaid customers in 1999, Westel made further value added services available to prepaid customers, such as caller ID, Domino data and fax in 2000. SimToolKit applications also became available for prepaid customers, and electronic recharge opportunities were introduced at ATMs and petrol stations. Prepaid customers (especially young people and security users) represent the majority of Westel's growth potential for 2001.

International voice over IP was introduced for Westel's customers at the end of 1999.

In 2000, Westel enhanced its value-added services and introduced several new products with the aim of stimulating usage growth.

- The introduction of WAP technology made mobile Internet available for customers with WAP-capable phones.
- The 777sms web site, created mainly for young people, offers logos, ring tones for download and SMS messaging.
- Another new service, GSM PRO, combines the advantages and services of GSM networks and introduces PMR (Private Mobil Radio) services such as group calls (maximum 15 members).
- In the field of m-commerce, in cooperation with Coca Cola Ltd. Westel made it possible to purchase soft drinks from designated vending machines via phone calls from Westel's network.
- SMSBroker, an automated stockbrokerage agency, provides non-stop coverage of the Budapest Stock Exchange and allows users to buy and sell shares through their mobile phones.
- Voice mail novelties introduced in 2000 include call return, which allows the subscriber, by pressing a single key, to return a call to a caller who left a message in the subscriber’s mailbox. Voice mail retrieval has also been made free of charge between 6 p.m. and 8 a.m. on weekdays and all day on weekends in an

attempt to increase voice mail penetration and usage.

Westel encourages customer loyalty with various programs. Golden Cards are awarded to customers based on length of service and bonus points are awarded to these cardholders based on level of usage. These points can be accumulated and then redeemed for various products and services in retail stores, via the Internet or through call centers.

The build-out of Westel's mobile network has been substantially completed. It provides nationwide coverage and is being developed to cope with the traffic demand of new, innovative services. Westel has entered into international roaming agreements with 177 operators in 83 countries by December 31, 2000.

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

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

	At December 31,		
	1998	**1999**	**2000**
Regular subscribers	468,054	654,549	760,575
Prepaid subscribers	78,500	187,730	838,511
Total subscribers	546,554	842,279	1,599,086
Annual growth in subscribers (%)	50.7	54.1	89.9

The rapid increase in the number of Westel subscribers since December 31, 1998 is attributable to a number of factors, including reductions in handset prices and traffic tariffs in real terms. Growth also can be attributed to handset discounts, installment purchase plans and aggressive marketing.

According to Telecommunications Inspectorate sources, as of December 31, 2000, Westel held approximately 53 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's average traffic per subscriber remains relatively high in Europe at 184 minutes per month in 2000. 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 deregulated 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 charges subscribers a one-time connection fee, monthly subscription charges, event charges and time based traffic charges. Customers using prepaid cards do not pay monthly subscription charges. Westel 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 is very innovative in tariffing. In 2000 it introduced a new location dependent tariff plan boosting rural usage.

Distribution. Westel has 25 Building Value showrooms, 14 Economy Shops and two mobile showrooms in Hungary. Building Value showrooms engage in sales, customer service and repair service. Economy Shops primarily engage in sales, but they also provide some customer service and receive phones to be repaired. In 2000, Westel opened a new high-tech showroom called “Enternet” to popularize value added services. Westel also broadened its sales channels by engaging independent sales representatives and began offering free home delivery service. The Major Account department with 50 employees serves the needs of Westel’s major account customers on a segmented basis. Through a Sales Support department Westel operates a regular home delivery and a Webshop service for its Internet sales. In addition to distributing products and services through its own sales network, Westel distributes products through master dealers (FOTEX Group, Westel 0660 and Matáv) on an agency basis, through large Hungarian retail and distribution chains (Shell, MOL, OMV, TESCO, Auchan, Billa, Cora, METRO, Lapker) and through franchise partners (Keravill, Fotex). In total, Westel's products are available in almost 1,760 outlets.

Westel 0660

Westel 0660 is the sole provider of analog mobile telecommunications services in Hungary. Westel 0660 commenced operations in 1990 and was the only provider of mobile services in Hungary until the commencement of GSM operations in 1994.

Westel 0660 service is based on the NMT standard, which predates digital mobile telephony services, including GSM. In response to competition from GSM operators, Westel 0660 took advantage of its lead in geographic coverage to focus on penetration. The Westel 0660 network covers over 98 percent of Hungary's geographic area.

At present, Westel 0660 has positioned itself as the mobile network offering the most affordable service in Hungary. Unlike the GSM service providers, Westel 0660 does not provide international roaming services. However, Westel 0660 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 0660 subscribers at the dates indicated:

	At December 31,		
	1998	**1999**	**2000**
Subscribers	93,596	97,753	75,866
Annual growth/(decline) in subscribers (%)…......................	18.3	4.4	(22.4)

In 1999, the number of Westel 0660 subscribers increased due to active promotional programs and innovative service offers. In 2000, Westel 0660 shifted its focus from customer acquisition to customer retention as subscribers were generally lost to digital mobile telecommunications providers in a very competitive market.

Tariffs. Westel 0660 charges its subscribers monthly subscription charges and traffic charges for outgoing calls. Westel 0660 does not charge subscribers for incoming calls, although it receives payments from other telecommunications service providers for terminating calls on its network. Westel 0660 offers a number of different packages of services designed for different customer requirements, including a package for low volume users.

Distribution. Westel 0660 markets its services through its own salesforce, through Westel salespeople 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. At the end of 2000, three call centers covering all residential and small business customers were operational.

Matáv has completed a process of enhancing its "local presence" by establishing retail stores where customers can see the various products and services the Company offers and experience features through demonstrations. The Company established a total of 23 retail shops across Hungary by the end of 2000, including 17 "Matáv Pont" shops. Matáv also operates an agent and dealer network, consisting of 54 dealer shops and approximately 260 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 February 2000, a new package was introduced for low-volume 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. For non-concessionary products, pricing is based on market information and cost-benefit analysis. In 1999, individual case based pricing was introduced to enhance competitiveness and to increase flexibility. This scheme allows the Company to prepare individualized offers for major customers within a short time period based on their particular needs.

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 demands, 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 high 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 tailoring 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.

Competition

Notwithstanding the Company's exclusive rights to provide certain fixed line telecommunications services, 42 percent of the Company's 2000 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. In addition, 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 fixed line telecommunications services include PANTEL Rt. ("PANTEL"), Novacom, Vivendi and Antenna Hungária. The investors in PANTEL include KPN Telecom B.V., MÁV Rt., the Hungarian National Railway Company and KFKI Számitástechnikai Rt. Novacom was founded by the Budapest Electric Works, the German RWE Telliance AG and Telekommunikations Holding Südwest GmbH. Vivendi is an investor in Hungarian local telephone operators. Antenna Hungária is owned primarily by 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. IP telephony also may redirect calls — primarily international calls — from Matáv's network. The number of service providers offering IP telephone services is continuously increasing. IP telephony can be less expensive than traditional telephony service but suffers from low quality. Companies offering IP telephony include PANTEL, Novacom, Netphone, Kiwwi, Amtel and the three digital mobile service providers in Hungary. The Company also faces competition from private networks connected through leased lines, and companies that lease lines for international data transmission.

Management believes that the historically balanced nature of its international tariffs limited competition from such services. 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.

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 PSINET, 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 currently competes principally with Pannon GSM and Vodafone, the latest entrant on the GSM market. In general, Westel has sought to attract customers through competitive pricing, excellent distribution, customer service and discounting handset sales.

Although Westel 0660 is the sole provider of analog mobile services, it competes with the digital services of Westel, Pannon GSM and Vodafone. To retain subscribers, Westel 0660 has maintained lower tariffs and launched an active customer retention campaign. Management believes that Westel 0660 will be able to maintain at least some of its analog subscriber base because of Westel 0660'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.

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").

In 2000, the government disintegrated the Ministry of Transport, Telecommunications and Water Management in order to establish the Ministry of Transport and Water Management and the Telecommunications Government Commissioner's Office, which is a part of the Prime Minister's Office and bears sole responsibility for all matters related to telecommunications.

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, tariffs for concessionary services in agreement with the Minister of Finance.

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 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 by and received from public telephone services. In its Debrecen Local Primary Area, Matáv must pay 3.3 percent of such revenues, 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 the subscriber liquidated damages equal to one third of the monthly subscriber's fee for each day of the delay. Matáv paid HUF 70 million in 1998 and HUF 46 million in 1999 in respect of these penalties. In 2000, Matáv did not have to pay any such penalties. The rights and obligations of the public telephone service providers and the subscribers are regulated under 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 2000, Matáv met these requirements in all of its Local Primary Areas subject to the Concession Contract.

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.

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. In 1998, 1999 and 2000 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 currently satisfies 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.

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 market. 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 AG and their affiliates.

The Draft New Telecommunications Act

Matáv’s future operations are heavily influenced by the planned liberalization of the Hungarian telecommunications market. The government has approved and submitted to the Parliament the draft new Telecommunications Act, which is expected to enter into effect on December 23, 2001. Set forth below is a brief summary of certain provisions of the draft new Telecommunications Act. This summary is qualified in its entirety by reference to the draft new Telecommunications Act T/3934.

Significant Market Power Regulation

All operators with significant market power ("SMP") in the telephony, mobile telecommunications, leased line or interconnection markets will be required to comply with certain obligations. An operator is identified in general as an SMP when its market share in a specific market exceeds 25 percent. Obligations of SMP operators include accounting separation, publishing reference offers for interconnection services and unbundled local loops, providing regulated leased lines and joint operation of directory assistance services.

Retail Prices

The draft new Telecommunications Act designates Matáv as an SMP operator in the voice telephony market. Consequently, the retail prices of fixed line voice telephony services provided by Matáv will continue to be regulated. Details on the method of price calculation will be determined in future legal decrees.

Matáv’s regulated access prices currently include an access deficit, i.e., Matáv's subscription fees do not cover the costs of access. According to the prevailing Act on Prices (Act 87/1990), the access deficit should be eliminated. The draft new Telecommunications Act does not address the access deficit problem.

Universal Service

Matáv will be a universal service provider under the draft new Telecommunications Act. According to the draft new Telecommunications Act, universal services are basic communications services that should be available to all customers. Universal services include access to fixed line voice telephony services of regulated minimum quality, a regulated density of public payphones, a public register of subscribers, operator services and cost-free emergency calls. Access to voice services at an affordable price will be provided through regulated tariff packages. The terms of such tariff packages will be determined in future legal decrees.

Universal service providers will be entitled to compensation for their loss of revenue resulting from the low price of universal service packages. Universal service costs will be calculated by using Long Run Incremental Cost ("LRIC") costing methodology as soon as the draft new Telecommunications Act comes into force. Costs of other services, such as interconnection and unbundled local loop services, may however, be determined by using Fully Allocated Cost ("FAC") methodology until January 1, 2003. This could require the simultaneous development and use of two different costing methodologies. A future decree will determine the detailed rules applying to costing, the percentage of revenues payable to the Universal Service Financing Fund and compensation available for universal service providers from the Fund.

Interconnection and Unbundled Local Loop

SMPs will be obliged to unbundle local loops and prepare reference offers for interconnection and unbundled local loops (whether fully or partially unbundled) and to provide these services when there is a request for them by other telecommunications service providers. There is no obligation to provide unbundled local loops when an SMP requesting the service has a significant advantage in financial status or in market power compared to the addressee of the request. The cost base of the price of these services will eventually have to be calculated using LRIC, although FAC methodology can be used until January 1, 2003. In contrast with EU regulation, the draft new Telecommunications Act does not explicitly provide that interconnection prices may contain a reasonable markup over costs.

Carrier Selection

After the expiration of Matáv's exclusive rights to provide domestic and international telephony services, from December 23, 2001, voice telephony customers will have the right to select different service providers for domestic and international traffic, and mobile subscribers will be permitted to select different service providers for international calls, both on a call-by-call basis and by changing their default international service provider. From January 1, 2003, subscribers will be able to select service providers for their local calls as well.

Number Portability

Fixed line telecommunications service providers are obliged to provide number portability on their networks from January 1, 2003, allowing subscribers to change service providers without changing their telephone numbers.

Mobile Concession Contracts

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

In 1999, the minority owner of Westel and Westel 0660, MediaOne International, entered into a purchase and sale agreement with Deutsche Telekom AG. As a result, on October 21, 1999 Deutsche Telekom AG entered into an agreement to purchase most of MediaOne International's Eastern European portfolio including both Westel companies' 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 AG providing Matáv the option to acquire Deutsche Telekom AG's 49 percent interest in Westel and Westel 0660 for a fixed price of U.S. dollar 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 beginning July 1, 2000. Because full exercise of the option would adversely affect Westel's preferred income tax status, Matáv is discussing with Deutsche Telekom AG the possibility of exercising the option in respect of only 19 percent of Westel shares. This would require modifications to the original contract. The option's expiration date may also be extended.

Under Hungarian law, the Hungarian Competition Authority must supervise the above-mentioned purchase. On February 28, 2000 the Competition Council of the Hungarian Competition Authority gave permission to Deutsche Telecom AG to make the purchase on the following conditions:

- Matáv has the obligation to provide all services provided to Westel and Westel 0660 on the same terms and conditions under which it provides such services to other public mobile telephony service providers; and

- Westel and Westel 0660 will not merge with Matáv as long as there is no regulation requiring the separation of accountancy for companies carrying out different kinds of telecommunication services, and Matáv does not provide for such separation.

Westel

Under the concession contract, dated November 4, 1993, as amended (the "900 Concession Contract"), between the Minister and Westel, Westel has the right for 15 years from that date to provide public GSM mobile telephony services. Westel 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 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 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 and Pannon GSM are obliged to provide national roaming services to Vodafone customers until 2002.

Westel, simultaneously with Pannon GSM, started commercial operation in the 1800 MHz band on November 16, 2000. Upon request by Vodafone, the national roaming agreement between Westel and Vodafone, was terminated effective November 30, 2000, whereby Westel was released from the obligation to provide Vodafone with domestic roaming services on a nation-wide basis. Vodafone has not altogether abandoned its national roaming agreement with Pannon GSM, but has amended it to exclude availability of the roaming feature within the metropolitan Budapest area.

By 2003, the three digital mobile telecommunications service providers will have the same spectrum resources allocated to them both on the 900 and the 1800 MHz bands. The Minister has agreed not to issue a new tender or otherwise license a new carrier for such services on these bands for 15 years beginning November 26, 2000.

Westel is required to pay a HUF 11 billion concession fee, adjusted for changes in the HUF/USD exchange rate. The first installment of the concession fee, HUF 2,750 million was paid eight days after the modification of the concession agreement (November 1999). The second installment of HUF 2,750 million, adjusted for changes in the HUF/USD exchange rate, was paid eight days after the commencement of 1800 MHz service (November 16, 2000). The remaining HUF 5,500 million, adjusted the changes in the HUF/USD exchange rate, is expected to be paid over the next three years, with one ninth of such fee becoming payable upon receipt of each additional one MHz of spectrum. Westel also pays an annual concession fee of USD 1 million since the commencement of the 1800 MHz service.

Frequency 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 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 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. In 2000, Westel paid a HUF 384 thousand frequency reservation fee and a HUF 1,469 million frequency usage fee.

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

Roaming Agreements. Westel 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 rules of the GSM Association, an association of digital mobile cellular telecommunications service providers.

Interconnection. If Westel receives a request for interconnection from another public telephony service provider, it is required under the Telecommunications Act to enter into an interconnection contract. For as long as Matáv has the exclusive right to provide domestic and international long distance telephony services, Westel is required to connect to the LTOs through Matáv. Westel is required to use Matáv's international gateway for mobile international calls.

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

Non-concessionary Services. Westel 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 may not sell mobile subscriber equipment that is manufactured by a company in which Westel has an interest.

Termination. The Minister has notified Westel that for each of 1998, 1999 and 2000 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. Westel would then have 90 days to agree with the Minister on a plan of action for curing the default. If Westel does not reach an agreement with the Minister or if Westel does not cure any such 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 would be dissolved under the Concessions Act.

Westel 0660

Pursuant to the concession contract, dated June 24, 1994 (the "0660 Concession Contract"), between the Minister and Westel 0660, Westel 0660 has the right for 15 years from October 15, 1990 to provide public NMT 0660 mobile telephony services in the 450 to 470 MHz frequency range in Hungary. The parties may agree to extend the Westel 0660 concession for a period of seven and one-half years.

Required Fees. Westel 0660 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 0660's subscriber charges ceased to be regulated under the Pricing Act or ministerial decree and consequently ceased to be subject to the previously applicable price cap regime.

Interconnection. Westel 0660 may use fixed links and equipment jointly with other providers if this does not reduce or inhibit competition. If Westel 0660 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 0660 is required to use lines leased from Matáv to connect with the fixed line network. Westel 0660 is required to use Matáv's international gateway for mobile international calls.

Domestic Goods and Services. Westel 0660 must use specified percentages of Hungarian goods and services. Westel 0660 is currently satisfying these requirements.

Non-concessionary Services. Westel 0660 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 0660 may not sell mobile subscriber equipment that is manufactured by a company in which Westel 0660 has an interest.

Termination. The Minister may terminate all or part of the 0660 Concession Contract, if Westel 0660 does not fulfill its obligations under the contract. The Minister is also entitled to terminate the 0660 Concession Contract in the case of intentional and repeated violations of the contract. Termination could result from, among other things, Westel 0660'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 0660 or if Westel 0660's inability to satisfy the claims of its creditors adversely affects its ability to fulfill its concession obligations. Upon termination of the 0660 Concession Contract, Westel 0660 would be dissolved under the Concessions Act. The Minister notified Westel 0660 that for each of 1998, 1999 and 2000 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 an amendment to the Telecommunications Act, since July 28, 1999, in addition to agreements for the interconnection of networks, a public telecommunications service provider may enter into a network contract to allow use of its telecommunications network by a third party with the aim of providing services. The Telecommunications Act also 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 signaling, 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 to 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.

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 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; and
- 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) required 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) provided 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 are 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 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.

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, 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 of less than 30,000. One of the leading insurance companies in Hungary, Hungária Biztosító Rt., subsequently purchased 25 percent of shares and 75 percent of voting rights in MatávkábelTV, which may consequently continue to engage in program distribution without any restrictions as described above.

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"), then by Decree 1/2000 (I.18) KHVM (the "2000 Fixed Line Tariff Decree") and most recently by Decree 1/2001 (I.26.) MeH (the "2001 Fixed Line Tariff Decree"). The 2001 Fixed Line Tariff Decree establishes new public fixed line telephone service charges to be applied from February 1, 2001.

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 (the "1999 Interconnection Decree"), Decree 8/2000 (III.29) KHVM (the "2000 Interconnection Decree") and Decree 8/2001 (III.9) MeH (the "2001 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. 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 2000, the aggregate price cap was 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 was four percent. At the same time the 2000 Fixed Line Tariff Decree limited 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. It was also stipulated that in case the real October to October consumer price index had exceeded the Government forecast (six percent) by at least two percent, the aggregate price cap for 2001 could have been increased by two-thirds of the difference as compensation. Should the real August residential consumer telephony price index had exceeded the permitted level (six percent), the tariffs would have had to be decreased in order to fulfill the price index requirement.

Matáv Rt. complied with the residential price cap of six percent in 2000 as verified by the Central Statistical Office, therefore it was not subject to any tariff reduction. On the other hand, the real October to October consumer price index exceeded the Government forecast (six percent) by 4.4 percent, which allowed Matáv Rt. a 2.9 percent surplus price increase. The 2001 Fixed Line Tariff Decree did not introduce changes in the price cap regulation: the aggregate price cap is still set by reference to the forward-looking consumer price index forecasted by the Government – determined as six percent once again – decreased by the productivity factor. The Minister, however, increased the productivity factor to 2.9 percent for 2001, accordingly – taking into account the 2.9 percent compensation for 2000 – the aggregate price cap totaled six percent. The residential price cap is still equal to the forecasted forward-looking consumer price index (six percent). A special new regulation limits tariff rebalancing by restricting the aggregate residential subscription fee increase to an average 20 percent in 2001. This is to be achieved by increasing the number of small user package subscribers to an average 12.5 percent of residential customers at annual level.

