HUNGARIAN TELEPHONE & CABLE CORP
Form 10-K
March 30, 2005

United States

Securities and Exchange Commission

Washington, DC 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

OR

¨ **TRANSITIONAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number 1-11484

HUNGARIAN TELEPHONE AND CABLE CORP.

(Exact Name of Registrant as specified in its charter)

Delaware	**13-3652685**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1201 Third Avenue, Suite 3400, Seattle, WA 98101-3034

(Address of Principal Executive Offices) (Zip Code)

Registrant s telephone number, including area code: (206) 654-0204

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.001 per share	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ¨ No x

As of March 30, 2005, 12,724,938 shares of the registrant s Common Stock were outstanding, of which 4,654,835 were held by non-affiliates of the registrant. The aggregate market value of the registrant s Common Stock held by non-affiliates, computed by reference to the closing price of the Common Stock on the American Stock Exchange as of the last business day of the registrant s most recently completed second fiscal quarter was $45.2 million. The exclusion of shares owned by any person from such amount shall not be deemed an admission by the registrant that such person is an affiliate of the registrant.

Documents Incorporated by Reference

Part III - Portions of the Registrant s proxy statement for the Annual Meeting of Stockholders for the fiscal year ended December 31, 2004.

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Cautionary Statement Regarding Forward-Looking Statements

Certain statements contained herein which express belief, anticipation, expectation, or intention or any other projection, insofar as they may apply prospectively and are not historical facts, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements include, but are not limited to, the factors set forth in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 7A Quantitative and Qualitative Disclosures about Market Risk.

PART I

In this Form 10-K, all references to $ or U.S. dollars are to United States dollars, all references to EUR or euros are to the euro which is the currency of the European Monetary Union, and all references to HUF or forints are to Hungarian forints. Certain amounts stated in euros and forints herein also have been stated in U.S. dollars solely for the informational purposes of the reader, and should not be construed as a representation that such euro or forint amounts actually represent such U.S. dollar amounts or could be, or could have been, converted into U.S. dollars at the rate indicated or at any other rate. Unless otherwise stated or the context otherwise requires, such amounts have been stated at December 31, 2004 exchange rates. The forint/U.S. dollar middle exchange rate as of December 31, 2004 was approximately 180.29 forints per U.S. dollar.

Item 1. Business

Company Overview

Hungarian Telephone and Cable Corp. (HTCC or the Registrant and, together with its consolidated subsidiaries, the Company) was incorporated in Delaware in 1992 as a holding company with the intention of acquiring concessions from the government of the Republic of Hungary to own and operate local wireline telephone networks in Hungary as Hungary privatized its telecommunications industry. The Company has been providing basic local wireline telephone services within three defined regions of Hungary since 1996 and long distance services to its customer base since 2002. HTCC operates that business through its Hungarian subsidiary, Hungarotel Tavkozlesi Rt. (Hungarotel). Hungarotel has approximately 189,000 telephone access lines to service its business and residential customer base. Hungarotel is also a broadband and dial-up Internet Services Provider under the brand name Globonet. The Company had $60 million in net revenue in 2004.

In order to expand its business in Hungary and the surrounding countries, HTCC recently acquired PanTel Tavkozlesi Kft., a Hungarian company (PanTel). HTCC acquired an initial 25% interest in PanTel in November 2004 and acquired the remaining 75% from Royal KPN NV, the Dutch telecommunications provider (KPN), on February 28, 2005. PanTel is Hungary s leading alternative telecommunications provider with a new nationwide fiber optical backbone telecommunications network linking every county in Hungary. PanTel principally provides voice, data and Internet services to businesses throughout Hungary in competition with other telecommunications service providers including Magyar Tavkozlesi Rt. (Matav), the formerly State-controlled monopoly telephone company. PanTel also uses its network capacity to transport voice, data and Internet services on a wholesale basis to other telecommunications service providers and Internet Service Providers in Hungary. PanTel also operates the telecommunications network of MOL (the Hungarian oil company). PanTel s network also crosses Hungary s borders and, using a combination of owned and leased capacity, extends into other countries of the Central and Eastern European region including Austria, Bulgaria, Croatia, the Czech Republic,

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Romania, Slovakia, Slovenia, Serbia and Montenegro, and Ukraine. To service its customers global telecommunications needs, PanTel has interconnection agreements with several major international telecommunications service operators which provide for interconnection at international telecommunications hubs in Amsterdam, Frankfurt and Vienna. PanTel had approximately $128 million in gross revenue in 2004.

Hungarotel

The Company acquired its concession rights for local wireline telephone service in the three defined regions from the Hungarian government for $11.5 million (at historical exchange rates) and purchased the existing telecommunications infrastructure, including 61,400 telephone access lines, from Matav in 1995 and 1996 for $23.2 million (at historical exchange rates). The acquired telecommunications infrastructure was somewhat antiquated (manual exchanges and analog lines). The Company overhauled the existing infrastructure with a major capital expenditures program ($210 million through 2004 (at historical exchange rates)). The results of this investment are expanded and modern telecommunications networks in the three operating regions (Bekes , Nograd and Papa/Sarvar , each a Hungarotel Operating Area and together, the Hungarotel Operating Areas) deploying Siemens and Ericsson technology. Hungarotel was able to provide connections to its customers who had waited years (in some cases, for over 20 years) for telephone service and offer modern telecommunications services beyond traditional voice service to all of its subscribers.

Hungarotel now owns and operates virtually all existing public telephone exchanges and local loop telecommunications network facilities in the Hungarotel Operating Areas and was, until the expiration of its exclusivity rights in 2002, the sole provider of non-cellular local voice telephone services in such areas. Hungarotel s networks have the capacity, with only normal additional capital expenditures required, to provide basic telephone services to virtually all of the estimated 279,600 residences and 38,500 business and other institutional subscribers (including government institutions) within the Hungarotel Operating Areas.

While Hungarotel had a government-protected monopoly on local wireline voice telephone service in the Hungarotel Operating Areas through 2002, Matav was the sole provider of domestic and international long distance wireline voice telephone service through 2001 under a government-protected monopoly. Hungarotel had to transfer all of its long distance voice traffic to Matav for completion. When Matav s monopoly expired, Hungarotel became the sole long distance carrier for its customer base beginning in 2002. Since the Company did not have its own nationwide long distance network or an international network, international calls and certain domestic long distance calls initiated in the Hungarotel Operating Areas by its subscribers had to be transferred to another telecommunications carrier for transmission to the local telecommunications network of the party receiving the call. Competition in the Hungarotel Operating Areas for wireline service effectively began in 2004. With carrier selection and number portability now fully implemented in the Hungarian telecommunications marketplace, Hungarotel is subject to competition in its markets but Hungarotel can now compete outside of the Hungarotel Operating Areas.

