LUBYS INC
Form 4
April 04, 2006

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
OMB Number: 3235-0287
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(Print or Type Responses)

1. Name and Address of Reporting Person *
CRAVEN JUDITH B

(Last) (First) (Middle)

13111 NORTHWEST FREEWAY, SUITE 600

(Street)

HOUSTON, TX 77040

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
LUBYS INC [LUB]

3. Date of Earliest Transaction (Month/Day/Year)
04/03/2006

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security	2. Conversion or Exercise	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any	4. Transaction Code	5. Number of Derivative	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount of Underlying Securities (Instr. 3 and 4)	8. Price Derivat Securit

(Instr. 3)	Price of Derivative Security	(Month/Day/Year)	(Instr. 8)		Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)						(Instr. 5
			Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Restricted Stock Units	(1)	04/03/2006	A		294		(1)	(1)	Common Stock	294	$ 12.

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
CRAVEN JUDITH B 13111 NORTHWEST FREEWAY SUITE 600 HOUSTON, TX 77040	X			

Signatures

Judith B. Craven	04/04/2006
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The security fully vests at time granted and remains restricted until the earier of 4/3/09 or the date of director's resignation or retirement.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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Other

1 to 4 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.

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(m) *Stock Based Compensation*

We have three equity compensation plans: the stock option plan that was adopted by our Board of Directors in April 1992, which was amended and renamed upon the approval of our stockholders in 2002 (the 2002 Plan); the Non-Employee Director Stock Option Plan (the Directors Plan) which was established by our Board of Directors in 1997; and the 2004 Long-Term Incentive Plan (the 2004 Plan) which was approved by our stockholders in 2004.

As of December 31, 2007, we had outstanding options to purchase 80,000 shares of common stock issued from the 2002 Plan; outstanding options to purchase 100,000 shares of common stock issued from the Directors Plan; and outstanding options to purchase 390,000 shares of common stock under the 2004 Plan.

Upon the approval of the 2004 Plan, we agreed not to issue any more options from either the 2002 Plan or the Directors Plan. The 2004 Plan authorized 1,000,000 shares of common stock for awards. In addition to such 1,000,000 shares, the 2004 Plan includes any shares of common stock that remained available for issuance under the 2002 Plan and the Directors Plan as of the date the 2004 Plan was approved by our stockholders. As of the adoption of the 2004 Plan, 424,410 shares of common stock which were then available for issuance under the 2002 Plan were rolled over and available for issuance under the 2004 Plan and 88,716 shares of common stock which were then available for issuance under the Directors Plan were rolled over and available for issuance under the 2004 Plan. In addition, any shares of common stock subject to awards outstanding under the 2002 Plan or the Directors Plan at the time of the adoption of the 2004 Plan which subsequently lapse, expire or otherwise terminate without the issuance of such shares of common stock are also available for awards under the 2004 Plan.

Stock options from the 2004 Plan may be either incentive stock options under Section 422 of the U.S. Internal Revenue Code or options not intended to qualify as incentive stock options (nonqualified options). The term of an option cannot exceed ten years from the date of grant. All options must have an exercise price that is not less than the fair market value of a share of common stock on the date of grant. Upon exercise of an option, the participant may pay the option price in cash, by delivering shares of common stock to the Company or by having the Company withhold shares otherwise deliverable to the participant upon exercise (net exercise). An option may also be exercised through a cashless exercise procedure involving a broker or dealer. The net exercise feature resulted in variable accounting under the previous accounting rules.

Effective January 1, 2006, we adopted Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004), Share-Based Payment, (SFAS 123R). SFAS 123R requires the measurement and recognition of compensation expense based on the fair value of the employee stock based awards issued. Compensation expense for awards and related tax effects are recognized as they vest. We adopted SFAS 123R using the modified prospective transition method. Under this transition method, compensation cost recognized effective January 1, 2006 includes: (1) compensation cost for all share based awards granted prior to, but not yet vested as of, January 1, 2006 based on the original measure of the grant date fair value method under the provisions of SFAS 123 for pro-forma disclosure; and (2) compensation cost for all share-based awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Results for periods prior to the adoption of the new standard were not restated at the time of transition.

