

HUNGARIAN TELECOMMUNICATIONS CO LTD MATAV
Form 20-F
May 11, 2004

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As filed with the Securities and Exchange Commission on May 11, 2004

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, 2003
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.....1,042,811,600
nominal value HUF 100 per share
(as of December 31, 2003)

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.

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

YES NO

Item 17 Item 18
*Not for trading, but only in connection with the registration of American Depositary Shares.

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Certain Defined Terms and Conventions

In this annual report, the terms "Matáv", the "Group", the "Company", "we", "us" and "our" 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 Telekomunikacii AD. In this annual report, the term "Minister" refers to the Minister heading the Ministry of Informatics and Communications, to whom the rights of the Prime Minister Office were transferred as of May 27, 2002. The rights belonging to the Prime Minister Office belonged to the Ministry of Transport, Telecommunications and Water Management prior to 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 information 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, 1999, 2000, 2001, 2002 and 2003 and the accompanying notes, which have been audited by PricewaterhouseCoopers Könyvvizsgáló és Gazdasági Tanácsadó Kft. These consolidated financial data are qualified by reference to Matáv's consolidated financial statements and accompanying notes, which the Company has prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS differs from U.S. Generally Accepted Accounting Principles ("GAAP"). For a discussion of the principal differences between IFRS and U.S. GAAP as they relate to the Company, see Note 35 to the consolidated financial statements.

Year ended December 31,

	1999	2000 (3)	2001 (3)	2002	2003	2003
	HUF	HUF	HUF	HUF	HUF	U.S.\$ (1)

(in millions, except per share amounts)

Consolidated Income Statement Data:

Amounts in accordance with IFRS

Revenues	384,932	445,945	547,735	590,585	607,252	2,921
Operating profit	121,131	96,091	119,400	122,240	122,064	587
Net income	78,632	66,652	82,560	68,128	57,475	277
Net income per share (2)	75.81	64.27	79.59	65.66	55.38	0.27
Diluted net income per share (2)	75.52	63.97	79.59	65.66	55.38	0.27

Amounts in accordance with U.S. GAAP

Revenues	385,306	461,537	550,900	592,294	610,946	2,938
Operating profit	121,460	90,456	120,144	132,585	132,715	638
Net income	78,721	64,508	82,231	78,153	66,104	318
Net income per share (2)	75.89	62.20	79.30	75.32	63.69	0.31
Diluted net income per share (2)	75.61	61.91	79.30	75.32	63.69	0.31

Consolidated Balance Sheet Data:

Amounts in accordance with IFRS

Total assets	647,870	954,424	1,104,196	1,077,451	1,058,837	5,092
Net assets	350,591	638,509	508,469	575,580	630,384	3,032
Capital stock	103,728	103,736	103,736	104,281	104,281	502
Total shareholders' equity	327,579	637,281	460,300	516,144	560,110	2,695

Amounts in accordance with U.S. GAAP

Total assets	647,239	962,379	1,114,742	1,096,006	1,086,487	5,226
Net assets	338,260	624,168	490,084	566,913	629,962	3,030
Total shareholders' equity	315,248	622,941	445,167	511,036	563,631	2,711

Year ended December 31,

	1999	2000	2001	2002	2003
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Other data:

Weighted average number of shares (millions)

Basic	1,037	1,037	1,037	1,038	1,038
Diluted	1,041	1,042	1,037	1,038	1,038

- (1) Translated into U.S. dollars at the official closing rate of the National Bank of Hungary on December 31, 2003 of U.S. dollar 1.00 = HUF 207.92. These translations are unaudited and presented for convenience purposes only.
- (2) Net income per share under IFRS and net income per share under U.S. GAAP are calculated by dividing net income by the weighted average number of shares outstanding during each period.
- (3) In December 2001 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. 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 per Matáv ordinary share for the years 1999, 2000, 2001, 2002 and 2003. The table shows the dividend amounts in Hungarian forints, together with U.S. dollar equivalents, for each of the years indicated.

Year	Dividend Paid Per Ordinary Share	
	HUF	U.S.\$ (1)
1999	9	0.0356
2000	10	0.0351
2001	11	0.0394
2002	18	0.0799
2003	70	0.3367

- (1) Translated into U.S. dollars at the official closing rate of the National Bank of Hungary on December 31, 2003 of U.S. dollar 1.00 = HUF 207.92, December 31, 2002 of U.S. dollar 1.00 = HUF 225.16, 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 and on December 31, 1999 of U.S. dollar 1.00 = HUF 252.52.

Exchange Rate Information

The National Bank of Hungary sets the official rate of exchange for Hungarian forint. 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 determined and announced 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. In October 2001, the crawling peg system ceased to exist. The middle of the intervention band was set at 276.1 HUF/EUR. On June 4, 2003 the midpoint of the intervention band was shifted to 282.36 HUF/EUR with the aim to improve the long term competitiveness of the Hungarian economy. This move directly did not effect Matáv, however the action led to significant depreciation of the forint together with increased volatility, which further enhanced the foreign exchange (EUR/HUF) risk in the market.

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 forint per U.S.\$1.00 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.\$)				
Year	Period-End	Average (1)	High	Low
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
2002	225.16	258.00	283.98	225.16
2003	207.92	224.44	237.63	206.61
2003				
October	222.70	218.46	222.70	214.01
November	221.12	221.68	227.28	216.50
December	207.92	215.82	227.35	207.92
2004				
January	214.20	209.76	214.37	203.90
February	208.20	207.94	214.48	203.79
March	203.65	206.58	210.76	203.65

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

Exchange Rates
(amounts in HUF/EUR)

Year	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
2002	235.90	242.97	252.38	235.17
2003	262.23	253.51	272.03	234.69
2003				
	October	259.13	255.47	259.13
	November	265.03	259.41	265.03
	December	262.23	264.84	272.03
2004				
	January	265.05	264.60	270.00
	February	257.86	262.97	268.47
	March	248.92	253.36	257.21

(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 American Depository Shares ("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. The risks described below are not the only risks we face. Additional risks not currently known to us or risks that we currently regard as immaterial also could have a material adverse effect on our financial condition or results of operations. 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.

The Act XL of 2001 on Communications ("Act on Communications") was approved by the Hungarian Parliament in June 2001 and entered into force on December 23, 2001. This act became the basis for the liberalized telecommunications market in Hungary. 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 required unbundling of local loops, transparency of cost-based pricing, and reference offers for interconnection, and for leased line interconnection services. Service providers with significant market power are obliged by law to prepare reference offers and to have the reference offers approved by the regulator. These reference offers contain all the main terms and conditions (services, prices etc.) which are relevant in an interconnection or unbundling agreement. The cost base of the price of these services had to be calculated using Long Run Incremental Costs ("LRIC") from January 1, 2003. The Act on Communications introduced carrier selection and carrier pre-selection possibilities.

