As filed with the Securities and Exchange Commission on May 9, 2002

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, 2001

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, 2001)

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 ☒ NO ☐

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

Item 17 ☒ Item 18 ☐

*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.; the term ”Westel 0660” refers to Westel Rádiótelefon Kft. and the term MakTel refers to Makedonski Telekommunikacii AD. The Company owns 100 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. Readers should also consider the information contained in Item 3, ”Key Information -Risk Factors” and Item 5, ”Operating and Financial Review and Prospects”, as well as the information contained in the Company's periodic filings with the Securities and Exchange Commission for further discussion of the risks and uncertainties that may cause such differences to occur. The Company's forward-looking statements speak only as of the date they are made, and the Company does not have an obligation to update or revise them, whether as a result of new information, future events or otherwise.

PART I

ITEM 1 — IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2 — OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3 — KEY INFORMATION

SELECTED FINANCIAL DATA

This selected consolidated financial and statistical 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, 1997, 1998, 1999, 2000 and 2001 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. Generally Accepted Accounting Principles ("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,					
	1997	1998	1999	2000 (3)	2001 (3)	2001 (3)
	HUF	HUF	HUF	HUF	HUF	U.S.$(1)
	(in millions, except per share amounts)					
Consolidated Income Statement Data:						
Amounts in accordance with IAS						
Revenues ....…………………………......	253,948	318,060	384,932	445,945	547,735	1,963
Operating profit ………………...………	74,054	96,109	121,131	96,091	119,400	428
Net income ………....………………….	36,034	58,337	78,632	66,652	82,560	296
Net income per share(2) ……… ……….	34.74	56.24	75.81	64.27	79.61	0.29
Diluted net income per share(2) ……….	34.74	56.24	75.52	63.97	79.61	0.29
Amounts in accordance with U.S. GAAP						
Revenues...	251,197	318,342	385,306	461,537	550,900	1,974
Operating profit ………………...………	68,331	96,346	121,460	90,456	120,144	431
Net income ………....………………….	30,130	58,564	78,721	64,508	82,231	295
Net income per share(2) ……… ……….	29.05	56.46	75.89	62.20	79.30	0.28
Diluted net income per share(2) ……….	29.05	56.46	75.61	61.91	79.30	0.28
Consolidated Balance Sheet Data:						
Amounts in accordance with IAS						
Total assets …………………………….	480,611	549,540	647,870	954,424	1,104,196	3,958
Net assets ………………………………	225,861	269,380	350,591	638,509	508,469	1,822
Capital stock …………………………..	103,728	103,728	103,728	103,736	103,736	372
Total shareholders' equity …….………..	208,676	257,245	327,579	637,281	460,300	1,650
Amounts in accordance with U.S. GAAP						
Total assets …………………………….	480,638	549,149	647,239	962,379	1,114,742	3,995
Net assets	210,642	256,918	338,260	624,168	490,084	1,756
Total shareholders' equity ……..……….	193,457	244,783	315,248	622,941	445,167	1,595

	Year ended December 31,				
	1997	**1998**	**1999**	**2000**	**2001**
Other data:					
Weighted average number of shares					
Basic ……………………………………...	1,037	1,037	1,037	1,037	1,037
Diluted …………………………………	1,037	1,037	1,041	1,042	1,037

(1) Translated into U.S. dollars at the official closing rate of the National Bank of Hungary on December 31, 2001 of U.S. dollar 1.00 = HUF 279.03. These translations are unaudited and presented for convenience purposes only.
(2) Net income per share under IAS and net income per share under U.S. GAAP are calculated by dividing net income by the weighted average number of shares outstanding during each period.
(3) In December 2001 the Company acquired 49 percent of the common shares of Westel and Westel 0660 ("the Westels") from Deutsche Telekom AG. The Company is controlled by Deutsche Telekom AG so this was a transaction between parties under common control.[SzSz1] The financial statements have been restated as if the Westels were wholly owned subsidiaries of Matáv since March 23, 2000, the date when Deutsche Telekom AG acquired 49 percent of the Westels.

Dividends

The following table sets forth the dividend paid per Matáv ordinary share for the years 1997, 1998, 1999, 2000 and 2001. The table shows the dividend amounts in Hungarian Forints, together with U.S. dollar equivalents, for each of the years indicated.

	Dividend Paid Per Ordinary Share	
	HUF	**U.S.$ (1)**
Year		
1997 ………………………………………………………………………...	7	0.0344
1998 ………………………………………………………………………...	8	0.0365
1999 ………………………………………………………………………...	9	0.0356
2000 ………………………………………………………………………...	10	0.0351
2001 ………………………………………………………………………...	11	0.0394

(1) Translated into U.S. dollars at the official closing rate of the National Bank of Hungary on December 31, 2001 of U.S. dollar 1.00 = HUF 279.03, 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 was 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, 0.3 percent in April 2000 and 0.2 percent in April 2001. In October 2001, the crawling peg system ceased to exist. The middle of the intervention band was set at 276.1 HUF/EUR.

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				
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
2001	279.03	286.54	304.06	271.35
2001				
October	282.22	281.52	284.38	279.44
November	283.91	283.15	287.44	278.15
December	279.03	277.01	281.52	271.35
2002				
January	282.21	275.92	282.49	271.67
February	283.98	279.91	283.98	276.07
March	279.18	279.48	283.62	276.22

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

Year	Exchange Rates (amounts in HUF/DM)			
	Period-End	**Average (1)**	**High**	**Low**
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.

Year	Exchange Rates (amounts in HUF/EUR)			
	Period-End	**Average (1)**	**High**	**Low**
1999	254.92	252.80	258.86	248.23
2000	264.94	260.04	265.67	254.47
2001	246.33	256.68	267.29	241.45
2001				
October	255.35	255.46	259.34	251.95
November	251.63	251.09	253.92	249.41
December	246.33	247.65	250.61	245.06
2002				
January	243.49	243.95	245.55	242.92
February	245.84	243.54	245.84	240.62
March	243.50	244.71	246.55	243.50

(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 had exclusive rights until December 23, 2001 to provide domestic long distance and international public voice telephony services throughout Hungary. The Company also had exclusive rights until December 23, 2001 to provide local public fixed line telephony service in 31 of 54 local primary areas in Hungary. Matáv's exclusive rights expire in May 2002 in an additional five local primary areas, while its subsidiary, Emitel has exclusive rights in an additional three concession areas through November 2002. Following the expiration of the exclusivity of the concession agreements of Matáv and other local telephone service providers, Act XL of 2001 on Communications (”Act on Communications”) became the basis for the liberalized telecommunications market in Hungary.

The Act on Communications was approved by the Hungarian Parliament in June 2001 and entered into force on December 23, 2001. The Act on Communications established a new regime of retail price controls on fixed line voice telephony services, introduced a universal service obligation and designated Matáv as a company with significant market power on the voice telephony market. The Act on Communications also requires unbundling of local loops, transparency of cost-based pricing, and reference offers for interconnection, local loop unbundling and eventually for regulated lease line services. In addition, the Act on Communications introduced carrier selection and carrier pre-selection possibilities. The Company cannot fully anticipate the combined impact of these changes on its business and results of operation. Matáv's business and results of operations may be adversely affected by the new Hungarian telecommunications regulatory regime. See ”Regulation and Pricing – the Act on Communications and the Contract on Universal Service Provision.”

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. Since December 23, 2001, other service providers have had the right to compete directly for Matáv's customers across Hungary in the public telephony services.

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. Although the exact identity of the first new entrants is already known, the scope of 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, the effect of an EU conform regulation on the Hungarian telecommunications market, which substantially differs from other European markets, as well as the effectiveness of the Company's efforts to prepare for increased competition.

In the mobile communications business, Matáv already faces intense competition. As all telecommunications markets have become increasingly saturated, the focus of competition is starting to shift from customer acquisition to customer retention. Significant customer defections would have an adverse effect on results of operations and customer acquisition and retention expenses are substantial. Due to the increased competition, prices for mobile voice telephony have been declining over the past several years and may continue to decline. Matáv also faces intense competitive pressure in the market for Internet services as well as in the data communications markets.

Competition in any or all of Matáv's principal lines of business could lead to:

- price erosion of Matáv's products and services;
- inability to increase market share or loss of market share;
- loss of existing or prospective customers and greater difficulty in retaining existing customers;
- more rapid deployment of new technologies and obsolescence of existing technologies; and
- other developments that could have a material adverse effect on Matáv's 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.

Matáv expects the number of fixed access lines and tariffs for telephony services to decrease as competition in fixed and mobile telephony increases. 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, as well as by geographic expansion. Matáv may not be able to sustain revenue growth, if it is not able in the future to offer attractive and 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 that is 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 and 2001, 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.

System failures could result in reduced user traffic and reduced revenue and could harm Matáv's reputation.

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

Matáv's credit rating is linked to the credit rating of its parent company, Deutsche Telekom.

Matáv's credit rating has been lowered by Standard & Poor's Ratings Services (”S&P”) in April 2002, because of the decreased credit rating of its parent company, Deutsche Telekom AG (”DT”). Moody's Investors Services (”Moody's”), however, maintained its credit rating of Matáv.

DT has substantially increased its outstanding debt to finance acquisitions and investments, resulting in a lowering of the credit rating on its long-term debt. If it is unable to reduce its indebtedness as planned, its credit ratings may be further lowered, which may lead to an increase in interest expense.

Primarily as a result of this increase in outstanding debt, S&P lowered its rating on DT's long-term debt from AA- to A- with a negative outlook in October 2000 and placed DT on CreditWatch with negative implications in February 2002. Moody's lowered its rating on DT's long-term debt from Aa2 to A2 in October 2000 and to A3 with a negative outlook in June 2001 and had DT under review for a further downgrade since February 2002. Both companies concluded their credit watch with a one notch downgrade, S&P to BBB+ and Moody's to Baa1 in April 2002. In taking these actions, each of the rating agencies noted a number of contributing factors, such as the possibility of continued debt leverage due to possible delays in DT's asset disposal program.

Both S&P and Moody's assigned a credit rating to Matáv in November 2000. S&P rated Matáv's long term foreign currency debt BBB+ and local currency debt A-, while Moody's rated Matáv's long term debt Baa1. S&P upgraded Matáv's foreign currency debt to A- in line with the Hungarian sovereign in January 2001. Matáv has sustained its Moody's rating since then and is still rated Baa1. However, S&P downgraded Matáv to BBB+ in April 2002, following DT's decreased rating. S&P sees Matáv as a strategic investment of DT; therefore, it is very likely that Matáv's rating will move parallel with that of DT's in the future as well.

Deutsche Telekom is committed to an ongoing debt reduction, but we cannot assure you that circumstances will permit these goals to be reached on time or that its credit rating will not be further downgraded by S&P, Moody's or other rating agencies. Future possible decreases of DT's rating may also affect Matáv's.

The interest rates on Matáv's current indebtedness contractually are not linked to its credit rating; therefore, such current interest rates will not increase because of downgrades of Matáv's long term debt. However, any such downgrade may increase the cost of future long-term indebtedness if Matáv's credit rating is considered when obtaining financing.

Loss of key personnel could weaken Matáv's business expertise.

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

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 faces limitations on further extension of its cable television business under the Act on Communications.

The Act on Communications, which has been the basis for the telecommunications market in Hungary since 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 measures 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 an 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.

Tensions between ethnic Albanian and Slavic populations in Macedonia have settled due to the efforts of various international organizations. The Macedonian Parliament has adopted most of the laws envisaged in the Framework Agreement and the international community acknowledged this by awarding a significant amount of grants to Macedonia. The early elections are expected to take place in mid-September 2002. The conflict in Macedonia may, however, start again. If as a result of a 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”.

The adoption by Matáv of new accounting standards for purposes of U.S. GAAP may have a significant adverse effect on Matáv's U.S. GAAP financial results.

In June 2001, the U.S. Financial Accounting Standards Board (”FASB”) issued Statement of Financial Accounting Standards (SFAS) 141, ”Business Combinations ”, and SFAS 142, ”Goodwill and Other Intangible Assets ”. SFAS 141 requires that under U.S. GAAP the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and changes the criteria for recognizing intangible assets apart from goodwill. SFAS 142 addresses how purchased intangibles should be accounted for upon acquisition. The statement prescribes the necessary accounting for both identifiable intangibles and goodwill after initial recognition. SFAS 142 requires that goodwill and indefinite lived intangible assets no longer be amortized upon adoption of this statement but instead be tested for impairment at least annually using the specific guidance and criteria described in the statement. Amortization of definite lived intangibles will continue over the useful life. For U.S. GAAP reporting, SFAS 142 is effective for fiscal years beginning after December 15, 2001, except for the non-amortization provisions for goodwill and indefinite lived intangible assets acquired after June 30, 2001, which will be effective immediately. Matáv is currently assessing the impact of this standard on its results of operations, financial position and cash flows. Any material impairment of goodwill recognized under these standards may adversely affect Matáv's results of operations under U.S. GAAP.

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 its ADSs are listed on 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 Vagyonkezel□ 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 gave 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.

BUSINESS OVERVIEW

Business Summary

Matáv is the principal provider of fixed line telecommunications services in Hungary, with approximately 2.9 million fixed access lines at December 31, 2001. The Company is also Hungary's largest mobile telecommunications service provider, with almost 2,537,800 mobile subscribers (including users of prepaid cards) at December 31, 2001. The Company's total consolidated revenues were HUF 547,735 million and its total consolidated net income was HUF 82,560 million in 2001.

Matáv is a full-service telecommunications provider operating in three 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 had exclusive rights through December 2001 to provide domestic long distance and international public telephony services throughout Hungary, and to provide local public fixed line telephony service in 31 of the 54 local primary areas in Hungary. The Company still has exclusive rights in five of the 54 local primary areas until May 2002, while its subsidiary, Emitel has exclusive rights in an additional three concession areas through November 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 117,336 million, before intersegment eliminations in 1999 to HUF 198,947 million before intersegment eliminations in 2001, while the number of subscribers increased to approximately 2.5 million by the end of 2001 from 0.6 million at the end of 1998. In 1999, Westel won one of the new 1800 GSM mobile telecommunications operating licenses. One new entrant in the Hungarian digital cellular market started operations 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.

International Activities. Matáv purchased an 86.5 percent stake in Stonebridge, which owns 51 percent of MakTel. MakTel, the first international subsidiary of Matáv, became a consolidated subsidiary as of January 15, 2001, the date when the closing of the purchase transaction took place. This transaction has contributed significantly to the Company's revenue growth. Revenues from international activities were HUF 60,034 million before intersegment eliminations in 2001. MakTel is the sole fixed line service provider and the leading mobile service provider in Macedonia. Its exclusive rights in fixed line telecommunications services will expire in December 2004. These exclusive rights include local, national and international long distance public voice services, voice over Internet Protocol (”IP”) services, leased lines services and building and operating public voice network services.

Business Strategy

Matáv’s key strategic objectives for 2002 are to maintain its leading market position and to continue successful performance in all segments of its operations in the new, liberalized telecommunications environment. The Company aims to enhance shareholder value by sustaining its strong financial results and its dominant market positions in core operational areas, i.e. the fixed, mobile and international segments of the telecommunications marketplace. In addition, the Company intends to improve its value proposition by shifting towards value added solutions in the corporate telecommunications arena to deliver additional value to its most crucial and profitable customers.

In order to adapt to the challenges of the liberalized market and increase the transparency of operations, Matáv successfully implemented a new line of business based governance structure in 2001 that became effective from January 1, 2002. These organizational changes were implemented in line with the reorganization of Deutsche Telekom AG. As a result, the Fixed Line, Mobile, Internet and Business Solutions lines of business

(”LoB”) will be able to execute their respective business strategy derived from the overall objectives of the Company. This approach will provide sufficient flexibility to meet the demand of diverse customer needs, while enabling the Company to fully exploit synergies to maximize sales potential, reap economies of scale and improve operational efficiency.

While focusing on the increasingly competitive domestic market, Matáv will also remain active in the international arena to seek new growth opportunities in the region. The Company will also work to fully integrate MakTel into its governance structure to leverage its own experience and maximize MakTel’s revenue potential. Similarly to the efforts abroad, Matáv will also continue to integrate its recently acquired domestic subsidiary Emitel into the Company to increase core telecommunications revenue and explore opportunities in new geographic areas within the country which became available for Matáv by the market liberalization.

Fixed Line Consumer Services

The area of fixed line telecommunications will be crucial strategically for Matáv because it is new to competition since the full liberalization on December 23, 2001. Because fixed line services in general, and fixed voice services in particular, will remain a significant revenue contributor of Matáv, it is imperative that the Company maintains its leading positions in the market. While it is inevitable that Matáv will lose some market share to the new competitors, the Company’s strategy will aim to minimize the negative impact of liberalization while exploiting Matáv’s own opportunities in Local Telecom Operators (”LTO”) areas.

In order to achieve those objectives, Matáv will reposition the fixed line business by strengthening and improving the sales and marketing focus of the existing voice and data portfolio. Accordingly, Matáv will improve sales efficiency and effectiveness by more rigorous planning and professional execution of sales and promotional activities. As a part of this strategy, Matáv will bring customer-needs-specific packages and calling plans to market to increase the customer-perceived value of its voice services to retain customers and to increase Average Revenue Per User (”ARPU”) and network capacity utilization. Matáv strongly believes that it will be able to offer to virtually all its customers such tariff (and access) packages, which provide additional features, more cost efficient usage or the combination of both.

An important element of Matáv’s fixed line strategy will be its effort to stabilize the access line base by reducing churn via tariff and usage packages and by reinvigorating the fixed line value proposition through further promotion of broadband access products and applications. In addition to retaining valuable high-end customer segments, broadband access services will help Matáv capture new revenues as well.

Matáv is convinced that Internet penetration will continue to grow in Hungary. Part of the growth will be fuelled by increased broadband access, a field in which Matáv will be able to seize significant revenues and market share through its Asynchronous Digital Subscriber Line (”ADSL”) offering, which is being rolled-out in Budapest and in increasingly more major cities of Hungary. In the meantime, the Company is set to continue its successful Integrated Services Digital Network (”ISDN”) migration process, which is also partly driven by increased demand for (dial-up) Internet access.

Liberalization will open new windows of opportunity for Matáv, particularly in LTO areas and in wholesale. Matáv intends to be the long distance carrier of choice in Hungary, i.e. capturing national voice traffic originated from LTOs. Taking advantage of the demands of competitors, Matáv also seeks to maintain the leading wholesale service provider position in Hungary. In addition to mandatory services, Matáv will approach competitors with tailor-made solutions to minimize the retail impact of liberalization by retaining wholesale revenues. These services will include highly competitive portfolio elements, such as international IP telephony, where other carriers are the most likely to take away traffic and customers from Matáv.

In line with leading international carriers, Matáv intends to maximize cash flow and profit from the fixed line business, via streamlining its fixed line operations by executing an ‘operational excellence’ strategy. The primary elements of this process include:

- implementing cost reduction plans not only to reduce administrative overhead but also to cut operational costs while maintaining the quality of the services;

- improving operating efficiencies; and

- eliminating unproductive assets.

One specific focus of the ‘operational excellence’ strategy of Matáv will be on the continued improvement of front office processes. Seamless customer service via enhanced, simplified and faster processes such as order taking, service delivery and service assurance will be increasingly important to retaining customers by differentiating Matáv through its service excellence, quality and reliability of operations from other service providers.

Mobile Services

Matáv considers mobile telecommunications services to be one of its most important sources of potential future growth. Mobile penetration in Hungary will continue to increase, albeit at a decelerating pace, and has already exceeded the penetration level of fixed line services.

Despite competitors’ attempts to change the status quo of the Hungarian mobile market, Matáv’s strategic objective is that Westel will keep its market leadership in 2002. This will be achieved by taking a firm position against rivals’ maneuvers of marketing actions and promotions, including large-scale price reductions. Meanwhile, Westel aims to manage the balance between ARPU growth, customer growth and operational expenses by value-based planning of customer acquisition and management.

As the extensive growth period in mobile telecommunications shows some decline, Westel will extend its non-voice service scope and increase the revenue through mobile data applications. The combination of Short Message Service (”SMS”), Wireless Application Protocol (”WAP”) and new services leveraging General Packet Radio Service (”GPRS”) will help to seize new opportunities to increase ARPU.

In order to maintain the status as the premium mobile service provider of Hungary, Westel will offer customers the latest mobile technologies on the market, a wide range of value added services, including GPRS, and outstanding 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.

Internet Services

Matáv’s Internet LoB is Axelero, Hungary’s leading Internet Service Provider (”ISP”). In 2001, Matáv decided to re-brand MatávNet to Axelero to reflect its Internet focus and support its expansion into the corporate ISP arena. Axelero, which has been the dominant consumer ISP in Hungary, also captured the leading corporate ISP position by the end of 2001. The main strategic objectives will be to stabilize those leading positions and to improve the gross margin potential of Axelero.

A major part of Axelero’s strategy will be to execute a ‘Portal ISP’ plan that will enable the company to use the power of its market leading, most visited [origo] portal to increase the Company’s dominance in the access market. This will be achieved by strong cross-promotion and the continuous development of [origo]’s content offering. The daily reach of approximately half a million unique visitors will provide Axelero with the unparalleled opportunity to gain new subscribers for its broadband and narrowband access service.

The Company aims to increase the proportion of its broadband (ADSL and cable television) customer base to more than 10 percent by the end of 2002 which growth will in turn increase ARPU and profitability as well. An additional means to enhance Axelero's position in the portal-visiting community will be the introduction of new multi-access, mobile features of [origo], combining Internet content with SMS in interactive applications. These will not only increase the perceived value of the portal but also generate direct (SMS) revenues for the Company.

When increasing the penetration in the traditional (dial-up) business segment, Axelero will continue to differentiate itself as the 'value-for-money' service provider. Accordingly, a significant element of the strategy will be to maintain Axelero's leadership in network quality, reliability and access speed, which can position Axelero above lower quality paid-for and 'free' ISPs.

In the corporate ISP arena Axelero will strengthen its broad product portfolio by offering full-scale Internet services for enterprises. Its Internet Data Center (”IDC”) not only provides professional hosting services but also e-commerce solutions, which can be combined with leased line and ADSL access services to provide a complete solution for corporate users. Axelero intends to target this integrated value proposition for small and medium sized enterprises providing them with 'one-stop-shopping' for access, web presence and e-commerce solutions.

Business Solutions and Fixed Line Data Services

A significant part of the business communications market, i.e. data-communications, has been open to competition for years. Matáv's natural objective will be to keep its leading market position in this competitive, but highly profitable, segment of telecommunications. In order to better serve the specific needs of communication-intensive large enterprises, Matáv will focus on the largest key-accounts via its Business Solutions LoB.

Matáv will work to stabilize the corporate customer base by executing a seamless and efficient account management process and enhancing Matáv's value by offering business solutions instead of standalone telecommunications products to the enterprise customers. The solutions will bundle existing portfolio elements such as Private Branch Exchange (”PBX”), Local Area Network (”LAN”), Wide Area Network (”WAN”), and Virtual Private Network (”VPN”) products into customer-specific offerings and will combine them with end-to-end managed services such as network and firewall management. Integration of data and voice services will largely drive the growth of the data business and Matáv aims to double the amount of bandwidth it sells as data-communications, IP and business solutions services.

In order to move up in the value chain and offer more value added service elements, Matáv will continue to work with partners such as T-Systems (a subsidiary of Deutsche Telekom AG) to enhance its ability to deliver network centric solutions, which will help the Company to redefine its role in the business communications market as a business solution provider. Obtaining Information Technology (”IT”) competencies via partnerships will enable Matáv to bundle telecommunications offers with IT solutions to create long-term business partnerships with key-accounts.

In the process of increasing the bandwidth sold to corporate customers, Matáv will not lose focus from selling traditional data products such as leased lines and business Digital Subscriber Lines (”DSL”), which bring significant revenues and carry adequate margin. However, more of these products will be sold as part of customer-specific bundles or will be replaced by cost effective and feature-rich IP solutions that can support high value added services such as Quality Of Service (”QoS”), bandwidth-on-demand and voice/ data integration.

Geographic Expansion

Matáv has demonstrated that it can be successful in both international and domestic expansion with its acquisitions of MakTel and Emitel, respectively. While Emitel has a high Earnings Before Interest, Tax, Depreciation and Amortization (”EBITDA”) margin and is a very efficient LTO, MakTel can be considered as the most successful privatization in the Balkan Region. In 2002, a major strategic step will be to continue and conclude the integration of those businesses in terms of operational, management and business synergies. In order to accomplish this, Matáv will continue the knowledge transfer it has started since the acquisition of those entities. Matáv will also emphasize the importance of economies of scale and will continuously assess the performance of the businesses to ensure the capture of growth opportunities and an adequate return on investment.

Matáv will continue to screen expansion opportunities in the region in close co-operation and alignment with the activities of DT. Matáv will also evaluate leveraging the potential of DT's global presence, network and broad service portfolio. As a part of the harmonized approach with DT, Matáv will selectively consider joint venture opportunities in areas such as IT-telecommunications convergence where DT has developed skills, competencies and resources.

In the domestic arena, Matáv's business development will focus on high-potential LTO areas where the company can capture national long distance traffic of corporate accounts and high-end residential subscribers and will assess the feasibility of obtaining access to the local loop via diverse means, including local loop unbundling or building the last mile to high value business and residential subscribers.

Overview of Matáv's Revenues

For the years ended December 31, 1999, 2000 and 2001, Matáv's total revenues by business segments were as follows:

	Year ended December 31,			Year ended December 31,
	1999	2000	2001	2001/2000
		(in HUF millions)		(% change)
Fixed line telecommunications services segment				
Subscriptions, connections and other charges.	63,413	83,243	97,128	16.7
Domestic traffic revenues	134,071	129,517	123,366	(4.7)
Other usage	26,999	26,679	24,276	(9.0)
International traffic revenues	43,807	41,432	35,119	(15.2)
Leased lines	13,816	16,453	18,010	9.5
Data transmission and related services	7,781	11,949	17,741	48.5
Telecommunications equipment sales	3,030	4,810	3,582	(25.5)
Construction, maintenance and other	9,313	12,197	14,463	18.6
Total fixed line segment	302,230	326,280	333,685	2.3
Mobile telecommunications services segment....	117,336	159,345	198,947	24.9
International segment	0	0	60,034	n.a.
Intersegment eliminations	(34,634)	(39,680)	(44,931)	13.2
Total	384,932	445,945	547,735	22.8

Fixed Line Telecommunications Service Segment

In 2001, Matáv's fixed line telecommunications services generated revenues of HUF 333,685 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 244,770 million in 2001, HUF 239,439 million in 2000 and HUF 224,483 million in 1999, 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 local service to its fixed line telephony subscribers in its 36 local concession areas, while its subsidiary, Emitel has exclusive rights in an additional three concession areas through November 2002. The Company also had the exclusive right to provide long distance service to customers in all 54 local primary areas of Hungary until December 23, 2001. See ”Regulation and Pricing – the Act on Communications and the Contract on Universal Service Provision.”