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In addition, awards previously treated as variable awards are classified as liability awards under the new standard and are subject to revaluation each period, with a corresponding adjustment in earnings for changes in the fair value of outstanding awards.

For the year ended December 31, 2007, we recognized a compensation benefit of $1,319,000 related to stock options according to SFAS 123R. For the year ended December 31, 2006, we recognized $373,000 of compensation expense related to the adoption of SFAS 123R as a cumulative effect of a change in accounting principle, and a decrease in compensation expense of $1,207,000 relating to the revaluation of outstanding option awards under SFAS 123R. For the year ended December 31, 2005, we recognized $1,203,000 of compensation expense related to the variable method of accounting.

As a result of adopting SFAS 123R on January 1, 2006, our loss before income taxes and net loss attributable to common stockholders for the year ended December 31, 2007 are $794,000 and $758,000 higher, respectively, than if we had continued to account for share-based compensation under APB Opinion No. 25 and followed the variable method of accounting. As a result of adopting SFAS 123R on January 1, 2006, our income before income taxes and net income attributable to common stockholders for the year ended December 31, 2006 are $827,000 and $697,000 lower, respectively, than if we had continued to account for share-based compensation under APB Opinion No. 25 and followed the variable method of accounting. Basic and diluted loss per common share would have been $6.17 and $6.16, respectively, for the year ended December 31, 2007 if we had not adopted SFAS 123R. Reported basic and diluted loss per common share were $6.23 and $6.23, respectively, for the year ended December 31, 2007.

The following table illustrates the effect on net income and earnings per common share if we had applied the fair value recognition provisions of SFAS 123R to options granted under our stock option plans for year ended December 31 2005. For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes option-pricing model and amortized to expense over the options vesting periods:

(in thousands)	**2005**
Net income attributable to common stockholders	$ 1,287
Plus: stock-based compensation expense included in reported earnings	1,295
Less: stock-based compensation expense determined under fair-value method	(1,321)
Pro forma Earnings	$ 1,261
Earnings per share Basic:	
As restated	$ 0.10
Pro forma	$ 0.10
Earnings per share Diluted:	
As restated	$ 0.10
Pro forma	$ 0.09

Upon the adoption of SFAS 123R, expected volatility was based on historical volatilities. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected option life assumed at the date of grant. The expected term was calculated based on historical experience and represents the time period options actually remained outstanding. We have estimated zero forfeitures based on historical experience and the limited number of option holders.

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The weighted average assumptions used in the Black-Scholes option-pricing model are as follows:

	2007	2006	2005
Dividend yield	0%	0%	0%
Risk free rate	3.46%	4.46%	4.47%
Expected option life (years)	6	10	10
Volatility	34.8%	38.0%	43.0%

(n) *Income Taxes*

Income tax expense comprises current and deferred taxes. Income tax expense is recognized in profit or loss 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.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities, net of valuation allowances, are recognized for the future tax consequences attributable to operating loss and tax credit carry-forwards, and differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date.

Interests and penalties associated with income tax are included in current tax expense.

(o) *Fair Value of Financial Instruments*

Our financial instruments include cash, receivables, other current assets, accounts payable, accruals and other current liabilities and short- and long-term debt. The carrying amounts of cash, receivables, other current assets, accounts payable, accruals and other current liabilities and short-term debt approximate fair value due to the short-term nature of these instruments. The fair value of long-term debt approximates its carrying value as the debt carries a floating interest rate.

(p) *Derivative Financial Instruments*

We account for derivative financial instruments in accordance with SFAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which requires that all derivative instruments be recorded on the balance sheet as either assets or liabilities and be measured at their respective fair values. The accounting treatment of changes in fair value is dependent upon whether or not a derivative instrument is designated as a hedge and if so, the type of hedge and its effectiveness as a hedge.

We engage in foreign currency and interest rate hedging activities to reduce the risk that changes in currency exchange rates and interest rates will adversely affect the eventual net cash flows resulting from our debt obligations.

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We do not enter into financial instruments for trading or speculative purposes. However the derivative instruments we use are not designated as hedges under SFAS 133 for accounting purposes and, as such, are referred to as undesignated hedges. Changes in the fair value of undesignated hedges are therefore recorded in current period earnings as a gain or loss on derivative instruments.