The Act on Communications was not in full conformity with the New European Union ("EU") Regulatory Framework for Telecommunications. In order to achieve harmonization of the telecommunications regulatory regime in Hungary to the EU Regulatory Framework and to further encourage competition, Act C of 2003 on Electronic Communications ("Act on Electronic Communications") was drafted and later approved by the Parliament. The main elements of the new regulation are as follows: Internet regulation, Significant Market Power ("SMP") obligation regulation, carrier selection, costing methodology, number portability regulation and institutional issues. The new act came into force on January 1, 2004.

The Company cannot fully anticipate the combined impact of these changes on its business and results of operations. Matáv's business and results of operations may be adversely affected by the new Hungarian telecommunications regulatory regime.

The liberalization of the fixed line telecommunications market is expected to have an effect on the mobile telecommunications industry as well. On November 4, 2002, the National Regulatory Authority ("NRA", Hírközlési Felügyelet) designated, for the first time, Westel as an SMP in the interconnections market. Westel was obligated to decrease its fixed-to-mobile termination charges by 10 percent, effective September 1, 2003. This status was assigned again to Westel on November 6, 2003, as a result of an annual assessment by the NRA. It is expected that government regulated fees and interconnection prices may change significantly in the future and such changes could adversely impact the operations of Westel.

Under the auspices of the new regulatory regime in Hungary, two changes affecting telecommunications customers' ability to retain telephone numbers when switching a carrier have been

implemented recently. From January 1, 2004, telecommunications customers are entitled to the geographic number portability, or the ability to retain a telephone number associated with a fixed telephone line when switching a carrier. From May 1, 2004, this portability was extended to include telephone numbers associated with mobile phone and non-fixed line.

This change may result in a larger churn rate among both fixed line and mobile customers, thus negatively impacting Matáv's results of operation.

See "Item 4 Regulation and Pricing"

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.

As a result of limited success that the Act on Communications had on the Hungarian telecommunications sector, the Act of Electronic Communications came into force on January 1, 2004 to further facilitate competition and encourage new entrants to the market. Although the identities of such new entrants are already known to some degrees, 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 Hungary's accession to the European Union, as well as the effectiveness of the Company's efforts to prepare for new market conditions, including increased competition, effected by the new regulatory regime.

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 have an adverse effect on results of operations, and customer acquisition and retention expenses are substantial. Due to the increased level of competition, prices for mobile voice telephony have been declining over the past several years and may continue to decline. 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 to offer attractive and affordable value added services in the future or if the Company's customers do not purchase its services.

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 largely depend on 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. 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.

Developments in the technology and telecommunications sectors have resulted and may result in substantial write-downs of the carrying value of certain of our assets.

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

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

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

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 telecommunications 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 may be linked to the credit rating of its parent company, Deutsche Telekom.

Matáv's credit rating was lowered by Standard & Poor's Ratings Services ("S&P") to BBB+ in April 2002, because of the downgrade of credit rating of its parent company, Deutsche Telekom ("DT"). Moody's Investors Services ("Moody's"), however, maintained its credit rating of Matáv at Baa1, while lowering DT's rating to Baa3 in January 2003.

Both agencies downgraded DT's credit ratings as a result of the substantial increase in DT's outstanding debt that was incurred to finance acquisitions and investments. Deutsche Telekom has strived to reduce its outstanding debt since then and, as a result, its financial position has significantly improved.

Its rating was affirmed by S&P in July 2003 and has a stable outlook, while currently it is on credit watch by Moody's for a possible upgrade. However, we cannot guarantee that DT's credit rating will improve in the future or will not be downgraded further.

S&P sees Matáv as a strategic investment of DT; therefore, it is very likely that S&P rating of Matáv will closely trail that of DT in the future as well. As the interest rates on Matáv's existing indebtedness are not linked to its credit rating, downgrading of Matáv's credit rating will not increase its financial obligations under the existing indebtedness. However, such downgrade may increase the cost of borrowing in the future and may adversely affect Matáv's financial position and results of operation.

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; however, the competition for qualified personnel in the telecommunications industry is intense. 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 to major global markets. As a result of the limitations of the Hungarian equities market and the volatility of the telecommunications sector, the price of Matáv shares may be relatively volatile and you may have difficulty selling your shares in the event of unfavorable market conditions.

Matáv has a substantial business interest based in Macedonia, where ethnic hostilities and economic pressures could reduce the value of Matáv's investment in that region.

Matáv owns 89.51 percent interest in Stonebridge Communications AD ("Stonebridge"), which owns 51 percent interest in MakTel, the formerly state-owned public telecommunications service provider in Macedonia. MakTel became a consolidated subsidiary of Matáv beginning on January 15, 2001.

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

MakTel may lose its dominant position and face significant competition as a result of the market liberalization measures in Macedonia.

The series of market liberalization measures in the telecommunications sector is planned to take place in Macedonia starting in 2005. MakTel is currently the only provider of fixed line telecommunications services that is allowed to operate in Macedonia. As a result of the market liberalization measures, however, MakTel's exclusive rights to provide fixed line telecommunications services will expire in December 2004 and other firms may start to provide services that are currently offered by MakTel.

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

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

Our business depends on general economic conditions in Hungary and abroad. From 2001 to 2003, there was a downturn in global economy in general and in the telecommunications industry in particular. There are many factors that influence global and regional economies, which are outside of our control. A cautious or negative business outlook may cause our customers to delay or cancel investment in information technology and telecommunications systems and services, which would adversely affect Matáv's revenues directly and, in turn, slow the development of new services and applications that could become future revenue sources. In addition, Hungary's accession to the European Union may impact the economic conditions in Hungary. If the global and regional economies do not improve, we may continue to experience adverse effects on our business, operating results and financial condition.

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

Matáv is subject to currency translation risks, mainly relating to the results of its Macedonian operations. A devaluation of the Macedonian denar and a strengthening of the Hungarian forint may exert a negative influence on MakTel's results that are converted into HUF, thereby lowering Matáv's results. This is mainly a reporting risk, but through the dividend payments it has direct financial (cash-flow) effects on Matáv as well.

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

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

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

ITEM 4 INFORMATION ON THE COMPANY

ORGANIZATION

The legal name of the Company is Magyar Távközlési Rt. and it operates under its commercial name, Matáv. Matáv is a stock corporation operating under the laws of Hungary. The Company 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. 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. The Hungarian Government made Magyar Távközlési Vállalat, the predecessor entity to Matáv, responsible for telecommunications operations. This entity was transformed on December 31, 1991 into a stock corporation, Magyar Távközlési Rt., or Matáv, then wholly owned by the predecessor of the Állami Privatizációs és Vagyonkezelő Rt. (the "State Privatization and Holding Company" or the "ÁPV").