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. In 2001, the Company introduced the Call Completion to Busy Subscriber service, whereby customers can request to get called back when a busy line they called becomes available. In 2001, 1.5 million Matáv subscribers used this free of charge service regularly.

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.

Special Administrator Service. In 2001, Matáv introduced the SignPronounce service, which allows hearing-impaired or speech defective customers to communicate directly via telephone with the help of an operator.

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 August 2000, Matáv enriched the service by introducing call return and call capture functions as part of the basic Voice-mail service. In 2001, Matáv introduced the Comfort Package, which bundled Voice-mail and digifon services, such as call forwarding, call waiting, conference call and Caller Identification (”caller ID”) into one package. In July 2001, Matáv introduced Voice-mail SMS service, which provides an SMS alert to the mobile handset of the customer each time he receives a message on his voicemail. These services allow better usage of the network, more comfort in using the phone and decrease the ratio of uncompleted calls. As of December 31, 2001 Voice-mail subscribers amounted to 426,000, which shows a 52 percent growth compared to December 31, 2000.

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, 2001, Matáv had installed 155,468 ISDN access lines with two channels and 4,582 ISDN access lines with 30 channels, amounting to 448,396 total ISDN channels. In February 2000, Matáv introduced the ISDN Net service, which enables subscribers to make calls and use the Internet at the same time. In June 2001, the Company introduced the Assemble Your ISDN package, which involves the customers in the installation process, allowing the implementation of the ISDN 2 technology to become faster and cheaper.

PBX Services. Matáv offers PBX services through one of its subsidiaries, Matávcom Kft. As of December 31, 2001, Matávcom Kft. leased and sold approximately 51,700 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, 2001, customers had subscribed to 105,763 World Cards. The business customers subscribing for the Ritmus package can also purchase Ritmus Calling Cards, which allow them to enjoy the discounts provided by the Ritmus package when using their cards from public payphones.

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 nearly 40 million inquiries by the end of 2001. In May 1999, the service was further developed to offer a call completion option, whereby calls may be connected automatically. The directory assistance database includes all fixed line and mobile subscribers' data in Hungary, except for Vodafone's. On February 15, 2001, Matáv introduced its new Directory Assistance-Plus (”DA-Plus”) service. DA-Plus offers a wide range of information including Yellow Pages, residential classified advertisements, encyclopaedias, dictionaries, recipes, poems, as well as telephone numbers, postal, e-mail and website addresses without any quantity restrictions. The tariff of calling the service is based on per minute prices. The duration of all calls received by DA-Plus service was over three million minutes in 2001.

Subscribers

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

	At December 31,		
	1999	**2000**	**2001**
Lines in service in Matáv's local concession areas:			
Residential lines	2,370,579	2,296,351	2,151,346
Business lines	378,605	326,503	299,267
Public payphones	36,205	36,774	37,432
Total	2,785,389	2,659,628	2,488,045
ISDN channels	114,466	305,882	448,396
Total	2,899,855	2,965,510	2,936,441
Lines in service in Emitel's local concession areas:	n.a.	n.a.	80,899
Lines installed per 100 inhabitants:			
in Matáv's local concession areas	38.6	39.5	39.1
Waiting list (in thousands)(1)	38	19	15
Digital exchange capacity as % of Matáv's total exchange capacity	79.0	85.1	85.4

(1) The waiting list consists of customers whose application for connection to an access line has been outstanding for 60 days or more.

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, 2001, 77 percent of Matáv's access lines were connected to residential customers and 22 percent to business customers. The remaining one 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 2001.

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,		
	1999	**2000**	**2001**
	(thousands of minutes)		
Domestic traffic at Matáv Rt..........	8,632,345	9,692,678	10,088,137
Domestic traffic at Emitel (1)	n.a.	n.a.	91,567

(1) Traffic generated since July 1, 2001, the date when Emitel became a fully consolidated subsidiary of the Company.

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.

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 1999. In 2000 and 2001, tariff changes were effective from February 1 for analog lines and from January 1 for ISDN lines. So far in 2002, tariffs have only changed for monthly subscription fees, which change was effective from February 1. Traffic charges are expected to change only in the second half of 2002.

	1999	2000	2001	2002
		(HUF, exclusive of VAT) (1)		
Entrance fee:				
Residential	27,000	27,000	27,000	27,000
Business	60,000	60,000	60,000	60,000
Standard monthly subscription charge:				
Residential	1,210	1,814	2,308	2,398
Business	1,630	2,440	3,100	3,224
ISDN entrance fee:				
Basic	125,000	99,000	60,000	60,000
Multiplex	1,350,000	1,350,000	990,000	990,000
ISDN standard monthly subscription charge:				
Basic	3,200-6,400	3,700-6,900	3,900-6,900	4,600-7,600
Multiplex	49,000-63,800	53,400-69,900	57,600-75,500	65,000-85,000
Charge for a three minute peak rate call: (2)				
Local	31.8	27.6	25.4	25.4
From the fixed line network to mobile subscribers (2)	186.6	186.0	183.8	183.8
Domestic long distance: (2)				
Zone 1 (Extended local)	33.6	27.6	25.4	25.4
Zone 2 (Budapest metropolitan area)	46.2	45.6	48.8	48.8
Zone 3 (Long distance)	98.4	87.0	75.8	75.8

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

(2) Includes a call set-up charge (HUF 6.6 in 1999, HUF 6.0 in 2000, HUF 3.8 in 2001 and 2002).

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, 1999 through December 31, 2001, in real terms the Company increased its monthly subscription charges by 60.1 percent, decreased its local tariffs by 29.9 percent, decreased charges for calls from fixed line to mobile telephones by 16.1 percent and decreased domestic long distance tariffs by 37.0 percent.

The Company has accelerated its drive towards tariff rebalancing in 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 the prior year's fee. In contrast, usage charges decreased on average in both nominal and real terms in 2000 and 2001. So far in 2002, traffic fees have only changed for ISDN lines.

Public Telephones

As of December 31, 2001, Matáv operated 37,432 public pay phones, representing a penetration rate of approximately five per 1,000 inhabitants in Matáv's concession areas. Approximately 51 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 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 it would purchase the remaining 50 percent stake. The change of ownership was conditional on the approval of the Minister responsible for telecommunications in Hungary as well as on the approval of the Hungarian Competition Office, which Matáv received in June 2001. The price of HUF 13,930 million was determined on the closing of the transaction on July 2, 2001.

International Telephone Services

International telephone services consist of outgoing and incoming international telephony traffic, including voice, data and switched transit traffic through Hungary. The Company had the exclusive right to provide international direct dialing service in Hungary until December 2001. In 2001, outgoing international telephony traffic generated revenues of HUF 13,843 million before intersegment eliminations, and incoming international telephony traffic generated revenues of HUF 21,276 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 50 countries abroad to their home phone numbers. In 1998, this service was widened with a post-paid international calling-card.

International toll-free service was launched in 1998. This service enables the caller to make international calls free of charge to and from 36 countries, while the call charges are covered by the subscriber of the toll-free number.

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, whereby customers can order and pay for the service at only one end-point of the connection, therefore they need to be in contact with only one service provider. 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. At December 31, 2001, approximately 65,000 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,					
	1999		**2000**		**2001**	
	(millions of minutes, except for percentages and ratios)					
Outgoing traffic:						
Germany and Austria	118.5	36.5 %	125.1	36.9 %	114.9	35.9 %
Neighboring countries other than Austria	54.5	16.8 %	58.3	17.2 %	56.6	17.7 %
United States	14.1	4.3 %	14.1	4.2 %	14.8	4.6 %
United Kingdom	18.9	5.8 %	17.8	5.3 %	16.5	5.2 %
Italy	18.5	5.7 %	19.2	5.7 %	19.4	6.0 %
All other countries	100.0	30.9 %	104.2	30.8 %	97.9	30.6 %
Total outgoing traffic	324.5	100.0 %	338.7	100.0 %	320.1	100.0 %
Growth in total outgoing traffic (% per annum)	-	9.5 %	-	4.4 %		(5.5) %
Incoming traffic:						
Germany and Austria	157.6	35.7 %	149.2	31.4 %	115.5	28.5 %
Neighboring countries other than Austria	41.5	9.4 %	43.7	9.2 %	45.4	11.2 %
United States	58.2	13.2 %	55.8	11.8 %	65.5	16.2 %
United Kingdom	49.0	11.1 %	74.4	15.7 %	40.3	9.9 %
Italy	18.2	4.1 %	19.0	4.0 %	20.3	5.0 %
All other countries	116.7	26.5 %	132.3	27.9 %	118.1	29.2 %
Total incoming traffic	441.2	100.0 %	474.4	100.0 %	405.1	100.0 %
Growth in total incoming traffic (% per annum)	-	17.8 %	-	7.5 %		(15.0) %
Ratio of incoming to outgoing traffic	-	1.36	-	1.4		1.3
Transit traffic (millions of minutes)	60.9	-	80.7	-	88.4	

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 51.7 percent of the outgoing traffic and 59.6 percent of the incoming traffic in 2001. Business customers make a substantial majority of the outgoing international calls carried by Matáv.

In 1999, and 2000, growth in incoming traffic outpaced growth in outgoing traffic. In 2001 incoming traffic decreased more than outgoing traffic, but the volume of incoming traffic still exceeds the volume of outgoing international traffic. The Company believes that outgoing traffic did not reach the volume of incoming traffic because customers are increasingly using leased lines and private branch exchange services such as call blocking.

Since 2000, Matáv met several challenges relating to international telephone traffic. 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' figures. Matáv's international switched transit service has provided a real back-up gateway to reach this part of the continent.

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 1999, in nominal Hungarian Forints, in the charge for a three-minute call to selected destinations. The timing for tariff changes for international telephone services has been the same as the timing of tariff changes for domestic services.

	1999	**2000**	**2001**	**2002**
		(HUF, exclusive of VAT) (1)		
Neighboring countries	244.2	222.0	219.8	219.8
Other Europe	330.6	285.0	228.8	228.8
United States and Canada	339.6	294.0	228.8	228.8

(1) Includes a call set-up charge (HUF 6.6 in 1999, HUF 6.0 in 2000, HUF 3.8 in 2001 and HUF 3.8 in 2002).

Tariff Rebalancing. Since 1995, as part of the rebalancing of its tariffs, Matáv reduced its international tariffs for outgoing calls, thus moving towards rates that foreign telecommunications service providers charge for calls to Hungary and taking into account the related international accounting rates. From December 31, 1999 through December 31, 2001, Matáv's international call tariffs fell on average by 37.3 percent in real terms. International tariffs introduced in 2001 have decreased on average in both nominal and real terms compared to 2000. As part of its ongoing tariff rebalancing, the Company expects to continue to lower its international tariffs to stimulate usage.

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. Matáv is prepared to use any foreign currency in its international settlement system, so SDR can be replaced by Euro or any other currency in international accounting rate negotiations.

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 launched its own Wavelength-Division Multiplexing (”WDM”) backbone network and is Deutsche Telekom's partner in Delivery of Advanced Network Technology to Europe (”DANTE”), which provides 2.5 Gb/s transmission paths for interconnecting Budapest into the European research and educational network, GEANT. 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. Matáv is present at the Vienna Internet Exchange and has peering arrangements (dedicated circuit for Internet data exchange) with approximately 30 ISPs there. Matáv has a direct Internet peering connection with Ukraine and provides high-capacity international Internet transit service to ISPs in Romania and Macedonia.

Leased Lines

Revenues from leased lines totaled HUF 18,010 million in 2001, HUF 16,453 million in 2000 and HUF 13,816 million in 1999, 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.

Matáv further widened the range of access options to the service in 2001. It developed and launched the outdoor Flex-Com subscriber access and the Kiloflex P type subscriber access. The outdoor access provides an opportunity for the outdoor installation of terminating equipment of lines with maximum 1984 Kb/s, focusing on the demands of mobile service providers. Kiloflex P provides a cheaper access in the speed range from 192 Kb/s to one Mb/s than the previous subscriber access, for example for IP purposes.

Matáv increased the number of its Flex-Com connections from 5,170 at December 31, 1998 to 11,386 lines at December 31, 2001.

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, 2001, Matáv had 1,028 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 Open Network Provision ("ONP") 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 2001, Matáv enlarged its HSLL services portfolio by offering new speed elements at 45 and 155 Mbit/s. Matáv increased its HSLL connections to 152 by December 31, 2001.

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 17,741 million in 2001, HUF 11,949 million in 2000 and HUF 7,781 million in 1999, 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, 2001, Matáv had 3,700 Datex-P terminals, compared to 3,279 at December 31, 1998. 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, 2001, Axelero (formerly known as Matávnet), Matáv's fully owned ISP subsidiary had over 133,000 customers. Axelero is the largest Internet service provider in Hungary with an estimated 44 percent market share based on the number of dial up 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 460,000 sessions per day in the last quarter of 2001, and Vizsla, one of the most well known search engines in the Hungarian language. In 1999, Axelero introduced netQuick, a package available in larger department stores that provides prepaid Internet access. Axelero also operates the most popular freemail service in Hungary with over 900,000 registered users at the end of 2001, as well as a business news and information service called Business Quarter. In addition, Axelero is in the process of developing business models and applications for e-commerce. In 2001, Axelero began to offer Internet packages based on ADSL technology as well as access through cable television, to provide residential customers with broadband, fast Internet service at affordable prices. For business users, Axelero offers Internet access through leased line and ADSL connections as well as webEDI (Electronic Data Interchange) and hosting and collocation services in its IDC. Axelero has four subsidiaries, including Fokuszonline Rt., which operates a book selling website and Marketline Rt., which operates an electronic market between companies. Axelero 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 discounted local call packages that charge a flat fee per local call during certain hours of the day.

VSAT. Matáv offers business satellite communications services through its own central station. Satellite services based on VSAT technology provide a solution for the rapid and reliable completion of data communications by establishing both domestic and international links.

Cable TV and Broadcasting Services. Matáv's cable television (”CATV”) group has several companies providing cable television services in Hungary. The ownership structure of the various companies is determined by regulatory requirements. On July 1, 1998, Matáv established MatávkábelTV Kft. (”MatávkábelTV”), which began providing cable television services on January 1, 1999. In 2000, MatávkábelTV became a subsidiary of InvesTel Rt., a subsidiary of Matáv which became the CATV asset management holding entity of Matáv. Through network development and acquisitions, Matáv's CATV group significantly increased its number of cable television customers during the past three years, and it strengthened its second position in the market despite the increasing competition. The Company had approximately 300,000 subscribers as of December 31, 2001, compared to a little over 7,000 at December 31, 1998. MatávkábelTV offers 40 television channels and three 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. In cooperation with ISPs, Matáv's CATV firms started to offer Internet services through the cable television network in Budapest, Kaposvár and South-Hungary in 2001. The CATV firms provide bi-directional network capacities, while the ISPs provide the Internet service. 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, network reconstruction and to increase ARPU.

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.

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 2001, from 21 percent to 34 percent considering the whole day and to 41 percent during prime-time (between 7 and 11 p.m.). The television advertising market in Hungary recorded significant growth in 2000, but only a moderate increase was realized during 2001. However, RTL KLUB’s advertising market share increased to approximately 52 percent by the end of 2001 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, Fox, MGM and Universal. Furthermore, MRTL won the right to broadcast Formula 1 races for five years commencing in 2002.

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. In 2001, operating profitability was further increased, despite the market growth being behind expectations.

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

Security Services. On July 5, 1998, Matáv established Matáv□r Kft., a wholly owned subsidiary, to provide security-monitoring services. On June 15, 2001, Matáv and Group 4 Securitas Kft. established Group 4 Matáv□r Rt.. The operations and customers of Matáv□r Kft. have been gradually taken over by the newly established joint venture company and after the completion of this process Matáv intends to wind up Matáv□r Kft. As of December 31, 2001 Group 4 Matáv□r Rt. and Matáv□r Kft. together had 8,292 customers.

Matáv ADSL. ADSL is an Asynchronous Transfer Mode (”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 mainly on a wholesale basis to ISPs, which in turn distribute the services to residential and small business customers. The service has been available in certain parts of Budapest since September 1, 2000 and its coverage is rapidly expanding. As of December 31, 2001 Matáv had approximately 6,200 ADSL connections.

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 analog or ISDN lines. 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. 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, PBXs 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. Matávcom Kft, Matáv's fully owned subsidiary, sells PBX equipment. Sales of fixed line telecommunications equipment generated revenues of HUF 3,582 million in 2001, HUF 4,810 million in 2000 and HUF 3,030 million in 1999, 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 are integral parts of being a full service telecommunications provider and are 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 14,463 million in 2001, HUF 12,197 million in 2000 and HUF 9,313 million in 1999, 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 198,947 million in 2001, HUF 159,345 million in 2000 and HUF 117,336 million in 1999, in each case before intersegment eliminations. Matáv provides mobile telecommunications services through two subsidiaries, Westel and Westel 0660, each of which is 100 percent owned by Matáv.

Westel provides digital services and Westel 0660 provides analog services. At December 31, 2001, Westel and Westel 0660 together accounted for an estimated 51.1 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 10.6 percent at December 31, 1998 to 48.7 percent at December 31, 2001.

Each of the Westel companies operates on a stand-alone basis as required by its concession. The companies cooperate with each other in certain areas and provide each other with certain services on an arm's length basis.

In 2001, the Wireless Competence Center project was launched to exploit the synergies between Matáv Rt., Westel and Westel 0660. As a result, operation and maintenance of all Matáv owned radio equipment as well as the staff employed in connection with these services has been transferred to Westel. In addition, all operations of Westel 0660, for which Westel was in a better position to deliver the services under more attractive conditions and where there was no legal obligation to retain the activity by Westel 0660, were transferred to Westel.

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. 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.

On December 21, 2001 Matáv paid Deutsche Telekom AG EUR 920 million (HUF 227 billion) and has agreed to pay in 2002 an additional amount equal to 49 percent of the dividend to be declared by Westel for 2001. Based on the amount of dividend with respect to 2001 declared by Westel, Matáv will have to pay an additional HUF 12 billion. No dividends were declared by Westel 0660. The purchase price was financed by way of a medium term EUR loan provided by Deutsche Telekom AG at an interest rate of LIBOR plus 50 basis points.

Westel

Westel commenced offering commercial GSM digital mobile telecommunications services on March 31, 1994, pursuant to a concession awarded in November 1993. GSM affords high quality digital transmission and is the dominant digital mobile telecommunications standard in Europe. During 2000, Westel 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, SMS, 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 service packages designed for different customer requirements, including various traffic packages targeted at low volume residential customers and higher volume business and governmental customers.

The prepaid card of Westel, Domino, provided 94.3 percent of net customer additions in 2001. Since the introduction of the SMS for prepaid customers in 1999, Westel has made more value added services available to prepaid customers, such as caller ID, Domino data and fax. SimToolKit applications also became available for prepaid customers, and electronic recharge opportunities were introduced at Automated Teller Machines (”ATMs”) and petrol stations. Prepaid customers (especially young people and security users) induced the majority of Westel's growth in 2001.

International voice over IP was introduced for Westel's customers at the end of 1999. In 2001, Westel continued enhancing its value-added services and introduced more new products:

- DOMINO customers were able to use their subscription in 92 countries using 210 operators’ networks as of December 31, 2001 without any limitation. They are able to initiate and receive calls and to send and receive SMSs.

- In 2001, Westel was the first to launch GPRS service in Hungary. With GPRS, the step toward the next generation of mobile services became a reality. The major advantages of this technology are higher speed of data transmission, always-on mode and the data volume based billing.

- There are more than forty categories in WAP information services. This gives traffic information, location based services, information on sport events, lottery and other gambling results, stock exchange prices and much more. This information can be accessed via WAP, web and SMS.

- Customers are able to request information not only by sending an SMS and receiving the answer, but they can make a weekly or a monthly subscription for a selected category via SMS.

- Westel introduced ”#GO”, the first SMS magazine in Hungary. This provides information on interesting entertainment programs and news and other community events for the younger generation.

- In September 2001, Westel introduced differentiated SMS pricing, which allows the launch of content, entertainment and information services for free SMS, discounted SMS or premium SMS pricing.

Westel encourages customer loyalty with various programs. Gold 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'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,		
	1999	**2000**	**2001**
Regular subscribers	654,549	760,575	811,864
Prepaid subscribers	187,730	838,511	1,681,621
Total subscribers	842,279	1,599,086	2,493,485
Annual growth in subscribers (%)	54.1	89.9	55,9

The rapid increase in the number of Westel subscribers since December 31, 1999 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, 2001, Westel held approximately 50.65 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 leadership.

Traffic. Westel's average traffic per subscriber remains relatively high in Europe at 146 minutes per month in 2001. 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. The liberalization of the fixed line telecommunications market in December 2001 is expected to have an effect on the mobile telecommunications industry as well. It is expected that government regulated fees and interconnection prices will significantly change and these changes will impact the operations of Westel.

Distribution. Westel has 27 Building Value showrooms, 14 Economy Shops, one mobile showroom and one high-tech showroom 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 and high-tech mobile handsets. Westel also broadened its sales channels by engaging independent sales representatives and began offering free home delivery service. The Major Account department with 64 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, 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. In total, Westel’s products are available in almost 6,000 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 Nordic Mobile Telephony (”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,		
	1999	2000	2001
Subscribers	97,753	75,866	44,308
Annual growth/(decline) in subscribers (%)…......................	4.4	(22.4)	(41,6)

In 1999, the number of Westel 0660 subscribers increased due to active promotional programs and innovative service offers. Since 2000, Westel 0660 has 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 and through Westel salespeople on an agency basis.

International Segment (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. The formula takes into account the purchase price paid by the consortium for the shares, the current EBITDA and the net debt of MakTel.

CosmoTelco and Matáv 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. Before the expiration of CosmoTelco's call option on February 8, 2002 Matáv and CosmoTelco amended the option agreement as a result of which CosmoTelco has one more year (until February 2003) to exercise its option for a 10 percent share in Stonebridge. Matáv paid a fee of EUR 7 million in return for CosmoTelco to let the option for the remaining 11.55 percent share to expire unused on February 8, 2002.

MakTel has been a consolidated subsidiary of the Group from January 15, 2001.

Overview of MakTel’s revenues

In 2001, approximately 44 percent of the total revenue of MakTel was derived from domestic fixed line telecommunications services. Mobile services contributed about 28 percent, while international telecommunications services contributed about 24 percent to total revenues. Various data services (telegraph, X.25, Frame Relay, leased lines, and Internet access) contributed only one percent of the total. Three percent of total revenues were derived from other miscellaneous services.

In the second half of 2001, the mobile operation of MakTel, MobiMak was established as a separate 100 percent owned subsidiary of MakTel.

The revenue stream of MakTel largely depends on international traffic (reflecting the historically high international charges, and low domestic tariffs). The proportion of mobile revenue is increasing, while data revenue is still insignificant. The low penetration rates of fixed line and mobile services represent high potential growth for MakTel.

Following the organizational changes of Matáv and DT, MakTel also introduced a four pillar organizational system, based on fixed line, mobile, Internet and business solutions. This organizational change will allow MakTel to become a more customer and market oriented company. The commercial aspects of the company are being given a face-lift in order to evolve our operations from a technical base to a market oriented one.

Fixed line Telecommunications Operations of MakTel

MakTel is the sole fixed line service provider and the leading mobile service provider in Macedonia. Its exclusive rights in fixed line telecommunications services will expire in December 2004. These exclusive rights include local, national and international long distance public voice services, voice over IP services, leased lines services and building and operating public voice network services. MakTel's objectives for the next three years are to become established as a leader in technology as well as to provide excellent services with attractive prices in order to prepare for the future competition.

During the last three years, MakTel's major operational goals were to digitalize the fixed network and to increase the number of subscribers. The digitalization rate increased from 71.1 percent at the end of 1999 to 91.3 percent at the end of 2001. MakTel has 534,418 analog fixed lines and 15,570 ISDN channels as of December 31, 2001 and fixed line penetration reached 26.2 percent in Macedonia.

MakTel introduced several value added services, such as call waiting, conference calling, abbreviated dialing and automatic redial.

In 2001, political factors played a substantial role at MakTel. The crisis situation increased both fixed line and mobile revenues by generating additional traffic due to the presence of both NATO and visiting journalists. At the same time, however, MakTel faced damages as well as difficulties in bill collection from the war-affected regions. In early 2002, MakTel's employees are still unable to visit some key sites. As the political situation continues to stabilize, revenue growth opportunities will arise in the currently war-affected area.

MakTel provides Internet services through its Internet subsidiary, MTNet. MTNet has a 50 percent market share in Macedonia. The number of Internet subscribers and the time they spend on the world wide web is also climbing rapidly. MTNet provides Internet access via the public switched telephone network and leased lines. By the end of 2001, MTNet had 21,674 Internet subscribers compared to 9,904 as of December 31, 2000, which amounts to a 119 percent growth. MakTel also provides web hosting, web design, web content-oriented IP applications and portal services. MTNet has established an IP backbone network with points of presence (”PoPs”), allowing customers to access Internet services with a local call anywhere in the country.

MakTel also has data transmission services, such as satellite communications, frame-relay, X.25 and audiotex services.

Historically, MakTel, like government-owned operators in other countries, maintained relatively low domestic charges and high tariffs for international calls. Since November 1999, MakTel has been gradually rebalancing its tariffs in accordance with its long-term re-balancing strategy. International tariffs are expected to decrease significantly by 2004, bringing them into line with EU standards prior to liberalization. Local tariffs and basic access charges are expected to increase in order to reflect costs, but MakTel will not seek to exploit the maximum increases allowed by the regulation, to keep the rates affordable to Macedonian citizens.

MakTel is continuously expanding and improving its access network. MakTel has a digital fiber optic national long distance network that connects local primary area networks. The Company has implemented three Synchronous Digital Hierarchy (”SDH”) rings that serve both the national long distance and international networks. In addition to cost advantages, SDH systems provide a flexible transmission infrastructure with automatic transmission paths. Additional routes of optical cable and SDH systems are being installed in the long distance network and the city networks, increasing both network availability and transmission capacity.