In the ordinary course of business, we enter into contractual arrangements with other telecommunications service providers to provide and receive telephone services, and for other services such as the lease of office space. Certain of these arrangements are denominated in currencies other than the functional currency of either party, and are required to be accounted for separately from the host contract as derivatives at fair value. Changes in fair value of such derivatives are accounted for as a gain or loss on derivative instruments.

We did not have any financial instruments designated as hedges under SFAS 133 for the years ended December 31, 2007, 2006 and 2005.

(q) *Earnings per Share*

Basic earnings per share (basic EPS) is computed by dividing income attributable to common stockholders by the weighted average number of common shares outstanding for the period. The computation of diluted EPS is similar to the computation of basic EPS, except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options and warrants, and the conversion of the convertible preferred stock, where dilutive. The number of additional shares is calculated by assuming that outstanding stock options and warrants were exercised, or preferred securities were converted and the proceeds were used to acquire shares of common stock at the average market price during the reporting period, except with respect to warrants that can be exercised through the tender of notes where the warrant holder has no economic advantage to tender in cash. For warrants that can be exercised through the surrender of notes, exercise is assumed through such surrender provided that exercise in cash is not more advantageous to the warrant holder and the numerator of the diluted earnings per share computation is adjusted by interest on the debt and fair value changes in the warrant (net of tax).

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The following is a reconciliation from basic earnings per share to diluted earnings per share for each of the years ended December 31, 2007, 2006 (as restated see Note 1(c)) and 2005:

($ in thousands, except share data)	**2007**	**2006**	**2005**
Net income (loss) before cumulative effect of change in accounting principle after minority interest	$ (96,472)	$ 16,900	$ 1,392
Cumulative effect of change in accounting principle (A)	$	$ (373)	$
Net income (loss) (B)	$ (96,472)	$ 16,527	$ 1,392
Preferred stock dividends (C)	$ (99)	$ (105)	$ (105)
Net income (loss) attributable to common stockholders (D)	$ (96,571)	$ 16,422	$ 1,287
Determination of shares:			
Weighted average common shares outstanding basic (E)	15,495,764	12,810,084	12,727,526
Assumed conversion of dilutive stock options and cumulative convertible preferred stock		3,126,212	661,574
Weighted average common shares outstanding diluted (F)	15,495,764	15,936,296	13,389,100
Basic net income (loss) per common share:			
Prior to cumulative effect of change in accounting principle ((D+A)/E)	$ (6.23)	$ 1.31	$ 0.10
Cumulative effect of change in accounting principle (A/E)	$	$ (0.03)	$
Total	(6.23)	1.28	0.10
Diluted net income (loss) per common share:			
Prior to cumulative effect of change in accounting principle ((B+A)/F)	$ (6.23)	$ 1.06	$ 0.10
Cumulative effect of change in accounting principle (A/F)	$	$ (0.02)	$
	$ (6.23)	$ 1.04	$ 0.10

Included in weighted average common shares outstanding for 2007 are 938,550 redeemable equity securities issued to certain members of management in connection with the Invitel Acquisition.

For the years ended December 31, 2007, 2006 and 2005 common stock equivalents, warrants and convertible preferred stock of 572,017, 55,000 and 2,500,000, respectively, were excluded from the computation of diluted earnings per share since the effects of inclusion would have been anti-dilutive.

(r) *Recently Adopted Accounting Pronouncements*

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN 48), which clarifies the accounting for uncertainty in income taxes. FIN 48 establishes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that we recognize in the financial statements, the impact of a tax position, if that position is

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more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 were effective beginning January 1, 2007, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of FIN 48 has not had a material effect on our financial position or results of operations.

(s) *Recently Issued Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS 157 applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. Earlier application is encouraged, provided the entity has not yet issued financial statements, including financial statements for any interim period for that fiscal year. In February, 2008 the FASB issued a Staff Position that delays the effective date of SFAS 157. Delayed application of SFAS 157 is permitted for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. We are currently evaluating the effect that the adoption of SFAS 157 will have on our consolidated results of operations and financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159), which permits entities to choose to measure many financial instruments and certain warranty and insurance contracts at fair value on a contract-by-contract basis. SFAS 159 applies to all reporting entities, including not-for-profit organizations, and contains financial statement presentation and disclosure requirements for assets and liabilities reported at fair value as a consequence of the election. SFAS 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. Early adoption is permitted subject to certain conditions; however an early adopter must also adopt SFAS No. 157, Fair Value Measurements , at the same time. We are currently evaluating the effect that the adoption of SFAS 159 will have on our consolidated results of operations and financial position or cash flows.