The following table sets forth changes in public fixed line subscription fees and usage charges for 2001 as established under the 2001 Fixed Line Tariff Decree.

Basket	**Percentage Change**
Subscription fees	27.2
Local and Zone 1 and Zone 2 (Budapest metropolitan area) charges	(6.1)
Zone 3 and international charges	(14.4)

Although Matáv Rt. fixes local and national usage charges separately for each of two time periods, it does not differentiate international charges by time of day. 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 2000, the call set-up charge was HUF 6.00 per call (in 2001, it is HUF 3.80 per call), exclusive of VAT, and is independent of the tariff zone or time period of the call.

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. In 2001, the average lease line tariff increase was 2.1 percent. Tariffs for local leased lines increased by 210 percent, while tariffs for long distance leased lines decreased by 30 percent in order to move tariffs closer to costs.

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 2000 Interconnection Decree, local service providers were entitled to retain an average of HUF 7.06/minute for the termination and HUF 11.56/minute for the origination of all domestic long distance calls. In 2001, a local service provider is entitled to the following interconnection fees if the call is originated in its area:

	peak	discounted	night
		(HUF/minute)	
National long distance	15.95	6.77	6.77
International	36.00	36.00	36.00

In 2001, a local service provider is entitled to the following interconnection fees if the call is terminated in its area:

	peak	discounted	night
		(HUF/minute)	
National long distance	7.00	3.60	3.60
International	22.00	22.00	22.00

In the case of calls within the Zone 2 Budapest metropolitan area, the interconnection regime is the same as in 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 (a) the average of the Zone 2 fees and (b) 20 percent of the average of the Zone 1 fees.

Under the 2001 Interconnection Decree, Matáv Rt. must pay HUF 7.70/call to the local service provider for any calls made to Matáv Rt.'s domestic or international directory assistance.

Mobile Interconnection Fees

In 2000, the local operator received an interconnection fee of HUF 10.31/minute for originating a mobile call from the fixed line network and HUF 4.80/minute for terminating a mobile call in the fixed line network. Under the 2001 Interconnection Decree, the local operator receives an interconnection fee of HUF 13.00/minute for originating a mobile call from the fixed line network and HUF 4.80/minute for terminating a mobile call in the fixed line network.

As the exclusive provider of national long distance services, Matáv Rt. received a long distance mobile interconnection fee of HUF 2.00/minute in 2000 for forwarding any kind of domestic call initiated or terminated in the network of a mobile service provider. In 2001, Matáv Rt. receives a HUF 1.85/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.

Under the 2000 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 18.00/minute to a mobile operator for terminating international calls in the mobile network. In 2001, 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 36.00/minute to a mobile operator for terminating international calls in the mobile network.

ORGANIZATIONAL STRUCTURE

The following table shows the principal consolidated subsidiaries of Matáv, which are all incorporated in Hungary:

Name of the consolidated company	Interest held (%)	Votes held (%)
CARDNET Rt.	72.00	72.00
Egertel Rt.	100.00	100.00
Első Pesti Telefontársaság Rt.	96.24	96.24
Inteltrade Kereskedelmi Rt.	83.33	83.33
InvesTel Rt.	100.00	100.00
Matávcom Kft.	100.00	100.00
MatávkábelTV Kft.	75.00	25.00
Matávőr Kft.	100.00	100.00
Matávnet Rt.	100.00	100.00
Westel Rádiótelefon Kft.	51.00	51.00
Westel Mobil Távközlési Rt.	51.00	51.00

In 1999, the minority owner of Westel and Westel 0660, MediaOne International, entered into a purchase and sale agreement with Deutsche Telekom AG. As a result, on October 21, 1999 Deutsche Telekom AG entered into an agreement to purchase MediaOne International B.V. and MediaOne International's 49 percent interest in Westel 0660. MediaOne International B.V. holds a 49 percent interest in Westel. This transaction was completed in March 2000.

On October 21, 1999, Matáv announced that it had entered into an agreement with Deutsche Telekom AG providing Matáv the option to acquire Deutsche Telekom AG's 49 percent interests in Westel and Westel 0660 for a fixed price of U.S. dollar 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. Because full exercise of the option would adversely affect Westel's preferred income tax status, Matáv is discussing with Deutsche Telekom AG the possibility of exercising the option in respect of only 19 percent of Westel shares. This would require modifications to the original contract. The option's expiration date may also be extended.

PROPERTY, PLANTS AND EQUIPMENT

Description of Property

As of December 31, 2000 Matáv's property, plants and equipment had a total net book value of HUF 561,702 million.

Matáv has one of the largest real estate portfolios in Hungary with an aggregate net book value at December 31, 2000 of HUF 74,783 million. The Company uses substantially all of these properties for telecommunications installations, computer installations, research centers, service outlets and offices. Matáv also has a number of operating lease contracts for 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 finance lease contracts in 2000. 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, a real estate management and consulting company.

The aggregate net book value of Matáv's technical equipment and machinery, which primarily consists of switches, communication towers, and other telecommunications equipment, at December 31, 2000 was HUF 407,639 million.

INFRASTRUCTURE AND TECHNOLOGY

Over the past three years, Matáv has invested approximately HUF 178 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 340 billion between 2001 and 2003. The Company expects an increasing proportion of capital expenditures to be devoted to on high-growth areas, such as mobile telecommunications, data transmissions and Internet.

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 by consolidating switching platforms into larger and more economical centralized switches.

The Company continues to digitalize its local networks. At December 31, 2000, 85.1 percent of Matáv's exchange capacity was digital, compared to 70.2 percent at December 31, 1997. Each of the Matáv concession areas is served by a digital primary exchange. Digitalization permits a broader range of services, and generates cost savings. Digitalization is also a prerequisite for providing ISDN services. The number of local exchanges capable of providing ISDN services has increased considerably and the number of ISDN channels grew from 38,520 at December 31, 1997 to 305,882 at December 31, 2000. On the basis of the ISDN infrastructure, Matáv's network supports switched high quality Internet access and packet switched data transmission for ISDN subscribers. In 2001 Matáv plans to introduce new generation of hardware in its exchanges to extend its Internet access and broadband capabilities.

Expansion of Access Networks. The Company has expanded and modernized its local networks. By the middle of 2000 the demand for new access lines had been largely saturated, although there has been an increase in demand for more valuable services. Over the last three years, Matáv has added in excess of 294,000 access lines and over 267,000 ISDN channels to its local networks. At the end of 2000 Matáv introduced its new broadband access services – based on ADSL and ATM technologies – providing faster access to the Internet. Currently, this service, the NetExpress is only available in Budapest. The ADSL transmission system provides high speed digital access to any data network over existing copper wires without interruption of POTS/ISDN2 services. In 2001, Matáv plans to enhance NetExpress services and introduce new products based on ADSL and other xDSL technologies.

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.

As part of the introduction of the DCS 1800 mobile system, the Ministry has required Matáv to exit part of its 900 MHz frequency bandwidth before the expiration of its license. In compliance, Matáv had removed its analog radio local loop system from Budapest by August 31, 1999. At December 31, 2000 the Company still provides services for approximately 108,000 RLL subscribers. Matáv introduced fixed GSM technology in March 2000 to replace the analogue RLL system. The fixed GSM uses the existing GSM mobile network for PSTN service provision by employing wall-mounted fixed GSM terminals. Matáv uses fixed GSM technology primarily for low-end customers in rural areas without fixed network access as well as to quickly provide services, on an interim basis, when new subscriber demands cannot be satisfied immediately with existing fixed line infrastructure. By the end of 2000, the number of fixed GSM subscribers in Matáv's access network included approximately 26,800 RLL replacements and 23,400 new connections.

Matáv uses fiber optic cables in its fixed line local loop networks, with approximately 192,000 channels connected to subscribers at the end of 2000. The Company installed a substantial portion of the local network fiber optic cable in Budapest, where segments of the old cable were in poor condition and where Matáv believes the demand for high capacity and quality transmission will be greatest. At the end of 2000, there were approximately 46,000 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 demands in existing areas.

CityNet. CityNet is an overlay network for large cities that connects Matáv nodes and key business customers with optical cables. It provides access for this network for business communications services of Matáv. By the end of 2000 more than 200 km of optical cable was installed in Budapest connecting 150 customers. Outside Budapest approximately 30 km optical cable was also installed connecting 14 customers. This network typically provides ISDN30, MLLN (managed leased line network), HSLL (high-speed leased line) and ATM-based services.

In the next three years about 150 km new optical cable is expected to be installed outside Budapest to connect about 150 customers. In Budapest about 50 new customers are planned to be connected to the existing cable network. New CityNet products are also expected to be introduced.

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 a flexible transmission infrastructure with automatic transmission paths. Matáv installed additional routes of optical cable and synchronous digital hierarchy systems in the long distance network during 2000, increasing both network availability and transmission capacity. As of December 31, 2000, Matáv had 4,573 km of digital backbone network.

Internet Core Network. Matáv introduced public Internet access service in 1997. As a result of developments in 2000 the underlying router network has been upgraded. Based on this platform, we have introduced new services including IP VPN (Virtual Private Network) offering secure, scalable remote site interconnection over a shared IP backbone; IP VPDN (Virtual Private Dial-up Network) offering dial-up access to the customer's private network, and Virtual PoP (Points of Presence) services providing Internet connection and access capacity with nationwide coverage to ISPs (Internet Service Providers). In the same year, Matáv's IP network capacity has been tripled. The network now has PoPs in each primary area in Hungary. Plans for the future include supporting new capabilities and services, and also increasing bandwidth available for IP services.

Intelligent Network. Matáv has modernized its intelligent network platform. The Company launched the first set of intelligent network services in 1998, including shared cost and toll free numbers, televoting, and virtual card calling. In 1999, these services were also made available to LTO areas and platform software was upgraded. In 2000, Matáv introduced prepaid card calling services as well. Matáv plans to develop new intelligent network based services and enhance and expand its existing services in the future.

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 service, while Cell-Flex offers a high-speed data transmission service. Both services provide flexible bandwidth delivery. Matáv intends to further develop this network to support additional capabilities and services.

International Network. As a result of enhancing and upgrading investments, the Company has completely ceased to use analog international connections. Matáv's international network consists of two digital gateway exchanges. These gateway exchanges connect Matáv's domestic network to the global international network providing automatic telephone service with 215 countries. Matáv has 12 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 50 countries and intends to expand these connections to three additional countries in 2001. Matáv has also established international ISDN connections with 40 countries and is scheduled to connect five additional countries in 2001.

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 19.0 percent in 1998 to 14.82 percent in 2000, and has reduced the call failure rate for national calls from 1.46 percent to 1.08 percent over the same period. The Company has also cut downtime per main line per year from 2.04 hours in 1998 to 1.62 hours in 2000. 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 customer billing information 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 had 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 services, 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 implemented a Work and Force Management System (WFMS), a new testing system for its access network and for POTS (Plain Old Telephone Service) and ADSL services, and a new Automatic Call Distributor (ACD) to establish call centers receiving customers' requests and complaints. The deployment of the test system, the ACD and the call centers were completed in the second quarter of 1999. The countrywide roll out of the WFMS was completed in 2000.

ITEM 5 — OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read together with the consolidated financial statements, including the accompanying notes, included in this annual report. The consolidated financial statements, the accompanying notes as well as the discussion of results presented below have been prepared in accordance with 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 30 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 2000, approximately 58 percent 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 domestic and international 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.

- *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 received from other local telephone operators for terminating calls decreased in comparison with 1998. In 2000, interconnection fees paid by Matáv for domestic calls have decreased, while interconnection fees paid by Matáv for international calls have further increased in comparison with 1999. In 2000, interconnection fees Matáv received from other local telephone operators for terminating calls have decreased in comparison with 1999.

- *Changing Revenue Mix.* Matáv anticipates that growth rates of fixed line services will slow down or decline in the near future because of the saturated market, the effect of liberalization of the Hungarian telecommunications market and continuing tariff decreases. At the same time, demand for mobile communications, data transmission, Internet access and related services is expected to grow. As a result of these changes, the Company's traditional reliance on fixed line telecommunications revenues is expected to shift gradually, and Matáv's future growth is likely to be dependent largely on revenues from mobile telecommunications, data transmission, Internet access and related services.

- *Taxation.* The Company benefits from reduced corporate income tax. Through 1998, Matáv Rt. and Westel qualified for a 100 percent allowance. Through 1995, Westel 0660 utilized a 100 percent allowance. From January 1, 1999, Matáv Rt. and Westel are utilizing a reduced allowance of 60 percent for a further five years (resulting in an effective tax rate of 7.2 percent). From January 1, 1996 through December 31, 1999, Westel 0660 utilized a reduced allowance of 60 percent. Management believes that the conditions underlying the reduction in income tax will continue to be met by Matáv Rt. With regard to Westel, should the foreign ownership falls below 30 percent (which would be the case if and when the Company exercises its option to buy the remaining 49 percent ownership), Westel will loose the benefit of its current 60 percent reduction in income tax.

- *Inflation.* Annual inflation in Hungary, as measured by changes in the consumer price index, averaged 14.3 percent in 1998, 10.0 percent in 1999 and 9.8 percent in 2000. The nominal increase in Matáv's revenues over this period derives partly 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.

OPERATING RESULTS

Results of Operations — Total

Total Revenues

Matáv's total revenues grew by 40.2 percent from 1998 to 2000. Matáv's total revenues amounted to HUF 318,060 million in 1998, HUF 384,932 million in 1999 and HUF 445,945 million in 2000. 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 76.5 percent from 1998 through 2000 driven by a rapid increase in the mobile subscriber base.

Total Operating Expenses

The Company's total operating expenses increased by 50.1 percent from 1998 to 2000. Operating expenses amounted to HUF 221,951 million in 1998, HUF 263,801 million in 1999 and HUF 333,074 million in 2000. Matáv's total operating expenses increased as a percentage of total revenues from 69.8 percent in 1998 to 74.7 percent in 2000. 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 16.8 percent in 1998 to 17.5 percent in 2000. 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 increased from 21.1 percent in 1998 to 22.3 percent in 2000 due primarily to increases in expenses related to materials, frequency fees, marketing, outsourcing of real estate management and IT activities. In addition, depreciation, employee related expenses and other operating expenses were eaffected by fourth quarter charges Matáv took in 2000. In preparation for the liberalized market, Matáv carried out a review of its assets and organizational structure in the last quarter of 2000. This resulted in accelerated depreciation and scrapping of certain fixed assets in an amount of HUF 3,442 million as well as provisions for severance of HUF 9,760 million. Matáv also recorded provisions for additional writedowns of receivables, inventory and other charges of HUF 1,552 million. The after tax impact of these charges was HUF 13.1 billion.

Total Operating Profit

The Company's total operating profit grew by 26.0 percent from HUF 96,109 million in 1998 to HUF

121,131 million in 1999, as total revenues grew at a faster rate than total operating expenses. Matáv's total operating profit decreased by 6.8 percent from HUF 121,131 million in 1999 to HUF 112,871 million in 2000, partly as a result of tariff decreases in the fixed line telecommunications services as well as the HUF 13 billion net income impact of non-recurring charges relating to depreciation and severance expenses Matáv in the fourth quarter.

Revenue and EBITDA margin targets

In light of Matáv's refocused activities, increased operating expenses and the inclusion of MakTel beginning in 2001, we expect revenues to grow over 22 percent in 2001, we plan to achieve high single digit percent revenue growth in 2002 and 2003, and we anticipate EBITDA margin in each of the next few years to exceed 42 percent.

Results of Operations — By Segment

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

	Year ended December 31,		
	1998	1999	2000
	(in HUF millions)		
Revenues:			
Fixed line	256,929	302,230	326,280
Mobile	88,142	117,336	159,345
Intersegment eliminations (1)	(27,011)	(34,634)	(39,680)
Total	318,060	384,932	445,945
Operating expenses:			
Fixed line	186,409	216,759	255,443
Mobile	62,553	81,676	117,311
Intersegment eliminations (1)	(27,011)	(34,634)	(39,680)
Total	221,951	263,801	333,074
Operating profit:			
Fixed line	70,520	85,471	70,837
Mobile	25,589	35,660	42,034
Total	96,109	121,131	112,871

(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,	
	1998	1999	2000	1999/1998	2000/1999
	(in HUF millions)			(% change)	
Revenues:					
Subscriptions, connections and other charges	55,673	63,413	83,243	13.9	31.3
Domestic traffic revenues ....……...	108,425	134,071	129,517	23.7	(3.4)
Other usage	26,807	26,999	26,679	0.7	(1.2)
International traffic revenues	38,792	43,807	41,432	12.9	(5.4)
Leased lines	10,493	13,816	16,453	31.7	19.1
Data transmission and related services	5,357	7,781	11,949	45.2	53.6
Telecommunications equipment sales	3,230	3,030	4,810	(6.2)	58.7
Construction, maintenance and other	8,152	9,313	12,197	14.2	31.0
Total..	256,929	302,230	326,280	17.6	8.0

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 1999 and 2000 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 31.8 percent in 1999 and 49.9 percent in 2000.

The table below sets forth information regarding average access lines in Matáv's local concession areas:

	Year ended December 31,			Year ended December 31,	
	1998	1999	2000	1999/1998	2000/1999
				(% change)	
Average access lines:					
Residential ……...	2,080,997	2,271,249	2,333,127	9.1	2.7
Business ……..	355,004	371,823	357,588	4.7	(3.8)
Public payphones	36,242	35,987	36,448	(0.7)	1.3
Total	2,472,243	2,679,059	2,727,163	8.4	1.8
ISDN channels	52,434	88,125	192,468	68.1	118.4
Total	2,524,677	2,767,184	2,919,631	9.6	5.5

The increase in access lines throughout the period reflects the build-out of Matáv's network. The majority of this increase related to residential lines. The number of ISDN channels, which are used primarily by business customers, is currently small but has grown rapidly since the introduction of ISDN in Hungary in November 1995. The number of business lines decreased in 2000 compared to 1999, partly as a result of migration of business customers to ISDN lines as well as to mobile services.

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 in 1999 compared to 1998 principally as a result of the increase in access lines and nominal increases in tariffs. On January 1, 1999 Matáv increased its local tariffs by 16.9 percent, increased fixed line to mobile telephone tariffs by 7.3 percent and decreased long distance tariffs by 1.8 percent in each case on average in nominal terms. Any growth in revenues as a result of tariff and access line increases was mitigated by the fact that the majority of new access lines were connected to low-volume residential customers.

Domestic traffic revenues decreased in 2000 compared to 1999 as a result of tariff decreases. On February 1, 2000 Matáv decreased its local tariffs by 10.8 percent and long distance tariffs by 12.6 percent, while tariffs for calls from fixed line to mobile telephone did not change. These tariff decreases were partly offset by increases in number of lines. Changes in tariffs did not have a significant effect on call volumes or call patterns.

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 1999 mainly as a result of growth in the volume of traffic, but decreased slightly in 2000 due to decreases in rates Matáv receives from other local telephone operators and mobile service providers.

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 December 31,**	
	1998	**1999**	**2000**	**1999/1998**	**2000/1999**
		(in HUF millions, except traffic figures)		**(% change)**	
Revenues:					
Outgoing international traffic revenue (1)..	20,897	21,215	17,490	1.5	(17.6)
Incoming international traffic revenue (2) .	17,895	22,592	23,942	26.2	6.0
	38,792	43,807	41,432	12.9	(5.4)
Traffic in thousand of minutes:					
Outgoing international (3)	188,412	192,356	182,479	2.1	(5.1)
Incoming international (4)	374,546	441,193	474,388	17.8	7.5

(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 minutes 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.