MakTel has installed a modern, packet optimised IP network based on Multi Protocol Label Switching (”MPLS”). The network is fully operational and already carries commercial traffic. This network is the first of its kind in the entire Southeastern European Region, establishing MakTel as an undisputed leader in this field. It uses DPT STM-4 (packets on fiber technology) at its core and packet over SDH STM-1 at the edges. It has nine large PoPs equipped with high-end routers and eleven small PoPs. The network provides a variety of VPN solutions for its business customers, offering secure, scalable remote site interconnection over a shared IP backbone. The company realizes the enormous importance of IP for its future and is considering this network to be the best foundation for its future generation of IP based services, combining voice and data and offering versatile multimedia capability.

Mobile Telecommunications Operations of MakTel

Mobile telephony was a significant growth driver in 2001 at MakTel. MobiMak is the digital cellular service provider of MakTel, which became a fully owned subsidiary of MakTel on June 4, 2001.

As one of the first important steps in its transformation, MobiMak introduced a new brand image to the market. For this activity MobiMak hired the advertising agency Indigo-Ogilvy. The new image is built on the slogan ”connecting your worlds” (connecting past, present and future, connecting work and private life, connecting family and friends, etc.). With a strong campaign, MobiMak hopes the new image will be successful as a marketing tool.

MobiMak's operations are based on GSM technology in the 900 MhZ frequency band. The number of mobile subscribers increased by 131 percent to 221,336 subscribers in 2001. The mobile penetration rate also grew significantly, to 11.4 percent at the end of 2001 compared to 4.9 percent a year earlier, but it is still well below the European average. MobiMak offers value-added services, such as call waiting, call forwarding, conference call, SMS, voice mail, international roaming and itemized bill.

MobiMak entered into a frame contract with the main network and infrastructure vendors. By fixing the prices of different services and products, it reached significant discounts in comparison with the previous prices. Based on the agreements, MobiMak started a fast network development activity between September and December 2001. MobiMak changed all the existing site rental contracts to make them exclusive, signed new contracts for the new base stations to be built during 2001 and 2002 and built 72 base stations during the last four months of 2001. As a result, MobiMak reached 95 percent of the population and 85 percent of the territorial coverage.

MobiMak put a high emphasis on marketing activities. It introduced new services (like SMS service, Info Services) and new tariff packages (Day and Night - flat rate prepaid tariff package, Tandem – free of monthly fee postpaid partner card tariff package). In addition, it also carried out a series of attractive sales promotions with good brand handsets based upon frame agreements with the main handset vendors. To focus on customer retention MobiMak introduced a customer loyalty program with valuable benefits for loyal customers. To measure the effectiveness of the marketing activity, MobiMak introduced a customer satisfaction measurement system, which monitors the satisfaction of the customers on a quarterly basis.

Marketing and Distribution

The liberalization of the telecommunications market in December 2001 marked the beginning of a new era for Matáv. While Matáv has already operated in the competitive markets of mobile telephone services and data communications services with success, it will still have to make some adjustments to a fully competitive environment.

Matáv's goal is to meet demands 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 2001, 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 which the Company offers and experience features through demonstrations. The Company established a total of 73 retail shops across Hungary by the end of 2001, including 23 ”Matáv Pont” shops. Matáv also operates an agent and dealer network, consisting of 100 dealer shops and approximately 200 agents. In 2001, Matáv created a unified incentive system for these indirect sales channels to ensure more effective sales activity.

Matáv's marketing activities focus on four elements:

- products;
- pricing;
- promotion; and
- 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 the fully liberalized market. The Company increasingly offers various pricing packages for its fixed line telecommunications services in order to satisfy the diverse needs of its clientele. Matáv has segmented the market and formed subscriber packages to offer solutions for all identified and targeted segments. 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. The Kontroll package introduced in September 2001 has no monthly subscription fee, but the calls have a higher per minute fee and are restricted to a prepaid amount. The Ritmus package was introduced in 2001 for business customers with reduced fees in the peak hours. In December 2001, another package was introduced which offers discounts based on the length of the calls. This package, Cseveg□, proved to be a very successful product, generating over 70,000 orders in its first 50 days of operations.

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, serving the residential, Small Office Home Office (”SOHO”) and Small and Medium Sized Enterprises (”SME”) customers;
- business customers, consisting of customers with relatively high usage and more specialized telecommunications needs, including the Hungarian government;
- wholesale providers, consisting of other LTOs 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, approximately 50 percent of the Company's 2001 revenues were derived from areas open to direct competition. Following the liberalization of the Hungarian telecommunications market, seven telephone service providers requested and received a carrier selection prefix code: Matáv, Vodafone, Vodacom, Pantel, e-Tel, GTS and Novacom.

Domestic Fixed Line Telecommunications Services

Until the end of 2001, the Company was 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, may begin to compete. Existing and potential service providers include other LTOs, operators of existing alternative networks, such as public utilities, railways and mobile telecommunications providers and global alliances of international telecommunications providers.

International Telecommunications Services

Matáv has been 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. 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 because of 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 Inter.net (formerly known as Elender), Datanet and Interware.

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.

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 provided for the promulgation of additional decrees by the Hungarian government and the Ministry. The concession telecommunications market was 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.

The regulation of the Hungarian telecommunications market has been changed fundamentally as of December 23, 2001 when the Act on Communications came into force. The Act on Communications provides the main legal framework for the Hungarian liberalized telecommunications market, and it provides for the promulgation of additional (governmental and ministerial) decrees.

The Telecommunications Act and the 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 gave Matáv the exclusive right to provide domestic long distance and international public fixed line voice telephony services throughout Hungary and local public fixed line voice telephony services in 29 Local Primary Areas for a term of eight years ending December 22, 2001. The concession has a total duration of 25 years and may be further extended by agreement with the Minister for another 12 and one-half years.

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

The Minister agreed in the Concession Contract that until December 22, 2001, it would 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 had 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 had to 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.

Modification and Termination of Concessions. Under the Telecommunications Act, the Minister had the right to 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 had to be supported by evidence and, subject to a reconciliation procedure, the Minister had the right to unilaterally modify such provisions. In such event, Matáv was entitled to compensation. The Minister has not exercised his authority to modify unilaterally any provisions of the fixed line concession contracts.

Pursuant to the Telecommunications Act, national telecommunications policy was developed by the Hungarian government and approved by the Hungarian parliament. The Minister was 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 set forth that the following services could 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 had 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 was allowed to engage in activities functionally related to its concession. In addition, the Concessions Act required that the concession holder be dissolved upon termination of its concession.

Until December 23, 2001, the Budapesti Hírközlési Felügyelet (the ”Budapest Telecommunications Inspectorate”) at the national and regional level, and the regional telecommunications authorities (”Regional Inspectorates” and, together with the Budapest Telecommunications Inspectorate, the ”Inspectorates”) at the local level were responsible for licensing. The activities of the Inspectorates were supervised by the Telecommunications General Inspectorate, a central budgetary organization established in 1993 under the control of the Ministry. The Inspectorates supervised the telecommunications service providers, issued required telecommunications service licenses and interconnection permits and monitored compliance with licenses and permits. In addition, the Budapest Telecommunications Inspectorate was 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

Service Provision Requirements. The Telecommunications Act generally required 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 did not connect a subscriber within the required period, it had to pay the subscriber liquidated damages equal to one third of the monthly subscriber's fee for each day of the delay. Matáv paid HUF 46 million in 1999 in respect of these penalties. In 2000, Matáv did not have to pay any such penalties. In 2001, Matáv paid HUF 47 million in respect of these penalties. The rights and obligations of the public telephone service providers and the subscribers were regulated until December 23, 2001 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 also had to meet requests of subscribers for public telephone services within certain time limits. The Company had to meet 90 percent of the requests of subscribers within six months and 98 percent within 12 months. In 2001, Matáv met these requirements in all of its Local Primary Areas subject to the Concession Contract.

Minimum Service Requirements. Matáv also had to 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.

Interconnection. The Telecommunications Act required public telephone service providers to provide interconnection to other public telecommunications networks and required 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 might have entered 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 required service providers, including Matáv, to meet technical and operating standards and regulations and to cooperate to permit unified network operation through interconnection.

The Minister had the right to issue decrees regarding signaling, traffic routing, synchronization, numbering and structure of the network interconnection. Government Decree 158/1993 (XI.11) on the Interconnection of Telephone Networks, the Licensing of their Cooperation and Network Contracts (the "Interconnection Decree") set forth the rules and procedures for interconnection of public networks and special purpose telecommunications networks for closed user groups. The Interconnection Decree prohibited a public telephone network from interconnecting with a network that was 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 required an additional interconnection license issued by the Budapest Telecommunications Inspectorate. The license for connection to a public network might have been granted subject to conditions ensuring, among other things, that the special purpose network was not used to provide services to third parties. With limited exceptions, operators of special purpose networks were permitted to interconnect for services other than public switched voice if they had an interconnection license issued by the Budapest Telecommunications Inspectorate or when such operators were affiliated.

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

Service Quality Requirements. The fixed line concession contracts also established 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 1999, 2000 and 2001 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.

From December 23, 2001, annual development targets and quality of service targets set in the concession contracts are no longer applicable. After the termination of the Concession Contracts these obligations are set in the Contract on Universal Service Provision and described in details in the Ministerial Decree 23/2001 (XII.22.) MeHVM on the Detailed Technical Obligations of the Universal Service Provision.

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

Domestic Goods and Services. The fixed line concession contracts required Matáv to use specified percentages of Hungarian goods and services in providing concessionary telephone services. Matáv satisfied 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 was obliged to 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.

Telecommunications Service Licensing Requirements. According to the Telecommunications Act, the provision of certain telecommunications services that did not require a concession was subject to service licenses, which were 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, was required for most liberalized telecommunications services. Certain additional non-public services might be provided subject to compliance with reporting requirements.

A service license might 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 was to be offered and the applicant's legal and technical qualifications. A service license might be issued for a term of ten years and might be extended, upon request, for successive additional terms of five years each. Matáv, holding a concession for public telecommunications services until the first half of 2002 (the national concession until January 31, 2002 and the local concession until May 24, 2002), 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. Emitel, holding a concession for public telecommunications services until November 1, 2002, may provide the services listed in the service license decree. Following this period, according to the Act on Communications and Government Decree 252/2001. (XII.18.) on the Notification of the Provision of Telecommunications Services, Emitel will confirm its right to provide communications services by notifying the relevant authorities.

Licensing and Allocation of Frequencies. The Minister set fees for frequency use by decree in agreement with the Minister of Finance. Act LXII of 1993 on Frequency Management (the ”Frequency Act”) set 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, regulated 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.

The state announced a tender for the 3.5 GHz frequency, where Matáv's bid was among the winners. The frequency will be used for the provision of new telecommunications services in the future.

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

Rights of Way. Under the Telecommunications Act, public telecommunications service providers were 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 was located for maintenance and fault elimination purposes. Further rights of use could be established on antennas and in utility tunnels. The public telecommunications service provider had to enter into a contract with the property owner setting forth the conditions for the common use of the property. Owners of real property were also obliged to remove obstructions to public telecommunications networks. Owners of real property had the right to claim compensation for the nuisance suffered as a result of entry onto their property.

Upon request, the competent Inspectorates could 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.

Change of Control. Under the Concession Contract, the Minister had to 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 could 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 had to 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 Telecommunications Act has been superseded since December 23, 2001 by the Act on Communications.

On January 28, 2002, the Minister and Matáv concluded the Contract on Universal Service Provision. According to this contract, the national concession was terminated on January 31, 2002, while in the five local areas (Debrecen, Nyíregyháza, Szentendre, Székesfehérvár and Szolnok) the local concessions will be terminated on May 24, 2002. On the basis of this contract, the obligation to pay concession fees ceased in respect of the national concession areas from January 31, 2002, while in the remaining five local concession areas the obligation to pay concession fees will cease on May 24, 2002.

The Act on Communications and the Contract on Universal Service Provision

Matáv’s future operations will be heavily influenced by the liberalization of the Hungarian telecommunications market. Act XL on Communications has been approved by the Parliament and entered into effect on December 23, 2001. Set forth below is a brief summary of certain provisions of the Act on Communications.

The Act on Communications has fundamentally changed the authority structure of the liberalized telecommunications market. The National Regulatory Authority (”NRA”, Hírközlési Felügyelet) is the supreme supervisory body, which includes three separate organizations: the Communications Inspectorate (Hírközlési Főfelügyelet), the Communications Regional Office (Hírközlési Területi Hivatal) and the Communications Arbitration Committee (Hírközlési Döntőbizottság), which have independent responsibilities and rights.

The Communications Inspectorate and the Communications Regional Office supervise the telecommunications market, may bring resolutions, start official procedures or initiate procedures before the

Communications Arbitration Committee or any other competent authority. The detailed provisions regarding the National Regulatory Authority contained in the Government Decree 252/2001. (XII.18.) on the Notification of the Provision of Telecommunication Services regulates the universal service.

Universal Service. According to the Act on Communications universal services are basic communications services that should be available to all customers at an affordable price. Universal services include access to fixed line voice telephony services of regulated minimum quality, 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 is provided through regulated tariff packages.

Universal service providers will be entitled to compensation for their loss of revenue resulting from the low price of universal service packages. Ministerial Decree 4/2002 (I.26.) MeHVM determines the detailed rules applicable to the percentage of revenues payable to the Universal Service Financing Fund and the compensation available for universal service providers from the fund.

Matáv became a universal service provider as a consequence of the contract that was concluded between Matáv and the Minister on January 28, 2002 (the ”Contract on Universal Service Provision”). Matáv’s Fixed Lines Concession Contracts have been superseded by the Contract on Universal Service Provision, in such a way that the national concession and the local concessions in 31 primary areas were terminated on January 31, 2002, while the local concessions in the remaining five concession areas will be terminated on May 24, 2002. Upon the termination of its concession contract in its three primary areas on November 1, 2002 at the latest, Emitel will also conclude the Contract on Universal Service Provision with the Minister.

Subscriber Contracts. The service providers must prepare both general terms and conditions and the subscriber contracts to be entered into with the subscribers. The Government Decree 249/2001 (XII.18.) on Telecommunications Subscriber Contract contains the general rules of agreements between subscribers for telecommunications services and the telecommunications service providers. In the subscribers contract the parties may rephrase the provisions of the Government Decree 249/2001 (XII.18) only if they are more favorable to the subscribers. The service providers already operating on the market are obliged to amend their existing general terms and conditions and subscribers contracts in accordance with the Government Decree 249/2001 (XII.18.) within 90 days from December 23, 2001.

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

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 and in a specific geographical area exceeds 25 percent. Obligations of SMP operators include accounting separation, publishing reference offers for interconnection services and unbundled local loops, operating a joint directory assistance service and eventually providing regulated leased line services.

Retail Prices. The Act on Communications 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 were determined in Decree 3/2002 (I.21.) MeHVM On Charges for Voice Telephony Services Provided by Companies with Significant Market Power and On Tariff Packages Related to Universal Services.

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 87/1990 on Prices and the relating ministerial decrees (3/2002 (I.21.) MeHVM and Decree 4/2002 (I.26.) MeHVM), the access deficit should be eliminated. Decree 3/2002 (I.21.) MeHVM deals with the access deficit problem by allowing an annual increase in subscription fees of universal tariff packages above annual inflation rate. In addition, Decree 1/2002 (I.11.) MeHVM on Costing Methodology of Network Services introduced an access deficit financing regime according to which an access deficit surcharge of HUF two per minute is applicable on all call origination and termination traffic until December 31, 2001.

Unbundled Local Loop. According to the Act on Communications and Government Decree 175/2001. (IX.26.) on Unbundling the Local Loops and its Procedural Rules, SMPs on the telephony market are obliged to unbundle twisted copper pair local loops and prepare reference offers for 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.

The SMPs may refuse the offer for unbundling if:

- the local loop in question does not have an appropriate length for the planned service of the other service provider;
- providing access to the local loop would endanger the unity of the SMPs' network; or
- the SMPs cannot provide physical connection to the local loop as a result of prior access having been granted to another service provider.

An SMP does not have to grant access to the local loops if any of the subscribers who have entered a pre-agreement with the intended new service provider have outstanding debts towards the SMP on the date on which it would be obliged to grant physical access. In addition, 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, therefore other local SMPs are not obliged to conclude unbundled local loop contracts with Matáv.

The cost base of the price of these services will eventually have to be calculated using Long Run Incremental Costs (”LRIC”), although Fully Allocated Costs (”FAC”) methodology can be used until January 1, 2003. Government Decree 175/2001 (IX.26.) provides for a transparent and non-discriminatory calculation method, which the service providers must keep to.

The SMPs must prepare a reference offer for the unbundling of the local loops in which they must regulate those matters listed in the Government Decree 175/2001 (IX.26.). The reference offer forms the basis of the agreements to be concluded with other service providers for unbundling the local loops. The reference offer of each SMP must be approved by the Arbitration Committee. The Arbitration Committee keeps a public, open register. Matáv’s Reference Offer for the Unbundling of the Local Loop (”MARUO”) has been approved by the Communications Arbitration Committee on February 28, 2002.

Interconnection. According to the Act on Communications and Government Decree 251/2001 (XII. 18.) on Network Interconnection Agreements, SMPs are obliged to prepare reference offers for interconnection and to provide these services when there is a request for them by other telecommunications service providers. The Act on Communications defines the basic rules under which the service providers may conclude agreements for a) access to each others’ networks, b) interconnection of their networks and c) the partial or full unbundling of their local loops.

According to the Government Decree 251/2001. (XII.18.), the SMPs are obliged to enter into agreements for access to their networks on the basis of an offer put forward by another service provider. The Communications Arbitration Committee has the competence to arbitrate in dispute cases. If the agreement is not entered into within 30-60 days of the offer because the service provider owning or using the network has not responded to the offer or has simply refused to enter into an agreement, the Arbitration Committee may establish the agreement between the parties. The reference offer of the SMPs must be approved by the Arbitration Committee.

Interconnection agreements concluded between service providers before the Act on Communications entered into force remain in effect, but modifications may be initiated by either party.

A new interconnection agreement on the basis of the provisions of the Act on Communications was concluded between Matáv and Vivendi (the second most significant fixed line telecommunications service provider in Hungary) on December 21, 2001 and between Matáv and Pantel on April 8, 2002. Matáv's Reference Offer for Interconnection ("MARIO") has been filed to the Communications Arbitration Committee for approval. This approval procedure is still in process. The tariffs applied in the new interconnection agreements will be retrospectively modified according to the approved Reference Interconnection Offer ("RIO") tariffs.

Carrier Selection. Since the expiration of Matáv's exclusive rights to provide domestic long distance and international telephony services on December 23, 2001, voice telephony customers have the right to select different service providers for domestic and international fixed line calls and for international mobile calls by dialing a pre-selected number or by using a call-by-call pre-fixed number. The requirements for carrier selection are an interconnection agreement between the affected service providers, a carrier selection number and the connection of the calls to the desired end user.

Carrier selection agreements can be concluded in writing, orally or through an implied contract, whereas pre-fixed selection is carried out only through an implied contract by actually using the pre-fixed number. Government Decree 250/2001 (XII.18.) on Carrier Selection obliges the chosen service providers to inform the former service providers about any form of carrier selection, and the rules also provide that in the case of faulty performance, the risk is born by the actual service provider unless the parties agree otherwise.

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 in the same geographic location.

Telecommunications Service Licensing Requirements. According to the Act on Communications the provision of communications services shall be notified to the Communications Regional Office for registration 30 day before its starting. The detailed rules to the notification of services are laid down in Government Decree 252/2001. (XII. 18.) on Notification of the Provision of Telecommunications Services. The authority may reject the registration in cases when the notifying entity does not fulfill the conditions specified in the Act on Communications and other legislation. All communications service providers that have obtained the right to provide communications services pursuant to license or notification before the Act on Communications entered into force may pursue such activity according to such right.

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

Rights of Way. According to the Act on Communications, communications service providers are entitled upon prior notification of the owner to install telecommunications equipment on private property and to enter private property where communications facilities (equipment, cables, antennas) are located for maintenance and fault elimination purposes. The public telecommunications service provider has to 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 have the right to claim compensation for the nuisance suffered as a result of entry onto their property.

Upon request, the competent Inspectorate could establish easements in favor of a public telecommunications service provider on real property for the purposes of placing communications facilities. Matáv is seeking easements over a substantial number of real properties on which the Company or its predecessors installed such facilities. 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. The party that orders construction (installation) of communications structures shall restore the initial conditions of the environment after the completion of construction works. If the communications structure installed by the service provider provides for the customer residing or staying in the direct proximity of the structure better than average service or additional services, the service provider may not require compensation for it, neither in the subscriber contracts nor in any other way.

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 March 2000, Deutsche Telekom AG finalized the purchase of MediaOne's interests in mobile operations in Central and Eastern Europe including MediaOne International B.V. (which owned 49 percent of Westel) and 49 percent of Westel 0660. At the same time the Company was granted an option to purchase the 49 percent holdings in Westel and Westel 0660 from Deutsche Telekom AG during the fifteen-month period ending September 2001. On December 21, 2001 Matáv paid Deutsche Telekom AG EUR 920 million (HUF 227 billion) and has agreed to pay in 2002 an additional amount equal to 49 percent of the dividend to be declared by Westel for 2001. Based on the amount of dividend with respect to 2001 declared by Westel, Matáv will have to pay an additional HUF 12 billion. No dividends were declared by Westel 0660. The purchase price was financed by way of a medium term EUR loan provided by Deutsche Telekom AG at an interest rate of LIBOR plus 50 basis points.

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. On October 7, 1999 an amended 900 Concession Contract was signed, allowing Westel and its 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.

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 900 Concession Contract (November 1999). The second installment of HUF 2,750 million, adjusted for changes in the HUF/USD exchange rate, was paid eight days after the commencement of 1800 MHz service (November 16, 2000). The remaining HUF 5,500 million, adjusted for 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 one million since the commencement of the 1800 MHz service.

Frequency Fees. In accordance with the 900 Concession Contract, the frequency fee payable to the Ministry consists of two parts: a frequency reservation fee and a frequency usage fee. 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 2001, Westel paid a HUF 333,000 frequency reservation fee and a HUF 2,013 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.

Roaming Agreements. Westel may sign roaming agreements with other public mobile telecommunications service operators outside of Hungary in accordance with the rules of the GSM Association, an association of digital mobile cellular telecommunications service providers.

Interconnection. If Westel receives a request for interconnection (to provide either network access or network interconnection) from another telecommunications operator, it is required under the Act on Communications and Government Decree No. 251/2001 to enter into a contract, provided that such request is justified on both technical and economic grounds and the meeting of such request is not rendered impossible due to a scarce resource. The meeting of this obligation should be on a non-discriminatory basis.

In case Westel is designated by the NRA as a telecommunications operator having an SMP status in the national interconnection market, it will be obligated to offer network interconnection services with charges calculated on the basis of FAC or LRIC, maintaining separate accounts, subject to filing for prior approval by the NRA. The NRA decision as to the eventual assignment of the SMP status is expected between May and July 2002.

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 1999, 2000 and 2001 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. If Westel 0660 receives a request for interconnection (to provide either network access or network interconnection) from another telecommunications operator, it is required under the Act on Communications and Government Decree No. 251/2001 to enter into a contract, provided that such request is justified on both technical and economic grounds and the meeting of such request is not rendered impossible due to a scarce resource. The meeting of this obligation should be on a non-discriminatory basis.

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 1999, 2000 and 2001 it had met its concession obligations.

Competition Law Restrictions

Similarly to the Concession Contract, the Act on Communications and the Contract on Universal Service Provision prohibit 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.

During the concession period, until December 23, 2001, the Concession Contract specifically prohibited several practices. Matáv could 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 used the public telephone network for providing its own services had to the same as those that it offered to other providers. Matáv could supply terminal equipment to customers but could 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.

According to the Act on Communications and the Competition Act, the service provider with significant market power shall provide services to other telecommunications service providers being in the same position on the same commercial terms, and these terms may not be less favorable than those offered to other service providers controlled by it or controlling it.

According to the Contract on Universal Service Provision, Matáv is obliged to provide subscribers in the same position reasonably similar treatment and to refrain from unfavorable distinction and/or unjustified advantage with respect to the conditions and fees of universal service provision.

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 and registering other broadcasters and transmitters.

National and regional television and radio broadcasting or broadcast ”distribution” to local operators generally required concessions under the Telecommunications Act and could be carried out on the basis of a program distribution contract in accordance with the Media Act between the NRTB and the distributor. The Act on Communications does not change the former regulation. 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, which is now reinforced in a more stringent way in the Act on Communications. As a result, Matáv Rt. and its subsidiary MatávkábelTV, which was founded with the aim of providing program distribution services, can 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. This restriction only prevails until January 1, 2004.

Pricing

Regulatory Framework

In accordance with the Pricing Act, as modified by the Act on Communications, the Minister, acting in agreement with the Minister of Finance, is responsible for setting maximum tariffs for voice telephony services provided by companies with significant market power and maximum tariffs for universal 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.) MeHVM (the "2001 Fixed Line Tariff Decree"). The 2001 Fixed Line Tariff Decree established public fixed line telephone service charges to be applied from February 1, 2001.

Entrance Fees. One-time entrance fees were 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").

Since February 1, 2002, fixed line tariffs and entrance fees have been regulated by one common decree, Decree 3/2002 (I.21.) MeHVM On Charges for Voice Telephony Services Provided by Companies with Significant Market Power and On Tariff Packages Related to Universal Services (the "2002 Fixed Line Tariff Decree"). The 2002 Fixed Line Tariff Decree extends the validity of tariffs set in 2001 until June 30, 2002, with the exception of subscription fees, for the first time including fixed to mobile tariffs as well. Subscription fees are uniformly increased by four percent as of February 1, 2002. After June 30, 2002 fixed line tariffs may be changed in accordance with the price cap rules stipulated by the 2002 Fixed Line Tariff Decree. The only exceptions are the residential main line subscription fee that can be increased by three percent and local usage fees that can be increased by an average of five percent as of July 1, 2002.

Interconnection Fees. Interconnection fees were regulated by Decree 1/1998 (I.12) KHVM 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) MeHVM (the "2001 Interconnection Decree"). From 2002, interconnection tariffs are not regulated any more in a decree but have to be cost-based and are fixed in the Reference Interconnection Offer approved by the NRA.

