ANNUAL REPORT
For the fiscal year ended December 31, 2011

Magyar Telecom B.V.

The Netherlands
(Jurisdiction of Incorporation or Organization)

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(Address of Principal Executive Offices)

Parent company of

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1. INTRODUCTION

Magyar Telecom B.V. (“Matel”) is a limited liability company (*besloten vennootschap met beperkete aansprakelijhied)* organized under the laws of The Netherlands on December 17, 1996.

Matel has:

(a) issued senior secured notes due 2016, with an aggregate principal amount on the issue date of €345 million (the “2009 Notes”) and an additional €80 million in aggregate principal amount on the issue date of additional notes (the “Additional 2009 Notes”, and collectively with the 2009 Notes, the “2009 Notes”) pursuant to an indenture dated as of December 16, 2009, as amended from time to time (the “Indenture”); and

(b) assumed the obligations under senior floating rate notes due 2013, issued by HTCC Holdco II B.V., with an aggregate principal amount on the issue date of €200 million (the “2007 Notes”) pursuant to an indenture dated as of April 27, 2007, as amended from time to time (the “2007 Notes Indenture”). On March 30, 2011 all of the 2007 Notes were repurchased or called for redemption and subsequently cancelled.

Invitel Holdings N.V., an indirect parent of Matel, has:

(c) issued Floating Rate Senior PIK Notes due 2013, with an aggregate principal amount on the issue date of €125 million (the “2006 PIK Notes”), the obligations of which have been held by Holdco I, an indirect parent of Matel. On February 22, 2011 all of the 2006 PIK Notes were redeemed and subsequently cancelled.

Matel is a holding company and conducts its operations entirely through its subsidiaries and depends on payments from its subsidiaries to make payments on the 2009 Notes. The main operational subsidiary through which Matel provides its services is Invitel Távközlési ZRt (“Invitel”). Invitel is the number one alternative and the second-largest fixed line telecommunications, cable TV and broadband internet services provider in Hungary.

The 2009 Notes are senior obligations of Matel and are guaranteed by certain of Matel’s subsidiaries (the “Subsidiary Guarantors”) on a senior basis. The 2009 Notes and the guarantees are secured by (a) a first priority pledge over the shares of Matel and the shares of each Subsidiary Guarantor held by Matel or a Subsidiary Guarantor, (b) a first priority assignment of certain intra-group loans made by Matel and certain of the Subsidiary Guarantors, (c) a first priority pledge of certain bank accounts of Matel and certain of the Subsidiary Guarantors and (d) a first priority charge over certain assets of certain of the Subsidiary Guarantors.

The 2009 Notes are listed on the Official List of the Luxembourg Stock Exchange.

2. INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report includes forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology, including the terms "believe," "estimate," "anticipate," "expect," "forecast," "foresee," "intend," "may," "plan," "project," "seek," "should" or "will" or, in each case, their negative, or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Annual Report and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the industry in which we operate.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We caution you that forward-looking statements are not guarantees of future performance and that the actual results of our operations, financial condition and liquidity, and the development of the Hungarian telecommunications industry in Central and Eastern Europe, and particularly in Hungary, may differ materially from those made in or suggested by the forward-looking statements contained in this Annual Report. In addition, even if our results of operations, financial condition and liquidity, and the development of the telecommunications industry in Central and Eastern Europe are consistent with the forward-looking statements contained in this Annual Report, those results or developments may not be indicative of results or developments in subsequent periods. Factors that could cause these differences include, but are not limited to:

- our inability to execute our business strategy;
- the continuing effects of the global economic crisis and in particular the effects of the recent macroeconomic issues affecting the Hungarian economy;
- changes in the growth rate of the overall Hungarian and E.U. economies such that inflation, interest rates, currency exchange rates, business investment and consumer spending are impacted;
- our ability to effectively manage and otherwise monitor our operations, costs, regulatory compliance and service quality;
- our ability to effectively implement our hedging strategies to limit our risks attributable to changes in foreign currency exchange rates and interest rates;
- changes in consumer preferences for different telecommunication technologies, including trends toward mobile and cable substitution;
- our ability to generate growth or profitable growth;
- material changes in available technology and the effects of such changes including product substitutions and deployment costs;
- our ability to retain key employees;
- effects of, and changes in, laws, regulations or governmental policy affecting our business activities in the markets in which we operate, including changes in tax laws;

- political changes in Hungary;
- changes in accounting rules or their application, which could result in an impact on our financial results;
- our ability to successfully complete the integration of any businesses or companies that we may acquire into our operations;
- our substantial leverage and debt service obligations;
- our ability to generate sufficient cash to service our debt, to control and finance our capital expenditures and operations;
- our ability to raise additional financing;
- risks associated with our structure, any offerings, and our other indebtedness;
- our relationship with our shareholders; and
- any other factors referred to in "*Risk Factors*."

We urge you to read "*Risk Factors*," "*Management's Discussion and Analysis of Financial Condition and Results of Operations*," "*Hungarian Telecommunications Industry and Regulation*," "*Company History*," and "*Our Business*" for a more complete discussion of the factors that could affect our future performance, the Hungarian telecommunications industry as well as the telecommunications industry throughout Central and Eastern Europe. In light of these risks, uncertainties and assumptions, the events described or suggested by the forward-looking statements in this Annual Report may not occur.

Except as required by law or applicable stock exchange rules or regulations, we undertake no obligation to update or revise publicly any forward-looking statement, whether as a result of new information, future events or otherwise. All subsequent written and oral forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the cautionary statements referred to above and contained elsewhere in this Annual Report.

3. CERTAIN DEFINITIONS AND PRESENTATION OF GENERAL INFORMATION

In this Annual Report, unless indicated otherwise or the context requires otherwise:

"*E.U.*" refers to the European Union;

"*Euro*", "*EUR*" or "*€*" refers to the lawful currency of the participating member states of the E.U.;

"*Fibernet Acquisition*" means the acquisition of Fibernet;

"*Fibernet Disposal*" means the disposal of certain Fibernet assets to UPC;

"*FiberNet Kft*" means FiberNet Hungary Tanácsadó Kft., an entity organized under the laws of Hungary and the direct parent of FiberNet Zrt;

"*FiberNet Zrt*" means FiberNet Kommunikációs Zártkörűen Működő Részvénytársaság, an entity organized under the laws of Hungary;

"*Fibernet*" refers to FiberNet Kft and its subsidiaries;

"*forint*" or "HUF" refers to the lawful currency of Hungary;

"*Holdco I*" refers to HTCC Holdco I B.V., a company incorporated under the laws of The Netherlands;

"*HTCC*" refers to Hungarian Telephone and Cable Corp. with or without its subsidiaries, as the context requires, the predecessor entity to Invitel Holdings A/S;

"*HTFI*" refers to Hungarian Telecom Finance International Limited, a company controlled by Mid Europa Partners Limited;

"*Hungarian Telecom*" refers to Hungarian Telecom (Netherlands) Cooperatief U.A., a cooperative association organized under the laws of The Netherlands and a company controlled by Mid Europa Partners Limited;

"*Intercreditor Deed*" refers to the Intercreditor Deed, dated December 16, 2009, as amended or supplemented from time to time, and entered into between Matel, the Subsidiary Guarantors, BNP Paribas Trust Corporation UK Limited, as security trustee for the Notes and the other parties thereto, establishing the rights of creditors under our finance arrangements;

"*International Holdings*" means Invitel International Holdings B.V., a company incorporated under the laws of The Netherlands;

"*International Hungary*" means Invitel International Hungary Kft., an entity organized under the laws of Hungary;

"*Invitel Holdings*" refers to Invitel Holdings A/S, the successor entity to HTCC, the ultimate parent company of Matel, with or without its consolidated subsidiaries, as the context requires;

"*Invitel*" refers to Invitel Távközlési ZRt., also known as Invitel ZRt, the main operating company and a 99.98% owned subsidiary of Matel;

Numbers of "*lines*" or "*fixed lines*" refers to numbers of fixed telecommunications line equivalents;

"*Magyar Telekom*" refers to Magyar Telekom Nyrt., the largest provider of fixed line telecommunications services in Hungary, which is listed on the Budapest Stock Exchange and whose parent company is Deutsche Telekom AG;

"*Matel Holdings*" refers to Matel Holdings N.V., which is 100% owned by Holdco I;

"*Mid Europa*" refers to Mid Europa Partners Limited and any investment fund or vehicle advised, sponsored or managed directly or indirectly by Mid Europa Partners Limited, including Hungarian Telecom and HTFI;

"*NMHH*" refers to the National Media and Infocommunications Authority;

"*Subsidiary Guarantors*" refers to Invitel, Invitel Technocom, and International Holdings;

"Invitel Technocom" means Invitel Technocom Kft., a limited liability company incorporated under the laws of Hungary;

"*Turk Telecom*" means Türk Telekomünikasyon A.S.;

"*U.S. dollar*" or "*U.S.$*" refers to the lawful currency of the United States of America; and

"*we*", "*us*" and "*our*" refer to Matel and its consolidated subsidiaries, unless the context otherwise requires.

In addition, we have included a glossary of certain technical terms used in this Annual Report under the heading "*Glossary*."

The market and macro-economic information contained in this Annual Report was derived from various public sources, including the Hungarian Central Statistical Office and the Ministry of National Development. We believe that the market share information contained in this Annual Report provides fair and adequate estimates of the size of our market and fairly reflects our competitive position within that market. However, our internal company surveys and management estimates have not been verified by any independent expert, and we can provide no assurance that a third party using different methods to assemble, analyze or calculate market data would obtain or generate the same results.

4. PRESENTATION OF FINANCIAL INFORMATION

Presentation of Financial Information

The audited consolidated financial statements of Matel as of and for the year ended December 31, 2011 included in this Annual Report have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board and as adopted by the E.U. ("IFRS"). The audited consolidated financial statements included in this Annual Report are presented in Euro. See "*Financial Statements*" for further discussion.

On October 7, 2010, we consummated the sale of our international wholesale business (the "International Sale") comprising the entire issued share capital of Invitel International AG and its subsidiaries (the "International Business") to Turk Telecom. Following the consummation of the sale, the following entities are no longer subsidiaries of Matel: Invitel International, International Hungary, Memorex Turkey and EuroWeb Romania. See "*Our Business — Recent Developments — Sale of the International Wholesale Business*." Our consolidated financial statements as of and for the year ended December 31, 2011 included in this Annual Report reflect the International Business as discontinued operations.

Certain amounts which appear in this Annual Report have been subject to rounding adjustments, and, accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

Non-IFRS Financial Measures

EBITDA, adjusted EBITDA, pro forma adjusted EBITDA, gross margin and segment gross margin and the related ratios presented in this Annual Report are supplemental measures of performance and liquidity that are not required by, or presented in accordance with, IFRS. We present non-IFRS measures because we believe that they and similar measures are widely used by certain investors, securities analysts and other interested parties as supplemental measures of performance and liquidity. The non-IFRS measures may not be comparable to other similarly titled measures of other companies and have limitations as analytical tools and should not be considered in isolation or as a substitute for analysis of our operating results as reported under IFRS. Furthermore, EBITDA, adjusted EBITDA, gross margin and segment gross margin and leverage and coverage ratios are not measurements of our financial performance or liquidity under IFRS and should not be considered as an alternative to net profit or any other performance measures derived in accordance with IFRS or as an alternative to cash flow from operating, investing or financing activities as a measure of our liquidity as derived in accordance with IFRS.

Exchange Rate Information

Hungarian Forint per Euro

The following table sets out, for the periods and dates indicated, the period-end, average, high and low official rates set by the National Bank of Hungary for Hungarian forints per €1.00. We make 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. As of April 27, 2012 the rate was 287.63.

	EUR/HUF Exchange Rates			
	Period End	**Average**	**High**	**Low**
	(amounts in HUF/€1.00)			
Year				
2006	252.30	264.27	282.69	249.55
2007	253.35	251.31	261.17	244.96
2008	264.78	251.25	275.79	229.11
2009	270.84	280.58	316.00	264.17
2010	278.75	275.41	290.03	261.60
2011	311.13	279.21	316.24	262.70
Month				
January 2012	293.70	307.41	321.93	293.70
February 2012	289.88	290.61	293.80	286.72
March 2012	295.60	292.18	295.60	287.72
April 2012 (through April 27)	287.63	295.67	299.21	287.35

5. RISK FACTORS

In addition to the other information contained in this Annual Report, you should carefully consider the following risk factors before making any investment decisions. The risks and uncertainties that are described below are not the only ones that we face. Additional risks and uncertainties of which we are not aware or that we currently believe are immaterial may also adversely affect our business, financial condition or results of operations. If any of the possible events described below occur, our business, financial condition or results of operations could be materially and adversely affected. In this section, we capitalize references to Residential Voice, Residential Internet, Corporate, Wholesale and Cable where and to the extent that the references are to our reporting segments in our consolidated financial statements prepared in accordance with IFRS.

This Annual Report also contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially *from those anticipated in these forward-looking statements as a result of various factors, including the risks described below and elsewhere in this Annual Report.*

Risks Relating to Our Business

We have experienced substantial net losses and may need additional liquidity in the future.

During the year ended December 31, 2010, we incurred net losses from continuing operations of €48.8 million. During the years ended December 31, 2011 and 2010, we used a substantial amount of cash for capital investments. We also may require additional financing in the future to fund our operations. We cannot assure you that we will be able to improve our results of operations or obtain additional financing. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations*."

Since the second half of 2008, the global capital and credit markets have experienced extreme volatility and disruptions, which has limited the availability and increased the cost of financing. Our ability to secure additional financing in the future will depend on a variety of factors, such as economic and market conditions, the availability of credit, as well as the possibility that lenders could develop a negative perception of our prospects, the industry generally or the geographic markets in which we operate. It may be difficult or impossible to obtain financing in the event that we need additional liquidity in the near future.

Our revenue and cash flow will be adversely affected if the Hungarian fixed line market further declines and our Residential Voice business declines at a higher rate than we expect.

Our business strategy depends, in part, on our ability to manage our Residential Voice operations, in terms of both our revenue and our market share. The Residential Voice market in Hungary has continued to decline, in terms of both the number of lines and total voice traffic (i.e. average usage per line). We experienced a decline in the number of Residential Voice lines in our historical concession areas from approximately 327,000 lines as at December 31, 2010 to 301,000 lines as at December 31, 2011. We experienced a decline in the number of Residential Voice outgoing minutes in our historical concession areas from approximately 394 million minutes in 2010 to 354 million minutes in 2011.

We believe that the declines in the number of our fixed lines and voice traffic in the Hungarian fixed line market in general have been caused primarily by competition from mobile operators and cable television operators. Although we believe that the rate of line churn from fixed service to mobile service has slowed since the end of 2007 due to the very high mobile penetration in Hungary (approximately 117% as of December 31, 2011 according to the NMHH). At the same time, we have seen increased competition from, and increased churn to, cable television operators (most significantly UPC Hungary, T-Home and Digi) offering voice services in "triple play" (combined television, internet and voice service) packages.

A decline in our Residential Voice business at a rate greater than we anticipate, through a decrease in the number of lines and/or voice traffic could have a material adverse effect on our business, operating results and financial condition.

Our failure to increase revenue in the Residential Internet market may adversely affect our results of operations and reduce our market share.

Our strategy includes increasing our revenue from Residential Internet (ADSL) by increasing our market penetration in the growing Residential Internet market. We are planning on increasing our revenue from internet services to partially offset our decreased revenue from our Residential Voice services. However, our Residential Internet services are subject to strong competition from cable television operators in "triple play" (combined television, internet and voice service) packages, and we have seen cable television operators increase their share of the overall fixed broadband market at the expense of ADSL. In addition, we have seen the growth in our Residential Internet business slow, reflecting the general slowdown in the Hungarian residential fixed broadband market, in the wake of the recent economic crisis, which has taken a toll on consumer spending. We expect our Residential Internet business to grow again in the future as we expect the broadband penetration rate in Hungary to eventually reach Western European levels. However, if Hungary's internet usage does not grow as expected, or if our competitors are more successful at obtaining new customers or place downward pressure on prices to a greater degree than expected, we may not be able to increase our revenue in the Residential Internet market as planned, which could have a material adverse effect on our results of operations and reduce our market share.

Additionally, outside of our historical concession areas, we rely on the wholesale products of other operators, most importantly Magyar Telekom, in providing our Residential Internet services. Currently, these operators are subject to regulatory remedies imposed by the National Media and Infocommunications Authority (the legal successor to the NMHH), pursuant to which we are granted access to such wholesale products on regulated prices and terms. However, subject to the findings of future market analysis procedures conducted by the NMHH, such remedies may be relaxed or lifted, which may affect the profitability of our Residential Internet services.

Our revenue from the Corporate segment may be adversely affected due to competition and the economic environment.

We believe that we are well positioned to increase our market share in the Corporate segment. However, our Corporate segment operations have been negatively impacted by the economy as businesses seek to cut their expenditures and contract renewals become more competitive, resulting in higher price erosion. If the economy continues to negatively impact the expenditures of businesses and competition continues to negatively affect the pricing of existing contracts and the pricing of our new contracts, this could have a material adverse affect on our business, operating results and financial condition. In addition, our Corporate revenue is impacted by the continued reduction in Corporate outgoing voice traffic as Corporate customers rely increasingly on mobile technology. If the decline in voice-related Corporate revenue occurs faster than we expect, then this too could have an adverse impact on our operating results and financial condition.

If we are not able to manage costs while effectively responding to competition and changing market conditions, our cash flow may be reduced and our ability to service our debt or implement our business

strategies may be adversely affected.

Our business plan is dependent on our ability to effectively manage the costs associated with running our business. If we need to respond to actions by our competitors or unanticipated changes in our markets, we may be required to make capital investments in our business and other expenditures which would reduce our cash flow available for other purposes. This could have a negative impact on our ability to service existing debt and our business, results of operations and financial condition could be adversely affected.

We are subject to increased competition due to the business strategies of our competitors, prevailing market conditions and the effect of E.U. regulation on the Hungarian telecommunications market, which may result in the loss of customers and market share.

Competition in the Hungarian telecommunications sector has increased as a result of market liberalization measures introduced by Act C of 2003 on Electronic Communications, effective from January 1, 2004 (the "2004 Communications Act"). The 2004 Communications Act promotes competition in fixed line and mobile telecommunications services through, among other things, the transposition of relevant E.U. directives and regulations and the imposition of universal service obligations ("USO"), cost accounting, price controls, Carrier Pre-Selection, Carrier Selection, Local Loop Unbundling and number portability. The 2004 Communications Act also grants powers to the NMHH to impose obligations on market participants to remedy competitive deficiencies. As a result, we have faced, and could continue to face, increased competition.

Our competitors include mobile and fixed line telecommunications services providers in both the Residential and Corporate markets and cable television operators offering "triple play" (combined television, internet and voice service packages) specifically in the Residential.

Competition in any or all of our services has led to, and may continue to lead to:

- price erosion;
- loss of market share;
- increased customer line churn;
- loss of existing customers and greater difficulty in obtaining new customers;
- the need for more rapid deployment of new technologies and related capital expenditure as existing technologies are becoming obsolescent at a more rapid pace; and
- other developments that could have a material adverse effect on our financial condition and results of operations.

The scope of competition and its effect on our business, operating results and financial condition will depend on a variety of factors that we currently cannot assess with precision and that are for the most part outside of our control. Such factors include, in addition to the regulatory measures described above, the business strategies and capabilities of current and potential competitors, prevailing market conditions and the effect of E.U. regulation on the Hungarian telecommunications market, as well as the effectiveness of our efforts to address increased competition. Fixed-to-mobile substitution has increased customer line churn in both the Residential and Corporate markets in the past, although we believe that the rate of fixed-to-mobile line churn has decreased since the end of 2007 as a result of Hungary's very high mobile penetration rate (approximately 117% as of December 31, 2011 according to the NMHH). Although we attempt to control customer line churn by improving our customer service, introducing new customized service offerings, utilizing effective advertising and through other means, if we are unsuccessful in any of these initiatives, our customer line churn could further increase and our business could be materially adversely affected.

The ongoing global financial and economic crisis may continue to result in the deterioration of economic conditions in our operating areas, which may continue to impact demand for our services and affect our ability to obtain additional financing. Austerity measures introduced by the Hungarian government may similarly impact demand for our services.

Continued concerns about the systemic impact of potential long-term and wide-spread recession, energy costs, the availability and cost of credit, diminished business and consumer confidence and increased unemployment have contributed to increased market volatility and diminished expectations for European and emerging economies, including the jurisdictions in which we operate.

Our business is affected by general economic conditions in Hungary and the Central and Eastern European region. 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 Business customers to delay or cancel investment in information technology and telecommunications systems and services, which may adversely and directly affect our revenue and, in turn, slow the development of new services that could become future revenue sources for us. Our revenue was adversely affected and any future deterioration of the global and regional economies could have a material adverse effect on our business, operating results and financial condition. The global financial and economic crisis may result in the deterioration of economic conditions in our operating areas. The impact of the credit crisis on our customers may adversely impact the overall demand for our products and services. This in turn may result in decreased revenue. In addition, a continued credit crisis may affect our ability to obtain additional financing.

In addition, as the global financial system experienced unprecedented credit and liquidity conditions and disruptions, leading to a reduction in liquidity, greater volatility, general widening of credit spreads and, in some cases, lack of transparency in money and capital markets, many lenders have reduced or ceased to provide funding to borrowers. If these conditions continue, or worsen, it could negatively affect our ability to raise funding in the debt capital markets and/or access secured lending markets on financial terms acceptable to us.

Budget deficits as a percentage of GDP have remained relatively high for Hungary over the last several years. The Updated Convergence Program, a government plan consisting of austerity measures to redress the Hungarian economy and which was endorsed by the European Commission in September 2006, contemplates a reduction in the general government budget deficit.

While the telecommunications sector is one of the industrial segments that has been less affected by the global financial crisis and economic slowdown, the recessionary conditions and uncertainty in the macroeconomic environment nevertheless adversely impacted consumer spending on telecommunications products and services. Customers may decide that they can no longer afford certain of our services that are instrumental in supporting our revenues. For example, there has been a trend among Hungarian customers to disconnect their fixed voice lines, as consumers rely primarily on mobile telecommunications and view fixed-line voice services as an expendable discretionary expense.

In addition to a significant budget deficit, in recent years the Hungarian economy has been marked by a large current account deficit, rapid credit growth and a reliance of Hungarian businesses and consumers on foreign currency loans. These factors have left Hungary especially vulnerable to the financial crisis.

According to the National Bank of Hungary's forecast, economic growth is expected to accelerate in the future. However, there are a number of risks to the pace of growth as the external economic environment remains fragile due to the adverse effects of fiscal austerity efforts by Euro-area governments. In addition, the depreciation of the Hungarian forint against the Swiss franc may substantially worsen the economic outlook in Hungary through a decline in domestic demand.

Employment growth and the reduction in personal income tax rates may contribute to an improvement in households' creditworthiness and domestic demand, while the cut in the corporate income tax may stimulate investment and borrowing. At the same time, however, the introduction of windfall taxes is likely to reduce the predictability of the tax regime, and may create a less favorable business climate particularly in the effected industries.

The continued impact of the global economic and market conditions, including, among others, the events described above could have a material adverse effect on our business, financial condition, results of operations or liquidity.

We are subject to a recently enacted special crisis tax and face a potential tax liability, which would have a significant impact on our operational results and profitability.

In October 2010, the Hungarian Parliament passed a law imposing a special crisis tax on certain sectors, including telecommunications, which was implemented with retrospective effect to January 1, 2010. As a result of this law, we estimate that we will be required to pay €28.8 million in tax before the end of 2012 (based upon forecasted revenues). In 2010, we incurred additional expense of €11.2 million as a result of this tax. Although this special crisis tax is expected to expire at the end of 2012, there is a risk that the Government will decide to prolong this tax. If extended, we estimate this special crisis tax would significantly adversely affect our operational results and profitability by reducing our yearly cash flow by up to approximately €10 million. For a discussion of the special crisis tax, see "*Management's Discussion and Analysis of Financial Condition and Results of Operations — Macroeconomic Factors*" and "*Hungarian Telecommunications Industry and Regulation — Our Other Statutory Obligations Imposed on us in Hungary — Special Crisis Tax*."

A new telecom tax to be introduced by the Hungarinan Ministry for Economy with a significant impact on our traffic revenue.

In April, 2012 the National Ministry for Economy announced the introduction of a new telecom tax to generate more income to the central budget. The new tax is planned to be introduced from July 1, 2012. The taxpayer will be the subscriber and the collector will be the telcom service providers. The tax is anticipated to be HUF 2 per minute on all voice based calls, except for emergency calls and donation lines, HUF 40 per minute on value added calls, HUF 2 per sms and mms, and 10% of all prepaid cards. Currently, the proposal is a draft bill before the Parliament. This is likely to have a negative impact on our traffic volumes and customer churn.

The provision of cable services is highly competitive, and may become more competitive in the future, which could result in a loss of ex-Fibernet's subscribers and revenue.

Our new cable business from the acquisition of Fibernet provides cable services. The provision of cable services is highly competitive and our cable business faces competition from established and new competitors. As existing technology develops and new technologies emerge, we believe that competition may intensify. Our cable business faces competition from other cable providers, satellite providers, wireless providers, terrestrial broadcasters, DSL providers, incumbent providers and other providers or delivery systems. Some of our cable business' competitors have substantially greater financial and technical resources than we do. Our cable business may be required to reduce its prices if its competitors reduce prices, or as a result of any other downward pressure on prices for cable services, which could result in a decrease of the average revenue per user, and/or a loss of subscribers. Our cable business' competitors may be able to launch products or services with superior capabilities or may be better able to fund development. An increase in competition in the provision of cable services, or activities by the competitors, including those mentioned above and others, could lead to a decline in sales, renewal rates and/or increase in costs, which could have an adverse effect on our cable business, financial condition, results of operations and cash flows.

The agreements entered into in relation to the International Sale may result in warranty claims against us.

As part of the International Sale, pursuant to the stock purchase agreement we agreed to certain warranties and indemnities with Turk Telecom, some of which do not expire until October 2015. In relation to these warranties, Turk Telecom may bring breach of warranty claims against us for the purchase price of the International Business. In addition, we entered into a master services agreement for the provision of reciprocal telecommunication services with Turk Telecom. Under this agreement, Turk Telecom may bring warranty claims against us for up to 100% of the aggregate of all fees and expenses paid by it and its affiliates to us for a service in that contractual year. If Turk Telecom were to bring a breach of warranty claim in either instance, it could have a material adverse effect on our revenues, results of operations, liquidity or financial condition. We hold insurance against such claims, however there can be no assurance that such insurance will be adequate to cover all losses.

The Fibernet Disposal may result in warranty claims.

As part of the Fibernet Disposal, we undertook a number of warranties to UPC for a period of 24 months from the date of the Fibernet Disposal. The aggregate amount of our liability towards UPC is limited to the amount of the purchase price paid by UPC for the divested assets, which is approximately €22.2 million. There can be no assurance that such payment under the warranty obligations will not arise during the warranty period.

Our acquisition strategy contains risks and uncertainties and will depend on the successful integration of existing and newly acquired businesses. Anticipated synergies may not materialize which may affect our ability to expand our operations successfully.

In order to strengthen our business, we intend to pursue expansion opportunities by selectively acquiring and pursuing investment opportunities which will compliment and enhance our existing operations. The ability to carry out this strategy will depend, among other things, on our ability to identify and compete for new opportunities, the availability of financing and regulatory approvals. In addition, our prospects should be considered in light of the risks and transaction costs that are inherent in acquisitions and the development of new activities. While we hope to benefit from integration synergies, there is no assurance that we will be successful in realizing the full extent of anticipated benefits and actual synergies may be materially different which may affect our ability to expand our operations successfully.

The loss of key senior management could negatively affect our ability to implement our business strategy and generate revenue.

Our performance and continued success depends, in part, on our senior management. The familiarity of our senior management with our company and our business, their experience in management and with financial matters, and their combined experience in the telecommunications market generally make them important to our continued success. The loss of key members of our senior management could negatively affect our ability to implement our business strategy and generate revenue.

Technological changes and the shortening life cycles of our services and infrastructure may affect our operating results and financial condition and may require us to make unanticipated capital expenditures.

The telecommunications industry is characterized by rapidly changing technology, related changes in customer demands and the need for new services at competitive prices. Technological developments are also shortening life cycles of both services and the business infrastructure on which those services are based, and are facilitating convergence of different segments of the increasingly global information industry. In addition, competition based on alternative technologies, such as cable television networks or voice-over IP, wireless based technologies or radio-based alternative networks in our voice markets, could provide a lower cost solution or render our services obsolete or cost-inefficient in our markets.

Our future success will be impacted by our ability to anticipate, invest in and implement new technologies in order to provide services at competitive prices. In addition, we may not receive the necessary licenses to provide services based on these new technologies or may be negatively impacted by unfavorable regulation regarding the usage of these technologies. Technological advances may also affect our operating results and financial condition by shortening the useful life of some of our assets or by requiring us to make additional unanticipated capital expenditures, particularly in connection with our network. If we need to respond to actions by our competitors or unanticipated changes in our markets or market conditions, we may be required to make investments in our business and other expenditures which would reduce our cash flow available for other purposes, including servicing our debt.

Network or system failures could result in reduced revenue, or require unanticipated capital or operating expenditures, and could harm our reputation.

Our technical infrastructure (including our network infrastructure for fixed-network services and our data center for hosting services) is vulnerable to damage or interruption from information technology failures, power loss, floods, windstorms, fires, intentional wrongdoing and similar events. Unanticipated problems at our facilities, network or system failures, hardware or software failures or computer viruses could affect the quality of our services and cause service interruptions. Any of these occurrences could result in reduced revenue, or require unanticipated capital or operating expenditures, and could harm our reputation.

We depend on our ability to store, retrieve, process and manage a significant amount of information. If our IT systems fail to perform as expected, or if we suffer an interruption, malfunction or loss of information processing capabilities, it could negatively affect our ability to service our customers.

Our business depends on continuously upgrading our existing networks. Any unanticipated investments required due to external or internal factors would require additional unplanned capital expenditure.

We must continue to upgrade our existing fixed-line networks in a timely manner in order to retain and expand our customer base in each of our markets and to successfully implement our strategy. Among other things, the needs of our business could require us to:

- upgrade the functionality and capacity of our networks;

- increase our network coverage in some of our markets;
- expand or upgrade our customer service, network management and administrative systems; and
- upgrade older systems and networks to adapt them to new technologies.

Many of these tasks, which could create additional financial strain on our business and financial condition, are not entirely under our control and may be affected by applicable regulation. If we fail to execute them successfully, our services and products may be less attractive to new customers and we may lose existing customers to our competitors, which would adversely affect our business, financial condition and results of operations.

We are dependent on third party vendors for our information, billing and network systems as well as IPTV service. Any significant disruption in our relationship with these vendors could increase our costs and affect our operating efficiencies.

Sophisticated information and billing systems are vital to our ability to monitor and control costs, bill customers, process customer orders, provide customer service and achieve operating efficiencies. We currently rely on internal systems and third party vendors to provide some of our information and processing systems as well as applications that support our IP services, including IPTV. Some of our billing, customer service and management information systems have been developed by third parties for us and may not perform as anticipated. In addition, our plans for developing our information systems, billing systems, network systems and IPTV service rely on the delivery of products and services by third party vendors. Our right to use these systems is dependent upon license agreements with third party vendors. Some of these agreements are cancelable by the vendor and the cancellation of these agreements could impair our ability to process orders or bill our customers. Since we rely on third party vendors to provide some of these services, any switch in vendors could be costly and affect operating efficiencies. We do not have direct operational or financial control over our key suppliers and have limited influence with respect to the manner in which these key suppliers conduct their businesses. Our reliance on these suppliers exposes us to risks related to delays in the delivery of their services.

We depend on third party telecommunications providers over which we have no direct control for the provision of certain of our services.