In addition to local, domestic long distance, and international voice services, Hungarotel offers its subscribers data transmission and other value-added services, including ADSL Internet access and services, dial-up Internet access and services, voice mail, Internet Protocol-based voice services for international calls, leased line services, caller ID, call waiting, call forwarding, three-way calling, toll free calling services and audio text services. The Company is an Internet Service Provider under the brand name Globonet.

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The following table sets forth certain information as of December 31, 2004 with respect to each of the Hungarotel Operating Areas.

Area	**Bekes**	**Nograd**	**Papa/Sarvar**	**Total**
Population	391,700	147,900	128,400	668,000
Residences	166,900	62,400	50,300	279,600
Businesses (1)	23,100	8,900	6,500	38,500
Access Lines:				
Residential	88,100	36,600	33,900	158,600
Business (2)	17,000	7,400	6,000	30,400
Total	105,100	44,000	39,900	189,000
Pay phones	1,052	399	362	1,813
Population Penetration (3)	26.8	29.7	31.1	28.3
Residential Penetration (4)	52.8	58.7	67.4	56.7

(1) Represents Company estimates of business and other institutional subscribers or potential subscribers (including government institutions).

(2) Represents Company estimates of subscribers which are businesses and other institutional subscribers (including government institutions), leased lines and pay phones. Includes ISDN equivalent lines.

(3) Population Penetration rate is defined as the number of access lines per 100 inhabitants.

(4) Residential Penetration rate is defined as the number of residential access lines per 100 residences.

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The following map shows the location within Hungary of the Hungarotel Operating Areas.

PanTel

PanTel was founded in 1998 by KPN, MAV Rt. (MAV , the Hungarian state railroad company) and KFKI Investment Ltd. (a Hungarian entity) to compete with Matav, the former State-controlled telecommunications company which had a government-protected monopoly in the Hungarian domestic and international long distance wireline voice telecommunications market. Following a tender process, the Hungarian government awarded PanTel licenses to provide data transmission and other services that were not subject to Matav s government-protected monopoly rights for long distance voice services. In 1999, PanTel began building along MAV s railroad rights-of-way what is now a 3,700 kilometer-long state-of-the-art fiber optical backbone telecommunications network. The network was built based on SDH/DWDM (synchronous digital hierarchy/dense wavelength division multiplexing) and Internet Protocol (IP) technology and can carry voice and data traffic on dedicated lines as well as voice and data over IP. PanTel s nationwide backbone network enables it to service customers throughout the entire country. PanTel also built a metropolitan area network covering Budapest, which network connects to PanTel s backbone network.

Until 2002 PanTel was only allowed to offer data and Voice-over-IP services in Hungary. When the Hungarian government ended Matav s monopoly rights for long distance voice services, PanTel was able to compete with Matav and offer all modern telecommunications services including traditional voice services. Customers can now choose their provider on a call-by-call basis through carrier selection (by dialing a 4 digit prefix) or on an automatic continuing basis through carrier pre-selection. PanTel s target market has been larger business customers with whom it can establish a direct high bandwidth fiber optical (fiber-to-the-premise) or wireless point-to-point connection between the business customer s premises and PanTel s network. For these business customers, PanTel can meet all of the business

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customer s telecommunications requirements by providing all of the capacity and bandwidth that the customer needs as well as high standard voice and high speed Internet services. PanTel has the authorization and the necessary network to utilize the 1.5 and 3.5 GHz wireless frequency blocks which enable PanTel to service smaller and medium-sized business customers with lower traffic and bandwidth requirements by connecting them to PanTel s backbone network with a wireless point-to-multipoint connection. For these customers, PanTel can provide high quality services without having to construct a direct physical connection to the business or lease an existing connection from another telecommunications service provider (via unbundling). See -Summary of the Communications Act-Significant Market Power.

In 2004 the Hungarian government took another step to increase competition in the telecommunications marketplace by implementing number portability. Subscribers are now free to switch telephone service providers and keep their existing phone numbers. Allowing subscribers, particularly business subscribers, to keep their phone numbers when they switch service providers took away one more hurdle to a competitive environment. PanTel is now able to compete primarily on price and service. PanTel can connect a new subscriber (switching service to PanTel) directly to the PanTel network by constructing a fiber optical or wireless connection to the subscriber s premises or by using the existing connection of the subscriber s former service provider under an interconnection or unbundling arrangement. See -Summary of the Communications Act-Significant Market Power.

Like Hungarotel, PanTel offers its business customers the full array of modern domestic and international telecommunications services over its high speed network and that of its international partners as well as the traditional voice services such as local calls and domestic and international long distance calls. PanTel also offers its business customers all the available services that businesses require including data transport, high speed Internet access, virtual private networks, hosting, and managed leased lines. PanTel is also a wholesaler and sells capacity and transport services on its network to other wireline and wireless telecommunications providers and Internet Service Providers. PanTel s international network allows it to transfer voice, data and Internet traffic to and from Hungary.

Today, PanTel has more than 1,200 customers in Hungary and other countries in Central and Eastern Europe including other telecommunications service providers, cable television operators and Internet Service Providers for whom PanTel transports voice, data and Internet traffic in the wholesale market.

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The following commercial maps depict PanTel s national and international networks.

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Hungarotel and PanTel

Prior to HTCC s acquisition of PanTel, Hungarotel and PanTel had established a working relationship and were providing each other with various services. With the PanTel acquisition complete, HTCC is now able to further capitalize on the synergies of a combined Hungarotel and PanTel. Hungarotel can bring the combined entity its experience in the residential markets and local networks while PanTel provides its experience in the business and wholesale markets along with its backbone network.

Other

HTCC s common stock is traded on the American Stock Exchange under the symbol HTC. The Company s principal office in Hungary is located at Teréz krt. 46, H-1066, Budapest; telephone (361) 474-7700. The Company s United States office is located at 1201 Third Avenue, Suite 3400, Seattle, Washington 98101-3034; telephone (206) 654-0204.

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The Republic of Hungary

Hungary is located in Central Europe bordering on Austria, Slovenia, Croatia, Serbia and Montenegro, Romania, Ukraine and Slovakia. Six Western European capitals are within a one-hour flight. Its total area is approximately 93,000 square kilometers. It has approximately 10.1 million inhabitants, approximately 1.7 million of whom reside in Hungary s capital, Budapest.

For nearly 40 years, Hungary had a one-party government and a centrally planned economy. Democracy was restored and the foundations of a market economy were built between 1988 and 1990. Free elections were held in 1990. Today, Hungary has a parliamentary democracy with a single-chamber National Assembly. As a result of a large scale privatization effort, private enterprise has become the basis of the Hungarian economy.