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 2002 Fixed Line Tariff Decree gives service providers the right to collect an additional fee for providing connections in rural areas of up to 50 percent of the costs incurred, if the entrance fee does not cover the direct costs of the service provider. Entrance fees and 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 2001, 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 2001. After taking into account a 2.9 percent productivity factor to which Matáv Rt. is subject and a 2.9 percent correction factor, Matáv Rt.'s aggregate price cap for tariff increases in 2001 under the principles set forth in the 2001 Fixed Line Tariff Decree was six percent. The correction factor was applied in order to compensate for the under-estimated consumer price index defined by the government as six percent for 2000, while the relevant October to October index was 10.9 percent. The correction factor was two-thirds of the difference. At the same time the 2001 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 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 2001 as verified by the Central Statistical Office, therefore it was not subject to any tariff reduction.

The 2002 Fixed Line Tariff Decree redefined 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 for 2002 as seven percent, and decreased by the productivity factor, and is increased, if necessary, by the correction factor. The correction factor should only be applied in cases where the real consumer price index exceeds the estimated figure by at least one percent. In such a case the correction factor is two-thirds of the difference between the estimated and the actual figure. The Minister increased the productivity factor to three percent for 2002, accordingly the aggregate price cap totals four percent. The residential price cap is no longer distinguished. Tariff rebalancing is regulated by setting the maximum increase of the residential main line subscription fee to an average 5.2 percent in 2002 and an annual ten percent in 2003 and 2004. Tariff rebalancing is also restricted by setting a maximum of five percent increase for local usage fees in 2002, which is lifted to six percent in 2003 and 2004. However, Decree 1/2002 (I.11.) MeHVM on Costing Methodology of Network Services introduced an access deficit financing regime according to which an access deficit surcharge of maximum HUF two per minute can be applied on all call origination and termination traffic until December 31, 2004. This access deficit financing regime will help to reduce the potential losses due to incomplete rebalancing.

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)

So far in 2002, tariffs have only changed for monthly subscription fees. Monthly subscription charges increased by four percent effective from February 1, 2002. Traffic list prices are expected to change only in the second half of 2002.

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 2001, the call set-up charge was HUF 3.80 per call (in 2000, it was HUF 6.00 per call), exclusive of VAT, and is independent of the tariff zone or time period of the call.

Leased Line Fees

The maximum tariffs for leased lines required for interconnection activities were subject to the Pricing Act and were regulated by ministerial decrees. All other leased line tariffs were unregulated. According to the new regulation, if and when Matáv is officially declared as a company with significant market power in the leased line market, the prices charged based on a network contract will have to be cost based. In 2001, the average leased 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 until December 23, 2001, paid 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 was entitled to the following interconnection fees if the call was 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 was entitled to the following interconnection fees if the call was 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 was the same as in 2000. Matáv Rt., as the exclusive provider of long distance services, was entitled to receive 20 percent of the average of the Zone 1 fees. The terminating local operator, including Matáv Rt. where it was the local service provider, was 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. had to 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 received 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 until December 23, 2001, 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. received a HUF 1.85/minute interconnection fee for transiting national long distance calls originated or terminated by a mobile service provider. Matáv Rt. received 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. was 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. had to pay a fixed fee of HUF 36.00/minute to a mobile operator for terminating international calls in the mobile network.

Interconnection fees in 2002

The Act on Communication, the Ministerial Decree 1/2002 (I.11.) MeHVM On Costing Methodology of Network Services, the Government Decree 251/2001 (XII.18.) on Network Interconnection Agreements and the Government Decree 250/2001 (XII.18.) on Carrier Selection have changed the principles of interconnection and interconnection fees.

SMPs are obliged to prepare reference offers for interconnection and local loop unbundling and to provide these services when there is a request for them by other telecommunications service providers. Matáv handed in its reference unbundling offer first on October 5, 2001 and a second version on December 22, 2001. The latter one was approved by NRA on February 28, 2002. Matáv handed in its first reference interconnection offer on January 22, 2002 and a second version was submitted on April 25, 2002. The corrected reference offer has to be reviewed by the NRA in 60 days. Taking all that into consideration, interconnection prices approved by the regulator are expected to be known by June 2002 at the latest.

Interconnection fees of an SMP on the interconnection market have to be cost-based. Until January 1, 2003, FAC methodology of costing can be used. In this methodology the service provider determines the cost per unit for a service, including the cost of capital, a rate which is prescribed in the Ministerial Decree 1/2002 (I.11.) MeHVM On Costing Methodology of Network Services. In 2002 the regulated cost of capital rate is 19 percent. From January 1, 2003 the methodology of LRIC will have to be used for interconnection pricing.

Between 2002 and 2004, an extra charge of maximum HUF two can be applied by both costing methodologies in cases of interconnection traffic services in order to compensate for local access deficit. This extra charge can be applied both for call origination and call termination.

Existing network interconnection contracts with LTOs and mobile operators remain in force until modification that can be initiated by any of the contracting parties. The tariffs applied in the new interconnection agreements will be retrospectively modified according to the approved reference interconnection tariffs.

The liberalization of the fixed line telecommunications market in December 2001 is expected to have an effect on the mobile telecommunications industry as well. It is expected that government regulated fees and interconnection prices will significantly change and these changes will impact the operations of Westel.

Reverse charging agreements between Matáv and ISPs

In November 2001 Matáv signed reverse charging agreements with a number of ISPs. According to these agreements, customers pay their telecommunications bills for Internet usage to the ISPs instead of paying directly to Matáv. This new scheme allows ISPs to form various fee-packages based on their customers' needs.

ORGANIZATIONAL STRUCTURE

At December 31, 2001 the principal operating associates, joint ventures and subsidiaries of the Company, which are incorporated in Hungary and Macedonia, were as follows:

Associates / Joint ventures	**Group interest in capital**	**Activity**
Hunsat Magyar □rtávközlési Koordinációs Egyesülés …..	50.00%	VSAT satellite communications
DSP Rt. …………………………………………………	36.84%	Cable TV holding
Magyar RTL Televízió Rt. ....….....	25.00%	Television broadcast company
Németkábel Vagyonkezel□ Rt. …………………………..	25.00%	Cable TV holding

Subsidiaries	**Group interest in capital**	**Activity**
Axelero Rt. …..........………………….........…………...	100.00%	Internet service and content provider
Emitel Rt. ……………….................................…..…….	100.00%	Local telecommunications operator
InvesTel Rt. ……………….....................................……	100.00%	Cable TV holding
Makedonski Telekommunikacii AD (Maktel) …………...	44.11%	Macedonian telecommunications company
Matávcom Kft. ……………........................…....…...........	100.00%	Solutions for business customers
MatávkábelTV Kft. ………...........................…...….......	75.00%	Cable television operator
Stonebridge A.D. …………………………………………	86.50%	Macedonian holding company
Westel Rádiótelefon Kft.………………………………..	100.00%	Cellular telephone services
Westel Mobil Távközlési Rt.………………….....…......	100.00%	GSM digital cellular telephone services

PROPERTY, PLANTS AND EQUIPMENT

Description of Property

As of December 31, 2001, Matáv's property, plants and equipment had a total net book value of HUF 654,298 million.

Matáv has one of the largest real estate portfolios in Hungary with an aggregate net book value at December 31, 2001 of HUF 92,649 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 were 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, 2001 was HUF 485,568 million.

INFRASTRUCTURE AND TECHNOLOGY

Over the past three years, 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 105 billion in 2002. The Company expects an increasing proportion of capital expenditures to be devoted to 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, 2001, 85.4 percent of Matáv's exchange capacity was digital, compared to 75.7 percent at December 31, 1998. Each of the Matáv concession areas is served by a digital primary exchange. Digitalization permits a broader range of services and generates operational cost savings. Digitalization is also a prerequisite for providing ISDN services. The number of local exchanges capable of providing ISDN services has increased considerably and the number of ISDN channels grew from 70,642 at December 31, 1998 to 448,396 at December 31, 2001. 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 2002, Matáv plans to introduce a 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. By the end of 2001, Matáv had installed nearly 2.5 million access lines and 450,000 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. At the end of 2001, this service was available in Budapest and major cities, distributed via wholesale ISP partners. The ADSL transmission system provides high speed digital access to any data network over existing copper wires without interruption of Plain Old Telephone System (”POTS”)/ISDN2 services. In 2002, Matáv plans to enhance broadband access services and introduce new products based on ADSL and other xDSL technologies, such as web based service selection. At the end of 2001, approximately 6,200 customers were using ADSL lines for connection to the Internet.

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 removed its analog radio local loop system from Budapest by August 31, 1999. At December 31, 2001, the Company still provides services for approximately 60,400 RLL subscribers. Matáv introduced fixed GSM technology in March 2000 to replace the analog RLL system. The fixed GSM uses the existing GSM mobile network for Public Switched Telephone Network (”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 2001, the number of fixed GSM subscribers in Matáv’s access network included approximately 43,900 RLL replacements and 22,000 new connections.

Matáv uses fiber optic cables in its fixed line local loop networks, with approximately 210,000 64 Kb/s equivalent channels connected to subscribers at the end of 2001. 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. Matáv plans to extend its local fiber optic network both inside and outside Budapest to cover new demands in existing areas.

3.5 GHz Point to Multipoint Systems. In 2001, Matáv began to deploy the 3.5 GHz microwave point to multipoint (”P-MP”) systems to meet customers' requirements, mainly for business communications. These systems can provide all of Matáv's services: managed leased line network (”MLLN”), IP (Voice over IP, VPN), ISDN2, ISDN30, POTS in all regions of Hungary. In 2002, Matáv is going to expand the deployment of the 3.5 GHz P-MP systems.

CityNet. CityNet is an overlay network for large cities that connects Matáv nodes and key business customers with optical cables. It provides access to business communications services of Matáv. By the end of 2001 more than 200 km of optical cable was installed in Budapest connecting 155 customers. Outside Budapest approximately 80 km of optical cable was also installed connecting 27 customers. This network typically provides ISDN30, MLLN, HSLL and ATM-based services.

In the next three years about 120 km of new optical cable is expected to be installed outside Budapest to connect about 200 customers. In Budapest about 80 new customers are planned to be connected to the existing cable network. New CityNet products are also expected to be introduced.

METRO. METRO is Matáv's network in the LTO areas and cities, for data communications purposes. By the end of 2001, Matáv had installed approximately 40 km of optical cables in four cities, reaching more than 150 customers.

Backbone Network. Matáv has a digital fiber optic national long distance network that connects local primary area networks. The Company has implemented dense wavelength division multiplexing (”DWDM”) technology and SDH systems in both the national long distance and Budapest networks. The countrywide DWDM backbone network, installed in 2001, provides huge capacity (maximum 64 times 10 Gb/s) in the most important nodes of Hungary, as well as in international directions. In addition to cost advantages, SDH systems provide a flexible transmission infrastructure with automatic transmission paths. Matáv installed additional routes of optical cable and SDH systems in the long distance network during 2001, increasing both network availability and transmission capacity. As of December 31, 2001, Matáv had 4,500 km of backbone optical cable 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. In 2001, Matáv introduced ATM based MPLS technology to merge IP backbone network with ATM network and to provide IP-VPN for business customers. We have introduced new services, including: IP-VPN offering secure, scalable remote site interconnection over a shared IP backbone; IP Virtual Private Dial-up Network (”VPDN”) offering dial-up access to the customer’s private network, and Virtual PoP services providing Internet connection and access capacity with nationwide coverage to ISPs. The network now has PoPs in each primary area in Hungary. In 2001, Matáv introduced IP based Integrated Voice and Data (”IVD”) service offering IVD interconnections between business customers' premises. We plan to support new capabilities and services and to increase the bandwidth available for IP services in the future.

Intelligent Network (”IN”). Matáv has modernized its intelligent network platform. The Company launched the first set of IN 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. In 2001, new features were added to the prepaid application, thus a new tariff package was introduced for residential customers. The recharging of the accounts can be done via bank automats. The IN Service Creation function is widely used to satisfy specific customer demands. Matáv plans to develop new IN based services and to enhance and expand its existing services in the future.

Asynchronous Transfer Mode. Matáv introduced the first public network in Hungary based on ATM 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 13 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 55 companies in 48 countries and intends to expand these connections in 2002. Matáv has also established international ISDN connections with 45 companies in 40 countries.

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 17.07 percent in 1999 to 12.24 percent in 2001 and has reduced the call failure rate for national calls from 1.13 percent to 0.92 percent over the same period. The Company has also cut downtime per main line per year from 2.07 hours in 1999 to 1.13 hours in 2001. 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, to 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 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 2001, approximately 50 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 ended in December 2001. Its exclusive rights to provide fixed line local service in 31 local concession areas ended in December 2001 and in its five local concession areas end in May 2002. Emitel, Matáv's fully owned subsidiary, has exclusive rights in an additional three concession areas through November 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 2001, 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 and 2001, 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 and 2000, respectively. In 2000 and 2001, interconnection fees Matáv received from other local telephone operators for terminating calls have decreased in comparison with 1999 and 2000, respectively. Matáv is in the process of concluding interconnection agreements with other fixed line and mobile service providers for 2002, therefore the direction of change is not known yet in respect of interconnection fees.

- *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. has been utilizing a reduced allowance of 60 percent for a maximum possible 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. As a result of Matáv's acquisition of the remaining 49 percent of Westel, foreign ownership fell below 30 percent, hence Westel lost its 60 percent reduction in income tax as of December 21, 2001.

- *Inflation.* Annual inflation in Hungary, as measured by changes in the consumer price index, averaged 10.0 percent in 1999, 9.8 percent in 2000 and 9.2 percent in 2001. 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. Until October 2001, the Hungarian Forint was 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

Basis of presentation

In March 2000, Deutsche Telekom finalized the purchase of MediaOne's interests in mobile operations in Central and Eastern Europe including MediaOne International B.V. (which owned 49 percent of Westel) and 49 percent of Westel 0660. At the same time the Company was granted an option to purchase the 49 percent holdings in Westel and Westel 0660 from Deutsche Telekom during the fifteen-month period ending September 2001. On December 21, 2001 Matáv paid Deutsche Telekom AG EUR 920 million (HUF 227 billion) and has agreed to pay in 2002 an additional amount equal to 49 percent of the dividend to be declared by Westel for 2001. Based on the amount of dividend with respect to 2001 declared by Westel, Matáv will have to pay an additional HUF 12 billion. No dividends were declared by Westel 0660. The purchase price was financed by way of a medium term EUR loan provided by Deutsche Telekom AG at an interest rate of LIBOR plus 50 basis points.

The Company was controlled by Deutsche Telekom so this was a transaction between parties under common control. The financial statements have been restated as if the Westels were wholly owned subsidiaries of Matáv since March 23, 2000, the date when Deutsche Telekom acquired 49 percent of the Westels. The consideration for the Company's acquisition of the Westels was financed by a loan from Deutsche Telekom. The loan agreement was completed on December 20, 2001. The book value of the Company's additional share of net assets (including goodwill and other intangibles) of the Westels on March 23, 2000 has been presented as an increase in equity at December 31, 2000 (HUF 252,408 million).

The impact of the restatement was to increase the amortization of intangibles by HUF 16,780 million in 2000 and HUF 16,411 million in 2001, increase deferred tax credit by HUF 456 million in 2000 and reduce deferred tax charge by HUF 26 million in 2001 and decrease minority interest in the income statement by HUF 14,213 million in 2000 and HUF 23,739 million in 2001. The minority interest in Westel and Westel 0660 was eliminated and considered as part of group net income both for 2000 and 2001.

Total Revenues

Matáv's total revenues grew by 42.3 percent from 1999 to 2001. Matáv's total revenues amounted to HUF 384,932 million in 1999, HUF 445,945 million in 2000 and HUF 547,735 million in 2001. Increases in revenues from fixed line telecommunications services have been driven by increases in monthly subscriptions 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 69.5 percent from 1999 through 2001 driven by a rapid increase in the mobile subscriber base. Total revenues of the Company also grew through international expansion.

Total Operating Expenses

The Company's total operating expenses increased by 62.4 percent from 1999 to 2001. Operating expenses amounted to HUF 263,801 million in 1999, HUF 349,854 million in 2000 and HUF 428,335 million in 2001. Matáv's total operating expenses as a percentage of total revenues increased from 68.5 percent in 1999 to 78.2 percent in 2001. 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 significantly from 16.1 percent in 1999 to 21.3 percent in 2001. 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 20.4 percent in 1999 to 22.6 percent in 2001 due primarily to increases in expenses related to materials, frequency fees, marketing, outsourcing of real estate management and IT activities.

Total Operating Profit

Matáv's total operating profit decreased by 1.43 percent from HUF 121,131 million in 1999 to HUF 119,400 million in 2001, as total operating expenses grew at a faster rate than total revenues.

Trend Information

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.

Revenue and EBITDA margin targets

In light of Matáv's refocused activities and increased operating expenses, we expect to achieve high single digit percent revenue growth and an EBITDA margin of over 40 percent in 2002.

Results of Operations — By Segment

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

	Year ended December 31,		
	1999	2000	2001
		(in HUF millions)	
Revenues:			
Fixed line	302,230	326,280	333,685
Mobile	117,336	159,345	198,947
International	n.a.	n.a.	60,034
Intersegment eliminations (1)	(34,634)	(39,680)	(44,931)
Total	384,932	445,945	547,735
Operating expenses:			
Fixed line	216,759	255,443	273,542
Mobile	81,676	134,091	163,154
International	n.a.	n.a.	36,570
Intersegment eliminations (1)	(34,634)	(39,680)	(44,931)
Total	263,801	349,854	428,335
Operating profit:			
Fixed line	85,471	70,837	60,143
Mobile	35,660	25,254	35,793
International	n.a.	n.a.	23,464
Total	121,131	96,091	119,400

(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,	
	1999	2000	2001	2000/1999	2001/2000
	(in HUF millions)			(% change)	
Revenues:					
Subscriptions, connections and other charges	63,413	83,243	97,128	31.3	16.7
Domestic traffic revenues ....….........	134,071	129,517	123,366	(3.4)	(4.7)
Other usage ....….…......	26,999	26,679	24,276	(1.2)	(9.0)
International traffic revenues ....…......	43,807	41,432	35,119	(5.4)	(15.2)
Leased lines ....…..	13,816	16,453	18,010	19.1	9.5
Data transmission and related services …....	7,781	11,949	17,741	53.6	48.5
Telecommunications equipment sales	3,030	4,810	3,582	58.7	(25.5)
Construction, maintenance and other ….......	9,313	12,197	14,463	31.0	18.6
Total...…........	302,230	326,280	333,685	8.0	2.3

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 2000 and 2001 principally as a result of nominal increases in standard monthly subscription fees and the increase in access lines as well as increases in usage of digifon services.

Monthly subscription fees increased in nominal terms by 49.9 percent in 2000 and 27.2 percent in 2001.

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

	Year ended December 31,			Year ended December 31,	
	1999	2000	2001	2000/1999	2001/2000
				(% change)	
Average access lines in Matáv's areas:					
Residential ……...........................….........	2,271,249	2,333,127	2,213,601	2.7	(5.1)
Business ……...............................….........	371,823	357,588	306,778	(3.8)	(14.2)
Public payphones ....….........	35,987	36,448	37,145	1.3	1.9
Total ....….......	2,679,059	2,727,163	2,557,524	1.8	(6.2)
ISDN channels ....…........	88,125	192,468	382,859	118.4	98.9
Total ....….......	2,767,184	2,919,631	2,940,383	5.5	0.7
Average access lines in Emitel's areas:	n.a.	n.a.	81,346	n.a.	n.a.

The increase in access lines throughout the period reflects the build-out of Matáv's network. The majority of this increase related to ISDN channels. The number of analog lines decreased in 2001 compared to 2000, partly as a result of migration of residential and 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 decreased in 2000 compared to 1999 principally as a result of nominal decreases in tariffs. On February 1, 2000 Matáv decreased its local tariffs by 10.8 percent, and decreased long distance tariffs by 12.6 percent in each case on average in nominal terms, while tariffs for calls from fixed line to mobile telephone did not change. Domestic traffic revenues decreased in 2001 compared to 2000 as a result of tariff decreases. On February 1, 2001 Matáv decreased its local tariffs by 6.4 percent and long distance tariffs by 14.1 percent, while tariffs for calls from fixed line to mobile telephone did not change. These tariff decreases were partly offset by increases in usage per line. Changes in tariffs did not have a significant effect on 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 decreased in 2000 and 2001 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,	
	1999	**2000**	**2001**	**2000/1999**	**2001/2000**
	(in HUF millions, except traffic figures)			**(% change)**	
Revenues:					
Outgoing international traffic revenue (1)..	21,215	17,490	13,843	(17.6)	(20.9)
Incoming international traffic revenue (2) .	22,592	23,942	21,276	6.0	(11.1)
Total	43,807	41,432	35,119	(5.4)	(15.2)
Traffic in thousand of minutes:					
Outgoing international at Matáv Rt.(3) ..…	192,356	182,479	166,649	(5.1)	(8.7)
Outgoing international at Emitel (4)………	n.a.	n.a.	1,370	n.a.	n.a.
Incoming international (5)	441,193	474,388	405,094	7.5	(14.6)

(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) Traffic generated since July 1, 2001, the date when Emitel became a fully consolidated subsidiary of the Company.
(5) 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 2000 and 2001, revenues from outgoing international traffic decreased principally as a result of tariff decreases. International tariffs decreased by 12.2 percent in 2000 compared to 1999 and by 15.0 percent in 2001 compared to 2000. In addition, international traffic also decreased both in 2000 and 2001 due to 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 2000, principally as a result of the increase in international incoming traffic minutes and the continuing devaluation of the Hungarian Forint against special drawing rights, in which international settlement payments between telecommunications providers are generally denominated. Revenues from incoming international traffic decreased in 2001 principally due to the decrease in incoming traffic minutes.

Leased Lines. Revenues from leased lines increased in both 2000 and 2001 principally as a result of growth in the number of leased line connections, which increased from 7,007 at December 31, 1999 to 11,386 at December 31, 2001.

Data Transmission and Related Services. Revenues from data transmission and related services increased in both 2000 and 2001 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 114,466 channels at the end of 1999 to 448,396 channels at the end of 2001. The number of dial-up Internet subscribers almost tripled from December 31, 1999 to December 31, 2001. Through network development and acquisitions, the number of cable customers has also grown significantly, reaching approximately 300,000 subscribers by the end of 2001.

Telecommunications Equipment Sales. Revenues from telecommunications equipment sales increased in 2000 compared to 1999 as a result of more ISDN telephone sets sold in 2000. Revenues from telecommunications equipment sales decreased in 2001 compared to 2000 as a result of decreased equipment sales activity of Matávcom.

Construction, Maintenance and Other Services. Revenues from construction, maintenance and other services increased both in 2000 and 2001 as a result of higher advertising revenue at Matáv Rt. from phonebook publishing, partly offset by lower construction and maintenance activities of Matávcom.

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,**	
	1999	**2000**	**2001**	**2000/1999**	**2001/2000**
	(in HUF millions)			**(% change)**	
Operating expenses:					
Employee-related expenses	45,881	51,595	53,775	12.5	4.2
Depreciation and amortization	49,873	60,932	65,948	22.2	8.2
Payments to other network operators	61,800	71,641	74,560	15.9	4.1
Cost of telecomm. equipment sales	3,370	5,071	4,070	50.5	(19.7)
Other operating expenses	55,835	66,204	75,189	18.6	13.6
Total	216,759	255,443	273,542	17.8	7.1

Employee-related Expenses. Employee-related expenses consist of wages and salaries, social security and other expenses. Employee-related expenses increased in 2000 and 2001 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 11.7 percent in April 2000 and 12.5 percent in April 2001. 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 expenses. Beginning in 2000, severance provision expenses as well as release of severance provision are shown as part of employee related expenses. 1999 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 1,256 employees or 8.7 percent in 2000 and by 1,685 employees or 12.78 percent in 2001 as a result of streamlining of the organizational structure, natural attrition and improved efficiency.

Depreciation and Amortization. Depreciation and amortization expenses increased in both 2000 and 2001 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 2000 and 2001 as a result of increased penetration of mobile customers.

Other Operating Expenses. The majority of the increases in other operating expenses in both 2000 and 2001 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 write-downs 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,**	
	1999	**2000**	**2001**	**2000/1999**	**2001/2000**
				(% change)	
Operating profit (in HUF millions)	85,471	70,837	60,143	(17.1)	(15.1)
Operating margin (%)(1) ....……..........	28.3	21.7	18.0	n.a.	n.a.

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

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. In 2001, operating profit decreased by 15.1 percent partly as a result of tariff decreases for fixed line telecommunication services.

Mobile Telecommunications Segment

Revenues

	Year ended December 31,			December 31,	
	1999	2000	2001	2000/1999	2001/2000
				(% change)	
Revenues	117,336	159,345	198,947	35.8	24.9

Revenues from the mobile telecommunications segment consist of one-time connection fees, monthly subscription fees (only payable by postpaid customers), traffic charges, including fees for value added services, and equipment sales. Revenues increased in 2000 and 2001 principally as a result of rapid growth in the number of subscribers. Within the mobile telecommunications segment, value added services show the highest increase, with 85.0 percent growth in 2001 compared to 2000. Value added services represented 7.0 percent of revenues from mobile telecommunications services in 2001. This revenue is primarily from fees charged for short message services.

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,	
	1999	2000	2001	2000/1999	2001/2000
				(% change)	
Average number of subscribers:					
Westel	686,973	1,186,293	2,008,667	72.7	69.3
Westel 0660	96,934	87,411	60,087	(9.8)	(31.3)
Average monthly usage per:					
Westel subscriber (minutes)	200	184	146	(8.0)	(20.7)
Westel 0660 subscriber (minutes)	179	170	156	(5.0)	(8.2)

Westel's revenues from mobile telecommunications services increased from 1999 through 2001, primarily as a consequence of the continued growth in the Westel subscriber base. The average number of Westel subscribers grew by 69.3 percent in 2001 compared to 2000. Within the Westel customers, the prepaid group shows a significant, 100.5 percent, increase. Prepaid customers accounted for approximately 84.9 percent of gross additions in the year ended December 31, 2001 and represented 67.4 percent of total Westel customers at December 31, 2001. The churn rate of Westel is low compared to international benchmarks. Westel continuously monitors its churn rates and proactively offers tailor-made discounts in order to retain valuable customers.

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. The decreasing minutes of use (”MOU”) is also due to the increasing proportion of the prepaid customer base, which has lower minutes of usage than regular subscribers. In addition, per minute charges also decreased both in 2001 and 2000 due to increasing competition and to changes in call patterns, whereby the proportion of lower tariff calls (such as within network and off-peak period) is increasing in the call distribution. As a result, ARPU decreased from HUF 9,067 in 2000 to HUF 6,946 in 2001.