Our ability to provide high quality fixed-line telecommunications services, depends on our ability to interconnect with the telecommunications networks and services of other fixed-line operators and mobile operators, particularly those of our competitors. While we have interconnection agreements in place with other operators, we do not have direct control over the quality of their networks and the interconnection services they provide. Any difficulties or delays in interconnecting with other networks and services, or the failure of any operator to provide reliable interconnection services to us on a consistent basis, could result in our loss of subscribers or a decrease in voice traffic, which would reduce our revenues and adversely affect our business, financial condition and results of operations.

Our operations require substantial capital expenditures, which we may not be able to fund from cash generated from operations or financing facilities.

We require substantial capital to maintain, upgrade and enhance our network facilities and operations. While we have historically been able to fund capital expenditures from cash generated from operations and financing facilities, this may not be possible in the future and the other risks described in this section could materially reduce cash available from operations or significantly increase our capital expenditure requirements, and these outcomes could cause capital not to be available when needed. In addition, costs associated with the licenses that we need to operate our existing networks and technologies and those that we may develop in the future, and costs and rental expenses related to their deployment, could be significant. The amount and timing of our future capital requirements may differ materially from our current estimates due to various factors, many of which are beyond our control. We may also be required to raise additional debt or equity financing in amounts that could be substantial. The type, timing and terms of any future financing will depend on our cash needs and the prevailing conditions in the financial markets. We cannot assure you that we would be able to accomplish any of these measures on a timely basis or on commercially reasonable terms, if at all. Further, we cannot assure you that we will generate sufficient cash flows in the future to meet our capital expenditure needs, sustain our operations or meet our other capital requirements, which may have a material adverse effect on our business, financial condition and results of operations. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources*." This could adversely affect our ability to implement our business strategy and result in a reduction of revenue.

Legal contingencies and liabilities could have a substantial negative impact on our financial condition, cash flows and profitability.

We are subject, in the ordinary course of business, to litigation and other legal, civil, tax, stamp duty, regulatory and competition claims. We cannot be certain that we will have a successful outcome in any proceedings or that our cash flow will be sufficient to cover all future claims against us. Any increase in the frequency and size of these claims, may adversely impact our profitability and cash flow and have a material adverse effect on our results of operations and financial condition. In addition, if these claims rise to a level of frequency or size that is significantly higher than similar claims made against our competitors, our reputation and business will likely be harmed.

Our financial conditions and prospects may be materially adversely affected by ratings downgrades.

Moody's Investors Services ("Moody's") announced on April 1, 2011 that it has downgraded the rating on the Notes to align with Matel's Corporate Family Rating. Such downgrades in the ratings of the 2009 Notes or other adverse actions by rating agencies could increase our borrowing costs for future financings and signal an increase in the risk of investment in the 2009 Notes.

Risks Relating to Regulatory Matters

The changing regulatory environment, the difficulty to predict the result of certain market analyses by the regulator, price regulations, and other regulatory initiatives and investigations could affect the results of our operations, our financial condition and the success and profitability of our business.

The 2004 Communications Act has resulted in significant changes to the Hungarian telecommunications sector and the regulatory environment is constantly changing. The NMHH was established in 2010 and is now the sole agency responsible for oversight and monitoring of the Hungarian telecommunications industry, with the power to impose regulatory remedies. In 2006, the Ministry of Information Technology and Communications (the government department formerly responsible for legislation relating to the Hungarian telecommunications industry) was incorporated into the Ministry of Economics and Transport. In mid-2008, the industrial parts were carved out into a new Ministry of Transport, Telecommunications and Energy. As of January 1, 2009, all relevant legislative and supervisory competences concerning telecommunications were taken over by the Prime Minister's Office, while the Ministry of Transport, Telecommunications and Energy remained the official department responsible for the postal sector only. Following the 2010 elections in Hungary, the structure of the central administration has changed substantially and currently the Ministry of National Development is responsible for all matters related to audiovisual policy, public administration IT, electronic communication of information, frequency management, information society and postal services. As a result of the modification of the Communication Act, NMHH received a right to create execution decrees. For a more detailed discussion of Hungary's telecommunications industry regulation, see "*Hungarian Telecommunications Industry and Regulation — Hungarian Regulatory Environment*."

This regulatory regime entails a number of risks that may adversely impact our business:

- The frequent changes in the telecommunications regulatory regime (including the 2010 general elections in Hungary that led to changes in the government, in the ministerial structure, the personnel in the ministries, creation of a convergent regulatory authority (i.e., the NMHH and the president of the NMHH), combined with the recent increased activity in the telecommunications industry by the Hungarian Competition Office (the "GVH") and the National Consumer Protection Authority (the "NFH"), as well as the recent adoption of a new media legislation and the transposition of recent E.U. directives governing electronic communications into the Communication Act, could cause or lead to inconsistent implementation and interpretation of laws governing the electronic communications industry, thereby hampering the stability of the regulatory environment. Such uncertainties in the regulatory environment could, in turn, negatively impact our future growth and profitability.

- In October 2010, the Hungarian Parliament passed a law imposing a special crisis tax on certain sectors, including telecommunications. As a result of this law, we estimate that we will be required to pay €28.8 million in tax before the end of 2012 (based upon forecasted revenues). In 2010, we incurred additional expense of €11.2 million as a result of this tax. Although this special crisis tax is expected to expire at the end of 2012, there is a risk that the Government will decide to prolong this tax. If extended, we estimate this special crisis tax would significantly adversely affect our operational results and profitability by reducing our yearly cash flow by up to approximately €10 million. For a discussion of the special crisis tax, please see "*Management's Discussion and Analysis of Financial Condition and Results of Operations — Macroeconomic Factors*" and "*Hungarian Telecommunications Industry and Regulation — Other Statutory Obligations Imposed on us in Hungary — Special Crisis Tax*."

- The NMHH conducts, on a periodical basis, market analysis exercises in order to determine the competitiveness of the market. However, the results of such analyses are often difficult to predict and the process is constantly being reviewed and modified both on the national and the international level pursuant to the inputs generated by public consultations and policy driven interventions of the European Commission. If we are unable to respond effectively to the evolving regulatory policies implemented by the NMHH, our ability to compete and the profitability of our business may be impaired.

- Although the regulatory findings of the NMHH may be challenged before the courts, the resolutions imposed by the NMHH are immediately enforceable unless injunctive relief is granted by the courts. Due to the lengthy nature of Hungarian court proceedings, therefore, even if a court decision is ultimately favorable to us, our business may already be adversely affected.

- If the NMHH does not respond effectively to changes in the market environment by changing the regulatory obligations imposed on us or on other incumbents in step with changes in the market, our ability to operate competitively in our industry may be adversely affected.

- The NMHH has designated us as a service provider with significant market power ("SMP"). As a result, the NMHH issued resolutions forcing us to adopt changes in our pricing models. As an operator with SMP, we have been required to submit to the NMHH and publish a Reference Interconnection Offer ("RIO") and a Reference Unbundling Offer ("RUO"). The NMHH reviews the cost based models submitted by us, and evaluates them by comparison to a hypothetical "efficient company." On the basis of such review, the NMHH may intervene and regulate the wholesale prices included in our RIO and RUO. The wholesale prices fixed in our RIO and RUO (as adjusted by the NMHH) may not be changed without the NMHH's approval. These powers of the NMHH may adversely affect our business and results of operations.

- Our universal service monthly fees and our residential and non-residential access fees are subject to price regulation such as price caps, which have previously been applied with retroactive effect. As a result, we cannot predict with certainty that our current pricing strategy will not result in penalties or in adverse changes to our price caps. Any such changes in the price caps could restrict our ability to determine our retail fees and could thereby reduce our profitability.

- Both the NMHH and the GVH regularly conduct investigations regarding market participants' compliance with applicable laws and regulations, whereby both the NMHH and the GVH may simultaneously sanction the same or similar market practices or behavior, as well as impose severe fines (in case of the NMHH, various percentages of the annual revenue, depending upon the nature of breach, and, in case of the GVH, up to 10% of the company's annual revenue) and other sanctions on market players. In addition, both regulatory authorities have increased their consumer protection efforts. Therefore, given the overlapping authority of the NMHH and the GVH, the increasing complexity of regulatory investigations and the indeterminate amounts at stake, regulatory disputes could have a material adverse effect on our operating results or cash flows.

- The power of the NFH has been increased due to the adoption of the Unfair Commercial Practices Directive (the "UCP"), which created a new regulatory environment in which the authority of the NFH and the GVH may overlap under certain circumstances, the applications of which may be unpredictable. The NFH may impose a penalty of up to HUF 2 billion or initiate litigation on behalf of consumers.

- Since 2004, the NMHH has published a series of resolutions regarding the regulation of the wholesale market for call termination in individual mobile networks, as a result of which all the mobile carriers in Hungary (T-Mobile, Telenor and Vodafone) were required to decrease their termination fees annually through December 1, 2010 (with no decrease required for 2006) to cost level plus a reasonable return above cost. Virtually all mobile operators have challenged such resolutions of the NMHH before the court. Although the NMHH has an improving track record of winning litigation initiated by the mobile operators challenging such termination fee decreases, the decisions of the court regarding more of the underlying decisions of the NMHH concerning termination rates are still pending and there is no guarantee that the NMHH will succeed with respect to such decisions in the courts. The mobile termination fee (i.e., the fees we pay to mobile operators for calls terminated on their networks) is an important element of our business model and uncertainties or retro-active changes in this area could adversely affect our business.

- The NMHH may introduce new regulatory policies in the future (for example, functional separation, or geographic segmentation) that may have a negative impact on our business and affect our profitability.

- Currently, in Hungary as well as in other E.U. member states, the cable television industry is subject to "light touch" regulation, resulting effectively in the absence of the type of wholesale regulation imposed on fixed line operators, such as wholesale access and cost control obligation. Whether or not the NMHH, either due to any future shift in European policy or any other reason, ultimately decides to regulate the cable television industry or continues to refrain from such regulation could affect our market share and pricing in the future. There is also a risk that either the NMHH or the GVH will stop us from using certain defensive marketing strategies with respect to the cable television industry, which could similarly affect our market share and pricing in the future.

- Due to a new rights-of-way approval process by the Hungarian state and state-owned enterprises, our construction projects could be delayed which could have a negative impact on our revenue.

- The Hungarian government plans to build, with E.U. funding, a "Digital Public Utility" in order to achieve 100% broadband internet penetration. Presently, it is not clear whether this proposed infrastructure project will cover rural areas where no broadband coverage exists or expand beyond such areas of Hungary where an existing broadband internet provider (or multiple providers) already provide service. Any competition from the Hungarian government in the provision of internet services could have a material adverse effect on our business, operating results and cash flows.

- The Hungarian government plans to issue frequency licenses to existing mobile operators enabling the roll-out out of fourth generation ("LTE") networks. Although the timing of such licensing procedure and the deployment of such networks is unclear at the moment, the increased broadband speeds made available by the LTE technology will have the potential to pose significant threat to our internet business.

Risks Relating to Our Reported Financial Results

We may be subject to risks resulting from fluctuations in interest rates, which could adversely affect our ability to service our debt.

In 2010 some of our indebtedness bore interest at variable rates tied to current market interest rates. An increase in market interest rates could adversely affected our ability to service our debt. We had, however, entered into certain derivative transactions designed to limit our interest rate risks from changes in interest rates. As a consequence of the Additional 2009 Notes issuance in 2011, all of our current debt instruments pay fixed rate interest.

Our hedging strategies and other risk management techniques may not be fully effective in mitigating our risk exposure.

We evaluate and review our risk management policies and procedures on a regular basis and expect to continue to do so in the future. Nonetheless, our hedging strategies and other risk management techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk, including risks that are unidentified or unanticipated. Some of our methods of managing risk are based upon our use of observed historical market behavior. As a result, these methods may not predict future risk exposures, which could be significantly greater than the historical measures indicate. Our hedging strategies and other risk management techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk.

We are subject to fluctuations in currency exchange rates which could have an adverse effect on our reported financial results.

We report our financial results in Euro, and we expect that a substantial portion of our revenue, expenses and liabilities will be in currencies other than the Euro, mainly Hungarian forint.

- *Effect on Revenue and Expense Translation in Our Statement of Comprehensive Income*. Changes in the Hungarian forint/Euro exchange rate will have an impact on the amounts reported by us in our financial statements when we translate Hungarian forint amounts into Euro for reporting purposes. For example, if we have the same amount of revenue in Hungarian forint during two consecutive financial reporting periods and the value of the Hungarian forint appreciates against the Euro during the second financial reporting period as compared to the first financial reporting period, we would report higher revenue in Euro during the second financial reporting period even though the amount of revenue in Hungarian forint remained the same during each of the two financial reporting periods. Conversely, if the Hungarian forint weakened against the Euro during the second financial reporting period as compared to the first financial reporting period, we would report lower revenue in Euro during the second financial reporting period even though the amount of revenue in Hungarian forint remained the same during each of the two financial reporting periods.

- *Subsidiary Debt Denominated in a Currency Other than the Hungarian Forint — Effect on Statement of Comprehensive Income* — Our Hungarian subsidiaries' functional currency for accounting purposes is the Hungarian forint. Invitel, our operating subsidiary, for example, has debt denominated in a currency other than the Hungarian forint (Euro). When Invitel prepares its balance sheet, it must re-value debt amounts denominated in currencies other than the Hungarian forint into Hungarian forint at the exchange rate in effect at the balance sheet date. Therefore, if Invitel were to hold the same amount of Euro-denominated debt on two consecutive balance sheet reporting dates, and if the Hungarian forint appreciated against the Euro on the second balance sheet reporting date as compared to the first balance sheet reporting date, Invitel would report less debt in Hungarian forint on its balance sheet, with respect to the Euro-denominated debt, even though the amount of Euro-denominated debt was the same on both balance sheet reporting dates. The difference in the amount of Hungarian forint reported for the Euro-denominated debt for the two periods would now be translated back into Euro at the average Hungarian forint/Euro exchange rate for the second period and be recorded as a foreign exchange gain for the period on our Consolidated Statement of Comprehensive Income with the compensating amounts being recorded as change in cumulative translation reserve. Conversely, if the Hungarian forint depreciated against the Euro on the second balance sheet reporting date as compared to the first balance sheet reporting date, Invitel would report more debt in Hungarian forint on its balance sheet, with respect to the Euro-denominated debt, even though the amount of Euro-denominated debt was the same on both balance sheet reporting dates. In this case, the difference in the amount of Hungarian forint reported for the Euro-denominated debt for the two periods would be translated back into Euro at the average Hungarian forint/Euro exchange rate for the second period and be recorded as a foreign exchange loss for the period on our Consolidated Statement of Comprehensive Income with the compensating amounts being recorded as change in cumulative translation reserve.

As a result of the above, while our reported financial performance may change, a significant portion of such change may be due to currency fluctuations.

Changes in foreign laws, including tax law changes, could adversely affect us, our subsidiaries and our shareholders.

Changes in tax laws, treaties or regulations or the interpretation or enforcement thereof could have adverse tax consequences for our business. In addition, the NAV, the local Hungarian tax authorities or other taxing authorities may not agree with our assessment of the effects of such laws, treaties and regulations, which could have a material adverse effect on our business, financial condition or results of operations.

We are subject to currency exchange rate risks.

Because we generate a substantial amount of our revenue in Hungarian forint, our ability to repay debt and other liabilities denominated in Euro may be adversely affected by the weakening of the Hungarian forint against the Euro. Substantially all of our debt is denominated in Euro. If the Hungarian forint were to weaken against the Euro, we would be required to use a greater amount of Hungarian forint to meet our payment obligations under our Euro-denominated debt. Therefore, fluctuations in the exchange rate of the Hungarian forint to the Euro could adversely affect our ability to service our debt. We have, however, entered into certain derivative transactions to limit our currency exchange rate risk. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations*."

The failure of our internal control over financial reporting could harm our business and financial results.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting for external purposes in accordance with IFRS. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of the financial statements; providing reasonable assurance that receipts and expenditures of our assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected. Any failure to maintain an effective system of internal control over financial reporting could limit our ability to report our financial results accurately and timely or to detect and prevent fraud.

Other Risks

We are subject to periodic audits and reviews by government agencies.

We are subject to periodic audits or other reviews by governmental agencies in Hungary. Any such examination or review requires management's time and a diversion of internal resources and, in the event of an unfavorable outcome, may result in additional liabilities or adjustments to our historical financial results.

We have a controlling shareholder whose interests may be different from the holders of the 2009 Notes.

Mid Europa has, directly or indirectly, the power to affect our business through its ability to control actions that require shareholder approval and through its representatives on our board of directors. The interests of Mid Europa and those of the holders of 2009 Notes may differ with respect to some matters. Conflicts between Mid Europa and holders of 2009 Notes may arise with respect to, among other things, our strategic direction and significant corporate transactions, conflicts related to corporate opportunities that could be pursued by us on the one hand, or by Mid Europa, on the other hand, or other contractual relationships between us and Mid Europa or its affiliates. We cannot anticipate in what form such differing interests may arise.

Risks Relating to Our Existing Debt

Our substantial debt could adversely affect our financial position and may limit our ability to take certain actions. Our debt also requires us to dedicate a large portion of our cash flow from operations to fund debt payments, reducing our ability to use such cash flows to fund working capital or capital expenditures.

We have a significant amount of debt and significant debt service obligations. As of December 31, 2011, the total third-party cash pay debt of Matel and its subsidiaries (related to continuing operations) was €332.2 million. Our substantial debt could have important adverse consequences for us. For example, our substantial debt:

- will require us to dedicate a large portion of our cash flows from operations to fund payments on our debt, thereby reducing the availability of our cash flows to fund working capital, capital expenditures and other general corporate needs;
- will increase our vulnerability to adverse general economic or industry conditions;
- could limit our flexibility in planning for, or reacting to, changes in our business or the industry in which we operate;
- could limit our ability to raise additional debt or equity capital in the future;
- could restrict us from making strategic acquisitions or exploiting business opportunities;
- could make it more difficult for us to satisfy our obligations with respect to our debt; and
- could place us at a competitive disadvantage compared to competitors that have less debt.

We may be able to incur substantially more debt in the future which would increase our leverage risks.

We may be able to incur substantial additional debt in the future. Although the Indentures and the agreements governing our other debt contain restrictions as to the incurrence of additional debt, these restrictions are subject to a number of significant qualifications and exceptions and additional debt incurred, albeit in compliance with these restrictions, could be substantial. To the extent new debt is added to our current debt level, the substantial leverage risks described above would increase.

Our ability to generate cash depends on many factors beyond our control, and we may not be able to

generate sufficient cash to service our debt.

Our ability to make principal or interest payments when due or refinance our debt will depend upon our future operating performance and our ability to generate cash, which will be affected by general economic, financial, competitive, regulatory and business factors, as well as other factors discussed in "*Risk Factors*" some of which may be beyond our control.

We anticipate that our operating cash flows will be sufficient to meet anticipated future operating expenses and to fund capital expenditures. However, we cannot assure you that our business will generate sufficient cash flows from operations, that currently anticipated revenue growth and operating improvements will be realized, or that future borrowings will be available to us in amounts sufficient to enable us to pay our debt or to fund our other liquidity needs. If we are unable to meet our debt service obligations or fund our other liquidity needs, we may be required to:

- reduce or delay capital expenditures;
- limit our growth;
- seek additional debt financing or equity capital;
- sell assets; or
- restructure or refinance our debt.

If we are required to reduce or delay capital expenditures, limit our growth, seek additional debt or equity capital, forego opportunities, sell assets or restructure or refinance our debt in order to meet our debt service obligations or fund our other liquidity needs, we cannot assure you that any of these actions could be effected on favorable terms or at all.

The Indentures and the agreements governing our other debt impose restrictions on our ability to take certain actions. We cannot assure you that the operating and financial restrictions and covenants in our debt instruments, including the Indentures, will not adversely affect our ability to finance our future operations or capital needs, or engage in other business activities that may be in our best interest.

The Indentures and the agreements governing our other debt contain restrictions that substantially limit the financial and operational flexibility of our subsidiaries. In particular, these agreements place limits on our ability to incur additional debt, grant security interests to third persons, dispose of material assets, undertake organizational measures such as mergers, changes of corporate form, joint ventures or similar transactions and enter into transactions with related parties. Other limitations in the Indentures and such agreements restrict our ability to pay dividends. Our ability to comply with these provisions may be affected by changes in economic or business conditions or other events beyond our control.

If we do not comply with the covenants and restrictions in the Indentures, we could be in default under those agreements. Any default under the Indentures could lead to an acceleration of debt under other debt instruments that contain cross acceleration or cross default provisions. If our obligations under the Notes were to be accelerated, it is possible that the collateral would not be sufficient to repay such debt in full.

Rights of holders of the 2009 Notes in the collateral may be adversely affected by the failure to perfect security interests in certain collateral.

The security interests in the shares and certain other assets of Matel and the Subsidiary Guarantors are granted to the security agent for the benefit of the trustee for the 2009 Notes and the holders of 2009 Notes. However, perfection of certain of such security interests may be subject to delays due to legal procedural requirements that can only be initiated following the date on which such security interests were granted. In addition, security interests in share capital and other assets of future Subsidiary Guarantors that are required to be pledged to secure the 2009 Notes can be perfected only at the time of, or following acquisition of, such property. For so long as any such security interest is not perfected, the holders of 2009 Notes would not have the full measure of legal protection that could be afforded by such security interest.

Matel is a holding company and conducts no business operations of its own and depends on payments from its subsidiaries to make payments on the 2009 Notes; Matel's subsidiaries are subject to restrictions on making any such payments.

Matel is a holding company that conducts no business operations of its own. Matel has no significant assets other than the shares it holds in its direct subsidiaries. Noteholders will not have any direct claim on the cash flows or assets of any of Matel's direct or indirect subsidiaries that are not Subsidiary Guarantors. Such subsidiaries have no obligation, contingent or otherwise, to pay amounts due under the 2009 Notes or to make funds available to us for these payments.

The Indentures and the agreements governing our other debt contain, and future borrowings by Matel and its subsidiaries may contain, restrictions or prohibitions on the payment of dividends by its subsidiaries to Matel. In addition, provisions of applicable law, such as those requiring dividends be paid only from distributable reserves, could limit the amounts Matel's subsidiaries are permitted to pay as dividends on their capital stock.

Fraudulent transfer statutes may limit the rights of Noteholders.

The Subsidiary Guarantors will guarantee the payment of the Notes on a senior basis. The Guarantees provide the holders of the 2009 Notes with a direct claim against the relevant Subsidiary Guarantor. The Guarantees will be limited to the maximum amount that can be guaranteed by the relevant Subsidiary Guarantor without rendering the Guarantee, as it relates to that Subsidiary Guarantor, voidable or otherwise ineffective under applicable laws, and enforcement of the Guarantee would be subject to certain generally available defenses. These laws and defenses include those that relate to fraudulent conveyance or transfer, voidable preference, financial assistance, corporate benefit, conflict of interest capital maintenance, rules of avoidance under insolvency laws, laws on the non-insolvency avoidance of transactions by a debtor or similar laws, regulations or defenses affecting the rights of creditors generally.

Each of the Subsidiary Guarantors is organized under the laws of Hungary or The Netherlands. Any additional guarantors may be incorporated in these or other jurisdictions. Although laws differ among various jurisdictions, in general, under fraudulent conveyance and other laws, a court could:

- avoid all or a portion of a Subsidiary Guarantors' obligations under its Guarantee;
- direct that holders of the Notes return any amounts paid under the Guarantee to the Subsidiary Guarantor or to a fund for the benefit of its creditors; or
- take other action detrimental to you, including invalidating the Guarantees.

Under such bankruptcy and fraudulent transfer laws, in order to take any of those actions, courts will typically need to find that, at the time the Guarantees were issued, the Subsidiary Guarantor:

- issued its Guarantee with the intent of hindering, delaying or defrauding current or future creditors; or
- received less than fair consideration or reasonably equivalent value for incurring the debt represented by its Guarantee on the basis that its Guarantee was incurred for Matel's benefit, and only indirectly for the benefit of the Subsidiary Guarantor, or some other basis and that the relevant Subsidiary Guarantor either:
  - was insolvent or was rendered insolvent by reason of the issuance of its Guarantee;
  - was engaged, or about to engage, in a business or transaction for which the Subsidiary Guarantor's assets were unreasonably small; or
  - intended to incur, or should have believed it would incur, debts beyond its ability to pay such debts as they mature.

Many of the foregoing terms are defined in or interpreted under those fraudulent transfer statutes.

The Netherlands

Under Dutch laws, if the granting of security or the issue of a Guarantee by a Subsidiary Guarantor incorporated under Dutch law (a "Dutch Guarantor") is not in its corporate interest, that security or the Guarantee may be voidable pursuant to section 2:7 of the Dutch Civil Code if the beneficiary knew or should have known that the Guarantee or security was not in the Dutch Guarantor's corporate interest. Furthermore, in relation to any Guarantee or security granted by any Dutch Guarantor, no such Guarantee or security includes obligations or liabilities to the extent that (if it were included) would result in that Guarantee or security contravening sections 2:98c or 2:207c of the Dutch Civil Code or any other law on financial assistance. See "*— Local insolvency laws may not be as favorable to you as those of another jurisdiction with which you may be familiar — The Netherlands*" below for a description of Dutch fraudulent conveyance legislation.

Hungary

Section 203 of the Civil Code of the Republic of Hungary prescribes that a contract, by which the cover for satisfying a third party creditor's claims has been deprived in whole or in part, shall not be effective vis-à-vis such third party creditor, if the beneficiary of the contract gave no adequate consideration or acted in bad faith. This provision of the Civil Code creates the risk that the guarantee undertaking of/third party security interest granted by any Subsidiary Guarantor incorporated under Hungarian law (a "Hungarian Subsidiary Guarantor") in relation to the 2009 Notes might be challenged by any of the existing third party creditors of the Hungarian Subsidiary Guarantor claiming that as such Hungarian Subsidiary Guarantor does not receive adequate consideration for the guarantee undertaking/security interest provided by it, it has no genuine business interest in providing such guarantee/security interest. Such claim, however, can only be made by the third party creditors if the remaining assets of the Hungarian Subsidiary Guarantor were insufficient to satisfy the existing third party creditors. If a third party creditor is successful in challenging the guarantee undertaking/security interest, the court may declare that the enforcement of the guarantee/security interest is not effective vis-à-vis the Hungarian Subsidiary Guarantor and it can be disregarded by such third party creditor, who therefore can claim an amount from the holders of the 2009 Notes equal to such creditor's existing claim against the Hungarian Subsidiary Guarantor, but not exceeding the amount received by the relevant holder of the 2009 Notes. In the absence of case law it is uncertain whether such guarantee or security interest can be successfully challenged based on the above. In any event, even if the challenge is successful, it will not result in the guarantee or security provided by the Hungarian Subsidiary Guarantor being held null and void, as it is only ineffective vis-à-vis the third party creditors concerned.

The value of the collateral securing the 2009 Notes may not be sufficient to satisfy our obligations under the 2009 Notes, and the collateral securing the 2009 Notes may be reduced or diluted in certain circumstances.

The 2009 Notes and the Guarantees will be secured by first priority liens on the collateral described in this Annual Report, which collateral is permitted under the terms of the Indenture to secure on a "super-senior" priority basis our and our subsidiaries' obligations under certain hedging obligations and certain future borrowings under revolving credit facilities permitted to be incurred under the Indenture. The collateral may also secure additional debt to the extent permitted by the terms of the Indentures and the agreements governing our other debt. Rights to the collateral would be diluted by any increase in the debt secured by the collateral.

In the event of foreclosure on the collateral, the proceeds from the sale of the collateral securing debt under the 2009 Notes may not be sufficient to satisfy the 2009 Notes because proceeds from a sale of collateral would be distributed to satisfy debt and all other obligations under any debt secured by a "super-senior" priority lien on the collateral before any such proceeds are distributed in respect of the 2009 Notes.

To the extent that holders of other secured debt or third parties enjoy liens (including statutory liens), whether or not permitted by the Indentures, such holders or third parties may have rights and remedies with respect to the collateral securing the 2009 Notes that, if exercised, could further reduce the proceeds available to satisfy the obligations under the 2009 Notes.

The ability of the security agent to enforce the collateral is subject to uncertainties under the laws of the jurisdictions in which our Subsidiary Guarantors are incorporated.

There is uncertainty under the laws of the jurisdictions in which our Subsidiary Guarantors are incorporated as to whether obligations to beneficial owners of the 2009 Notes that are not identified as registered holders in a security document will be validly secured by accessory security such as pledges over shares, partnership interests or receivables, including bank accounts. Therefore, there are risks regarding the enforceability of such pledges. In this connection, the Intercreditor Deed contains a provision pursuant to which Matel and the Subsidiary Guarantors will be obliged to pay to the security agent as joint and several creditors any amount owed by them under the 2009 Notes and the Indenture (so-called parallel debt). However, courts in the jurisdictions in which our Subsidiary Guarantors are incorporated have not yet ruled in respect of such a parallel debt structure. As a result, we cannot assure holders of the Notes that such structure will eliminate or mitigate the risk of unenforceability of such pledges posed by such law. If any challenge to the validity of such pledges or the parallel debt structure was successful, holders of the 2009 Notes may not be able to recover any amounts under such pledges.

It may be difficult to realize the value of the collateral securing the 2009 Notes.

The collateral securing the 2009 Notes will be subject to any and all exceptions, defects, encumbrances, liens and other imperfections permitted under the Indenture and accepted by other creditors that will have the benefit of first-priority security interests in the collateral securing the 2009 Notes from time to time, whether on or after the date the 2009 Notes are first issued.

The existence of any such exceptions, defects, encumbrances, liens and other imperfections could adversely affect the value of the collateral securing the 2009 Notes as well as the ability of the security agent to realize or foreclose on such collateral. Furthermore, the first-priority ranking of security interests can be affected by a variety of factors, including, among others, the timely satisfaction of perfection requirements, statutory liens or re-characterization under the laws of certain jurisdictions.

The security interests of the security agent will be subject to practical problems generally associated with the realization of security interests in collateral. For example, the security agent may need to obtain the consent of a third party to enforce a security interest. We cannot assure you that the security agent will be able to obtain any such consent. We also cannot assure you that the consents of any third parties will be given when required to facilitate a foreclosure on such assets. Accordingly, the security agent may not have the ability to foreclose upon those assets and the value of the collateral may significantly decrease.

In addition, our business requires certain national and local permits and licenses. The continued operation of properties that comprise part of the collateral and which depend on the maintenance of such permits and licenses may be prohibited. Our business is subject to regulations and permitting requirements and may be adversely affected if we are unable to comply with existing regulations or requirements or changes in applicable regulations or requirements. In the event of foreclosure, the transfer of such permits and licenses may be prohibited or may require us to incur significant cost and expense. Further, we cannot assure you that the applicable governmental authorities will consent to the transfer of all such permits. If the regulatory approvals required for such transfers are not obtained or are delayed, the foreclosure may be delayed, a temporary shutdown of operations may result and the value of the collateral may be significantly decreased.

The rights of the Noteholders to enforce remedies with respect to the collateral are subject to the Intercreditor Deed.

The security interests in our assets that secure the 2009 Notes and the guarantees thereof are also granted as collateral in favor of certain hedging counterparties for hedging. The Intercreditor Deed and the Indenture governing the 2009 Notes also permit a security interest in such collateral to be granted to lenders of certain additional indebtedness and to hedging counterparties under certain of our hedging obligations. The Intercreditor Deed provides that a common security agent, who will also serve as the security agent for our hedging obligations and any additional secured debt, will act only as provided for in the Intercreditor Deed.

The Intercreditor Deed provides that the security agent may release the collateral securing the 2009 Notes in connection with sales of assets pursuant to a permitted disposal or enforcement sale and in other circumstances permitted by the Indenture. Therefore, the collateral available to secure the 2009 Notes could be reduced in connection with the sales of assets or otherwise, subject to the requirements of the Indenture governing the 2009 Notes.

In addition, the Intercreditor Deed provides that the enforcement sale of certain collateral will be subject to, as a condition to the release of any claims of any other indebtedness secured by such collateral under the Intercreditor Deed, certain protections intended to maximize the recovery from an enforcement sale.