MagyarCom GmbH ("MagyarCom"), a holding company in which Deutsche Telekom and Ameritech Corporation ("Ameritech") each held a 50 percent interest, was selected by the Minister in an international tender and subsequently purchased a 30.1 percent stake in Matáv for approximately U.S. dollar 875 million on December 22, 1993. 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 (the "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 December 22, 1995, MagyarCom acquired from the ÁPV an additional 37.2 percent interest for approximately U.S. dollar 852 million, raising its stake to 67.3 percent.

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

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

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

As of December 31, 2003, 59.21 percent of Matáv's ordinary shares was held by MagyarCom, 40.32 percent of the ordinary shares was publicly traded and the Company had 0.47 percent treasury shares. The Hungarian Government controls one Series "B" voting preference share to which special rights attach.

On October 21, 1999, Matáv announced that it had entered into an agreement with DT providing Matáv the option to acquire DT's 49 percent interest in Westel and Westel 0660 for a price of U.S. dollar 885 million. On December 21, 2001 Matáv paid DT EUR 920 million (HUF 227 billion) and had 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 had to pay an additional HUF 11.5 billion.

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, had an 86.5 percent stake in Stonebridge, which owns 51 percent of MakTel, thereby Matáv had 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, Earnings Before Net Interest and Other Charges, Tax, Depreciation and Amortization ("EBITDA") and the net debt of MakTel.

Pursuant to the terms of the Deed, SEEF exercised its put option relating to its 3.05 percent holding in Stonebridge on June 20, 2003 and Matáv paid EUR 21 million to SEEF on July 27, 2003. Following the closing of the transaction, Matáv had an 89.51 percent ownership in Stonebridge with an effective ownership share in MakTel of 45.65 percent.

See "Item 10 Material contracts".

DESCRIPTION OF BUSINESS AND ITS SEGMENTS

Matáv is the principal provider of fixed line telecommunications services in Hungary, with approximately 2.8 million fixed access lines at December 31, 2003. The Company is also Hungary's largest mobile telecommunications service provider, with more than 3,766,000 mobile subscribers (including users of prepaid cards) at December 31, 2003. The Company's total consolidated revenues were HUF 607,252 million, and its total consolidated net income was HUF 57,475 million in 2003.

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 had exclusive rights in five of the 54 local primary areas until May 2002, while its subsidiary, Emitel had exclusive rights in an additional three concession areas through November 2002. The Company's 36 former local concession areas cover approximately 70 percent of Hungary's geographic area and include Budapest as well as nearly all of the other major cities in Hungary. As there is limited competition for public voice telephony services even after the liberalization of the telecommunications market, Matáv is still the dominant service provider in these 36 areas. 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 mobile telecommunications subsidiary, Westel, the Company is a leading provider of mobile telecommunications services in Hungary. Westel is one of three GSM digital providers in Hungary. Matáv's former mobile subsidiary, Westel 0660, merged into Westel on November 30, 2003. Mobile telecommunications services have contributed significantly to the Company's revenue growth. Revenues from mobile telecommunications services increased from HUF 198,947 million before intersegment eliminations in 2001 to HUF 254,141 million before intersegment eliminations in 2003, while the number of subscribers increased to approximately 3.8 million by the end of 2003 from 1.7 million at the end of 2000.

International Activities. The international segment includes four Macedonian companies. Stonebridge is a holding company through which Matáv controls MakTel. MakTel is Macedonia's exclusive fixed line telecommunications company. 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 the construction and operation of public voice network services. MobiMak is MakTel's subsidiary, which is the leading mobile telecommunications service provider in Macedonia. Telemacedonia is a management company through which Matáv provides management and consulting services to MakTel, MobiMak and Stonebridge. Matáv's acquisition of MakTel closed on January 15, 2001 and MakTel became a consolidated subsidiary as of that date. This transaction has contributed significantly to the Company's revenue growth. Revenues from international activities were HUF 70,014 million before intersegment eliminations in 2003.

STRATEGY

The Hungarian telecommunications market and Matáv's current position

Matáv has a leading position in the integrated telecommunications service sector in Hungary. Despite the liberalization of the Hungarian telecommunications market at the end of 2001, Matáv has successfully retained its leading position in all market segments. Accordingly, we believe that Matáv is positioned well to play a leadership role and continue its course of sustainable growth.

Since 1999, the Hungarian telecommunications market grew by an annual rate of 11 percent according to Matáv estimates. Most of the growth was due to growth in mobile telecommunications market. Hungarian mobile penetration rate has already reached the average Western European levels. However, the pace of growth is expected to slow after penetration rate exceeds 80 percent. Additionally, data and Internet services are emerging as promising growth drivers, in line with management's expectation and focus on these sectors. For example, broadband penetration rate almost tripled in 2003 as a result of Matáv's intensive Asymmetrical Digital Subscriber Line ("ADSL") marketing campaign.

Competition continues to develop in both the fixed line and mobile markets. In fixed line, competitors have gained momentum only in certain segments (mainly corporate) so far. In mobile, rapid growth of the Hungarian market has attracted competitors with strong global background such as Vodafone.

Matáv's future operational environment

Regulatory environment

The first key trend, which will determine Matáv's future operational environment, is the development of the regulatory regime in line with the requirements of the European Union. Matáv has successfully avoided the "worst case" regulatory scenario by implementing proactive regulatory management, however several adverse regulatory changes are planned for 2004, which may disadvantage established service providers such as Matáv. Regulatory management must remain an area of intense focus for management to ensure the best possible operating conditions.

Fixed/mobile substitution

The second major trend is fixed-mobile substitution. The key competitors of the fixed line business are the mobile service providers. In the long run, the outcome of the current fixed-mobile substitution process will play the most important role in shaping the voice and data markets. Accordingly, defense of the fixed line business that at the same time complements Matáv's growth objective for Westel's mobile business will be the second key area of management focus for the coming year. Key elements of the fixed line defense strategy include making the existing fixed line service more attractive (e.g. consumer friendly pricing plans such as a flat-rate plan for unlimited long-distance calls, extended broadband services) and offering "one-stop" solutions for the customers' all telecommunications needs.

Matáv's strategic approach to creating maximum value

Matáv's management is committed to a comprehensive value creation program that includes pursuit of all organic and non-organic growth opportunities.

The following four areas are the key elements of this program:

1. Maximize the value of the residential voice market

Residential Mobile Business: consolidate market leadership

Strengthening Westel's position in the residential mobile market is important given the mobile telecommunications' increasing role in the telecommunications market. To achieve this goal, management has adopted four strategic goals:

Guard our profitability while stabilizing our market share;

Be a market leader through introduction of innovative products and focus on product and service quality;

Strengthening the "value for money" message, promising the customers a full-spectrum of high-quality services at affordable and competitive prices;

Introduce tailored promotions for high and middle value segment and extend the existing retention programs.