In 2000 and 2001, Westel 0660's subscriber base as well as the average monthly usage per Westel 0660 subscriber 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,	
	1999	**2000**	**2001**	**2000/1999**	**2001/2000**
	(in HUF millions)			**(% change)**	
Operating expenses:					
Employee-related expenses	10,749	14,429	15,964	34.2	10.6
Depreciation and amortization	12,272	33,788	40,282	175.3	19.2
Payments to other network operators..........	15,304	21,164	30,456	38.3	43.9
Cost of telecomm. equipment sales............	19,024	29,269	32,863	53.9	12.3
Other operating expenses	24,327	35,441	43,589	45.7	23.0
	81,676	134,091	163,154	64.2	21.7

Employee-related Expenses. Employee-related expenses increased in 2000 and 2001, principally as a result of higher workforce levels and nominal increases in wages. The average number of mobile employees grew by 63 or 4.0 percent in 2000 and by 44 or 2.66 percent in 2001, 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 expenses were restated in relation to the Westel acquisition. The adjustments reflect an additional amortization of goodwill and intangible assets of HUF 16,411 million in 2001 and HUF 16,780 million in 2000 compared to the pro-forma results. Depreciation and amortization expenses also increased in both 2000 and 2001 due 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 the foreign mobile telephone operators for terminating their calls. Payments to other network operators increased in both 2000 and 2001 as a result of the significantly higher subscriber base of Westel.

Cost of Telecommunications Equipment Sales. Cost of telecommunications equipment sales increased in both 2000 and 2001 as a result of a significantly higher number of mobile handsets sold.

Other Operating Expenses. Other operating expenses increased in both 2000 and 2001, principally due to marketing expenses, SIM costs, maintenance of base stations, upgrading software and hardware support to accommodate 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,	
	1999	**2000**	**2001**	**2000/1999**	**2001/2000**
				(% change)	
Operating profit (in HUF millions)	35,660	25,254	35,793	(29.2)	41.7
Operating margin (%)(1) ....……..........	30.4	15.8	18.0	n.a.	n.a.

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

Operating profit decreased by 29.2 percent in 2000 mainly because of the additional amortization expenses recorded in relation to the Westel acquisition. Operating profit increased by 41.7 percent in 2001 as a result of further significant growth in the number of mobile customers.

International Segment

The international segment includes the operations of MakTel, Stonebridge, Telemacedónia, and the goodwill amortization arising from the consolidation of MakTel.

MakTel has been a consolidated company of Matáv since January 15, 2001. MakTel had 549,988 fixed line subscribers, 221,336 mobile subscribers and 21,674 Internet subscribers at December 31, 2001.

In 2001, approximately 44 percent of the total revenue of MakTel was derived from domestic fixed line telecommunications services. Mobile services contributed about 28 percent, while international telecommunications services contributed about 24 percent to total revenues. Various data services (telegraph, X.25, Frame Relay, leased lines, and Internet access) contributed only one percent of the total. Three percent of total revenues were derived from other miscellaneous services.

The international segment has a strong, 56.4 percent EBITDA margin and 39.1 percent operating margin for the year ended December 31, 2001.

Minority interest of HUF 11,873 million mainly represents the share of income accruing to the minority owners of MakTel and Stonebridge. Minority interest is not calculated on the amortization relating to the goodwill acquired by Matáv Rt.

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,	
	1999	**2000**	**2001**	**2000/1999**	**2001/2000**
		(in HUF millions)		**(% change)**	
Interest expense:					
Hungarian Forint loans	11,112	11,333	11,473	2.0	1.2
Foreign currency loans	6,182	5,318	9,042	(14.0)	70.0
Finance leases	47	157	119	234.0	(24.2)
Foreign exchange loss - net	6,289	4,835	(7,405)	(23.1)	(253.1)
Commissions and other bank charges	1,941	2,042	2,420	5.2	18.5
Total interest payable and other charges	25,571	23,685	15,649	(7.4)	(33.9)
Interest capitalized	(541)	(626)	(404)	15.7	(35.5)
Interest and other financial income	(2,897)	(2,067)	(2,141)	(28.7)	3.6
	22,133	20,992	13,104	(5.2)	(37.6)

Net interest and other charges decreased in 2000 and 2001 primarily as a result of a decrease in net foreign exchange loss. Net foreign exchange loss decreased in 2000 and 2001 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 addition, in 2001 foreign exchange loss also decreased due to significant strengthening of the Hungarian Forint following the widening of the intervention band. In 2001, in shifting the loan portfolio to Hungarian Forint denominated loans, Matáv benefited from decreasing Hungarian Forint interest rates. In 2001, interest expense on foreign currency loans increased significantly because of the foreign exchange denominated loans taken from Deutsche Telekom to finance the acquisitions of MakTel and the remaining 49 percent of Westel.

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,	
	1999	**2000**	**2001**	**2000/1999**	**2001/2000**
		(in HUF millions)		**(% change)**	
Income tax expense /(benefit).......................	6,911	7,752	11,733	12.2	51.4

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 reductions in the tax payable amounts are 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. Since January 1, 1999, Matáv Rt. has been utilizing the reduced allowance of 60 percent, which is allowed for a total of 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. As a result of Matáv's acquisition of the remaining 49 percent of Westel, foreign ownership fell below 30 percent, hence Westel lost its 60 percent reduction in income tax as of December 21, 2001. This resulted in a deferred tax credit of approximately HUF 1,600 million. All other Hungarian subsidiaries were subject to income tax of 18 percent, while the Macedonian companies are subject to income tax of 15 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 Company has tax losses of HUF 11,455 million to carry forward against future taxable income, which have not been recognized in these financial statements due to uncertainty of their recoverability. Recognized tax losses of HUF 288 million expire in 2006.

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. Income tax expense increased in 2001 compared to 2000 mainly due to higher taxable profit of Westel, higher deferred tax expense to cover the tax impact of future non-deductible depreciation expenses and deferred tax expense relating to non-taxable release of severance provisions. In addition, income tax expense increased in 2001, because Westel lost its 60 percent reduction in income tax as of December 21, 2001 because foreign ownership fell below 30 percent.

SIGNIFICANT ACCOUNTING POLICIES

Matáv's discussion and analysis of its financial condition and results of operations are based upon Matáv's consolidated financial statements, which have been prepared in accordance with IAS. Reported financial conditions and results of operations of Matáv are sensitive to accounting methods, assumptions and estimates that underlie preparation of the financial statements. Matáv bases its estimates on historical experience and on various other assumptions, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

The selection of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing Matáv's financial statements. Matáv believes the following critical accounting policies involve the most significant judgments and estimates used in the preparation of its consolidated financial statements.

Accounting for property, plant, equipment and intangible assets

Property, plant and equipment and purchased intangible assets other than goodwill are recorded at acquisition cost. If such assets are acquired in a business combination, the purchase price is allocated to the estimated fair value of the acquired property, plant and equipment and intangible assets. Property, plant, equipment and intangible assets are depreciated or amortized on a straight-line basis over their estimated useful lives.

Property, plant and equipment are valued at acquisition or construction cost, less scheduled depreciation. Construction costs include directly allocable costs, an appropriate allocation of material and production overhead and interest accruing during construction. However, general administration expenses are not capitalized.

Accounting for property, plant, equipment and intangible assets involves the use of estimates for determining fair value at the acquisition date, especially in the case of such assets acquired in a business combination, and the useful lives of the assets over which the costs of acquiring these assets are charged to the income statement.

When an impairment in the value of assets occurs, nonscheduled write-downs are made. Matáv assesses the impairment of identifiable property, plant, equipment and intangibles whenever there is reason to believe that the carrying value may materially exceed the fair value and where a permanent impairment in value is anticipated. Determination of impairments of property, plant, equipment and intangible assets also involves the use of estimates which include but are not limited to the cause, the timing and the amount of the impairment. Impairment is based on a broad measure of factors. Among others, the Company typically considers technological obsolescence, discontinuance of services and other changes in circumstances that indicate an impairment.

Valuation of goodwill

Goodwill resulting from business combinations is amortized on a straight-line basis over its useful life. The determination of goodwill is dependent on the allocation of the purchase price to the tangible and intangible assets acquired and the liabilities assumed. Such an allocation is based on management's judgment. In addition, the useful life assigned to goodwill is an estimate based on the judgement of management at the time of acquisition.

Nonscheduled write-downs are provided when an impairment in the value of goodwill occurs. Matáv reviews, on a regular basis, the performance of its subsidiaries. When there is reason to believe that the goodwill arising from the acquisition of a subsidiary is impaired and that the impairment is of a permanent nature, Matáv records an impairment charge in the income statement. Matáv uses estimates in determining fair values and the amount of any goodwill impairment.

Revenue recognition

A portion of fees charged to Matáv 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 fixed line 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.

Under U.S. GAAP, Matáv defers the recognition of customer activation revenues and related incremental customer activation costs and amortizes them over the expected duration of the customer relationship. Matáv assesses the estimated average duration of the relationship based on historical customer turnover. If management's estimates are revised, material differences may result in the amount and timing of Matáv's revenue for any period.

Revenues for all services, shown net of VAT and discounts and after eliminated sales within Matáv, 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. This treatment is applied to the recognition of fixed line and mobile connection fee revenues in the international segment as well. Revenue from sale of telephone sets is recognized upon delivery.

Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into the local currency (HUF or MKD) 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.

For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date are incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at that date. The fair value adjustments resulting from the purchase price allocation and goodwill is accounted for in HUF.

At year-end the assets and liabilities of the foreign subsidiaries are translated into HUF using the exchange rates prevailing on the balance sheet date. The income statements of the foreign subsidiaries are translated into HUF using the average rate of exchange during the year. The translation difference arising on consolidation is booked against the cumulative translation adjustment in shareholders' equity.

Deferred taxes

Matáv is required to estimate its actual current tax exposure and to assess the temporary differences resulting from differing treatment of items, such as accruals and amortization, for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities, which are included in Matáv's consolidated balance sheet. Matáv must assess in the course of its tax planning procedures the fiscal year of the reversal of its deferred tax assets and liabilities. The actual reversal of these timing differences may be different from initial expectations.

Impairment loss for doubtful accounts

Management calculates impairment for doubtful accounts for estimated losses resulting from the inability of Matáv's customers to make required payments. Management bases its estimates on the aging of Matáv's accounts receivable balances and Matáv's historical write-off experience, customer credit-worthiness and changes in Matáv's customer payment terms when evaluating the adequacy of the impairment loss for doubtful accounts. If the financial condition of Matáv's customer were to deteriorate, actual write-offs may be higher than expected.

Fair value of financials instruments

In assessing the fair value of non-traded derivatives and other financial instruments, Matáv makes assumptions that are based on market conditions existing at each balance sheet date. Other techniques, such as estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

LIQUIDITY AND CAPITAL RESOURCES

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

	Year ended December 31,		
	1999	2000	2001
		(in HUF millions)	
Net cash flows:			
from operating activities	138,465	156,449	196,545
from investing activities	(126,460)	(145,805)	(429,550)
from financing activities	(9,034)	(3,932)	230,197
Effect of foreign exchange rate changes on cash and cash equivalents	0	0	(371)
Change in cash and cash equivalents	2,971	6,712	(3,179)
Cash and cash equivalents, beginning of period	3,613	6,584	13,296
Cash and cash equivalents, end of period	6,584	13,296	10,117

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 17,984 million in 2000 compared to 1999, partly due to lower interest paid. In addition, 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.

Net cash flows from operating activities increased by HUF 40,096 million in 2001 compared to 2000, primarily due to higher operating profit, which increased by HUF 23,309 million. In 2001, the change in receivables decreased by HUF 6,546 million, and the change in payables increased by HUF 6,250 million, both of which led to a corresponding increase in net cash flows from operating activities. These cash inflows were partly offset by the increase of HUF 5,233 million in income tax paid.

Net Cash Flows from Investing Activities. Net cash flows from investing activities are primarily driven by the purchase of subsidiaries and capital expenditures. Matáv invested HUF 324,813 million on the purchase of subsidiaries in 2001, mainly for the acquisition of MakTel in January 2001 and the remaining 49 percent of Westel in December 2001. Capital expenditures were HUF 127,678 million in 1999, HUF 152,784 million in 2000 and HUF 127,747 million in 2001.

Net Cash Flows from Financing Activities. Net cash flows from financing activities are primarily driven by the Company's borrowing activities. Matáv received net proceeds from loans of HUF 2,268 million in 1999, HUF

4,915 million in 2000 and HUF 249,164 million in 2001, increasing net cash flows. The net proceeds of HUF 249,164 million in 2001 were received to finance the acquisition of subsidiaries.

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, 1999, 2000 and 2001, 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, 2001, Matáv had undrawn committed credit facilities of HUF 20,372 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 6,173 million.

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

	At December 31,	
	2000	**2001**
	(in HUF millions)	
Hungarian Forint	103,910	113,554
EURO	74,238	318,796
U.S. Dollar	12,720	21,020
Net hedging position	(1,502)	0
	189,366	453,370

HUF 33,607 million of indebtedness is scheduled for repayment in 2002, HUF 279,612 million is scheduled for repayment in 2003 and HUF 40,451 million is scheduled for repayment in 2004. Matáv expects scheduled repayments of indebtedness to be financed primarily from cash flows from operating activities and from undrawn committed credit facilities.

As of December 31, 2001, approximately 88.1 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 9.8 percent and 11.2 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 4.8 percent and 8.7 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 7.0 percent.

On March 24, 1998, the Company completed two domestic bond offerings. A one-year bond offering in the total amount of HUF five 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 six-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 three-year Hungarian Treasury Bills. On March 21, 2001, Matáv issued a 2.5-year fixed rate 9.25 percent bonds in a nominal amount of HUF three billion. The bonds were sold at an average price of 74 basis points over the three-year 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.

Matáv's loan agreements contain covenant restrictions that, among other things, require maintenance of certain financial ratios. Breach of those covenants would make HUF 88,574 million due and payable in 30 days if not remedied. At December 31, 2001, Matáv was in breach of a covenant applied in one agreement. The covenant was based on a debt-equity ratio, in which equity was defined as net of the book value of intangible assets. Due to the substantial amount of goodwill assumed on the acquisition of Westel's remaining 49 percent stake, the book value of intangible assets to be netted against the Company's shareholders' equity increased significantly, while the net debt also increased as the acquisitions were financed from loans. However, Matáv agreed a one-month waiver from the partner banks to renegotiate the terms of the relevant covenant. The Company renegotiated the terms of the loans and came to an agreement with the lenders in January 2002, as a result of which the debt-equity covenant was replaced with a debt-EBITD (earnings before interest, tax and depreciation) covenant, with which the Company was in compliance. In 2002, three other agreements were modified with the same terms.

For the acquisition of a 44 percent stake in MakTel, Matáv received a loan of EUR 301.5 million (HUF 79,985 million) from Deutsche Telekom Finance B.V. on January 15, 2001. The loan is based on a variable rate of EURIBOR plus 30 basis points and repayable in one amount on January 31, 2006. Interest payments are due semi-annually.

For the acquisition of the remaining 49 percent stake in Westel, Matáv received a loan of EUR 920 million (HUF 226,750 million) from Deutsche Telekom Finance B.V. on December 20, 2001. The loan is based on a variable rate of EURIBOR plus 50 basis points and repayable in one amount on August 14, 2003. Interest payments are due quarterly.

The loan will be mainly refinanced from Hungarian and international financial market sources and partially repaid at maturity from the free cash flow generated by Matáv.

In 2000, Matáv approached both Moody's and S&P 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, was Baa1, with a stable outlook.

On December 7, 2000, S&P 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, S&P 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.

On February 25, 2002 both Moody's and S&P put Deutsche Telekom on negative watch and stated a possible one-notch downgrade of Deutsche Telekom referring to pressure to reduce debt and doubts over asset sales. Following this step Standard & Poor's placed Matáv on negative watch as well quoting the correlation with Deutsche Telekom as the sole justification for a possible downgrade, while emphasizing the satisfying own performance of Matáv.

S&P placed Deutsche Telekom off credit watch and downgraded its rating by one notch to BBB+ with stable outlook on April 8, 2002. In line with S&P's methodology, Matáv, as a strategically owned subsidiary of Deutsche Telekom, was downgraded to BBB+ with stable outlook as well on the same day. S&P quoted

Deutsche Telekom's downgrade as the rationale for the downgrade of Matáv and emphasized its good 2001 results again.

Despite of putting Deutsche Telekom on negative watch and downgrading Deutsche Telekom to Baa1 with stable outlook from A3 on March 28, 2002, Moody’s maintained Matáv’s rating of Baa1 with stable outlook and did not place the company on credit watch.

Matáv's contractual obligations, including commitments for future payments under non-cancelable lease arrangements and short and long term debt arrangements, are summarized below and are disclosed in more details in Notes 12 and 25 to Matáv's Consolidated Financial Statements. Matáv does not participate in, nor secure, financings for any unconsolidated, limited purpose entities.

	Payments Due by Period				
	Total	**Less than one year**	**1-2 years**	**3-4 years**	**Over four years**
Loans and borrowings including finance lease commitments……………………………………	453,370	33,607	320,063	88,122	11,578
Operating leases………………………………..	10,961	3,245	4,584	2,354	778
Unconditional purchase agreements……………	11,258	11,258	0	0	0
Trade payables………………………………….	122,126	122,126	0	0	0
Total contractual cash obligations…………….....	597,715	170,236	324,647	90,476	12,356

CAPITAL EXPENDITURES

The Company's capital expenditures on tangible and intangible assets totaled HUF 127,678 million in 1999, HUF 152,784 million in 2000 and HUF 127,747 million in 2001, including in each year changes in capital expenditure creditors. 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 segment accounted for 74 percent of total capital expenditures in 1999, 73 percent of total capital expenditures in 2000 and 59 percent of total capital expenditures in 2001. Capital expenditures for the mobile segment totaled 26 percent of total capital expenditures in 1999, 27 percent of total capital expenditures in 2000 and 28 percent of total capital expenditures in 2001. The remaining 13 percent of capital expenditures for 2001 related to the international segment.

The Company expects capital expenditures to be approximately HUF 105 billion in 2002. The Company expects to be able to finance capital expenditures over the next several years from net cash flows from operations and from borrowings. The Company's actual future capital expenditures will depend on a variety of factors, such as the development of its business and of the Hungarian economy and whether Matáv enters into any new lines of business. As a result, the Company's actual future capital expenditures may be significantly different.

IMPLEMENTATION OF THE EURO

The Euro's implementation impacts Matáv in two ways: (1) through debt denominated in Deutsche marks, French francs, Dutch guilders and ECUs and (2) through capital expenditures payable in foreign currencies of European Monetary Union member countries. Since January 1, 1999, new contracts with EU-based suppliers and new loans made with EU-based institutions have been denominated in Euros. With respect to contracts and loans in place prior to January 1, 1999, the Company had the right during the Euro transition period, which ended January 1, 2002, either to pay in the currency of the contract or to convert these contracts into Euro terms. The Company evaluated its contracts on a case-by-case basis to determine whether it was advantageous to convert agreements to Euros before the end of the transition period. Since January 1, 2002, all agreements made with reference to national currencies of European Monetary Union member countries 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,		
	1999	2000	2001
	(in HUF millions)		
Net income:			
IAS	78,632	66,652	82,560
U.S. GAAP	78,721	64,508	82,231
Shareholders' equity:			
IAS	327,579	637,281	460,300
U.S. GAAP	315,248	622,941	445,167

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

Recent Accounting Pronouncements

On January 1, 2002, Matáv is required to adopt Statement of Financial Accounting Standards (SFAS) No. 141, ”Business Combinations” and No. 142, ”Goodwill and Other Intangible Assets”. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is prohibited. SFAS 141 also provides new criteria to determine whether an acquired intangible asset should be recognized separately from goodwill. On adoption of SFAS 142 Matáv will stop amortizing goodwill. At least annually, goodwill will be tested for impairment using a new two-step test, which is described below. After initial adoption of the statements, any future impairment will be recorded in amortization expense.

The amount of goodwill amortization amounted to HUF 17,681 million in 2001. Amortization for these items will not occur in 2002. Matáv is still reviewing the impact of SFAS 141 and 142 on other intangible assets, however, a significant impact on net income is not expected for 2002.

In October 2001, the FASB issued SFAS 144, ”Accounting for the Impairment or Disposal of Long-Lived Assets and for Long-Lived Assets to Be Disposed of”, which supercedes SFAS 121. SFAS 144 provides one accounting model for the review of asset impairment. It retained a number of recognition and measurement provisions of SFAS 121 but removed goodwill from its scope.

For 2001, the carrying values and lives of tangible and intangible assets were reviewed. Based on this review an impairment charge was recorded (see note 8 and 9 of the consolidated financial statements).

During 2002, the first step of the required SFAS 142 impairment tests will be performed as of January 1, 2002. This first step requires the comparison of the carrying value of any reporting unit that has goodwill to the estimated fair value of the reporting unit. A reporting unit is an operating segment or a discrete component of that segment. If the current fair value is less than the carrying value, then the second step of the impairment test will be performed. This second step requires the measurement of the excess of the recorded goodwill over the current value of the goodwill, and to record any excess as an impairment charge.

Matáv plans to complete the impairment tests in the first half of 2002. Any impairment resulting from the initial application of the statements will be recorded as a cumulative effect of accounting change as of January 1, 2002, and will reduce net income in 2002.

RESEARCH AND DEVELOPMENT

Matáv has a separate organization called PKI Telecommunications Development Institute for the performance of research and development (”R&D”) 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 development organizations.

The R&D field of Matáv is facing new challenges due to the convergence of telecommunications, media and information technology.

Significant resources are devoted to upgrading Matáv's digital backbone network. DWDM technology was introduced in the backbone network. Significant resources were allocated to upgrade Matáv's existing network to support broadband services, for example quick Internet access and broadband IP-VPN. In the last two years Matáv started to roll out a wide range of broadband access technologies (ADSL, cable television, optical access network, 3.5 GHz point to multipoint systems, managed leased line technologies) to satisfy the increased bandwidth demand.

Matáv is continuously developing its data communications and IP network and services. In 2001, a joint project started with Cisco to accelerate IP developments. Matáv has introduced IP telephony into the Company's product portfolio based on its international voice over IP portfolio development. Matáv has also developed European Union conform solution products (Intelligent City, etc.). The Company has laid the foundations of establishing city networks (”CityNets”) to satisfy special demands of our key customers. In addition to basic IN 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.

On February 15, 2002 Matáv announced that T-Systems International, a division of Deutsche Telekom, and Matáv intend to found the T-Systems Regional Innovation Center in Budapest. The goal is to establish a an R&D center for innovative convergent solutions involving both information and telecommunications technologies, and to promote regional economic development. In addition to its R&D function, the center will also serve as an incubation bed for technology know-how to strengthen the region's overall competitive position and attractiveness for investors. The center will also benefit young Hungarian engineers by providing them with unique career opportunities.

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 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	57	Chairman and Chief Executive Officer of Matáv	1995
Detlev Buchal	56	n.a.	2000
Dr. Sándor Csányi	48	Chairman and Chief Executive Officer of OTP Bank	2000
Gyula Gansperger*	38	Chairman and Chief Executive Officer of Budapest Ferihegy Nemzetközi Repülőtér Üzemeltető Rt.	2000
Fridbert Gerlach.....………...	44	Vice President Regional Build-up and Integration, Central and Eastern Europe and Middle East, Deutsche Telekom AG	2001
Christoph M. Baldus.............	45	Senior Executive Vice President, Central and Eastern Europe, T-Systems International	2001
Dr. Klaus Hartmann	40	Chief Financial Officer of Matáv	2000
Franz X. Hiergeist	60	Advisor at Deutsche Telekom AG	1994
Dr. Mihály Patai	48	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 Supervisory Board	DeTeMedien Deutsche Telekom Medien
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.. ......…..	Chairman of Board of Directors	Ferihegyi Repül□tér Rt.
Fridbert Gerlach……..…….	Member of Board of Directors	RadioMobil a.s.
	Member of Board of Directors	Slovenske Telekomunikacie, a.s.
	Member of Supervisory Board	Polska Telefonia Cyfrowa
	Member of Board of Directors	EuroTel Bratislava, a.s.
	Member of Board of Directors	PragoNet, a.s.
	Member of Board of Directors	Westel
	Member of Board of Directors	C Mobil, BV
	Member of Supervisory Board	Hrvatske Telekomunikacije
Christoph M. Baldus…….	Member of Board of Directors	debis IT Services Czech, s.r.o.
	Chairman of Board of Directors	debis Bilisim Teknolojileri Hizmetleri a.s.
	Chairman of Board of Directors	Debis IT Services Australia Pty. Ltd.
	Chairman of Board of Directors	T-Systems Multilink s.a.
	Chairman of Board of Directors	T-Systems Schweiz AG
	Member of Board of Directors	T-Systems Singapore PTE Ltd.
Dr. Klaus Hartmann	Member of Board of Directors	Westel
Franz X. Hiergeist	None	
Dr. Mihály Patai	Chairman of Board of Directors	Allianz Hungária Biztosító Rt.
	Member of Supervisory Board	Siemens Rt.

Biographies of Members of the Board of Directors

Elek Straub. 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. 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.

Dr. Sándor Csányi. Dr. Csányi Ph.D. is Chairman and CEO of OTP Bank (National Savings and Commercial Bank Ltd.). He has a degree in finance from the University of Economics, and 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 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. 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.

Fridbert Gerlach. Mr. Gerlach joined Deutsche Telekom AG in 1999 as Vice President Regional Build-up and Integration in the Region Central- Eastern Europe and Middle East. After his graduation in telecommunications from Aachen University in 1983, he stayed there to work as an electrical engineer until 1987 and, during that time, completed his studies in business administration. From 1987 to 1997 he held several management positions within the international division of Alcatel SEL AG in Stuttgart, Germany. Before joining Deutsche Telekom in 1999, he worked as director for international joint ventures at T-Mobil.

Christoph M. Baldus. Mr. Baldus joined T-Systems International in February 2001 as Senior Executive Vice President for the Regions of Central and Eastern Europe, Asia and the Pacific Rim, reporting to the Board of Directors of T-Systems International. Mr. Baldus has held various international management positions in the IT industry. Prior to joining Deutsche Telekom AG, he worked for Platinum Technology Inc. as Managing Director in Germany and before that he was Director for the Outsourcing Management Services of Digital Equipment Corporation in Switzerland and Member of the Board. He holds a Masters degree in Business Administration and a Diploma in Electrical Engineering form the Technical University in Munich, Germany.