(4) Includes minutes from calls terminating with subscribers of Matáv, other local telephone operators and mobile service providers. Does not include transit traffic and other international services 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. In 1999, revenues from outgoing international traffic increased as a result of an increased number of access lines, partly offset by a tariff decrease of 1.2 percent. In 2000, revenues from outgoing international traffic decreased principally as a result of a 12.2 percent tariff decrease. The Company believes that the limited increase in outgoing minutes in 1999 and the decrease in outgoing minutes in 2000 were at least in part the result of the relatively high number of international calls placed by mobile subscribers, the rapid growth of private leased lines and the introduction of IP telephony.

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 1999 and 2000, 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 on average 11.4 percent in 1999 and 14.3 percent in 2000. 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 12.2 percent in 1999 and 13.2 percent in 2000.

Leased Lines. Revenues from leased lines increased in both 1999 and 2000 principally as a result of growth in the number of leased line connections, which increased from 5,170 in December 31, 1998 to 8,920 in December 31, 2000.

Data Transmission and Related Services. Revenues from data transmission and related services increased in both 1999 and 2000 as a result of growth in the number of ISDN connections, Internet subscribers and cable television customers. The number of ISDN channels has grown significantly, from 70,642 channels at the end of 1998 to 305,882 channels at the end of 2000. The number of dial-up Internet subscribers tripled from December 31, 1998 to December 31, 2000. Through network development and acquisitions, the number of cable customers has also grown significantly, reaching over 267 thousand subscribers by the end of 2000.

Telecommunications Equipment Sales. Revenues from telecommunications equipment sales decreased in 1999 compared to 1998 as a result of fewer fixed line telephone sets and PBX equipments sold in 1999 compared to 1998. Revenues from telecommunications equipment sales increased in 2000 compared to 1999 as a result of more ISDN telephone sets sold in 2000.

Construction, Maintenance and Other Services. Revenues from construction, maintenance and other services increased both in 1999 and 2000 as a result of broader activities of MatávCom, which added LAN and WAN construction to its traditional PBX business.

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,	
	1998	1999	2000	1999/1998	2000/1999
	(in HUF millions)			(% change)	
Operating expenses:					
Employee-related expenses	40,468	45,881	51,595	13.4	12.5
Depreciation and amortization	44,044	49,873	60,932	13.2	22.2
Payments to other network operators	50,155	61,800	71,641	23.2	15.9
Cost of telecomm. equipment sales	2,891	3,370	5,071	16.6	50.5
Other operating expenses	48,851	55,835	66,204	14.3	18.6
	186,409	216,759	255,443	16.3	17.8

Employee-related Expenses. Employee-related expenses consist of wages and salaries, social security and other expenses. Employee-related expenses increased in 1999 and 2000 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 for Matáv Rt.'s employees was 15.0 percent in April 1999 and 11.7 percent in April 2000. Required social security contributions and bonus, welfare and pension payments rose in line with wages. The growth in employee-related expenses in 2000 is also due to a HUF 8.6 billion severance provision made in connection with headcount reductions in 2001.

Provision expenses in connection with severance were reclassified in 2000. In the prior years, severance provision expense and release of severance provision were included as part of other expense. Beginning in 2000, severance expenses as well as release of severance provision are shown as part of employee related expenses. 1999 and 1998 expenses shown in this report have also been reclassified on this basis.

The average number of employees in the fixed line telecommunications segment decreased by 1,621 employees or 10.1 percent in 1999 and by 1,256 employees or 8.7 percent in 2000 as a result of natural attrition, improved efficiency and streamlining of the organizational structure.

Depreciation and Amortization. Depreciation and amortization expenses increased in both 1999 and 2000 as a result of continued investment in Matáv's fixed line telecommunications network. In preparation for the liberalized market, Matáv carried out a review of its assets and organizational structure in the last quarter of 2000. This review resulted in accelerated depreciation and scrapping of certain fixed assets in an amount of HUF 3,442 million.

Payments to Other Network Operators. Payments to other network operators include amounts paid to mobile operators, other local fixed line telephone operators and to foreign telephone operators for calls terminated on their network. Payments to other network operators increased in both 1999 and 2000 as a result of increased penetration of mobile customers.

Other Operating Expenses. The majority of the increases in other operating expenses in both 1999 and 2000 related to materials and maintenance, frequency and service fees, legal and other consulting fees, marketing fees, outsourcing of real estate and IT operations and provisions. In addition, in 2000, other operating expenses increased as a result of provisions for additional writedowns of receivables, inventory and other charges of HUF 1,552 million relating to the fourth quarter review of the Company's operations.

Operating Profit

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

	Year ended December 31,			Year ended December 31,	
	1998	1999	2000	1999/1998	2000/1999
				(% change)	
Operating profit (in HUF millions)	70,520	85,471	70,837	21.2	(17.1)
Operating margin (%)(1) ....……..........	27.4	28.3	21.7	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 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. In 2000 operating profit decreased by 17.1 percent due in part to charges taken in the fourth quarter for severance provision of HUF 8.6 billion, for depreciation of HUF 3.4 billion and for other operating expenses of 1.5 billion. The decline in operating profit also resulted in part from tariff decreases for fixed line telecommunication services.

Mobile Telecommunications Segment

Revenues

	Year ended December 31,			December 31,	
	1998	1999	2000	1999/1998	2000/1999
				(% change)	
Revenues..	88,142	117,336	159,345	33.1	35.8

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 1999 and 2000 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,	
	1998	1999	2000	1999/1998	2000/1999
				(% change)	
Average number of subscribers:					
Westel	450,945	686,973	1,186,293	52.3	72.7
Westel 0660	86,348	96,934	87,411	12.3	(9.8)
Average monthly usage per:					
Westel subscriber (minutes)	221	200	184	(9.5)	(8.0)
Westel 0660 subscriber (minutes)	205	179	170	(12.7)	(5.0)

Westel's revenues from mobile telecommunications services increased from 1998 through 2000, primarily as a consequence of the continued growth in the Westel subscriber base. The average number of Westel subscribers grew by 72.7 percent in 2000 compared to 1999. The effects of subscriber-base growth 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.

Westel 0660's revenues from mobile telecommunications services increased in 1999 compared to 1998, which was primarily attributable to the growing number of subscribers and increase in tariffs. In contrast, in 2000 Westel 0660's subscriber base decreased resulting in lower revenues from mobile telecommunications 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 for the mobile telecommunications segment:

	Year ended December 31,			Year ended December 31,	
	1998	1999	2000	1999/1998	2000/1999
	(in HUF millions)			(% change)	
Operating expenses:					
Employee-related expenses	7,649	10,749	14,429	40.5	34.2
Depreciation and amortization	9,510	12,272	17,008	29.0	38.6
Payments to other network operators	11,750	15,304	21,164	30.2	38.3
Cost of telecomm. equipment sales	14,284	19,024	29,269	33.2	53.9
Other operating expenses	19,360	24,327	35,441	25.7	45.7
	62,553	81,676	117,311	30.6	43.6

Employee-related Expenses. Employee-related expenses increased in 1999 and 2000, principally as a result of higher workforce levels and nominal increases in wages. The average number of mobile employees grew by 120 or 8.2 percent in 1999 and by 63 or 4.0 percent in 2000, principally as a result of increased sales and service personnel to accommodate the expanded subscriber base. In 2000, employee-related expenses also include an approximately HUF one billion provision charge Westel 0660 took in the fourth quarter for anticipated severance expenses.

Depreciation and Amortization. Depreciation and amortization increased in both 1999 and 2000. These increases were primarily attributable to increases in property, plant and equipment and investment in the mobile network.

Payments to Other Network Operators. Payments to other network operators include amounts paid by Westel and Westel 0660 to other mobile telephone operators and to the fixed line telephone operators as well as to foreign mobile telephone operators for terminating their calls. Payments to other network operators increased in both 1999 and 2000 as a result of the significantly higher subscriber base of Westel.

Cost of Telecommunications Equipment Sales. Cost of telecommunications equipment sales increased in both 1999 and 2000 as a result of significantly higher numbers of mobile handsets sold.

Other Operating Expenses. Other operating expenses increased in both 1999 and 2000, principally due to marketing expenses, SIM costs, maintenance of base stations, upgrading software and hardware support to accomodate the needs of the increased subscriber base and higher local taxes 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,**	
	1998	**1999**	**2000**	**1999/1998**	**2000/1999**
				(% change)	
Operating profit (in HUF millions)	25,589	35,660	42,034	39.4	17.9
Operating margin (%)(1) ....…….........	29.0	30.4	26.4	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 1999 principally as a result of growing revenues from mobile telecommunications services, due mainly to the increasing customer base. Operating profit grew by 17.9 percent in 2000 as a result of further significant growth in the number of mobile customers, while operating margin showed a decline due primarily to the higher acquisition cost of these customers.

__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,	
	1998	1999	2000	1999/1998	2000/1999
	(in HUF millions)			(% change)	
Interest expense:					
Hungarian Forint loans	11,720	11,112	11,333	(5.2)	2.0
Foreign currency loans	6,134	6,182	5,318	0.8	(14.0)
Finance leases	192	47	157	(75.5)	234.0
Foreign exchange loss - net	12,378	6,289	4,835	(49.2)	(23.1)
Commissions and other bank charges	1,311	1,941	2,042	48.1	5.2
Total interest payable and other charges	31,735	25,571	23,685	(19.4)	(7.4)
Interest capitalized	(895)	(541)	(626)	(39.6)	15.7
Interest and other financial income	(2,045)	(2,897)	(2,067)	41.7	(28.7)
	28,795	22,133	20,992	(23.1)	(5.2)

Net interest and other charges decreased in 1999 and 2000 primarily as a result of a decrease in net foreign exchange loss. Net foreign exchange loss decreased in 1999 and 2000 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 11 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:

	Year ended December 31,			Year ended December 31,	
	1998	1999	2000	1999/1998	2000/1999
	(in HUF millions)			(% change)	
Income tax expense /(benefit)........................	(1,267)	6,911	8,208	(645.5)	18.8

The Company and certain of its subsidiaries qualify for a reduction in income tax payable on meeting certain conditions. These conditions 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.

The reduction in the tax payable amounts 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 qualified for the 100 percent allowance. Through 1995, Westel 0660 utilized the 100 percent allowance. From January 1, 1999, Matáv Rt. and Westel are utilizing the reduced allowance of 60 percent for a further five years (resulting in an effective tax rate of 7.2 percent).

From January 1, 1996 through December 31, 1999, Westel 0660 utilized the reduced allowance of 60 percent.

Management believes that the conditions underlying the reduction in income tax will continue to be met by Matáv Rt. With regard to Westel, should the foreign ownership falls below 30 percent (which would be the case if and when the Company exercises its option to buy the remaining 49 percent ownership), Westel will lose its 60 percent reduction in income tax. Because full exercise of the option would adversely affect Westel's preferred income tax status, Matáv is discussing with Deutsche Telekom AG the possibility of exercising the option in respect of only 19 percent of Westel shares. This would require modifications to the original contract. The option's expiration date may also be extended.

All other subsidiaries were subject to income tax of 18 percent.

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. The Group has tax losses of HUF 3,417 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 91 million expire in 2003, HUF 46 million expire in 2005.

Income tax expense increased in 1999 compared to 1998 because Matáv Rt. and Westel were required to pay income tax following the expiration of their 100 percent tax allowance at the end of 1998. Income tax expense increased in 2000 compared to 1999 as a result of discontinuation of tax loss recognition for certain subsidiaries due to the uncertainty of the recoverability of their tax losses, reversal of temporary differences at different income tax rates and Westel 0660, which started to pay income tax at 18 percent in 2000.

LIQUIDITY AND CAPITAL RESOURCES

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

	Year ended December 31,		
	1998	**1999**	**2000**
		(in HUF millions)	
Net cash flows:			
from operating activities	135,499	138,465	156,449
from investing activities	(114,357)	(126,460)	(145,805)
from financing activities	(26,788)	(9,034)	(3,932)
Change in cash and cash equivalents	(5,646)	2,971	6,712
Cash and cash equivalents, beginning of period	9,259	3,613	6,584
Cash and cash equivalents, end of period	3,613	6,584	13,296

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 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 level of depreciation and amortization of fixed assets, which increased by HUF 8,591 million. In 1999, change in receivables increased by HUF 906 million, and change in payables decreased by HUF 15,671 million, which led to 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 operating activities increased by HUF 17,984 million in 2000 compared to 1999, primarily due to the effect of a higher charge for depreciation and amortization of fixed assets, which increased by HUF 15,795 million. In 2000, the change in receivables decreased by HUF 5,177 million, and the change in payables increased by HUF 2,558 million, both of which led to a corresponding increase in net cash flows from operating activities. These cash inflows were partly offset by a decrease of HUF 8,260 million in operating profit.

Net Cash Flows from Investing Activities. Net cash flows from investing activities are primarily driven by capital expenditures, movements in other financial assets, purchase of investments and sale of fixed assets. Capital expenditures were HUF 116,283 million in 1998, HUF 127,678 million in 1999, and HUF 152,784 million in 2000. 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 and 2000 represented cash outflows of HUF 2,458 million and HUF 2,313 million respectively, from purchase of government bonds. Purchase of investments represented a cash outflow of HUF 9,604 million in 1998, primarily as a result of Westel's repurchase of its shares, HUF 3,551 million in 1999 and HUF 3,568 million in 2000, as a result of acquisitions. Proceeds from disposal of fixed assets increased by HUF 5,980 million in 2000 to HUF 9,784 million mainly as a result of compensation received by Matáv for exiting part of its 900 MHz frequency band width. See "Infrastructure and Technology - Expansion of Access Networks".

Net Cash Flows from Financing Activities. Net cash flows from financing activities are primarily driven by the Company's borrowing activities. Matáv made net repayments of HUF 8,954 million in 1998, but received net proceeds from loans of HUF 2,268 million in 1999 and HUF 4,915 million in 2000, increasing net cash flows. Net cash flows utilized in financing activities decreased in 1999 as a result of a HUF 6,250 million decrease in dividends paid. Net cash flows utilized in financing activities decreased in 2000 compared to 1999 as a result of a HUF 2,107 million decrease in dividends paid in 2000.

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 an increase in 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, 1998, 1999 and 2000, Matáv 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. Management believes it has adequate working capital to finance the Company's operations.

At December 31, 2000, Matáv had undrawn committed credit facilities of HUF 58,401 million. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin depending on the currency and institution providing the facilities. There are pledges on receivables for loans totaling HUF 7,049 million.

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

	At December 31, 1999	At December 31, 2000
	(in HUF millions)	
Hungarian Forint	93,988	103,910
EURO	59,713	74,238
U.S. Dollar	24,383	12,720
Net hedging position	(377)	(1,502)
Other	4,812	0
	182,519	189,366

HUF 78,725 million of indebtedness is scheduled for repayment in 2001, HUF 22,347 million is scheduled for repayment in 2002 and HUF 43,015 million is scheduled for repayment in 2003. 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, 2000, approximately 77.9 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 11.0 percent and 13.7 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 5.2 percent and 5.6 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.

On March 24, 1998, the Company completed two domestic bond offerings. A one-year bond offering in the total amount of HUF 5 billion was fully subscribed and subsequently repaid on March 26, 1999. The other transaction included five-year bonds with a total amount of HUF 10 billion with interest payable semi-annually at an interest rate of 50 basis points over the average yield of the last three auctions of 6-month Hungarian Treasury Bills.

On June 22, 2000, Matáv launched a HUF 45 billion bond program. This program allows Matáv to issue fixed, floating or zero coupon bonds with maturities of between 1 and 10 years. On July 12, 2000, Matáv issued a three-year, fixed rate tranche in the nominal amount of HUF 10 billion. The bonds were sold at an average price 51 basis points over 3-year Hungarian Treasury Bills. On March 21, 2001 an additional HUF 3 billion bond was issued through a public auction. The bonds were sold with an average interest rate of 10.89 percent, which was 74 basis points over the relevant benchmark Hungarian Treasury Bills.

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, 2000, the Company was in compliance with these requirements. These restrictions do not significantly affect the liquidity of the Company.

In 2000, Matáv approached both Moody’s and Standard&Poor’s to initiate rating coverage.

Moody’s initial credit rating for the long-term senior unsecured foreign and domestic currency ratings, announced on November 14, 2000, were Baa1, with a stable outlook.

On December 7, 2000, Standard&Poor’s announced a local corporate credit rating of A- with negative outlook, and a foreign currency corporate credit rating of BBB+ with positive outlook. The local currency rating took into account the Deutsche Telecom AG influence, whereas for the foreign currency rating, the positive outlook of the Hungarian sovereign was factored in. On January 3, 2001, Standard & Poor’s raised the long term foreign currency corporate rating of Matáv to A- from BBB+, and revised the outlook to negative from positive. The rating actions reflected the upgrade of the long-term foreign currency issuer credit rating on the Republic of Hungary.

CAPITAL EXPENDITURES

The Company's capital expenditures totaled HUF 116,283 million in 1998, HUF 127,678 million in 1999 and HUF 152,784 million in 2000. 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 48 percent of total capital expenditures in 1998, 43 percent of total capital expenditures in 1999 and approximately 41 percent of total capital expenditures in 2000. Capital expenditures for mobile telecommunications totaled 16 percent of total capital expenditures in 1998, 25 percent of total capital expenditures in 1999 and approximately 34 percent of total capital expenditures in 2000. The remainder of capital expenditures for this period related to investment in infrastructure not directly attributable to either fixed line networks or mobile telecommunications.

The Company expects capital expenditures to be approximately HUF 340 billion between 2001 and 2003. The Company expects to be able to finance capital expenditures over the next several years from net cash flows from operations and from borrowings. Matáv intends to secure upfront financing for the exercise price of the Westel option through an intra-company loan raised from Deutsche Telekom AG. 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,		
	1998	1999	2000
	(in HUF millions)		
Net income:			
IAS	58,337	78,632	68,763
U.S. GAAP	58,564	78,721	63,793
Shareholders' equity:			
IAS	257,245	327,579	386,984
U.S. GAAP	244,783	315,248	369,817

Reconciling adjustments relate principally to the different treatment under U.S. GAAP of deferred revenue, including the adoption of SAB 101, post-retirement benefits and management incentive plan bonds. See Note 30 to the consolidated financial statements.

Consolidation of Westel 0660 and Westel

The consolidated financial statements, prepared in accordance with IAS, include the accounts of Westel 0660 and Westel as consolidated subsidiaries. In prior years, these companies were not consolidated under U.S. GAAP as the Company's ownership in Westel 0660 and Westel was 51 percent in 1999 and the ownership rights of the other shareholder were considered participatory in nature. This precluded consolidation under U.S. GAAP, consequently, these investments were accounted for using the equity method in years prior to 2000.

In October 1999 Deutsche Telekom AG, the principal shareholder of Matáv acquired the other 49 percent stake in both companies and enabled Matáv to take operational, management and voting control of Deutsche Telekom AG's share. This required Matáv to account for Westel 0660 and Westel as consolidated subsidiaries in 2000 for U.S GAAP purposes as well.

Additional Disclosures Required for IAS — Recent Accounting Pronouncements

The following IAS standards were not required to be implemented in 2000. The adoption of these standards is not expected to have a material impact on the Company's consolidated financial statements.

IAS 39 "Financial Instruments Recognition and Measurement"
IAS 40 "Investment Property"

Additional Disclosures Required for U.S. GAAP — Recent Accounting Pronouncements

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. 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 does not expect SFAS No.

133 to have a significant effect on its financial statements.

RESEARCH AND DEVELOPMENT

Matáv has a separate organization called PKI Telecommunications Development Institute for the performance of research and development tasks needed for meeting the demands of the rapidly changing market through development of its telecommunications networks and service platforms. The institute is in close cooperation with strategic partners, domestic and international research organizations. Matáv Rt. expensed HUF 644 million in 1998, HUF 1,333 million in 1999 and HUF 1,426 million in 2000 on research and development activities.