Since 1995, the Hungarian government has embarked on an economic stabilization effort aimed at putting the economy on a sustainable path of low-inflationary growth. The following table provides Hungary s annual GDP growth and inflation rates since 1995.

	Annual GDP % Growth Rate	Annual % Inflation Rate
1995	1.7	28.2
1996	1.3	23.6
1997	3.5	18.2
1998	5.0	14.5
1999	4.9	10.0
2000	5.3	9.8
2001	3.8	9.2
2002	3.5	5.3
2003	2.9	4.7
2004	4.0	6.8

The unemployment rate has decreased from 11.1% in 1995 to 6.1% in 2004.

Today Hungary is considered one of the most developed countries in Central and Eastern Europe. Since 1990, foreign direct investment, from countries around the world including the United States, the United Kingdom, Germany, Austria, the Netherlands, and Japan, has exceeded EUR 42 billion. The Hungarian government has undertaken increased efforts to create a positive and competitive business climate and infrastructure in order to attract investment capital. The Hungarian government is promoting Hungary as the logical regional hub for Central and Eastern Europe based on a knowledge-based economy, innovation and hi-tech industries. Hungary has seen increased investment in service and R&D centers as well as the electronics, automotive, IT, biotechnology, pharmaceutics, chemical and energy sectors of the economy. Foreign investors in Hungary include global companies such as Ericsson, ExxonMobil, Flextronics, GE, General Motors, GlaxoSmithKline, IBM, Microsoft, Nokia, Novartis, Oracle, Philips, Siemens and Zoltek.

On May 1, 2004, Hungary and 9 other countries joined the European Union (EU). Hungary plans to adopt the euro as its currency in 2010. Hungary joined the North Atlantic Treaty Organization (NATO) in 1999. Hungary is also a member of the World Trade Organization.

Overview of Hungarian Telecommunications Industry

The Hungarian Telecommunications Industry Prior to Privatization

In 1989, the Hungarian state-owned Post, Telegraph and Telephone (PTT) was divided into three separate companies: the Hungarian Broadcasting Company (Antenna Hungaria), the Hungarian Post Office (Magyar Posta) and Matav. The Hungarian PTT was historically the exclusive provider of telecommunications services in Hungary. The Hungarian telecommunications market was significantly underdeveloped without the investment in the telecommunications infrastructure necessary to achieve a comparable level of teledensity to that of Western Europe. As of December 31, 1995, Hungary had a basic telephone penetration rate of approximately 21 telephone access lines per 100 inhabitants compared to a European Union average of approximately 48 telephone access lines per 100 inhabitants and a United States average of approximately 60 telephone access lines per 100 inhabitants. Of such access lines in Hungary, approximately 40% were located in Budapest (in which approximately 18% of Hungary s population resides). In the Hungarotel Operating Areas, access line penetration was approximately 9 telephone access lines per 100 inhabitants as of December 31, 1995.

Privatization of Matav and Local Telephone Service

In 1992, the Hungarian government began the process of privatizing Hungary s telecommunications industry by selling an initial 30% stake in Matav (raised to 67% in 1995) to

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MagyarCom, a company then wholly owned by Deutsche Telekom AG, the German public telephone operator (Deutsche Telekom), and Ameritech, a United States telecommunications company. In 1997, Matav completed its initial public offering pursuant to which MagyarCom s stake in Matav was reduced to approximately 60% and the Hungarian State s stake was reduced to approximately 6%. The Hungarian State also retained certain shareholder rights by retaining one Golden Share. In 1999, the Hungarian State sold its remaining 6% ownership interest in Matav but retained its Golden Share. In 2000, Deutsche Telekom purchased the entire ownership interest of SBC Communications Inc. (Ameritech s successor) in MagyarCom. As of December 31, 2004, MagyarCom owned 59.2% of Matav while 40.8% was publicly traded.

In 1992, the Hungarian government divided the country into 54 primary telecommunications service areas in order to take some of such primary telecommunications service areas out of Matav s national network with respect to the provision of local basic wireline telephone service. Matav was allowed to continue its monopoly in the provision of domestic and international long distance services through 2001. In 1993, the Hungarian government solicited bids for concessions to build, own and operate telecommunications networks in the 25 service areas which had been chosen to exit the Matav system. The Hungarian government awarded 23 concessions out of the 25 that the Hungarian government solicited bids for. Holders of those 23 concessions today (each a Local Telephone Operator, LTO , and together the LTOs) include: the Company (5 concession areas); Invitel Telecommunications Services Rt. (Invitel), owned by AIG Emerging Europe Infrastructure Fund and GMT Communications Partners Limited (9 concession areas); Monor Communications Group (Monortel), part of UnitedGlobalCom, Inc., the global television operator based out of Denver, Colorado (NASDAQ:UCOMA) (1 concession area); and Matav (8 concession areas). Matav also retained the rights to service the 2 concession areas for which there were no successful bidders. Each of the LTOs (including Matav) received 25-year licenses to provide local basic wireline telephone service with exclusivity rights in their respective concession areas, which exclusivity rights all expired by the end of 2002. In addition to the fees paid to the government which aggregated approximately $80.0 million (at historical exchange rates), each of the non-Matav LTOs negotiated a separate asset purchase agreement with Matav for each concession area s existing basic telephone plant and equipment, which led to the transfer of approximately 260,000 access lines from a total of 1.2 million access lines in the Matav system. Today Matav s local basic wireline telephone service areas cover approximately 72% of Hungary s population and approximately 70% of its geographic area.

Domestic and International Long Distance Services

The Hungarian government allowed Matav to continue its monopoly in the provision of domestic and international long distance wireline voice services through 2001. In 1998, the Hungarian government awarded PanTel licenses to provide such services as data transmission, voice mail and other services, which were not subject to exclusive concessions. PanTel built its own countrywide telecommunications network. At the end of 2001, the domestic and international long distance market was officially opened up to competition when Matav s right to provide exclusive domestic and international long distance wireline voice transmission expired. Other telecommunications service providers have since entered the market. See -Competition.

Cellular Service

In 1993, the Hungarian government awarded Westel (the predecessor name to T-Mobile Hungary) and Pannon licenses to provide nationwide digital cellular telephone services. Westel already had a license to provide analog cellular telephone services. Today Matav owns 100% of T-Mobile Hungary and Telenor ASA (the Norwegian telecommunications company) owns 100% of Pannon.

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In 1999, the TTW Ministry awarded an additional digital mobile phone license to Vodafone Rt. (Vodafone), a subsidiary of Vodafone Group Plc., following a bidding process. Vodafone began operations in late 1999.