Dr. Klaus Hartmann. Dr. Hartmann graduated with a Ph.D. in Economics. He also holds an MBA from 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 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 established a Management Committee in 2000, which is empowered to carry out the day-to-day operations in accordance with the annual business plan. At the end of 2001, the Management Committee consisted of six members who were the six chief officers of Matáv. The six members are as follows:

Name	Age	Position	Member since
Elek Straub	57	Chairman and Chief Executive Officer	2000
László Bodnár	53	Chief Logistics Officer	2000
Dr. Klaus Hartmann	40	Vice-Chairman and Chief Financial Officer	2000
Manfred Ohl	54	Chief Technical Officer	2000
Dr. Tamás Pásztory	50	Chief Human Resources and Legal Officer	2000
Zoltán Tankó	44	Chief Sales Officer	2000

Other Principal Directorships of Members of Management Committee

Name	Position held	Company
Elek Straub ....….....	See above	
László Bodnár	Member of Board of Directors	TCW
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	Axelero Rt.
Zoltán Tankó	Chairman of Supervisory Board	Linum Foundation

Biographies of Chief Officers

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

László Bodnár, Chief Logistics Officer. Mr. Bodnár's 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. Since January 1, 1999, he has served as Director of the West Hungary Technical Directorate.

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 of Deutsche Telekom AG 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 of Deutsche Telekom AG 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 started as an IT development engineer for Budapest Radio Technology Enterprise in 1980 and for Kőbánya Pharmaceuticals in 1982. He had several positions at Műszertechnika (Instrument technology) starting in 1984, including Chief Telecommunications Officer starting in 1990. He became Director of Matáv's Business Communications Branch in February 1996.

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	52	Head of Network Communications Business Unit at Deutsche Telekom AG	2000
Dr. Manfred Balz	57	General Counsel to Deutsche Telecom AG	2000
Dieter Cazzonelli ....…....	45	Senior Executive Vice President, Taxes and Risk Management at Deutsche Telekom AG	2000
Dr. Gábor Germus	31	Solicitor, S. B. G. & K. Law Firm, Budapest	2000
Joachim Kregel ....……	48	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	58	Budapest University of Technology, Dean, Professor, Head of Department	1997
József Szabó	58	President of the Works Council, West Hungary Technical Directorate	1999
György Varju	55	President of the Works Council, Budapest Technical Directorate	1999
Péter Vermes	54	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
	Chairman of Supervisory Board	HT Croatian Telekom
	Member of Supervisory Board	T-systems International, Frankfurt
Dr. Manfred Balz	Member of Supervisory Board	Deutsche Telekom International Finance B.V.
	Member of Supervisory Board	Deutsche Telekom Holding B.V.
	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 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	Member of Board of Directors	Real Time Devices, USA
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, 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 a 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 a member of the Group Committee for Organizational Projects and the Central Advisory Committee. Mr. Kregel is also a 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 earned his 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 Vice President of the Scientific Society of Telecommunications, a member of the editorial board of the periodical World of Nature, a member of the Hungarian Society of Inventors, and an 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 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 the 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, 2001, the aggregate compensation of the Board of Directors was HUF seven million.

For the year ended December 31, 2001, the aggregate compensation of the members of the Supervisory Board was HUF seven million.

For the year ended December 31, 2001, the aggregate compensation of the members of the Management Committee was HUF 323 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 contain special provisions regarding entitlements after termination of employment; therefore, the amount of severance is higher than the amount regulated by the applicable provisions of the Labor Code.

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, Fridbert Gerlach, Franz X. Hiergeist and Dr. Mihály Patai. The Remuneration Committee holds at least two meetings each year.

Employees

Matáv employed 16,633 persons as of December 31, 2001. The following table provides information concerning the number of full-time employees, including full-time equivalents, of Matáv Rt. and its consolidated subsidiaries:

	1999	2000	2001
Matáv Rt.:			
Average number of employees	12,665	11,573	9,864
Number of employees at period end	12,093	11,227	9,298
Matáv Rt. and its consolidated subsidiaries:			
Average number of employees	16,034	14,841	16,914
Number of employees at period end	15,377	14,380	16,633

The following table provides information on the breakdown of Matáv Rt.'s employees by activity at December 31, 2001.

Branches	**Number of employees**
Operation and maintenance	4,670
Marketing	2,233
Logistics	879
Finance	385
Research and development	279
Human Resource and Legal	535
Other support	317

Workforce Reduction and Redeployment. Centralization, technological improvements and 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 201 at December 31, 1998 to 316 at December 31, 2001. In 2001, Matáv Rt. carried out a restructuring program including a 16 percent headcount reduction. The objective of the restructuring program was to redefine the focus of the Company's operation and consumption patterns. Matáv reallocated substantial human and financial resources to the mobile communications, data communication and Internet areas.

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, two members of the Supervisory Board are employee representatives. These members are 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, interest-free loans to purchase real estate, 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 2001, 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 7,666 at the end of 2001.

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, 2001:

Name	Title	No. of Shares Owned
Elek Straub	Chairman-CEO	76,338
Dr. Mihály Patai	Board Member	58,190
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, 4,231 thousand bonds were allocated to management. In 1999, 402 thousand bonds were forfeited. In 2000, an additional 876 thousand bonds were allocated to management and 283 thousand bonds were forfeited. In 2001, 242 thousand bonds were forfeited. See Item 10 ”Additional information - Option to Purchase Securities from Registrant or Subsidiaries”.

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, 2001 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 173,686,650 shares on its accounts as of December 28, 2001 for 51 registered holders, such amount representing 16.74 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 147,333 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 Minister, 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

MagyarCom GmbH holds the majority (59.49 percent) of the Matáv Rt’s shares. MagyarCom GmbH has been wholly owned by Deutsche Telekom since Deutsche Telekom bought SBC Inc’s 50 percent share 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 1999, 2000 and 2001 amounted to HUF 2,152 million, HUF 2,478 million and HUF 1,563 million, respectively. Matáv had no outstanding amounts payable to MagyarCom GmbH, while the outstanding payable for the services rendered by MagyarCom Services Kft. amounted to HUF 515 million at December 31, 2001 (HUF 760 million at December 31, 2000). 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 owned 49 percent of Westel as of December 31, 2000. Costs incurred relating to these services amounted to HUF 161 million in 1999, while in 2000 and 2001 such expenses were not incurred. Westel had no amounts payable to MediaOne International at the end of 2000 and 2001.

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

Hunsat is a joint venture founded by the Company (50 percent) 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 269 million in 2001, HUF 324 million in 2000 and HUF 301 million in 1999. Any profits made by Hunsat are repaid to the joint venture partners.

On September 21, 2001 Matáv and Westel signed an agreement which gives Westel majority (99.5 percent) ownership in Promokom. The transaction was closed on October 11, 2001. Promokom was founded in 1999 with a share capital of HUF 20 million by Matáv. Promokom will participate in the establishment of the emergency Tetra system as subcontractor of Magyar Posta Tetra Rt.

Loans from related parties

For the acquisition of a 44 percent stake in MakTel, Matáv received a loan of EUR 301.5 million (HUF 79,985 million) from Deutsche Telekom Finance B.V. on January 15, 2001. The loan is based on a variable rate of EURIBOR plus 30 basis points and repayable in one amount on January 31, 2006. Interest payments are due semi-annually.

For the acquisition of the remaining 49 percent stake in Westel, Matáv received a loan of EUR 920 million (HUF 226,750 million) from Deutsche Telekom Finance B.V. on December 20, 2001. The loan is based on a variable rate of EURIBOR plus 50 basis points and repayable in one amount on August 14, 2003. Interest payments are due quarterly.

ITEM 8 — FINANCIAL INFORMATION

CONSOLIDATED FINANCIAL STATEMENTS

See ”Item 17. Financial Statements” and pages F-1 through F-43.

OTHER FINANCIAL INFORMATION

Legal Proceedings - Acquisitions Submitted for Approval

MatávkábelTV acquired a number of cable television networks between June 1999 and February 2000. The acquisitions of cable television networks 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. Upon the Company's appeal to the court, the court has confirmed the legality of the decision of the ECC. 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 was approved by the ECC.

Matáv Rt. had 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 would purchase the remaining 50 percent stake. The change of ownership was conditional on the approval of the Minister, as well as on the approval of the Hungarian Competition Office. The approval was received on June 19, 2001. The transaction was completed on July 2, 2001.

Dividend Policy

The shareholders have approved the payment of cash dividends of HUF 11,417 million, equal to HUF 11 per share, from the Company's consolidated net income for 2001. This amount corresponds to 14 percent of 2001 net income. The record date for payment of the dividends is May 24, 2002.

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, 2001, the profit reserves available for distribution were approximately HUF 255,000 million.

The Company will declare any cash dividends in Hungarian Forints. In the case of shares represented by American Depository Shares (”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
2001	23.75	11.32
First Quarter	23.75	13.95
Second Quarter	17.35	13.37
Third Quarter	14.80	11.32
Fourth Quarter	17.03	13.35
October	15.79	13.35
November	17.03	15.47
December	16.99	16.19
2002		
January	19.04	16.82
February	18.05	16.12
March	18.03	16.20

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
2001	1,318	571
First Quarter	1,318	858
Second Quarter	1,039	792
Third Quarter	835	571
Fourth Quarter	975	735
October	910	735
November	975	870
December	935	885
2002		
January	1,056	905
February	1,012	907
March	1,016	915

Source: Bloomberg

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 96,097 treasury shares held by Matáv as of December 31, 2001.

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;
- Management 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. In 2001, no additional bonds were allocated and 242,000 bonds were forfeited.

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 an 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 of compensation expense was recognized in 2000, while the remaining HUF 37 million was recognized in 2001.

Matáv’s current long-term ”Management Incentive Plan” will expire on June 30, 2002. The new Executive Stock Option Plan, planned to start during the summer of 2002, is modeled on the principles of the plan currently in place at Deutsche Telekom, however its parameters have been tailored to operate within local market conditions and legal constraints. The new program will not effect other, existing incentive programs and conditions.

Main parameters of the program:

- 320 senior and middle-level managers will be eligible to participate in the program. Eligibility and the number of options granted will be determined on the employees' position within the organization.
- The options will be issued annually, in three installments in three consecutive years until the third anniversary of the start of the program.
- For the total duration of the program, the total number of shares potentially attainable through the exercise of the options will be 17 million. The breakdown for the three years is as follows: 4.9 million in 2002, 5.6 million in 2003 and 6.5 million in 2004.
- Options will have a life of five years and options not exercised after five years from the date of grant will expire.
- The options issued will be subject to a graded vesting provision under which the employee may not exercise any options until the first anniversary of the grant, at which time one third of the options will vest. The remaining options will vest over the next two years in equal installments such that all options will be exercisable as of the third anniversary of the grant date.
- The option exercise price will be the lower of the fair market value on the date of grant plus a 10 percent premium, or the weighted average stock exchange price of the month preceding the grant plus a 10 percent premium. The option price in either instance will equal or exceed the fair market value on the grant date.
- The program includes an adjustment for inflation.
- Matáv will fund the option exercises by transferring from Treasury the appropriate number of shares acquired through exercise to the respective employee upon receipt of the necessary funds. Once the shares are delivered, Matáv will not undertake any responsibility with respect to the employees’ sale of those shares.

The financing structure of the program:

To start the program, Matáv will issue 17 million shares, with the involvement of an investment bank, in the framework of a closed-circle capital raise (private or closed offering) in compliance with take-over regulations set forth in the Act on Equity Markets. The General Meeting empowered the Board of Directors to decide on the timing of the capital raises as needed for the plan's operations when the granted options become exercisable.

Matáv will purchase treasury shares equal to the amount of vested options in order to provide physical shares to the employees upon the exercise their options. The General Meeting empowered the Board of Directors to authorize the repurchase of the necessary shares into treasury.

Expected EPS dilution:

The number of the shares will increase during the program as described above and assuming a given earnings figure, it will result in the following maximal EPS dilution: 0.47 percent in 2002, 0.53 percent in 2003 and 0.62 percent in 2004 resulting in a cumulative EPS dilution of 1.61 percent for the three years.

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. 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 Board 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 six 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 the 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.

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

Purchase of the Remaining 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.

On December 21, 2001 Matáv paid Deutsche Telekom AG EUR 920 million (HUF 227 billion) and has agreed to pay in 2002 an additional amount equal to 49 percent of the dividend to be declared by Westel for 2001. Based on the amount of dividend with respect to 2001 declared by Westel, Matáv will have to pay an additional HUF 12 billion. No dividends were declared by Westel 0660. The purchase price was financed by way of a medium term EUR loan provided by Deutsche Telekom AG at an interest rate of LIBOR plus 50 basis points.

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. The formula takes into account the purchase price paid by the consortium for the shares, EBITDA and the net debt of MakTel.

CosmoTelco and Matáv 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. Before the expiration of CosmoTelco's call option on February 8, 2002 Matáv and CosmoTelco amended the option agreement as a result of which CosmoTelco has one more year (until February 2003) to exercise its option for a 10 percent share in Stonebridge. Matáv paid a fee of EUR 7 million in return for CosmoTelco to let the option for the remaining 11.55 percent share to expire unused 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. In the case of dividends paid to non-resident individuals, the portion of distributed dividends exceeding a certain limit set by legislation are subject to a general withholding tax of 35 percent and health tax contribution of 11 percent unless the provisions of a relevant double tax treaty apply.

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. The U.S.-Hungary treaty reduces Hungarian withholding tax to 5 percent if the beneficial owner of the dividends is a company, which owns, directly or indirectly, at least 10 percent of the voting stock of the company paying the dividends.

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. Notwithstanding, a residence certificate and a beneficial ownership declaration are required.

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.

Capital gains derived by non-resident individuals from the sale or other disposition of securities may be offset quarterly against capital losses and additional costs incurred by non-resident individuals from the sale of shares quoted on the Hungarian stock exchange. Excess capital losses may be carried forward for the subsequent tax year. The quarterly offsetting and the carry-forward of excess capital losses are only possible if the sale or disposition of securities is handled through a broker registered in Hungary. This rule may be of importance, particularly if there is no applicable tax treaty.

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. The portion of distributed dividends exceeding a certain limit set by legislation are subject to withholding tax of 35 percent and health tax contribution of 11 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.

Capital gains derived by an individual resident in Hungary from the sale or other disposition of securities may be offset quarterly against capital losses and additional costs incurred by the resident individual from the sale of shares quoted on the Hungarian stock exchange. Excess capital losses may be carried forward for the subsequent tax year. The quarterly offsetting and the carry-forward of excess capital losses are only possible if the sale or disposition of securities is handled through a broker registered in Hungary.

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.

Holders should also note that United States and Hungary are currently in the process of renegotiating the U.S.-Hungary Treaty. Any resulting new treaty may have provisions that differ from those described herein.

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, 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

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

Payments in respect of ADSs or shares made within the United States or through certain U.S.-related financial intermediaries are subject to information reporting, and may be subject to backup withholding, 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 office located at 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 debt and foreign exchange payments (i.e. international third party telecommunications carriers and capital expenditure). To reduce foreign exchange risk, Matáv's debt portfolio guidelines limit the individual classes of currencies in the debt portfolio. Matáv 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 denominated in Euro. The National Bank of Hungary lifted the devaluation of the Hungarian Forint against the Euro in October 2001 after widening the intervention band from +/-2.25 percent to +/-15 percent as of May 4, 2001. The introduction of this new foreign exchange regulation increased the foreign exchange risk of the Company significantly.

In 2000 and 2001, 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 (Euro) 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 recognized at cost 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 2001, losses of HUF 1,001 million were recognized in the statements of income related to foreign currency forward contracts. As of December 31, 2001, Matáv had no open foreign currency forward positions.

Included in bank loans is a USD denominated loan amounting to HUF 5,519 million that is subject to interest based on a fixed rate of 7.05 percent. 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 EUR interest and principal repayments at floating rates of the EURIBOR rate plus a margin of 0.66 percent. The EUR principal payments are fixed at a rate of 1 EUR = 1.0777 USD. The timing and amount of the USD payments to be received exactly match the underlying payment obligations on the USD loan. In 2000, Matáv accounted for interest and foreign exchange movements on these loans at the EUR rate. As a result, the value of the net hedging position at December 31, 2000 amounted to HUF 871 million.

Included in bank loans is a USD denominated loan amounting to HUF 5,710 million that is subject to interest based on a fixed rate of 6.56 percent. 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 EUR interest and principal payments at fixed rates of 5.17 percent. EUR principal payments are determined according to the EUR equivalent of the USD principal payments at 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. In 2000, Matáv accounted for interest and foreign exchange movements on these loans at the EUR rate. As a result, the value of the net hedging position at December 31, 2000 amounted to HUF 631 million.

The two loans described above are accounted for as USD loans, while the fair value of the swap agreements is accounted for separately as derivative assets and is disclosed in other non current assets in 2001.

To decrease the foreign exchange rate risk of the foreign exchange loan portfolio, Matáv swapped the EUR 301,5 million loan (HUF 79,985 million) to HUF as of February 4, 2002. The counterparty in the transaction is Deutsche Telekom. The cross currency swap agreement entitles Matáv to receive EUR interest and principal payments and pay HUF interest and principal payments. The EUR loan is subject to floating rate interest based on 6 month EURIBOR plus a margin of 30 basis points, while under the swap Matáv is obliged to pay an interest based on 6 month BUBOR plus a margin of 34 basis points. The HUF principal payment is fixed at a rate of one EUR to 244.36 HUF. The timing and the amount of the EUR payments to be received under the swap are matched with the underlying payment obligations on the EUR loan.

EUR 920 million loan (HUF 226,750 million) was partially swapped to HUF effective April 18, 2002 to allow Matáv to take an advantage of the strong HUF. The counterparty in the transaction is Deutsche Telekom. The cross currency swap agreement entitles Matáv to receive EUR interest subject to 3 month EURIBOR plus a margin of 50 basis points and EUR 300 million principal amount, while Matáv has the obligation to pay HUF interest subject to 3 month BUBOR plus a margin of 57 basis points and HUF 72,685 million principal amount. The timing of the EUR payments to be received under the swap are matched with the timing of the EUR payment obligations relating to the EUR loan.

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, 2001, Matáv's cash balance included HUF denominated cash equivalent instruments with a value of HUF 3,491 million at an average fixed interest rate of 7.17 percent and HUF 1,627 million in variable rate instruments with an average interest rate of 7.16 percent.

Financial investments of HUF 327 million were held in fixed rate instruments at an average interest rate of 9.75 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, 2001.

	Maturities							
	2002	2003	2004	2005	2006	after 2006	Total	Fair value
	(in HUF millions, except percentages)							
Bank loans (HUF Denominated)								
Fixed rate ....…	1,504	4	12,500	0	0	0	14,008	14,773
Average interest rate …....	10.41%	0.00%	11.75%				11.60%	
Variable rate	21,972	22,625	22,175	6,125	625	625	74,147	74,147
Average interest rate ..…..	10.57%	10.63%	10.60%	10.90%	11.01%	11.01%	10.63%	
Total	23,476	22,629	34,675	6,125	625	625	88,155	88,920
Bank loans (foreign Currency denominated)								
Fixed rate ....…	3,125	3,125	3,125	3,125	2,376	10,697	25,573	25,068
Average interest rate …....	7.13%	7.13%	7.13%	7.13%	6.91%	6.91%	7.02%	
Variable rate	6,307	3,511	2,235	754	410	118	13,335	13,335
Average interest rate	7.80%	7.34%	6.74%	8.36%	8.08%	4.76%	7.52%	
Total	9,432	6,636	5,360	3,879	2,786	10,815	38,908	38,403
Total bank loans	32,908	29,265	40,035	10,004	3,411	11,440	127,063	127,323
Bonds and bills Of exchange (HUF Denominated)								
Fixed rate	81	13,000	0	0	0	136	13,217	13,335
Average interest rate	0.49%	9.25%				0.00%	9.10%	
Variable rate	0	10,000	0	0	0	0	10,000	10,000
Average interest rate		11.18%					11.18%	
Total	81	23,000	0	0	0	136	23,217	23,335

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-43 incorporated herein by reference.

ITEM 18 — FINANCIAL STATEMENTS

Not applicable.

ITEM 19 — EXHIBITS

1.1. Articles of Association of Matáv (incorporated herein by reference to Exhibit 1.1. of Matáv's 2000 Form 20F dated May 9, 2001).

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 (incorporated herein by reference to Exhibit 2.2. of Matáv's 2000 Form 20F dated May 9, 2001).

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).

4.3.1. Concession Contract, as amended, dated December 22, 1993, between the Minister and Matáv (incorporated herein by reference to Exhibit 4.3. of Matáv's 2000 Form 20F dated May 9, 2001).

4.3.2. Contract for the revision and termination of the Nationwide Concession Contract concluded on December 22, 1993 and the Concession Contract concluded on May 25, 1994 and for the provision of universal telecommunications services, dated January 28, 2002, by and among 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 (incorporated herein by reference to Exhibit 4.5. of Matáv's 2000 Form 20F dated May 9, 2001).

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 (incorporated herein by reference to Exhibit 4.6.1 of Matáv's 2000 Form 20F dated May 9, 2001).

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 (incorporated herein by reference to Exhibit 4.6.2. of Matáv's 2000 Form 20F dated May 9, 2001).

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 (incorporated herein by reference to Exhibit 4.6.3. of Matáv's 2000 Form 20F dated May 9, 2001).

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 (incorporated herein by reference to Exhibit 4.6.4. of Matáv's 2000 Form 20F dated May 9, 2001).

4.6.5. Shareholders Agreement between The Republic of Macedonia and Matáv in relation to Makedonski Telekomunikacii, dated January 15, 2001 (incorporated herein by reference to Exhibit 4.6.5. of Matáv's 2000 Form 20F dated May 9, 2001).

4.6.6. Modification of the Subscription and Shareholders' Deed between Matáv and CosmoTelco Added Value Services S.A with respect to the option, dated February 7, 2002.

4.7.1. Call Option Agreement between Deutsche Telekom AG and Matáv, dated October 20, 1999 (incorporated herein by reference to Exhibit 4.7.1. of Matáv's 2000 Form 20F dated May 9, 2001).

4.7.2. Westel Proxy between Deutsche Telekom AG and Matáv, dated October 20, 1999 (incorporated herein by reference to Exhibit 4.7.2. of Matáv's 2000 Form 20F dated May 9, 2001).

4.7.3. Business Share Sale and Purchase Agreement, dated December 21, 2001 between Deutsche Telekom AG and MATÁV.

4.7.4. Share Sale and Purchase Agreement, dated December 21, 2001 between Deutsche Telekom AG and MATÁV.

4.7.5. Determination of the foreign exchange rate for the exercise of the Westel Call Option and e-denomination of purchase price to Euro, letter dated October 31, 2001 from Deutsche Telekom AG to Matáv.

4.7.6. Loan Agreement between Deutsche Telekom International Finance B.V. and Matáv to finance the acquisition of a 49 percent stake both in Westel and Westel 0660, dated December 20, 2001.

4.8. Loan Agreement for the purpose of Financing the Acquisition of MakTel, dated January 11, 2001 between Matáv and Deutsche Telekom AG (incorporated herein by reference to Exhibit 4.8. of Matáv's 2000 Form 20F dated May 9, 2001).

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, except for MakTel and Stonebridge A.D. which were incorporated in Macedonia.

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 9, 2002

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, 2000 and 2001, and the related consolidated statements of income, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 2001. 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 generally accepted auditing standards in the United States of America. 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, 2000 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2001 in accordance with International Accounting Standards.

As discussed in Note 2. the purchase of the additional 49% of Westel Mobil Távközlési Rt. and Westel Rádiótelefon Kft. has been accounted as a transaction between entities under common control and the consolidated financial statements have been restated as if both companies had been wholly owned subsidiaries of Matáv since the date when common control existed.

Application of accounting principles generally accepted in the United States of America would have affected shareholders' equity as of December 31, 2000 and 2001 and net income for each of the years in the three year period ended December 31, 2001 to the extent summarized in Note 30 to the consolidated financial statements.

PricewaterhouseCoopers
Könyvvizsgáló és Gazdasági Tanácsadó Kft.

Budapest
February 21, 2002

MAGYAR TÁVKÖZLÉSI RT.

CONSOLIDATED BALANCE SHEETS

	Notes	At December 31, HUF 2000	2001	U.S.$ 2001
			(in HUF millions)	(million USD) (unaudited) (note 2)
ASSETS				
Current assets				
Cash and cash equivalents	4	13,296	10,117	36
Trading investments	5	6,045	327	1
Receivables	6	71,251	88,079	316
Inventories	7	10,587	13,297	48
Total current assets		101,179	111,820	401
Non current assets				
Property, plant and equipment	8	561,702	654,298	2,345
Intangible assets	9	262,416	306,029	1,097
Associates and other long term investments	10	14,062	13,199	47
Other non-current assets	11	15,065	18,850	68
Total non-current assets		853,245	992,376	3,557
Total assets		954,424	1,104,196	3,958
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Loans and other borrowings	12	78,725	33,607	120
Trade and other payables	14	93,876	122,126	438
Deferred revenue	15	3,690	3,430	12
Provision for liabilities and charges	17	11,624	3,320	12
Total current liabilities		187,915	162,483	582
Non current liabilities				
Loans and other borrowings	12	110,641	419,763	1,505
Deferred revenue	15	9,949	7,101	25
Deferred tax liability	22	313	1,763	6
Other non current liabilities	16	7,067	4,617	17
Provision for liabilities and charges	17	30	0	0
Total non current liabilities		128,000	433,244	1,553
Minority interests	18	1,228	48,169	173
Shareholders' equity				
Common stock		103,736	103,736	372
Additional paid in capital		22,955	22,955	82
Treasury stock		(127)	(163)	(1)
Cumulative translation adjustment		0	(2,420)	(9)
Retained earnings		510,717	336,192	1,206
Total shareholders' equity		637,281	460,300	1,650
Total liabilities and shareholders' equity		954,424	1,104,196	3,958

These consolidated financial statements were accepted for the Board of Directors on February 21, 2002 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	1999	2000	2001	2001
		For the year ended December 31, HUF			U.S.$
		(in HUF millions, except per share amounts)			(million USD) (unaudited) (note 2)
Revenues	19	384,932	445,945	547,735	1,963
Employee-related expenses		(56,630)	(66,024)	(75,962)	(272)
Depreciation and amortization		(62,145)	(94,720)	(116,622)	(418)
Payments to other network operators		(44,184)	(55,617)	(72,606)	(260)
Cost of telecommunications equipment sales		(22,392)	(34,111)	(39,101)	(140)
Other operating expenses	20	(78,450)	(99,382)	(124,044)	(445)
Total operating expenses		(263,801)	(349,854)	(428,335)	(1,535)
Operating profit		121,131	96,091	119,400	428
Net interest and other charges	21	(22,133)	(20,992)	(13,104)	(47)
Share of associates' results before income tax		1,428	2,174	1,703	6
Profit before income tax		100,426	77,273	107,999	387
Income tax expense	22	(6,911)	(7,752)	(11,733)	(42)
Profit after income tax		93,515	69,521	96,266	345
Minority interest	18	(14,883)	(2,869)	(13,706)	(49)
Net income		78,632	66,652	82,560	296
Basic earnings per share					
Weighted average number of common stock outstanding (millions)		1,037	1,037	1,037	1,037
Net income (HUF millions)		78,632	66,652	82,560	296
Basic earnings per share (HUF)		75.81	64.27	79.61	0.29
Diluted earnings per share					
Weighted average number of common stock outstanding (millions)		1,037	1,037	1,037	1,037
Number of dilutive convertible bonds (millions)		4	5	0	0
Weighted average number of common stock outstanding for diluted earnings per share (millions)		1,041	1,042	1,037	1,037
Net income (HUF millions)		78,632	66,652	82,560	296
Diluted earnings per share (HUF)		75.52	63.97	79.61	0.29

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

MAGYAR TÁVKÖZLÉSI RT.