Residential Fixed Line Business: defend access base

Matáv's management will take all possible actions to increase the value of the fixed line residential voice business. Two strategic guidelines address this issue:

Extend churn management initiatives (e.g. customer relations management, proactively contacting customers intending to switch to another provider, service level differentiation, boosting Internet access); and

Gradually introduce flat-rate voice pricing plans to increase competitiveness of the fixed line business. The flat-rate pricing plan has the potential to dramatically increase the value of the fixed line subscription to the customer.

Mobile and Fixed Residential Lines Business: offer integrated fixed-mobile propositions

In addition, Matáv plans to evaluate the feasibility of integrated fixed-mobile service plans for residential customers.

2. Strengthen Matáv's leadership in the corporate sector

Corporate Telecommunications Business: increase competitiveness and develop system integration business

The corporate telecommunications market in Hungary continues to grow, as demand for business data services increases. Due to intense competition in the market, the primary strategic initiative in the corporate sector remains to continue to improve competitiveness:

Improve our sales force through further training, rigorous staff selection, performance management and incentives;

Use bundled service contracts to strengthen relationships with key accounts while avoiding direct price competition; and

Improve sector focus using reorganized account management/sales force structure.

Successful initiatives to market "solutions" to corporate customers have been in process for a year; Matáv will continue to expand in this area. The "Partnership Program" presents an opportunity to capture a share of system integration revenues by cooperating with system integrator partners.

Corporate Fixed Line, Mobile and Internet Business: offer bundled value propositions

Matáv is exploring introduction of business value plans that include products and services from its fixed line, mobile and Internet businesses to leverage the Company's status as the only integrated telecommunications service provider in the market. Customers have demonstrated demand for such services and Matáv can offer greater value in some cases by approaching customers as a group rather than as separate business units. Management is testing the feasibility of fully bundled value plans by evaluating market demand and creating a set of integrated product offers and joint bidding processes to test in the market.

3. Develop new growth areas

Residential and Internet Business: grow ADSL and dial-up profitability

The Internet market is Matáv's important growth area, both because of its intrinsic profit potential and its importance in retaining fixed line access subscriptions. Management has adopted a number of measures to continue ADSL growth while restoring rapid growth to the dial-up market:

Pursue aggressive growth plans in ADSL following the successful ADSL growth campaign in 2003;

Restore growth in the dial-up market through "breakout" ideas, such as aggressively promoting "Open Internet" (Internet access for a per-minute fee without any monthly fee, call set up charge or registration fee), offering a simplified and competitive dial-up product package, and supporting content development; and

Coordinate between Matáv's Internet brands to create effective product migration paths, coordinate marketing communication and promotions, and avoid competition within the Group.

4. Reduce costs

Continue to identify and exploit further cost reduction opportunities

Cost reduction may represent Matáv's most important short-term value creation opportunity in light of saturating/stagnating markets. Financial cost reduction measures have been successfully used at Matáv for several years. Management is, however, committed to significant cost reduction over the next three years to further enhance efficiency. Several cost areas are being carefully studied to ensure that all cost reduction opportunities are identified and exploited.

International segment - MakTel Group

Macedonia's telecommunications market is growing and is expected to outpace the GDP growth over the next three years. With a relatively low penetration rate and the entry of a second service provider, the mobile market is now entering its rapid growth phase and mobile penetration rate is expected to increase dramatically over the coming years. Internet is also expected to enter into a phase of rapid growth in Macedonia.

In the long term, Matáv's objective is to make MakTel the most successful telecommunications company in the Balkans. In order to secure sustainable profitability and strong financial performance, management has developed a Value Creation Program with the aim to increase MakTel's value by pursuing all feasible revenue growth and cost reduction opportunities. The program consists of five major categories, as follows:

Improve fixed line residential business: introduce new pricing plans to improve average revenue per user ("ARPU") and support soft rebalancing; realign sales force structure and increase sales where capacity exists; improve receivables management;

Enhance MakTel's corporate position: strengthen key account management and introduce focus to improve sales; upgrade value plans for major corporate clients;

Maintain mobile leadership: harmonize mobile and fixed line operations to preserve dominant market position; apply appropriate pricing for both prepaid and regular accounts to ensure rapid customer base growth while successfully defending dominant market position;

Redesign the Internet business model: act as a market shaper to increase dial-up penetration; launch ADSL broadband services; and

Optimize MakTel's cost structure: bring operating costs and capital expenditure down to minimum sustainable levels.

OVERVIEW OF MATÁV'S REVENUES AND PRINCIPAL ACTIVITIES BY BUSINESS SEGMENTS

For the years ended December 31, 2001, 2002 and 2003, Matáv's total revenues by business segments were as follows:

	Year ended December 31,			Year ended December 31,
	2001	2002	2003	2003/2002
	(in HUF millions)			(% change)
Fixed line telecommunications services segment				
Subscriptions, connections and other charges	97,942	98,797	98,250	(0.6)
Domestic traffic revenues	123,366	118,839	112,227	(5.6)
Other usage	24,276	20,885	15,365	(26.4)
International traffic revenues	32,339	27,274	22,513	(17.5)
Leased lines	18,010	20,377	21,286	4.5
Data transmission and related services	15,184	17,597	22,550	28.1
Telecommunications equipment sales	3,582	3,671	2,949	(19.7)
Other revenues	18,986	28,866	29,412	1.9
	333,685	336,306	324,552	(3.5)
Mobile telecommunications services segment				
International segment	60,034	67,562	70,014	3.6
Intersegment eliminations	(44,931)	(45,895)	(41,455)	(9.7)
	198,947	232,612	254,141	9.3
Total	547,735	590,585	607,252	2.8

Most of Matáv's revenues in 2001, 2002 and 2003 were derived from services provided within Hungary, except for the revenues of the international segment, which were mainly derived from services provided within Macedonia.

The business of Matáv is not materially affected by seasonal variations.

Fixed Line Telecommunications Services Segment

In 2003, Matáv's fixed line telecommunications services generated revenues of HUF 324,552 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 225,842 million in 2003, HUF 238,521 million in 2002 and HUF 245,584 million in 2001, 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, domestic and international long distance telephony service to its fixed line telephony subscribers.

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

Shared Cost/Toll Free Numbers. To enable business customers to better meet the needs of their clients, Matáv has introduced a wide range of "blue" numbers, which are shared cost numbers, and "green" numbers, through which businesses provide toll free access for their customers.