Furthermore, the Indenture permits certain additional indebtedness and certain of our hedging obligations to benefit from a priority over the 2009 Notes in the allocation of proceeds of enforcement of the security interests securing such debt and the 2009 Notes.

Matel may not be able to finance the change of control offer required by the Indenture.

Upon a change of control, as defined under the Indenture, Matel will be required to offer to repurchase all outstanding 2009 Notes at a purchase price equal to 101% of their principal amount plus accrued and unpaid interest and additional amounts, if any, to the date of repurchase. If a change of control were to occur, we cannot assure you that Matel would have sufficient funds available at the time to pay the purchase price of the outstanding 2009 Notes or that the restrictions in the agreements governing our other borrowing arrangements would allow us to make such required repurchases. A change of control may result in an event of default under our other borrowing arrangements, may require us to offer to repurchase the 2009 Notes and may cause the acceleration of other indebtedness. In any case, we expect that we would require third-party financing to make a change of control offer. We cannot assure you that we would be able to obtain this financing.

Enforcing your rights as a Noteholder may prove difficult.

The 2009 Notes are issued by Matel, which is incorporated under the laws of The Netherlands. In addition, the 2009 Notes and the Indenture are governed by the laws of the State of New York.

In the event of a bankruptcy, insolvency or a similar event, proceedings could be initiated in The Netherlands, Hungary and the United States. Such multi-jurisdictional proceedings are likely to be complex and costly for creditors and otherwise may result in greater uncertainty and delay regarding the enforcement of your rights. Your rights under the 2009 Notes will be subject to the insolvency and administrative laws of several jurisdictions, and there can be no assurance that you will be able to effectively enforce your rights in such complex multiple bankruptcy, insolvency or similar proceedings.

In addition, the bankruptcy, insolvency, administrative and other laws of Matel and its subsidiaries' jurisdictions of incorporation or organization may be materially different from, or be in conflict with, each other and those with which you may be familiar, including in the areas of the rights of creditors, the priority of governmental and other creditors, the ability to obtain post-petition interest and the duration of the proceeding. The application of these laws, or any conflict among them, could call into question whether any particular jurisdiction's laws should apply, adversely affect your ability to enforce your rights under the 2009 Notes in the relevant jurisdictions or limit any amounts that you may receive.

Local insolvency laws may not be as favorable to you as those of another jurisdiction with which you may be familiar.

Matel is incorporated under the laws of The Netherlands and its principal subsidiaries are incorporated under Hungarian law. The insolvency laws of these jurisdictions may not be as favorable to your interests as the laws of the United States or other jurisdictions with which you may be familiar.

The following is a brief description of certain aspects of insolvency law in The Netherlands and Hungary. In the event that any one or more of our subsidiaries experience financial difficulty, it is not possible to predict with certainty the jurisdiction or jurisdictions in which insolvency or similar proceedings would be commenced, or the outcome of such proceedings.

The Netherlands

As Matel is incorporated under the laws of The Netherlands, any insolvency proceedings with respect to Matel or any Dutch Guarantor would be likely to proceed under, and be governed by, the insolvency laws of The Netherlands, provided that the "centre of main interest" of these companies as referred to in European Council Regulation (EC) No. 1346/2000 of May 29, 2000 on insolvency proceedings (the "European Insolvency Regulation") is located in The Netherlands at the time of opening of any insolvency proceedings.

Dutch insolvency laws may make it difficult or impossible for holders of the Notes to recover amounts owing under the Notes in an insolvency proceeding involving Matel or a Dutch Guarantor. There are two primary insolvency regimes under Dutch law: the first, suspension of payment or moratorium (*surséance van betaling*), is intended to grant temporary relief from a debtor's payment obligations and may be used to facilitate the reorganization of a debtor's obligations and enable the debtor to continue as a going concern. The second, bankruptcy (*faillissement*), is designed to liquidate the assets of a debtor.

Upon commencement of moratorium proceedings by way of filing by the debtor, the court will grant a provisional moratorium. A definitive moratorium will generally be granted thereafter. In both cases, creditors are barred from recovering their claims from the assets of the debtor. The moratorium is subject to exceptions, the most important of which excludes secured creditors and preferential creditors (such as tax and social security authorities) from the application of the moratorium, although conditions and restrictions apply. During moratorium proceedings, secured creditors may proceed against the assets that secure their claims to satisfy their claims, and preferential creditors are also not barred from seeking to recover their claims, although conditions and restrictions apply.

A definitive or provisional moratorium may be converted into a bankruptcy proceeding if the court concludes that it is undesirable to continue the moratorium in effect or if it appears unlikely that the debtor will be able in the course of time to satisfy its liabilities.

In Dutch bankruptcy proceedings the assets of a debtor are generally liquidated and the proceeds distributed to the debtor's creditors on a *pro rata* basis. However, preferential creditors (such as tax and social security authorities) have a right to have their claims paid before those of unsecured creditors. In addition, secured creditors can generally proceed against the assets that secure their claims without any restriction, regardless of the pending bankruptcy proceedings, although only insofar as their claims can be satisfied out of the proceeds of the relevant collateral. Claims of unsecured creditors would have to be submitted to Matel's receiver to be verified by the receiver. "Verification" under Dutch law means that the receiver determines the value of the claim and whether and to what extent it will be admitted in the bankruptcy proceedings. Creditors that wish to dispute the rejection or valuation of their claims by the receiver would need to commence a proceeding before the Dutch court. These verification procedures, and the fact that claims under the 2009 Notes will be subordinated in bankruptcy to the claims of secured creditors and preferential creditors, could cause holders of the 2009 Notes to recover less under the 2009 Notes than the principal amount of their 2009 Notes.

A debtor which has been granted a suspension of payments or which has been declared bankrupt may petition the court for a freezing period *(afkoelingsperiode)*. During such period secured creditors or preferred creditors are prohibited from enforcing their security over assets without the prior approval of the court or the supervising judge. A freezing period can be granted for the duration of 2 months, and be extended only once for another 2 months.

A debtor which has been granted a suspension of payment or which has been declared bankrupt can offer its ordinary (unsecured and non-preferential) creditors a composition of its debts. If (i) more than half of such creditors (whose claims are accepted as valid by the receiver or the Dutch courts) representing at least half of the total non-preferential and unsecured debt cast their votes in favor of the composition and (ii) the court approves the composition, the composition is accepted and binding upon the debtor and the unsecured and non-preferential creditors. These composition procedures could cause holders of the 2009 Notes to recover less under the 2009 Notes than the amount due under their 2009 Notes and could result in certain Noteholders receiving a greater portion of the amount owed to them under the 2009 Notes than other Noteholders.

Fraudulent conveyance legislation is in force in The Netherlands. This legislation provides generally that certain transactions with a creditor entered into voluntarily by the debtor are subject to avoidance if both parties to the transaction knew or should have known that the transaction would prejudice other creditors. In addition, the guarantee of the 2009 Notes by a Dutch Guarantor would be subject to avoidance if the Dutch Guarantor at the time of entering into the transaction knew or should have known that the transaction would prejudice other creditors. Knowledge that the transaction would prejudice other creditors is presumed by law for all transactions performed within the year preceding the adjudication of bankruptcy, if it is also established that one of the conditions mentioned in Article 43 of the Dutch Bankruptcy Act is fulfilled. These conditions include, but are not limited to, situations in which (1) the value of the obligation of the debtor materially exceeds the value of the obligation of the creditor, (2) the debtor pays or grants security for debts which are not yet due, (3) an agreement is made between legal entities having common directors or an obligation arises from one legal entity towards another if a director of one of those legal entities is also a director of the other or (4) an agreement is made with or an obligation is created in favor of a group company of the debtor.

Hungary

Under Hungarian law, insolvency is governed by the provisions of the Bankruptcy Act, as amended. The Bankruptcy Act distinguishes between (i) a bankruptcy procedure in which a borrower having financial difficulties attempts to reach an agreement with its creditors as to the restructuring of its debts ("Bankruptcy Procedure") and (ii) an insolvency procedure in which an insolvent debtor is dissolved and its assets are distributed among its creditors and, if any assets remain, its owners ("Liquidation Procedure").

In a Bankruptcy Procedure, which may be initiated by the debtor or any of its creditors, the creditors and debtor are aiming to agree upon the settlement of all the debtor's obligations.

The relevant court will decide (in co-operation with the debtor, if initiated by a creditor) on the commencement of the Bankruptcy Procedure and grants a moratorium — although if the Bankruptcy Procedure initiated by the debtor, a temporary moratorium is also granted for the period from the next business day immediately following the submission of an application up to the relevant decision of the court. Upon the decision of the court, the moratorium will last at least 90 days, but it may extend to (with the consent of certain proportions of the creditors) 180 or even 365 days.

During a moratorium granted in connection with the Bankruptcy Procedure, the debtor may not make payments to creditors, except with regard to certain liabilities specified by the Bankruptcy Act. In a Bankruptcy Procedure, an asset manager is appointed by the court to monitor and supervise the business activities of the debtor. The asset manager's approval needs to be obtained to make financial commitments.

If no such settlement is agreed upon, then the Liquidation Procedure will begin.

In a Liquidation Procedure, which may be initiated by, *inter alia*, the debtor, the receiver (appointed in any voluntary winding-up proceedings) or any of its creditors, a liquidator appointed by the court is charged with satisfying the claims of the creditors by way of the borrower's assets. A court will establish a debtor is insolvent if, *inter alia*, (i) it does not perform its non-disputed or acknowledged payment obligations neither upon its due date, nor within 15 days of the receipt of a written notification that such payment obligation has matured; (ii) it does not fulfill its payment obligation within the deadline set forth in an applicable final and non-appealable court ruling; (iii) a foreclosure procedure remained unsuccessful against the debtor; or (iv) it does not comply with its payment obligation, as stated in the negotiated bankruptcy moratorium.

Only the liquidator can make statements on behalf of the debtor with respect to the debtor's property. However, the liquidator or any of the creditors may request that the relevant court establish that for the period up to three years prior to the commencement of the Liquidation Procedure, any of the executive officers of the debtor did not fulfill their respective obligations in accordance with the interest of the debtor or any of its creditors, provided that the relevant court finds that such failure resulted in a reduction of the value of the assets of the debtor and the executive officer did not, upon becoming aware of the circumstances, make all appropriate efforts to mitigate such reduction in value of the assets.

Most secured creditors are satisfied immediately upon the sale of the encumbered assets (irrespectively of when the Liquidation Procedure is closed). Beneficiaries of floating charges, however, receive only 50% of the proceeds of such sale up-front. In the ultimate distribution of the assets of the debtor at the final state of the Liquidation Procedure, priority is, generally, given to the costs of the liquidation, the remaining 50% of floating charge proceeds, certain claims of individuals arising from non-business activities, outstanding and enforceable social security contributions, taxes and public charges over other claims, other unsecured claims, default interest and penalties, and claims of the members, executive officers and senior employees (including their close relatives) of the debtor and any company under the direct control of the debtor.

In addition, the Bankruptcy Act sets out certain hardening periods; the liquidator may challenge the following arrangements of the debtor: (i) agreements of the debtor concluded within five years prior to the filing of the claim with the relevant court, with respect to which agreements the debtor's intention was to frustrate the fulfillment of the claims of certain creditors, provided that the other party was (or should have been) aware of the debtor's intention; and/or (ii) agreements of the debtor concluded within two years prior to the filing of the claim with the relevant court, where the subject of the agreement in question was the transfer of assets free of charge, where the subject of the agreement in question was the undertaking by the debtor of an obligation without the debtor being provided with compensation in return or where the value of the subject of the agreement in question was significantly discounted; and/or (iii) agreements of the debtor concluded within 90 days prior to the filing of the claim with the relevant court, the purpose of which was to favor certain creditors to the detriment of others (especially the amendment of an existing agreement in favor of the creditor or the provision of collateral to a creditor who was not previously provided with any collateral).

Furthermore, the liquidator may reclaim (on behalf of the debtor) payments (or services) made by the debtor within sixty days prior to the filing of the claim with the relevant court, if the payments (or services) in question were to the benefit of certain creditors and if the payments (or services) in question were not in the course of the normal business activities of the debtor. Pursuant to the relevant rules, the liquidator must reclaim the payments or services (as outlined above) in the case of the repayment of loans prior to their maturity.

Finally, the liquidator may also terminate, with immediate effect, any of the agreements entered into by the debtor, subject to the creditor's right to register and enforce any claim it may have in the course of the Liquidation Procedure. In addition, the liquidator may rescind any other agreement of the debtor, to the extent any of the contracting parties have not yet performed its obligations.

Other Jurisdictions

In addition, it is possible that we may be subject to the insolvency laws of other jurisdictions. Any insolvency proceedings with respect to Matel would be subject to the insolvency laws of the jurisdiction where such proceeding is commenced. The provisions of such insolvency laws may substantially differ from each other and those described above, including with regard to the rights of debtors, priority claims and procedures, and may contain provisions that are unfavorable to the holders of the 2009 Notes. In addition, there can be no assurance as to how the insolvency laws of any jurisdiction will be applied in an insolvency proceeding relating to several jurisdictions.

The 2009 Notes are subject to restrictions on transfer.

The 2009 Notes have not been and will not be registered under the U.S. Securities Act or any state securities laws and, unless so registered, may not be offered or sold except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the U.S. Securities Act and applicable state securities laws.

The 2009 Notes will initially be held in book-entry form and therefore you must rely on the procedures of the relevant clearing systems to exercise any rights and remedies.

Unless and until the 2009 Notes in definitive registered form, or definitive registered 2009 Notes, are issued in exchange for book-entry interests, owners of book-entry interests will not be considered owners or holders of Notes. The common depositary (or its nominee) for the accounts of Euroclear and Clearstream will be the registered holder of the global notes representing the 2009 Notes. After payment to the registered holder, we will have no responsibility or liability for the payment of interest, principal or other amounts to the owners of book-entry interests. Accordingly, if you own a book-entry interest, you must rely on the procedures of Euroclear and Clearstream, and if you are not a participant in Euroclear and Clearstream, on the procedures of the participant through which you own your interest, to exercise any rights and obligations of a holder under the Indenture.

Unlike the holders of the 2009 Notes themselves, owners of book-entry interests will not have any direct rights to act upon our solicitations for consents, requests for waivers or other actions from holders of the 2009 Notes. Instead, if you own a book-entry interest, you will be permitted to act only to the extent you have received appropriate proxies to do so from Euroclear or Clearstream. There can be no assurance that procedures implemented for the granting of such proxies will be sufficient to enable you to vote on any matters on a timely basis.

Similarly, upon the occurrence of an event of default under the Indenture, unless and until definitive registered 2009 Notes are issued in respect of all book-entry interests, if you own a book-entry interest, you will be restricted to acting through Euroclear or Clearstream. We cannot assure you that the procedures to be implemented through Euroclear or Clearstream will be adequate to ensure the timely exercise of rights under the 2009 Notes.

6. SELECTED HISTORICAL FINANCIAL INFORMATION

The following tables provide a summary of the continued operations of the consolidated financial statements of Matel as of and for the year ended December 31, 2011 and 2010. The summary consolidated financial information presented here as of and for the year ended December 31, 2011 and 2010 should be read in conjunction with the consolidated financial statements of Matel as of and for the year ended December 31, 2011 and the accompanying notes thereto included elsewhere in this Annual Report. The consolidated financial statements and the accompanying notes thereto have been prepared in accordance with IFRS.

On October 7, 2010 we completed the sale of the International Business, whereby the International Business was sold to Türk Telecom. Accordingly, the International Business was classified as discontinued operations in our consolidated income statement for the year ended December 31, 2010.

On November 19, 2010 we entered into a Sale and Purchase Agreement with FN Cable Holdings N.V. for the acquisition of FiberNet Kft. and its subsidiaries ("Fibernet"), the direct parent of FiberNet Zrt, Hungary's fourth largest cable network operator (the "Fibernet Acquisition"). The purchase price of Fibernet was approximately €44.5 million including acquisition costs paid on behalf of Fibernet, but excluding acquisition costs payable by Matel). In order to meet Hungarian competition office requirements relating to infrastructure competition, we simultaneously sold approximately one-third of the Fibernet network assets to UPC for approximately €22.2 million (the "Fibernet Disposal"). The Fibernet network we retained is located outside our historical fixed line concession areas. The transaction was completed on February 28, 2011 and accordingly, the consolidated results of Fibernet were included from March 1, 2011 in our financial statements for the year ended December 31, 2011. On September 30, 2011 Fibenret was merged into Invitel.

We encourage you to read the information contained in this section in conjunction with "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" included elsewhere in this Annual Report.

	For the year ended December 31,	
	2011	2010
	(€ in millions)	
Statement of Comprehensive Income Data:		
Residential Voice	50.1	63.9
Residential Internet	33.5	32.7
Corporate	62.0	66.1
Wholesale	32.7	30.5
Cable	16.8	-
Total operating revenue	**195.1**	**193.2**
Cost of sales exclusive of depreciation	(68.5)	(62.6)
Operating expenses	(47.0)	(46.2)
Cost of restructuring[1]	(6.1)	(1.2)
Depreciation and amortization	(115.5)	(53.9)
Income from operations	(42.0)	29.3
Net financial expense[2]	(30.5)	(59.7)
Gain on acquisition	28.5	-
Income/ (loss) before tax	(44.0)	(30.4)
Income tax benefit/(expense)	(3.5)	(18.4)
Income/ (loss) from Continuing Operations	(47.5)	(48.8)

	For the year ended December 31,	
	2011	2010
	(€ in millions)	
Income/ (loss) from Discontinued Operations	-	60.0
Income/ (loss) for the Year	(47.5)	11.2

	As of	
	December 31, 2011	December 31, 2010
	(€ in millions)	
Balance Sheet Data:		
Cash and cash equivalents	35.7	109.0
Net working capital(3)	(11.4)	(7.4)
Total assets	357.5	485.9
Liabilities relating to derivative financial instruments, net	0.8	2.2
Liabilities relating to finance leases	3.8	4.4
Cash-pay third party debt(4)	329.6	348.1
Related party loan(5)	-	15.2
Shareholders' equity(6)	(14.4)	78.1

	For the year ended December 31,	
	2011	2010
	(€ in millions)	
Cash Flow Data(7):		
Net cash flow provided by /(used in) operating activities	28.2	36.3
Net cash flow provided by /(used in) investing activities	(55.7)	158.0
Net cash flow provided by /(used in) financing activities	(40.5)	(150.0)
Net increase /(decrease) in cash and cash equivalents	(73.3)	43.9
Free cash flow before debt service and the acquisition of Fibernet(8)	26.2	232.1

	For the year ended December 31,	
	2011	2010
	(€ in millions)	
Other Data (unaudited):		
EBITDA(9)	73.5	83.2
Adjusted EBITDA(10)	94.0	99.1
Capital expenditures cash outflows(11)	44.5	41.6
Adjusted EBITDA less capital expenditures cash outflows	49.5	57.5
Net interest expense(12)	(29.7)	(34.3)
Net cash-pay third party debt(13)	293.9	239.1
Net cash-pay third party debt to adjusted EBITDA	3.1x	2.4x
Adjusted EBITDA to net interest expense	3.2x	2.9x

(1) Cost of restructuring represents costs related to the reorganizations we have undertaken and mainly includes severance expenses. Cost of restructuring for the year ended December 31, 2011 is mainly related to reorganizations after the Fibernet Acquisition.
(2) Net financial expense includes interest income, interest expense, amortization of bond discount, amortization of deferred borrowing costs, net foreign exchange gains / (losses), gains / (losses) on extinguishment of debt, gains / (losses) from fair value changes of derivative financial instruments and net other financial expense.
(3) Net working capital is calculated as total current assets (excluding cash and cash equivalents and current assets relating to derivative financial instruments) less current liabilities (excluding the current portion of liabilities relating to derivative financial instruments and the current portion of borrowings).
(4) Cash-pay third party debt includes debt under the 2007 Notes and the 2009 Notes net of unamortized bond discount and liabilities related to finance leases as of December 31, 2010 and includes debt under the 2009 Notes net of unamortized bond discount and liabilities related to finance leases as of December 31, 2011 and excludes liabilities related to deferred borrowing costs in both periods.
(5) Related party loan includes the loan provided by Matel Holdings N.V. to the Group amounting EUR 26.3 million which has been netted by

intercompany receivables.

(6) Shareholders' equity includes non-controlling interest.

(7) For both periods, transactions relating to discontinued operations have been eliminated. The International Business was classified as discontinued operations in our consolidated statement of comprehensive income for the year ended December 31, 2010. The Fibernet Disposal was classified as discontinued operations in our consolidated statement of comprehensive income for the year ended December 31, 2011.

(8) Free cash flow before debt service equals net cash flow provided by / (used in) operating activities plus cash interest paid minus net cash flow used in / (provided by) investing activities. The following table sets forth the reconciliation of net cash flow provided by / (used in) operating activities to free cash flow before debt service:

	For the year ended December 31,	
	2011	2010
	(€ in millions)	
Net cash flow provided by /(used in) operating activities	28.2	36.3
Cash interest paid	36.1	37.8
Net cash flow used in /(provided by) investing activities	(38.1)	158.0
Free cash flow before debt service and the acquisition of Fibernet	26.2	232.1

(9) We define EBITDA as net income / (loss) plus income taxes, net financial expense and depreciation and amortization. Other companies in our industry may calculate EBITDA in a different manner. EBITDA is not a measurement of financial performance under IFRS and should not be considered as an alternative to net income / (loss) or to cash flow from operating, investing or financing activities, as a measure of liquidity or an indicator of our operating performance or any other measures of performance derived in accordance with IFRS. Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements. In addition, EBITDA does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments. Management uses EBITDA as a tool for various purposes including measuring and evaluating financial and operational performance, making compensation decisions, planning and budgeting decisions and financial planning purposes. We believe that the presentation of EBITDA is useful for investors because it reflects management's view of core operations and cash flow generation upon which management bases financial, operational and planning decisions and presents measurements that investors and their lending banks have indicated to management are important in assessing us and our liquidity. Management compensates for the shortcomings of this measure of financial performance by utilizing it in conjunction with financial measures under IFRS. The following table sets forth the reconciliation of net income / (loss) from continuing operations to EBITDA:

	For the year ended December 31,	
	2011	2010
	(€ in millions)	
Net loss from continuing operations	(47.5)	(48.8)
Income taxes /(benefit) expense	3.5	18.4
Gain(loss) on derivatives	(0.8)	6.9
Foreign exchange loss, net	1.9	7.1
Other financing expenses, net	29.4	45.7
Gain on acquisition	(28.5)	-
Depreciation and amortization	115.5	53.9
EBITDA	73.5	83.2

(10) We define Adjusted EBITDA as EBITDA plus the cost of restructuring, consulting expenses relating to strategic projects, management fees, crisis tax and other items. The same considerations set forth in footnote 9 above with respect to the uses and limitations of EBITDA apply to Adjusted EBITDA. The following table sets forth the reconciliation of EBITDA to Adjusted EBITDA:

	For the year ended December 31,	
	2011	2010
	(€ in millions)	
EBITDA	73.5	83.2
Cost of restructuring[(a)]	6.1	1.2
Crisis tax[(b)]	10.9	11.2
Management fee[(c)]	1.0	0.6
Consulting expenses relating to strategic projects[(d)]	1.0	2.7
Other items[(e)]	1.5	0.2
Adjusted EBITDA	94.0	99.1

(a) Cost of restructuring represents costs related to the reorganizations we have undertaken and mainly includes severance expenses. Cost of restructuring in 2011 is mainly related to the reorganization after the Fibernet Acquisition.

(b) Crisis tax was introduced by the Hungarian government in the fourth quarter of 2010 with retrospective effect to January 1, 2010.

(c) Management fee includes costs charged by our trustee as well as management fees paid to Mid Europa.

(d) Consulting expenses relating to strategic projects mainly include non-recurring financial and legal consulting and due diligence expenses.

(e) Other items for the year ended December 31, 2011 mainly include a compoetition office penalty charge in connection with a case inherited from Hungarotel (one of the predecessors of Invitel) in 2005, relating to a breach of the regulation on carrier selection. Other items for the year ended December 31, 2010 mainly include tender offer expenses and a gain from the mark-to-market revaluation in connection with the termination of share options.

(11) Capital expenditures cash outflows represent the "purchase of intangible assets" and the "purchase of property, plant and equipment" line items of our continued operations in our consolidated statements of cash flows.

(12) Net interest expense equals third party interest expense (excluding interest on the Related Party Loan) less interest income and excludes the amortization of deferred borrowing costs, the amortization of bond discount and other interest expenses relating to finance leases.

(13) Net cash-pay third party debt equals cash-pay third-party debt less cash and cash equivalents.

7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is based on the consolidated financial statements of Matel as of and for the year ended December 31, 2011 prepared in accordance with IFRS included in this Annual Report.

In this Management's Discussion and Analysis of Financial Condition and Results of Operations, "we," "our" and other similar terms are generally used to refer to Matel's business and its consolidated subsidiaries. In this section, we capitalize references to Residential Voice, Residential Internet, Cable, Corporate and Wholesale where and to the extent that the references are to our reporting segments in our consolidated financial statements.

You should read this discussion in conjunction with the consolidated financial statements and the accompanying notes included elsewhere in this Annual Report. A summary of the critical accounting policies and estimates that have been applied to our consolidated financial statements is set forth below in "Critical Accounting Policies." Some of the information in the discussion and analysis set forth below and elsewhere in this Annual Report includes forward-looking statements that involve risks and uncertainties. See "Risk Factors" for a discussion of important factors that could cause actual results to differ materially from the results described in the forward-looking statements contained in this Annual Report.

Overview

We are the second largest fixed line telecommunications services provider in Hungary and the incumbent provider of fixed line telecommunications services to residential and business customers in our 14 historical concession areas, where we have a dominant market share. We are the number one alternative fixed line operator outside our historical concession areas in Hungary.

Our historical concession areas are geographically clustered and cover an estimated 2.1 million people, representing approximately 21% of Hungary's population. Outside our historical concession areas, we believe that we are well positioned to continue to grow our revenue and market share using our owned state-of-the-art backbone network, our experienced sales force and our comprehensive portfolio of services. Our extensive backbone network (comprising approximately 8,500 route km in Hungary) provides us with nationwide and international reach. It allows business customers to be connected directly to our network to access voice, data and internet services.

As of December 31, 2011, we had approximately 301,000 telephone lines connected to our network within our historical concession areas to service Residential Voice customers and we had approximately 257,000 active Residential Voice customers outside our historical concession areas connected through Carrier Pre-Selection ("CPS"), Carrier Selection ("CS") or Local Loop Unbundling ("LLU"). This is compared to December 31, 2010 when we had approximately 327,000 telephone lines in service within our historical concession areas to service Residential Voice customers and approximately 298,000 active Residential Voice customers connected through indirect access outside our historical concession areas.

The number of our Residential broadband DSL customers has decreased from approximately 151,000 as of December 31, 2010 to approximately 150,000 as of December 31, 2011.

In the Corporate segment, as of December 31, 2011, we had approximately 41,000 voice telephone lines within our historical concession areas compared to approximately 42,000 lines as of December 31, 2010. Outside our historical concession areas, we had approximately 40,000 direct access voice telephone lines and approximately 7,000 indirect access voice telephone lines as of December 31, 2011, compared to approximately 43,000 direct access voice telephone lines and approximately 8,000 indirect access voice telephone lines as of December 31, 2010. We had approximately 14,000 DSL lines and approximately 16,000 leased lines as of December 31, 2011 compared to approximately 15,000 DSL lines and approximately 16,000 leased lines As of December 31, 2010.

In the Wholesale segment, we had over 250 customers as of December 31, 2011, which customers include incumbent telecommunications services providers, alternative fixed line telecommunications services providers, mobile operators, cable television operators and internet service providers in Hungary.

In the Cable segment, as of December 31, 2011, we had approximately 84,000 cable TV lines, 61,000 cable Internet lines and 17,000 cable voice lines.

On October 7, 2010, we consummated the sale of our International Business to Turk Telecom for an enterprise value of approximately €221 million. The International Business included operations in Austria, Bulgaria, the Czech Republic, Hungary, Italy, Romania, Serbia, Slovakia, Slovenia, Turkey and Ukraine, but excluded our Hungarian domestic wholesale business. The purpose of the sale was to deleverage and focus on our core Hungarian domestic markets. Accordingly, the International Business was classified as discontinued operations our consolidated statement of comprehensive income for the year ended December 31, 2010.

On February 28, 2011, we entered into a Sale and Purchase Agreement with FN Cable Holdings N.V. for the acquisition of FiberNet Kft and its subsidiaries (“Fibernet”), the direct parent of FiberNet Zrt, Hungary’s fourth largest cable network operator. Pursuant to such Sales and Purchase agreement, we consummated the acquisition of Fibernet on November 19, 2010 for a purchase price of approximately €44.5 million (including acquisition costs paid on behalf of Fibernet, but excluding acquisition costs payable by Matel). In order to meet Hungarian competition office requirements relating to infrastructure competition, we simultaneously sold approximately one-third of the Fibernet network assets to UPC for approximately €22.2 million. The Fibernet network we retained is located outside our historical fixed line concession areas. The closing of the transaction occurred on February 28, 2011 and accordingly the consolidated results of Fibernet are included in our consolidated financial statements from March 1, 2011. On September 30, 2011 Fibernet was merged into Invitel.

Macroeconomic Factors

Over the past three years there have been significant fluctuations in the global economy, including within the Hungarian economy and financial markets.

From 2001 to 2006, the Republic of Hungary was negatively impacted by inadequate governmental monetary and fiscal policies, which resulted in a state budget deficit that peaked at 10% of gross domestic product (“GDP”) in 2006. Starting in 2006, the Hungarian government introduced austerity measures, including reduced state spending and increased taxes, which were intended to reduce the state budget deficit. Hungary also held back consumption in Hungarian forint by keeping the Hungarian forint interest rate relatively high. These state cutbacks have resulted in lower economic growth. The high domestic interest rates did, however, lead Hungarian consumers and businesses to take out a majority of their recent loans in foreign currencies, mainly Euro and Swiss francs. These factors have contributed to Hungary’s current trade deficit and large current account deficit However, with a large current account deficit, a budget deficit, rapid credit growth and a reliance on foreign currency loans, Hungary left itself vulnerable to a financial crisis.

During the global financial crisis in 2009, risk-averse investors fled riskier debt-laden countries such as Hungary for alternative countries, which resulted in a significant decrease in the value of the

Hungarian forint. The Hungarian forint depreciated against the Euro from a rate of 243.17 as of September 31, 2008 to as high as 316.00 as of March 6, 2009. With credit squeezed, the Hungarian government, as well as Hungarian businesses and consumers have significantly reduced their investments and spending, which in turn is expected to slow economic growth in Hungary.

Hungary has taken several measures to combat its financial crisis. Hungary reduced its debt issuances and lowered its government budget deficit target.

In October 2008, the European Central Bank (the "ECB"), the International Monetary Fund (the "IMF"), the EU and the World Bank agreed to lend Hungary to help support liquidity. In addition, in October 2008, in an effort to defend its currency and prevent an investment outflow, the National Bank of Hungary raised its base rate from 8.5% to 11.5%.

In April 2009, at the G-20 Summit in London, the G-20 Nations agreed to fund the IMF with an additional U.S.$750 billion to combat the global economic downturn. These actions have stabilized the Euro/Hungarian forint exchange rate in the 260 to 270 range. The National Bank of Hungary has gradually lowered its base rate to 5.25% as of the end of April 2010.

In early 2010, Greece's large deficit became unsustainable which drove the country into a fiscal crisis. The leaders of the European Union developed a €45.0 billion rescue plan for Greece in April 2010, however, the crisis caused negative pressure to the Hungarian forint that significantly increased the Hungarian forint/euro exchange rate to the level of 280-290 in the second quarter of 2010.

In April 2010, Hungary's center-right party, Fidesz won a two-third legislative majority in the Hungarian Parliament. In mid July 2010, the IMF and the EU Delegation suspended the review of Hungary's funding program as the Hungarian government was reluctant to give clarification on open issues. Due to the uncertainty created by the suspension of negotiations, the Hungarian forint weakened against the Euro up to 290 HUF/EUR levels. However, Hungary was still able to get financing through government bonds and treasury bills, moreover the country had foreign exchange reserves because of previous drawdowns from the credit facility.