CONSOLIDATED CASH FLOW STATEMENTS

	Notes	For the year ended December 31, HUF 1999	2000 (in HUF millions)	2001	U.S.$ 2001 (million USD) (unaudited) (note 2)
Cash flows from operating activities					
Operating profit		121,131	96,091	119,400	428
Depreciation and amortization		62,145	94,720	116,622	418
Change in payables		5,170	7,728	13,978	50
Change in inventory		(1,302)	(1,634)	(3,450)	(12)
Change in receivables		(17,310)	(12,133)	(5,587)	(20)
Amortization of deferred revenue		(5,607)	(4,652)	(3,499)	(13)
Interest paid		(17,533)	(15,123)	(19,416)	(70)
Commissions and bank charges		(1,941)	(2,042)	(2,420)	(9)
Income tax paid		(7,838)	(8,150)	(13,383)	(48)
Other cash flows from operations		1,550	1,644	(5,700)	(20)
Net cash flows from operating activities		138,465	156,449	196,545	704
Cash flows from investing activities					
Capital expenditures on tangible and intangible assets		(127,678)	(152,784)	(127,747)	(458)
Purchase of investments		(3,551)	(3,568)	(1,740)	(6)
Purchase of subsidiaries	2	0	0	(324,813)	(1,164)
Cash acquired	2	0	0	6,314	23
Interest received		2,897	2,067	2,141	8
Dividends received		526	1,009	779	3
Movement in other financial assets		(2,458)	(2,313)	6,417	22
Proceeds from disposal of fixed assets		3,804	9,784	9,099	33
Net cash flows from investing activities		(126,460)	(145,805)	(429,550)	(1,539)
Cash flows from financing activities					
Dividends paid to shareholders and minority interest		(11,518)	(9,411)	(18,806)	(68)
Proceeds from loans and other borrowings		245,544	261,870	522,464	1,872
Repayment of loans and other borrowings		(243,276)	(256,955)	(273,300)	(979)
Proceeds from issue of common stock		0	129	0	0
Purchase of treasury stock		0	(256)	(36)	0
Proceeds from sale of treasury stock		0	104	0	0
Other		216	587	(125)	0
Net cash flows from financing activities		(9,034)	(3,932)	230,197	825
Effect of foreign exchange rate changes on cash and cash equivalents		0	0	(371)	(1)
Change in cash and cash equivalents		2,971	6,712	(3,179)	(11)
Cash and cash equivalents, beginning of year		3,613	6,584	13,296	47
Cash and cash equivalents, end of year		6,584	13,296	10,117	36

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	Cumulative translation adjustment	Retained earnings	Total Shareholders' equity
					(in HUF millions)		
Balance at 1 January 1 999	1,037,281,600	103,728	22,834			130,683	257,245
Dividend ....…						(8,298)	(8,298)
Net income ………………………...						78,632	78,632
Balance at December 31, 1999	1,037,281,600	103,728	22,834	0	0	201,017	327,579
Dividend ....……….....						(9,335)	(9,335)
Stock issuance (b)………………..…	77,270	8	121				129
Purchase of treasury stock (c) …….				(256)			(256)
Sale of treasury stock (c) ………..….				129		(25)	104
Net income as previously reported (j) ………………………...						68,763	68,763
Balance at December 31, 2000	1,037,358,870	103,736	22,955	(127)	0	260,420	386,984
Acquisition of additional 49% interest in Westels							
Equity effect (f) ..………..…...…..…						252,408	252,408
Net income effect (g) ………..…..…						(2,111)	(2,111)
Balance at December 31, 2000 after restatement	1,037,358,870	103,736	22,955	(127)	0	510,717	637,281
Effect of adopting IAS 39 (d) …….						501	501
Dividend ………………………..…						(10,373)	(10,373)
Purchase of treasury stock (e) …….				(36)			(36)
Cumulative Translation Adjustment					(2,420)		(2,420)
Acquisition of additional 49% interest in Westels							
Equity effect (h) ……………..….…						(247,213)	(247,213)
Net income effect (g) ….………….						7,354	7,354
Net income before the impacts of the Westel transaction						75,206	75,206
Net income reported in the income statement						82,560	
Balance at December 31, 2001 (a)	1,037,358,870	103,736	22,955	(163)	(2,420)	336,192	460,300
Of which treasury stock …………..	96,097						
Shares of common stock outstanding at December 31, 2001 (a)	1,037,262,773						

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (notes)

(a) In addition to the 1,037,358,870 common stocks at a nominal value of HUF 100 outstanding on December 31, 2001, 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 23.

(b) 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.

(c) 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.

(d) The Company adopted IAS 39 "Financial instruments – Recognition and Measurement" and has recognized the cumulative effect of the change in accounting directly in equity for the derivative asset of HUF 589 million with a related deferred tax liability of HUF 88 million (see note 21).

(e) During 2001 the Company purchased 21,333 shares of its common stock.

(f) In December 2001 the Company acquired 49 percent of the common shares of Westel and Westel 0660 ("the Westels") from Deutsche Telekom ("DT"). The Company was controlled by DT so this was a transaction between parties under common control.[SzSz1] The financial statements have been restated as if the Westels were wholly owned subsidiaries of Matáv since March 23, 2000, the date when DT acquired 49% of the Westels. The consideration for the Company's acquisition of the Westels was financed by a loan from DT. Terms of the loan agreement are described in Note 12. The loan agreement was completed on 20 December 2001. The book value of the Company's additional share of net assets (including goodwill and other intangibles) of the Westels on March 23, 2000 has been presented as an increase in equity at December 31, 2000 (HUF 252,408 million). See Note 2 for more details.

(g) This reflects the amortisation of goodwill and intangible assets of HUF –16,411 million (2000: HUF -16,780 million) relating to the additional 49% shareholding in the Westels, the related deferred tax of HUF 26 million (2000: HUF 456 million) and the reduction in the minority interest in net profit of the Westels of HUF 23,739 million (2000: HUF 14,213 million).

(h) The loan agreement with DT was completed on December 20, 2001 and the total consideration payable by the Company for the additional 49% interest in the Westels was transferred from equity to liabilities. In addition the reduction of equity included dividends paid by Westel to DT prior to the transaction.

(i) The distributable reserves of the Company under Hungarian law at December 31, 2000 and 2001 amounted to approximately HUF 205,000 million and HUF 255,000 million, respectively.

(j) The net income in 2000 of HUF 66,652 million as reported in the income statement comprises HUF 68,763 million as previously reported and an net income effect of HUF (2,111) million due to the acquisition of the Westels.

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

1 Principal activities

Magyar Távközlési Rt. (the "Company" or "Matáv Rt.") with its subsidiaries form the 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 had 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 had exclusive rights to provide local public fixed line telephony service in 31 areas until December 23, 2001. Since that date, Matáv is subject to competition in these areas. Matáv Rt. has exclusive rights in additional five concession areas through May 2002, while its subsidiary, Emitel has exclusive rights in an additional three concession areas through November 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 sells and leases telecommunications equipment.

Matáv had 16,633 full time equivalent employees at December 31, 2001, while at the end of 2000 the number of employees was 14,380.

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, except as disclosed in the accounting policies below, and in compliance with International Accounting Standards ("IAS").

The consolidated financial statements are shown in millions of Hungarian Forints ("HUF"). For the convenience of the reader, the consolidated balance sheet, income statement and cash-flow statement for the year 2001 are also presented in millions of U.S. dollars ("USD") translated at a rate of HUF 279.03 to USD 1.00 (the official rate of the National Bank of Hungary at December 31, 2001). These translations are unaudited. The effect of inflation is significant (1999: 10.0%, 2000: 9.8%, 2001: 9.2%) 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.

Acquisition of the remaining 49% ownership in Westel Mobil Rt. (Westel) and Westel Rádiótelefon Kft. (Westel 0660)

In March 2000, Deutsche Telekom finalised the purchase of MediaOne's interests in mobile operations in Central and Eastern Europe including MediaOne International B.V. (which owned 49% of Westel) and 49% of Westel 0660. At the same time the Company was granted an option to purchase the 49% holdings in Westel and Westel 0660 from Deutsche Telekom during the fifteen-month period ending September 2001. On December 21, 2001 the transaction was closed whereby Matáv became a 100% owner of both Westel and Westel 0660. The purchase price included HUF 226,750 million (EUR 920 million), paid in December 2001, financed by a loan from DT as described in Note 12, plus an estimated additional HUF 12,000 million payable in 2002 equal to 49% of the amount of dividends to be declared by Westel for the year 2001.

The Company was controlled by DT so this was a transaction between parties under common control.[SzSz1] The financial statements have been restated as if the Westels were wholly owned subsidiaries of Matáv since March 23, 2000, the date when DT acquired 49% of the Westels. The consideration for the Company's acquisition of the Westels was financed by a loan from DT. The terms of the loan agreement are described in note 12. The loan agreement was completed on December 20, 2001. The book value of the Company's additional share of net assets (including goodwill and other intangibles) of the Westels on March 23, 2000 has been presented as an increase in equity at December 31, 2000 (HUF 252,408 million).

Below is a summary of the impact of the restatement on shareholders' equity and net income in HUF millions.

	At December 31.	
	2000	**2001**
Equity (excluding the effect the restatement)	386,984	449,862
Adjustment in relation to the Westel acquisition	250,297	
257,[SzSz2]651		
Transfer of consideration payable to liability	-	(247,213)
As restated	637,281	460,300

The increase in equity as of December 31, 2000 reflects the Company's additional share of the assets and liabilities (including goodwill and other intangibles) of Westel and Westel 0660 at March 23, 2000, which was presented as equity because the loan from DT was not completed until December 20, 2001. The decrease in equity in December 2001 reflects the loan agreement with DT, which was completed on December 20, 2001, dividends paid by Westel to DT prior to the transaction and additional consideration payable. The consideration payable by the company was then transferred from equity to liabilities.

	At December 31.	
	2000	**2001**
Net income (before the restatement)	68,763	75,206
Adjustment in relation to the Westel acquisition	(2,111)	7,354
As restated	66,652	82,560

The adjustments above reflect the additional amortisation of goodwill and intangible assets of HUF -16,411 million (2000: HUF -16,780 million), the related deferred tax of HUF 26 million (2000: HUF 456 million) and the reduction in the minority interest of HUF 23,739 million (2000 HUF: 14,213 million) . The minority interest in Westel and Westel 0660 was eliminated and considered as part of group net income both for 2000 and 2001.

The minority interest in the net income of the two companies between March 31, 2000 and December 21, 2001 was as follows:

	At December 31.	
	2000	**2001**
Westel	13,987	23,542
Westel 0660	226	196

Acquisition of Makedonski Telekommunikacii A.D. (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 holding company, 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 total acquisition cost of the 44% effective ownership amounted to HUF 83,380 million.

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. The formula takes into account the purchase price paid by the consortium for the shares, the current earnings before interest, tax, depreciation and amortization (EBITDA) and the net debt of Maktel.

CosmoTelco and Matáv 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. Before the expiration of CosmoTelco's call option on February 8, 2002 Matáv and CosmoTelco amended the option agreement as a result of which CosmoTelco has one more year (until February 2003) to exercise its option for a 10% share in Stonebridge. Matáv paid a fee of EUR 7 million in return for CosmoTelco to let the option for the remaining 11.55% share to expire unused on February 8, 2002.

MakTel has been a consolidated subsidiary of the Group from January 15, 2001.

The share of Matáv's ownership in Stonebridge and the share of Stonebridge's ownership in Maktel represent the same share of voting rights.

Acquisition of the remaining 50% ownership in Emitel Rt.

Matáv Rt. had been a 50% owner of Emitel since its establishment and accounted for 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 would purchase the remaining shares. The change of ownership was conditional on the approval of the Minister responsible for telecommunications in Hungary as well as on the approval of the Hungarian Competition Office, which Matáv received in June 2001. The price of HUF 13,930 million was determined on the closing of the transaction on July 2, 2001.

The assets and liabilities of subsidiaries acquired are summarized in the table below:

	Westel and Westel 0660	Maktel	Emitel
	(in HUF millions)		
Purchase consideration:			
- cash paid ………………………………………………...	227,503	83,380	13,930
- additional purchase price payable …………………………	12,000	0	0
Total purchase consideration …………………………………	239,503	83,380	13,930
Fair value of net assets acquired …………………………...	51,708	32,027	5,847
Goodwill ……………………………………………………	187,795	51,353	8,083
Fair value of net assets acquired:			
Cash and cash equivalents ……………………………………		5,488	826
Trading investments …………………………………………..		699	
Receivables ……………………………………………………		10,096	742
Inventory ……………………………………………………...		785	96
Property, plant and equipment ………………………………..		74,023	10,270
Intangible assets ………………………………………………	6,246	171	311
Associates ……………………………………………………..			(3,234)
Trade and other payables ……………………………………..	2,192	(5,768)	(1,018)
Deferred revenue ……………………………………………...			(391)
Loans and other borrowings …………………………………..		(19,661)	(1,265)
Net deferred tax assets ………………………………………..	(1,124)	2,157	(490)
Minority interests ……………………………………………..	54,832	(35,963)	
Equity adjustment …………………………………………….	(10,438)		
Fair value of net assets acquired …………………………...	51,708	32,027	5,847

3 Statement of accounting policies

(a) Principles of consolidation

The consolidated financial statements include the financial statements of the Company and its 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 has significant influence but not control) and joint ventures (companies where the activity is subject to joint control based on a contractual arrangement) are accounted for in the consolidated financial statements using the equity method of accounting.

Business combinations are accounted for according to the purchase method of accounting prescribed by IAS 22 – Business combinations.

(b) 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.

(c) Financial investments

Financial investments include securities issued by the government, the maturities of which are between three months and one year.

At January 1, 2001 the Group adopted IAS 39 and classified its investments into the following categories: trading, held-to-maturity and available-for-sale. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets. Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale. These are included in non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Trading and available-for-sale investments are subsequently carried at fair value, while held-to-maturity investments are carried at amortized cost. Any changes in the carrying values are accounted for in the income statement.

During the period the group did not hold any available-for-sale or held-to-maturity types of investments.

(d) Receivables

Receivables are stated at their recoverable amount, after accounting for any impairment losses included in other operating expenses. Recoverable amounts are estimated taking into account potential delays and defaults on payments.

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.

(e) Inventories

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

(f) 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

(g) 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. The useful lives of concessions and licenses were determined based on the terms of the underlying agreements. Such assets are stated at cost less amortization on a straight-line basis over the following periods:

	Years
Concessions and licenses	8 – 25
Software	3 - 5
Leasehold interests	6
Customer base and brand-name	2 - 10
Goodwill on purchase of subsidiaries and associates.	5 - 20

(h) 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. Impairment losses are included in the depreciation and amortization line of the income statement.

(i) 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.

(j) Financial Instruments

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

Matáv adopted International Accounting Standards No. 39 (IAS 39), "Financial Instruments: Recognition and Measurement" on January 1, 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 in earnings unless specific hedge accounting criteria are met.

Matáv does not apply hedge accounting for its financial instruments, all gains and losses are recognized in the income statement. The cumulative effect of adopting IAS 39 was recognized against the retained earnings on January 1, 2001.

On the date a derivative contract is entered into, the Group designates certain derivatives as either (1) a hedge of the fair value of a recognized asset or liability (fair value hedge), or (2) a hedge of a forecasted transaction or of a firm commitment (cash flow hedge), or (3) a hedge of a net investment in a foreign entity.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective, are recorded in the income statement, along with any changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective, are recognized in equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of an asset or liability. Otherwise, amounts deferred in equity are transferred to the income statement and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects the income statement.

Hedges of net investment in foreign entities are accounted for similarly to cash flow hedges.

The fair value of publicly traded derivatives and trading and available-for-sale securities is based on quoted market prices at the balance sheet date. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date.

In assessing the fair value of non-traded derivatives and other financial instruments, the Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Other techniques, such as estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

(k) 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.

(l) 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. Revenue from sale of telephone sets is recognized upon delivery.

(m) 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.

(n) Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into the local currency (HUF or MKD) 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.

For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date were incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at that date. The fair value adjustments resulting from the purchase price allocation and goodwill is accounted for in HUF.

At year-end the assets and liabilities of the foreign subsidiaries are translated into HUF using the exchange rates prevailing on the balance sheet date. The income statements of the foreign subsidiaries are translated into HUF using the average rate of exchange during the year. The translation difference arising on consolidation is booked against the cumulative translation adjustment in shareholders' equity.

(o) Loans and other borrowings

Borrowings are recognized initially at the proceeds received. In subsequent periods they are stated at amortized costs. Any difference between the proceeds and the redemption value is recognized in the income statement over the period of the borrowings.

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.

(p) 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, intangible assets, deferred revenue, impairment of receivables, inventory, liabilities and charges, government loans and tax losses carried forward.

(q) Pensions and other post-retirement benefits

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 1,616 million, HUF 1,850 million and HUF 2,082 million for the years ended December 31, 1999, 2000 and 2001 respectively.

(r) 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.

(s) 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

Cash and cash equivalents held by the Hungarian members of the Group are primarily denominated in Hungarian Forint and concentrations of credit risk are limited as Matáv places its cash with substantial credit institutions. Cash and cash equivalents held by the Macedonian subsidiaries are denominated in Macedonian Denars, Euros and in U.S. dollars.

5 Financial investments

Financial investments consist of treasury instruments with maturities of three to twelve months, held for trading purposes.

6 Receivables

	At December 31, 2000	At December 31, 2001
	(in HUF millions)	
Domestic trade receivables	74,757	74,936
Foreign trade receivables	5,604	22,974
Advances paid for current assets	704	480
Other receivables	4,797	3,429
Receivables from Associates	985	668
Taxes receivable	1,273	6,277
Other prepayments and accrued income	1,600	1,960
	89,720	110,724
Less impairment loss	(18,469)	(22,645)
	71,251	88,079

The significant increase in foreign trade receivables is due to the inclusion of Maktel's trade receivables in the consolidated financial statements.

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 impairment loss and changes therein for 2000 and 2001 are as follows:

	At December 31, 2000	At December 31, 2001
	(in HUF millions)	
Impairment loss, beginning of period	(14,977)	(18,469)
Change in the composition of the Group	0	(3,338)
Charged to expense	(8,176)	(6,462)
Utilized	4,684	5,624
Impairment loss, end of period	(18,469)	(22,645)

7 Inventories

	At December 31, 2000	At December 31, 2001
	(in HUF millions)	
Cables, wires and other inventory	3,601	5,573
Inventory for resale	8,124	10,483
Subtotal	11,725	16,056
Less allowances for obsolete inventory	(1,138)	(2,759)
	10,587	13,297

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, 2001 …….....	3,991	81,857	200,397	398,136	90,962	32,558	807,901
Change in the composition of the Group	90	16,953	37,390	45,358	13,000	10,447	123,238
Additions …..…..........	43	7,804	21,870	70,641	15,482	(14,115)	101,725
Disposals ………..........	(10)	(100)	(2,240)	(16,494)	(6,754)		(25,598)
Translation adjustment ...	(2)	(1,008)	(2,340)	(3,410)	(889)	(510)	(8,159)
December 31, 2001 …….	4,112	105,506	255,077	494,231	111,801	28,380	999,107
Depreciation							
January 1, 2001 ….........		11,065	42,116	146,707	46,311		246,199
Change in the composition of the Group		3,042	13,605	17,070	5,189		38,906
Charge for the year ....…		3,123	9,776	50,269	19,408		82,576
Impairment losses ……...				1,843			1,843
Disposals ………..........		(31)	(1,719)	(13,807)	(6,413)		(21,970)
Translation adjustment ...		(230)	(905)	(1,215)	(395)		(2,745)
December 31, 2001 ..…...		16,969	62,873	200,867	64,100		344,809
Net book value							
December 31, 2001 ...…...	4,112	88,537	192,204	293,364	47,701	28,380	654,298
Net book value							
December 31, 2000 ..…...	3,991	70,792	158,281	251,429	44,651	32,558	561,702

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

Included in telephone exchanges at 31 December 2001 are assets subject to finance leases with a gross book value of HUF 1,501 million and net book value of HUF 678 million.

Included in telephone exchanges at 31 December 2001 are assets leased under operating lease contracts to customers with a gross book value of HUF 8,175 million and net book value of HUF 4,318 million. Depreciation for the year of these assets amounted to HUF 1,360 million.

Impairment losses are mostly related to analog cellular and security monitoring equipment.

9 Intangible assets

	Concession costs and licenses	Software	Leasehold interest	Other intangible	Goodwill	Total
	(in HUF millions)					
Cost						
January 1, 2001	20,141	39,380	7,190	15,235	221,279	303,225
Change in the composition of the Group	195	421	88			704
Additions	1,280	13,937	600		60,291	76,108
Disposals	(141)	(1,600)	(1,209)	(7,689)	(766)	(11,405)
Translation adjustment	(25)	(149)				(174)
December 31, 2001	21,450	51,989	6,669	7,546	280,804	368,458
Amortization						
January 1, 2001	2,869	16,826	3,264	6,333	11,517	40,809
Change in the composition of the Group	51	135	28			214
Charge for the year	1,073	8,956	857	2,677	17,681	31,244
Impairment		468			491	959
Disposals	(5)	(1,586)	(709)	(7,689)	(766)	(10,755)
Translation adjustment	(5)	(20)	(17)			(42)
December 31, 2001	3,983	24,779	3,423	1,321	28,923	62,429
Net book value						
December 31, 2001	17,467	27,210	3,246	6,225	251,881	306,029
Net book value						
December 31, 2000	17,272	22,554	3,926	8,902	209,762	262,416

The amortization expense of intangible assets including goodwill is accounted for in the Depreciation and amortization line of the Income statement.

Impairment of software is related to the analog cellular activity, while the impairment of goodwill is related to investments in various subsidiaries.

10 Associates and other long term investments

	For the year ended December 31,	
	2000	2001
	(in HUF millions)	
Opening balance of associates	6,534	8,438
Additions to associates	1,132	300
Share of associates' profit before tax	2,174	1,703
Share of associates' corporate tax	(229)	(51)
Dividend payments	(1,009)	(779)
Disposals	0	(168)
Associates becoming subsidiaries	(164)	(3,234)
Closing balance of associates	8,438	6,209
Other long term investments	5,624	6,990
	14,062	13,199

Other long term investments include loans given to associated undertakings and third parties classified as originated loans under IAS 39.

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,	
	2000	2001
	(in HUF millions)	
Deferred tax asset (note 22)	3,188	3,816
Assets held for disposal	4,932	3,725
Cross-currency interest rate swaps	0	2,671
Prepayments falling due after 1 year	2,864	4,978
Other non current assets	4,081	3,660
	15,065	18,850

Derivative assets (cross-currency interest rate swaps) in an amount of HUF 1,502 million were offset against the underlying bank loans at December 31, 2000 (see note 12). In addition to this amount HUF 589 million was recognized on adoption of IAS 39 on January 1, 2001 against retained earnings to reflect the fair value of the cross-currency interest rate swaps in the balance sheet.

Cross-currency interest rate swaps on December 31, 2001 include the fair value of the swap agreements described in note 13.

12 Loans and other borrowings

	Notes	At December 31, 2000	At December 31, 2001
		(in HUF millions)	
Bank loans	(a)	166,331	127,063
Bonds	(b)	20,228	23,217
Loans from Related parties	(c)	0	300,908
Finance leases		1,214	888
Other		1,593	1,294
		189,366	453,370

At December 31, 2001, principal repayments fall due in:

	2002	2003	2004	2005	2006	after 2006	Total
Total	33,607	279,612	40,451	10,264	77,858	11,578	453,370

The effective borrowings costs (total interest payable and other charges) for Matáv's loans and borrowings were 14.4%, 12.7% and 7.5% for the years ended 1999, 2000 and 2001 respectively. The weighted average interest rate on short-term borrowings (denominated in Hungarian Forints and foreign currencies) was 12.7% in 1999, 6.88% in 2000 and 9.61% in 2001.

(a) Bank loans

Bank loans analyzed by currency are as follows:

	At December 31, 2000	At December 31, 2001
	(in HUF millions)	
HUF	80,875	88,155
EUR	74,238	17,888
USD	12,720	21,020
Net hedging position	(1,502)	0
	166,331	127,063

Bank loans of HUF 87,482 million at December 31, 2001 were subject to variable interest rates. Variable rate loans raised in Hungarian Forint are subject to interest rates between 9.75% and 11.17% 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 4.76% and 8.7% 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 2002 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 42,095 million and HUF 38,489 million at December 31, 2000 and 2001, respectively. The majority of these loans are taken in foreign currency, which are subject to interest 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 5,519 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 is described in note 13.

Included in bank loans is a USD denominated loan amounting to HUF 5,710 million that is subject to interest based on a fixed rate of 6.56%. This loan is subject to a cross currency swap agreement, which is described in note 13.