Significant resources are devoted to upgrading Matáv's digital backbone network. Matáv is continuously developing its data communications and IP network and services. To ensure quick Internet access and broadband IP-VPN we are developing a broadband access network with ADSL, ISDN and managed lease line technologies. Matáv has introduced IP telephony into the Company's product portfolio based on its international voice over IP portfolio development. The Company has laid the foundations of establishing city networks (CityNets) to satisfy special demands of our key customers. In addition to basic IN (Intelligent Network) services, such as toll free, shared cost and premium rate services, Matáv has developed new services, such as televoting, world card and virtual private network. The Company is making preparations for interconnection and convergence of the currently separate voice and data networks.

Being an environment conscious company, Matáv is continuously working to reduce the environmental impacts of its products and services and to preserve resources.

ITEM 6 — DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

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. One current director was nominated by the holder of the Series "B" share pursuant to the Articles of Association, six of the current directors were nominated by MagyarCom and two of the current directors were elected upon proposal of other shareholders of the Company.

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:

Name	Age	Principal Occupation	Member since
Elek Straub	56	Chairman and Chief Executive Officer of Matáv	1995
Detlev Buchal	55	Member of the Board of Deutsche Telekom AG and Head of Product Marketing Division of DT	2000
Dr. Sándor Csányi	47	Chairman and Chief Executive Officer of OTP Bank	2000
Gyula Gansperger*	37	Chief Executive Officer of State Privatization and Asset Management Company (ÁPV)	2000
Moritz Gerke	48	Senior Executive Director for Central Europe, Eastern Europe and the Middle East at Deutsche Telekom AG	1996
Rudolf Gröger	46	Executive Director of T-System International, Deutsche Telekom AG	2000
Dr. Klaus Hartmann	39	Chief Financial Officer of Matáv	2000
Franz X. Hiergeist	59	Executive Director, Domestic Networks, Planning and Systems at Deutsche Telekom AG	1994
Dr. Mihály Patai	47	Chairman and Chief Executive of Hungária Biztosító	1998

* Representative of the holder of the Series “B” Share.

Other Principal Directorships of Members of the Board of Directors

Name	Position held	Company
Elek Straub	Chairman of Board of Directors	Westel
Detlev Buchal ....…	Member of Board of Management	Deutsche Telekom AG
	Member of Supervisory Board	DeTeMedien Deutsche Telekom Medien
	Member of Supervisory Board	DeTeMobil Deutsche Telekom MobilNet GmbH
	Member of Supervisory Board	Max Mobil Telekommunikation Service GmbH
	Member of Supervisory Board	Siris SAS Paris
	Member of Supervisory Board	T-Online International AG
	Member of Supervisory Board	T-Telematik Venture Holding GmbH
	Member of Supervisory Board	T-Nova Deutsche Telekom GmbH
	Member of Supervisory Board	T-Systems GmbH
Dr. Sándor Csányi ......…....	Chairman of Board of Directors	OTP Bank Rt.
	Member of Board of Directors	MOL Rt.
	Chairman of Supervisory Board	OTP Garancia Biztosító Rt.
	Chairman of Supervisory Board	„Gyulaj" Rt.
	Chairman of Supervisory Board	Villányi Borászati Rt.
Gyula Gansperger.. ......…..	None	
Moritz Gerke	Member of Board of Directors	Westel
	Member of Board of Directors	EuroTel Bratislava a.s.
	Vice-Chairman of the Board of Directors	RadioMobil a.s.
	Vice-Chairman of Supervisory Board	Polska Telefonia Cyfrowa
	Member of Supervisory Board	DeTeSat GmbH
	Member of Supervisory Board	Zeta GmbH
	Member of Board of Directors	ISH
Rudolf Gröger	Member of Supervisory Board	dITS France
	Member of Supervisory Board	dSH Österreich
	Member of Supervisory Board	Groupe Spring
	Member of Board of Directors	dITS NA
	Member of Board of Directors	dITS Italia
	Member of Supervisory Board	Dtag Desktop
	Member of Supervisory Board	Dtag Card Services
	Member of Supervisory Board	Dtag debis Informatik
Dr. Klaus Hartmann	Member of Board of Directors	Westel
	Chairman of Board of Directors	Stonebridge Rt.
Franz X. Hiergeist	Member of Supervisory Board	T-Data
	Member of Supervisory Board	T-Nova
	Member of Supervisory Board	T-Mobil
Dr. Mihály Patai	None	

Biographies of Members of the Board of Directors

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, Chairman of the Executive Committee in 1996 and Chairman of the Management Committee in 2000.

Detlev Buchal. Mr. Detlev Buchal studied law and then started a professional career at the German Savings Bank and Giro Center Association, first as a legal expert and then as legal adviser. In 1980 he became Head of the Legal Department and later the Chief Legal Adviser at Schleswig-Holstein Landesbank in Kiel. In 1984 he joined the German Savings Bank and Giro Center Association again as Director of the Department for Giro Centers and Payment Transactions. In 1988 Mr. Buchal joined the board of Gesellschaft für Zahlungsysteme GmbH of the German Eurocards and Eurochecque Center in Frankfurt, and was appointed Chairman of the Board. He was primarily responsible for strategic planning, marketing and sales, and was also Chairman of the Supervisory Board for Eurocard Service GmbH. He represented the interests of the German banking industry in the committees of Eurocard Int., Brussels, and Mastercard Int., New York. Mr. Detlev Buchal has been a Member of the Board of Deutsche Telekom AG since February 1, 1996, and currently heads the Product Marketing Division.

Dr. Sándor Csányi. Dr. Sándor Csányi Ph.D. is Chairman and CEO of OTP Bank. He has a degree in finance from the University of Economics, he is a certified price analyst and a chartered accountant. He started his career at the Ministry of Finance in 1974, and worked for the Ministry of Agriculture between 1983 and 1986. He became Head of Department at Magyar Hitelbank in 1986, and served as Deputy CEO of the Kereskedelmi és Hitelbank between 1989 and 1992. He has been Chairman and CEO of OTP Bank (National Savings and Commercial Bank Ltd.) since 1992. In 1996, the World Economic Forum of Davos elected him as one of the Global Leaders for Tomorrow. Global Finance listed him among the world's 600 most influential people in finance in 1998. Wall Street Journal Europe listed him as one of the top ten executives of Central Europe in 1999. He was elected as Entrepreneur of the year in Hungary in 2000.

Gyula Gansperger. Mr. Gyula Gansperger graduated from the University of Economics as an economist majoring in finance in 1986. He served as chief accountant in several firms. In 1990 he became owner and managing director of TAXORG Tax Consultants and Accounting Ltd. that developed complete accounting and controlling systems for domestic and foreign companies. He served as a member of the Supervisory Board of ÁPV between 1995 and 1998, headed audits and controlled the company's business and financial reports. After Mr. Gansperger became CEO of ÁPV in 1998, he restructured the company and prepared it for its new primary function of asset management .

Moritz Gerke. Mr. Gerke was appointed as a member of the Board of Directors 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 AG. Since 1998, he has been the Senior Executive Director for Central Europe, Eastern Europe and the Middle East at Deutsche Telekom AG.

Mr. Rudolf Gröger. Mr. Rudolf Gröger is a member of the Board of Directors at T-Systems International, and is also Head of Global Industries in charge of international operations. After finishing his business studies, he started his career at Siemens as a sales expert in 1978. He joined Siemens Nixdorf Informations Systeme AG in 1983, and became advocate for the German management and head of regional sales. He graduated from the Academy of State Administration and Economics in Munich in 1985 as an economist majoring in corporate management. He joined Deutsche Telekom AG in 1999 as Corporate-level Head of IT and Communications Systems.

Dr. Klaus Hartmann. Dr. Klaus Hartmann graduated with a Ph.D. in Economics. He also holds an MBA of the University of Birmingham. Prior to his employment with Deutsche Telekom AG, he worked for Arthur Andersen in Germany, and as treasurer and operational controller for a subsidiary of the BICC Group. He joined Deutsche Telekom AG in 1995 as Manager of International Capital Markets, and became Corporate Treasurer of Global One, a joint venture of Deutsche Telekom AG, France Telekom and Sprint in 1997. He returned to Deutsche Telekom AG's Bonn Headquarters as Senior Advisor to the CFO in April 2000. He was appointed CFO of Matáv and Vice-Chairman of its Management Committee in November 2000.

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 AG General Directorate.

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. He became managing director of Kereskedelmi Bank Rt. in charge of International and Foreign Exchange Operations in 1993, and was appointed Chairman and CEO at Budapest Investment International Inc. in 1996. He has been Chairman of the Board and CEO of Hungária Biztosító since 1996.

Management Committee

Pursuant to the Company's amended Articles of Association, and the amended Rules of Procedure of the Board of Directors, the Board of Directors has established a Management Committee, which is empowered to carry out the day-to-day operations in accordance with the annual business plan. The Management Committee consists of seven members, who are the seven chief officers of Matáv. The seven members are as follows:

Name	Age	Position	Member since
Elek Straub	56	Chairman and Chief Executive Officer	1996
László Bodnár	52	Chief Logistics Officer	1999
Ottó Gecser *	50	Chief Marketing and Internet Officer	1996
Dr. Klaus Hartmann	39	Chief Financial Officer	2000
Manfred Ohl	53	Chief Technical Officer	1999
Dr. Tamás Pásztory	49	Chief Human Resources and Legal Officer	1996
Zoltán Tankó	43	Chief Sales Officer	2000

* Mr. Gecser resigned from his position on April 30, 2001. His successor has not yet been appointed.

Other Principal Directorships of Members of Management Committee

Name	Position held	Company
Elek Straub ....….....	See above	
László Bodnár	None	
Ottó Gecser.	Member of Board of Directors	MatávNet Rt.
	Member of Board of Directors	M-RTL
	Chairman of Supervisory Board	SKF Hungary Rt.
Dr. Klaus Hartmann	See above	
Manfred Ohl	Member of Board of Directors	Westel
	Member of Board of Directors	DeTeLine Budapest
Dr. Tamás Pásztory	Chairman of Supervisory Board	Investel Rt.
	Member of Board of Directors	MatávNet Rt.
Zoltán Tankó	Member of Board of Directors	EPT Rt.

Biographies of Chief Officers

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 positions with 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.

Ottó Gecser, Chief Marketing and Internet 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 Fotex Group as Senior Deputy CEO and was responsible for coordinating the operation of the companies owned by the Fotex Group and coordinating the launch of new products for the Fotex Group.

Dr. Klaus Hartmann, Chief Financial Officer. See biography above.

Manfred Ohl, Chief Technical Officer. Deutsche Telekom AG appointed Mr. Ohl Chief Technical Officer of Matáv in January 1999. 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 AG, and for central coordination of investments.

Dr. Tamás Pásztory, Chief Human Resources and Legal Officer. Dr. Pásztory 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 joined Matáv's predecessor in 1969 and has been in various positions in the human resources area since 1980.

Zoltán Tankó, Chief Sales Officer. Mr. Tankó worked as IT development engineer for Budapest Radio Technology Enterprise from 1980, and Kőbánya Pharmaceuticals from 1982. He had several positions at Műszertechnika (Instrument technology) from 1984, including Chief Telecommunications Officer from 1990. He became Director of Matáv's Business Communications Branch in February 1996. He has been Chief Sales Officer of Matáv since January 1, 2000.

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, 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:

Name	Age	Principal Occupation	Member since
Hans Albert Aukes	51	Head of Network Communications Business Unit at Deutsche Telekom AG	2000
Dr. Manfred Balz	56	General Counsel to Deutsche Telecom AG	2000
Dieter Cazzonelli ....….....	44	Senior Executive Vice President, Taxes and Risk Management at Deutsche Telekom AG	2000
Dr. Gábor Germus	30	Solicitor, S. B. G. & K. Law Firm, Budapest	2000
Joachim Kregel ....……	47	Head of Group Auditing at Deutsche Telekom AG in Bonn, and member of the Group Committee for Organizational Projects and of the Central Consulting Committee	2000
Dr. László Pap	57	Budapest University of Technology, Dean, Professor, Head of Department	1997
József Szabó	57	President of the Works Council, West Hungary Technical Directorate	1999
György Varju	54	President of the Works Council, Budapest Technical Directorate	1999
Péter Vermes	53	Chairman of Matáv's Works Council	1997

Other Principal Directorships of Members of the Supervisory Board

Name	Position held	Company
Hans Albert Aukes	Member of Supervisory Board	DeTeKabel Service GmbH
	Member of Supervisory Board	Hrvatske Telekomunikacije
Dr. Manfred Balz	Member of Supervisory Board	DeTeImmobilien
	Member of Supervisory Board	BVS
Dieter Cazzonelli	Member of Supervisory Board	Deutsche Telekom K.K.
	Member of Supervisory Board	Deutsche Telekom Japan K.K.
	Member of Supervisory Board	NAB Nordamerika Beteiligungs Holding GmbH
	Chairman of Supervisory Board	DeTeAsia Holding GmbH
	Member of Supervisory Board	Deutsche Telekom International Finance B.V.
	Member of Supervisory Board	Deutsche Telekom Holding B.V.
	Chairman of Supervisory Board	DeTeAssekuranz
Dr. Gábor Germus	None	
Joachim Kregel ....…	None	
Dr. László Pap	None	
József Szabó ....,.........	None	
György Varju	None	
Péter Vermes	None	

Biographies of Members of the Supervisory Board

Hans-Albert Aukes. Mr. Aukes worked for the German Ministry of Post and Telecommunications, and held an executive position in the field of telecommunications policy-making. From 1990 to 1993 Mr. Aukes was head of the office of Deutsche Telecom AG's Supervisory Board and personal assistant to the Chairman of the Supervisory Board. Later, he became Head of the Corporate Strategy Branch of Deutsche Telecom AG in the division of the CEO. Since March 1, 1996, he has been Head of Deutsche Telecom AG's Network Communications business unit since March 1, 1996, the largest branch of Deutsche Telecom AG.

Dr. Manfred Balz. Mr. Balz studied law in Germany, the USA (Harvard Law School) and in Leningrad, Russia. His professional career evolved both through government and private enterprise assignments. He was involved in the revision of economic and commercial legislation, carried out by the German Federal Ministry of Justice, served as General Counsel to Treuhandanstalt, the East German Privatization Agency, and was a senior partner of Wilmer, Cutler & Pickering, a leading international law firm. He has been General Counsel to Deutsche Telecom AG since 1997.

Dieter Cazzonelli. Mr. Cazzonelli graduated from Albert-Ludwig University in Freiburg, Germany. He started his professional career at Grundig AG, as Director of the Tax Department, and later became Senior Director of Taxes and Customs. He joined Deutsche Telecom AG in 1996, and was appointed Executive Director of Taxes. On November 1, 1999 Mr. Cazzonelli became senior Executive Vice President of Taxes and Risk Management at Deutsche Telekom AG.

Dr. Gábor Germus. Mr. Germus studied law at the Law Schools of University of Miskolc and Eötvös Lóránd University. He is member of the Budapest Bar. He specializes in financial law, intellectual property, corporate law, competition law, representation in financial law cases, privatization, investments in various industries and representation of multinational clients. Currently he works for S.B.G.&K. Law Firm in Budapest.

Joachim Kregel. Mr. Kregel is an economist. He studied economics and business administration at the University of Bochum. Subsequently, he held various positions at Deutsche Unilever GmbH and Otto Versand GmbH & Co. in Hamburg. Between 1992 and 1995 he headed the Audit Department of Kaufhof Holding AG in Cologne. He has been head of Group Auditing at Deutsche Telekom AG in Bonn since 1996. He is also member of the Group Committee for Organizational Projects and the Central Advisory Committee. Mr. Kregel is member of various committees within the German Institute of Internal Audit.

Dr. László Pap. Mr. Pap graduated from the Technical University of Budapest as a Telecommunications major. He became Ph.D. in 1980 and Doctor of Sciences (top degree awarded by the Hungarian Academy of Sciences) in 1992. He has been a professor of the Electrical Engineering Department, and Head of the Department of Telecommunications at the Budapest Technical University since 1967. He has obtained numerous patents for his inventions. He is Vise President of the Scientific Society of Telecommunications, member of the editorial board of the periodical World of Nature, member of the Hungarian Society of Inventors, and expert of the Hungarian Space Research Governmental Committee.

József Szabó. Mr. Szabó became a qualified telecommunications technician in 1961 in Budapest, and started to work for the Sopron Telephone Exchange. There he served in various positions, assuming increasing responsibilities. He has been a staff member of the Investment Department of the Sopron Directorate since 1996. He joined the trade union in 1958 and served in several different positions. He was elected as Chairman of the Works Council in 1993 for the first time. He was reelected in 1995 and 1998 as well, and is currently Chairman of the Works Council of the West Hungarian Technical Directorate.

György Varju. Mr. Varju became a qualified technician in 1968, and started to work for the Hungarian Institute of Electrotechnical Control. He graduated as quality controller in 1971. He has been a construction manager at the Postal Service and Matáv since 1973. Mr. Varju joined the trade union in 1968 and served in various positions. He was elected Chairman of the Works Council in 1993. He is currently Chairman of the Works Council of the Budapest Technical Directorate.

Péter Vermes. Mr. Vermes became a qualified technician in 1972, graduated as a telecommunications engineer in 1975 and as teacher of technical sciences in 1978. Between 1972 and 1986 he worked for the Budapest Regional Directorate, and between 1986 and 1997 for the Long-Distance Telecom Directorate. He currently works for the Operations and Maintenance Directorate. He has been Chairman of Matáv's Central Workers' Council since 1993. He was elected as employees' representative on the Supervisory Board in 1995 for the first time.

Indemnification of the Board of Directors and the 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, the Company must indemnify him. The Company may maintain insurance on behalf of any 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.

Compensation of Directors and Officers

For the year ended December 31, 2000, the aggregate compensation of the Board of Directors was HUF 13 million.

For the year ended December 31, 2000, the aggregate compensation of the members of the Supervisory Board was HUF 7 million.

For the year ended December 31, 2000, the aggregate compensation of the members of the Management Committee was HUF 294 million.

Board Practices

Members of the Board of Directors and the Supervisory Board are elected for a term of one year. Members of the Management Committee are elected for an indefinite period.

Work contracts of management employees of the Company do not contain special provisions regarding entitlements after termination of employment, therefore the applicable provisions of the Labor Code regulate severance payments.

Audit Committee members are appointed from the Supervisory Board and Remuneration Committee members are appointed from the Board of Directors.

The Audit Committee assists in the appointment of independent auditors to be elected by the annual general meeting and reviews the scope of external audit services. The Audit Committee also reviews the annual financial statements of Matáv, taking into account the results of the audits and reviews performed by the independent auditors. The Audit Committee also reviews financial reports submitted to the stock exchanges, banks and regulatory bodies as well as reports prepared by the Company's internal auditors. Members of the Audit Committee are Dieter Cazzonelli, Joachim Kregel and Dr. László Pap. The Audit Committee holds at least two meetings each year.

The Remuneration Committee makes proposals to the Board of Directors regarding remuneration of executive officers, including setting and evaluating their bonus targets. Members of the Remuneration Committee are Detlev Buchal, Moritz Gerke, Franz X. Hiergeist and Dr. Mihály Patai. The Remuneration Committee holds at least two meetings each year.

Employees

Matáv employed 14,380 persons as of December 31, 2000. The following table provides information concerning the number of full-time employees, including full-time equivalents, of Matáv Rt. and its consolidated subsidiaries:

	1998	1999	2000
Matáv Rt.:			
Average number of employees	14,098	12,665	11,573
Number of employees at period end	13,287	12,093	11,227
Matáv Rt. and its consolidated subsidiaries:			
Average number of employees	17,535	16,034	14,841
Number of employees at period end	16,595	15,377	14,380

The following table provides information on breakdown of Matáv Rt.'s employees by activity at December 31, 2000.