In December 2007, the FASB issued SFAS No. 141 Revised, Business Combinations (SFAS 141R), which replaces SFAS 141, Business Combinations . SFAS 141R establishes principles and requirements for measurement of identifiable assets and liabilities in a business combination and the measurement and recognition of goodwill acquired in the business combination or a gain from a bargain purchase. The standard also determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R requires transaction costs to be expensed as incurred, rather capitalizing as a cost of the acquisition, recording contingent at fair value with subsequent adjustments in income and reduction in valuation allowances on deferred taxes in income rather than goodwill. The impact of the adoption of SFAS 141 will depend on the nature and timing of our future acquisitions.

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In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS 160), which we will adopt on January 1, 2009. SFAS 160 will significantly change the accounting and reporting related to a non-controlling interest in a subsidiary. After adoption, non-controlling interests will be classified as shareholders equity, a change from its current classification between liabilities and shareholders equity. Earnings attributable to minority interests will be included in net income, although such earnings will continue to be deducted to measure earnings per share. Purchases and sales of minority interests will be reported in equity. We do not expect that the adoption of SFAS 160 will have a material impact on our financial statements.

(2) **Acquisitions**

Acquisition of PanTel

On June 30, 2005, we completed our final purchase allocation of the PanTel business that was acquired in a two-step transaction, 24.9% on November 10, 2004 and the remaining 75.1% on February 28, 2005 (the Pantel Acquisition). The estimated fair values of assets acquired and liabilities assumed as of February 28, 2005 were determined in accordance with SFAS No. 141 Business Combinations and we were required to allocate the cost of an acquired business based on the estimated fair values of assets acquired and liabilities assumed.

The purchase price for the PanTel business was arrived at by arms length negotiations between us and the sellers. The total purchase price of $120.1 million included: (i) the payment of cash of 26.9 million ($35.4 million at historical exchange rates), (ii) 250,000 shares at a fair value of $2.7 million, (iii) transaction costs of $1.5 million and (iv) debt assumed of 66 million ($80.5 million at historical exchange rates). Under the purchase method of accounting, the purchase price is allocated to the net tangible and intangible assets based upon their estimated fair values as of the date of the acquisition. $30.2 million has been calculated as negative goodwill that represented the excess of the fair value of the net tangible and intangible assets acquired over the purchase price. Negative goodwill is due to the decision of the majority shareholder of the PanTel business to divest its investments in Central and Eastern Europe. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, negative goodwill has been proportionally allocated to reduce long-lived assets.

The closing of the transaction occurred on February 28, 2005 and the results of the PanTel business for the ten months ended December 31, 2005 (and the Balance Sheet as at December 31, 2005) have been consolidated into our financial statements for the year ended December 31, 2005.

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The following represents the final allocation of the purchase price paid for the PanTel business based on the fair values of the acquired assets and assumed liabilities as of February 28, 2005:

(in thousands)	**February 28, 2005**
Current assets	$ 48,232
Fixed assets, net	62,425
Intangible assets	49,488
Other non-current assets	1,940
Current and non-current liabilities	(42,004)
Net assets acquired	$ 120,081
Purchase Price:	
Long-term debt assumed	80,514
Cash	35,367
Shares issued	2,700
Transaction costs	1,500
Total purchase price	$ 120,081

The following table presents our unaudited summarized combined results of operations, on a pro forma basis, as though the PanTel Acquisition had been completed as of January 1, 2005:

(in thousands, except share data)	**Year ended December 31, 2005**
Revenues	$ 197,357
Income from operations	34,134
Foreign exchange (losses) gains, net	(4,118)
Interest expense	14,712
Net income	12,473
Net income per share	$ 0.98

The above unaudited pro forma summarized results of operations are intended for informational purposes only and, in our opinion, are not indicative of our results of operations we could have had if the PanTel Acquisition had actually taken place as of January 1, 2005. The unaudited pro forma summarized results of operations do not include potential cost savings from operating efficiencies or synergies that may result from the PanTel Acquisition.