At the end of July 2010, the Hungarian Parliament passed the law on extraordinary bank tax, which was meant to bring in an extra HUF 200 billion of budget revenue in 2010. In October 2010, the Hungarian Parliament passed the law on the "crisis tax" in order to bring in an extra HUF 161 billion of budget revenue in 2010. The government also stopped the transfer of pension contributions to private pension funds in order to raise an extra HUF 60 billion to the budget revenue in 2010. Revenues from the crisis tax and the pension transfer freeze totaled HUF 221 billion in 2010 and met the 3.8% deficit goal.

In December 2010, Moody's and Fitch downgraded Hungary's rating: Moody's: from Baa1 to Baa3 and Fitch: from BBB to BBB-, both with a negative outlook. Between November 2010 and December 2011 the National Bank of Hungary has gradually increased its base rate to 7.0%. For 2011, the Hungarian Government introduced major changes to the tax regime including a 16% flat rate personal income tax and a reduction of corporate income tax rates.

From late 2010, a sovereign debt crisis developed in some European states, intensifying in early 2011.This included Eurozone members Greece, Ireland, Italy, Spain and Portugal, and also some non-Eurozone European Union countries. Greece, Ireland and Portugal received bail out packages. Increased concern about Italy and possible default has weighed heavily on equity markets. The European Union has been unable to come up with a consensus view on how to address the issue which has increased uncertainty and volatility. The market was also impacted by the U.S. loosing its AAA rating from

Standard & Poors. Rising government debt levels concerned investors and resulted in a wave of downgrades of European government debt.

EUR/HUF devalued to over 300 at the end of October 2011, and remained well above that level. The Hungarian forint has been weighed down by concerns about the country's potential downgrade to junk status. S&P placed its BBB-/A-3 foreign and local currency sovereign credit ratings on Hungary on CreditWatch with negative implications. As a result, the forint became the world's worst-performing currency since June 30, 2011.

In November 2011, Hungary turned again to the IMF / EU to take out a Precautionary Credit Line. The formal negotiations could not be started then because of the European Commission (EC)'s infringement proceedings against Hungary. At the end of April, 2012 the Hungarian Government agreed with EC on the law changes needed and EC is likely to give the go-ahead to Hungary to start the IMF talks once it implements the legal changes.

In December 2011, S&P downgraded Hungary's rating from BBB- to BB+, with a negative outlook driven by unpredictable economic policy and government actions that has raised questions about the independence of oversight institutions and are complicating the operating environment for investors. Analysts' main criticism over measures in 2011 was that the 2011 budget plan relied heavily on extra taxes, diverted pension transfers and a reduction in public sector employment, while it lacked structural measures.

Effect of Economic and Financial Crisis on Business and Financial Covenant Compliance

The economic crisis has had an impact on all of our business segments, particularly our Residential segments. Our Residential Voice business continues to be impacted by a decreasing number of telephone lines and customers migrating to lower cost packages in our historical concession areas as well as reduced usage both in and outside our historical concession areas. As an offset to this, we have seen growth in our Residential Internet business in 2011 reflecting the increase in the broadband penetration rate in Hungary convergeing to that of Western Europe. We see increasing competition, particularly from cable television operators providing broadband internet services, which impacts our DSL broadband business.

Our Corporate segment operations have also been impacted by the economy as businesses look to cut expenditures and contract renewals become more competitive.

We continue to carefully manage our operating costs and capital expenditure, however, we cannot at this time predict with certainty the impact such economic conditions will continue to have on our business in Hungary, with respect to consumer and business spending on our services or on our ability to repay our debt obligations. We do, however, believe that cash provided by our operating activities and our financing activities will provide adequate resources to satisfy our working capital requirements, scheduled principal and interest payments on our debt and our anticipated capital expenditure requirements for the next 12 months. However, in light of the unpredictable economic trends, our ability to generate cash sufficient to meet our existing indebtedness obligations could be adversely affected, and we could be required either to find alternate sources of liquidity or to refinance our existing indebtedness in order to avoid defaulting on our debt obligations.

Explanation of Statement of Comprehensive Income Items

Revenue

Revenue is generated by five principal areas of activity as follows:

Residential Voice — the revenue generated from the fixed line voice and voice-related services provided to Residential customers within our historical concession areas and outside our historical concession areas in Hungary. Residential Voice revenue comprises monthly fees charged for accessing the network, time based fixed-to-mobile, local, long distance and international call charges, interconnect charges on calls terminated in our network, monthly fees for value added services, subsidies, one-time connection and new service fees, as well as monthly fees for packages with built-in call minutes.

Residential Internet — the revenue generated from DSL internet connections provided to Residential customers in Hungary both inside and outside the historical concession areas. Residential Internet revenue comprises DSL revenue, which is generated through a variety of monthly packages.

Cable — the revenue generated from the provision of cable voice, broadband internet and TV services to customers outside our historical concession areas using our cable network acquired in the acquisition of Fibernet in March 2011.

Corporate — the revenue generated from the fixed line voice, data and internet services provided to business, government and other institutional customers nationwide. Corporate revenue comprises access charges, monthly fees, time based fixed-to-mobile, local, long distance and international call charges, interconnect charges on calls terminated in our network, monthly fees for value added services, internet access packages and regular data transmission services. In addition, Corporate revenue includes revenue from leased line, internet and data transmission services which is comprised of fixed monthly rental fees based on the capacity/bandwidth of the service and the distance between the endpoints of the customers.

Wholesale — the revenue generated from voice and data services is provided on a wholesale basis to resellers to use excess network capacity. Wholesale revenue comprises rental payments for high bandwidth leased line services, which are based on the bandwidth of the service and the distance between the endpoints of the customers, and voice transit charges from other Hungarian and international telecommunications service providers, which are based on the number of minutes transited.

Cost of sales exclusive of depreciation

Cost of sales exclusive of depreciation consists of cost directly attributable to operations of segments such as interconnect expenses, access type charges, direct sales commissions (segment cost of sales in total) and expenses which are attributable to all segments such as network operating expenses and direct personnel expenses.

Operating Expenses

Principal operating expenses consist of:

- indirect personnel expenses, including salaries, social security and other contributions, personnel related expenses, contracted employees and expatriate costs and bonuses and charges;
- headcount related costs, including office, building rental and maintenance, car related and training costs;
- advertising and marketing costs, including the costs of advertising campaigns and other publicity and market research;
- local operating and other taxes and crisis tax, which was introduced by the Hungarian

Government in the fourth quarter of 2010 with retrospective effect to January 1, 2010;

- IT costs including IT maintenance, software license and other IT related costs;
- bad debt expenses, including provisions for doubtful debts from customers;
- collection costs, including bank charges in respect of collecting payments from customers;
- legal and audit fees including fees paid to legal advisors and to auditors;
- consultant expenses including fees paid to other advisors;
- management fee including fees paid to our trustees and Mid Europa;
- non-recurring consulting expenses, which are fees paid to legal and financial advisors relating to our strategic projects; and
- other overhead costs, net including other miscellaneous expenses and revenues.

Network expense and personnel expense are included as part of cost of sales and are not an operating expense attributable to any segment in our segment reporting. Therefore, we present general operating expense, which includes network expense and personnel expense in our year on year comparison included in this Annual Report to present a complete view of our expenses.

Depreciation and Amortization

We charge depreciation to our income statement on a straight-line basis over the estimated useful lives of items of property, plant and equipment, and major components that are accounted for separately. Assets leased under finance leases are depreciated over the shorter of the lease term or their useful lives. Land and capital work in progress are not depreciated.

Intangible assets with a finite useful life are amortized on a straight-line basis over the period in which the asset is expected to be available for use. Intangible assets with an indefinite useful life are reviewed for impairment at least annually or when there are indicators for impairment.

Historically, we amortized the amounts paid for the right to provide fixed line telecommunications services in our historical concession areas over the 25-year term provided for in concession contracts. As of January 1, 2008, due to the changes in customer churn rates, we completed a review of the estimated amortization period of such concession rights and as a result of this review the remaining useful life of concession rights was reduced to 3 years, which was accounted for prospectively from January 1, 2008. Concession rights were amortized to zero by December 31, 2010.

Net Financial Expenses

Our net financial expenses comprise interest income, interest expense, amortization of bond discounts, amortization of deferred borrowing costs calculated using the effective interest rate method, foreign exchange gains and losses, gains and losses resulting from the changes in the fair values of derivative financial instruments and net other financial expense. Our net financial expense also included charges on extinguishment of debt incurred in 2009.

Income Taxes

Income tax expense comprises current and deferred taxes. Income tax expense is recognized in the income statement except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected corporate income tax and Hungarian local business tax payable on taxable income for the year, using tax rates enacted at the balance sheet date and any adjustment to tax payable in respect of previous years.

During the fourth quarter of 2010, the Hungarian government introduced a crisis tax, which was implemented with retrospective effect to January 1, 2010. Such crisis tax is accounted for among operating expenses in our consolidated statement of comprehensive income.

Critical Accounting Policies

We believe the following accounting policies are critical to the understanding our results of operations and the effect of the more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue Recognition — Revenues are primarily earned from providing access to and usage of our networks and facilities. Access revenue is billed one month in advance and recognized the following month when earned. Revenues based on measured traffic are recognized when the service is rendered. Revenue from connection fees are recognized upon service activation. Wholesale data revenue from leased lines is based on the bandwidth of the service and the particular route involved and is recognized in the period of usage or when the service is available to the customer. From time to time, we sell fiber optical assets to other telecommunications companies. Revenue is recognized as and when the transfer of ownership is complete. For further details about revenue recognition, see note 2.17 -*"Revenue Recognition"* in the notes to the consolidated financial statements for the year ended December 31, 2011.

Subscriber Acquisition Costs — Subscriber acquisition costs are fees paid to our internal sales force and fees paid to third party sales agents. We capitalize subscriber acquisition costs that relate to fixed term subscriber contracts. Such capitalized subscriber acquisition costs are amortized over the period of the related subscriber contracts.

Goodwill — Goodwill is calculated as the amount of the fair value of the purchase price paid over the fair value of the net assets acquired in a business combination. The fair values of the assets are determined using different valuation techniques depending on the nature of the assets. Goodwill is allocated to operating segments for the purposes of impairment testing. The allocation is made to those operating segments that were expected to benefit from business combinations in which goodwill arose. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill maybe impaired, in accordance with IAS 36 — *"Impairment of Assets"*. Our segments are as follows: Residential Voice In-Concession, Residential Voice Out-of-Concession, Residential Internet (including IPTV), Corporate Voice In-Concession, Business Voice Out-of-Concession, Business Data and Internet and Wholesale.

Property, Plant and Equipment — Property, plant and equipment comprise a significant portion of our total assets. Changes in technology, changes in our intended use of these assets and/or changes in the regulatory environment may cause the estimated period of use or the value of these assets to change. These assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Estimates and assumptions used in both setting depreciable lives and reviewing recoverability require both judgment and estimation by management. Impairment is deemed to have occurred if projected undiscounted cash flows related to the asset are less than its carrying value. If impairment is deemed to have occurred, the carrying values of the assets are written down to their fair value, through a charge against earnings.

Intangible Assets — Intangible assets that have finite useful lives (whether or not acquired in a business combination) are amortized over their estimated useful lives. Intangible assets with finite lives consist of software, property rights and other intangible assets, mainly capitalized subscriber acquisition costs. Property rights represent the amounts paid for the right to use third party property for the placement of telecommunication equipment and the amounts paid for the usage of networks owned by third parties.

The estimated useful lives of other intangible assets are as follows:

Property rights	1-43 years
Software	3 years
Other	1-16 years

We evaluate the carrying value of intangible assets to be held and used whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying value of an intangible asset is considered impaired when the projected undiscounted future cash flows related to the asset are less than its carrying value. We measure impairment based on the amount by which the carrying value of the respective asset exceeds its fair value. Fair value is determined primarily using the projected future cash flows discounted at a rate commensurate with the risk involved. For further details on the accounting policies of intangible assets, see note 2.11 – *"Intangible Assets and Goodwill"* in the notes to the consolidated financial statements for the year ended December 31, 2011.

Contingent Liabilities — We establish accruals for estimated loss contingencies when we determine that a loss is probable and the amount of the loss can be reasonably estimated. Revisions to contingent liabilities are reflected in income in the period in which different facts or information become known or circumstances change that affect our previous assessments as to the likelihood of and estimated amount of loss. Accruals for contingent liabilities are based upon our assumptions and estimates, after giving consideration to the advice of the legal department and other information relevant to the assessment of the probable outcome of the matter.

Derivative Financial Instruments — We use derivative financial instruments to manage our exposure to foreign exchange and interest rate risks arising from operational, financing and investing activities. In accordance with our treasury policy, we do not hold or issue derivative financial instruments for trading purposes. The derivative financial instruments held do not qualify for hedge accounting and are therefore designated as fair value through profit and loss. The gains or losses resulting from the changes in the fair value of financial instruments are recorded in the consolidated income statement for the period to which they relate. The fair value of interest rate swaps is the estimated amount that we would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates. The fair value of forward exchange contracts is their estimated market price at the balance sheet date, being the present value of the quoted forward price. The fair value of cross currency interest rate swaps is the estimated amount that we would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and, foreign exchange rates. For further details on the accounting policies relating to derivative financial instruments, see note 2.7 – *"Derivative Financial Instruments"* in the notes to the consolidated financial statements for the year ended December 31, 2011.

Critical Accounting Estimates and Judgements

Impairment provision for doubtful accounts

The group maintains an impairment provision for doubtful accounts for estimated losses resulting from customers' or carriers' failure to make payments on amounts due. These estimates are based on a number of factors including: (a) historical experience; (b) aging of trade accounts receivable; (c) amounts disputed and the nature of dispute; (d) bankruptcy; (e) general economic, industry or business information; and (f) specific information that we obtain on the financial condition and current credit worthiness of customers or carriers. The estimates used in evaluating the adequacy of the impairment provision for doubtful accounts receivable are based on the aging of the accounts receivable balances and historical write-off experience, customer credit-worthiness, payment defaults and changes in customer payment terms.

Depreciation and amortization

Property, plant and equipment and intangible assets are recorded at cost and are depreciated or amortized on a straight-line basis over their estimated useful lives. The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technology evolution and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually.

Comparison of Continued Operations for the Year ended December 31, 2011 and the Year ended December 31, 2010

The functional currency of our continued operations is the HUF. The average EUR/HUF exchange rate for the year ended December 31, 2011 was 279.21, compared to an average EUR/HUF exchange rate for the year ended December 31, 2010 of 275.41. When comparing the year ended December 31, 2011 to the year ended December 31, 2010, EUR reported amounts have been affected by this 1% depreciation of the HUF against the EUR.

Revenue

The following table presents a breakdown of our revenue by segment for the year ended December 31, 2011 and 2010:

	Year Ended December 31,		
	2011	**2010**	**% change**
	(€ in millions)		
Residential Voice	50.1	63.9	(22%)
Residential Internet	33.5	32.7	2%
Corporate	62.0	66.1	(6%)
Wholesale	32.7	30.5	7%
Cable	16.8	-	-
Total Revenue	**195.1**	**193.2**	1%

Our revenue increased by €1.9 million, or 1% for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase is attributable to the factors described below.

Residential Voice

Our Residential Voice revenue was €50.1 million for the year ended December 31, 2011 compared to €63.9 million for the year ended December 31, 2010, representing a decrease of €13.8 million or 22%. This decrease is mainly due to the decrease in the number of our Residential Voice customers both in and outside of our concession areas and the decrease in higher value fixed to mobile and international traffic.

The number of Residential Voice telephone lines within our historical concession areas was approximately 301,000 as of December 31, 2011 compared to 327,000 as of December 31, 2010 and the number of Carrier Selection ("CS"), Carrier Pre-Selection ("CPS") and LLU customers that represents our customer base outside our historical concession areas was approximately 257,000 as of December 31, 2011 compared to 298,000 as of December 31, 2010.

Residential Internet

Our Residential Internet revenue was €33.5 million for the year ended December 31, 2011 compared to €32.7 million for the year ended December 31, 2010, representing a €0.8 million or 2% increase. This increase is mainly due to the increase in IPTV and ADSL revenue within our historical concession areas as a result of the increase in our IPTV customer base.

As of December 31, 2011, we had approximately 150,000 broadband DSL customers compared to approximately 151,000 broadband DSL customers as of December 31, 2010, which represents a 1% decrease and we had approximately 20,000 IPTV customers compared to approximately 17,000 IPTV customers as of December 31, 2010, which represents a 14% increase.

Corporate

Our Corporate segment revenue was €62.0 million for the year ended December 31, 2011 compared to €66.1 million for the year ended December 31, 2010, representing a €4.1 million or 6% decrease. This decrease was primarily due to lower voice traffic and loss of lines as well as price erosion due to competition and lower data and Internet endpoints reflecting economic conditions.

The number of Corporate Voice telephone lines inside our historical concession areas was approximately 41,000 as of December 31, 2011 compared to 42,000 as of December 31, 2010. The number of direct access Corporate voice telephone lines outside our historical concession areas was approximately 40,000 as of December 31, 2011 compared to 43,000 as of December 31, 2010 and the number of indirect access Corporate voice telephone lines outside our historical concession areas was approximately 7,000 as of December 31, 2011 compared to approximately 8,000 as of December 31, 2010. In addition, we had approximately 14,000 DSL lines and approximately 16,000 leased lines as of December 31, 2011 compared to approximately 16,000 DSL lines and approximately 16,000 leased lines as of December 31, 2010.

Wholesale

Our Wholesale revenue was €32.7 million for the year ended December 31, 2011 compared to €30.5 million for the year ended December 31, 2010, representing a €2.2 million or 7% increase. In the year ended December 31, 2010 a significant dark fiber sale to Vodafone amounting of €4.5 million is included. Without such dark fiber sale our Wholesale revenue increased by €6.7 million or 26%.

Cable

Our Cable revenue was €16.8 million for the year ended December 31, 2011. In the Cable segment, as of December 31, 2011, we had approximately 84,000 cable TV lines, 61,000 cable internet lines and

17,000 cable voice lines. Our Cable segment was introduced as at February 28, 2011 and relates to the revenue generated by Fibernet.

Cost of Sales

The following table presents segment cost of sales for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	**2010**
	(€ in millions)	
Segment cost of sales	35.4	32.3

Cost of sales, at the segment level, totaled €35.4 million for the year ended December 31, 2011 compared to €32.3 million for the year ended December 31, 2010, representing an increase of €3.1 million or 10%. The increase in cost of sales is mainly due to the Fibernet Acquisition, as a result of which approximately €5.0 million was added to our cost of sales for the year ended December 31, 2011.

The following table presents the reconciliation of segment cost of sales to total cost of sales as per our consolidated statement of comprehensive income for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	**2010**
	(€ in millions)	
Segment cost of sales	35.4	32.3
Network operating expenses	21.3	19.5
Direct personnel expenses	11.8	10.8
Total cost of sales, exclusive of depreciation	**68.5**	**62.6**

Segment Gross Margin

We define segment gross margin as segment revenue minus segment cost of sales for each of our operating segments. Segment gross margin is not a measurement of financial performance under IFRS and should not be considered as an alternative to net income or to cash flow from operating, investing or financing activities, as a measure of liquidity or an indicator of our operating performance or any other measures of performance derived in accordance with IFRS. Management uses segment gross margin as a tool for various purposes including measuring and evaluating our financial and operational performance, making compensation decisions, budgeting decisions and for financial planning purposes. We believe that the presentation of segment gross margin is useful for investors because it reflects management's view of core operations and cash flow generation upon which management bases financial, operational and planning decisions and presents measurements that investors and their lending banks have indicated to management are important in assessing us and our liquidity.

The following table presents a reconciliation of segment gross margin to income from operations for the year ended December 31, 2011 and 2010:

	Year Ended December 31, 2011	2010	% change
	(€ in millions)		
Residential Voice gross margin	44.3	55.5	(20%)
Residential Internet gross margin	27.3	26.2	4%
Corporate gross margin	48.5	51.3	(5%)
Wholesale gross margin	26.5	27.9	(5%)
Cable gross margin	13.1	-	-
Total segment gross margin	**159.7**	**160.9**	**(1%)**
Network operating expenses	(21.3)	(19.5)	
Direct personnel expenses	(11.8)	(10.8)	
Operating expenses	(47.0)	(46.2)	
Depreciation and amortization	(115.5)	(53.9)	
Cost of restructuring	(6.1)	(1.2)	
Income from operations	**(42.0)**	**29.3**	

Our segment gross margin changed from €160.9 million for the year ended December 31, 2010 to €159.7 million for the year ended December 31, 2011, representing a decrease of €1.2 million or 1%. This decrease is attributable to the factors below.

Residential Voice

Our Residential Voice segment gross margin was €44.3 million for the year ended December 31, 2011 compared to €55.5 million for the year ended December 31, 2010, representing a decrease of €11.2 million or 20%. This decrease is mainly due to the decrease in our Residential Voice revenue as a result of the decrease in the number of customers and traffic.

Residential Internet

Our Residential Internet segment gross margin was €27.3 million for the year ended December 31, 2011 compared to €26.2 million for the year ended December 31, 2010, representing an increase of €1.1 million or 4%. This increase is due to the increase in IPTV and ADSL revenue within our historical concession areas mainly as a result of the increase in our IPTV customer base during the year ended December 31, 2011 compared to the prior year.

Corporate

Our Corporate segment gross margin was €48.5 million for the year ended December 31, 2011 compared to €51.3 million for the year ended December 31, 2010, representing a decrease of €2.8 million or 5%. This decrease is mainly due to the decrease in Corporate Voice revenue as a result of loss of lines and price erosion due to competition.

Wholesale

Our Wholesale segment gross margin was €26.5 million for the year ended December 31, 2011 compared to €27.9 million for the year ended December 31, 2010, representing a decrease of €1.4 million or 5%. This decrease is primarily attributable to a dark fiber sale to Vodafone in the amount of

€4.2 million for the year ended December 31, 2010. Without such dark fiber sale, our Wholesale segment gross margin increased by €2.8 million or 12%.

Cable

Our Cable segment gross margin was €13.1 million for the year ended December 31, 2011, and represents the gross margin generated by Fibernet.

General Operating Expenses

Our general operating expenses consists of operating expenses as included in our consolidated statement of comprehensive income and the cost of sales which are not allocated to individual segments. The following table presents general operating expenses for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	**2010**
	(€ in millions)	
General operating expenses	80.1	76.5

Our general operating expenses increased by €3.6 million or 5% from €76.5 million for the year ended December 31, 2010 to €80.1 million for the year ended December 31, 2011. This increase is mainly the result of the Fibernet Acquisition, which added general operating expenses amounting to €7.0 million for the year ended December 31, 2011. General operating expenses of Fibernet include personnel related cost of €3.3 million, network operating expenses of €3.1 million and other operating expenses of €0.6 million.

The following table presents a reconciliation of general operating expenses to operating expenses as per our consolidated statement of comprehensive income for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	**2010**
	(€ in millions)	
General operating expense	80.1	76.5
Network operating expenses	(21.3)	(19.5)
Direct personnel expenses	(11.8)	(10.8)
Operating Expense	**47.0**	**46.2**

Depreciation and Amortization

The following table presents our depreciation and amortization for the year ended December 31, 2011 and 2010:

Year Ended December 31,

	2011	2010
	(€ in millions)	
Depreciation and amortization	115.5	53.9

Our depreciation and amortization increased by €61.6 million or 114% from €53.9 million for the year ended December 31, 2010 to €115.5 million for the year ended December 31, 2011. This increase is mainly the result of impairment of assets of €58.6 million recognized because the carrying amount of certain assets relating to segments Residential Voice in, Residential Internet and Corporate Voice Out exceed its recoverable amount and the Fibernet Acquisition, which added depreciation and amortization of approximately €5.9 million for the year ended December 31, 2011.

Cost of Restructuring

The following table presents our cost of restructuring for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Cost of restructuring	6.1	1.2

Cost of restructuring increased by €4.9 million from €1.2 million for the year ended December 31, 2010 to €6.1 million for the year ended December 31, 2011. Cost of restructuring is related to reorganizations we have undertaken and mainly includes severance expenses. For the year ended December 31, 2011 cost of restructuring is mainly related to reorganizations after the Fibernet Acquisition and inlcudes severance expenses as well as other cost items such as relocation, rebranding and termination of real-estate lease expenses.

Income from Operations

The following table presents our income from operations for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Income from operations	(42.0)	29.3

As a result of the factors described above, income from operations decreased by €71.3 million from an income of €29.3 million for the year ended December 31, 2010 to a loss of €42.0 million for the year ended December 31, 2011.

Foreign Exchange Gains / (Losses), Net

The following table presents our net foreign exchange gains / (losses) for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Foreign exchange gains / (losses), net	(1.9)	(7.1)

Our foreign exchange losses of €1.9 million for the year ended December 31, 2011 resulted primarily from unrealized losses of €1.6 million due to the revaluation of our EUR denominated assets and liabilities at period end and from realized losses of €0.3 million of our EUR denominated assets and liabilities.

Our foreign exchange losses of €7.1 million for the year ended December 31, 2010 resulted primarily from realized foreign exchange losses of €5.1 million on the repayments of our debt during the year partially offset by realized gains on our receivables of €2.0 million and net unrealized losses of €4.0 million due to the revaluation of our EUR denominated debt and receivables at period end.

Interest Expense

The following table presents our interest expense for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Interest expense	39.2	46.2

Our interest expense decreased by €7.0 million from €46.2 million for the year ended December 31, 2010 to €39.2 million for the year ended December 31, 2011. This decrease is mainly due to the repurchases of certain of our other notes in November 2010 and during 2011. See note 19 - *"Borrowings"* in the notes to the consolidated financial statements for the year ended December 31, 2011.

Interest Income

The following table presents our interest income for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Interest income	3.2	1.5

Our interest income was €1.5 million for the year ended December 31, 2010 and €3.2 million for the year ended December 31, 2011. Interest income was realized on our cash balances during these periods.

Gain on Acquisition

The following table presents our gain on acquisition for the year ended December 31, 2011:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Gain on acquisition	28.5	-

Our gain on acquisition (negative goodwill) of €28.5 million represents the difference between the fair value of the acquired net assets and the purchase price paid in the Fibernet Acquisition.

Net Fair Value Change of Derivative Financial Instruments

The following table presents our gains / (losses) from net fair value changes of derivative financial instruments for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Net fair value change of derivative financial instruments	0.8	(6.9)

The €0.8 million gain on the net fair value change of derivative financial instruments for the year ended December 31, 2011 includes realized gains in the amount of €1.6 million and unrealized losses in the amount of €0.8 million. Realized gains are due to the interest rate swaps and forward deals closed which matured during the year ended December 31, 2011.

The €6.9 million loss on the net fair value change of derivative financial instruments for the year ended December 31, 2010 includes realized losses in the amount of €17.4 million related to the settlement of our interest rate swaps and forward deals which matured during the year and unrealized gains in the amount of €10.5 million related to the mark-to-market revaluation of our open positions at period end.

Income Tax Benefit / (Expense)

The following table presents our income tax benefit / (expense) for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ in millions)	
Corporate tax	-	-
Local business tax	(3.5)	(3.6)
Current tax benefit / (expense)	(3.5)	(3.6)
Deferred tax benefit / (expense)	-	(14.8)
Total income tax benefit / (expense)	**(3.5)**	**(18.4)**

Our income tax expense changed from €18.4 million for the year ended December 31, 2010 to €3.5 million for the year ended December 31 2011.

The deferred tax expense of €14.8 million for the year ended December 31, 2010 relates to the write-off of our deferred tax assets, mainly relating to the Invitel tax losses carried forward.

Income / (Loss) from Continuing Operations

The following table presents our income / (loss) from continuing operations for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ millions)	
Income / (loss) from continuing operations	(47.5)	(48.8)

As a result of the factors discussed above, we recorded a loss from continuing operations of €47.5 million for the year ended December 31, 2011 compared to a loss from continuing operations of €48.8 million for the year ended December 31, 2010.

Income / (Loss) from Discontinued Operations

The following table presents our income / (loss) from discontinued operations for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ millions)	
Income / (loss) from discontinued operations	-	60.0

Discontinued operations for the year ended December 31, 2010 includes the results of the International Business, which was sold on October 7, 2010.

Liquidity and Capital Resources

The table below summarizes our cash flows for the year ended December 31, 2011 and 2010:

	Year Ended December 31,	
	2011	2010
	(€ millions)	
Cash Flow Data:		
Net cash flow provided by / (used in) operating activities	28.2	36.3
Net cash flow provided by / (used in) investing activities	(55.7)	158.0
Net cash flow provided by / (used in) financing activities	(40.5)	(150.0)

Our net cash provided by continuing operating activities was €28.2 million and €36.3 million for the year ended December 31, 2011 and 2010, respectively. The decrease of €8.1 million in cash provided by continuing operating activities is due to the fiber sale to Vodafone in the amount of €4.2 million recorded for the year ended December 31, 2010 and the consultancy cost of the Fibernet Acquisition of €3.6

million for the year ended December 31, 2011.

Our net cash used in investing activities of continuing operations was €55.7 million for the year ended December 31, 2011, which mainly included the acquisition of Fibernet, net of cash, in the amount of €17.6 million and net capital expenditure of €41.2 million decreased by interest income of €3.1 million. Our net cash provided by investing activities of continuing operations was €158.0 million for the year ended December 31, 2010, which mainly included net proceeds from the sale of the International Business in the amount of €191.0 million and proceeds from the sale of tangible and intangible assets of €7.4 million decreased by net capital expenditure of €41.6 million.

Our net cash used in financing activities of continuing operations was €40.5 million for the year ended December 31, 2011 compared to €150.0 million for the year ended December 31, 2010. Cash flows used in financing activities for the year ended December 31, 2011 mainly included the repurchase of our 2007 Notes in the amount of €75.6 million, repurchase of our 2006 Notes in the amount of €20.4 million, the repurchase of our 2009 Notes in the amount of €17.6 million, and refinancing costs of €5.6 million offset by the proceeds from issuance of additional 2009 Notes in the amount of €79.2 million. Cash flows used in financing activities for the year ended December 31, 2010 mainly included the repurchase of our 2007 Notes in the amount of €47.6 million, the repurchase of our 2009 Notes in the amount of €75.0 million, principal payments under capital leases in the amount of €2.5 million and the settlement of our derivative financial instruments in the amount of €17.0 million.

The table below presents our other major contractual cash obligations as of December 31, 2011 (at December 31, 2011 exchange rates):

	Cash Payments Due by Period				
Obligation	**Total**	**1 Year or Less**	**2-3 Years**	**4-5 Years**	**After 5 Years**
			(€ thousands)		
Long Term Debt Principal Payments	349,997	—	—	349,997	—
Long Term Debt Interest[(1)]	166,249	33,251	66,499	66,499	—
Lease Commitments to Telecommunication Providers	8,532	966	1,808	1,727	4,031
Other Operating Leases	28,419	4,078	7,315	6,383	10,643
Capital Leases	3,771	179	440	532	2,620
Total	**556,968**	**38,474**	**76,062**	**425,138**	**17,294**

(1) Long-term debt interest payment obligations are calculated by 9.50% for the 2009 Notes.

Liquidity risk represents the risk that we are unable to meet our payment obligations when those become due. We monitor our liquidity position on an ongoing basis by forecasting and monitoring revenue, capital and operating expenditures, investments and debt service.

The global financial crisis has affected the whole Central and South Eastern European economy. In addition, Hungary's monetary and fiscal policies have had a significant impact on the Hungarian economy, which has resulted in a recent significant devaluation of the Hungarian forint. We cannot at this time predict with certainty the impact such conditions will have on our business in Hungary with respect to consumer and business spending on our services or on our ability to repay our debt obligations. We do, however, believe that cash provided by our operating activities and our financing activities will provide adequate resources to satisfy our working capital requirements, scheduled principal and interest payments on our debt and our anticipated capital expenditure requirements.