Branches	Number of employees
Operation and maintenance ………………………………………………………..….	5,208
Marketing ………………………………………………………………………...……	2,145
Logistics ……………………………………….…………………………...….	1,024
Finance …………………………………………………………………………...…	893
Research and development ………………………….…………………………....	884
Human Resource and Legal ………………………………………………………...…	638
Other support …………………………………………………………………….....	435

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 163 at December 31, 1997 to 264 at December 31, 2000. This ratio exceeded Matáv's goal of 250 access lines per employee, which the Company had targeted by the end of 2000. In December 2000, Matáv announced a restructuring program including a 16 percent headcount reduction for 2001. The objective of the restructuring program is to redefine the focus of the Company's operation and consumption patterns. Matáv will reallocate substantial human and financial resources to the mobile communications, data communication and Internet areas. As a result of the restructuring efforts approximately 150 organization units will be discountinued.

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 Works 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 Works Council directly represents employee interests in dealings with management and decides jointly with the employer on matters involving employee welfare funds and institutions. The Works 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 Works Council must also be consulted regarding corporate measures affecting employees. The Works Council elects one-third of the members of the Company's Supervisory Board.

Under the Hungarian Companies Act, employees' representatives on the Supervisory Board are nominated by the Works Council in cooperation with the Trade Union. The composition of the Supervisory Board is approved by the annual general meeting. At least one third of the members of the Supervisory Board must be employee representatives. Currently, there are three members of the Supervisory Board are employee representatives. These members are József Szabó, György Varju and Péter Vermes.

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 provide 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 2000, approximately 92 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 8,943 at the end of 2000.

Share Ownership of Management

The following table sets out information relating to holdings of ordinary shares by the directors and executive officers of Matáv at December 31, 2000:

Name	Title	No. of Shares Owned
Elek Straub	Chairman-CEO	76,338
Dr. Mihály Patai	Board Member	28,190
László Bodnár	Chief Logistics Officer	881
Zoltán Tankó	Chief Sales Officer	1,100
József Szabó	Supervisory Board Member	24
György Varju	Supervisory Board Member	2,000
Péter Vermes	Supervisory Board Member	8,800

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 stock with a nominal value of HUF 100, in accordance with the allocation and conversion rules. On July 1, 1998, 4.2 million bonds were allocated to the management.

During 2000 additional 876,000 bonds were allocated to management and 283,000 bonds were forfeited (402,000 in 1999). See "Additional information - Management Incentive Program Bonds".

The aggregate number of convertible bonds held by directors and executive officers under the management incentive program is 450,790.

ITEM 7 — MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

The issued share capital of the Company is HUF 103,735,887,000, consisting of 1,037,358,870 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. See "Item 10 — Additional Information — Voting Rights and Voting — Series "B" Share".

Ordinary shares outstanding as of December 31, 1998 and 1999 amounted to 1,037,281,600 shares. In June 2000, 630,000 ordinary shares of the Company were registered, which increased Matáv Rt.'s number of registered ordinary shares to 1,037,911,600. Of the newly issued shares, 77,270 ordinary shares were issued outside Matáv. Consequently, the number of shares outstanding increased to 1,037,358,870 shares.

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, 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 percent 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, 2000 is set out in the following table:

Shareholder	Number of shares	Percentage of share capital
MagyarCom	617,478,081	59.52
Publicly traded (1)	419,880,789	40.48
	1,037,358,870	100.00
Holder of Series "B" Shares (2)	1	
	1,037,358,871	

(1) Of Matáv's publicly traded shares, Morgan Guaranty Trust Company had 200,515,985 shares on its accounts as of December 29, 2000 for 52 registered holders, such amount representing 19.32 percent of the total shares outstanding. Matáv does not know whether this percentage may be indicative of the percentage of its ordinary shares held by U.S. persons. Also, the members of the Board of Directors, Supervisory Board and the management own a total of 117,333 shares.

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

One current director was nominated by the holder of the Series "B" share pursuant to the Articles of Association, six of the current directors were nominated by MagyarCom and two of the current directors were elected upon proposal of other shareholders of the Company. MagyarCom therefore controls Matáv.

SBC and Deutsche Telekom AG managed and operated MagyarCom jointly up until SBC's 50 percent ownership in MagyarCom was transferred to Deutsche Telekom AG in a transaction with a value based on Matáv Rt.'s share price as of market closing on June 30, 2000 in accordance with the terms of the shareholders' agreement between Deutsche Telekom AG and SBC.

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 market. 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 continue 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.

Related party transactions

Under a service agreement, MagyarCom Services Kft., a Hungarian company owned by Deutsche Telekom AG, provides Matáv with management and consultancy services. The total service fees charged in 1998, 1999 and 2000 amounted to HUF 3,135 million, HUF 2,152 million and HUF 2,478 million, respectively. Matáv paid MagyarCom GmbH dividends of HUF 4,110 million in 1998 (from the 1997 profits), HUF 4,697 million in 1999 (from the 1998 profits) and HUF 5,279 million in 2000 (from the 1999 profits).

At December 31, 2000, Matáv had no outstanding payable to MagyarCom GmbH, while the outstanding payable for the services rendered by MagyarCom Services Kft. amounted to HUF 760 million (HUF 756 million at December 31, 1999). Matáv had no amounts receivable from MagyarCom GmbH and MagyarCom Services Kft. as of the same dates.

Prior to 2000, Westel and Westel 0660 used consulting and other technical services provided by MediaOne International B.V., which owned 49 percent of Westel as of December 31, 2000. Costs incurred relating to these services amounted to HUF 93 million in 1998 and HUF 161 million in 1999, while in 2000 such expenses were not incurred. Westel paid MediaOne International B.V. dividends of HUF 7,909 million in 1998, HUF 2,257 million in 1999 and none in 2000. Westel 0660 paid MediaOne International dividends of HUF 1,960 million in 1998, HUF 807 million in 1999 and none in 2000.

Westel 0660 had outstanding dividends payable to Deutsche Telekom AG of HUF 2,192 million as at December 31, 2000. Due to changes in the ownership structure of Westel 0660, this dividend payable to Deutsche Telekom AG may be retained by the Company. At December 31, 1999 Westel had HUF 77 million of amounts payable to MediaOne International, while at the end of 2000 there were no amounts payable to MediaOne International.

Matáv provides services to government departments and businesses on an arm’s length basis, however, individually none of these customers represent a significant source of revenue.

Hunsat is a 50-50 percent joint venture founded by the Company and Antenna Hungária Rt. The revenues of Hunsat include membership fees paid by Matáv and Antenna Hungária Rt. and subsidies received from an international space communications organization. Costs incurred by Matáv including payment of these membership fees amounted to HUF 324 million in 2000, HUF 301 million in 1999 and HUF 281 million in 1998. Any profits made by Hunsat are paid to the joint venture partners.

EMITEL Távközlési Rt. (“EMITEL”) is a Local Telephone Operator (“LTO”) that is 50 percent owned by the Company. 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 amounted to HUF 1,550 million in 2000 (HUF 1,496 million in 1999 and HUF 732 million in 1998). Expenses paid to EMITEL amounted to HUF 1,026 million in 2000 (HUF 698 million in 1999 and HUF 1,801 million in 1998). Matáv has entered into an agreement to purchase the remaining 50 percent as described in note 25 to the consolidated financial statements.

ITEM 8 — FINANCIAL INFORMATION

CONSOLIDATED FINANCIAL STATEMENTS

See "Item 17. Financial Statements" and pages F-1 through F-35.

OTHER FINANCIAL INFORMATION

Legal Proceedings - Acquisitions Submitted for Approval

MatávkábelTV 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, Szeged and Dunakeszi are subject to the authorization of the Office of Economic Competition Council (ECC). Matáv has obtained authorizations with respect to the above territories, with the exception of Tata. In the case of Tata, the ECC refused to approve the transaction. The Company is now challenging this decision in court. In the meantime, the Tata network has been resold to another entity, in which Matáv holds a 25 percent interest.

Matáv sold its shares in MatávkábelTV in December 2000 to InvesTel Rt. (51 percent of which is owned by Egertel Rt., a fully owned subsidiary of Matáv, and 49 percent by Matáv). This transaction is also subject to ECC approval that has been filed and the case is now pending.

Matáv Rt. has been a 50 percent owner of EMITEL since its establishment and treated EMITEL as an associated company in its consolidated financial statements. On December 31, 2000, Matáv Rt. agreed with Aphrodite BV, the owner of the other 50 percent stake, that Matáv will purchase the remaining 50 percent stake. The change of ownership is conditional on the approval of the Minister as well as on the approval of the Hungarian Competition Office, which could take several months. The price will be determined when the transaction is finalized and will be partially dependent on the operations of EMITEL, but it shall not be less than USD 46.5 million.

Dividend Policy

The shareholders have approved the payment of cash dividends of HUF 10,379 million, equal to HUF 10 per share, from the Company's consolidated net income for 2000. This amount corresponds to 15 percent of 2000 net income. The record date for payment of the dividends is April 4, 2001.

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, 2000, the profit reserves available for distribution were approximately HUF 205,000 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.

SIGNIFICANT CHANGES

No significant change has occurred since the date of the annual financial statements included in this annual report.

ITEM 9 — THE OFFER AND LISTING

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. dollar 1.0 billion. The offer price was HUF 730 per share and U.S. dollar 18.65 per ADS.

In June 1999, the ÁPV sold its remaining 5.75 percent stake in Matáv through 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. dollar 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:

	Price per ADS	
	High	Low
	(U.S.$)	
1997	26.37	18.65
1998	33.25	19.00
1999	36.50	24.94
First Quarter	34.00	24.94
Second Quarter	29.75	26.37
Third Quarter	31.25	26.75
Fourth Quarter	36.50	26.06
2000	49.00	15.94
First Quarter	49.00	34.75
Second Quarter	43.06	28.06
Third Quarter	34.81	23.06
Fourth Quarter	23.62	15.94
October	23.62	20.12
November	22.81	15.94
December	20.56	16.00
2001		
January	23.75	19.63
February	22.57	16.60
March	17.42	13.95

Source: Bloomberg

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:

	Price per Share	
	High	Low
	(HUF)	
1997	1,084	730
1998	1,411	859
1999	1,791	1,150
First Quarter	1,379	1,150
Second Quarter	1,406	1,250
Third Quarter	1,507	1,306
Fourth Quarter	1,791	1,220
2000	2,655	958
First Quarter	2,655	1,702
Second Quarter	2,318	1,650
Third Quarter	1,960	1,384
Fourth Quarter	1,440	958
October	1,440	1,247
November	1,347	1,001
December	1,222	958
2001		
January	1,318	1,070
February	1,272	960
March	997	858

Source: Bloomberg

The Hungarian securities market is supervised by the Financial Supervisory Authority ("PSZÁF"), which oversees the activities of the Budapest Stock Exchange, 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.

Under the Securities Act, a public company is required to provide a preliminary financial report to the PSZÁF by February 15 and an audited annual financial report by April 30 each year covering the preceding calendar year. The preliminary financial report and the audited annual financial report must also be made public and available for inspection by investors. In the case of Matáv, public information is available at Központi Elszámolóház és Értéktár Rt. ("KELER") as well as on the Company's official webpage (www.matav.hu). All announcements are also simultaneously sent to the New York Stock Exchange and the U.S. Securities and Exchange Commission as well. A public company is also subject to certain extraordinary reporting requirements with respect to certain changes made to its share capital and any significant matters affecting the value of the securities.

To increase investor protection, the Securities Act established the Investor Protection Fund, which is funded by certain investment service enterprises. The Investor Protection Fund provides limited compensation to investors who become entitled to such compensation pursuant to the terms of the Securities Act.

The Budapest Stock Exchange ("BSE"), an independent and self-regulated non-profit organization, reopened on June 21, 1990 after having been closed for 42 years. As of December 29, 2000, the BSE had 42 members acting either as brokers or dealers. The BSE has grown from an aggregate market capitalization of equity securities of HUF 3,250 billion on December 31, 1997, to HUF 3,394 billion on December 29, 2000. The average daily turnover of securities on the spot market of the BSE was HUF 17.0 billion in 2000.

Since April 1, 2001, there are two categories of equity securities on the Budapest Stock Exchange: “A” and “B”, both categories being subject to different listing and reporting requirements. A company, such as Matáv, whose shares are to be admitted to the “A” category must meet the following requirements:

- the aggregate market value of the shares to be listed may not be less than HUF 2.5 billion;
- the public must hold at least 25 percent of the shares;
- at least 100 individuals or entities must hold the shares; and
- the company must have published audited financial statements for three full fiscal years.

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 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 KELER 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 it becomes aware of, 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 base of index was set at 1,000 points on January 2, 1991. It consists of a changing portfolio of a maximum of 25 stocks, which are chosen according to criteria including liquidity and market segment representation. Since February 1998, the Exchange has examined three new criteria (number of suspensions, cross trades and days traded) in addition to the five existing ones (the face value and market value of the listed quantity of each series, turnover in terms of number of trades and market value and velocity) to check whether an equity series is suitable for inclusion. Only equity series that have been traded on the BSE for at least three weeks are eligible for inclusion in the basket. The composition of the BUX has changed a number of times to reflect the development of the BSE. Composition is revised on March 24 and September 23 of each year. Weightings within the BUX reflect the market capitalization of its constituent companies. Formerly, the maximum weight a single company’s shares could carry in the basked was 15 percent.

Since October 1999 an algorithm assigned to reduce the ratio of shares with extreme weights has been used to calculate the proportions of basket equities and compare them to each other, using the percentage relationship of the capitalization of each equity after adjustment with the public ownership ratio. As a result, Matáv received the highest weighting of 25.46 percent. At the end of 2000, Matáv’s weighting was 20.57 percent, although since April 2, 2001, it changed to 21.6 percent, as a result of a revision of the BUX’s composition.

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

	BUX(1)		
	Closing Value	**High**	**Low**
1997			
First Quarter	5,414	5,815	4,291
Second Quarter	6,795	6,795	5,301
Third Quarter	7,693	8,484	6,754
Fourth Quarter	7,999	8,107	5,561
1998			
First Quarter	8,656	8,691	8,597
Second Quarter	7,806	7,866	7,802
Third Quarter	4,571	4,674	4,556
Fourth Quarter	6,308	6,343	6,294
1999			
First Quarter	5,490	6,946	5,130
Second Quarter	6,486	6,646	5,479
Third Quarter	6,747	7,626	6,548
Fourth Quarter	8,819	8,921	6,182
2000			
First Quarter	10,001	10,472	8,464
Second Quarter	8,318	9,991	8,216
Third Quarter	8,270	8,654	7,923
Fourth Quarter	7,850	8,368	6,685

Source: Bloomberg

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

ITEM 10 – ADDITIONAL INFORMATION

Share Capital

The issued share capital of the Company is HUF 103,735,887,000, consisting of 1,037,358,870 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.

Ordinary shares outstanding as of December 31, 1998 and 1999 amounted to 1,037,281,600 shares. In June 2000, 630,000 new ordinary shares of the Company were registered, relating to the 7,000,000 convertible management bond program. These new shares increased Matáv Rt.'s number of registered ordinary shares to 1,037,911,600. Of the newly issued shares, 77,270 ordinary shares were issued outside Matáv, therefore the number of shares outstanding increased to 1,037,358,870 shares. This amount includes 74,764 treasury shares held by Matáv as of December 31, 2000.

Option to Purchase Securities from Registrant or Subsidiaries

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 and 2.8 million bonds remained unallocated. During 2000, an additional 876,000 bonds were allocated to management and 283,000 bonds (402,000 in 1999) were forfeited by managers leaving the Company.

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.

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. Total compensation expense of HUF 143 million was going to be recognized over the three-year vesting period starting July 1, 1998. The amount amortized in 1999 took into account the impact of the forfeit of 402,000 bonds by managers. In 2000, 283,000 bonds were forfeited and additional 876,000 bonds were allocated to management. Compensation expense of HUF 117 million was calculated in relation to the new grants. In total, HUF 134 million compensation expense was recognized in 2000 in connection with the bonds. See Note 30 to the consolidated financial statements.

Memorandum and Articles of Association

Matáv is a company limited by shares. As an association, it is organized by the Act XCLIV of 1997 on Business Associations and registered in the Court of Registration in Budapest, under the entry number 01-10-041928. The purpose of the Company is identified in paragraph 1.6 in its Articles of Association as follows: The Company is authorized to provide public telephony services within the entire territory of the Republic of Hungary, along with certain closely related auxiliary services, in accordance with the Concession Contract, dated December 22, 1993, between the Minister and the Company.

Corporate Governance

Hungarian stock corporations are governed by three separate bodies: the annual general meeting of shareholders, the supervisory board and the board of directors. Their roles are defined by Hungarian law and by the Company's memorandum and articles of association and may be described generally as follows:

General Meeting of the Shareholders

The supreme decision making body of the Company is the general meeting of shareholders. If required, extraordinary general meetings may be held at any time. A general meeting is convened as frequently as set forth in the deed of foundation, but at least once a year.

The Board of Directors must call an annual general meeting to approve the audited financial statements for the prior year. Shareholders holding at least one-tenth of the outstanding shares may require the Board of Directors to hold an extraordinary general meeting. The Board of Directors and the Supervisory Board also have the right to call an extraordinary general meeting. The Court of Registration may call a general meeting if, following the request of shareholders holding at least one-tenth of the outstanding shares, the Board of Directors fails to take any action within 30 days, or if the Board of Directors fails to call a general meeting within the periods prescribed by law or the Articles of Association.

The Board of Directors must call a general meeting within eight days in order to take necessary measures when:

- due to losses, the equity of the company has decreased to two thirds of the share capital;
- the equity of the Company has decreased below HUF 20 million;
- the Company has stopped payments and its assets do not cover its debts;
- the number of the members of the Board of Directors falls below six;

- the number of the members of the Supervisory Board falls below six; or
- upon the request of the holder of the Series "B" share.

Typically, the Board of Directors calls general meetings. To call a general meeting, the Board of Directors must publish notice of the meeting and an agenda at least 30 days before the scheduled date of the meeting in Magyar Hírlap and in the official gazette of the Budapest Stock Exchange. The Company must notify each director, the Supervisory Board and the auditor that a general meeting has been called within eight days following publication of notice.

A general meeting has a quorum if shareholders representing more than half of the voting shares are present in person or by proxy. If an agenda item requires the affirmative vote of the holder of the Series “B” Share, for a quorum the holder of the Series “B” Share must also be present at the meeting in person or by proxy. If the general meeting does not have a quorum, it will be reconvened within 15 days. A reconvened general meeting will have a quorum for those matters on the original agenda, regardless of the number of shareholders present, except for matters requiring the holder of the Series “B” Share to be present.

The general meeting of the shareholders has the sole right to:

1. to approve and amend the Articles of Association;
2. increase or decrease the Company’s registered capital;
3. amend the rights attached to a series of shares or change their class;
4. merge, consolidate, separate, terminate, dissolve, liquidate or transform the Company into another form of association;
5. convert shares from bearer form to registered form or vice-versa;
6. issue convertible bonds or shares conferring subscription rights over a new issue of shares;
7. elect members of the Supervisory Board, the Board of Directors and the Company’s auditor;
8. remove and fix the remuneration of the members of the Supervisory Board, the Board of Directors and the Company’s auditor;
9. approve the financial statements and the amount of dividends to be distributed if the Company is distributing dividends;
10. approve changes in the Company’s registered scope of activities;
11. designate the persons entitled to subscribe for new shares in a closed subscription;
12. alter the number or nominal value of the Series “B” Share and the rights attached to the Series “B” Share;
13. approve the listing of the Company’s shares on a stock exchange;
14. approve the delisting of the Company’s shares from a stock exchange subject to any group of shareholders agreeing to make a public tender to purchase the shares of those shareholders who do not vote in favor of the delisting;
15. approve the dematerialization of securities the Company has previously issued in printed form;

16. approve an issue that is within its competence pursuant to law or the Company's Articles of Association;

17. transfer or encumber a valuable right held by the Company that enables it to operate its national and local concessions;

18. transfer all or a substantial part of the Company's assets;

19. generally approve the acquisition of shares which would result in a person or persons acting in concert holding ten percent or more of the outstanding voting shares of the Company;

20. approve the payment of a dividend advance determined on the basis of interim accounting;

21. change the corporate form from a public to a private company; and

22. approve the repurchase of shares and accept a public tender offer in respect of treasury shares.