Market Liberalization; The Regulatory Framework

In 2001, the Hungarian government enacted its first significant market-oriented telecommunications act. The goal of this act was to provide for a more liberalized telecommunications market by making market entry easier, promoting competition and harmonizing Hungary s telecommunications laws with those of the European Union. In 2003, the Hungarian government enacted Act C of 2003 on Electronic Communications (the Communications Act). The goal of the Communications Act is to further promote competition and to harmonize Hungary s telecommunications laws with the European Union framework that was put into effect in 2003. The Communications Act is a framework piece of legislation with the detailed governing regulations contained in a series of implementing decrees.

Telecommunications services in Hungary are currently regulated by the Informatics and Communications Ministry of the Hungarian government (the IC Ministry) which is led by the Informatics and Communications Minister (the IC Minister). The National Communications Authority, a central administrative organization, reports to the IC Minister and the Hungarian government. The National Communications Authority is divided into two units: the Council of the National Communications Authority and the Office of the National Communications Authority. Hungarotel s operating concessions for local wireline telephone service from the Hungarian government were originally governed by individual concession contracts which have been substantially superseded by subsequent legislation. The Company is in negotiations with the IC Minister to amend or terminate Hungarotel s concession contracts. See - Summary of the Communications Act.

The Hungarian Telecommunications Industry Today

Since 1994, the LTOs, including Matav, have spent approximately $1 billion (at historical exchange rates) to build modern state-of-the-art telecommunications networks throughout Hungary. At the end of 2004, Matav had approximately 2.9 million access lines connected to its telecommunications network, while Invitel, Monortel and Hungarotel (the other LTOs) had approximately 366,000, 64,000 and 189,000 access lines, respectively, connected to their local telecommunications networks. Hungarotel had 28 access lines per 100 inhabitants in its Hungarotel Operating Areas as compared to 35 access lines per 100 inhabitants in all of Hungary at the end of 2004.

In the domestic and international long distance market, other service providers have entered the market to compete with Matav and PanTel. However, only Matav and PanTel have nationwide networks while Invitel has expanded its network out of its local service areas to a large part of Hungary.

At the end of 2004, T-Mobile Hungary had a mobile cellular phone subscriber base of 4.0 million, while Pannon s subscriber base was 3.0 million and Vodafone s subscriber base was 1.7 million. The overall penetration rate for cellular service in Hungary was over 86% at the end of 2004. The Hungarian government awarded each of three incumbent wireless providers a Universal Mobile Telecommunications System (UMTS or 3G) license in December 2004 following a tender process.

In the Internet services market, all of the telecommunications providers are providing dial-up and/or broadband Internet service. In addition, there are Internet Service Providers without telecommunications networks. Some of the cable television companies operating in Hungary are offering Internet services and Monortel s affiliate, UPC Hungary, has recently introduced telephone services.

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Company Stockholders

The Company has two large stockholders who own 63% of the Company s outstanding common stock (Common Stock) in the aggregate. Most of the remaining 37% of the Common Stock is held by the public and traded on the American Stock Exchange. Set forth below is a brief description of the two largest stockholders of the Company.

Ashmore Investment Management

Ashmore Investment Management (Ashmore) is a specialist emerging markets fund manager based out of London. It manages over $8.0 billion of assets.

As of March 30, 2005, Ashmore owned 22% of the outstanding Common Stock and 33% of the outstanding Common Stock on a fully diluted basis. Ashmore also owns $25 million of notes issued by the Company which mature in 2007. See Notes 8 and 12 of Notes to Consolidated Financial Statements, and see also Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

TDC

TDC A/S, formerly known as Tele Danmark A/S (together with its affiliates, TDC), is a Danish full-service provider of communications solutions throughout Europe. TDC is the leading provider of communications services in Denmark, the second-largest communications provider in Switzerland and holds significant interests in a range of communications companies elsewhere across Northern and Continental Europe. TDC s stock is traded on the stock exchanges in Copenhagen, London and New York (NYSE:TLD).

At December 31, 2004, TDC had total assets of Danish Kroner 87.5 billion (approximately $16.1 billion) and shareholders equity of Danish Kroner 36.0 billion (approximately $6.6 billion). For 2004, TDC had net income of Danish Kroner 8.7 billion (approximately $1.6 billion) on net revenues of Danish Kroner 43.6 billion (approximately $8.0 billion).

As a result of certain agreements between the Company and TDC (the TDC Agreements), the Company has issued 2,579,588 shares of Common Stock to TDC. In 2002, TDC purchased 1,285,714 shares of Common Stock from a former shareholder of the Company and, in 2004, TDC purchased an additional 1,383,544 shares of Common Stock that were held by another former shareholder. As of March 30, 2005, TDC owned 41% of the outstanding Common Stock and 33% of the outstanding Common Stock on a fully diluted basis. The TDC Agreements provide TDC with certain preemptive rights to purchase, upon the issuance of Common Stock in certain circumstances to third parties, shares of Common Stock in order to maintain its percentage ownership interest of the outstanding Common Stock. See Notes 4, 8 and 12 of Notes to Consolidated Financial Statements, and see also Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Stockholders Agreement

TDC and Ashmore have entered into a stockholders agreement (the Stockholders Agreement) governing their rights and obligations to each other as stockholders of the Company. The Stockholders Agreement provides TDC and Ashmore with rights of first refusal and rights to participate in dispositions with respect to each other s shares of Common Stock. In addition, the Stockholders Agreement provides for a voting agreement among the parties pursuant to which Ashmore and TDC will each have the right to nominate at least two persons for election as directors of the Company so long as each party (collectively with its affiliates) owns at least 20% of the outstanding equity securities (on a fully-diluted basis) of the

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Company. The number of directors to be nominated by either party will be reduced to one director in the event that such party together with its affiliates holds less than 20% but more than 10% of the outstanding equity securities (on a fully-diluted basis) of the Company.

Ashmore and TDC have also agreed: (i) to maintain a joint majority of the board of directors of the Company for so long as Ashmore and TDC each hold (together with their respective affiliates) at least 20% of the outstanding equity securities (on a fully-diluted basis) of the Company, (ii) that, for so long as TDC owns at least 20% of the outstanding equity securities (on a fully-diluted basis) of the Company, TDC shall have the right to nominate one of its directors as Chairman of the Company s Board and (iii) that for so long as TDC owns at least 30% of the outstanding equity securities (on a fully-diluted basis) of the Company, TDC will have the right to nominate the chief executive officer and the chief financial officer of the Company.