The 2009 Notes mature in 2016. We will continue to evaluate our capital structure and the capital markets in the future in making our capital financing decisions. For a detailed description of our debt agreements, see note 19 -*"Borrowings"* in the notes to the consolidated financial statements for the year ended December 31, 2011.

We may, subject to the terms of our debt instruments, from time to time purchase or otherwise acquire or retire our subsidiaries' debt and take other steps to reduce our consolidated debt or otherwise change our capital structure. These actions may include open market purchases and sales, negotiated transactions, tender offers, exchange offers or other transactions. The timing and amount of any debt purchases or acquisitions would depend on market conditions, trading levels of the debt from time to time, our cash position and the availability and terms of cash financing from other sources, and other considerations.

Changes in capital structure

The 2009 Notes

On March 30, 2011 Matel issued €80,000,000 Senior Secured Notes (the "Additional 2009 Notes"). The Additional 2009 Notes were offered as additional notes under the indenture of the 2009 Notes and have identical terms and conditions, are the same series as, and, upon completion of a 40-day distribution compliance period, was fully fungible with, the existing 2009 Notes. The price of the Additional 2009 Notes was 99.00% plus accrued interest from December 16, 2010. The proceeds of the issuance of the Additional 2009 Notes were used to fund the repurchase and redemption of all outstanding 2007 Notes.

With the issuance of the Additional 2009 Notes, Matel has received consent for certain amendments and waivers to the Indenture of the 2009 Notes to, among other things, (i) permit the issuance of the Additional Notes, (ii) waive restrictions of the application of asset sale proceeds under the "Limitation on Sale of Certain Assets" covenant of the Indenture to allow for certain asset sale proceeds from the sale of the International Business and the Fibernet Disposal to be used for general corporate purposes, (iii) allow for a supplement to the share pledge over the shares of Matel benefiting the 2009 Notes to allow for the liquidation of Matel's direct parent companies (to simplify the group structure) and (iv) amend the definition of Permitted Collateral Liens in the Indenture (and the related provisions of the Intercreditor Deed) such that €25.0 million of additional Indebtedness currently permitted to be incurred under the Indenture may also benefit from the security over the collateral securing the 2009 Notes on a pari passu or junior basis.

On June 10, 2011 Matel purchased 2009 Notes in the aggregate principal amount of €5,271 thousand at a weighted average purchase price equal to 100% of the principal amount thereof plus accrued interest up to but excluding the date of settlement.

During September 2011, Matel purchased 2009 Notes in several transactions in the aggregate principal amount of €10,770 thousand at a weighted average purchase price equal to 80.4% of the principal amount thereof plus accrued interest up to but excluding the date of settlement.

During December 2011, Matel purchased 2009 Notes in several transactions in the aggregate principal amount of €5,000 thousand at a weighted average purchase price equal to 73.0% of the principal amount thereof plus accrued interest up to but excluding the date of settlement. After these transactions, the aggregate principal amount outstanding of the 2009 Notes including bond discount is €328.9 million as of December 31, 2011.

The 2007 Notes

During November and December 2010 and January 2011, Matel has repurchased and subsequently cancelled €31.7 million of 2007 Notes. Using the proceeds of the issuance of the Additional 2009 Notes all remaining outstanding 2007 Notes were redeemed and cancelled.

The 2006 PIK Notes

On February 22, 2011 (the "Redemption Date") all of Holdco I's 2006 PIK Notes were redeemed for cancellation. The redemption price was 101% of the principal amount thereof plus accrued and unpaid interest thereon, from the most recent interest payment date for which interest has been paid to the Redemption Date.

Inflation and Foreign Currency

The EUR/HUF exchange rate changed from 278.75 as of December 31, 2010 to 311.13 as of December 31, 2011, an approximate 11.6% depreciation in the value of the HUF against the EUR. Overall, this resulted in a net foreign exchange loss of €1.9 million for the year ended December 31, 2011 compared to a net foreign exchange loss of €7.1 million for the year ended December 31, 2010.

Approximately all of the revenue of our continuing operations is denominated in HUF and our operating and other expenses, including capital expenditures, are predominantly in HUF and in EUR. In addition, certain items in the balance sheet accounts are denominated in currencies other than the HUF. Accordingly, when such accounts are translated into HUF, our functional currency, we are subject to foreign exchange gains and losses which are reflected as a component of earnings. When the subsidiaries financial statements are translated into EUR for financial reporting purposes, we are subject to translation adjustments, the effect of which is reflected as a component of equity.

Quantitative and Qualitative Disclosures about Market Risk

Market Risk Exposure

Foreign Currency Exchange Rate Risks

We are exposed to various types of risk in the normal course of our business, including the risk from foreign currency exchange rate fluctuations. Approximately all of our revenue and approximately 15% of our operating expenses of our continuing operations are HUF based. Therefore, we are subject to currency exchange rate risk with respect to our non-HUF denominated expenses, primarily EUR, due to the variability between the HUF and the EUR. Due to our limited exposure with respect to non-HUF denominated expenses, we have not entered into any agreements to manage our foreign currency risks related to such expenses but we continue to monitor the currency exchange rate risk related to such expenses.

We are also exposed to exchange rate risk since all of our debt obligations are in EUR. The EUR/HUF exchange rate changed from 278.75 as of December 31, 2010 to 311.13 as of December 31, 2011, an approximate 11.6% depreciation in the value of the HUF versus the EUR. Given our EUR denominated debt obligations, exchange rate fluctuations can have a significant impact on our consolidated financial statements in connection with foreign exchange gains/losses and the resulting debt balances. Our future cash-flows are sensitive to foreign exchange rate changes related to our debt service, including all hedging in place.

Interest Rate Risks

In 2010 we were exposed to interest rate risks in relation to our 2007 Notes, which accrued interest at variable rates tied to market interest rates. The interest rates on the floating rate EUR denominated obligations were based on EURIBOR. On March 30, 2011 we redeemed and subsequently cancelled all of our outstanding 2007 Notes. Consequently, all of our debt instruments pay fixed rate interest thus having no more interest rate risk.

Subsequent to the redemption of all outstanding 2007 Notes all interest rate swaps were unwound in April 2011, as a result of which we realized a loss of €0.8 million.

We evaluate market interest rates and the costs of interest rate hedging instruments by reviewing historical variances between market rates and rates offered by third parties on hedging instruments, as well as market expectations of future interest rates.

Sensitivity Analysis

The following table shows the sensitivity of our debt instruments and related derivative financial instruments, factoring in the related hedging positions, to potential foreign currency exchange rate and interest rate changes as of December 31, 2011:

Instrument	**Notional amount**	**1%p.a. increase in EURIBOR**	**20% increase in HUF/EUR rate**
		(€ in thousands)	
Debt			
2009 Notes[(1)]	349,997	—	(6,650)
Total Debt	**349,997**	—	**(6,650)**
Derivative financial instruments			
Forward deals	1,930	19	(551)
Total Derivates	**1,930**	**19**	**(551)**

(1) The 2009 Notes pay fixed rate interest therefore they are not affected by changes in interest rates.

The above table shows the impact of a 1% increase in interest rates (e.g. BUBOR and EURIBOR) and a 20% increase in the EUR/HUF exchange rate on our debt service related cash flows due in the next 12 months.

8. HUNGARIAN TELECOMMUNICATIONS INDUSTRY AND REGULATION

Certain of the projections and other information set forth in this section have been derived from external sources, including the Hungarian Central Statistical Office, the former Hungarian Ministry of Economy and Transport and the National Media and Infocommunications Authority. Industry publications, surveys and forecasts generally state that the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information is not guaranteed. We believe that these industry publications, surveys and forecasts are reliable but we have not independently verified them and cannot guarantee their accuracy or completeness.

The projections and forward looking statements in this section are not guarantees of future performance and actual events and circumstances could differ materially from current expectations. Numerous factors could cause or contribute to such differences. See "Risk Factors" and "Information Regarding Forward-Looking Statements."

Hungary and its Telecommunications Industry

Hungary

Hungary is located in Central Europe bordering on Austria, Slovenia, Croatia, Serbia, Romania, Ukraine and Slovakia. It has approximately 10.0 million inhabitants, approximately 1.7 million of whom reside in Hungary's capital, Budapest.

Since 1990, foreign direct investment into Hungary has been approximately €62.1 billion as of December 31, 2011. Hungary, Poland and the Czech Republic are the recipients of more than 50% of the total foreign direct investment into the former Communist countries in the region. Since 1995, the Hungarian government has embarked on an economic stabilization effort aimed at putting the economy on a sustainable path of low inflation growth. The unemployment rate decreased from 10.3% in 1995 to 8.0% at December 31, 2008; however, due primarily to the global economic crisis, the unemployment rate climbed back to 10.8% in December 2010. As of December 31, 2011 the rate of unemployment was 10.7%.

On May 1, 2004, Hungary joined the E.U., together with nine other countries. After several delays, currently no official deadline has been declared by the government regarding the adoption of the Euro as the currency of Hungary. Hungary joined the North Atlantic Treaty Organization in 1999. Hungary is also a member of the Organization for Economic Cooperation and Development and the World Trade Organization.

The following table sets out Hungary's annual GDP growth and inflation rates since 2006 according to the Hungarian Central Statistical Office.

	Annual GDP Growth Rate	Annual Inflation Rate
	%	%
2006	3.6	3.9
2007	0.8	8.0
2008	0.8	6.1
2009	(6.7)	4.2
2010	1.2	4.9

	Annual GDP Growth Rate	Annual Inflation Rate
	%	%
2011	1.7	4.1

History

In 1989, the Hungarian state owned Post, Telegraph and Telephone Company was divided into three separate companies: the Hungarian Broadcasting Company, the Hungarian Post Office and Magyar Távközlési Vállalat (the former Hungarian Telecommunications Operator which was privatized in 1992 and currently comprises Magyar Telekom, a subsidiary of Deutsche Telekom).

Pursuant to Act LXXII of 1992 on Telecommunications (the "1992 Telecommunications Act"), the Hungarian government divided Hungary in 1993 into 54 geographically defined concession areas for local public fixed line voice telephony services (each, a "historical concession area"). Although the concession regime of the 1992 Telecommunications Act was repealed by Act XL of 2001 on Communications (the "2001 Communications Act"), the currently operating telecommunications service providers are still the primary operators in those geographic areas of Hungary, which previously constituted their historical concession areas as defined by the 1992 Telecommunications Act.

In August 1993, the Ministry of Transport, Telecommunications and Water Management announced an international tender for the exclusive right to provide international and domestic long distance telephony services throughout Hungary and to provide local public fixed line voice telephony services in 29 out of the 54 historical concession areas, including Budapest. The Ministry selected Magyar Telekom as the winner of this tender.

In September 1993, the Ministry announced a second competitive bid for the exclusive right to provide local public fixed line voice telephony services in the remaining 25 of the 54 historical concession areas. The Ministry awarded 23 out of the 25 concession areas offered in the second tender. The right to operate 15 of those historical concession areas were distributed among 12 local telephone operators (each a Local Telephone Operator or "LTO"). Magyar Telekom, either directly or through predecessor companies, was awarded eight historical concession areas and additionally chosen as the default provider in two areas where there was no successful bidder. Each of the LTOs (including HTCC and the predecessors of Invitel ZRt and HTCC) received 25 year licenses to provide local basic telephony services with exclusive rights in their respective concession areas until 2002. Each of the LTOs other than Magyar Telekom negotiated a separate asset purchase agreement with Magyar Telekom to acquire each historical concession area's existing telephony plant and equipment.

The liberalization of the fixed line telecommunications market in Hungary could only be launched following the expiration of Magyar Telekom's exclusive right to provide national long distance and international telephony services in December 2001 and the expiration of each LTOs' exclusive concession rights in their respective historical concession areas in 2002.

In line with the E.U. regulatory framework on electronic communications, the 2004 Communications Act restructured the regulatory authorities responsible for the supervision of the liberalized telecommunications market, with the primary supervisory authority being the National Media and Infocommunications Authority (the legal successor to the National Communications Authority and the National Radio and Television Board) (the "NMHH").

Hungarian Fixed Line Telecommunications Industry

We are the second largest incumbent fixed line telecommunications operator with 14 of the above mentioned historical concession areas. In addition to us, the two other incumbent fixed line telecommunications services providers operating in Hungary today are Magyar Telekom and UPC Hungary:

- *Magyar Telekom*: Magyar Telekom is the largest provider of fixed line telecommunications services in Hungary. Magyar Telekom is the successor company of the former monopoly provider of long distance and international telephony services in Hungary, and the provider of local telephony services in 39 historical concession areas. Magyar Telekom has an estimated 64% national residential fixed voice and 36% internet market value share and an estimated 58% national market value share in the corporate segment. Magyar Telekom is listed on the Budapest Stock Exchange.

- *UPC Hungary*: UPC Hungary is a wholly owned subsidiary of Liberty Group, Inc., a global cable operator that operates within 15 countries, principally in Europe. UPC Hungary provides local telephony services in one historical concession area and through its cable network covers approximately 1,417 million homes where it provides internet and fixed voice services in addition to cable television.

The Hungarian Market

Fixed Line Voice

The fixed line telecommunications market in Hungary has been characterized by a decline in the number of subscriber lines in recent years. The penetration of fixed lines has fallen from a peak of approximately 38% in 2000 to approximately 29.45% as of December 2011 (expressed as a proportion of the overall population), primarily as a result of the rapid increase in mobile penetration from approximately 10% of the population in 1998 to approximately 117% in December 2011 (and the resulting migration of both residential and Business traffic from fixed to mobile networks) as well as increased competition from cable television operators (offering "triple play" packages comprised of television, internet and voice services). The fixed line penetration per household was approximately 60.9% in December 2011. However, in terms of subscribers, the contraction of the fixed line market has slowed as the mobile penetration growth has also slowed and broadband penetration has increased. The number of fixed lines decreased by 4.9% between December 2008 and December 2011, while the decrease in the mobile penetration rate was only 4.5% during the same period.

Internet

The most significant internet service providers in Hungary in addition to us are Magyar Telekom (through the T-Home brand), GTS Datanet, and Enternet, each providing both residential and business (DSL or leased line) internet services. Incumbent fixed line operators also benefit from the DSL wholesale services to reseller internet service providers. The importance of telecommunications traffic generated by dial up customers is marginal. As an alternative to DSL based broadband service, cable television based broadband access offers substantially the same speed and quality as the DSL technology, for a price comparable to DSL prices. Both Magyar Telekom (through its cable television business unit) and UPC, the two largest cable operators, offer broadband internet access services in certain parts of our historical concession areas. Although mobile internet services are often inferior to DSL technology in both speed and quality these services are also rapidly gaining popularity in Hungary, reaching a subscriber base of over 1.3 million subscriptions in December 2010 and over 2.1 million as of December 31, 2011.

Cable

Cable broadband is widely available in Hungary due to the reach of cable TV networks. Despite the strong competition from ADSL, cable broadband has retained its popularity. Access speeds offered by cable broadband ISPs have increased over the years as the technology platform with ADSL for new subscribers.

UPC Hungary launched cable broadband services in late 2000 and is the market leader. They offer eight tiers of broadband service with download speeds ranging from 1Mb/s to 120Mb/s. UPC Hungary launched DOCSIS3.0 services in mid-2009, with availability soon expanding to almost all two-way homes passed. The NMHH estimates that there were some 110,000 subscribers to DOCSIS3.0 by mid-2011.

Magyar Telekom also offers cable modem services through its T-Home brand, having approximately 200,000 cable broadband subscribers as of December 2011.

On February 28, 2011, we purchased Fibernet, Hungary's fourth largest cable network operator. As a result of the acquisition of Fibernet, Invitel entered into Hungary's cable market, significantly growing the Group's presence on the residential market.

Data

The provision of data services has been liberalized in Hungary since 1992, with no regulatory barriers to entering into the market. This factor, together with Hungary's expected economic growth and central location, attracted significant investment into the data communications sector. Not only did incumbent fixed line operators expand their existing networks but alternative service providers emerged and established backbone and access networks, providing both wholesale broadband data transmission and data services (including voice over IP) primarily targeting the lucrative business market in Budapest and in other large business centers in Hungary.

Alternative service providers typically benefit from the combined use of existing third party networks and state of the art new networks (typically optical fiber based) and agreements with international communications operators ensuring international traffic. Currently, the most important providers of data transmission services in Hungary other than us are Magyar Telekom, Antenna Hungária (a broadcasting company having a digital microwave backbone network), GTS-Datanet (an operator recently acquired by the Menatep group) and Magyar Villamos Művek ("MVM").

MVM received free network capacity for the National Telecommunications Backbone Network from December 2011, in order to pass towards the "e-Government Backbone Network". The purpose of the government is to create networks with standardized and streamlined operations, enabling significant cost savings in the management of government information technology.

Mobile

Hungary was the first country in Central and Eastern Europe to introduce public mobile telecommunications services. Currently there are three primary mobile operators providing mobile voice telephone services in Hungary, T-Mobile (a Deutsche Telekom affiliate operating since 1993, and consolidated into Magyar Telekom in 2005), Telenor Magyarország Zrt (a Telenor affiliate operating since 1993, formerly Pannon GSM), and Vodafone (operating since 1999).

The mobile communications market in Hungary is highly competitive and characterized by successive promotional campaigns and price competition. Historically, mobile telephony, due in part to limited fixed line penetration in the 1980s and early 1990s, increased rapidly in penetration in Hungary which has led to a mobile penetration rate which is significantly higher than that of fixed lines. Around 2006, mobile operators also introduced new tariff structures for voice (such as pre-payment) which proved to be successful with customers. The financial success of mobile operators has been further supported by the relatively high prices which they have been able to charge to fixed line operators for terminating voice calls originated on fixed line networks on their own networks. As of December 2011, mobile penetration was approximately 117% as compared with a fixed line penetration of 60.9%, each according to the NMHH.

Until November 2009, mobile virtual network operator ("MVNO") services were wholly absent from the Hungarian market. Magyar Posta ZRt, the Hungarian incumbent postal services provider, became the first MVNO in Hungary in November 2009, with the introduction of its "Postafon" mobile service through its MVNO cooperation with Vodafone. Mobile internet and data services are becoming popular with Hungarian subscribers, generating further competition among the mobile service providers and pushing the prices of mobile data services down. We also try to benefit from mobile services by cooperating with both Telenor and Vodafone, in the form of resale services, not as an MVNO.

In January 2012 a consortium of state-owned Magyar Posta Zrt, MVM and a unit of the Hungarian Development Bank has successfully bid for a 5MHz frequency block in the 900MHz band at auction, making it the fourth player on Hungary's mobile telecommunications market.The new service provider has until the end of the year 2012 to establish its network in the inner areas of Budapest and until the end of 2014 to bring services to localities with 30,000 or more residents.

Hungarian Regulatory Environment

Hungarian Regulatory Framework

The current regulation of the telecommunications services in Hungary is based on the 2004 Communications Act, which entered into force on January 1, 2004 and resulted in far reaching changes within the Hungarian telecommunications sector. The 2004 Communications Act was enacted in line with, and so as to implement, the E.U. electronic communications regulatory framework and to promote competition regarding the internet, universal service obligations, cost accounting, pricing, Carrier Selection, unbundling and number portability and to sufficiently address specific local issues.

The 2004 Communications Act fundamentally changed the structure of the regulatory authorities responsible for the supervision of the liberalized telecommunications market and designated the NMHH as the top supervisory authority in Hungary. The Act CLXXXV of 2010 on Media Services and Mass Media (the "Media Act") established NMHH as being responsible for overseeing both the telecommunications and media sector. The NMHH is an autonomous administrative body which reports to the Hungarian Parliament.

Since 2010, the Ministry of National Development handled all matters related to audiovisual policy, public administration IT, electronic communication of information, frequency management, information society and postal services.

Unlike the previous laws, the 2004 Communications Act adopted the general principle, accepted throughout the E.U. that the NMHH may only intervene into the telecommunications sector by way of issuing certain ex ante (forward looking) regulations, if competition in a specific telecommunications market was and was likely to remain ineffective in the absence of a direct regulatory intervention. Further, pursuant to the 2004 Communications Act, the right of imposing certain obligations upon telecommunications service providers on the retail market, such as price caps (except for Universal Service) has also been assigned to the NMHH. The 2004 Communications Act has vested significant regulatory powers into the NMHH to efficiently regulate the Hungarian telecommunications market.

In November 2007, the European Commission published a proposal package regarding the amendment of the 2002 regulatory framework, with the aim to further promote the single European market, modernize existing regulation and increase consumer benefits. The Council and European Parliament adopted a package of amendments to the 2002 regulatory framework in November 2009. The new rules were published on 18 December 2009 and were to be transposed into the Member States' national laws by 25 May 2011.

Hungary transposed the amended EU Regulatory Framework, "Better regulation" into the Communication Act which came into force on 3rd August 2011. Since then, the Ministry of National Development handles matters related to public administration IT, information society, universal and concession issues while NMHH handles matters including creation of execution decrees related to electronic communication of information, frequency management and audiovisual policy.

Market Analysis and Obligations

Pursuant to the 2011 Communications Act, the NMHH is required to conduct periodic market analyses to determine, in line with conventional competition law principles, whether a certain market is effectively competitive and, if not, to designate operators with SMP and impose certain forward looking obligations on them.

The 2011 Communications Act provides a list of obligations out of which at least one must be imposed on operators defined as having SMP by the NMHH. Such obligations refer to:

- transparency;
- non-discrimination;
- accounting separation;
- access to specific network facilities;
- functional separation; and
- cost orientation and price control.

The NMHH completed several rounds of market analysis with respect to 17 out of the former 18 electronic communication markets as defined originally in Decree 16/2004 issued by the Ministry of Informatics and Communications. According to the changes in the list of markets to be regulated, NMHH now conducts market analyses in respect of seven markets. We were found to have SMP in our respective historical concession areas and, as such, subject to certain obligations in the following markets:

Retail markets:

- Access to the public telephone network at a fixed location for residential and non-residential customers;

With respect to the markets regarding access to the public telephone network at a fixed location for residential and non residential customers, in September 2010, the NMHH imposed:

- a price cap on our services, which seeks to prohibit unreasonably high price increases;
- a non-discrimination obligation in respect of subscribers, in particular in respect of fixed term subscriptions; and
- Carrier Selection and Carrier Pre Selection obligations on us. The same obligations have been imposed on Magyar Telekom and UPC.

According to the work plans of NMHH, a launch of new market analysis is expected during 2012 in relation to the retail market for access to the public telephone network at a fixed location for residential and non residential customers.

Wholesale markets:

- Call origination on the public telephone network provided at a fixed location;
- Call termination on individual public telephone networks provided at a fixed location;
- Wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location; and
- Wholesale broadband access.

The NMHH has imposed an obligation for us to implement accounting separation (in order to enable the assessment of cross-financing between service lines) with respect to all the wholesale markets listed above.

With respect to the markets regarding call origination on the public telephone network provided at a fixed location and call termination on the public telephone network provided at a fixed location, the NMHH also imposed transparency (including the submission to the NMHH and publication of reference interconnection offers, ("RIO")), cost orientation, and access and interconnection related obligations.

With respect to the market regarding call termination on the public telephone network provided at a fixed location, we are also subject to non-discrimination obligations.

With respect to the markets regarding wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location and wholesale broadband access, the obligations imposed on us include transparency (requiring us to prepare and publish to the NMHH a reference unbundling offer ("RUO")), cost orientation, access (both copper and fibre network) related and non-discrimination obligations.

Regulatory Obligations Imposed on us in Hungary by the NMHH as a Result of the Market Analysis

Reference Interconnection Offer

The terms of our RIO are used whenever a telecommunications operator wants to interconnect with our telephone network in order to provide telephone service to our subscribers through Carrier Selection or Carrier Pre-Selection, or to terminate calls on our network. The parties may agree on the terms of the interconnection services that are not covered by the RIO.

Tariffs on interconnection traffic services (origination and termination) offered in the RIO are set by NMHH based on Magyar Telekom cost calculation model. NMHH 's goal is to harmonize the tariffs of services providers and to introduce symmetric fees within fixed network considering the COMMISSION RECOMMENDATION of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC).

Magyar Telekom is obliged to calculate the cost with a Top-down Long Run Incremental Cost ("TD LRIC") model with a current cost accounting approach. The reasonable profit is defined by a weighted average cost of capital figure of which the regulated percentage is 11.8%. The cost calculation must be approved by the NMHH, which has the right to overrule it if it finds that the calculation does not reflect the costs of an efficient operator. In such a case the NMHH may define the appropriate interconnection tariffs by benchmarking or using a bottom-up cost model.

Auxiliary services (such as interconnect link and co-location) offered in the RIO are also required to be based on cost plus a reasonable profit (based on a bottom-up cost model).

Invitel submitted new RIO to NMHH in September, 2011. The approval of NMHH is expected in April-May 2012.

Accounting Separation

The NMHH requires us to implement accounting separation on several wholesale markets (call origination, call termination, wholesale network infrastructure access and wholesale broadband access). We are required to prepare separate income statements, balance sheets and profitability calculations for both our retail and wholesale arms, and within the retail arm for certain retail services. Service transfers between the different business lines are required to be settled at the regulated price.

Our accounting separation model for 2010 was approved by NMHH. The procedure concerning the approval of our accounting separation model for 2011 is due to commence in the first half of 2012.

Reference Unbundling Offer and Wholesale Bitstream-access General Terms and Conditions

The terms of our RUO are used when another operator wants to rent the last mile of our copper based or fiber based network which connects the subscribers to the telephone network (Local Loop Unbundling ("LLU")). By renting the last mile of our network, alternative operators are able to provide telephone, broadband internet access and TV services without the need for significant investment in an access network. In addition, by using RUO services, alternative operators may develop complete triple play packages (TV, Internet, voice) which subscribers are able to pay for through a single bill issued by the alternative operators. In this case the incumbent operator does not have a direct contact with the subscriber. Alternative operators are able to use our backhaul network including dark fiber and duct to reach co-location points.

The RUO is required to include contractual terms for full and partial unbundling of the local loop and local bitstream access. The terms of the RUO must be approved by the NMHH.

The tariff on access services offered in the RUO must be based on cost plus a reasonable profit. The cost of the monthly fee for the LLU is calculated using a Top-Down Long Run Incremental Cost ("TD LRIC") model with a current cost accounting approach. The reasonable profit is defined by a weighted average cost of capital figure, of which the regulated percentage is 12.4%. The cost calculation must be approved by the NMHH, which has the right to overrule the results if the cost calculation applied by the operator does not comply with the related regulations. In such a case, the NMHH may define the appropriate access prices.

Auxiliary services offered in the RUO are also required to be based on cost plus a reasonable profit (based on a bottom-up cost model).

Our currently approved RUOs have been in place since April 1, 2012.

In the market for wholesale broadband access, the NMHH has also imposed on us the obligations of non discrimination, pricing regulation and transparency. In order to comply with these obligations, we must apply equivalent conditions to others in relation to the provision of wholesale broadband services as we do for our own retail services, or those of our subsidiaries or partners. Furthermore, we must provide national bitstream access, meaning that we must offer at least one access point through which all broadband subscribers of the alternative operators can be served. The tariff of single point bitstream service is calculated by a "retail minus" method whereby the NMHH defines the applicable retail margin, whereas we calculate our average retail prices. The wholesale tariffs are recalculated twice a year and, therefore, closely follow the retail price trends. The current tariffs were set by the NMHH based on market data for the first half of 2011, being effective as of December 1, 2011, until the next respective NMHH decision. The terms and conditions of contracts for the provision of local and single point bitstream access must be disclosed on our website in the form of wholesale bitstream access general terms and conditions.

Retail Price Regulation

In the retail markets for access, the NMHH imposed price caps on us, because, according to the NMHH, in the absence of competition only a safeguard cap over the subscription fee can avoid excessive price increases. The permitted price increase is the historical consumer price index minus 0%, which prohibits us from increasing our subscription fees over the rate of inflation. The historical consumer price index minus 0% price cap applies to all residential and business packages.

Retail Non-discriminatory Obligation

The NMHH imposed an obligation on us not to discriminate against subscribers without an economically justified reason. In particular, we are prohibited from applying conditions which restrict customers with fixed term subscriptions contracts to terminate such contracts or to change to other subscriptions before the expiry of such fixed term if such conditions are not justified or economically not proportional to the costs born or the benefits offered by us.

Call-by-Call Carrier Selection and Carrier Pre-selection

According to these obligations, we are to provide wholesale Carrier Selection and Carrier Pre-Selection services to any telecommunications provider who is eligible to sign an interconnection agreement with us based on our RIO, which sets the fees we are entitled to bill for such services. The calculation of such fees is part of the TD LRIC model and thus such fees are cost based and subject to the authorization of the NMHH.

Other Statutory Obligations Imposed on us in Hungary

Special Crisis Tax

In October 2010, the Hungarian Parliament passed a law imposing a special crisis tax on each of the retail, energy and telecommunications sectors, with the aim of restoring balance to the national budget. The special crisis tax was introduced with retrospective effect to January 1, 2010. The Government intended the special crisis tax to be a temporary measure only with the payment liability limited to the tax years 2010 to 2012, however, there is a possibility that this tax may be extended.

Telecommunications companies are liable to pay special crisis tax on their net sales revenue realized from providing electronic communicational services. The rate of special crisis tax payable is staggered with 0% payable on the part of the tax base between zero and HUF 100 million, 2.5% payable on the part of the tax base between HUF 100 million and HUF 500 million, 4.5% payable on the part of the tax base between HUF 500 million and HUF 5 billion and 6.5% payable on the part of the tax base exceeding HUF 5 billion.

There are special rules regarding the calculation of the tax liability of related parties. The taxable net sales revenue of related parties is added and the special crisis tax calculated on that consolidated amount. The total special crisis tax payment liability is borne by the related parties in line with the proportion of their net sales revenue in the total sales revenue.

The taxpayer must assess its tax liability and file a tax return with the tax authority within 150 days of the end of the tax year. Taxpayers must make advance special crisis tax payments in two installments, by July 20th and October 20th of the given tax year, based on the net turnover figures of their previous tax year.

Invitel and Technocom are subject to the special crisis tax. In 2011, Invitel and Technocom had a combined special crisis tax payment obligation of €10.9 million.

Number Portability

Since January 2004, all fixed line telephone service providers are required to ensure that their subscribers can keep their existing fixed telephone numbers when they change fixed line service providers. Porting may only be refused if an outstanding debt is associated with the user's account.

Universal Service Obligation

The 2004 Communications Act defines universal service as a set of basic communications services which must be made available to all customers at an affordable price. Universal service includes providing access to the fixed line telephone network at a specified minimum quality, operating public payphones with regulated density, issuing a public directory of subscribers, providing operator services, and providing free emergency calls.

We became a universal service provider in our historical concession areas on the basis of the universal service agreements (the "Universal Service Agreements") concluded by our legal predecessors with the legal predecessor of the Minister of National Development in 2002, which agreements were later revised to comply with the current E.U. regulatory regime. The Universal Service Agreements were concluded for a definite term expiring on December 31, 2008.

On December 19, 2008, the then active Minister heading the Prime Minister's Office unilaterally terminated negotiations on the extension of the Universal Service Agreements. The Government Decree No. 352/2008. (XII.31.) ("Government Decree") was adopted, under which the current universal service providers are obliged to provide universal services under unchanged terms and conditions for one year following the expiration of the Universal Service Agreements (i.e., until December 31, 2009). On

April 21, 2009, we submitted a petition to the Constitutional Court requesting that the Constitutional Court review the provisions of the above decree and declare them as void and thus not applicable.

On December 29, 2009, we executed a pre-contract outlining certain amended terms and conditions to the Universal Services Agreements. In July 2010, the Constitutional Court declared the Government Decree to be void with an effective date of December 31, 2010 and negotiations on the Universal Service Agreements were suspended. In March 2011, we agreed with the Ministry of National Development offered to conclude the Universal Service Agreement, valid until December 31, 2011 with an option to extend. In December 2011 the parties prolonged the Universal Service Agreement until December 31, 2013. The execution of the Universal Service Agreement is now in progress. Invitel is subsidized with approximately HUF 23 million (approximately €82 thousand) annually, the final settlement for 2010 is completed while the subsidy for 2011 is ongoing, the advance payment is received.