The Supervisory Board

The Supervisory Board supervises the management of the Company. It may request information from the executive officers or the managerial employees of the Company and may inspect the books and documents of the Company. Supervisory Board members shall bear unlimited, joint and several liability for damages caused to the Company through the violation of their supervisory obligations.

The Supervisory Board consists of nine members at Matáv. Its members shall be elected by the General Meeting for a period of one year. The Supervisory Board acts as a body. It may assign certain supervisory tasks to any of its members, or may divide supervisory tasks between its members on a permanent basis. The members must act in person, not through a representative. A member of the Supervisory Board may not be instructed in his capacity as such by the members or the employer of the Company. The Supervisory Board carries out its activities in accordance with the rules of procedure established by the Supervisory Board, which are approved by the company's general meeting.

The Boards of Directors

The Board of Directors is the executive body of the Company and represents the Company before third parties, courts of law and other authorities. The board of directors exercises its rights and performs its duties as an independent body.

The Board of Directors is comprised of a minimum of six, and a maximum of eleven members. The members of the Board of Directors are elected for a term of one year commencing at an annual general meeting and expiring at the next year's annual general meeting. Members of the Board of Directors may be removed or re-elected by the general meeting at any time. The Board of Directors carries out its activity in accordance with the rules of procedure established by the Board of Directors and subject to the provisions of applicable law and the Company's articles.

The members of the Board of Directors must act with the degree of care that can generally be expected from persons in such a position and shall be held liable, in accordance with the provisions of the general rules of civil law, for damages to the Company caused by their failure to carry out their tasks in the appropriate manner. The members of the Board of Directors shall bear unlimited, joint and several liability for all and any damage resulting from the untruthfulness of any data, right or fact entered into the share register; or any damage resulting from a late or non-existing entry.

Capital Increases, Preemptive Rights

The general meeting of shareholders must approve any increase in the registered share capital of the Company. The general meeting may increase capital by a new issue of shares, through a public offering or a private placement of shares to investors approved by the general meeting, by converting the Company's reserves in excess of the registered share capital into authorized share capital or by converting convertible bonds into shares. If the Company proposes to issue new shares, the shareholders of the Company by a three-quarters' majority may pass a resolution at a general meeting granting existing shareholders preemptive rights in proportion to their shareholdings.

Unless the general meeting otherwise determines by a three-quarters' majority vote, if the Company converts all or a portion of its reserves in excess of its registered capital into registered capital, it must offer the newly issued shares free of charge to existing shareholders in proportion to their shareholding. If the general meeting decides otherwise by a three-quarters' majority vote, the decision will be valid only if it also includes the price or price-setting principles for the issue of shares.

Voting Rights and Voting

Each ordinary share entitles the holder to one vote. Only shareholders or their proxies registered in the shareholders' register two business days prior to a general meeting may cast a vote. The Series "B" Share has special voting rights described below. The matters listed in clauses 1. to 6. and 11. to 14. above, any decision overriding a resolution of the Board of Directors and preemptive shareholder rights in the event of a capital increase all require a minimum three-quarters' majority of votes cast by the shareholders present of represented at the general meeting. All other matters submitted to a general meeting require only a simple majority vote.

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, may be resolved by an amendment to the Company's Concession Contract or by the Minister, as the holder of the Series "B" Share, approving an amendment to Matáv's Articles of Association removing these restrictions.

The new Telecommunications Act that is expected to be promulgated this year, according to the most recent draft version, will not contain any regulations regarding the concession, so Matáv's exclusive concession rights with respect to the national concessions will expire.

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.

Material contracts

Option to Purchase 49 Percent Interest in Westel and Westel 0660

On October 21, 1999, Matáv announced that it had entered into an agreement with Deutsche Telekom AG providing Matáv the option to acquire Deutsche Telekom AG's 49 percent interest in Westel and Westel 0660 for a fixed price of U.S. dollar 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 later than December 31, 2001.

Acquisition of Macedonian Telecommunications Company ("MakTel")

In December 2000, the Company, on behalf of a consortium, reached agreement with the government of Macedonia to purchase 51 percent of MakTel on its privatization. The closing of the transaction took place on January 15, 2001 whereby the Company paid EUR 343.3 million on behalf of the consortium in accordance with the relevant agreement. The 51 percent ownership acquired by Matáv was contributed on January 16, 2001 to a newly established Macedonian acquisition vehicle, Stonebridge.

In accordance with a subscription and shareholders' deed ("Deed") between Matáv, SEEF Holdings Ltd. ("SEEF") and CosmoTelco Added Value Services S.A. ("CosmoTelco"), the latter two acquired a 6.1 percent and a 7.4 percent ownership respectively in Stonebridge reducing Matáv's investment in Stonebridge to EUR 301.5 million. Matáv, consequently, has an 86.5 percent stake in Stonebridge, which owns 51 percent of MakTel, thereby Matáv has an effective ownership percent in MakTel of approximately 44 percent.

The Deed provides for a put option which entitles SEEF to sell its shares to Matáv on May 15 of each of 2003, 2004 or 2005 or upon the occurrence of certain events at a price formula also set out in the Deed. CosmoTelco and Matáv on the other hand, have entered into a call option agreement whereby CosmoTelco has the right to acquire additional shares in Stonebridge from Matáv such that CosmoTelco's holding can be increased to 29 percent of the issued share capital of Stonebridge. The price for each share is based on Matáv's acquisition cost plus holding costs. CosmoTelco's call option expires on February 8, 2002.

Exchange Control

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 generally, under Hungarian law, 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.

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, treaties, 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 of 20 percent on capital gains realized with respect to ADSs or shares held for more than one year.

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.

Documents on Display

Matáv is subject to the informational requirements of the U.S. Securities Exchange Act of 1934, as amended. In addition, we are required to file annual reports and other information we make public in Hungary or with the Budapest Stock Exchange with the U.S. Securities and Exchange Commission under the Exchange Act. We file our annual reports on or before June 30 each year. We file other information at the time we make it public in Hungary or file it with the Budapest Stock Exchange.

You may read and copy the registration statement, including the attached exhibits, the reports, statements or other information that we file at the Commission's public reference room in Washington D.C., which is located at Room 1024, 450 Fifth Street, N.W., Washington, D.C., 20549. These documents are also available at the Commission's regional offices located at Seven World Trade Center, Suite 1300, New York, New York 10048 and Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois, 60661. You can request copies of these documents, upon payment of a duplicating fee, by writing the Commission at 450 Fifth Street, N.W., Washington D.C., 20549. Please call the Commission at 1-800-SEC-0330 for further information on the operation of the public reference rooms. In addition, you may also obtain the reports and other information we file at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York, 10005.

ITEM 11 — 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 is exposed to financial market risk through 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, 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 denominated debt and foreign exchange payments (i.e. payments to international third party telecommunications carriers and certain capital expenditures). To reduce foreign exchange risk, Matáv's debt portfolio guidelines limit the individual classes of currencies in the debt portfolio. Matáv aims to increase 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 Forint and to determine official exchange rates. From January 1, 2000 the content of the official basket is 100 percent Euro. 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 related foreign exchange cross currency risk.

In 1999 and 2000 Matáv occasionally entered into derivative contracts for hedging purposes. These foreign currency forward contracts and swap arrangements were entered into 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 order to partially hedge the foreign currency exposure on certain DEM denominated debts, Matáv has entered into short term foreign currency forwards to purchase DEM for HUF. As these forwards expire, new short-term forwards are entered into in order to maintain a hedge of approximately 30 percent of the principal balance of the debt. In the case of foreign currency forward contracts, any increase or decrease in the amount required to settle the liability net of premium or discount is offset 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 2000, losses of HUF 551 million were recognized in the statements of income related to foreign currency forward contracts. As of December 31, 2000, Matáv held foreign currency forward contracts covering DEM 85 million. 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. dollar 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 seeks to mitigate credit risk by investing only in what the Company believes to be high quality securities.

As of December 31, 2000, Matáv's cash balance included HUF denominated cash equivalent instruments with a value of HUF 9,226 million at an average fixed interest rate of 9.65 percent and HUF 4,066 million in variable rate instruments with an average interest rate of 5.96 percent.

Financial investments of HUF 6,030 million were held in fixed rate instruments at an average interest rate of 9.93 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, 2000.

	Maturities							
	2001	2002	2003	2004	2005	after 2005	Total	Fair value
	(in HUF millions, except percentages)							
Bank loans (HUF denominated)								
Fixed rate	0	0	0	12,500	0	0	12,500	13,290
Average interest rate				11.75%				
Variable rate	18,209	18,541	19,125	5,125	6,125	1,250	68,375	68,375
Average interest rate	11.88%	12.13%	12.01%	12.08%	12.11%	11.15%		
Total	18,209	18,541	19,125	17,625	6,125	1,250	80,875	81,655
Bank loans (foreign currency denominated)								
Fixed rate	2,094	2,094	2,094	2,094	2,094	7,077	17,547	20,755
Average interest rate	7.26%	7.26%	7.26%	7.26%	7.26%	6.89%		
Variable rate	57,761	1,068	1,068	1,068	1,068	5,876	67,909	68,000
Average interest rate	5.31%	5.53%	5.53%	5.53%	5.53%	5.53%		
Total	59,855	3,162	3,162	3,162	3,162	12,953	85,456	88,755
Total bank loans	78,064	21,703	22,287	20,787	9,287	14,203	166,331	170,410
Bonds and bills of exchange (HUF denominated)								
Fixed rate	80	4	10,000	0	0	144	10,228	9,941
Average interest rate	0%	10%	9.25%			0%		
Variable rate	0	0	10,000	0	0	0	10,000	10,000
Average interest rate			11%					
Total	80	4	20,000	0	0	144	20,228	19,941

ITEM 12 — DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13 — DEFAULTS, DIVIDEND ARRERAGES AND DELINQUENCIES

None.

ITEM 14 — MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

ITEM 15 — (RESERVED)

ITEM 16 — (RESERVED)

PART III

ITEM 17 — FINANCIAL STATEMENTS

See pages F-1 through F-35 incorporated herein by reference.

ITEM 18 — FINANCIAL STATEMENTS

Not applicable.

ITEM 19 — EXHIBITS

1.1. Articles of Association of Matáv

2.1. Form of Deposit Agreement, dated as of October 8, 1997, among Matáv, Morgan Guaranty Trust Company of New York, as Depository, and holders from time to time of American Depositary Receipts issued thereunder, including the form of American Depositary Receipt - incorporated herein by reference to Exhibit 4.1. of Matáv's Form F-1 dated November 13, 1997.

2.2. Agreement to furnish to the Securities and Exchange Commission copy of the HUF 45 billion Medium Term Note Program upon request.

4.1. Concession Agreement, dated December 19, 1993, between the Minister and MagyarCom - incorporated herein by reference to Exhibit 10.1. of Matáv's Form F-1 dated November 13, 1997.

4.2. Assignment and Assumption, dated December 22, 1993, by and among MagyarCom, Matáv and the Minister - incorporated herein by reference to Exhibit 10.2. of Matáv's Form F-1 dated November 13, 1997.

4.3. Concession Contract, as amended, dated December 22, 1993, between the Minister and Matáv

4.4. Shareholders' Agreement, dated September 26, 1997, by and among Matáv, MagyarCom and the Minister - incorporated herein by reference to Exhibit 10.5. of Matáv's Form F-1 dated November 13, 1997

4.5. Amended and Restated Framework Services Agreement, dated January 1, 2000, by and among Matáv, Deutsche Telekom AG, Ameritech International Inc. and MagyarCom services Kft

4.6.1. Share Purchase Agreement between the Republic of Macedonia and Matáv relating to the sale of 50 percent of the issued share capital of Makedonski Telekomunikacii dated December 22, 2000

4.6.2. Subscription and Shareholders' Deed between Matáv, Cosmotelco Added Value Services S.A., SEEF Holdings Limited and Telemacedonija Ad Skopje, dated December 14, 2000

4.6.3. First Supplemental Deed to the Subscription and Shareholders' Deed between Matáv, Cosmotelco Added Value Services S.A., SEEF Holdings Limited and Telemacedonija Ad Skopje, dated December 14, 2000

4.6.4. Second Supplemental Deed to the Subscription and Shareholders' Deed between Matáv, Cosmotelco Added Value Services S.A., SEEF Holdings Limited and Telemacedonija Ad Skopje, dated December 14, 2000

4.6.5. Shareholders Agreement between The Republic of Macedonia and Matáv in relation to Makedonski Telekomunikacii, dated January 15, 2001

4.7.1. Call Option Agreement between Deutsche Telekom AG and Matáv, dated October 20, 1999

4.7.2. Westel Proxy between Deutsche Telekom AG and Matáv, dated October 20, 1999

4.8. Loan Agreement for the purpose of Financing the Acquisition of MakTel, dated January 11, 2001 between Matáv and Deutsche Telekom AG

8.1. See "Significant Subsidiaries" in "Item 4. Information on the Company" for significant subsidiaries as of December 31, 2000. All subsidiaries were incorporated in Hungary.

10.1. Independent Auditors' Consent of PricewaterhouseCoopers

SIGNATURES

The registrant hereby certifies that it meets all the requirements for filing the Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Date: May 7, 2001	Magyar Távközlési Rt.

By:	________________________
Name:	Elek Straub
Title:	Chairman and Chief Executive Officer
By:	________________________
Name:	Dr. Klaus Hartmann
Title:	Chief Financial Officer

MAGYAR TÁVKÖZLÉSI RT.

INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

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, 1999 and 2000, and the related consolidated statements of income, cash flows and changes in shareholders’s equity for each of the three years in the period ended December 31, 2000. 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, 1999 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2000 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, 1999 and 2000 and net income for each of the years in the three year period ended December 31, 2000 to the extent summarized in Note 30 to the consolidated financial statements.

PricewaterhouseCoopers
Könyvvizsgáló és Gazdasági Tanácsadó Kft.

Budapest
February 19, 2001

MAGYAR TÁVKÖZLÉSI RT.

CONSOLIDATED BALANCE SHEETS

	Notes	At December 31, HUF 1999	HUF 2000	U.S.$ 2000
			(in millions)	(unaudited)
ASSETS				
Current assets				
Cash and cash equivalents	4	6,584	13,296	47
Financial investments	5	3,732	6,045	21
Receivables	6	66,667	71,951	253
Inventories	7	9,539	10,587	37
Total current assets		86,522	101,879	358
Non current assets				
Property, plant and equipment	8	512,700	561,702	1,973
Intangible assets	9	33,007	51,964	183
Associates and other long term investments	10	9,392	14,062	49
Other non-current assets	11	6,249	15,902	56
Total non-current assets		561,348	643,630	2,261
Total assets		647,870	745,509	2,619
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Loans and other borrowings	12	17,804	78,725	277
Trade and other payables	14	87,945	96,068	337
Deferred revenue	15	4,685	3,690	13
Provision for liabilities and charges	17	4,925	11,624	41
Total current liabilities		115,359	190,107	668
Non current liabilities				
Loans and other borrowings	12	164,715	110,641	388
Deferred revenue	15	13,606	9,949	35
Other non current liabilities	16	0	7,067	25
Provision for liabilities and charges	17	3,599	30	0
Total non current liabilities		181,920	127,687	448
Minority interests	18	23,012	40,731	143
Shareholders' equity				
Common stock		103,728	103,736	364
Additional paid in capital		22,834	22,955	81
Treasury stock		0	(127)	0
Retained earnings		201,017	260,420	915
Total shareholders' equity		327,579	386,984	1,360
Total liabilities and shareholders' equity		647,870	745,509	2,619

These consolidated financial statements were accepted for the Board of Directors on February 19, 2001 and signed on their behalf by:

Elek Straub
Chairman and Chief Executive Officer

Dr. Klaus Hartmann
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, HUF 1998	1999	2000	U.S.$ 2000 (unaudited)
		(in millions, except per share amounts)			
Revenues	19	318,060	384,932	445,945	1,566
Employee-related expenses		(48,117)	(56,630)	(66,024)	(232)
Depreciation and amortization		(53,554)	(62,145)	(77,940)	(274)
Payments to other network operators		(35,965)	(44,184)	(55,617)	(195)
Cost of telecommunications equipment sales		(17,175)	(22,392)	(34,111)	(120)
Other operating expenses	20	(67,140)	(78,450)	(99,382)	(349)
Total operating expenses		(221,951)	(263,801)	(333,074)	(1,170)
Operating profit		96,109	121,131	112,871	396
Net interest and other charges	21	(28,795)	(22,133)	(20,992)	(74)
Share of associates' results before income tax		302	1,428	2,174	8
Profit before income tax		67,616	100,426	94,053	330
Income tax (expense) / benefit	22	1,267	(6,911)	(8,208)	(29)
Profit after income tax		68,883	93,515	85,845	301
Minority interest	18	(10,546)	(14,883)	(17,082)	(60)
Net income		58,337	78,632	68,763	242
Basic earnings per share					
Net income per share		56.24	75.81	66.29	0.23
Weighted average common stock outstanding		1,037	1,037	1,037	1,037
Diluted earnings per share					
Net income per share		56.24	75.52	66.02	0.23
Weighted average common stock outstanding		1,037	1,041	1,042	1,042

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,			
	HUF			U.S.$
	1998	1999	2000	2000
		(in millions)		(unaudited)
Cash flows from operating activities				
Operating profit	96,109	121,131	112,871	396
Depreciation and amortization	53,554	62,145	77,940	274
Change in payables	20,841	5,170	7,728	27
Change in inventory	(806)	(1,302)	(1,634)	(6)
Change in receivables	(16,404)	(17,310)	(12,133)	(43)
Amortization of deferred revenue	(5,886)	(5,607)	(4,652)	(16)
Interest paid	(15,225)	(17,533)	(15,123)	(53)
Commissions and bank charges	(1,311)	(1,941)	(2,042)	(7)
Net income tax paid	(288)	(7,838)	(8,150)	(29)
Other cash flows from operations	4,915	1,550	1,644	6
Net cash flows from operating activities	135,499	138,465	156,449	549
Cash flows from investing activities				
Capital expenditures on tangible and intangible assets	(116,283)	(127,678)	(152,784)	(537)
Purchase of investments	(9,604)	(3,551)	(3,568)	(13)
Interest received	2,045	2,897	2,067	7
Dividends received	410	526	1,009	4
Movement in other financial assets	6,638	(2,458)	(2,313)	(8)
Proceeds from disposal of fixed assets	2,437	3,804	9,784	34
Net cash flows from investing activities	(114,357)	(126,460)	(145,805)	(513)
Cash flows from financing activities				
Dividends paid to shareholders and minority interest	(17,768)	(11,518)	(9,411)	(33)
Proceeds from loans and other borrowings	179,060	245,544	261,870	920
Repayment of loans and other borrowings	(188,014)	(243,276)	(256,955)	(902)
Proceeds from issue of common stock	0	0	129	0
Purchase of treasury stock	0	0	(256)	(1)
Proceeds from sale of treasury stock	0	0	104	0
Other	(66)	216	587	2
Net cash flows utilized in financing activities	(26,788)	(9,034)	(3,932)	(14)
Change in cash and cash equivalents	(5,646)	2,971	6,712	24
Cash and cash equivalents, beginning of year	9,259	3,613	6,584	23
Cash and cash equivalents, end of year	3,613	6,584	13,296	47

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

MAGYAR TÁVKÖZLÉSI RT.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Shares of common stock	Common stock	Additional Paid-in capital	Treasury stock	Retained Earnings (5)	Total shareholders' equity
Balance at 1 January 1 998 ..….	1,037,281,600	103,728	22,834		82,114	208,676
Effect of adopting IAS 19 - revised 1997 (net of deferred tax) (2) ……					(2,506)	(2,506)
As restated ....…......……….….....	1,037,281,600	103,728	22,834	0	79,608	206,170
Dividend					(7,262)	(7,262)
Net income ……………………..					58,337	58,337
Balance at January 1, 1999 …….	1,037,281,600	103,728	22,834	0	130,683	257,245
Dividend					(8,298)	(8,298)
Net income					78,632	78,632
Balance at December 31, 1999 (1)	1,037,281,600	103,728	22,834	0	201,017	327,579
Dividend					(9,335)	(9,335)
Stock issuance (3)…………………	77,270	8	121			129
Purchase of treasury stock (4) …….				(256)		(256)
Sale of treasury stock (4) ………				129	(25)	104
Net income					68,763	68,763
Balance at December 31, 2000 ….	1,037,358,870	103,736	22,955	(127)	260,420	386,984

(1) In addition to the 1,037,281,600 common stocks outstanding on December 31,1999, total shareholders' equity includes one Series "B" preference stock at the nominal value of HUF 10,000. This stock is held by the Prime Minister's Office and bestows certain rights on its owner, including access to information, and the appointment of a Director. This stock may only be held by the Government or its nominee. The Company has been authorized to issue 7 million ordinary stocks for the purpose of fulfilling its obligation in connection with any conversion of the management incentive program bonds described in Note 21.