Directors and Officers

The current directors of the Company are Ole Bertram, a Company director and the Company s President and Chief Executive Officer; Robert Barnes, a partner with Alchemy Partners LLP, a London-based private equity group; Michael Fortier, currently a London-based consultant and formerly a managing director with JP Morgan Chase specializing in mergers and acquisitions; Torben V. Holm, a Company director and the head of the Corporate Business Development department at TDC; Jesper Helmuth Larsen, the Chief Financial Officer of TDC Solutions, TDC s nordic and broadband fixed line business; John B. Ryan, a Company director and a retired financial consultant; and William E. Starkey, a Company director and a retired Senior Executive with GTE Corporation. Key officers include William T. McGann, the Company s Controller and Treasurer; Jan Mulder, the Chief Executive Officer of PanTel; and Peter T. Noone, the Company s General Counsel and Secretary.

The Hungarotel Operating Areas

The following is a brief description of each of the Hungarotel Operating Areas:

Bekes

The Bekes operating region encompasses the southern portion of Bekes County, which borders Romania. The Bekes operating region is comprised of 75 municipalities and has a population of approximately 391,700 with an estimated 166,900 residences and 23,100 business and other potential subscribers (including government institutions). Bekes is the most intensively cultivated agrarian region in Hungary and produces a substantial portion of Hungary s total wheat production. Industry, generally related to food processing, glass and textile production, is also a strong employer in the region. Foreign investors in the operating region include Owens-Illinois of the United States and a number of European manufacturers. The region is also a center for natural gas exploration and production. As of December 31, 2004, the Company had 105,100 access lines connected to its network in the Bekes operating region. The Company s network in the Bekes operating region utilizes a combination of a conventional build, fiber optic and wireless local loop technology.

Nograd

The Nograd operating region is comprised of 76 municipalities in the eastern portion of Nograd County, which borders Slovakia. The Nograd operating region has a population of approximately 147,900, with an estimated 62,400 residences and 8,900 business and other potential subscribers (including government institutions). The principal economic activities in the Nograd operating region include light manufacturing, tourism, some coal mining and agriculture. Foreign investors in the region include the Italian-owned dairy producer, Sole, and the German company, Paramount Glass. The Nograd

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operating region s proximity to Budapest, 1.5 hours by car, and its many cultural attractions makes it a desirable weekend and tourist destination. As of December 31, 2004, the Company had 44,000 access lines connected to its network in the Nograd operating region. The Company s network in the Nograd operating region utilizes a combination of a conventional build, fiber optic and wireless local loop technology.

Papa/Sarvar

The Papa/Sarvar operating region is composed of 114 municipalities located in the counties of Veszprem and Vas. The population of the Papa/Sarvar operating region is approximately 128,400 with an estimated 50,300 residences and 6,500 business and other potential subscribers (including government institutions). The portion of the Papa/Sarvar operating region in Veszprem County is relatively underdeveloped economically with the principal economic activities centered around light industry, appliance manufacturing, agriculture and forest products. Significant foreign investors in Veszprem County include ATAG, the Dutch appliance maker, and Electricité de France. The principal economic activities in the portion of the Papa/Sarvar operating region located in Vas County include heavy manufacturing and assembling, agriculture and tourism. Significant employers in Vas County include: Linde (a German natural gas distributor); Flextronics (an electronics components assembler); and Saga (a British-owned poultry processor). As of December 31, 2004, the Papa/Sarvar operating region had 39,900 access lines connected to its network. The Company s network in the Papa/Sarvar operating region utilizes a combination of a conventional build, fiber optic and wireless local loop technology.

Network Design

Hungarotel has versatile modern telecommunications networks which substantially replaced the antiquated systems purchased from Matav. Its networks provide many of the technologically advanced services currently available in the United States and Western Europe. Most of Hungarotel s networks are based on digital hosts and remotes with fiber optic rings and copper feeder and distribution. Such a distribution system is the conventional system used in the United States and Western Europe. Telecommunications services are transmitted to the home through twisted pair copper wire telephone cable. The Company has replaced all manually operated local battery and common battery cord type switchboards purchased from Matav while retaining certain analog switching systems. The Company has continually replaced these analog switching systems with digital technology in order to provide the latest features and services. The Company plans to replace the last analog switching system in 2005. Hungarotel s conventional networks have been designed to employ an open architecture, generally using Synchronous Digital Hierarchy (SDH) technology for system resilience. Hungarotel s networks are designed to provide voice and high speed data services. The Company believes that the flexible design of Hungarotel s conventional networks allows it to readily implement new technologies and provide enhanced or new services. Hungarotel s switches in its conventional networks allow it to connect to networks operated by other LTOs, Matav or PanTel in order to route voice and data transmissions.

PanTel built a nationwide state-of-the-art fiber optical backbone network based on SDH/DWDM and Internet-Protocol technology linking every county in Hungary. The network provides fiber optical access to every major city within each Hungarian county. Within these cities PanTel has microwave access networks which cover up to a 20 to 30 kilometer range around each city. PanTel s network enables it to provide all of its customers capacity and bandwidth requirements for voice, data and Internet transmission. PanTel built a metropolitan area network in Budapest, which network connects to the PanTel backbone network allowing PanTel access to Hungary s capital. PanTel has city-wide coverage in Budapest with 3.5 GHz point-to-point and point-to-multipoint wireless systems.

In some areas, when geographic conditions make it more feasible, Hungarotel is utilizing a wireless network technology based upon the Digital Enhanced Cordless Telecommunications (DECT)

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system which interfaces radio technology to fiber-optic, digital microwave, or fixed copper networks. Hungarotel is deploying a fiber optic cable to the node in the same fashion as in a conventional network build-out. At each node, the Company has constructed a radio base station (RBS), rather than switching to twisted pair copper wire distribution to the home. Each RBS has the capacity to provide service to between 60 and 600 customers. As additional customers are brought onto the network, the Company will install a transceiver unit at the subscriber s premises. Such transceiver s operating software is digitally encrypted so that it will operate only with its supporting RBS. A conventional telephone jack is then installed in the subscriber s household near an electrical outlet which is used to power the transceiver unit. The subscriber then uses a conventional phone to make outgoing and receive incoming calls. The DECT-based wireless local loop system provides the same type and quality of services as a conventional telephone network, including such services as voice mail, call forwarding and call blocking. When an expedited connection is required, the DECT system can connect the subscriber quickly while a wireline connection is being constructed.

PanTel is also deploying a similar wireless connection to certain businesses with much more bandwidth capacity than Hungarotel s wireless system. Rather than deploying a fiber optical connection to the business s premises, PanTel can use its wireless 1.5 and 3.5 GHz frequency bands. This enables lower traffic and bandwidth customers (smaller and medium-sized businesses) to be connected to the PanTel backbone network.

The Company has interconnection arrangements in place with the other significant wireline telecommunications service providers and all three Hungarian wireless providers. PanTel s network also crosses Hungary s borders and extends into other countries in the Central and Eastern European region including Austria, Bulgaria, Croatia, the Czech Republic, Romania, Slovakia, Slovenia, Serbia and Montenegro, and Ukraine. To service its customers global telecommunications needs, PanTel has interconnection agreements with several major international telecommunications service operators which provide for interconnection at international telecommunications hubs in Amsterdam, Frankfurt and Vienna.