On the adoption of IAS 39, Matáv calculated the fair value of the above mentioned two swap agreements. As a result of the calculation, the fair value of the swaps exceeded the value of the net hedging position by HUF 589 million, which was recognized as an asset against the retained earnings as of January 1, 2001. The value of the net hedging position (HUF 1,502 million) and the HUF 589 million together reflected the fair value of the swap arrangements as of January 1, 2001 and are now disclosed as cross-currency interest rate swaps among other non current assets.

Loans totaling HUF 24,554 million and HUF 27,550 million at December 31, 2000 and 2001 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 88,574 million due and payable in 30 days if not remedied. At December 31, 2001, Matáv was in breach of a covenant applied in one agreement. The covenant was based on a debt-equity ratio, in which equity was defined as net of the book value of intangible assets. Due to the substantial amount of goodwill assumed on the acquisition of Westel's remaining 49% stake, the book value of intangible assets to be netted against the Group's shareholders' equity increased significantly, while the net debt also increased as the acquisitions were financed from loans (note 12c). However, Matáv agreed a one month waiver from the partner banks to re-negotiate the terms of the relevant covenant. The Company renegotiated the terms of the loans and came to an agreement with the lenders in January 2002, as a result of which the debt-equity covenant was replaced with a debt-EBITD (earnings before interest, tax and depreciation) covenant, with which the Company was in compliance. In 2002 three other agreements were modified with the same terms.

(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. On March 21, 2001 Matáv issued a 2.5-year fixed rate

9.25% bonds in the nominal amount of HUF 3 billion. The bonds were sold at an average price 74 basis points over the 3-year Hungarian Treasury Bills.

(c) Loans from related parties

For the acquisition of a 44% stake in Maktel, Matáv received a loan of EUR 301.5 million (HUF 79,985 million) from Deutsche Telekom Finance B.V. on January 15, 2001. The loan is based on a variable rate of EURIBOR+ 30 basis points and repayable in one amount on January 31, 2006. Interest payments are due semi-annually.

For the acquisition of the remaining 49% stake in Westel, Matáv received a loan of EUR 920 million (HUF 226,750 million) from Deutsche Telekom Finance B.V. on December 20, 2001. The loan is based on a variable rate of EURIBOR+ 50 basis points and repayable in one amount on August 14, 2003. Interest payments are due quarterly.

(d) credit facilities and pledges

At December 31, 2001, Matáv had undrawn committed credit facilities of HUF 20,372 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 6,173 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 denominated in Euro. The National Bank of Hungary lifted the devaluation of the Hungarian Forint against the Euro in October 2001 after widening the intervention band from +/-2.25% to +/-15% as of May 4, 2001. The introduction of this new foreign exchange regulation increased the foreign exchange risk of the Group significantly.

In 2000 and 2001 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 (Euro) 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 recognized at cost 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 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 2001, losses of HUF 1,001 million were recognized in the statements of income related to foreign currency forward contracts. As of December 31, 2001, Matáv had no open foreign currency forward positions.

Included in bank loans is a USD denominated loan amounting to HUF 5,519 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 EUR interest and principal repayments at floating rates of the EURIBOR rate plus a margin of 0.66%. The EUR principal payments are fixed at a rate of 1 EUR = 1.0777 USD. The timing and amount of the USD payments to be received exactly match the underlying payment obligations on the USD loan. In 2000 Matáv accounted for interest and foreign exchange movements on these loans at the EUR rate. As a result, the value of the net hedging position at December 31, 2000 amounted to HUF 871 million.

Included in bank loans is a USD denominated loan amounting to HUF 5,710 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 EUR interest and principal payments at fixed rates of 5.17%. EUR principal payments are determined according to the EUR equivalent of the USD principal payments at 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. In 2000 Matáv accounted for interest and foreign exchange movements on these loans at the EUR rate. As a result, the value of the net hedging position at December 31, 2000 amounted to HUF 631 million.

The two loans described above are accounted for as USD loans, while the fair value of the swap agreements is accounted for separately as derivative assets and is disclosed in other non current assets in 2001.

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, 2001, Matáv's cash balance included HUF denominated cash equivalent instruments with a value of HUF 3,491 million at an average fixed interest rate of 7.17% and HUF 1,627 million in variable rate instruments with an average interest rate of 7.16%.

Financial investments of HUF 327 million were held in fixed rate instruments at an average interest rate of 9.75%.

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, 2001.

	Maturities							
	2002	2003	2004	2005	2006	after 2006	Total	Fair value
	(in HUF millions, except percentages)							
Bank loans (HUF Denominated)								
Fixed rate	1,504	4	12,500	0	0	0	14,008	14,773
Average interest rate	10.41%	0.00%	11.75%				11.60%	
Variable rate	21,972	22,625	22,175	6,125	625	625	74,147	74,147
Average interest rate	10.57%	10.63%	10.60%	10.90%	11.01%	11.01%	10.63%	
Total	23,476	22,629	34,675	6,125	625	625	88,155	88,920
Bank loans (foreign Currency denominated)								
Fixed rate	3,125	3,125	3,125	3,125	2,376	10,697	25,573	25,068
Average interest rate	7.13%	7.13%	7.13%	7.13%	6.91%	6.91%	7.02%	
Variable rate	6,307	3,511	2,235	754	410	118	13,335	13,335
Average interest rate	7.80%	7.34%	6.74%	8.36%	8.08%	4.76%	7.52%	
Total	9,432	6,636	5,360	3,879	2,786	10,815	38,908	38,403
Total bank loans	32,908	29,265	40,035	10,004	3,411	11,440	127,063	127,323
Bonds and bills of exchange (HUF denominated)								
Fixed rate	81	13,000	0	0	0	136	13,217	13,335
Average interest rate	0.49%	9.25%				0.00%	9.10%	
Variable rate	0	10,000	0	0	0	0	10,000	10,000
Average interest rate		11.18%					11.18%	
Total	81	23,000	0	0	0	136	23,217	23,335

14 Trade and other payables

	At December 31, 2000	At December 31, 2001
	(in HUF millions)	
Domestic trade payables	49,427	47,832
Foreign trade payables	9,569	11,753
Amounts owed to related parties	760	12,515
Taxation and social security	7,223	12,661
Accrued expenses and prepayments	13,960	19,830
Amounts received in advance	1,666	1,460
Salaries and wages	6,102	9,462
Payables to associates	196	87
Dividends payable to minority interest holders	27	63
Other payables	4,946	6,463
	93,876	122,126

15 Deferred revenue

	At December 31, 2000	At December 31, 2001
	(in HUF millions)	
Beginning of period	18,291	13,639
Change in the composition of the Group	0	391
Amortization	(4,652)	(3,499)
End of period	13,639	10,531
Amount to be recognized within one year	3,690	3,430

16 Other non current liabilities

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

17 Provision for liabilities and charges

	Severance	Customer loyalty programs	Other	Total
		(in HUF millions)		
January 1, 2001	9,760	1,699	195	11,654
Additions	0	1,972	308	2,280
Amounts used	(9,220)	(1,378)	(16)	(10,614)
December 31, 2001	540	2,293	487	3,320

The provision for severance relates to the employee termination benefit payable in 2002 in accordance with the agreement made with employee representatives.

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,		
	1999	2000	2001
	(in HUF millions)		
Beginning of period	12,135	23,012	1,228
Acquisition of Maktel	0	0	35,963
Other movement in capital contributed by minority interest	216	780	396
Share of results for the year	14,883	2,869	13,706
Dividends paid / payable to minority shareholders	(4,222)	(143)	(58)
Acquisition of minority interest in Westel and Westel 0660	0	(25,290)	0
Cumulative Translation Adjustment	0	0	(3,066)
End of period	23,012	1,228	48,169

The minority interest share of results for the year 2001 includes an amount of HUF 2,100 million in relation to the call option of CosmoTelco representing the loss to Matáv had CosmoTelco exercised its option for further interest in Stonebridge at December 31, 2001 (see note 2).

19 Revenues

	For the year ended December 31,		
	1999	2000	2001
	(in HUF millions)		
Domestic fixed line telecommunications services:			
Subscriptions, connections and other charges	63,191	82,918	96,673
Domestic traffic revenue	134,071	129,517	123,366
Other usage	18,743	19,136	17,254
International traffic revenues	43,807	41,432	34,992
Mobile telecommunications services	82,746	108,885	140,234
Leased lines and data transmission	20,241	26,819	36,604
Other services	22,133	37,238	38,635
Revenue from international activities	0	0	59,977
	384,932	445,945	547,735

Revenue from international activities includes the total consolidated revenues of Maktel.

20 Other operating expenses

	For the year ended December 31,		
	1999	2000	2001
	(in HUF millions)		
Materials, maintenance and service fees	30,414	38,946	53,946
Subcontractors	3,217	12,277	11,514
Fees and levies	10,025	11,901	15,921
Marketing	8,507	10,348	13,360
Other expenses	26,287	25,910	29,303
	78,450	99,382	124,044

21 Net interest and other charges

	For the year ended December 31,		
	1999	2000	2001
	(in HUF millions)		
Interest expense:			
Hungarian Forint loans	11,112	11,333	11,473
Foreign currency loans	6,182	5,318	9,042
Finance leases	47	157	119
Net foreign exchange losses / (gains)	6,289	4,835	(7,405)
Commissions and other bank charges	1,941	2,042	2,420
Total interest expense and other charges	25,571	23,685	15,649
Interest capitalized	(541)	(626)	(404)
Interest and other financial income	(2,897)	(2,067)	(2,141)
	22,133	20,992	13,104

22 Income tax

	For the year ended December 31,		
	1999	2000	2001
	(in HUF millions)		
Income tax charge on the profit for the year	(7,646)	(8,625)	(9,464)
Deferred income taxes	832	1,102	(2,218)
Income tax on the Group's share of the results of associates	(97)	(229)	(51)
Income tax expense	(6,911)	(7,752)	(11,733)

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. has been 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.. As result of Matáv's acquisition of the remaining 49% of Westel, foreign ownership fell below 30%, hence Westel lost its 60% reduction in income tax as of December 21, 2001. This resulted in a deferred tax credit of approximately HUF 1,600 million. All other Hungarian subsidiaries were subject to income tax of 18%, while the Macedonian companies are subject to income tax of 15%.

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 11,455 million to carry forward against future taxable income, which have not been recognized in these financial statements due to uncertainty of their recoverability. Recognized tax losses of HUF 288 million expire in 2006.

Matáv's deferred tax balances are as follows.

	Balance at December 31, 2000	Change in the composition of the group	Cumulative translation adjustment	Adoption of IAS 39	Income statement effect	Balance at December 31, 2001
Deferred tax assets						
Net operating loss carry-forward	347				(295)	52
Investments in consolidated subsidiaries	0				(1,055)	(1,055)
Impairment of receivables, inventory and financial investments.	1,311	510	(37)	(88)	2,188	3,884
Property, plant and equipment and intangible assets.	(1,089)	1,053	(143)		(1,730)	(1,909)
Derivative assets	0				(184)	(184)
Trade and other payables	0	103	(2)		(56)	45
Loans and other borrowings	287				(341)	(54)
Deferred revenue	1,060				(131)	929
Provisions for liabilities and charges	959				(614)	345
Total net deferred tax assets	2,875	1,666	(182)	(88)	(2,218)	2,053
Add back: deferred tax liability	313					1,763
Deferred tax assets	3,188					3,816

Deferred tax assets and liabilities are determined by the legal entities of the Group.

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,		
	1999	2000	2001
	(in HUF millions)		
IAS profit before income tax	100,426	77,273	107,999
Tax at 18%	(18,077)	(13,910)	(19,440)
Effect of different tax rates	9,932	8,510	11,259
Tax on items not subject to tax	2,534	981	1,368
Tax effect of unrecognized tax losses	(284)	(352)	(1,151)
Tax on non deductible expenses	(1,298)	(2,511)	(4,459)
Temporary differences reversing at different rates	379	(241)	741
Income tax expense (before associates' tax)	(6,814)	(7,523)	(11,682)
Share of associates tax expense	(97)	(229)	(51)
Income tax expense	(6,911)	(7,752)	(11,733)

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, 4,231 thousand bonds were allocated to management. In 1999, 402 thousand bonds were forfeited. In 2000 additional 876 thousand bonds were allocated to management and 283 thousand bonds were forfeited. In 2001, 242 thousand bonds were forfeited.

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, 1999 (in HUF millions)
Benefits earned during the year	83
Interest cost on projected benefit obligation	373
Post-retirement benefit costs	456

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

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

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

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

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

	1999 (in HUF millions)
At the beginning of the year	3,230
	3,230
Post-retirement benefit costs	456
Benefits paid	(137)
Accrued post-retirement benefit cost included in Provisions for liabilities and charges	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, 2001 are as follows:

	Capital Leases At December 31, 2000	2001
	(in HUF millions)	
Year		
2001	400	-
2002	436	410
2003	489	462
2004	142	139
2005	0	0
2006	0	0
Thereafter	0	0
Total minimum lease payments	1,467	1,011
Less: amounts representing interest and executory costs	(253)	(123)
Present value of net minimum lease payments	1,214	888
Less: capital lease obligations included in short-term debt	282	331
Long-term capital lease obligations	932	557

	Operating Leases At December 31, 2000	2001
	(in HUF millions)	
Year		
2001	2,351	-
2002	1,737	3,245
2003	1,621	2,502
2004	1,252	2,082
2005	661	1,388
2006	521	966
Thereafter	-	778
Total minimum lease payments	8,143	10,960

(b) Purchase commitments

As of December 31, 1999, 2000 and 2001, capital and other expenditures amounting to HUF 18.6 billion, HUF 18.2 billion and HUF 11.2 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, 2001 Matáv Rt. has outstanding commitments of approximately DEM 4 million to provide further funds to M-RTL.

26 Lease revenues

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

Year	Operating Leases (in HUF millions)
2002	5,269
2003 – 2005	9,833
2006 and thereafter	1,833
Total minimum lease payments receivable	16,935

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 1999, 2000 and 2001 amounted to HUF 2,152 million, HUF 2,478 million and HUF 1,563 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 515 million at December 31, 2001 (HUF 760 million at December 31, 2000). 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 owned 49% of Westel as of December 31, 2000. Costs incurred relating to these services amounted to HUF 161 million in 1999, while in 2000 and 2001 such expenses were not incurred. Westel had no amounts payable to MediaOne International, at the end of 2000 and 2001.

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 269 million in 2001, HUF 324 million in 2000 and HUF 301 million in 1999. Any profits made by Hunsat are repaid to the joint venture partners.

The remuneration of the Company's Directors amounted to HUF 7 million in 2001 (HUF 13 million in 2000 and HUF 14 million in 1999). The remuneration of the members of the Company's Supervisory Board amounted to HUF 7 million in 2001 (HUF 7 million in 2000 and HUF 10 million in 1999).

The Company paid contributions in an amount of HUF 185 million to life insurance plans for the management in 2001.

28 Principal investees

At December 31, 2001 the principal operating associates, joint ventures and subsidiaries of the Group, which are incorporated in Hungary and Macedonia, were as follows:

Associates / Joint ventures	Group interest in capital	Activity
Hunsat Magyar □rtávközlési Koordinációs Egyesülés	50.00%	VSAT satellite communications
DSP Rt.	36.84%	Cable TV holding
Magyar RTL Televízió Rt.	25.00%	Television broadcast company
Németkábel Vagyonkezel□ Rt.	25.00%	Cable TV holding

Subsidiaries	Group interest in capital	Activity
Axelero Rt.	100.00%	Internet service and content provider
Emitel Rt.	100.00%	Local telecommunications operator
InvesTel Rt.	100.00%	Cable TV holding company
Makedonski Telekommunikacii AD (Maktel)	44.11%	Macedonian telecommunications company
Matávcom Kft.	100.00%	Solutions for business customers
MatávkábelTV Kft.	75.00%	Cable television operator
Stonebridge A.D.	86.50%	Macedonian holding company
Westel Rádiótelefon Kft.	100.00%	Cellular telephone services
Westel Mobil Távközlési Rt.	100.00%	GSM digital cellular telephone services

29 Segment information

Matáv has three operating segments, fixed line telecommunications, mobile telecommunications and international activities.

The fixed line telecommunications segment provides local telephony in Matáv's 39 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 and internet.

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 international segment includes the four Macedonian companies, Stonebridge, the holding company through which Matáv controls Maktel, Maktel, Macedonia’s exclusive fixed line telecommunications company, Mobimak, Maktel’s subsidiary that is the exclusive cellular telecommunications service provider in Macedonia and Telemacedonia A.D. through which Matáv provides management and consultancy services to Maktel, Mobimak A.D. and Stonebridge.

The following table presents a summary of operating results of the Group by segment for the years ended December 31, 1999, 2000 and 2001. The segments presented below are substantially consistent with the format used by the Company's Management Committee.

	For the year ended December 31,		
	1999	2000	2001
	(in HUF millions)		
Revenues			
Total revenue of Fixed line segment	302,230	326,280	333,685
Fixed line revenue from other segments	(9,905)	(9,491)	(11,241)
Fixed line revenue from external customers	292,325	316,789	322,444
Total revenue of Mobile segment	117,336	159,345	198,947
Mobile revenue from other segments	(24,729)	(30,189)	(33,653)
Mobile revenue from external customers	92,607	129,156	165,294
Total revenue of International segment	0	0	60,034
International revenue from other segments	0	0	(57)
International revenue from external customers	0	0	59,997
Total revenue of the group	384,932	445,945	547,735

	For the year ended December 31,		
	1999	2000	2001
	(in HUF millions)		
Depreciation and amortization			
Fixed line	49,873	60,932	65,948
Mobile	12,272	33,788	40,282
International	0	0	10,392
Total	62,145	94,720	116,622
Operating profit			
Fixed line	85,471	70,837	60,143
Mobile	35,660	25,254	35,793
International	0	0	23,464
Total	121,131	96,091	119,400
Assets			
Fixed line	535,932	584,937	508,889
Mobile	113,595	374,953	359,614
International	0	0	240,839
Inter-segment elimination	(5,361)	(8,813)	(12,989)
Total segment assets	644,166	951,077	1,096,353
Unallocated assets	3,704	3,347	7,843
Total assets	647,870	954,424	1,104,196
Capital expenditures on tangible and intangible assets			
Fixed line	94,063	111,134	75,050
Mobile	33,615	41,650	36,494
International	0	0	16,203
Total	127,678	152,784	127,747
Liabilities			
Fixed line	97,153	94,191	102,048
Mobile	22,968	40,549	43,766
International	0	0	7,511
Inter-segment elimination	(5,361)	(8,813)	(12,989)
Total segment liabilities	114,760	125,927	140,336
Unallocated liabilities	182,519	189,988	455,391
Total liabilities	297,279	315,915	595,727

Unallocated assets include tax assets, while unallocated liabilities include loans and other borrowings and tax liabilities.

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 fixed line and mobile segments operate exclusively in Hungary, while the international segment operates in Macedonia. Matáv does not analyze results on a more detailed level based on geographic areas within Hungary or Macedonia.

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, 2001 and total shareholders' equity as of December 31, 2000 and 2001.

	Notes	For the year ended December 31, 1999	2000	2001
		(in HUF millions, except per share amounts)		
Net income under IAS		78,632	66,652	82,560
Adjustments for U.S. GAAP:				
Cumulative effect of adopting SAB 101	(a)	0	(22,167)	0
Deferred revenue	(a)	374	15,197	2,947
Post-retirement benefits	(b)	(3)	(621)	0
Management Incentive Plan Bonds	(c)	(42)	(134)	(37)
Amortization of intangible assets	(d)	0	2,534	(2,546)
Cumulative effect of adopting SFAS 133 net of deferred tax	(e)	0	0	501
Cumulative income tax effect of adopting SAB 101		0	3,042	0
Deferred income tax on U.S. GAAP adjustments		(240)	5	(1,194)
Net income under U.S. GAAP		78,721	64,508	82,231
Other comprehensive income	(f)	0	0	(2,420)
Total comprehensive income		78,721	64,508	79,811
Basic earnings per share under U.S. GAAP		75.89	62.20	79.30
Diluted earnings per share under U.S. GAAP		75.61	61.91	79.30

	Notes	At December 31, 2000	At December 31, 2001
		(in HUF millions)	
Shareholders' equity under IAS		637,281	460,300
Adjustments for U.S. GAAP:			
Cumulative effect of adopting SAB 101	(a)	(22,167)	0
Deferred revenue	(a)	2,876	(16,344)
Amortization of intangible assets	(d)	2,535	(11)
Cumulative income tax effect of adopting SAB 101		3,042	0
Deferred income tax on U.S. GAAP adjustments		(626)	1,222
Shareholders' equity under U.S. GAAP		622,941	445,167

(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 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 3 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. During 2000 Matáv terminated the provision of post-retirement benefits, therefore, the difference in equity was eliminated. The difference in net income in 2000 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 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 was amortized until July 1, 2001. In total, HUF 134 million compensation expense was recognized in 2000 while the remaining HUF 37 million was recognized in 2001. In 2001, 242 thousand bonds were forfeited.

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:

	1999	2000	2001
Net income as reported (HUF million)	78,721	64,508	82,231
Net income pro forma (HUF million)	78,002	63,503	81,897
Basic earning per share as reported (HUF)	75.89	62.20	79.30
Basic earning per share pro forma (HUF)	75.20	61.24	78.97
Diluted earning per share as reported (HUF)	75.61	61.91	79.30
Diluted earning per share pro forma (HUF)	74.94	60.94	78.97

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

(d) Amortization of intangible assets

Due to the different revenue and intangible asset recognition rules of IAS and US GAAP, the shareholders' equity of Westel, Maktel and Emitel on acquisition was different under the different accounting conventions resulting in differences in goodwill, the value of customer base on acquisition related.

As a result of the adoption of SAB 101, the value of net assets of Westel acquired effective March 2000 was different for IAS and US GAAP purposes, therefore the gross book value of goodwill acquired was HUF 691 million higher for US GAAP purposes. The amortization of this additional amount of goodwill amounted to HUF 35 million in 2000 and HUF 46 million in 2001. In addition, as the recognition rules of intangible assets in IAS and US GAAP are different, the gross book value of intangible assets recognized on the 49% acquisition in US GAAP was HUF 3,819 million higher and consequently goodwill was lower. The estimated useful lives of the intangible assets were 1-10 years under IAS and 5-10 years in US GAAP. The combination of this and the different allocation to goodwill resulted in a lower amount of amortization expense in US GAAP of HUF 2,569 million in 2000. In 2001 the amortization expense was HUF 2,265 million higher in US GAAP as certain assets were fully amortized in IAS over one year.

As a result of the revenue recognition rules of SAB 101, the net assets of Maktel and Emitel acquired in 2001 were different for IAS and US GAAP purposes, therefore the gross book value of goodwill acquired was HUF 3,069 million higher for US GAAP purposes. The amortization of this additional amount of goodwill amounted to HUF 143 million in 2001.

As the recognition rules of intangible assets in IAS and US GAAP are different, the gross book value of intangible assets recognized was HUF 273 million higher in US GAAP on the acquisition of Maktel. As the useful lives of other intangible assets recognized in US GAAP were lower than the useful life of the remaining goodwill, this resulted in a higher amount of amortization expense in US GAAP of HUF 299 million in 2001.

As a result of the new accounting announcements (SFAS 141 and 142) goodwill on the acquisition of Emitel (as of July 2, 2001) is not amortized under U.S. GAAP as the transaction was concluded after July 1, 2001. The amortization expense in IAS amounted to HUF 207 million in 2001.

APB 16 – Business Combinations requires that supplemental pro-forma information be disclosed for business combinations accounted for as acquisitions. This pro-forma information presents revenue, net income, basic and diluted earnings per share as though the business combination had been completed at the beginning of the immediately preceding period. The table below shows this information as though Maktel and Emitel had been acquired at January 1, 2000.

	2000	**2001**
	unaudited	**unaudited**
Revenue (HUF million)	461,537	550,900
Revenue pro forma (HUF million)	521,118	553,458
Net income as reported (HUF million)	64,508	82,231
Net income pro forma (HUF million)	65,976	82,130
Basic earning per share as reported (HUF)	62.20	79.30
Basic earning per share pro forma (HUF)	63.62	79.20
Diluted earning per share as reported (HUF)	61.91	79.30
Diluted earning per share pro forma (HUF)	63.32	79.20

(f) Other comprehensive income

Other comprehensive income includes the cumulative translation adjustment related to the consolidation of the financial statements of the Macedonian subsidiaries (mainly Maktel). This item is not subject to tax.

31 Additional disclosures required for U.S. GAAP

Accrued interest

Included in accrued expenses is accrued interest in an amount of HUF 3,939 million in 2001 (HUF 3,125 million in 2000).

Valuation allowance of deferred tax assets

At December 31, 2001 Matáv had tax losses of HUF 11,455 million for which the deferred tax asset of HUF 2,062 million was offset by a 100% valuation allowance. The corresponding amounts for 2000 are HUF 3,417 million and HUF 615 million respectively.

Recent accounting pronouncements

On January 1, 2002, Matáv is required to adopt Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets". SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is prohibited. SFAS 141 also provides new criteria to determine whether an acquired intangible asset should be recognized separately from goodwill. On adoption of SFAS 142 Matáv will stop amortizing goodwill. At least annually, goodwill will be tested for impairment using a new two-step test, which is described below. After initial adoption of the statements, any future impairment will be recorded in amortization expense.

The amount of goodwill amortization amounted to HUF 17,681 million in 2001. Amortization for these items will not occur in 2002. Matáv is still reviewing the impact of SFAS 141 and 142 on other intangible assets, however, a significant impact on net income is not expected for 2002.

In October 2001, the FASB issued SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets and for Long-Lived Assets to Be Disposed of”, which supercedes SFAS 121. SFAS 144 provides one accounting model for the review of asset impairment. It retained a number of recognition and measurement provisions of SFAS 121 but removed goodwill from its scope.

For 2001, the carrying values and lives of tangible and intangible assets were reviewed. Based on this review an impairment charge was recorded (see note 8 and 9 of the consolidated financial statements).

During 2002, the first step of the required SFAS 142 impairment tests will be performed as of January 1, 2002. This first step requires the comparison of the carrying value of any reporting unit that has goodwill to the estimated fair value of the reporting unit. A reporting unit is an operating segment or a discrete component of that segment. If the current fair value is less than the carrying value, then the second step of the impairment test will be performed. This second step requires the measurement of the excess of the recorded goodwill over the current value of the goodwill, and to record any excess as an impairment charge.

Matáv plans to complete the impairment tests in the first half of 2002. Any impairment resulting from the initial application of the statements will be recorded as a cumulative effect of accounting change as of January 1, 2002, and will reduce net income in 2002.