(2) The Company adopted IAS 19 "Employee Benefits" (revised 1997) and 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 22).

(3) In June 2000, 630,000 shares of common stock of the Company were registered which were subscribed by Investel (a consolidated subsidiary of the Group). Of these shares 77,270 were issued outside the Group for HUF 129 million.

(4) During 2000 the Company purchased 129,591 shares of its common stock and sold 54,827 shares of this common stock. These transactions resulted in a loss of HUF 25 million.

(5) The distributable reserves of the Company under Hungarian law at December 31, 1999 and 2000 amounted to approximately HUF 173,000 million and HUF 205,000 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 Matáv Group (“Matáv” or “the Group”). Matáv 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 through its subsidiaries, Westel Mobil Távközlési Rt. (“Westel”) and Westel Rádiótelefon Kft. (“Westel 0660”). In addition, Matáv provides leased lines, data transmission, corporate network, cable television, internet, and security monitoring services and sells and leases telecommunications equipment.

Matáv had 14,380 full time equivalent employees at December 31, 2000, while at the end of 1999 the number of employees was 15,377.

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. Matáv 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 2000 are also presented in millions of U.S. dollars ("USD") translated at a rate of HUF 284.73 to USD 1.00 (the official rate of the National Bank of Hungary at December 31, 2000). These translations are unaudited. The effect of inflation is significant (1998: 14.3%, 1999: 10.0%, 2000: 9.8%) 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.

In preparation for the liberalized market, Matáv carried out a review of its assets and organizational structure in the last quarter of 2000. This resulted in accelerated depreciation and scrapping of certain fixed assets in an amount of HUF 3,442 million as well as provisions for severance of HUF 9,760 million. Matáv also recorded provisions for additional writedowns of receivables, inventory and other charges of HUF 1,552 million. The after tax impact of these charges was HUF 13.1 billion.

In 2000 Matáv adopted the following International Accounting Standards:

IAS 10 (revised)	– Events after the balance sheet date
IAS 16 (revised)	– Property, plant and equipment
IAS 22 (revised)	– Business combinations
IAS 36	– Impairment of assets
IAS 37	– Provisions, contingent liabilities and contingent assets
IAS 38	– Intangible assets

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. Inter-company balances and transactions have been eliminated in the consolidation.

Associated companies (companies for which Matáv 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

Matáv regularly reviews its non-current assets, including property, plant and equipment, intangible assets and associates and other long-term investments for impairment. Impairment losses are recognized as an expense for assets whose carrying value exceeds their recoverable amount.

(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. Matáv 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 intangible assets. 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 are expensed as incurred.

Costs associated with the acquisition of long term licenses are capitalized including any related borrowing costs.

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:

Concession costs and licenses ……………….....…….………………………….....….…	8 - 25 years
Software ……………………………….……..…………………………………….	5 years
Leasehold interests ………………………………………………………….………..	6 years
Goodwill on purchase of subsidiaries and associates.…………….……………………..	5 - 20 years

(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 Matáv 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 are depreciated over the lease term or 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.

Matáv'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 were 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 as well as marketing costs are expensed as incurred.

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

(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 any unrealized 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 amounts 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, deferred revenue, provisions for receivables, inventory, liabilities and charges, government loans and tax losses carried forward.

(o) Earnings per share

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

(p) Pensions and other post-retirement benefits

Matáv 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. Matáv had provided post-retirement meal and other benefits to their retirees. Under IAS 19 the expected costs of these benefits were accrued over the period of employment using a single actuarial method not tied to the funding of the plan. The valuation of these obligations had been carried out using the projected unit cost method. During 2000 Matáv terminated the provision of such benefits to its former employees, which resulted in the reversal of the accumulated provision to employee related expenses.

Payments to defined contribution pension plans are recognized as expense in the period in which they become due. Payments amounted to HUF 1,272 million, HUF 1,616 million and HUF 1,850 million for the years ended December 31, 1998, 1999, and 2000, respectively. Matáv 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 hedges are included in the income statement.

International Accounting Standards No. 39 (IAS 39), "Financial Instruments: Recognition and Measurement" will be effective for Matáv in 2001. IAS 39 requires that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or a liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement (fair value hedges), or allows the change to be recognized in equity until the underlying hedged item is recognized in earnings (cash-flow hedges). In addition, IAS 39 requires the use of fair value accounting for debt securities, equity securities and other securities held for trading or available for sale. Matáv does not expect IAS 39 to have a significant effect on its operations.

(r) Comparative information

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

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

	At December 31, 1999	At December 31, 2000
	(in HUF millions)	
Domestic trade receivables	67,342	74,757
Foreign trade receivables	4,999	5,604
Other receivables	3,975	6,770
Advances paid for current assets	424	704
Associates	305	985
Prepayment on 1800 MHz bandwidth concession	2,750	0
Other prepayments and accrued income	1,849	1,600
	81,644	90,420
Less allowances for doubtful accounts	(14,977)	(18,469)
	66,667	71,951

Concentrations of credit risk relating to trade receivables are limited due to the large number of customers comprising Matáv's customer base and their dispersion across many different industries and geographic areas. The allowance for doubtful accounts and changes therein for 1999 and 2000 are as follows:

	At December 31, 1999	At December 31, 2000
	(in HUF millions)	
Allowance, beginning of period	(12,498)	(14,977)
Charged to expense	(7,298)	(8,176)
Written off	4,819	4,684
Allowance, end of period	(14,977)	(18,469)

7 Inventories

	At December 31, 1999	At December 31, 2000
	(in HUF millions)	
Cables, wires and other inventory	3,534	3,601
Inventory for resale	6,557	8,124
Subtotal	10,091	11,725
Less allowances for obsolete inventory	(552)	(1,138)
	9,539	10,587

8 Property, plant and equipment

	Land	Buildings	Duct, cable and other outside plant	Telephone exchanges	Other fixed assets	Capital work in progress	Total
				(in HUF millions)			
Cost							
January 1, 2000 …….....	3,764	74,743	188,571	335,837	76,193	31,011	710,119
Additions …..…...........	36	13,719	17,112	77,538	22,433	1,547	132,385
Reclassification ………..	295	(5,726)			(963)		(6,394)
Disposals ………….........	(104)	(879)	(5,286)	(15,239)	(6,701)		(28,209)
December 31, 2000 …….	3,991	81,857	200,397	398,136	90,962	32,558	807,901
Depreciation							
January 1, 2000 ….........		9,961	37,530	114,556	35,372		197,419
Charge for the year ...….		2,620	9,299	42,162	15,676		69,757
Reclassification ……….		(1,088)			(53)		(1,141)
Disposals ….................		(428)	(4,713)	(10,011)	(4,684)		(19,836)
December 31, 2000 ..…..		(11,065)	(42,116)	(146,707)	(46,311)		(246,199)
Net book value							
December 31, 2000 ..…..	3,991	70,792	158,281	251,429	44,651	32,558	561,702
Net book value							
December 31, 1999 ..…..	3,764	64,782	151,041	221,281	40,821	31,011	512,700

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

Reclassifications mostly represent real estate held for disposal, which is disclosed in other non current assets. Minor reclassifications were also made between land and buildings as well as between software and other tangible assets.

Included in property, plant and equipment at 31 December 2000 are assets subject to finance leases with a gross book value of HUF 1,107 million and net book value of HUF 691 million.

9 Intangible assets

	Concession costs and licenses	Software	Leasehold interest	Goodwill	Total
		(in HUF millions)			
Cost					
January 1, 2000	6,790	30,246	5,885	6,379	49,300
Additions	13,351	8,399	1,587	3,261	26,598
Reclassification		963			963
Disposals		(228)	(282)	(358)	(868)
December 31, 2000	20,141	39,380	7,190	9,282	75,993
Amortization					
January 1, 2000	2,389	10,666	2,699	539	16,293
Charge for the year	480	6,320	841	542	8,183
Reclassification		53			53
Disposals		(213)	(276)	(11)	(500)
December 31, 2000	(2,869)	(16,826)	(3,264)	(1,070)	(24,029)
Net book value					
December 31, 2000	17,272	22,554	3,926	8,212	51,964
Net book value					
December 31, 1999	4,401	19,580	3,186	5,840	33,007

Additions to concession costs and licenses represent the costs of the concession rights acquired by Westel to provide mobile telecommunication services in the 1800 MHz frequency band.

The adoption of IAS 38 did not require any adjustments to the carrying value of the intangible assets.

10 Associates and other long term investments

	For the year ended December 31, 1999	2000
	(in HUF millions)	
Opening balance of associates	5,019	6,534
Additions to associates	710	1,132
Share of associates' profit before tax	1,428	2,174
Share of associates' corporate tax	(97)	(229)
Dividend payments	(526)	(1,009)
Reclassification	0	(164)
Closing balance of associates	6,534	8,438
Other long term investments	2,858	5,624
	9,392	14,062

Other long term investments include loans given to associated undertakings and third parties.

The associated companies, whose results are included in the table above, are all included in the fixed line segment (note 29).

11 Other non current assets

	At December 31, 1999	At December 31, 2000
	(in HUF millions)	
Net deferred tax asset (note 22)	3,379	4,025
Assets held for disposal	589	4,932
Other non current assets	2,281	6,945
	6,249	15,902

12 Loans and other borrowings

	Notes	At December 31, 1999	At December 31, 2000
		(in HUF millions)	
Bank loans	(a)	168,790	166,331
Bonds	(b)	10,091	20,228
Finance leases		1,525	1,214
Other		2,113	1,593
		182,519	189,366

At December 31, 2000, principal repayments fall due in:

	2001	2002	2003	2004	2005	after 2005	Total
Total	78,725	22,347	43,015	21,205	9,547	14,527	189,366

The effective borrowings costs (total interest payable and other charges) for Matáv's loans and borrowings were 18.6%, 14.4% and 12.7% for the years ended 1998, 1999, and 2000, respectively. The weighted average interest rate on short-term borrowings (denominated in Hungarian Forints and foreign currencies) was 12.7% in 1999 and 6.88% in 2000. The significant decrease in the interest rate is due to the higher portion of the foreign exchange debts in the short-term balance.

(a) Bank loans

Bank loans analyzed by currency are as follows:

	At December 31,	
	1999	2000
	(in HUF millions)	
Hungarian Forint	80,259	80,875
EURO	59,713	74,238
U.S. Dollar	24,383	12,720
Net hedging position	(377)	(1,502)
Other	4,812	0
	168,790	166,331

Bank loans of HUF 136,239 million at December 31, 2000 were subject to variable interest rates. Variable rate loans raised in Hungarian Forint are subject to interest rates between 11.0% and 13.7% and are based on various rates, including BUBOR (Budapest Inter-bank Offered Rate), yield of treasury bills and the rate quoted by the National Bank of Hungary. Funds raised in foreign currency with variable rates are subject to interest rates between 5.27% and 5.62% generally based on LIBOR plus a margin. The remaining foreign currency bank loans were subject to fixed interest rates between 5.99% and 8.6%. The bank loans have maturities ranging from 2001 to 2011.

Included in bank loans are loans from the World Bank and the European Investment Bank (collectively known as "IFIs" – International Finance Institutions) totaling HUF 49,908 million and HUF 42,095 million at December 31, 1999 and 2000, respectively. The majority of these loans are taken in foreign currency, which are subject to rates of between 5.99 % and 8.6% with maturities ranging from 2005 to 2011.

Included in bank loans is a USD denominated loan amounting to HUF 6,251 million that is subject to interest based on a fixed rate of 7.05%. This loan is subject to a cross currency interest rate swap arrangement which entitles Matáv 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 = 1.0777 USD. The timing and amount of the USD payments to be received exactly match the underlying payment obligations on the USD loan. Matáv accounts for interest and foreign exchange movements on these loans at the Euro rate. As a result, the value of the loan at December 31, 2000, net of the impact of the swap arrangement is HUF 5,380 million and is subject to interest based on variable rates.

Included in bank loans is a USD denominated loan amounting to HUF 6,467 million that is subject to interest based on a fixed rate of 6.56%. This loan is subject to a cross currency swap agreement. This swap agreement entitles Matáv 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 are 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 (ie. a rate of 1.0277 USD/EUR). The timing and amount of the USD payments received exactly match the underlying payment obligations of the USD loans. As a result, the value of the loan at December 31, 2000, net of the impact of the swap transaction is HUF 5,836 million and is subject to interest based on a fixed rate of 5.17%.

Net hedging position represents the net value of the swaps described above.

Loans totaling HUF 20,857 million and HUF 24,554 million at December 31, 1999 and 2000 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 that - among other things - require maintenance of certain financial ratios. Breach of those covenants would make HUF 80,191 million due and payable in 30 days if not remedied. At December 31, 2000, Matáv was in compliance with these financial ratio requirements, the most restrictive was a debt to equity ratio of 1.2.

(b) Bonds

On March 24, 1998, the Company completed two domestic bond offerings. A one-year bond offering in the total amount of HUF 5 billion was fully subscribed and subsequently repaid on March 26, 1999. The other transaction included five-year bonds with a total amount of HUF 10 billion with interest payable semi-annually at an interest rate of 50 basis points over the average yield of the last three auctions of 6-month Hungarian Treasury Bills.

On June 22, 2000 Matáv launched a HUF 45 billion bond program. This program allows Matáv to issue fixed, floating or zero coupon bonds with maturities of between 1 and 10 years. On July 12, 2000, Matáv issued a three-year, fixed rate tranche in the nominal amount of HUF 10 billion. The bonds were sold at an average price 51 basis points over the 3-year Hungarian Treasury Bills.

At December 31, 2000, Matáv had undrawn committed credit facilities of HUF 58,401 million. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin depending on the currency and institution providing the facilities. There are pledges on receivables for loans totaling HUF 7,049 million.

13 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. Matáv is also a party to financial instruments that reduce exposure to fluctuations in foreign currency exchange.

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 is exposed to financial market risk through 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, 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 (ie. 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 aims to increase 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 Forint and to determine official exchange rates. From

January 1, 2000 the content of the official basket is 100% Euro. 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 1999 and 2000 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.

Derivative instruments are limited to foreign currency forward contracts and swap agreements that are not recognized in the financial statements on inception. In order to partially hedge the foreign currency exposure on certain DEM denominated debts, Matáv has entered into short term foreign currency forwards to purchase DEM for HUF. As these forwards expire, new short-term forwards are entered into in order to maintain a hedge of approximately 30% of the principal balance of the debt. In the case of foreign currency forward contracts, any increase or decrease in the amount required to settle the liability net of premium or discount 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 2000, losses of HUF 551 million were recognized in the statements of income related to foreign currency forward contracts. As of December 31, 2000, Matáv held foreign currency forward contracts covering DEM 85 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, 2000, Matáv's cash balance included HUF denominated cash equivalent instruments with a value of HUF 9,226 million at an average fixed interest rate of 9.65% and HUF 4,066 million in variable rate instruments with an average interest rate of 5.96%.

Financial investments of HUF 6,030 million were held in fixed rate instruments at an average interest rate of 9.93%.

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, 2000.

	Maturities							
	2001	2002	2003	2004	2005	after 2005	Total	Fair value
	(in HUF millions, except percentages)							
Bank loans (HUF denominated)								
Fixed rate	0	0	0	12,500	0	0	12,500	13,290
Average interest rate				11.75%				
Variable rate	18,209	18,541	19,125	5,125	6,125	1,250	68,375	68,375
Average interest rate	11.88%	12.13%	12.01%	12.08%	12.11%	11.15%		
Total	18,209	18,541	19,125	17,625	6,125	1,250	80,875	81,655
Bank loans (foreign currency denominated)								
Fixed rate	2,094	2,094	2,094	2,094	2,094	7,077	17,547	20,755
Average interest rate	7.26%	7.26%	7.26%	7.26%	7.26%	6.89%		
Variable rate	57,761	1,068	1,068	1,068	1,068	5,876	67,909	68,000
Average interest rate	5.31%	5.53%	5.53%	5.53%	5.53%	5.53%		
Total	59,855	3,162	3,162	3,162	3,162	12,953	85,456	88,755
Total bank loans	78,064	21,703	22,287	20,787	9,287	14,203	166,331	170,410
Bonds and bills of exchange (HUF denominated)								
Fixed rate	80	4	10,000	0	0	144	10,228	9,941
Average interest rate	0%	10%	9.25%			0%		
Variable rate	0	0	10,000	0	0	0	10,000	10,000
Average interest rate			11%					
Total	80	4	20,000	0	0	144	20,228	19,941

14 Trade and other payables

	At December 31, 1999	At December 31, 2000
	(in HUF millions)	
Domestic trade payables	48,576	49,427
Foreign trade payables	9,284	9,569
Amounts owed to related parties	833	760
Taxation and social security	6,659	7,223
Accrued expenses and prepayments	9,220	13,960
Amounts received in advance	1,450	1,666
Salaries and wages	4,288	6,102
Payables to associates	66	196
Dividends payable to minority interest holders	2,314	2,192
Other payables	5,255	4,973
	87,945	96,068

15 Deferred revenue

	At December 31, 1999	At December 31, 2000
	(in HUF millions)	
Beginning of period	23,898	18,291
Amortization	(5,607)	(4,652)
End of period	18,291	13,639
Amount to be recognized within one year	4,685	3,690

16 Other non current liabilities

The majority of other non current liabilities is the 1800 license fee payable by Westel in 2002 and 2003.

17 Provision for liabilities and charges

	Severance	Investment contribution fees	Post retirement benefits	Other	Total
		(in HUF millions)			
January 1, 2000	3,076	643	3,549	1,256	8,524
Additions	9,760			688	10,448
Utilized / Retired	(3,076)	(643)	(3,549)	(50)	(7,318)
December 31, 2000	9,760	0	0	1,894	11,654

The provision for severance relates to the employee termination benefit payable in 2001 in accordance with the agreement made with employee representatives.

The provision for investment contribution fees recognized the amount that Matáv estimated would be refunded prior to June 2000, the point in time when legal refundability ceased. The opening provision was sufficient for the repayments made in 2000.