Acquisition of Matel Holdings N.V.

On April 27, 2007, pursuant to a Sale and Purchase Agreement that we entered into with Invitel Holdings N.V. on January 8, 2007, we completed our acquisition of 100% of the issued ordinary shares of Matel Holdings and thus 99.98% of the outstanding shares of Invitel (the Invitel Acquisition).

The primary reason for the Invitel Acquisition was that this business combination significantly strengthens our position as the second largest fixed line telecommunications service provider and the number one alternative fixed line operator in Hungary. The Invitel Acquisition provides us with a larger customer base, a more extensive backbone network and enables us to benefit from Invitel s and Hungarotel s combined 14 geographically clustered historical concession areas. The business

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combination also provides us with a more substantial platform from which to take advantage of key potential service development opportunities and any further market consolidation. The combined business will also benefit from a greater diversity in its sources of revenue, which will make us less susceptible to market pressures in any single market.

The purchase price, including the assumption of net indebtedness, was 470 million. We used a discounted cash flow methodology and comparable trading multiples in determining the purchase price.

The purchase price was increased by transaction and other directly related expenses. The total purchase consideration of 479 million included: (i) the payment of cash in the amount of 71 million (approximately $96 million at closing), (ii) 938,550 shares issued by HTCC at a fair value of 11 million (approximately $15 million at closing), (iii) transaction costs and other directly related expenses of 11 million (approximately $15 million at closing) and (iv) net debt assumed of 389 million (approximately $525 million at closing, the Assumed Net Debt). The Assumed Net Debt consists primarily of (a) 133 million in aggregate principal amount and accrued interest of floating rate senior PIK notes due 2013 (the 2006 PIK Notes), (b) 145 million in aggregate principal amount of 10 3/4% Senior Notes due 2012 (the 2004 Notes), and (c) a Facilities Agreement in the amount of 116 million, which was amended and restated in connection with the Invitel Acquisition (the Amended Facilities Agreement) less cash and cash equivalents on closing.

The Invitel Acquisition was financed by: (i) the issuance on April 27, 2007 of Floating Rate Senior Notes, due 2013, for an amount of 200 million (the 2007 Notes), which proceeds were used to pay part of the Invitel Acquisition consideration and to refinance our existing Credit Facility, and (ii) the issuance of 938,550 shares of our common stock to certain members of Invitel s management team. In order to clarify the rights of the creditors under the various debt instruments, HTCC Holdco II B.V., Matel Holdings and various creditors and certain other parties also entered into an amended and restated Intercreditor Agreement (the Intercreditor Agreement).

Under the purchase method of accounting, and in accordance with SFAS No. 141, Business Combinations , we are required to allocate the cost of an acquired business based on the estimated fair values of the assets acquired and liabilities assumed. We finalized the purchase price allocation and determined $71 million in goodwill, which represents the excess of the purchase price over the fair value of the net assets acquired.

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The following represents the final allocation of the purchase price paid for Matel Holdings based on the fair values of the acquired assets and assumed liabilities as of April 27, 2007:

(in thousands)	**April 27, 2007**
Current assets	$ 50,754
Property, plant and equipment	476,146
Intangible assets	132,921
Other non-current assets	13,174
Deferred tax	(28,721)
Current and non-current liabilities	(63,608)
Net assets acquired	$ 580,666
Purchase Price:	
Long-term debt assumed	525,192
Cash	96,483
Shares issued	15,052
Transaction costs and other directly related expenses	14,865
Total purchase price	$ 651,592
Goodwill	$ 70,926

The following table presents the fair values of major components of the intangible assets acquired:

(in thousands)	**April 27, 2007**	**Weighted average amortization period**
Customer relationships	$ 62,991	16 years
Trademark	27,038	indefinite
Homezone	2,030	4 years
3.5 GHz license	13,033	9 years
Right of ways	1,921	14 years
Software	16,893	4 years
Other intangible assets	9,015	3 years
Total:	$ 132,921	

The closing of the transaction occurred on April 27, 2007 and the consolidated results of Matel Holdings for the eight months ended December 31, 2007 (and the balance sheet as at December 31, 2007) have been consolidated into our financial statements.