Network Administration

Both Hungarotel and PanTel continually monitor their networks with modern technology to ensure uninterrupted and high quality service. Both entities are able to evaluate and respond promptly and appropriately to any network failures.

The Market/Tariff and Fee Structure

Background

The LTOs, including Hungarotel and Matav, had government-protected exclusivity rights to provide local wireline voice services in their concession areas, which exclusivity rights all expired by the end of 2002. Matav also had exclusive rights to provide wireline long distance voice services throughout Hungary, which rights expired at the end of 2001. While competition was officially sanctioned in both the local and long distance voice markets prior to the adoption of the Communications Act, it took the enactment and implementation of the Communications Act, particularly the introduction of carrier selection and number portability in 2004, to truly stimulate competition. See -Summary of the Communications Act.

A Hungarian subscriber may now pre-select a telecommunications service provider to provide (i) local and domestic long distance service and (ii) international service. A subscriber may choose the same service provider to provide both (i) local and domestic long distance service and (ii) international service. Therefore, while the Company, Matav and the other LTOs still retain their rights to provide telecommunications services, they are subject to competition in their home markets from each other and other new entrants into the market, including PanTel. Competitors can enter these markets either by building out their own networks (an overbuild) or by using the existing network of the incumbent LTO through either interconnection or an unbundling agreement. See -Summary of the Communications Act-Significant Market Power.

With the stated goal of further promoting competition and getting interconnection rates in line with EU rates, the Hungarian government significantly lowered the LTOs interconnection rates in 2004 (The Company has contested this action, see -Summary of the Communications Act-Significant Market Power.). This means, for example, that a competitor can enter one of the Hungarotel Operating Areas and take a subscriber away from Hungarotel while using Hungarotel s network to service that subscriber. That service provider could provide the subscriber with local and long distance service with a minimal investment. That competitor could use Hungarotel s connection to its customer to service outgoing calls and pay a per minute interconnection fee to Hungarotel. In this case, Hungarotel would still receive a monthly subscription fee from the subscriber for supplying the line connection to the home or business. Conversely, Hungarotel and PanTel can go into markets outside of the Hungarotel Operating Areas and compete with the incumbent LTO using that LTO s network. See -Summary of the Communications Act-Significant Market Power.

Hungarotel s fees and retail tariffs are currently regulated while PanTel s fees and tariffs are currently not subject to regulation. See -Summary of the Communications Act-Significant Market Power and -Price Regulation.

Revenue

Hungarotel s revenues are primarily derived from the provision of local and long distance (domestic and international) telephone services which consist of (i) charges for measured telephone service, which vary depending on the day, the time of day, distance and duration of the call, and (ii) subscription fees. Hungarotel is also permitted to charge its customers connection fees. Hungarotel also receives other operating revenues consisting principally of charges and fees from leased lines, fees for the provision of ADSL and dial-up Internet services, detailed billing, voicemail, caller ID and other customer services, including revenues from the sale and lease of telephone equipment. PanTel s revenues are derived from (i) local, domestic and international long distance voice and data services, (ii) Internet services, and (iii) similar to Hungarotel, fees for value added services like voicemail and caller ID and such business oriented services as the provision of leased lines and virtual private networks. In addition, PanTel derives revenues from the wholesale market - transporting voice, data and Internet traffic and providing leased line services for other telecommunications service providers, cable television operators and Internet Service Providers.

Measured Service

Hungarotel has two basic rates for outgoing calls, peak and off-peak, for each of local and domestic long distance calls and calls to Hungarian cellular phones within Hungary. The rates for outgoing international long distance calls are based solely on the country called and do not depend on the time of day called. Hungarotel has established special rate plans for low usage subscribers which include a lower per month subscription fee and a higher variable fee for measured service. PanTel derives fees from measured service as well. PanTel has competitive peak and off-peak tariffs but also negotiates special customized rate plans, including bundled packages of services, for some of its larger business customers who generate a significant volume of traffic. The measured service fee scheme is summarized below.

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Local Calls - For all local calls between its customers within a Hungarotel Operating Area, Hungarotel retains all of the revenues associated with the call. For PanTel customers, local calls to non-Company customers require the payment of a per minute interconnection fee to the telecommunications service provider of the recipient for completing the call.

Outgoing Domestic and International Long Distance Calls - For calls between subscribers, the Company has the capability to carry the call from the calling party to the receiving party entirely over its own telecommunications network. For such calls, the Company keeps the entire revenue collected from its subscribers. For domestic calls initiated by a Company subscriber to another service provider s customer, the Company has the network capability to deliver the call to the local telecommunications network containing the party receiving the call. In such cases, the Company collects the fee for the domestic long distance call from its subscriber and pays a per minute interconnection termination fee to the telecommunications provider completing the call. Prior to the acquisition of PanTel, Hungarotel had to, in some cases, arrange for either Matav or PanTel to transport the call to the local telecomunications network containing the party receiving the call. Today, PanTel can transport all of these calls. For international calls, the Company has to transfer the call to one of its international service partners for completion. The Company must then pay, directly or indirectly, a per minute termination fee to the telecommunications provider completing the call, and, in some cases, a per minute transmission fee to the telecommunications provider who transports the call from the Company s network to the local telecommunications network of the telecommunications provider who completes the call. With PanTel s international network, the Company can deliver the calls to various countries in the Central and Eastern European region. For other calls, the Company can use PanTel s network and transfer the calls for completion to one of PanTel s international partners at one of the international telecommunications hubs in either Amsterdam, Frankfurt or Vienna.

Incoming Domestic and International Long Distance Calls - For domestic and international long distance calls to the Company s subscribers from subscribers of other service providers, the Company receives a per minute interconnection fee for completing the call.

Cellular Calls - The Company s networks directly interconnect with the three Hungarian cell phone carriers networks. For calls by its customers to Hungarian cell phones, the Company must pay a per minute fee to the cellular carrier for completing the call. For calls to Pannon and T-Mobile Hungary and Vodafone subscribers, this fee is currently regulated. The price of calls from a Hungarian cellular phone to the Company s customers is unregulated and set by the cellular carriers. The cellular carriers pay the Company a per minute interconnection fee for completing mobile calls to the Company s subscribers. See -Summary of the Communications Act-Significant Market Power.