Voice-mail. In November 1999, Matáv launched a voice-mail product. Matáv believes voice-mail is an attractive 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 July 2001, Matáv introduced voice-mail Short Message Service ("SMS"), which provides an SMS alert to the mobile handset of the customer each time he or she receives a voice-mail message. These services allow better usage of the network, more comfort in using the phone and decrease the ratio of uncompleted calls. As of December 31, 2003, voice-mail subscribers amounted to approximately 400,000.

Fixed SMS. In September 2002, Matáv launched a new messaging service called Fixed SMS. The service first operated within Matáv Rt.'s network and between Matáv Rt.'s and Westel's networks. From February 1, 2003 this service is also available between Matáv Rt.'s and Pannon GMS Rt's ("Pannon's") networks. From the fixed line, short text messages can be sent with an SMS-capable phoneset and SMS termination is available for every subscriber. If the SMS's addressee does not have an SMS-capable phoneset, the text message is sent as a voice message (text-to-speech function). The maximum length of an SMS is 160 characters. The service has other useful functions as well: SMS to fixed fax machines, SMS redirection and multi-SMS sending.

Integrated Services Digital Network ("ISDN"). ISDN allows a single access line to be used simultaneously for a number of purposes, including voice, data, facsimile and video transmission. ISDN also provides higher quality connections with faster transmission of signals while increasing the bandwidth capacity of the network. The coverage of ISDN is 95 percent of Matáv Rt.'s network. Matáv offers both basic ISDN access lines with two channels and multiplex ISDN access lines with 30 channels. As of December 31, 2003, Matáv had installed 185,459 ISDN access lines with two channels and 5,227 ISDN access lines with 30 channels, amounting to 527,728 total ISDN channels compared to 305,882 channels at the end of 2000. In 2003, Matáv introduced the Turbo ISDN service. This product provides the highest speed dial-up Internet connection (128 Kbit/s). The Turbo ISDN service extended the life-cycle of the mature ISDN product without any additional investment.

Private Branch Exchange ("PBX") Services. Matáv offers PBX services through one of its subsidiaries, Matávcom Kft. As of December 31, 2003, Matávcom Kft. leased and sold approximately 35,000 ports. The vast majority of the equipment leased is digital and meets the demands of developing technologies such as ISDN and digital enhanced cordless telecommunications.

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

Directory Assistance. The Company offers directory inquiry services. The high-quality directory assistance service received 31.2 million inquiries relating to domestic and 0.5 million inquiries relating to foreign phone numbers in 2003. The domestic directory assistance database includes all fixed line and non-prepaid mobile subscribers' data in Hungary. We offer a call completion option to Matáv Rt. and Westel subscribers, whereby calls may be connected automatically. Matáv's directory services center performed 6.3 million call completions in 2003. The Directory Assistance-Plus ("DA-Plus") service is becoming increasingly successful. DA-Plus offers a wide range of information including Yellow Pages, residential classified advertisements, encyclopaedia, dictionary-based information, recipes, poems, as well as telephone numbers, postal, e-mail and website addresses without any quantity restrictions. The tariff of the service is based on per minute usage. The number of minutes charged by the DA-Plus service was 5.7 million in 2003.

Subscribers

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

	At December 31,		
	2001	2002	2003
Lines in service in Matáv Rt.'s service areas:			
Residential lines	2,151,346	2,055,338	2,012,672
Business lines	299,267	282,406	261,642
Public payphones	37,432	33,316	28,799
Total	2,488,045	2,371,060	2,303,113
ISDN channels	448,396	511,326	527,728
Total	2,936,441	2,882,386	2,830,841
Lines in service in Emitel's service areas:	80,899	79,460	78,638
Lines installed per 100 inhabitants:			
in Matáv Rt.'s service areas	39.1	38.4	37.7
Digital exchange capacity as % of Matáv Rt.'s total exchange capacity	85.4	87.1	89.9

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, 2003, 75 percent of Matáv's access lines were connected to residential customers and 24 percent to business customers. The remaining one percent of access lines was connected to public payphones. 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, as each of these institutions and departments generally has its own annual budget, particular telecommunications needs and responsibility. From a strategic perspective, however, Matáv considers the Hungarian government to be a single customer. Matáv offers most of 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 2003.

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,		
	2001	2002	2003
	(thousands of minutes)		
Domestic traffic at Matáv Rt.	10,088,137	8,820,201	7,958,292
Domestic traffic at Emitel (1)	91,567	179,670	152,614

(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 connection fee, monthly subscription charges and traffic charges based on usage. A call charge consists of two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration. 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.

The following table sets forth Matáv Rt.'s domestic fixed line tariffs in each of the years indicated in nominal Hungarian forint. In 2000 and 2001, tariff changes were effective from February 1 for analog lines and from January 1 for ISDN lines. In 2002, monthly subscription fees for analog and ISDN lines changed from February 1. From September 1, 2002 subscription fees for analog lines changed again and local and long distance tariffs have been altered as well. From February 1, 2003, subscription fees for analog and

ISDN lines changed, and local tariffs have been altered as well. In September and October 2003, Matáv reduced the fixed to mobile tariffs.

	As of			
	December 31, 2001	December 31, 2002	December 31, 2003	January 1, 2004
	(HUF, exclusive of VAT) (1)			
Connection fee:				
Residential	27,000	27,000	27,000	27,000
Business	60,000	60,000	60,000	60,000
Standard monthly subscription charge:				
Residential	2,308	2,464	2,568	2,568
Business	3,100	3,320	3,424	3,500
ISDN connection fee:				
Basic	60,000	60,000	60,000	39,000
Multiplex	990,000	990,000	990,000	990,000
ISDN standard monthly subscription charge:				
Basic	3,900-6,900	4,080-7,600	4,080-8,240	4,080-8,570
Multiplex	57,600-75,500	65,000-85,000	68,500-89,600	71,240-93,184
Charge for a three minute peak rate call: (2)				
Local	25.4	27.2	28.4	29.8
From the fixed line network to mobile subscribers (2)	183.8-192.8	183.4-192.4	169.2-186.2	169.2-186.2
Domestic long distance: (2)				
Zone 1 (Extended local)	25.4	27.2	28.4	29.8
Zone 2 (Budapest metropolitan area)	48.8	48.4	57.2	57.2
Zone 3 (Long distance)	75.8	75.4	75.2	75.2

(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 3.8 in 2001, HUF 3.4 in 2002, HUF 3.2 in 2003 and HUF 3.2 in 2004).

Matáv's one-time connection 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 on analog telephone lines and on ISDN lines.

The prices above reflect the tariffs for Matáv's Bázis pricing plan. In 2003, Matáv increased the number of pricing plans to allow customers in different market segments to choose pricing plans that best suit their calling patterns. These pricing plans also served as a tool to protect Matáv's customer base in the fully liberalized market as those customers who select Matáv as the operator for every traffic direction (local, long distance and international) receive the highest discounts.