Price Regulation

Pursuant to regulatory burdens imposed by the NMHH and applicable law, we are currently subject to two retail pricing restrictions; (i) a price cap on universal access service, and (ii) a price cap over retail fixed line access services.

9. COMPANY HISTORY

In this section, we capitalize references to Residential Voice, Residential Internet, Cable, Corporate and Wholesale where and to the extent that the references are to our reporting segments in our consolidated financial statements prepared in accordance with IFRS.

Historical Information

Our predecessor company, Hungarian Telephone and Cable Corp. ("HTCC"), was incorporated in Delaware in 1992 as a holding company to acquire concessions from the government of the Republic of Hungary to own and operate local fixed line telecommunications networks in Hungary as Hungary privatized its telecommunications industry.

HTCC acquired the right to operate fixed line telecommunications networks in five historical concession areas from the Hungarian government and purchased the existing telecommunications infrastructure, including 61,400 telephone lines, from Magyar Telekom in 1995 and 1996. The acquired telecommunications infrastructure was outdated (manual exchanges and analog lines). HTCC overhauled the existing infrastructure with a major capital expenditures program. HTCC owned and operated all public telephone exchanges and local loop telecommunications network facilities in these five historical concession areas and were, until the expiration of its exclusivity rights in 2002, the sole provider of non-cellular local voice telephone services in such areas. The five Hungarotel historical concession areas covered a population of approximately 668,000 with approximately 280,000 residences. Until 2007, HTCC operated and marketed this business through its Hungarian subsidiary Hungarotel Távkozlési ZRt ("Hungarotel") which was merged into Invitel as of January 1, 2008.

The PanTel Acquisition

HTCC purchased an initial 25% interest in PanTel Távközlési Kft. ("PanTel") in November 2004 and acquired the remaining 75% from Royal KPN NV, the Dutch telecommunications provider ("KPN"), on February 28, 2005. PanTel was Hungary's leading alternative telecommunications provider with a nationwide fiber optic backbone telecommunications network linking every county in Hungary. PanTel provided voice, data and internet services to businesses throughout Hungary in competition with other telecommunications service providers including Magyar Telekom. PanTel's subsidiary, PanTel Technocom Kft, provided telecommunications services to MOL (a Hungarian oil company) and operated and maintained various parts of MOL's telecommunications network. As of January 1, 2008, we merged PanTel into Invitel and changed PanTel Technocom Kft's name to Invitel Technocom Kft.

PanTel was founded in 1998 by KPN, MÀV Rt. ("MAV"), the Hungarian state railroad company and KFKI Investment Ltd. (a Hungarian entity) to compete with Magyar Telekom. Following a tender process, the Hungarian government awarded PanTel licenses to provide data transmission and other services that were not subject to Magyar Telekom's government protected monopoly rights for long distance voice services. In 1999, PanTel began building, along MAV's railroad rights-of-way, a 3,700 kilometer-long state-of-the-art fiber optic backbone telecommunications network. PanTel also built metropolitan area networks, including a metropolitan area network covering Budapest, which networks connected to PanTel's backbone network.

The Invitel Acquisition

In 2007, HTCC combined its operations with Invitel following the acquisition of Invitel, on April 27, 2007, by way of the acquisition of the shares of Invitel's parent company, Matel Holdings (the "Invitel Acquisition").

Invitel began its operations in Hungary in 1994. Invitel initially owned and operated two Hungarian telecommunication companies which had the right to operate in four historical concession areas in the Csongràd and Pest counties (Szeged, Szentes, Gödöllő and Vác). In 1996 and 1997, Invitel developed its network infrastructure within those areas and in 1998 established a joint venture for the provision of data services in and out of its historical concession areas, especially in Budapest. In 1999, Invitel acquired Jásztel ZRt, a regional telephone operating company operating in the Jászberény historical concession area (east of Budapest). In the same year, Invitel also acquired Corvin Telecom Távközlesi ZRt., an optical network operator specializing in data transmission which allowed Invitel to further the development of its Budapest joint venture. In 2000, Invitel acquired four additional historical concession areas (Dunaújváros, Esztergom, Veszprém and Szigetszentmiklós) through the acquisition of United Telecom International B.V. from Alcatel of France.

In 2000 and 2001, Invitel developed the national coverage for its telephone network in Budapest and more generally outside its historical concession areas. In 2001, Invitel was granted one of five national 3.5 GHz licenses over which it has deployed its point-to-multipoint ("PMP") network. In the same year, Invitel also began its internet access activity nationwide.

During 2002, the exclusivity period ended in Invitel's concession areas. At this time, Invitel simplified its complex group legal structure. In May 2003, Emerging Europe Infrastructure Fund LP ("EEIF") and funds managed by GMT Communications Partner III LLP ("GMT") acquired the entire share capital of Invitel from Vivendi Telecom International S.A., and was subsequently renamed Invitel Távközlesi Szolgáltató ZRt.

On May 23, 2006, Invitel completed the acquisition of Euroweb International Corporation's two, internet and telecom related operating subsidiaries, Euroweb Hungary and Euroweb Romania (collectively, "Euroweb") which provided internet access and additional value added services including international/national leased line and voice services primarily to business customers. Euroweb Hungary was merged with Invitel in December 2007.

The Tele2 Hungary Acquisition

On October 18, 2007 HTCC purchased the Hungarian business of Tele2, the Swedish-based alternative telecom operator, by purchasing the entire equity interests in Tele2's Hungarian subsidiary. Tele2 Hungary provided Carrier Selection and Carrier Pre-Selection fixed line telecommunications services to residential customers as a reseller using the network facilities of other operators pursuant to regulated resale agreements. Tele2 Hungary merged with Invitel in June 2009.

The Invitel International Acquisition

On March 5, 2008, HTCC acquired 95.7% of the outstanding equity in Austrian-based Memorex Telex Communications AG and its subsidiaries (the "Invitel International"). On August 28, 2008, HTCC acquired the remaining 4.3% stake of Invitel International from the minority shareholders, which gave a 100% ownership. Invitel International was one of the leading alternative telecommunications providers in the Central and South Eastern European region. Invitel International provided wholesale data and capacity services to leading global telecommunications providers and internet companies between 14 countries in the region including Austria, Bulgaria, the Czech Republic, Italy, Romania, Slovakia, Turkey, and Ukraine. Invitel International operated over 12,500 route kilometers of fiber optic cable in the region which enabled it to provide high quality wholesale services to large international carriers. Invitel International and its subsidiaries, including Invitel International Kft, Invitel's international wholesale business, were sold on October 7, 2010.

Redomiciliation

In February 2009, HTCC completed a reorganization, whereby the Group effectively changed its place of incorporation from the United Stated to Denmark. The successor company to HTCC as a parent company of the Group became a newly established Danish entiry, Invitel Holdings A/S ("Invitel Holdings"). As part of the reorganization, all assets and liabilities of HTCC were transferred to Invitel Holdings and after the completion of the reorganization Invitel Holdings and its subsidiaries continued the same business as HTCC and its subsidiaries. See "*Liquidation of Holding Companies*".

The Acquisition by Mid Europa

In November 2009, Hungarian Telecom (Netherlands) Cooperatief U.A. ("Hungarian Telecom"), a company controlled by Mid Europa, became our controlling shareholder through the acquisition from TDC of 64.6% of the capital stock of Invitel Holdings. On November 27, 2009, Mid Europa completed the acquisition of an additional 9.8% of capital stock from Straumur—Burdaras Investment Bank hf., increasing their ownership interest to 74.4%.

On December 7, 2009, Mid Europa announced its intention to offer to purchase all of the remaining ordinary shares of Invitel Holdings (the "Equity Tender Offer"). As a result of the completion of the Equity Tender Offer on January 22, 2010, Mid Europa increased its ownership in Invitel Holdings to 91.78%. Mid Europa then acquired the remaining Invitel Holdings' shares in a compulsory acquisition procedure under Danish law.

Deregistration from Securities and Exchange Commission

On April 2, 2010 Invitel Holdings filed Form 15 with the United States Securities and Exchange Commission ("SEC") enabling Invitel Holdings to deregister from the SEC and to cease reporting under the Securities Exchange Act of 1934, as amended. Upon the filing of the Form 15, the obligation of Invitel Holdings to file periodic reports with the SEC under the Exchange Act was suspended immediately. The deregistration from the SEC was effective 90 days after the filing on July 2, 2010, after which date Invitel Holdings no longer had an obligation to file an Annual Reports on Form 20-F with the SEC.

The Sale of Invitel International

On October 7, 2010, we consummated the sale of Invitel International, the Group's wholesale business, comprising the entire issued share capital of Invitel International AG (including its subsidiaries), Invitel International Hungary Kft and S.C. EuroWeb Romania S.A., to Türk Telekomünikasyon a.s. ("Turk Telecom"). Invitel International included operations in Austria, Bulgaria, the Czech Republic, Hungary, Italy, Romania, Serbia, Slovakia, Slovenia, Turkey and Ukraine, but excluded our Hungarian domestic wholesale business. The purpose of the sale was to deleverage and focus on our core Hungarian domestic markets.

The Acquisition of Fibernet

On February 28, 2011, we consummated the acquisition of FiberNet Kft, the direct parent of FiberNet Zrt, Hungary's fourth largest cable network operator ("Fibernet"). In order to meet Hungarian competition office requirements relating to infrastructure competition, we simultaneously sold approximately one-third of the Fibernet network assets to UPC (the "Fibernet Disposal"). The Fibernet network we retained is located outside Invitel's historical fixed line concession areas. On September 30, 2011 Fibernet was merged into Invitel.

10. OUR BUSINESS

In this section, we capitalize references to Residential Voice, Residential Internet, Cable, Corporate and Wholesale where and to the extent that the references are to our reporting segments in our consolidated financial statements prepared in accordance with IFRS.

Overview

We are the second largest fixed line telecommunications services provider in Hungary and the incumbent provider of fixed line telecommunications services in our 14 historical concession areas, where we have a dominant market share of the traditional fixed line market. We are the number one alternative fixed line operator outside our historical concession areas. With the acquisition of Fibernet, the fourth largest cable netwotk operator in Hungary, in March 2011, we entered into the Hungarian cable market, where we provide services to residential customers outside our historical concession areas.

We also use our network capacity to transport voice, data and internet traffic for other telecommunications service providers and internet service providers on a wholesale basis.

Our historical fixed line concession areas are geographically clustered and cover an estimated 2.1 million people, representing approximately 21% of Hungary's population. Our extensive fiber optic backbone network (comprising approximately 8,500 route kilometers in Hungary) provides us with nationwide reach. It allows corporate and wholesale customers, in particular, to be connected directly to our network to access voice, data and internet services.

We operate in the following five market segments in our business:

- Residential Voice. We provide a full range of basic and value added voice related services to our residential and small office and home office customers both inside and outside our historical concession areas. These services include local, national and international calling, voicemail, fax, Integrated Services Digital Network ("ISDN") and directory assistance services.

- Residential Internet. We provide Digital Subscriber Line ("DSL") broadband internet services to our Mass Market customers both in and outside our historical concession areas. We also provide IPTV (TV delivered over DSL broadband connections) services to our Mass Market customers in our historical concession areas.

- Cable. We provide cable voice, broadband internet and TV services principally to residential cable customers outside our historical concession areas. We provice analogue and digital TV packages and offer the option for various premium channels. The broadband internet packages include 1Mbs, 6Mbs, and 10 Mbs options. In addition, we offer low-cost voice services on cable.

- Corporate. We provide fixed line voice, data, internet and server hosting services to our corporate (comprised of small and medium sized enterprises ("SMEs") and larger corporations), government and other institutional customers nationwide.

- Wholesale. We provide voice, data and network capacity services on a wholesale basis to a number of other telecommunications and internet service providers within Hungary.

Recent Developments

Post Balance Sheet Date Developments

Liquidation of Holding Companies

On March 12, 2012 the liquidation of Invitel Holdings was completed, when Invitel Holdings was deleted from the Danish Registar of Companies. After such liquidation, the ultimate parent company of the Group is HTCC Holdco I. B.V., one of the subsidiaries of Invitel Holdings.

On March 16, 2012 the liquidation of Matel Holdings N.V. was also completed, when it was deleted from the Registar of Companies in the Netherlands Antilles.

The Board of Director passed a resolution on the liquidation of HTCC Holdco I. B.V. on December 22, 2011. The liquidation process is expected to be completed in the second quarter of 2012. After the liquidation of HTCC Holdco I. B.V. and Matel Holdings, Matel will be the ultimate parent company of the Group.

Reorganization of Invitel Technocom

In March 2012, a reorganization affecting Invitel Technocom took place. A new company, MID-NEW Technocom Kft. was established by one of the directors of Mid Europa on March 8, 2012. Matel transfered 75% of its membership interest in Invitel Technocom to MID-NEW Technocom Kft.

Matel and MID-NEW Technocom Kft. accepted a revised Articles of Association of Invitel Technocom following the transfer of the membership interest due to the fact that Invitel Technocom became a two member company. According to the revised articles of association, only Matel is entitled to any distribution of dividends from Invitel Technocom and there is a restriction on the transfer of membership interest in Invitel Technocom whereby such transfer can not take place without the approval of Matel. In the revised Articles of Association it is stated that the profit and the retained earnings declared by Invitel Technocom with regards to the year ended December 31, 2011 shall be paid to Matel.

A Deed was concluded between MID-NEW Technocom Kft. and Matel, which contains (i) a put option, (ii) a call option, (iii) an assignment of dividends, and (iv) a lock up prohibiting MID-NEW Technocom Kft. from selling its shares without Matel's approval.

A loan agreement was concluded between MID-NEW Technocom Kft., as borrower, and Matel, as lender. This loan agreement provides for funds for the payment of the purchase price of the 75% of the membership interest in Invitel Technocom. Subject to the terms of the put and call option agreements the borrower shall repay the entire outstanding amount of the loan in one lump sum to the lender in March, 2062 or, if earlier, upon the borrower exercise of its put option right or the lender exercise of its call option right. Neither party is entitled to terminate, or, accelerate any amount independently from the option agreements.

Competitive Strengths

We are the number one national alternative fixed line telecommunications service provider in Hungary with a track record of increasing our market share.

We are the number one alternative fixed line operator in Hungary outside of our historical concession areas. We believe that we are well positioned to continue to grow our market share outside our historical concession areas particularly in our Corporate market segment through our owned backbone network, our experienced sales force and our comprehensive portfolio of services. Our backbone fiber optic network provides us with nationwide coverage, allowing us to directly connect to a high proportion of our

Corporate customers.

We have a strong cash generating incumbent business in Hungary.

We are the incumbent provider of fixed line telecommunications services in Hungary in each of our 14 historical concession areas, where we have a leading market share of the residential fixed line market. Our historical concession areas cover a population of approximately 2.1 million, representing 21% of Hungary's population. We believe that we have been able to maintain a leading position in these areas as a result of our incumbent status, high quality network, targeted service offerings and strong customer relationships. Our incumbent status, combined with low capital expenditure requirements and high gross margins, results in strong cash generation.

Diversified revenues and earnings base across four segments.

We have a diversified revenue and earnings base across four segments. For the year ended December 31, 2011, the Residential Voice, Residential Internet, Corporate, Wholesale and Cable segments each account for 26%, 17%, 32% , 17% and 9% of revenues and 28%, 17%, 30% , 17% and 8% of segment gross margin, respectively. We therefore are not overly dependent upon any one segment, and over time, in line with our strategy, the contribution from the traditional voice business segment has declined, and, we expect, will continue to decline in importance and it has been replaced by high quality data business.

We have an extensive, modern and high quality domestic network infrastructure in Hungary.

Our backbone network has nationwide reach, provides a high quality of service and does not require major capital investments. The national backbone network comprises over 8,500 kilometers of route fiber connecting our historical concession areas and all of Hungary's urban centers. As the incumbent operator in our historical concession areas, we benefit from an extensive access network in terms of both capacity and reach. We have the capability to provide DSL services on 95% of our copper access lines. In addition, currently we are able to provide IPTV on around 60% of our lines. Outside our historical concession areas, our network allows us to connect our Corporate customers to our backbone by using our own metropolitan fiber, point-to-point or point-to-multipoint microwave, unbundled local loops or leased circuits.

We have a substantial existing customer base, much of which is served by our infrastructure.

As of December 31, 2011, we had 301,000 Residential customers in our historical concession areas being served by our access network. In addition, we had 257,000 Residential customers outside our historical concession areas being served by Magyar Telekom's (the main incumbent operator) infrastructure. Following the Fibernet Acquisition, we now have an additional 88,000 Residential customers being served by our own cable access network. Furthermore, we have approximately 13,000 Corporate customers, the majority of whom are connected to our national backbone network or our historical concession access network. This substantial customer base presents an opportunity for cross-selling additional products and services.

We have comprehensive and well established national distribution channels and a strong national brand.

We have a well established and comprehensive set of effective distribution channels both inside and outside of our historical concession areas which enable us to optimize our customer acquisition costs and to respond quickly to changing market conditions. To market to residential customers, we have our own shops in our historical concession areas, and we also have our own in-house telesales team. In addition, we use independent third party direct sales agents, telesales channels and retail outlet partners. Corporate customers are addressed by our own national direct sales organization and telesales team.

We have worked to continuously improve the national brand recognition of Invitel. As a result of these efforts, together with selective marketing communications activity, we now enjoy strong nationwide brand awareness.

We have strong management and benefit from the added expertise of our majority shareholder.

We benefit from a strong and experienced senior leadership team, most of whom have served our business for over seven years. Our management has substantial mobile and fixed line telecommunications and cable services experience within the region and a proven track record of cost control and achieving operational efficiency. In addition, the team has extensive experience in both the Corporate and Residential segments. David McGowan, the Chief Executive Officer, has extensive and distinguished experience in the media and telecommunications industry and has previously held positions as chief executive officers in cable companies such as Cablecom and content providers. Robert Bowker, the Chief Financial Officer previously served as Chief Financial Officer at Eurotel Praha and has 14 years of experience in the financial services and telecommunications sectors within Eastern Europe. In addition, the Board of Directors has recently been augmented to include Bruno Claude, the former CEO of Cablecom.

Further, Mid Europa, the majority shareholder, has extensive experience as an investor in the telecommunications services industry and in infrastructure companies in Central and Eastern Europe. Mid Europa owns, or has owned, ten telecommunications assets in Central and Eastern Europe.

Our Strategy

Maximizing voice revenue and cash flow in our historical concession areas.

We intend to maximize our voice revenue and cash flow derived from the provision of voice services within our historical concession areas through the continued migration of customers from traffic-based to subscription-based packages with higher monthly fees and lower usage charges, the ongoing introduction of targeted, innovative and flexible service offerings and by maintaining the quality of our customer service. In addition, we have focused on, and will continue focusing on, formulating effective strategies to retain customers and defend against churn in our historical concession areas resulting from competition from cable operators and to a lesser extent Carrier Pre-Selection from Magyar Telekom. Examples of these strategies include:

- pricing our service offerings to limit the incentive to switch to a competitor;
- offering new commercial packages with a higher monthly fee but with bundled minutes included in the base subscription or with low call charges in all directions or various combinations thereof;
- launching win-back activities aimed at cable users and Carrier Pre-selection, Carrier Selection users with new promotional offers;
- establishing and developing loyalty programs, which will offer exclusive benefits to our customers;

- offering attractive bundled packages (voice and Internet and IPTV) to counter bundled service offerings by cable operators; and

- conducting programs to proactively migrate existing customers to more attractive packages via our telesales channels in combination with targeted promotional campaigns.

Capitalizing on growth opportunities for Residential DSL services, both in and outside our historical concession areas.

We believe that there is potential for further growth of DSL services in Hungary as personal computer and internet penetration levels in Hungary continue to climb towards Western European levels. Broadband internet usage has grown significantly in Hungary with penetration estimated to have increased from 0.7% of the households in Hungary as of December 2002 to an estimated 55% as of December 2011. In comparison, broadband internet penetration in Western European countries was estimated at approximately 60% of households as of December 2011.

We intend to continue to capitalize on the trend of increasing broadband usage by continuing to grow our DSL customer base both inside and outside our historical concession areas. We grew our DSL subscriber base 1% in 2011 while the market slightly declined in 2011. The growth in our DSL customer base is a key business priority as we believe it will increase line retention and stimulate fixed line revenue growth. For example, we have acquired the majority of new fixed line contracts through bundled voice/DSL offerings. We intend to continue to grow our DSL business principally through the following initiatives:

- the introduction of IPTV (in 2008) to enable us to offer triple play (telephone, broadband internet and TV) and dual play packages (broadband Internet and TV or telephone and TV) in our historical concession areas. As of December 31, 2011, we had 19,800 IPTV customers representing a penetration rate of 14.5% of our ASDL base in our historical concession areas;

- the launch of our "Net and Go" combined fixed ADSL and mobile broadband proposition in September 2009. This enables us to offer fixed broadband and mobile broadband in a single package all under the Invitel brand. This product was developed in cooperation with Telenor, the second biggest mobile operator in Hungary. As of December 31, 2011, we had 27,000 Net and Go subscribers;

- the use of unbundled local loops in Magyar Telekom's area to offer increasingly attractive and profitable higher speed internet and bundled voice/internet services;

- the use of WiMAX technology (and our existing 3.5 Ghz licenses) to provide broadband access in those historical concession areas where there is no copper network today;

- maintaining a broad mix of distribution channels such as our own and outsourced telesales, owned shops, third party channels and points of sale, and agent networks;

- quarterly promotions supported by targeted television, radio and billboard advertising campaigns; and

- developing innovative bundled packages together with progressively increasing broadband access speeds.

Expanding our Corporate segment revenue and market share nationwide.

We will continue to focus on expanding our business customer base and growing our share of the national Corporate market. We intend to capitalize on our extensive national backbone network, which means that in many cases business customers can be connected directly to our network, resulting in higher margins and more competitive pricing through lower access costs. Corporate customers can be connected directly to our backbone network mainly through the use of metropolitan fiber, line-of-site microwave, leased circuits or local loop unbundling. Lower value/volume business customers outside our historical concession areas are served through indirect methods such as Carrier Pre-Selection voice, and by buying DSL wholesale capacity from the incumbent. We plan to continue to increase our share in the business market through the following actions:

- focusing on new customer acquisitions in the small and medium enterprises market through attractively priced, easily understood, voice, data, internet and value added services, sold through an efficient direct sales organization and complemented by high quality customer care;
- capitalizing on our traditional strength in the high-end corporate market and utilizing our extensive infrastructure, to sell additional services to existing customers and to selectively pursue new corporate business and government sector customers;
- retaining existing customers through effective account management, attractive renewal packages and continued customer care enhancement, such as our "Top 100 Key Account program;"
- cross selling new services to existing customers in all segments; and
- the continued development of our service portfolio and the introduction of a broader range of value added services such as we have done with data center services including co-location services, server hosting and server virtualization services, and most recently software as a service.

Continuing to leverage our modern national backbone network and our market reputation to grow our revenue in the Wholesale data market.

We will continue to leverage our backbone network in Hungary, and our ability to easily add further capacity where required to sell infrastructure and capacity services to other service providers, including principally mobile operators and cable operators. We believe that the continuing growth in the fixed and mobile broadband markets will result in continued growth in the wholesale capacity market in the foreseeable future. We have developed a strong reputation for the quality of our service, our partnership oriented approach and our speed of execution in the Wholesale segment.

Pursue selective, value enhancing market consolidation driven acquisition opportunities in Hungary.

We believe that we are well positioned to participate in the further consolidation of the Hungarian market as a result of our market position as the number one alternative fixed line operator, our significant understanding of the competitive environment, both as an incumbent and as an alternative operator, and our solid track record of improving efficiency, achieving operating cost savings and realizing synergies from bolt-on acquisitions.

We intend to identify acquisition opportunities that can strengthen and compliment our existing business, and where we can enjoy the benefit of consolidation related synergies. In particular, we will focus on suitable acquisition opportunities, such as the acquisition of Fibernet, that extend our geographic area and infrastructure footprint in Hungary and which deliver cost synergies and enhance growth potential in TV and broadband particularly through cable outside our historical fixed line concession areas.

Historical Concession Areas

Through the Hungarian government's tender process and as a result of subsequent acquisitions, we acquired exclusive licenses to provide local fixed line voice telephony services within our 14 historical concession areas which were valid until the end of 2002. Since 2002, the provision of fixed line voice services has become liberalized, and while we can therefore no longer rely on legal exclusivity we continue to benefit from our extensive copper network that we had already constructed in our historical concession areas. Our historical concession areas are geographically clustered and cover an estimated 2.1 million people, representing approximately 21% of Hungary's population. We have developed a full range of telecommunications services in our historical concession areas where we have a strong presence in the Residential Voice, Residential Internet, Corporate and Wholesale markets.

Outside our historical concession areas, we have a national network which provides Corporate customers in Budapest and all other major urban centers with the ability to be connected directly to our network, enabling us to deliver voice, data and internet services, primarily through our PMP microwave networks and metropolitan fiber, or through unbundled local loops and leased lines. We also provide voice and internet services to Residential customers and lower-value Corporate customers outside our historical concession areas using Carrier Pre Selection, Carrier Selection, Wholesale DSL services and Unbundled Local Loop. With the acquisition of Fibernet, we are able to provide cable voice, briadband internet and TV services to customers in the Residential segment outside our historical conseccion areas.

Our Business

In our business, we operate in five market segments: Residential Voice, Residential Internet, Cable, Corporate and Wholesale. We are continually seeking to develop and improve our overall service through improving the quality of our customer care and developing new service packages and offerings.

Residential Voice

We offer our Residential Voice customers a full range of basic and value-added voice services, both inside and outside our historical concession areas. Our basic services in our historical concession areas include access to analog and ISDN2 lines for local, long distance, fixed to mobile and international calling, a full set of operator services, directory services and public telephones. Our value-added services include voicemail, a variety of special calling features such as call waiting, call forwarding and caller ID. New services include a variety of bundled voice, internet and IPTV packages.

Outside our historical concession areas, we provide a full range of basic and value added voice services to Residential Voice customers. We have been offering Carrier Pre-Selection based voice services since early 2002, after Hungary's telecommunications market was liberalized. We also have some Carrier Selection customers, mainly as a result of the Tele2 Hungary acquisition, but have focused primarily on Carrier Pre-Selection outside our historical concession areas, as we believe that Carrier Pre-Selection ensures a higher quality and sustainability of revenue than Carrier Selection. These services enable customers who have fixed line voice access provided by other operators (primarily Magyar Telekom) to use our voice services. Carrier Pre-Selection and Carrier Selection packages include call charges only, since the monthly access fees are paid to the incumbent provider. The acquisition of Tele2

Hungary in 2007 has added significantly to our Residential Voice customer base outside our historical concession areas. Outside our historical concession areas, we have focused principally on retaining and developing our higher value Residential Voice customers.

Residential Internet

We generate Residential Internet revenue inside our historical concession areas by providing DSL broadband access, internet and IPTV services over our own network. Outside our historical concession areas, we provide broadband internet services mainly by purchasing DSL services on a wholesale basis from the incumbent operator and acting as a third party internet service provider. Outside our historical concession areas, we also offer high speed internet access services using Local Loop Unbundling, in which case we rent the basic copper telephone line from the incumbent operator.

We provide this service on a flat fee basis at four different standard bandwidths (2 Mbps, 5 Mbps, 10 Mbps and 15 Mbps) inside and outside our historical concession areas.

In our historical concession areas we offer DSL through our own network. Substantially all of our network is already capable of providing DSL services. We expect revenue from DSL services to grow as the result of a number of factors, including:

- a gradual increase in personal computer penetration and demand for internet access in Hungary;
- continuous DSL development in new residential housing and other areas; and
- focused marketing campaigns that have previously proved successful.

In September 2009, we also introduced our "Net and Go", a combined fixed ADSL and mobile broadband proposition in our historical concession areas. This enables us to offer fixed broadband and mobile broadband in a single package all under the Invitel brand. This product was developed in cooperation with Telenor, the second biggest mobile operator in Hungary. As of December 31, 2011, we had 27,000 Net and Go customers.

Although we still have some dial-up access internet customers, we have stopped actively marketing dial-up access services. The number of our dial-up access internet customers has declined sharply since the beginning of 2005 and we expect that this product will continue to be used by only a small number of customers in the future. As of December 31, 2011, we had 8,900 remaining dial-up internet customers.

Cable

On February 28, 2011, we purchased Fibernet, Hungary's fourth largest cable network operator. As a result of this acquisition, Invitel entered into the Hungarian cable market, significantly growing the Group's presence in the residential market. We provide cable voice, broadband internet and TV services principally to residential cable customers outside our historical concession areas. We provice analogue and digital TV packages and offer the option for various premium channels. The broadband internet packages include 1Mbs, 6Mbs, and 10 Mbs options. In addition, we offer low-cost voice services on cable. As of December 31, 2011 we had 162,000 Residential customers being served on our cable access network.

In October 2011, we also introduced our "Net and Go", a combined fixed cable internet and mobile broadband proposition in our cable internet capable areas. This enables us to offer fixed broadband and mobile broadband in a single package all under the Invitel brand.

Corporate

We offer fixed line voice, data, internet, server hosting and other data center services to SME corporatees, larger corporations and governmental and other institutional customers nationwide. Our Corporate customers are defined as enterprises with over five employees. Inside our historical concession areas, we provide these services directly through our incumbent network. Outside our historical concession areas, we provide Corporate customers throughout Hungary with access to our voice, data and internet services by directly connecting them to our national backbone network by using our own PP and PMP microwave network, by metropolitan fiber or by using unbundled local loops or through leased lines. Outside our historical concession areas, we also provide lower-volume Corporate customers with voice services using Carrier Pre-Selection and DSL internet services by purchasing and reselling wholesale DSL services from the incumbent local telephone operator.

Our nationwide voice services include a full range of basic and value added voice services, including operator services, call waiting, call forwarding and toll-free numbers through analog PSTN, ISDN2, and ISDN30 connections both on TDM and IP technology.

Our nationwide Corporate data services include managed leased line services, IP-Virtual Private Network ("VPN") services, and national frame relay Asynchronous Transfer Mode ("ATM") services, which is a broadband, network transport service that provides an efficient means of moving large quantities of information. Our managed leased line service consists of PP leased lines which corporatees and institutions can use to establish direct digital connections between each other on a closed network, enabling the exchange of audio, data and multimedia files. We provide nationwide IP-VPN services from 64 Kbps to 1 Gbps. Our IP-VPN network uses Multiprotocol Label Switching ("MPLS") technology that allows unified, flexible, secure and value added voice, data and internet services. Our national frame relay service enables high-speed switched digital data communication and can transport voice and data at the same time.

Our nationwide Corporate internet services consist primarily of internet access services. Our internet access services are provided primarily through leased lines and DSL services nationwide. In addition, we have also started to bundle a mobile internet proposition using a re-sell model. Corporate DSL services are available in four standard bandwidths (2 Mbps, 5 Mbps, 10 Mbps and 15Mbps). We also offer Corporate customers the "IP Sec" feature, which allows Corporate customers to work from home via secure broadband internet access. We also offer server hosting and server virtualization services.

We offer these services individually or on a "bundled" basis to Corporate customers nationwide, including voice and internet packages for smaller enterprises and voice, data and internet packages for larger corporatees. We have introduced corporate loyalty programs under which we offer discounts on either the full portfolio or certain designated services, according to individual user profiles. We believe that these loyalty programs increase usage, decrease churn, and enable us to capture a higher proportion of our Corporate customers' expenditure on telecommunications services.

As part of our strategy of extending our service portfolio for Corporate customers, we also now provide a range of co-location, server hosting and rental, server virtualization, and data center outsourcing services based at our two flagship data centers in Budapest (which together comprise approximately 1,800 square meters).

Wholesale

We provide data bandwidth capacity, dark fiber and, to a small extent, voice services on a wholesale basis to other operators and service providers. These services typically generate revenue in the form of rental payments for capacity or managed bandwidth services (based on the bandwidth of the service and the distance between the endpoints of the customers), occasionally one-time payments for infrastructure sales, and traffic-based charges for voice transit services to and from other Hungarian and international telecommunication service providers.