Internet Services - Hungarotel provides dial-up, ADSL and leased line Internet services under the brand name Globonet. When Hungarotel provides dial-up Internet service to its subscribers within the Hungarotel Operating Areas, it charges its Internet subscribers for both the telephone usage and the Internet usage. Hungarotel offers its dial-up Internet subscribers monthly packages consisting of a flat monthly discounted fee for the telephone and Internet usage for a fixed amount of monthly hours with variable telephone and Internet charges for Internet usage beyond the monthly limit. Lower usage dial-up Internet subscribers can pay a per hour fee for telephone and Internet usage without a monthly fee. For the ADSL broadband and leased line Internet service, Hungarotel charges a combined monthly fee for both the high-speed access and the Internet service for an unlimited amount of time. When a third party Internet Service Provider provides Internet service to a Hungarotel customer, Hungarotel receives a monthly access fee from the third party Internet Service Provider plus, in the case of dial-up Internet service, variable fees from its telephone subscriber for the telephone usage which have to be shared with the third party Internet Service Provider. See -Summary of the Communications Act-Significant Market Power-Internet Service. PanTel provides high speed Internet access to its customers at set prices or, in some cases, as part of a customized bundled service package.

Subscription Fees

Hungarotel collects a monthly subscription fee from its subscribers. The basic monthly subscription fee is HUF 4,500 ($24.96). In an effort to retain low usage customers, Hungarotel has introduced different subscription fee options for its residential subscriber base. For a reduced monthly subscription fee, a residential subscriber agrees to pay his regular monthly measured service fee plus an additional percentage of such measured service fee which should lower the overall bill for low volume users. Dependent upon the terms of agreement for service, PanTel may charge its business customers a subscription fee. See -Summary of the Communications Act-Price Regulation.

Connection Fees

Hungarotel charges its subscribers connection fees when they are added to the Company s network. Connection fees for some subscribers are regulated by the IC Ministry and the maximum fees are currently HUF 30,000 ($166.40) for residential subscribers and HUF 90,000 ($499.20) for business and other institutional subscribers (including government institutions). Hungarotel currently charges its unregulated customers connection fees of HUF 25,000 ($138.67) for residential subscribers and HUF 68,750 ($381.33) for business and other institutional subscribers. Hungarotel can offer special promotions on the connection fees if it so chooses. In the past, the Company has allowed its subscribers to pay connection fees on various installment plans. Dependent upon the terms of agreement for service, PanTel may charge its business customers a connection fee. See -Summary of the Communications Act-Price Regulation.

Other Operating Revenue

The Company supplies private line service (point-to-point and point-to-multi-point), virtual private networks and other services primarily to business subscribers. The Company generates additional revenues from the provision of value-added services, including ISDN, voice mail, call waiting, call forwarding, and three-way calling, as well as through the sale and rental of telephone equipment.

Wholesale Transport Services

PanTel provides wholesale telecommunications services pursuant to which PanTel transports voice, data and Internet services for other telecommunications service providers, cable television operators and Internet Service Providers. PanTel also provides leased line services to this market. For example, PanTel provides transport services to the Hungarian cellular providers as well as cable television companies that have begun offering voice services. PanTel also provides transport services for Hungarian Internet Service Providers, including cable television operators providing Internet services. With its international network and international partners, PanTel can transport voice, data and Internet traffic into, and out of, Hungary for, and to, its international partners.

Strategy

With competition fully in place in Hungary, the Company faces new opportunities and challenges. The Company s goal is to provide the broadest array of telecommunications services with exceptional quality and service at reasonable prices by becoming the most efficient full service telecommunications provider in Central and Eastern Europe. The Company s strategy is currently focused on six key market segments: the Hungarotel Operating Areas; the Residential and Small Business Market Outside of the Hungarotel Operating Areas; the Large and Medium-Sized Business Market throughout Hungary; the Internet Services Market; the Wholesale Market; and the International Market.

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The Hungarotel Operating Areas. Hungarotel is the dominant service provider in the Hungarotel Operating Areas. In order to maintain that advantage and compete with the cellular providers and other wireline service providers, Hungarotel intends to continue to capitalize on its brand awareness by marketing itself as the known service provider that has brought modern telecommunications services to the cities and villages of the Hungarotel Operating Areas at fair prices with exceptional customer service. Hungarotel s marketing efforts include advertising on radio and television, door-to-door marketing, newspaper advertising, participation in local trade shows, direct mail, community meetings, billboard advertising and sponsorships. Since many Hungarians prefer face-to-face personal marketing, Hungarotel has leveraged the benefits of having a customer service center in each Hungarotel Operating Area to give personal demonstrations.

For residential customers, Hungarotel is focusing its efforts on educating the customer on the availability of such products and services as voice mail, caller ID and call waiting, which are all new to the Company s residential customer base. Hungarotel is also highlighting the benefits of the Internet and encouraging its use by offering special rate packages for Internet usage

While Hungarotel s business and other institutional subscribers account for only 16% of its access lines, these customers account for a greater portion of Hungarotel s revenue. The Company believes that its business customers have the greatest need for the variety of new products and services that a modern telecommunications company can offer. The Company also believes that its business customers are the primary target for competition. Since the availability of modern telecommunications services is still a relatively new phenomena in Hungary, educating the smaller and medium-sized business customers on the availability and benefits of Hungarotel s products and services is a continuing goal. Hungarotel focuses on the marketing and sales of various products and services to its business customers such as managed lease lines, ADSL Internet service, PBX sales and services, ISDN, and Digifon Services (e.g. call forwarding, call waiting, call blocking restrictions). Hungarotel has an account manager assigned to each business customer who is responsible for continually meeting with each customer to find out their telecommunications needs. The account manager can then demonstrate each of Hungarotel s products and services and, working together with that customer, develop a telecommunications strategy using Hungarotel s products and services which can best enhance that customer s business. Hungarotel will also continue to offer value-oriented tariff packages to retain customers and limit churn.

Residential and Small Business Market Outside of the Hungarotel Operating Areas. Hungarotel has just begun offering Hungarotel s services to the residential and small business market outside of the Hungarotel Operating Areas. The Company believes that it can penetrate these markets by challenging the incumbent service providers on service and price. Hungarotel is able to use the networks of the incumbent service providers to reach this market with a minimal capital investment. With the PanTel network behind it, the Company believes that Hungarotel can compete by offering the latest products and services at attractive prices. With carrier pre-selection and number portability, the Company believes that customers are receptive to switching service providers given competitive packages from alternative service providers. See -Summary of the Communications Act-Significant Market Power.

Business Customers. The Company plans to continue to build on the reputation that PanTel has developed in Hungary as the most competitive alternative to Matav in the business market (which includes other institutional subscribers and government institutions). The Company plans on continuing to market PanTel throughout Hungary as an efficient, high quality alternative to Matav with excellent pricing plans. PanTel will continue to offer innovative bundled product offerings at competitive prices. The Company expects that PanTel s nationwide marketing, supplemented by a personalized sales effort, will give PanTel the opportunity to continue to increase its market share in a more liberalized telecommunications market.