The provision for post-retirement benefits was reversed in 2000 as Matáv terminated the provision of such benefits. For details of historic information refer to note 22.

The majority of the other provisions relates to the customer loyalty programs launched by Westel.

18 Minority interests

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

	For the year ended December 31,		
	1998	1999	2000
	(in HUF millions)		
Beginning of period	17,185	12,135	23,012
Movement in capital contributed by minority interest	(4,409)	216	780
Share of results for the year	10,546	14,883	17,082
Dividends paid / payable to minority shareholders	(11,187)	(4,222)	(143)
End of period	12,135	23,012	40,731

19 Revenues

	For the year ended December 31,		
	1998	1999	2000
	(in HUF millions)		
Domestic fixed line telecommunications services:			
Subscriptions, connections and other charges	55,728	63,191	82,918
Domestic traffic revenue	108,425	134,071	129,517
Other usage	19,964	18,743	19,136
International traffic revenues	38,792	43,807	41,432
Mobile telecommunications services	61,677	82,746	108,885
Leased lines and data transmission	14,931	20,241	26,819
Other services	18,543	22,133	37,238
	318,060	384,932	445,945

Telephone tariffs are regulated by the Prime Minister’s Office through a price cap regime. There can be no certainty with regard to future regulatory developments.

20 Other operating expenses

	For the year ended December 31,		
	1998	1999	2000
	(in HUF millions)		
Materials, maintenance and service fees	23,306	30,414	38,946
Subcontractors	2,462	3,217	12,277
Fees and levies	8,775	10,025	11,901
Marketing	6,949	8,507	10,348
Other expenses	25,648	26,287	25,910
	67,140	78,450	99,382

21 Net interest and other charges

	For the year ended December 31,		
	1998	1999	2000
	(in HUF millions)		
Interest expense:			
Hungarian Forint loans	11,720	11,112	11,333
Foreign currency loans	6,134	6,182	5,318
Finance leases	192	47	157
Net foreign exchange losses	12,378	6,289	4,835
Commissions and other bank charges	1,311	1,941	2,042
Total interest expense and other charges	31,735	25,571	23,685
Interest capitalized	(895)	(541)	(626)
Interest and other financial income	(2,045)	(2,897)	(2,067)
	28,795	22,133	20,992

22 Income tax

	For the year ended December 31,		
	1998	1999	2000
	(in HUF millions)		
Income tax charge on the profit for the year	(324)	(7,646)	(8,625)
Deferred income taxes	1,631	832	646
Income tax on the Group's share of the results of associates	(40)	(97)	(229)
Income tax (expense) / benefit	1,267	(6,911)	(8,208)

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 qualified for the 100% allowance. Through 1995, Westel 0660 utilized the 100% allowance. From January 1, 1999, Matáv Rt. and Westel are utilizing the reduced allowance of 60% for a maximum possible five years (effective tax rate of 7.2%). Westel 0660 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 by Matáv Rt. With regard to

Westel, when the foreign ownership falls below 30% (which will be the case if and when the Company exercises its option to buy the remaining 49% ownership), Westel will lose its 60% reduction in income tax. 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 3,417 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 91 million expire in 2003, HUF 46 million expire in 2005.

Matáv's deferred tax balances are as follows.

	At December 31,	
	1999	2000
	(in HUF millions)	
Deferred tax assets		
Net operating loss carry-forward	391	347
Deferred income	1,060	1,060
Loans and other borrowings	294	287
Post retirement benefits	568	0
Provisions for receivables and inventory	1,059	1,311
Provisions for liabilities and charges	385	959
Property, plant and equipment	(378)	61
Net deferred tax asset	3,379	4,025

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

	For the year ended December 31,		
	1998	1999	2000
	(in HUF millions)		
IAS profit before income tax	67,616	100,426	94,053
Tax at 18%	(12,171)	(18,077)	(16,930)
Effect of reduced tax rates	12,211	9,932	9,194
Tax on items not subject to tax	3,840	2,534	981
Tax on non deductible expenses	(1,005)	(1,582)	(983)
Temporary differences reversing at different rates	(1,568)	379	(241)
Income tax benefit / (expense) (before associates)	1,307	(6,814)	(7,979)
Share of associates tax expense	(40)	(97)	(229)
Income tax (expense) / benefit	1,267	(6,911)	(8,208)

Items not subject to income tax consist primarily of amortization of investment contribution fees and connection fees as well as the share of associates' profit before income tax as the results of the associates are not included in the reconciliation.

23 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 stock 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. During 2000 additional 876 thousand bonds were allocated to management and 283 thousand bonds were forfeited (402 thousand in 1999).

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, June 2002.

The conversion price of the bonds is the Hungarian Forint equivalent of USD 5.75 per bond, calculated based on the 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.

24 Post-retirement benefits

Under IAS 19 "Employee Benefits (revised 1997), Matáv records expense for post-retirement benefits in the period in which they are earned. During 2000, Matáv terminated the provision of post-retirement benefit and reversed the accumulated provision to Employee related expenses. The tables below show historical details of the benefit plan.

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

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

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

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

	For the year ended December 31, 1998	1999
Discount rate	13%	10%
Weighted average projected growth rate of per-capita benefit costs	10%	10%

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

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

25 Commitments

(a) Lease commitments

Operating lease commitments were mainly in respect of the lease of buildings, network and other telecommunications facilities. Included in these leases are PBX assets sold and leased back under operating lease agreements. Capital leases primarily relate to the sale and lease back of PBX and other telecommunications equipment. Future minimum lease payments under capital and operating leases at December 31, 2000 are as follows:

	Capital Leases (in HUF millions)	Operating Leases
Year		
2001	400	2,351
2002	436	1,737
2003	489	1,621
2004	142	1,252
2005	0	661
Thereafter	0	521
Total minimum lease payments	1,467	8,143
Less: amounts representing interest and executory costs	(253)	
Present value of net minimum lease payments	1,214	
Less: capital lease obligations included in short-term debt	282	
Long-term capital lease obligations	932	

(b) Purchase commitments

As of December 31, 1999 and 2000, capital and other expenditures amounting to HUF 18.6 billion and HUF 18.2 billion, respectively, principally relating to the telecommunications network, had been committed to under contractual arrangements, with the majority of payments due within one year.

(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, 2000 Matáv Rt. has outstanding commitments of approximately DEM 4 million to provide further funds to M-RTL.

(d) Acquisition of Emitel

Matáv Rt. has been a 50% owner of Emitel since its establishment and treated Emitel as an associated company in its consolidated financial statements. On December 31, 2000, Matáv Rt. agreed with Aphrodite BV, the owner of the other 50% stake that it will purchase the remaining 50% stake. The change of ownership is conditional on the approval of the Minister responsible for telecommunications in Hungary as well as on the approval of the Hungarian Competition Office, which could be several months. The price will be determined when the transaction is finalized and will be partially dependent on the operations of Emitel, but it shall not be less than USD 46.5 million.

(e) Acquisition of Macedonian Telecom (MakTel)

In December 2000, the Company, on behalf of a consortium, reached agreement with the government of Macedonia to purchase 51 percent of MakTel on its privatization. The closing of the transaction took place on January 15, 2001 whereby the Company paid EUR 343.3 million on behalf of the consortium in accordance with the relevant agreement. The 51 percent ownership acquired by Matáv was contributed on January 16, 2001 to a newly established Macedonian acquisition vehicle, Stonebridge Communications AD ("Stonebridge").

In accordance with a subscription and shareholders' deed ("Deed") between Matáv, SEEF Holdings Ltd. ("SEEF") and CosmoTelco Added Value Services S.A. ("CosmoTelco"), the latter two acquired a 6.1 percent and a 7.4 percent ownership respectively in Stonebridge reducing Matáv's investment in Stonebridge to EUR 301.5 million. Matáv, consequently, has an 86.5 percent stake in Stonebridge, which owns 51 percent of MakTel, thereby Matáv has an effective ownership percent in MakTel of approximately 44 percent.

The Deed provides for a put option which entitles SEEF to sell its shares to Matáv on May 15 of each of 2003, 2004 or 2005 or upon the occurrence of certain events at a price formula also set out in the Deed. CosmoTelco and Matáv on the other hand, have entered into a call option agreement whereby CosmoTelco has the right to acquire additional shares in Stonebridge from Matáv such that CosmoTelco's holding can be increased to 29 percent of the issued share capital of Stonebridge. The price for each share is based on Matáv's acquisition cost plus holding costs. CosmoTelco's call option expires on February 8, 2002.

MakTel will be a consolidated subsidiary of the Group from January 15, 2001.

The summary of the latest available unaudited financial information below is related to the year ended December 31, 1999, as well as to the nine months ended September 30, 2000.

	December 31, 1999	September 30, 2000
	(in HUF millions)	
Total revenues	43,894	38,206
Net income	15,964	12,734
Current assets	25,118	26,192
Non current assets	61,464	69,254
Total assets	**86,582**	**95,446**
Current liabilities	9,230	12,194
Non current liabilities	19,561	20,312
Minority interest	11	15
Shareholders' equity	57,780	62,925
Total liabilities and shareholders' equity	**86,582**	**95,446**

26 Lease revenues

Operating lease revenues relate primarily to the leasing of PBX equipment where Matáv is the lessor.

	Operating Leases
Year	(in HUF millions)
2001	4,844
2002 – 2004	9,314
2005 and thereafter	2,145
Total minimum lease payments receivable	16,303

27 Related party transactions

The Company is majority owned by MagyarCom GmbH (59.49%), which is owned by Deutsche Telekom AG after buying out the 50% share of SBC Inc. in MagyarCom in June 2000. 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 owned by Deutsche Telekom provides Matáv with management and consultancy services. The total service fees charged in 1998, 1999 and 2000 amounted to HUF 3,135 million, HUF 2,152 million and HUF 2,478 million, respectively. Matáv had no outstanding payable to MagyarCom GmbH, while the outstanding payable for the services rendered by MagyarCom Services Kft. amounted to HUF 760 million at December 31, 2000 (HUF 756 million at December 31, 1999). Matáv had no amounts receivable from the above companies as of the same dates.

Prior to 2000, Westel and Westel 0660 used consulting and other technical services provided by MediaOne International B.V., which owns 49% of Westel as of December 31, 2000. Costs incurred relating to these services amounted to HUF 93 million in 1998, HUF 161 million in 1999, while in 2000 such expenses were not incurred. Westel 0660 had outstanding dividends payable to Deutsche Telekom of HUF 2,192 million as at December 31, 2000. At December 31, 1999 Westel had HUF 77 million of amounts payable to MediaOne International, while at the end of 2000 there were no amounts payable to MediaOne.

Matáv provides services to Government departments and businesses on arm's length basis, however, individually none of these customers represent a significant source of revenue.

Hunsat is a joint venture founded by the Company (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 Matáv including payment of these membership fees amounted to HUF 324 million in 2000, HUF 301 million in 1999 and HUF 281 million in 1998. Any profits made by Hunsat are repaid to the joint venture partners.

Emitel is a Local Telephone Operator ("LTO") that is 50% owned by the Company. 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 amounted to HUF 1,550 million in 2000 (HUF 1,496 million in 1999 and HUF 732 million in 1998). Expenses paid to Emitel amounted to HUF 1,026 million in 2000 (HUF 698 million in 1999 and HUF 1,801 million in 1998). Matáv has entered into an agreement to purchase the remaining 50% as described in note 25.

The remuneration of the Company's Directors amounted to HUF 13 million in 2000 (HUF 14 million in 1999 and HUF 14 million in 1998). The remuneration of the members of the Company's Supervisory Board amounted to HUF 7 million in 2000 (HUF 10 million in 1999 and HUF 9 million in 1998).

28 Principal investees

At December 31, 2000 the principal operating associates, joint ventures and subsidiaries of the Group, which are all incorporated in Hungary, were as follows:

Associates / Joint ventures	Group interest in capital	Activity
Hunsat Magyar Űrtávközlési Koordinációs Egyesülés …..	50.00%	VSAT satellite communications
EMITEL Távközlési Rt. ....……..……	50.00%	Local telecommunications operator
DSP Rt. …………………………………………………	36.84%	Cable TV holding
Magyar RTL Televízió Rt. ....…....	25.00%	Television broadcast company
Németkábel Vagyonkezelő Rt. …………………………..	25.00%	Cable TV holding

Subsidiaries	Group interest in capital		Activity
CARDNET Rt. ………….............…....................……..	72.00%		Point-of-sale terminal supplier
Egertel Rt. ………….……………..………………..……	100.00%		Local telecommunications operator
Első Pesti Telefontársaság Rt. ……........................…......	96.24%		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
Matávőr Kft. …………..............................…..........	100.00%		Security monitoring company
Matávnet Rt. …...........…………………........………...	100.00%		Hungarian language internet content server
Westel Rádiótelefon Kft.………………………………..	51.00%	(a)	Cellular telephone services
Westel Mobil Távközlési Rt.…………………......…......	51.00%	(a)	GSM digital cellular telephone services

(a) In October 1999, Deutsche Telekom purchased MediaOne's interests in mobile operations in Central and Eastern Europe including MedieOne International B.V. (minority shareholder of Westel) and Westel 0660. The Company was granted a fifteen-month option to purchase the 49% holdings in Westel and Westel 0660 from Deutsche Telekom for USD 885 million, the same price agreed between Deutsche Telekom and MediaOne.

29 Segment information

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 and Westel 0660. Westel 0660 provides analog services in the 450 MHz frequency bandwidth and Westel provides digital services in the 900 and 1,800 MHz frequency bandwidth. Services provided between the Company, Westel and Westel 0660 are made on an arms-length basis. Westel and Westel 0660 each provide distribution for the other's products. Both Westel and Westel 0660 lease space at base stations to each other and from the Company on a contract basis.

The following table presents a summary of operating results of the Group by segment for the years ended December 31, 1998, 1999 and 2000. 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,		
	1998	1999	2000
	(in HUF millions)		
Revenues			
Fixed line	256,929	302,230	326,280
Mobile	88,142	117,336	159,345
Inter-segment elimination	(27,011)	(34,634)	(39,680)
Total	318,060	384,932	445,945
Depreciation and amortization			
Fixed line	44,044	49,873	60,932
Mobile	9,510	12,272	17,008
Total	53,554	62,145	77,940
Operating profit			
Fixed line	70,520	85,471	70,837
Mobile	25,589	35,660	42,034
Total	96,109	121,131	112,871
Assets			
Fixed line	478,136	543,148	591,084
Mobile	82,038	114,494	168,449
Inter-segment elimination	(10,634)	(9,772)	(14,024)
Total	549,540	647,870	745,509
Capital expenditures			
Fixed line	97,729	94,063	111,134
Mobile	18,554	33,615	41,650
Total	116,283	127,678	152,784
Liabilities			
Fixed line	230,771	236,107	242,181
Mobile	55,612	66,533	85,226
Inter-segment elimination	(6,223)	(5,361)	(9,613)
Total	280,160	297,279	317,794

Basis of Inter-segment pricing. Inter-segment pricing between mobile and fixed line is based upon rates as regulated and set out by the Prime Minister’s Office.

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.

30 Reconciliation to U.S. GAAP

Matáv'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, 1998	1999	2000
		(in HUF millions, except per share amounts)		
Net income under IAS		58,337	78,632	68,763
Adjustments for U.S. GAAP:				
Cumulative effect of adopting SAB 101	(a)	0	0	(22,167)
Deferred revenue	(a)	282	374	14,786
Post-retirement benefits	(b)	(21)	(3)	(621)
Management Incentive Plan Bonds	(c)	(24)	(42)	(134)
Cumulative income tax effect of adopting SAB 101	(a)	0	0	3,042
Deferred income tax on U.S. GAAP adjustments		(10)	(240)	124
Net income under U.S. GAAP		58,564	78,721	63,793
Basic earnings per share under U.S. GAAP		56.46	75.89	61.50
Diluted earnings per share under U.S. GAAP		56.46	75.61	61.25

	Notes	At December 31, 1999	2000
		(in HUF millions)	
Shareholders' equity under IAS		327,579	386,984
Adjustments for U.S. GAAP:			
Cumulative effect of adopting SAB 101	(a)	0	(22,167)
Deferred revenue	(a)	(12,321)	2,465
Post-retirement benefits	(b)	621	0
Cumulative income tax effect of adopting SAB 101	(a)	0	3,042
Deferred income tax on U.S. GAAP adjustments		(631)	(507)
Shareholders' equity under U.S. GAAP		315,248	369,817

(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.

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 up-front fees to be deferred and recognized over the expected period of customer relationship.

Under U.S. GAAP Matáv applied the guidance of SAB 101 as follows:

For fixed line customers a relationship period of 10 years was assessed and up-front fees are deferred over that term. Incremental direct costs are also deferred to the extent of the revenues.

For mobile subscribers activation fees are deferred over a 2 to 4 year customer relationship period together with incremental direct costs up to the amount of revenue deferred. Losses arising from the sale of handsets are recognized upon sale.

(b) 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 621 million in 1999 was 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 1999 of HUF 621 million reflected "Unrecognized net loss from past experience" per U.S. GAAP. During 2000 Matáv terminated the provision of post-retirement benefits, therefore, the difference in equity was also eliminated. The difference in net income reflects the release of the difference between the provisions in IAS and US GAAP, accumulated in prior years.

(c) 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 was going to be recognized over the three-year vesting period starting July 1, 1998. The amount amortized from July 1, 1998 to December 31, 1998 was HUF 24 million. The amount amortized in 1999 was HUF 42 million taking into account the impact of the forfeit of 402 thousand bonds by managers.

In 2000, 283 thousand bonds were forfeited and additional 876 thousand bonds were allocated to management. Compensation expense of HUF 117 million was calculated in relation to the new grants. As two thirds of the newly allocated bonds became convertible on July 1, 2000, the corresponding proportion of the compensation expense was recognized immediately. The remaining one third is amortized until July 1, 2001. In total, HUF 134 million compensation expense was recognized in 2000.

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:

	1998	1999	2000
Net income as reported (HUF million)	58,564	78,721	63,793
Net income pro forma (HUF million)	58,158	78,002	62,788
Basic earning per share as reported (HUF)	56.46	75.89	61.50
Basic earning per share pro forma (HUF)	56.07	75.20	60.53
Diluted earning per share as reported (HUF)	56.46	75.61	61.25
Diluted earning per share pro forma (HUF)	56.07	74.94	60.28

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

Risk free rate	10.2% for 2 year maturity
Expected dividend yield	0.51%
Expected option life (in years)	2
Expected stock volatility	50%
Grant date value	HUF 675

Consolidation of Westel 0660 and Westel 900

The consolidated financial statements, prepared in accordance with IAS, include the accounts of Westel 0660 and Westel 900 as consolidated subsidiaries. Under IAS, a parent company must consolidate all enterprises 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. As the Company's ownerhip in Westel 0660 and Westel 900 was 51% in 1999 and the ownership rights of the other shareholder were considered participatory in nature, that precluded consolidation under U.S. GAAP. Consequently, under U.S. GAAP, these investments were accounted for using the equity method in years prior to 2000.

In October 1999 MediaOne International Holdings Inc. sold MediaOne International BV (owner of Westel 900) to Deutsche Telekom, the principal shareholder of Matáv. When the MediaOne and Deutsche Telekom transaction was closed early 2000, the Company took operational, management and voting control of Deutsche Telekom's share. This required Matáv to account for Westel 900 as a consolidated subsidiary in 2000 for U.S GAAP purposes as well.

In October 1999 MediaOne International Holdings Inc. sold Westel 0660 to Deutsche Telekom, the principal shareholder of Matáv. When the MediaOne and Deutsche Telekom transaction was closed early 2000, the Company took operational, management and voting control of Deutsche Telekom's share. This required Matáv to account for Westel 0660 as a consolidated subsidiary in 2000 for U.S GAAP purposes as well.

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

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. 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 does not expect SFAS No. 133 to have a significant effect on its financial statements.