Our Wholesale business consists of four product lines: providing managed bandwidth services; providing dark fiber; providing IP capacity; and providing wholesale voice services.

We provide managed bandwidth services with speeds up to 10 Gbps. This means, for example, that for a large telecommunications company, we can provide and manage the leased line connections to the endpoints of a network that they are providing to their corporate clients. We also provide lateral support services such as co-location and managed router services.

Providing dark fiber entails renting or selling fiber optic cables to cable television operators, mobile operators and government institutions, which enables these customers to manage their own networks. We provide co-location facilities in addition to repair and maintenance services to these customers.

Providing IP capacity entails providing connectivity to the internet at a guaranteed minimum bandwidth to internet service providers and cable television operators that provide internet services. The service provided is normally fully protected and routed on two independent routes back to "Tier 1" providers. Invitel has a direct Google peering too.

Our Wholesale voice services involve routing voice calls to worldwide destinations. Through our international partner (Invitel International Hungary Kft., now renamed Pantel International Kft following its sale to Turk Telecom) we have access to over 120 international connections to incumbent telecommunications services providers, alternative fixed line telecommunications services providers and mobile operators, enabling us to route calls for such providers globally. While Wholesale voice routing is a somewhat commoditized service (and accordingly less profitable), by providing this service to new operators in developing countries, we are able to establish relationships that often lead to more profitable mandates.

Pricing and Tariffs

Residential In-Concession

We charge our Residential Voice customers a monthly subscription fee and measured service fees for local, mobile, long distance and international calls. We generally charge our Residential Internet customers a monthly subscription fee.

Competition in the Residential Voice market in our historical concession areas from mobile operators and cable television companies, and to a lesser extent, the main incumbent (T-Home), has driven down the pricing of our Residential Voice service packages. We provide our customers with a variety of voice packages that provide customers with the flexibility to choose between different price options. For example, our customers can choose between packages with a higher monthly subscription fee bundled with cheaper off-peak calls or minutes included in the monthly subscription fee or more favorable tariffs in particular call directions. In order to ensure that our service offerings remain highly competitive, we introduce new packages for all markets on a regular basis. The overall effect has been to generally increase the proportion of revenue derived from monthly subscription fees, as opposed to revenue from individual call charges.

In addition to developing new pricing structures, we have initiated a bundling strategy. Our bundled offerings include extra voice minutes and internet access and/or usage in voice package monthly fees. These packages range from offers including dial-up minutes for entry level or low-end internet users to high-end packages with unlimited DSL access. Our sales strategies emphasize our new commercial packages with higher monthly fees but with local and off-peak calls included in the base monthly subscription fee or with low call charges. We often run retention programs with DSL access to keep our customers from switching to cable television operators. We also target residences that would perhaps not otherwise use our voice service by offering bundled voice and internet packages. We estimate that we currently achieve the majority of our new line subscriptions through bundled voice/DSL offerings. Since June 2008, we have also been offering IPTV services to customers in most of our historical concession areas, and have sold these services in all our historical concession areas since February 2009. "InviTV" is offered bundled with voice service and internet access as a "triple play" package, or with internet access as a "dual play package." In September 2009, we also introduced our "Net and Go" bundled Fixed and Mobile broadband product package.

Residential Out-of-Concession

Outside our historical concession areas, we offer Carrier Pre-Selection based voice services. While we have a limited number of Carrier Selection customers (principally as a result of the Tele2 Hungary Acquisition), we are not actively marketing that service and are attempting to convert those higher value Carrier Selection customers to Carrier Pre-Selection based services. For such services, we bill on the basis of usage (i.e. minutes), since the monthly subscription fees are paid by the customer to the incumbent provider to whose access network the customer is directly connected. Our pricing packages outside of our historical concession areas tend to be simpler, with less differentiation among types of calls.

With respect to the Residential Internet market outside of our historical concession areas, we charge a fixed monthly fee with no usage fee. We use different pricing points and promote bundled voice with internet services both in propositions on a wholesale basis (WS ADSL and CPS) and using unbundled local loop ("ULL") We face stronger competition in the Residential Internet market outside our historical concession areas, and accordingly, re-evaluate the pricing of our services on a regular basis to ensure they remain competitive by creating customized packages to differentiate ourselves from our competitors in categories and segments where we intend to increase market share.

Cable

We charge our Cable voice customers a monthly subscription fee. We generally charge our Cable TV and internet customers a monthly subscription fee.

We provide our customers with a variety of cable TV and internet packages and a cable voice package. Our price level is determined by the market and competition. In case of moderate or strong competition (against T-Home copper and against local providers) we can charge higher monthly fees. In case of extreme competition (against Digi and/or T-Home FTTx) we have to decrease our prices close to our competitors' price level.

We provide different monthly fees to the same package in case of one, two or three product subscription. The discount is being increased as more subscriptions ordered. Our goal is to provide multiple services instead of single play subscriptions.

To our existing customers we have cross sell, upsell, pro- and reactive retention price levels. We launch cross sell, upsell and proactive retention campaigns.

Corporate

In the Corporate market, we price voice, internet and data services individually or on a bundled basis driven by competition in the specific customer segment and access technology available to provide the required service.

We have been very successful in increasing our market share in the SME segment in the last few years by using targeted direct sales with tailored pricing and bundling data/internet access with voice services. With respect to large accounts, we compete with Magyar Telekom for a relatively low number of new customers in selected projects where pricing is determined by tenders. Our recently expanded server related services provides us with increased pricing flexibility in both standard bundled packages for small enterprises and customized solutions for larger customers.

We regularly adjust our pricing schemes and tools by monitoring our competition (mainly Magyar Telekom, GTS and UPC in the lower market segment). We price data, data related services and fixed line access on the basis of fixed monthly fees, with variable call charges for voice usage.

Corporate voice tariffs have decreased significantly since the beginning of 2004 as a result of increased competition from both fixed and mobile operators.

While monthly fees for corporate data and internet services show a year-on-year decline, higher usage in terms of data and associated increased bandwidth requirements present opportunities of pricing new service features in bundled offers.

Wholesale

For managed bandwidth services, we charge our customers a fixed monthly fee for a guaranteed minimum bandwidth along with a service agreement.

To the extent we provide dark fiber, we generally charge either a monthly fee on a per kilometer basis, or alternatively, a one-off outright sale charge. Customers often require us to extend our backbone network directly to their premises or to another city or, in the case of mobile operators, to one of their central switching locations. We generally charge our customers a one-time fee for extending our network to meet such requirements.

For IP capacity services, we generally charge a monthly fee based on a guaranteed minimum bandwidth along with a service agreement. Customers can also pay for a committed amount of bandwidth and purchase supplemental bandwidth, if available, as needed.

For Wholesale voice services, we generally charge our customers a variable amount based on the length of the call, the time of day and the destination.

Interconnection

A small portion of our revenue and a substantial portion of our cost of sales are made up of interconnection fees. Interconnection fees were introduced to ensure widespread provision and interoperability of telecommunications services. Operators of public telecommunications networks have a right and, when requested by other operators, an obligation to interconnect their networks to each other. This interoperability enables customers to choose any telecommunications services provider and place and receive calls from all other service providers. The telecommunications services provider that provides the initial connection and the telecommunications services provider that terminates the call, as well as any telecommunications services provider that transports the traffic between the two, share in the revenue collected from the call. Interconnection charges, like retail voice tariffs, are often dependent on the time of day that the call is placed, the length of the call and the distance covered. The settlements are coordinated through wholesale arrangements and the fees are largely regulated. See "— *Our Network — Interconnection Agreements with Other Operators*."

We receive per minute call termination fees for completing calls to our customers who are directly connected to our network. These fees are passed to us from other telecom operators (fixed line, mobile, cable television operators, whether within or outside Hungary). We receive fees with respect to all of our directly connected customers, whether within, or outside, our historical concession areas. In our historical concession areas, our customers are directly connected to our network. Outside our historical concession areas, customers are connected to our network through a PP or PMP wireless connection, metropolitan fiber, a leased line, Local Loop Unbundling or over WiMAX.

We pay per minute call termination fees to other telecom operators for completing calls originating from our customers (including any of our directly connected voice customers, our customers using Carrier Pre-Selection and Carrier Selection services outside our historical concession areas and our wholesale carrier customers) to customers who are directly connected to the network of other telecom operators (fixed line, mobile or cable television operators, whether within or outside Hungary).

We receive per minute call origination fees when any customer who is directly connected to our network elects to use a competing fixed line telecommunications services provider to make outgoing calls through the use of either Carrier Pre-Selection or Carrier Selection (in these cases we still collect a monthly subscription fee from the customer for the use of our fixed line connection).

We pay per minute call origination fees when a customer who is directly connected to another Hungarian fixed operator's network, elects to use our service to make outgoing calls through the use of either Carrier Pre-Selection or Carrier Selection (in these cases, the operator to whose network the customer is directly connected still collects a monthly subscription fee from the customer, for the use of the fixed connection). See "*Hungarian Telecommunications Industry and Regulation — Hungarian Regulatory Environment*."

Local Loop Unbundling Fees

When we connect a customer to our network through a Local Loop Unbundling arrangement, we rent the connection to the customer from the incumbent local operator for a monthly fee. We then collect from our customer a monthly subscription fee and a traffic fee for service or a bundled fee. The incumbent operator loses the billing relationship with the customer. Conversely, when a competitor comes into one of our historical concession areas and connects a subscriber to their network through a Local Loop Unbundling arrangement with us, we receive a monthly fee for allowing the competitor to use the telephone line that we own and we loose the direct billing relationship with the customer. See "*Hungarian Telecommunications Industry and Regulation — Hungarian Regulatory Environment*."

Our Customers

As of December 31, 2011, we had approximately 301,000 Residential Voice telephone lines within our historical concession areas and we had approximately 257,000 Residential Voice telephone lines outside our historical concession areas connected primarily through Carrier Pre-Selection and Carrier Selection. As of December 31, 2010 we had approximately 327,000 telephone lines in service within our historical concession areas to service Residential Voice customers, and approximately 292,000 active Residential Voice customers connected through indirect access and LLU outside our historical concession areas, respectively. This decrease in the number of active Residential Voice customers both in and outside our historical concession areas is due to the gradual decline in the overall fixed voice market. The rate of decline is lower in our historical concession areas as we provide service on our own infrastructure, face less competition and are able, in many cases, to offer triple play bundles. The rate of decline has increased slightly during 2009 and 2010 as a result of general economic conditions but showed a slowing decline during 2011.

As of December 31, 2011, we had approximately 150,000 Residential broadband DSL customers, of which approximately 120,000 were connected directly to our networks within our historical concession areas and 30,000 were outside our historical concession areas and serviced principally by our purchasing wholesale DSL services from the incumbent local telephone operator (primarily Magyar Telekom). This compares to December 31, 2010 when we had 151,000 Residential broadband DSL customers. The lower growth reflects the fact that during the last year, as a result of the economic conditions, there has been no growth in the ADSL market. The number of IPTV customers has increased to approximately 20,000 as of December 31, 2011.

Since the acquisition of Fibernet, we have an additional 162,000 Residential customers being served on our cable access network.

As of December 31, 2011, we had approximately 13,000 Corporate customers. We had approximately 41,000 voice telephone lines within our historical concession areas serving Corporate customers compared to approximately 42,000 lines as of December 31, 2010. Outside our historical concession areas, we had approximately 40,000 direct access voice telephone lines and approximately 7,000 indirect access voice telephone lines as of December 31, 2011, compared to approximately 43,000 direct access voice telephone lines and approximately 8,000 indirect access voice telephone lines as of December 31, 2010. We had approximately 14,000 DSL lines and approximately 16,000 leased lines as of December 31, 2011 compared to approximately 15,000 DSL lines and approximately 16,000 leased lines as of December 31, 2009.

In the Wholesale market, we had approximately 250 customers as of December 31, 2011 which was consistent with our customer base as of December 31, 2010. Customers include fixed line telecommunications services providers, mobile operators, cable television operators and internet service providers.

Our Sales and Distribution Channels

Residential

In our historical concession areas, our Residential sales channels include walk-in shops, point-of-sale reseller and partner shops, independent third-party sales agents, our own telesales operations and our internet web site. We manage 18 walk-in shops in our historical concession areas. Our services are sold to Residential customers outside our historical concession areas through a non-exclusive network of agents and point-of-sale reseller and partner shops and our own and outsourced third-party telesales operations.

Corporate

Our direct sales force of 45 direct sales executives and approximately six key account managers is our primary Corporate sales channel. Key account managers are responsible for managing the relationship with and developing corporate with our top 100 larger corporate customers. Our sales executives are responsible for successful contract renewals, selling new services to our existing customers and for driving new corporate acquisition primarily in the SME market. This group also works with a specialized telesales group for contract renewals, appointment setting, and sales to lower-end SME customers.

We also use agents and resellers as indirect sales channels, which allows us to expand the geographical range of our Corporate sales and improve our coverage of the small enterprise market. In the case of contracts originated by our resellers and strategic partners, we become the contracting party and the exclusive owner of the customer in respect of the telecommunication services.

Wholesale

We have a dedicated business development and sales staff that focuses primarily on marketing our managed bandwidth IP capacity and dark fiber services throughout Hungary to mobile operators, cable television operators and internet service providers.

Our Network

Overview

Our telecommunications network is comprised of our original network in the Hungarotel historical concession areas, the national backbone network and access networks that we added when we acquired PanTel in 2005, the network we added through the acquisition of Invitel in 2007 (which consisted of the network covering the Invitel historical concession areas as well as a national backbone network) and access networks covering many of Hungary's urban centers. In 2011 we acquired Fibernet and added HFC (Hybrid Fiber Coax) network to our existing network. Today our telecommunications network consists of a national backbone network and access networks throughout Hungary.

Backbone Network

Our national fiber network comprises approximately 10,000 route kilometers of fiber (8,500 route kilometers in the backbone and 1,500 route kilometers of access network) with points of presence in Budapest and more than 40 urban centers across Hungary. Our network carries traffic between the major cities of Hungary, provides connectivity to and within our historical concession areas, connects major urban business centers outside our historical concession areas and provides international connectivity. Our backbone network consists of fiber rings that management believes are on par with Western European digital network standards and has been designed for an open architecture using Synchronous Digital Hierarchy ("SDH"), IP and DWDM technologies.

Access Networks Inside Our Historical Concession Areas

Within our historical concession area (which covers approximately 21% of Hungary's population), we have versatile modern telecommunications networks. The networks are designed to offer voice and broadband (DSL, GPON) services to substantially all of our customers as well as data services to our Business customers. The network is based on a combination of copper lines, wireless technologies and fiber optic cable for certain major customers.

Access Networks Outside Our Historical Concession Areas

Point-to-Multipoint Networks. We have developed the largest PMP radio system in Hungary in the licensed 3.5 GHz frequency band. By covering Budapest, all major urban centers and ten other smaller cities outside our historical concession areas, we have gained a competitive advantage by creating an alternative access network independent of Magyar Telekom's local loops. These networks enable us to deliver a full complement of managed voice, data and internet services to our Business customers.

Point-to-Point Networks. We use PP microwave radio to provide high bandwidth connections to corporate clients and, to a lesser extent, for backhaul transmission (connecting our core network with small sub-networks) to interconnect PMP sites to our network. The majority of our PP sites have been deployed in Budapest. We have installed more than 2,850 PP links to date for connection to corporate clients and approximately 20 links to provide connections between PMP and PP sites.

Metropolitan Areas Networks ("MANs"). In addition to the PMP and PP networks, we operate approximately 1,500 route kilometers of MANs in Budapest and eight of the urban centers outside our historical concessions areas. Our MANs provide a direct link between our backbone network and access network (e.g. radio (PP and PMP) base stations and xDSL). This allows the city rings to be fully integrated in a seamless manner with our overall network. Each MAN is built with fiber cable technology which is essentially the same as that used for our backbone network. Our Budapest MAN consists of more than 1,000 route kilometers and passes through areas of the capital with significant business potential.

Cable (CMTS) and Wi-Fi Internet Network The networks are designed to offer voice and broadband (CMTS and Wi-Fi) services to substantially all of our customers as well as our residential customers. The network is based on HFC wireless technologies.

The networks which we operate outside our historical concession areas also include network lines which we lease from other telecommunications operators and unbundled local loops (Local Loop Unbundling). This enables us to reach a wider geographical area beyond the coverage of our PMP and PP networks and MANs over which we have control. Local Loop Unbundling also provides us with a lower cost option for directly connecting smaller business customers. We have approximately 10,000 customers connected through Local Loop Unbundling, with 13 Local Loop Unbundling sites in Budapest and 10 Local Loop Unbundling sites outside of Budapest. In addition, we have 30 WiMAX base stations in Hungary to provide alternative low cost access methodology to directly connect principally smaller business and residential customers.

Switched Voice Network

We have deployed a fully digital switching network hierarchy. A total of 19 exchanges have been deployed in a hierarchical network. Local Exchanges handle the interconnection of customer lines and the switching of local traffic while the Primary Exchanges handle traffic for other areas. Secondary Exchanges provide the transit functionality for switching traffic between different regions. Secondary Exchanges also handle the interconnection of Business voice traffic from outside our historical concession areas. The International Gateway Exchange is the point of interconnection for all international traffic, secondary exchanges and is the point of interconnection for all national and mobile traffic in our network.

Data and Leased Line Network

Multi-service network. We have deployed an extensive multi-service network to provide advanced IP based services to corporate, SME and internet service provider clients. The range of services includes IP and Ethernet based VPN, Layer 2 Ethernet ("L2E"), virtual dial-up networks, VoIP, internet access, VLAN and Extranet services. This enables us to provide tailored services to meet the customers' needs. This multi-service network has been deployed throughout Budapest, our historical concession areas and major cities in Hungary. There are 28 main nodes that are interconnected by a 10 Gigabit Ethernet network which also extends nationally to the main centers in our historical concession areas. The smaller nodes are connected in a star or mesh configuration.

Managed leased line network. The managed leased line network provides "last mile" access to leased line customers. The extensive network provides multiple points of presence for managed leased line services. It also provides cross-connect capabilities to enable leased line networks to be remotely reconfigured. Leased Line services are provided through fiber, PP and PMP networks in more than 40 cities outside our historical concession areas.

Both the multi-service and the leased line networks are designed to offer capacity and flexibility for the positioning of advanced data and leased line services.

CaTV Head Ends

We have 72 head ends for Cable TV serving 111 settlements outside our historical concession areas.

Datacenter

In the first quarter of 2009 we opened a new datacenter in Budapest which services an area of 1,500 square meters. This datacenter has large telecommunication capacities and resilience with multiple, independent optical connections to both the national and the Budapest regional backbone network and also direct connections to the bigger internet junctions such as the Invitel "Ilka Datacenter", BIX, Infopark and Dataplex. The datacenter is able to provide services including rented server, virtualization, collocation, server hosting services.

Interconnection Agreements with Other Operators

We have interconnection agreements with each of the major Hungarian fixed line, mobile and alternative operators, including, among others, Magyar Telekom, UPC Hungary, T-Mobile, Telenor, Vodafone and GTS. The objective of these interconnection agreements is to enable the parties to access each other's networks and terminate traffic originated in the other party's network, which enables the two operators' customers to connect with each other. These interconnection agreements are typically for indefinite terms and are based on, or incorporate the terms of, our reference interconnection offers ("RIOs"). If the other interconnection party is considered to have significant market power, then typically the terms of the other party's RIO are also incorporated. See "*Hungarian Telecommunications Industry and Regulation — Hungarian Regulatory Environment*" and "*— Pricing and Tariffs — Interconnection*."

We also have an interconnection agreement for international traffic with Pantel International. This voice interconnection agreement relates to the interoperability of the networks and the provision of mainly reciprocal international voice carrier services. Under this agreement, we are purchasing from and providing for other telephone operators voice hubbing (i.e. collection of voice traffic), transit and call termination services in the most favorable directions at the best possible fees.

Network Access Agreements with Internet Service Providers

We have wholesale agreements with various internet service providers under network management agreements enabling them to provide Mass Market Internet and Business Internet services. These agreements provide for DSL broadband Internet access through our networks. See "*Hungarian Telecommunications Industry and Regulation — Hungarian Regulatory Environment.*"

We have been a DSL services provider in our historical concession areas since 2001. We offer DSL services in our historical concession areas on a wholesale basis, mainly to Magyar Telekom (for the sale of products under its T-Home brand) and Enternet.

Outside our historical concession areas, we have network access agreements with Magyar Telekom and UPC Hungary for DSL services and dial-up access.

Additionally, in the Domestic Wholesale market, we act as a nationwide internet service provider and purchase international peering services primarily through Pantel International. We also have direct peering with Magyar Telekom, DIGI and Google to exchange direct traffic.

Network Management

We monitor our voice network with continuously running systems, which has enabled us to improve our quality of service to an average fault rate per month which was below 0.0054% in 2010, which we believe is comparable to European benchmark operators and is significantly better than the threshold imposed by the Hungarian regulatory authorities. Monitoring provides us with the proactive management ability of network/service failures, allowing us to provide a high, guaranteed level of service availability, which is particularly important to and valued by our Business customers.

The backbone and access networks are monitored via various management systems (including Alcatel NM, Tellabs Network Manager and Newbridge NMS).

We also constantly monitor our IP network using the IBM Tivoli Netcool//OMNIBUS network management system. This platform provides integrated management of our operation and maintenance processes by our centralized network management staff and significantly reduces our network operating costs. These network monitoring systems, which also have back-up facilities, are located at our Service Management Center near our corporate headquarters in Budaörs near Budapest and can be accessed from other locations on our network.

In addition, we monitor customer service level agreements to ensure that we apply the appropriate priority and escalation levels to customer service calls logged.

Our Competition

In Hungary one of our most significant fixed line competitors is Magyar Telekom, the largest provider of fixed line telecommunications services in Hungary, with its historical concession areas covering an estimated 77% of Hungary's population. Inside our historical concession areas, T-Home is a cable and a CS/CPS service operator in one piece, besides in certain larger settlements the major Hungarian cable TV operators, UPC and Digi are even more powerful operators, finally on the top of that in smaller settlements there smaller, more local and less competitive local cable service operators.

Residential Voice

In the Residential Voice market in our historical concession areas, the competitive positioning is mainly based on perceived value added of bundled product offerings and price. Outside our historical concession areas, price is the main basis for competition. Regarding residential voice, we face three main challenges: the competition from mobile voice, cable and VoIP operators.

Mobile substitution has still been an existing phenomenon on this market however it shows a decreasing tendency. We compete with mobile network operators, both in and out of our historic concession areas. The mobile subscriber base in Hungary has grown rapidly since the 1990s, partly due to low pre-existing levels of fixed line penetration. As a result, the mobile penetration rate in Hungary is approximately 117% of the population as of December 31, 2011, according to the NMHH and the number of mobile subscriptions is more than three times the number of fixed lines (2.99 million fixed line voice channels including copper and cable as of December 31, 2011 according to the National Communications Authority report). Mobile telecommunications services have contributed to the decline of the fixed line subscriber base and have led to fixed-to-mobile churn. Whilst fixed to mobile line churn has slowed in recent years, there is still traffic churn to mobile. Despite the negative trend of voice markets, declining mobile and fixed accesses, shrinking values of markets, it is interesting to see that the overall volume of the voice traffic has not gone the same path even more the mobile and fixed voice traffic volume was able to grow last year, compared to 2010.

Cable Voice is at least as significant, if not more significant a competitor than mobile substitution by now. We have seen increased competition from cable television operators both in and out of our historic concession areas. Cable companies can effectively cross-finance services (TV, internet and voice services) in product offers, enabling them to aggressively price and market the voice portion of their product offering. The cable television operators' unique selling points are their low monthly fees for voice and free calls inside their own network. However, the Hungarian cable market is still rather fragmented and cable competitors impact our corporate differently in each of our historical concession areas. The principal cable television operators we compete with in our Residential Voice market are UPC Hungary, Magyar Telekom (through the T-Home brand) and Digi, each of which have introduced triple play solutions in our historical concession areas, and which collectively cover around 58% in our historical concession areas. In total, cable accounts for around 16% of all voice channels in Hungary.

CS/CPS competition has lost its weight, by now only approximately 1% of the fixed voice market value generated in this segment. In our historical concession areas, our fixed line competitors may offer voice services on a Carrier Selection basis or on a Carrier Pre-Selection basis although this has significantly reduced as a competitive threat during the last few years. Outside our historical concession areas, we compete with the main incumbent network operator as well as with other cable and mobile operators. In the past, we have focused mainly on providing Carrier Pre-Selection based voice services outside our historical concession areas. We also acquired a significant Carrier Select customer base at the time we acquired Tele-2 in Hungary in 2007. However, we now mainly focus on selling CPS voice bundled with broadband internet access, and, where possible, migrating higher value dual play customers onto ULL access.

We also face some competition from providers of VoIP services such as free Voice over Internet solutions (e.g. Skype) or via professional niche VoIP operators, although this constitutes a very small part of the market. At the moment approx. 3% of the fixed voice market value generated in this segment. We are also marketing VoIP services.

Residential Internet

Hungary enjoys a relatively high internet usage level with broadband representing the majority of internet connections. Competition is both infrastructure and regulatory-based, with the latter made viable due to the regulator's actions to promote competition. DSL and cable are the two most popular broadband platforms. Competition and the demand for bandwidth are pushing the drive for higher speed platforms, such as FTTx and DOCSIS 3.0 for existing CATV networks.

In our historical concession areas, we principally compete with cable television network operators such as UPC Hungary, Magyar Telekom (through the T-Home brand) and Digi, which utilize their cable networks to provide broadband internet services and VoIP bundled together with analogue or digital TV. Competition in this market is primarily on the basis of price, speed of access and brand. We also compete to a lesser extent with internet service providers which buy ADSL wholesale from us. However, this source of competition is declining.

In our historical concession areas, we are able to offer DSL broadband services to substantially all of our fixed line customers, which gives us a strong competitive position in these areas. Since February 2009, we have been offering IPTV services over broadband DSL to customers in approximately 60% of our historical concession areas as part of “triple play” and “dual play” offerings. In September 2009, we also introduced “Net and Go”, a combined fixed ADSL and mobile broadband proposition in our historical concession areas. This enables us to offer fixed broadband and mobile broadband in a single package all under the Invitel brand. This product was developed in cooperation with Telenor, the second biggest mobile operator in Hungary.

Outside of our historical concession areas, we are competing with cable operators and the main incumbent fixed line operator (Magyar Telekom). We provide DSL based broadband internet services principally by buying the service on a wholesale basis from the incumbent operator and bundling it with CPS voice. In some cases, we provide this service through Local Loop Unbundling (“LLU”) and we expect our use of this technology to continue to increase in the future.

By 2012 the mobile broadband has become a feasible proposition, following substantial investments in 3G technology, despite lower transmission speeds than fixed-line broadband access platforms. Mobile broadband services are accessible via data-cards, USB keys and internet-enabled 3G handsets. As mobile broadband is still primarily a 3G handset solution, we can forecast for the close future that fixed broadband connections will not be replaced by the increasing prevalence of mobile broadband, given the different user experiences and applications that each can offer.

Cable

In the case of our Cable internet services, we principally compete with cable television network operators such as UPC Hungary, Magyar Telekom (through the T-Home brand) and Digi, which utilize their cable networks to provide broadband internet services and VoIP bundled together with analogue or digital TV.

We also compete with Magyar Telekom providing copper voice, ADSL and Satellite TV services under the T-Home brand. This is a competition both inside and outside our historical concession areas.

Our main competition inlcude the local cable TV providers. In this group there are mainly small local operators who provide cable TV, cable internet and cable VoIP services. The price level of the local providers is similar to T-Home copper, but because of the local presence, they represent stronger competition on local level.

There are also so-called extreme competitors on the market, such as Digi (with TV, internet and voice products) and T-Home FTTx (with IPTV, high speed internet and voice services), charging extremely low prices. Due to this fact, the acquisition of new subscribers on their areas (larger cities with high purchasing power such as Kecskemét, Baja, Cegléd) is challenging.

Corporate

Including mobile operators, Invitel is the third largest operator in the Corporate segment, The market leader, T-Systems still holds 58% of the total market, followed by Telenor (15%) and Invitel (10% of total market value).

Our main fixed line competitor in the Corporate market is Magyar Telekom, T-Systems and to a lesser extent, GTS. The basis of competition includes network reach, proximity to customer premises, price and customer service. Operators who rent networks from the incumbent provider cannot compete as effectively as those with direct network presence in the area. Margin per customer is closely correlated with how much capacity is provided or how much traffic is carried on our own network infrastructure.

We believe that our national network, as well as our modern data center facilities, gives us a strong competitive position when selling voice, data, internet access, and data center services like server hosting to Corporate customers throughout Hungary. In most urban centers, we have a point of presence on our own fiber optic backbone network and, therefore, are able to connect customers directly to our backbone network using our metropolitan fiber, line of sight microwave, Local Loop Unbundling or leased lines. We are also deploying WiMAX technology in certain areas as another method of directly connecting corporate customers to our backbone network.

We also compete with the mobile operators who target corporate customers, which has led to substantial fixed-to-mobile traffic substitution in the Corporate voice market.

Wholesale

Inside our historical concession areas, we currently experience limited competition for Wholesale services because these services are typically provided by the primary incumbent local telephone operator. Outside our historical concession areas in Hungary, our competition is comprised primarily of the incumbent operators, mainly Magyar Telekom as well as MVMNet (a newly established government owned telecommunication provider), Antenna Hungaria (the national broadcast company) which provides smaller bandwidth services over microwave and GTS.

Billing and Customer Care Software Systems

We currently operate on a single monthly billing period. At the end of each billing period, our usage traffic generating external systems transfer metered data to the billing systems and an update is prepared for the general ledger. The majority of printing files of billing systems are sent to a third party for printing and another third party for distribution. The vast majority of our residential customers pay their bills through the Hungarian Post Office's third party payment system. Under this system, customers fill out a payment order and pay the amount due to the Hungarian Post Office, which in turn transfers all amounts paid by our customers promptly to our account. The Hungarian Post Office's third party payment system has traditionally been the main means of bill payment for service providers in Hungary. A minority of our customers pay their bills through direct debit and bank transfers.

We currently operate two major billing systems:

- *CosmOSS,* a post-paid billing system that provides billing services to Residential and Corporate customers. CosmOSS bills for analogue standard voice, Carrier Selection, Carrier Pre-Selections services and data services. CosmOSS is partly operated by Euromacc Kft.

- *FusionR,* a post-paid billing system that provides billing services for certain important Corporate customers, Wholesale services and Carrier Pre-Selection and Carrier Selection services.

We also operate four different customer administration systems:

- *Contract Management (*"CM") is an order management application that provides a consolidated platform for the entire Corporate customer market. It also supports the entire sales cycle from prospect to disconnection.

- *Network Management Tool (*"NMT") is an order management system serving Residential customers with voice services and automatic provisioning support for Residential and Corporate customers in our historical concession areas.

- *Internet Administrator (*"IA") is an order management system serving Residential customers with internet and bundled (voice and IP) services with automatic provisioning support and also with Carrier Selection and Carrier Pre-Selection services.

- *VITRIN* is a workflow application providing provisioning and fault handling workflow support mainly for Corporate customers (data, ISDN 30 and ADSL services) and partially some residential services (IPTV, LLU).

We believe that our billing and customer care systems are adequate to meet the current functional requirements for invoicing our customer base.

Employees

As of December 31, 2011, we had approximately 1,287 active employees, all of which were located in Hungary. As of December 31, 2010 and 2009, we had approximately 1,102 and 1,399 employees, respectively, of which approximately 1,102 and 1,181 were located in Hungary, respectively.

A breakdown by job function as of December 31, 2011 is set forth in the table below:

Function	Number of Employees
Business Operation	1,050
Finance	125
IT	71
Human Resources	22
Legal	10
General Management and Administration	9
Total	**1,287**

We believe that we have satisfactory working relationships with our employees and have not experienced any significant labor disputes or work stoppages.

Property, Plant and Equipment

Our Property

We lease our principal executive offices in Budaörs, Hungary. In addition, we own and lease properties throughout Hungary. We have secured all the necessary rights-of-way with respect to our telecommunications networks. We believe that our leased and owned office space and real property are adequate for our present needs but we periodically review our future needs.