Matáv offers the following primary pricing plans:

Minimal pricing plan. This pricing plan was targeted for residential customers with analog lines who use their phones less often but want to be available for incoming calls and would like to pay lower monthly fees. Customers using this pricing plan paid a significantly discounted monthly subscription fee and were allowed a 66.7 percent discount on call set-up fees and call charges to fixed line numbers. The discount could not exceed HUF 500 per month, above which customers had to pay three times the Bázis pricing

plan rates. At the same time, the customers using the Minimál pricing plan had the option to select a favorite friend or relative's fixed line number in Hungary to call at a low, Basic rate throughout a month. By the end of 2003, over 505,000 customers chose this pricing plan. As a result of change in the regulatory environment, Matáv terminated the sales of the Minimál pricing plan from January 1, 2004. Customers who subscribed for this pricing plan as of December 31, 2003 may maintain their Minimál subscription, however, Matáv does not offer it to new customers since January 1, 2004. Consequently, for low-usage residential customers Matáv's best product offering is the Felező pricing plan.

Felező pricing plan. On February 1, 2003 Matáv launched Felező pricing plan. With the Felező pricing plan half the monthly fee is applied toward call charges and subscribers can initiate calls without the call set up fee. Calculation of the telephony costs is also easy since the local and the domestic long distance numbers can be called at the same per minute fee. The international, fixed to mobile and Internet per minute fees of the pricing plan are the same as those of the Bázis pricing plan. The discount, that can be used to initiate calls against the monthly fee, cannot be used to generate Internet usage. As of December 31, 2003, over 297,000 subscribers are enrolled in this pricing plan.

Csevegő pricing plan. On December 27, 2001, Matáv launched the first pricing plan for residential customers that offers increasing discount for longer calls. The discount is 20 percent from the 5th minute and 30 percent from the 10th minute up to the 60th minute of the call. The discount is valid for all calls all day. From June 16, 2003, half of the monthly fee can be applied toward Internet usage if customers access the Internet via Matáv's Open Internet service. The pricing plan also contains 20 free fixed SMSs per month. In 2003, it was the second most popular pricing plan with approximately 375,000 customers as of December 31, 2003.

Kontroll pricing plan. Matáv's first pricing plan involving neither monthly subscription nor call set-up fees for residential customers with analog lines is the Kontroll pricing plan. Subscribers may chose a 30-day card for HUF 3,700, a 60-day card for HUF 7,400, a 90-day card for HUF 10,500, or a 180-day card for HUF 19,500. The card can be refilled during its period of validity or within 10 days after expiry. This pricing plan is similar to mobile prepaid offers.

Sokatmondó pricing plan. Matáv launched this pricing plan on October 1, 2002. As of December 31, 2003 over 50,000 customers had ordered this pricing plan. Signing a definite-period pre-selection contract is a precondition for this offer. The elements of the pricing plan are as follows:

Peak period lasts until 3 p.m. in Matáv, i.e. non-Local Telecommunications Operator ("LTO") or non-mobile directions; and until 6 p.m. in LTO and mobile directions;

30 SMSs free of charge per month (in Matáv, Westel and Pannon directions);

60 minutes free Internet access (in cooperation with Axelero); and

Sokatmondó Digifon pricing plan (with caller identification function).

The subscribers of the Sokatmondó pricing plan can order the Sokatmondó calling card, by which calls can be originated at the per minute rates of the pricing plan from Matáv's area and from abroad.

Ritmus pricing plan. Matáv offers the Ritmus pricing plan for residential and business customers making calls mainly in peak hours. The pricing plan is available for customers with analog or ISDN lines. Signing a definite-period pre-selection contract is a precondition for this offer. By subscribing to this pricing plan the customers receive discounted per minute rates. Various schemes in the Ritmus pricing plan family:

Ritmus Standard pricing plan: for those customers who mainly make peak-time calls;

Ritmus Helyi (Local) pricing plan: for those customers who mostly make local peak-time calls;

Ritmus Belföldi (Domestic) pricing plan: for those customers who mainly make domestic long distance and international peak-time calls;

Ritmus Mobile pricing plan: for those customers who mainly make mobile and international peak time calls;

Ritmus Csúcs (Peak) pricing plan: for those high-end customers who wish to take advantage of heavily discounted rates to every call direction;

Ritmus Calling Card, which is available with any of the Ritmus pricing plans free of charge to use the rates of the Ritmus pricing plan family from any Matáv telephone in Hungary and abroad.

XL supplementary pricing plan. On December 3, 2003 Matáv introduced the XL supplementary pricing plan which may be ordered in addition to a Bázis, Csevegő or a Sokatmondó pricing plan subscription. For a monthly gross fee of HUF 990, customers using the supplementary pricing plan may generate calls without the payment of any usage fee or call set up charge for local calls up to the first 60 minutes per call (the discount is only offered for voice calls).

Matáv Open Internet service. On June 16, 2003, Matáv launched its Internet service based on per-minute pricing. Matáv's Open Internet service offers an Internet access for a per-minute fee without any monthly fee, call set up charge or registration fee. The service is available for every Matáv subscriber via 06 51 622 622. In addition, Csevegő pricing plan subscribers can apply half of their monthly fee toward on-line time, if the new service dial-in number is used to access the Internet.

Public Telephones

As of December 31, 2003, Matáv Rt. operated 28,799 public payphones, representing a penetration rate of approximately 3.8 per 1,000 inhabitants in Matáv Rt.'s service areas. The traffic tariffs charged for calls from public payphones are at a premium to those charged to fixed line subscribers.

International Telephone Services

International telephone services consist of outgoing and incoming international telephony traffic, including voice and switched transit traffic through Hungary. In 2003, outgoing international telephony traffic generated revenues of HUF 9,473 million before intersegment eliminations, and incoming international telephony traffic generated revenues of HUF 13,040 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. Matáv's Hungary Direct and Country Direct services permit customers to charge calls made from 50 countries abroad to their home phone numbers. In 1998, this service was widened with a postpaid 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. Universal international toll-free service was launched in 2003. This service is available from 21 countries and enables the subscribers to be called on a unique universal number free of charge from abroad.