Internet Services. The Hungarian government is promoting Hungary as the logical regional hub for Central and Eastern Europe based on a knowledge-based economy, innovation and hi-tech industries. As part of this effort, the government has been promoting the use of the Internet throughout Hungary. The Company believes that both dial-up and broadband Internet access are long-term growth industries in Hungary as the Hungarian economy progresses with Hungary now a member of the EU. Internet growth can generate additional telecommunications revenue. The Company intends to continue to offer innovative incentives to increase its Internet services penetration in the Hungarotel Operating Areas, including special introductory rates for broadband ADSL service. Hungarotel s goal is to be the market leading Internet Service Provider in the Hungarotel Operating Areas. Hungarotel has just begun offering Globonet s services to the residential and small business market outside of the Hungarotel Operating Areas. For these markets, Hungarotel will use the incumbent providers networks and purchase dial-up and ADSL access at a wholesale rate. See -Summary of Communications Act-Significant Market Power-Internet Service.

Wholesale Services. The Company plans to continue to leverage PanTel s modern backbone telecommunications network to make PanTel the provider of choice in the wholesale market by selling capacity on its network to other service providers for the national and international transmission of their voice, data and Internet traffic. The Company believes that PanTel s ability to offer large bandwidth capacity at competitive prices makes it an attractive choice in the wholesale market.

International Services. The Company plans on continuing to use the PanTel network as a bridge between Eastern and Western Europe. With its expanding network in Central and Eastern Europe and its international partners, PanTel is well positioned to capitalize on the growth in telecommunications services in the region.

The Company will continue to review its options with respect to any merger or strategic alliance possibilities that may enable the Company to increase its presence in the Hungarian telecommunications marketplace. The Company will also continue to pursue alternatives for offering cellular phone service.

Competition

The Company anticipates that competition in the wireline telephone services market will be centered around Hungary s business customers. Three telecommunications service providers have built long distance networks capable of servicing substantially all of Hungary: Matav; Invitel; and PanTel. Invitel provides local telephone service in nine concession areas (covering approximately 14% of the country) and has built a network covering Budapest and 16 other urban areas. Matav, Invitel and PanTel are competing for business customers throughout much of Hungary. Today, Hungarotel faces competition within the Hungarotel Operating Areas primarily from Matav. As Hungarotel expands into the residential and small business market outside the Hungarotel Operating Areas, it will face competition from the incumbent providers Matav, Invitel and Monortel.

Other Hungarian telecommunications providers include the following entities which have entered the telecommunications marketplace, particularly the business marketplace: e-Tel, an Irish telecommunications services provider; GTS Hungary Kft. (GTS) which provides data and voice transmission services through a nationwide microwave network and a satellite based network (GTS also owns one of the leading Hungarian ISPs); Antenna Hungaria, the national broadcaster which is still controlled by the state; BT Hungaria, an affiliate of British Telecom; and Sweden s Telia AB. Tele2 has also entered the telecommunications market and is providing voice services through carrier selection to residential and small business customers in Matav s and Monortel s local service areas using Matav s and Monortel s networks as a reseller.

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The Company faces intense competition from the three Hungarian cellular providers: T-Mobile Hungary; Pannon; and Vodafone. The cellular market growth has been very fast in Hungary with a penetration rate of over 86% at the end of 2004. Unlike the United States and Western Europe, many Hungarians have gone from having no telephone (wireline or wireless) straight to a wireless telephone without getting a traditional wireline telephone first. Historically, the airtime and monthly fees charged by the cellular operators are generally more than the fees for comparable services charged by the Company. The cellular telephone providers are, however, currently deploying various discounted pre-paid plans, which make pricing comparisons difficult.

In the Internet Services Provider market, in addition to the incumbent telecommunications service providers, there are numerous independent Internet Service Providers without extensive telecommunications facilities. The independent ISP market has been consolidating over the last few years into fewer larger providers.

The Hungarian cable television market is highly fragmented with about 60 cable television operators providing coverage to approximately 55% of the Hungarian households. The Hungarian cable television industry is undergoing consolidation. UPC, an affiliate of Monortel, is the largest cable television operator in Hungary. UPC is now offering voice and Internet services in some parts of Hungary, including Budapest. Matavkabel, an affiliate of Matav, offers Internet service in some locations.

Summary of the Communications Act

In 2003, the Hungarian Parliament enacted the Communications Act, which took effect on January 1, 2004. The goal of the Communications Act is to further promote competition in the telecommunications market and to harmonize Hungary s telecommunications laws with the current European Union regulatory framework. The Communications Act is a framework piece of legislation with the detailed governing regulations contained in a series of implementing decrees. Some of the key provisions of the Communications Act and the implementing decrees are summarized below. The provisions are subject to change and legal interpretation.

Administration

The National Communications Authority is the central administrative body that reports to the IC Minister and the Hungarian government. It is divided into two units: the Office of the National Communications Authority (NCA Office) which is responsible for administrative tasks such as issuing licenses, verifying reports, managing frequencies and supervising markets; and the Council of the National Communications Authority (NCA Council) which identifies providers with significant market power, reviews reference interconnection and local loop unbundling offers for approval and settles disputes between parties.

Market Entry

From a legal standpoint, market entry is now easier than in the past when a concession from the government was required. A potential telecommunications service provider need only notify the NCA Office that it intends to provide a telecommunications service and provide certain documentation. Licenses are only required if the telecommunications service provider intends to use radio frequencies, build a network or wants a number range to allocate to subscribers.

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Significant Market Power

Under the Communication Act, a service provider shall be deemed to have significant market power (SMP) in a specific market if it possesses a dominant market share of such market. The NCA Council is charged with conducting an annual market analysis and is empowered to assess whether there is effective competition in each of the 18 designated communications markets. If the NCA Council determines that a designated market is not effectively competitive, it shall identify the service provider(s) with SMP in that market and may impose specific regulatory obligations on such service provider(s) in order to induce competition. The first recourse of the NCA Council to stimulate competition in one of the 18 designated markets is to regulate the wholesale market the market between telecommunications service providers. If such action by the NCA Council does not make the designated market competitive, the NCA Council can then regulate the retail side of that market.

Today Hungarotel, Matav, Invitel, and Monortel are designated as service providers with SMP in the provision of fixed-line non-cellular voice services in their respective local markets. T-Mobile Hungary, Pannon and Vodafone are designated as service providers with SMP in the cellular telephone interconnection market and Matav is designated as a service provider with SMP in the leased line (transmission) market. The SMP designation is not removed until such time as the NCA Council determines otherwise following a market analysis. The current telecommunications service providers deemed to have SMP have additional obligations, some of which are summarized below.