In Hungary, our material properties include properties that we own that comprise part of our telecommunications infrastructure ("telecom freehold" properties), properties that we lease that comprise part of our telecommunications infrastructure ("telecom leasehold" properties) and properties we lease in connection with the day-to-day operations of our business ("other leasehold" properties), each of which is summarized below:

Telecom Freehold. Of our 482 telecom freehold properties, we own the land and infrastructure for 198 properties, we own the infrastructure only for an additional 255, we have joint ownership with third parties over 26 properties, and we have free rights of use, although the Hungarian Post Office has title, over 3. All of our telecom freehold properties are located in our historical concession areas except for 10 buildings, which we bought as part of the Fiberner Acquisition, which are outside our histirical concession areas.

Telecom Leasehold. We have 1,261 telecom leasehold properties that comprise part of our telecommunication network. The total annual rental fees for our telecom leasehold properties are approximately €5.3 million, with various durations; approximately 45% of these leases are of an indefinite duration, approximately 50% of these leases are for a period of one to five years and the remainder are for 5 to 25 year periods.

Other Leasehold Facilities. We lease an additional 40 properties, comprising 17 office buildings, 20 customer services offices and 3 other leasehold properties. The total annual rental fees for these other leasehold properties are approximately €2.6 million, with various durations; approximately 30% of these leases are of an indefinite duration and approximately 70% of these leases are for 5 to 10 year periods.

Rights of Use. Under the Hungarian Civil Code, we are authorized to obtain rights of use over real property owned by third parties in exchange for a lump sum of compensation. Furthermore, the 2003 Communications Act re-enforced existing rights to construct buildings and install telecommunications equipment, wires and antennas on real property owned by third parties. In keeping with standard market practice among Hungarian telecommunications network operators, we have historically commenced operations based on a landowner's consent granted during the construction permitting process but before reaching formal written agreements. In connection with our national backbone network, we have successfully concluded agreements with affected landowners for the most part. However, in connection with certain portions of our national backbone network constructed from 1996 through to 1998, we initiated formal contractual negotiations to reach agreements with the affected landowners at the beginning of 2001, and these contractual negotiations, along with the related registration of rights of use, are still ongoing.

Insurance

We maintain the types and amounts of third party insurance coverage customary in the industry in which we operate, including coverage for business interruption, property damage, liability and employee related accidents and injuries above specified self-insured amounts for each type of risk. We are current with all of our premium payments and have made no material claims under our insurance policies in the past three years. We also maintain directors', supervisory board members' and officers' insurance. We consider our insurance coverage to be adequate for our business, as to both the nature of the risks and the amounts insured.

Environmental

Our operations are subject to a variety of laws and regulations relating to land use and environmental protection. We have a good relationship with the environmental authorities. The internal environmental protection activities are governed by certain internal rules on environmental protection issued by us, for the purpose of educating our employees about environmental protection and requiring them to be environmentally conscious. In the past five years, no environmental fines have been imposed on us. We believe that we are in substantial compliance with the applicable requirements.

Legal Proceedings

Postal Cash Payments Litigation

Invitel customers can pay their invoices in Invitel's Telepoints and via bank transfer free of charge. If an Invitel subscriber pays his or her invoice via a yellow postal check, Invitel charges the subscriber the amount that the Hungarian Post charges to Invitel for the collection via the yellow check. In late 2008, the Hungarian Consumer Protection Authority ("the NFH") initiated a court proceeding against Invitel and Telenor. The NFH requested the court to establish that such practice is unfair, violates consumer interests and therefore is invalid. Further, the NFH requested that Invitel and Telenor retrospectively refund all such amounts invoiced on to the subscriber.

In 2011 a consumer protection civil society also filed a claim against Invitel on the same grounds as the NFH, however, they did not request that Invitel retrospectively refund all such amounts invoiced on to the subscriber.

According to our management, monthly revenues from extra fees charged on postal cash payments since the introduction of such extra fees amount to approximately €0.135 million. As a result, the original amount of the claim (approximately €1.7 million) has increased to approximately €7.0 million as of December 31, 2011 due to the ongoing billing of the disputed recharge.

In late 2011, the Supreme Court of Hungary issued an Official Opinion stating that multiple cases may not be launched against a service provider on the same grounds, therefore, the lawsuit filed by the consumer protection civil society is likely to be terminated in the near future. Pursuant to the same Official Opinion, the NFH may not be considered a party to any subscriber contract, therefore, the NFH may not request the court that it retrospectively, and/or collectively refund the yellow check amounts charged on by Invitel to its customers.

The court proceeding is ongoing and a final and binding ruling is expected within the next 24 months. The court is awaiting a preliminary ruling from the European Court of Justice. Based on the above, although, in our assessment, the risk of losing the litigation and being required to repay the claimed amount (approximately €7.0 million) or any increased amount depending on the date of the final judgment) to customers is remote, we are not in a position to predict the final judgment of the court.

In April 2012, the Government submitted a draft bill to Parliament which would restrict telecom service providers to invoice onto the customer the yellow check fee charged by the Hungarian Post. Pursuant to the draft bill this requirement would only apply in our historical concession areas and for the provision of universal services only. Therefore, based on the current draft bill, a significant financial impact is not expected.

Universal Service Agreements

We became a universal service provider in our historical concession areas on the basis of the Universal Service Agreements concluded by our legal predecessors with the legal predecessor of the Minister in 2002, which agreements were later revised to comply with the current E.U. regulatory regime. See "*Hungarian Telecommunications and Regulation — Hungary and its Telecommunications Industry*." The Universal Service Agreements were concluded for a definite term expiring on December 31, 2008. On December 19, 2008, the then active Minister heading the Prime Minister's Office unilaterally closed the negotiations on the extension of the Universal Service Agreements. At the same time, a Government Decree (Government Decree No. 352/2008. (XII.31.)) was adopted, under which the universal service providers were obliged to provide universal services under unchanged terms and conditions for one year following the expiration of the Universal Service Agreements (i.e., until December 31, 2009). On April 21, 2009, we submitted a petition to the Constitutional Court requesting that the Constitutional Court review the provisions of the above decree and declare them as void and thus not applicable. On December 29, 2009, we executed a pre-contract in relation to the Universal Services Agreements under which we undertook to execute the Universal Services Agreements on the amended terms and conditions as set out in the pre-contract. Negotiations on the Universal Service Agreements commenced. In July 2010, the Constitutional Court declared the above decree to be void with an effective date of December 31, 2010 and negotiations on the Universal Service Agreements were suspended. At the start of March 2011, the Ministry of National Development made an offer to us to conclude a Universal Service Agreement valid until December 31, 2011 with an option to extend and we agreed to such terms. In December 2011 the parties prolonged the Universal Service Agreement until 31 December 2013. The execution of the Universal Service Agreement is now in progress. Invitel is subsidized with approximately HUF 23 million (approximately €82 thousand) annually, the final settlement for 2010 is completed, while the subsidy for 2011 is ongoing, the advance payment is received.

GVH proceeding

On December 5, 2006, the GVH imposed a penalty of HUF 150 million (approximately €537 thousand) on Hungarotel (which has since been merged into Invitel), claiming that Hungarotel abused its dominant position by inhibiting Carrier Selection in the voice services market. Invitel appealed the GVH's decision before the Metropolitan Court, requesting the suspension of its enforcement. The Metropolitan Court suspended the enforcement of the fine and subsequently overturned the decision of the GVH on procedural grounds and ordered the GVH to repeat the administrative procedure against Invitel. The GVH subsequently appealed the decision of the Metropolitan Court before the Metropolitan Court of Appeal. On November 21, 2008, the Metropolitan Court of Appeal confirmed the ruling of the Metropolitan Court, and accordingly the GVH decision was annulled with final effect. The GVH commenced the repeat administrative procedure against Invitel with respect to the same alleged violations on September 24, 2009. In September 2010, the GVH extended the deadline for GVH to complete its investigation. The Competition Council, the forum bringing the decisions of GVH, held a hearing in March 2011 where it adopted a resolution imposing a fine of HUF 200 million (approximately €727.2 thousand) on Invitel, which Invitel must pay in May 2011. Invitel has paid the fine but turned to the court against the GVH's decision with petition of review. The procedure is in progress.

The COPMPASS-case

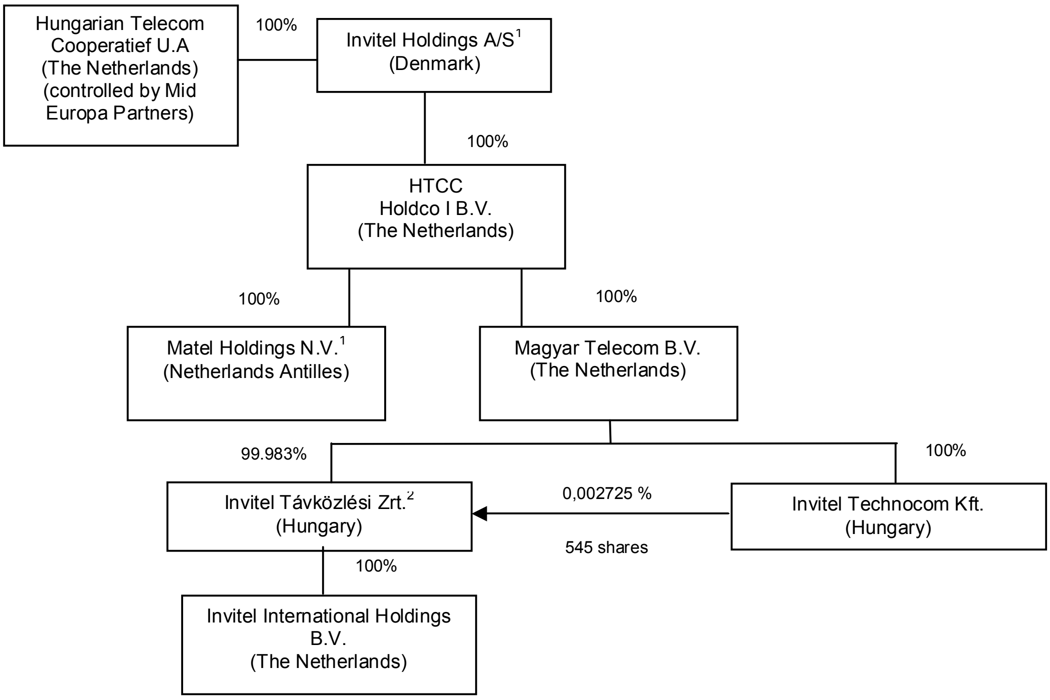
Fibernet Zrt is a legal predecessor of Invitel and merged into Invitel as of September 30, 2011. In August 2009 the former CEO of Fibernet and the managing director of COMPASS Kft. allegedly reached an oral agreement that COMPASS will help to find purchasers for Fibernet. Fibernet sent to COMPASS a Morgan Stanley presentation about the Fibernet Group and the status of the telecommunication market in Eastern-Europe. Later COMPASS sent to Fibernet a draft of an engagement agreement to which the CEO never answered and never signed and thus there isn't any written agreement between the parties. In 2011 COMPASS filed an action against Fibernet at the Pest County Court. Its legal argument is based on the draft contract sent to the CEO and on the fact that the CEO didn't answer to it (according to their argument he accepted the contract with all its terms and conditions). The claim has been refused by the former Fibernet management and by Invitel. The disputed sum is EUR 16.5 million plus charges. The procedure is in progress.

Other

We are involved in various other legal actions arising in the ordinary course of business. We are contesting these legal actions in addition to the actions noted above; however, the outcome of individual matters is not predictable with assurance. Although the ultimate resolution of these actions (including the actions discussed above) is not presently determinable, we believe that any liability resulting from the current pending legal actions involving us, in excess of amounts provided therefore, will not have a material effect on our consolidated financial position, results of operations or liquidity.

8. ORGANIZATIONAL STRUCTURE

The following chart summarizes our corporate structure at December 31, 2011.



1. Invitel Holdings A/S was dissolved as of March 12, 2012 and Matel Holdings N.V. was dissolved as of March 16, 2012. HTCC Holdco I B.V. and Invitel Hungary Holdings Kft. are also under liquidation as of the date of this Annual Report (the dissolution proceedings for these entities have commenced), after which Matel will be the parent company of the Group.
2. The FiberNet entities, namely FiberNet Hungary Tanácsadó Kft., FiberNet Kommuikációs Zrt., DunaWeb Távközlési Kft. and Donet-Info Kft., acquired on February 28, 2011 by Matel, were merged into Invitel on September 30, 2011.

9. OUR DIRECTORS AND SENIOR MANAGEMENT

Matel

As a result of their integration, the trust companies: Tradman Netherlands B.V. and Tradman Management B.V. , the subsidiaries of TMF and the former directors of Matel, into TMF Netherlands B.V. ("TMF") have been liquidated and were replaced by TMF Management B.V. and Clear Management Company B.V. (collectively "TMF") by entering into new services agreements with Matel. Effective as of March 12, 2012, the business address of TMF has changed from Parnassustoren, Locatellikade 1, 1076 AZ Amsterdam to Luna ArenA Herikerbergweg 238 1101 CM Amsterdam Zuidost The Netherlands. TMF is not related to the ultimate shareholders of Matel and, as a trust company, TMF is an independent service provider engaged in the management of Dutch special purpose vehicles. TMF exercises its voting rights on the Board of Directors of Matel in accordance with the terms of a service agreement.

Invitel Holdings A/S

Invitel Holdings, our parent company started its liquidation on September 14, 2011. As a result of the appointment of the liquidator, the Board of Directors has ceased to exist and the Board members' mandate has been terminated. The process has been completed and Invitel Holdings deleted from the registration of the Danish Business Agency on March, 12, 2012.

Members of the Board of Directors

The following table sets out certain information concerning our Board of Directors of Invitel. The business address of each of the directors is the address of Invitel.

Name	Age	Position
Board of Directors		
Craig Butcher	48	Chairman of the Board
Nikolaus Bethlen	34	Member of the Board
Bruno Claude	53	Member of the Board
Robert Bowker	45	Member of the Board
László Madarász	73	Member of the Board
David McGowan	51	Member of the Board

Certain information relating to Invitel Holdings directors is set out below.

Craig Butcher (Chairman) has been a member of the Board of Directors since November 2009. Mr. Butcher is a Senior Partner of Mid Europa and has been with Mid Europa since 2001. He is responsible for deal origination, execution, and monitoring across the Central and Eastern European region. While with Mid Europa, Mr. Butcher has been responsible for investments in five telecommunications operators and has served or is serving on the boards of directors of Invitel, Karneval, T-Mobile Czech Republic, Bité and Wheelabrator. From 1995 to 2000, Mr. Butcher worked with the EBRD. From 1991 to 1993 he worked with the Boston Consulting Group. He holds a B.Sc. (Hons) in Mathematics from Canterbury University, New Zealand, and an MBA from INSEAD.

Nikolaus Bethlen has been a member of the Board of Directors since November 2009. Mr. Bethlen is a Director of Mid Europa. Prior to joining Mid Europa, he worked for Kohlberg, Kravis, Roberts & Co. ("KKR") in London. Prior to joining KKR, he was with Morgan Stanley & Co. in its European Mergers and Acquisitions and Capital Markets Departments. Mr. Bethlen serves on the Board of Orange Austria.

He holds a B.A. in Business Economics from Durham University, England.

Bruno Claude has been a member of the Board of Directors since October 1, 2010. Mr. Claude served as President and CEO of Cablecom, the largest Cable Television provider in Switzerland, from 2001 to 2005 when the company was successfully sold to Liberty Global. During his tenure, he was responsible for the turn around and strategic re-direction of the company, building a dynamic and successful "triple play" provider out of a candidate for bankruptcy. From October 2000 to July 2003 he was Senior Vice President and COO of NTL's continental European operations. While with NTL, Mr. Claude was also appointed CEO of iEsy, a large German Cable operator which he led through a successful financial and operational restructuring. Prior to joining NTL, he was managing director of CEA Capital Advisor where he was responsible for the turn around and successful exit of a number of businesses in the media and communications industries. Prior to this, he held various positions with Prime Cable, which he joined in 1985, most recently as deputy to the President. Prime Cable was a highly successful private equity backed US cable television operator focusing on the turn around of under performing cable television systems across the United States. Mr. Claude graduated from the University of Louvain with a Masters degree in engineering in 1983 and from Cornell University with an MBA in 1985.

Robert Bowker has been Chief Financial Officer of Invitel since 2004. Mr. Bowker has served as a member of our Board of Directors since 2004. Prior to that, he served as Chief Financial Officer at Eurotel Praha between 2000 and 2004 and at EuroTel Slovakia and PricewaterhouseCoopers before that. He holds a Bachelor of Commerce from Rhodes University. Mr. Bowker is a South African Chartered Accountant and a Chartered Financial Analyst.

László Madarász has been a member of our Board of Directors since August 10, 2011. Mr. Madarász has held a number of positions with BNP in various jurisdictions, including Director and Chief Executive Officer of BNP-Dresdner Bank Hungary, and has held several important board positions in companies such as Postabank Hungary, BNP Paribas Bank Hungary and MALÉV Hungarian Airlines. Mr. Madarász is also currently a member of the Supervisory Board of the Hungarian National Bank.

David McGowan has been a member of the Board of Directors and Chief Executive Officer of Invitel since January 2012. Prior to joining Invitel, he had a long and distinguished background in the European media and telecommunications sector. Since 1999, he has served in senior management positions at leading cable operators including Cablecom in Switzerland and Unity Media in Germany. In addition to his operating experience, Mr. McGowan brings a deep background in television and content, having been a senior executive in those industries prio to his arrival in Europe in 1999.

Audit Committee

At the same time with the commencement of the liquidation of Invitel Holdings and the related termination of the Board of Directors, the Audit Committee, a committee under the Board of Directors has ceased to exist. The Audit Committee has been formally set up again in Matel on February 20, 2012. The new Audit Committee consists of Craig Butcher, Nikolaus Bethlen and Peter Daboczi.

The purpose of the Audit Committee is to:

- oversee the accounting and financial reporting processes of Matel and audits of its financial statements;

- assist the Board in oversight and monitoring of (i) the quality and integrity of the financial statements of Matel and related disclosure, (ii) preparation of the annual reports and the audit of the annual reports, (iii) compliance with legal and regulatory requirements, (iv) the independent auditor's qualifications, independence and performance, and (v) internal control system and any internal auditing and risk management systems;

- provide the Board of Directors with the results of its monitoring and recommendations derived therefrom; and

- provide to the Board of Directors such additional information and materials as it may deem necessary to make it aware of significant financial matters that require its attention.

The Audit Committee meets regularly and also holds meetings with the external auditor of Matel in order to discuss a variety of topics relating to its duties.

Executive Officers

David McGowan is the Chief Executive Officer and Robert Bowker is the Chief Financial Officer of Invitel, and their respective biographies are as follows:

David McGowan has been Chief Executive Officer since January 2012. Mr. McGowan is also a member of the Board of Directors of Invitel since January 2012. Prior to joining Invitel, he had a long and distinguished background in the European media and telecommunications sector. Since 1999, he has served in senior management positions at leading cable operators including Cablecom in Switzerland and Unity Media in Germany. In addition to his operating experience, Mr. McGowan brings a deep background in television and content, having been a senior executive in those industries priot to his arrival in Europe in 1999.

Robert Bowker has been Chief Financial Officer since April 2007. Mr. Bowker has served as a member of our Board of Directors and the Chief Financial Officer of Invitel Holdings N.V. (before it was acquired in the Invitel ZRt Acquisition in April 2007) since 2004. Prior to that, he served as Chief Financial Officer at Eurotel Praha between 2000 and 2004 and at EuroTel Slovakia and PricewaterhouseCoopers before that. He holds a Bachelor of Commerce from Rhodes University. Mr. Bowker is a South African Chartered Accountant and a Chartered Financial Analyst.

Compensation

Director Compensation

The compensation of the Board of Directors is determined by the Board of Directors, approved at the Annual General Meeting of Invitel and is based on prevailing market rates. Only László Madarász receives compensation for serving as a director of Invitel.

Employment arrangements

Invitel has agreed to management service agreements with the companies providing the services of certain members of the executive team. These arrangements provide that Invitel will compensate the service companies with annual service fees (paid monthly) with an annual bonus of up to 50% of such service fees.

In 2011, the aggregate compensation of the Board of Directors and Executive Officers was €2.3 million.

10. OUR PRINCIPAL SHAREHOLDERS

Hungarian Telecom (Netherlands) Cooperatief U.A., a cooperative association organized under the laws of the Netherlands, a company controlled by Mid Europa, is the ultimate parent company of Matel and 100% owner of our shares.

Mid Europa Partners Limited is a private equity firm focused on Central and Eastern Europe. Operating from London, Budapest and Warsaw, Mid Europa Partners Limited advises and manages funds with an asset value of approximately €3.2 billion. Mid Europa Partners Limited has been investing in Central and Eastern Europe since 1999.

11. RELATED PARTY TRANSACTIONS

In November 2009, Hungarian Telecom, a company controlled by Mid Europa, acquired a 74.4% equity stake in our shares in two separate transactions which resulted in Mid Europa indirectly becoming a controlling shareholder. As a result of an equity tender offer on January 22, 2010, Mid Europa increased its ownership in Invitel Holdings to 91.78%. Mid Europa then acquired all remaining shares not owned by it in a compulsory acquisition procedure under Danish law and became a 100% stakeholder of our shares.

The Shareholder Loan

On October 30, 2006, Invitel Holdings N.V., a former owner of Matel Holdings, issued the 2006 PIK Notes pursuant to an Indenture, dated as of October 30, 2006 (the "2006 PIK Notes Indenture"). Upon the closing of the sale of Matel Holdings to Hungarian Telephone and Cable Corp. ("HTCC") on April 27, 2007, HTCC entered into a supplemental indenture with Invitel Holdings N.V. and the 2006 PIK Notes Indenture trustee. Pursuant to such supplemental indenture, Holdco I. B.V., a 100% subsidiary of HTCC replaced Invitel Holdings N.V. as the issuer of the 2006 PIK Notes and assumed all of the rights and obligations of the issuer under the 2006 PIK Notes Indenture.

In connection with the 2009 November Refinancing, Hungarian Telecom Finance International Limited ("HTFI"), a company controlled by Mid Europa purchased approximately EUR 154.6 million or 87% of the outstanding aggregate principal amount of the 2006 PIK Notes issued by Holdco I. B.V. in a tender offer (the "2006 PIK Notes Tender Offer"). Concurrently with the consummation of the 2006 PIK Notes Tender Offer, holders of the 2006 PIK Notes consented to eliminate substantially all of the covenants and related events of default under the indenture governing the 2006 PIK Notes.

Concurrently with the 2009 December Refinancing, all of the 2006 PIK Notes held by HTFI were converted into the second tranche of a new shareholder loan by Mid Europa to Holdco I. B.V. ("Advance 2").

Advance 1 provided by Mid Europa to Matel and Advance 2 provided by Mid Europa to Holdco I. B.V. were converted into a new subordinated shareholder loan (the "Shareholder Loan") between Mid Europa and Holdco I. B.V. (the "Shareholder Debt Conversion"). Holdco I. B.V. owns 100% of the equity of Matel Holdings and Matel Holdings owns 100% of the equity of Matel. The Shareholder Loan is non-cash pay and has a 15 year maturity. Following assignment to Holdco I. B.V. the Shareholder Loan of €133.9 million was contributed as a capital contribution to Matel Holdings and then from Matel Holdings to Matel after which Matel's obligations under the Shareholder Loan was automatically extinguished by operation of law.

Following the Shareholder Debt Conversion, approximately €279.7 million aggregate principal amount of the Shareholder Loan remained outstanding for Holdco I.B.V. Advance 1 accrues interest of EURIBOR plus 20.00% per annum. The balance as of December 31, 2011 was € 201.7 million and the balance of accrued but not capitalized interest was €1.9 million. Advance 2 accrues interest of EURIBOR plus 10.25% per annum. The balance as of December 31, 2011 was €193.6 million and the balance of accrued but not capitalized interest was €4.8 million.

12. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Principal Accountant Fees and Services

PricewaterhouseCoopers Kft ("PWC") served as our independent auditor for the audit of our financial statements for fiscal years 2011 and 2010. The following table presents fees for professional audit services rendered by PWC for the audit of our annual financial statements for the years ended December 31, 2011 and 2010 and fees for other services rendered by PWC during that period.

(In €)	2010	2011
Audit fees	307,118	**346,209**
Audit-related fees	72,619	**144,634**
Other fees	9,077	**12,856**
Total	388,814	**503,699**

Audit Fees

For the years ended December 31, 2011 and 2010, audit fees included fees associated with the annual audit of our consolidated financial statements and our Annual Report, the audit of statutory financial statements of Group companies and certain other services customarily provided in connection with statutory and regulatory filings.

Audit-Related Fees

Audit-Related Fees consist of fees for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements but not reported under "Audit Fees". The Audit-Related services provided by PWC for the year ended December 31, 2010 include agreed upon procedures performed in relation to the International Business and those for the year ended December 31, 2011 include services in connection with the issue of EUR 80 million senior secured notes.

Other Fees

Other Fees for the year ended December 31, 2010 consists of evaluation of data migration relating to software conversions and related to the migration of accounting and billing systems of Fibernet for the year ended December 31, 2011.

All audit services, audit-related services, tax services and other services provided by PWC in connection with fiscal years 2010 and 2011 were pre-approved by the Audit Committee, which concluded that the provision of such services by PWC was compatible with the maintenance of their firms' independence in the conduct of their auditing functions.

The Audit Committee has adopted an Audit and Non-Audit Services Pre-Approval Policy ("Pre-Approval Policy"). The Pre-Approval Policy provides for the Audit Committee to specifically pre-approve the annual audit services engagement. The Pre-Approval Policy provides for pre-approval, without specific authorization from the Audit Committee, of specifically described audit-related services, tax services and other services within certain financial thresholds. Individual engagements anticipated to exceed pre-established thresholds and other services not specifically described must be separately pre-approved by the Audit Committee. The Pre-Approval Policy authorizes the Audit Committee to delegate to one or more of its members specific pre-approval authority with respect to permitted services. During fiscal years 2010 and 2011, the Audit Committee or the Chairman of the Audit Committee specifically pre-approved all services performed by PWC related to fiscal years 2010 and 2011.

13. GLOSSARY OF TERMS

Our industry uses many terms and acronyms that may not be familiar to you. To assist you in reading this Report, we have provided below definitions of some of these terms.

"*access network*" part of a network which connects end-users to the backbone.

"*ADSL*" means asymmetric digital subscriber line.

"*ATM*" or "*asynchronous transfer mode*" an international high-speed, high-volume, packet-switching protocol which supplies bandwidth on demand and divides any signal (voice, data or video) into efficient, manageable packets for ultra-fast switching.

"*backbone*" a high-speed line or series of connections that forms a major pathway within a network.

"*bitstream access*" a broadband access product which utilizes DSL in the local loop point of presence and then transports across the network to a DSL regional point of presence. It allows a voice and a DSL service to be integrated over the same two-wire copper pair.

"*broadband*" a descriptive term for evolving digital technologies that provided consumers with a signal-switched facility offering integrated access to voice, high-speed data service, video-demand services and interactive delivery services.

"*Corporate*" refers to one of the four markets in which we operate.

"*cable modem*" a cable modem is a device that enables connection of a PC to the cable TV network and receive data at a high speed.

"*CPS*" or "*Carrier Pre-selection*" whereby the selected operator is pre-set as the default operator for making certain calls so that no prefix needs to be dialed.

"*CS*" or "*Carrier Selection*" carrier selection on a call-by-call basis, whereby an operator different from the default operator may be selected by the subscriber through dialing a prefix for making certain calls.

"*Dark fiber*" unused fiber optic cable. Fiber optic cables convey information in the form of light pulses so that "dark" fiber means that no light pulses are being sent over the fiber optic cable.

"*DSL*" or "*digital subscriber line*" an access technology that allows voice and high-speed data to be sent simultaneously over local exchange service copper facilities.

"*DWDM*" or "*Dense Wavelength Division Multiplexing*" is a technology which multiplexes multiple optical carrier signals on a single optical fiber by using different wavelengths (colors) of laser light to carry different signals. This allows for a multiplication in capacity, in addition to making it possible to perform bidirectional communications over one strand of fiber.

"*Ethernet*" the most common type of connection computers used in a local area network.

"*Frame Relay*" industry-standard switched data link layer protocol, used typically for high speed data transmission through leased lines.

"*GSM*" global system for mobile communications.

"*incumbent*" the dominant operator which was licensed to enter the market and establish a proprietary network under the protection of a regulatory monopoly.

"*IP*" or "*Internet protocol*" the communications standard that defines the unit of information passed between computer systems that provides a basic packet delivery service.

"*IPTV*" Internet protocol television.

"*ISDN*" or "integrated services digital network" an international standard which enables high speed simultaneous transmission of voice and/or data over an existing public network.

"*ISDN2*" ISDN access with two channels designed primarily for residential use.

"*ISDN30*" ISDN access with 30 channels designed primarily for business use.

"*leased line*" A dedicated communications circuit for continual data transmission leased typically by business customers enabling the connection of two geographically distant points.

"*local loop*" the part of a communications circuit between the subscriber's equipment and the equipment in the local exchange. Also known as the subscriber loop, local line and access line.

"*LLU*" local loop unbundling.

"*LRIC*" or "*long run incremental cost*" a cost accounting methodology focusing on long-run incremental costs.

"*LTO*" or "*local telephone operator*" a telecommunications operator which, until the liberalization of voice telephony, was licensed to provide local telephone services in designated concession areas only.

"*MAN*" metropolitan area network.

"*managed leased line*" a leased line monitored, managed and controlled by a network management system offering an increased level of flexibility, reliability and security.

"*MPLS*" or "*Multiprotocol label switching*": a widely supported method of speeding up data communication over combined IP/ATM networks.

"*number portability*": the ability of a customer to transfer from one telecom operator to another and retain the original telephone number.

"*PMP*" or "*Point-to-multipoint*": point-multipoint; usually refers to access networks utilizing microwave technology to link the operator's point of presence with a number of remote customer locations.

"*POP*" or "*point of presence*": the interface point between communications entities.

"*PP*" or "*point-to-point*": refers to the use of microwave technology to link the telecommunications service provider's point-of-presence directly with one single customer location.

"*PSTN*" or "*public switched telephone network*": traditional landline network for voice telephony.

"*RIO*": reference interconnection offer.

"*RUO*": reference unbundling offer.

"*SDH*" or "*synchronous digital hierarchy*": European standard that defines a set of rate and format standards that are transmitted using optical signals over fiber.

"*SME*": small and medium-sized enterprises.

"*SMP*": significant market power.

"*transit services*": an interconnection service comprising of conveyance on a network between two points of interconnection, linking two networks that are not directly interconnected.

"*UMTS*": universal mobile telecommunications system; a third generation (3G) mobile system designed to provide a wide range of voice, high speed data and multimedia services.

"*unbundling*": granting unbundled access to the local loop so that the third party operators requesting access to the local loop is not required to purchase interconnection services from the incumbent operator; also referred to as "*local loop unbundling*."

"*VLAN*": virtual local area network.

"*VoIP*": voice over Internet protocol.

"*VPN*" or "*virtual private network*": A private network (often an Intranet) that makes use of the public telecommunication infrastructure, maintaining privacy through the use of specific protocols and security procedures. A VPN can be contrasted with a system of owned or leased lines that can only be used by one company. The main purpose of a VPN is to give the company the same capabilities as private leased lines at much lower cost by using the shared public infrastructure.

"*Wholesale*": refers to one of the four markets in which we operate.

"*WiMAX*" or "*Worldwide Interoperability for Microwave Access*": a telecommunications technology that provides for the wireless transmission of data using a variety of transmission modes.

In addition, we have included a list of certain other defined terms used in this Report under the heading "*Certain Definitions and Presentation of General Information*".

14. FINANCIAL STATEMENTS

The following financial statements are included as part of this Annual Report.

MAGYAR TELECOM B.V.

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2011