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

Traffic

The following table sets forth information regarding international telephony traffic to and from Hungary, transited by Matáv Rt., including other LTOs' and mobile service providers' 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,					
	2001		2002		2003	
	(millions of minutes, except for percentages and ratios)					
Outgoing traffic:						
Germany and Austria	114.9	35.9%	94.5	33.4%	87.7	32.8%
Neighboring countries other than Austria	56.6	17.7%	52.2	18.4%	56.9	21.2%
United States	14.8	4.6%	11.1	3.9%	11.2	4.2%
United Kingdom	16.5	5.2%	16.0	5.6%	13.9	5.2%
Italy	19.4	6.0%	16.6	5.9%	16.6	6.2%
All other countries	97.9	30.6%	92.7	32.8%	81.3	30.4%
Total outgoing traffic	320.1	100.0%	283.1	100.0%	267.6	100.0%
Growth in total outgoing traffic (% per annum)		(5.5)%		(11.6)%		(5.5)%
Incoming traffic:						
Germany and Austria	115.5	28.5%	117.4	31.8%	122.4	36.6%
Neighboring countries other than Austria	45.4	11.2%	41.7	11.2%	36.9	11.0%
United States	65.5	16.2%	43.5	11.8%	35.6	10.6%
United Kingdom	40.3	9.9%	33.9	9.2%	25.9	7.7%
Italy	20.3	5.0%	18.3	5.0%	16.6	5.0%
All other countries	118.1	29.2%	114.3	31.0%	97.3	29.1%
Total incoming traffic	405.1	100.0%	369.1	100.0%	334.7	100.0%
Growth in total incoming traffic (% per annum)		(15.0)%		(8.9)%		(9.3)%
Ratio of incoming to outgoing traffic		1.3		1.3		1.3
Transit traffic (millions of minutes)	88.4		87.0		58.1	

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 48.4 percent of the outgoing traffic and 59.9 percent of the incoming traffic in 2003.

In 2001, 2002 and 2003 the volume of incoming traffic exceeded 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. In addition, both outgoing and incoming international traffic handled by Matáv Rt. decreased as alternative service providers started to offer both call origination and call termination services for other domestic fixed line and mobile operators in Hungary. The decrease in the international traffic from 2002 to 2003 was also due to the establishment of the independent international links in 2003 by Westel, that allowed Westel to

independently handle international call origination and termination traffic. Westel's international traffic data is not included in the table above.

Despite the increasing competition in the international transit market, Matáv carried a considerable amount of switched transit traffic between Western and Central/Eastern Europe. In 2002 and 2003, international transit traffic decreased compared to the previous year's figure. This decrease was due to the liberalization in the neighboring countries, which made it possible for new telecommunications operators to handle some of Matáv's previous transit traffic.

Tariffs

The call charge for an international call, like that for a domestic call, contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration. On September 1, 2002, Matáv introduced eleven international tariff zones instead of the former six zones to better differentiate the rates of the international fixed line and mobile calls. International tariffs decreased on average both in 2002 and 2003 and 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 Telecommunications Union. Settlement payments, which are generally denominated in Special Drawing Rights ("SDR"), are calculated using a currency basket in which U.S. dollars have the greatest weight. Due to the large exchange rate fluctuations of the SDR caused by the recent volatility of the U.S. dollars, Matáv started to shift its accounting rate agreements to euro based arrangements. As the Company's important European partners were in agreement with this change, Matáv will continue these efforts in 2004 as well.

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 12 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 52 international networks. In order to increase the utilization of its transmission network, Matáv offers advantageous pricing plans for dedicated transit services via Hungary. Matáv has launched its own Dense Wavelength-Division Multiplexing ("DWDM") backbone network and is DT's partner in Delivery of Advanced Network Technology to Europe ("DANTE"), which provides 2.5 Gbit/s transmission paths for interconnecting Budapest and Zagreb into the European research and educational network, GEANT.

To seize the opportunities presented by liberalization of the telecommunications market in Romania, Matáv established interconnections with major Romanian alternative service operators and network service providers in order to offer transit services towards Western Europe. In addition, Matáv uses its own point of presence in Austria, which enables the Company to engage in telephone and Internet business with alternative telecommunications carriers located in Vienna. Matáv is present at the Vienna Internet Exchange (with dedicated circuit for Internet data exchange) and has peering arrangements with approximately 60 ISPs there. Matáv has direct Internet peering connections with Ukraine and Slovakia and provided high-capacity international Internet transit service to Internet Service Providers ("ISPs") in Moldova and Macedonia.

Leased Lines

Revenues from leased lines totaled HUF 21,286 million in 2003, HUF 20,377 million in 2002 and HUF 18,010 million in 2001, 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 64 Kbit/s to 155.0 Mbit/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 34 Mbit/s central access for the main site of a large enterprise network. City-Voice service is a version of the Voice-Flex service, which offers hot-line voice and fax communication capabilities on the managed leased line network between two customer premises.

Matáv further widened the range of access options to the service in 2002. 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 1,984 Kbit/s, focusing on the demands of mobile service providers. In the speed range from 192 Kbit/s to one Mbit/s, Kiloflex P provides a cheaper access than the previous subscriber access, for example for IP purposes.

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

Matáv increased the number of its Flex-Com connections from 8,920 as of December 31, 2000 to 11,480 lines as of December 31, 2003.

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. As of December 31, 2003, Matáv had 827 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 ("HSL"). The HSL service provides permanent, digital, transparent, point-to-point leased line service between service access points ("SAPs") which meets 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 HSL service are 2, 34 and 140 Mbit/s. In 2001, Matáv enlarged its HSL services portfolio by offering new speed elements at 45 and 155 Mbit/s. Matáv increased its HSL connections to 522 by December 31, 2003 compared to 432 at December 31, 2002.

As an addition to the High Speed Leased Line portfolio, Matáv introduced a Wavelength Division Multiplexing ("WDM") technology based premium service, Gigalink, which provides an even higher speed (622 Mbit/s) leased line service to business customers and to other service providers.

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, which partly offset the revenue increase generated by volume and bandwidth increases of the leased line services.

Data Transmission and Related Services

Revenues from data transmission and related services amounted to HUF 22,550 million in 2003, HUF 17,597 million in 2002 and HUF 15,184 million in 2001, 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 demand. 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.

Internet. Axelero, Matáv's fully owned ISP subsidiary, increased its subscriber base by 40.5 percent to 210,680. Axelero is the largest Internet service provider in Hungary with an estimated 44 percent market share based on the number of dial-up subscribers. Axelero also offers Internet services based on ADSL technology as well as access through cable television, to provide residential and business customers with fast, broadband Internet service at affordable prices. The number of Axelero's broadband (ADSL and cable television) customers has nearly quadrupled and reached 77,760 as of December 31, 2003 compared to 20,913 a year earlier.

Axelero maintained its market leader status in residential, corporate and content services market segments.