Acquisition of Tele2 Hungary

On October 18, 2007, we purchased the Hungarian business of Tele2, the Swedish-based alternative telecom operator by purchasing the entire equity interests in Tele2 s Hungarian subsidiary, Tele2 Magyarorszag Kft. (Tele2 Hungary). Tele2 Hungary (since renamed Invitel Telecom Kft.) provides Carrier Selection and Carrier Pre-Selection fixed line telecommunications services to Mass Market customers as a reseller using the network facilities of other operators pursuant to resale agreements.

The total purchase consideration for Tele2 Hungary was 9.7 million (approximately $13.6 million at closing). The total purchase consideration of 9.7 million included: (i) the payment of cash in the amount of 4.0 million (approximately $5.6 million at closing); (ii) a net debt adjustment of 5.0 million (approximately $7.0 million at closing); (iii) a net working capital adjustment of

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0.4 million (approximately $0.6 million at closing); and (iv) transaction costs and other directly related expenses of 0.3 million (approximately $0.4 million at closing). We used a discounted cash flow methodology and comparable trading multiples in determining the purchase price.

The Tele2 Hungary Acquisition was financed by (i) our existing cash and (ii) the draw down of 6.0 million (approximately $8.4 million at closing) from our Amended Facilities Agreement on October 15, 2007 (from the total available 20 million of Tranche D of our revolving credit facility). The revolving credit facility was repaid on December 16, 2007. Tranche D bears a floating interest based on EURIBOR, plus 1.5% margin.

Under the purchase method of accounting, and in accordance with SFAS No. 141, Business Combinations , we are required to allocate the cost of an acquired business based on the estimated fair values of the assets acquired and liabilities assumed. The following represents the final allocation of the purchase price paid for Tele2 Hungary based on the fair values of the acquired assets and assumed liabilities as of October 18, 2007:

(in thousands)	**October 18, 2007**
Current assets	$ 11,400
Property, plant and equipment	166
Intangible assets	4,410
Deferred tax	1,317
Current and non-current liabilities	(3,742)
Net assets acquired	$ 13,551
Purchase Price:	
Cash	5,609
Net indebtedness adjustment	6,949
Net working capital adjustment	589
Transaction costs and other directly related expenses	404
Total purchase price	$ 13,551

The following table presents the fair values of major components of the intangible assets acquired:

(in thousands)	**October 18, 2007**	**Weighted average amortization period**
Customer relationships	$ 4,244	2 years
Property rights	162	0.5 years
Software	4	2 years
Total:	$ 4,410	

The closing of the transaction occurred on October 18, 2007 and the consolidated results of Tele2 Hungary for the two months ended December 31, 2007 (and the balance sheet as at December 31, 2007) have been consolidated into our financial statements.

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The following table presents our unaudited summarized consolidated financial information, on a pro-forma basis, as though the Invitel Acquisition and the Tele2 Hungary Acquisition had occurred at the beginning of the respective periods:

(in thousands)	**2007 Pro-forma (unaudited)**	**2007 Actual**	**2006 Pro-forma (unaudited)**	**2006 Actual**
Revenue	$ 505,239	$ 385,193	$ 477,562	$ 189,260
Income from operations	50,770	46,187	68,805	29,306
Foreign exchange gains (losses), net	411	(6,481)	(2,658)	1,104
Interest expense	(79,976)	(58,744)	(71,512)	(14,883)
Net income (loss)	(104,878)	$ (96,472)	(53,344)	16,527
Net income (loss) per basic share	$ (6.77)	$ (6.23)	$ (4.16)	$ 1.28

The above unaudited pro-forma summarized combined financial information is intended for informational purposes only and is not indicative of our results of operations had the Invitel Acquisition and the Tele2 Hungary Acquisition actually taken place at the beginning of the respective periods. The unaudited pro-forma summarized combined financial information does not include potential cost savings from operating efficiencies or synergies that may result from integrating the acquisitions.