In 2003, the number of Internet users increased dynamically, Internet penetration rate among the population aged 14 and above reached 22 percent, while 12 percent of Hungarian households were connected to the Internet. In parallel, Personal Computer ("PC") penetration rate also improved, providing a basis for further growth potentials. Costs of using the Internet decreased by 25 percent, which also contributed to the results achieved in 2003. Axelero is committed to accelerate Internet penetration growth and invests significant amount of resources in attractive and innovative content development. The efforts seem to be fruitful, as the popularity of the [origo] portal has increased significantly. Additionally, the government plays a critical role besides the private sector in creating favorable conditions for the expansion of the Internet. Axelero joined the Government's Sulinet Expressz program, which provides tax credit to students and teachers on PC purchases. Axelero offered a free trial Internet access service to Sulinet Expressz configured PC's. The [origo] portal supported the initiative by creating a training site to educate beginners.

The accelerated broadband expansion in Hungary can help to utilize the full potential of the Internet and attract the number of educated users who consume more content and services. While an average Internet user spends 24 hours on-line monthly and only 9 percent use the Internet for electronic administration, a broadband subscriber spends 163 hours on the net and 35 percent use the Internet for electronic banking or shopping. Axelero Internet research shows that an increasing number of households skip dial-up technology and start to use Internet on broadband.

The growth of Axelero was greatly fostered by [origo], the most frequently visited portal in Hungary in excess of one million hits per day in November 2003. On a record-breaking day of November 24, 2003, 418,000 visitors generated 10 million page impressions ("PIs") as opposed to 4.6 million PIs on the same day in 2002. The extraordinary growth was the result of introduction new services and contents, including [origo]"shopping mall", multi-player strategy games and a film column. Axelero Internet is concerned with social responsibility issues and made [origo]accessible to the blind and near-sighted visitors.

As of October 2003, Axelero became the majority owner of Marketline, which provides the dominant horizontal electronic marketplace service in Hungary. In 2003, the total volume of on-line auction service (reverse purchasing auction) reached HUF 60 billion in Hungary.

Other important results of Axelero during 2003 included:

In March 2003, Axelero launched new products, including packages bundling Internet and telephone usage costs. As a result of the new portfolio, customers can access the Internet at 25 percent lower costs;

In May 2003, Axelero entered Invitel (formerly known as Vivendi) service areas with ADSL and Kombi products;

In July 2003, Axelero joined Matáv's "Small town ADSL program";

In September 2003, Axelero implemented a new e-mail system, aimed to increase service level and reliability. Automatic virus scan software was put into operation for enhanced security. Value added services (extra storage place and spam filter) were launched on Freemail, the most popular free e-mail service in Hungary.

To help stimulate demand and promote wider Internet usage, Matáv offers discounted Internet packages from August 1, 2002. There is one package that contains 15 hours of off-peak time Public Switched Telephone Network ("PSTN") access to the Internet for HUF 1,240 exclusive of Value Added Tax ("VAT") and another one that contains 40 hours of off-peak time PSTN access to the internet for HUF 3,200 exclusive of VAT. These schemes were developed in cooperation with the government in order to contribute to the development of the Internet community and to stimulate usage.

Datex-P. Matáv offers Datex-P, a packet-switched data transmission service based on the X.25 protocol. As of December 31, 2003, Matáv had 3,636 Datex-P terminals. The service provides low to medium speed domestic switched data communications services with international connectivity to business customers. As a result of the proliferation of new technologies, growth in the number of subscribers has stopped. In order to extend the lifecycle of the product and maintain profitability, network optimization and cost reduction were the major objectives in 2003.

rEDInet. This service allows editing of business documents electronically, quickly, accurately and with full security. The technology of the Electronic Data Interchange ("EDI") service is used in more than 25 countries. Matáv also provides professional training and consultation services to its rEDInet user business partners. The rEDInet covers more than 80 percent of the traditional EDI market in the Fast Moving Consumer Goods ("FMCG") sector. In recent years the growth of the traditional EDI market has slowed. Further growth opportunities may appear through providing of Internet-based solutions with lower costs and more simple operations to those companies, which do not require implementations integrated to their company information systems.

Security Services. On July 5, 1998, Matáv established Matávör Kft., a wholly owned subsidiary, to provide security-monitoring services. On June 15, 2001, Matáv and Group 4 Securitas Kft. established Group 4 Matávör Rt. The operations and customers of Matávör Kft. were taken over by the newly established associated company, in which Matáv owns a 50 percent interest. As of December 31, 2003, Group 4 Matávör Rt. had 10,831 customers.

Matáv ADSL. ADSL is a continuous, high-speed Internet access services based on the Asymmetric DSL technology. 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. In 2003, this service had significant growth with the number of ADSL connections reaching 103,564 by December 31, 2003 from 6,201 at December 31, 2001.

Matáv's ADSL service family that provides high-speed Internet through a broadband access was introduced in September 2000. Matáv's ADSL products explicitly serve high-speed Internet access; with their help a constant connection can be established that may be up to 20 times quicker than traditional dial-up or ISDN connection.

In 2003, Matáv implemented a major infrastructure expansion project in order to accomplish its Internet market goals. A large amount of investment was used for the roll-out of broadband Internet. As a result of these steps, 175 towns were connected to the service in 2003, and broadband access is now available for more than two-thirds of the fixed line subscribers in Matáv's service area.

The proportion of Hungarian broadband Internet users to the total Internet users has reached a high level even in comparison to the Western European standards, as 33 percent of domestic Internet subscribers have a broadband connection to the Internet. In Matáv service area, every fifth Internet access is an ADSL connection. In the East Central European region, Matáv is the market leader in terms of total ADSL lines; with regard to ADSL penetration Hungary ranks second in the region, following Estonia. The proportion of ADSL Internet users is 20 percent, and this figure exceeds the EU average of 19 percent.

Small town ADSL program. The successful "Small town ADSL program" was launched in 2003. Through regional development activities catered to market demand, this program has made ADSL access available in small towns and villages that are often economically less developed. The goal of the "Small town program" is to identify and serve towns and locations that show a significant interest in ADSL. In the first phase of the program (started on June 23, 2003), prospective users from 42 locations could register

their requests. The list of towns included in the program is continuously expanding. So far, about 200 towns have signed up for the program.

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

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

Matáv EasyNet Plusz was launched on August 1, 2003. This service provides significant additional capabilities compared to those offered by Matáv EasyNet. The most significant feature is the end user identification, as well as the use of prepaid cards, which allow the use of the wireless broadband Internet service. EasyNet Plusz cards are available in three various forms offering fixed time Internet access (1-hour, 5-hour, 24-hour) to the end users and may be used at any time up until the expiry of the card. At the end of 2003, there were 13 Public Hot Spot Sites in operation (6 hotels, 5 Matáv Points and 2 others).

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 a leased line. In order to maintain market share and competitive position, a new bundled service, called Symmetrical Internet was introduced in 2003, which includes access and IP/Internet service.

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