(3) **Cash and Cash Equivalents and Restricted Cash**

At December 31, 2007, cash of $20,897,000 comprised the following: $63,000 on deposit in the United States, the equivalent of $839,000 in the Netherlands, the equivalent of $1,446,000 on deposit in Serbia, Bulgaria, Romania, Slovakia and Slovenia, and $18,549,000 on deposit with banks in Hungary, consisting of $110,000 denominated in U.S. dollars, the equivalent of $2,888,000 denominated in euros and the equivalent of $15,551,000 denominated in Hungarian forint.

At December 31, 2006, cash of $18,794,000 comprised the following: $231,000 on deposit in the United States, the equivalent of $768,000 on deposit in Austria, Bulgaria, Romania, Slovakia and Slovenia, and $17,795,000 on deposit with banks in Hungary, consisting of $350,000 denominated in U.S. dollars, the equivalent of $3,286,000 denominated in euros and the equivalent of $14,159,000 denominated in Hungarian forint.

Restricted cash of $11,850,000 at December 31, 2006 was comprised of a 9 million deposit in a debt service reserve account, which was required under the terms of our Credit Facility Agreement. We were required to maintain this 9 million deposit in the debt service reserve account until such time as our leverage ratio, defined as consolidated net borrowings to consolidated EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization as defined in the Credit Agreement), was below 2:1 for two consecutive quarters. The deposit earned interest at bank deposit rates. We refinanced our Credit Facility Agreement and our restricted cash balance was released on April 27, 2007.

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(4) **Property, Plant and Equipment**

The components of property, plant and equipment at December 31, 2007 and 2006 are as follows:

(in thousands)	**2007**	**2006**
Land and buildings	$ 23,759	14,723
Telecommunications equipment	830,007	275,610
Other equipment	18,464	17,310
Construction in progress	35,345	14,187
	907,575	321,830
Less: accumulated depreciation and impairment losses		
Land and buildings	$ (5,228)	(2,388)
Telecommunications equipment	(201,056)	(127,177)
Other equipment	(9,806)	(13,221)
	(216,090)	(142,786)
Property, plant and equipment, net	$ 691,485	179,044

(5) **Intangible Assets**

The components of intangible assets at December 31, 2007 and 2006 are as follows:

(in thousands)	**2007**	**2006**
Customer relationships	$ 70,383	
Trademark	28,357	1,347
Concession rights	8,119	7,538
Property rights	68,682	48,476
Software	31,485	7,043
Other	29,232	2,906
	236,258	67,310
Less: accumulated amortization and impairment losses		
Customer relationships	(3,507)	
Trademark		(155)
Concession rights	$ (4,214)	(3,666)
Property rights	(9,462)	(6,603)
Software	(10,594)	(5,795)
Other	(7,533)	(442)
	(35,310)	(16,661)
Intangible assets, net	$ 200,948	50,649

Aggregate amortization expenses for amortizing intangible assets were $16,988,000, $2,951,000 and $2,666,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Estimated amortization expenses for the next five years, at December 31, 2007 exchange rates are: $16,087,000 in 2008, $14,885,000 in 2009, $12,211,000 in 2010, $10,535,000 in 2011 and $8,320,000 in 2012.

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(6) **Goodwill**

The carrying amount of goodwill has changed during the year ended December 31, 2007 as follows:

(in thousands)	
Goodwill as of December 31, 2006	$ 9,622
Goodwill acquired	70,926
Foreign exchange difference on goodwill	986
Goodwill as of December 31, 2007	$ 81,534

Goodwill acquired relates to the Invitel Acquisition.

The carrying amount of goodwill by segment as of December 31, 2007 and 2006 was as follows:

(in thousands)	**2007**	**2006**
Mass Market Voice	$ 27,522	$ 1,703
Mass Market Internet	11,256	167
Business	25,929	3,592
Wholesale	16,827	4,160
Total goodwill	$ 81,534	$ 9,622

(7) **Other Assets**

Included in other assets at December 31, 2006 is 400,000 ($527,000 at December 31, 2006 exchange rates) in a restricted cash account related to a performance bond guarantee given to a customer.

(8) **Long-term Debt**

Long-term debt at December 31, 2007 and 2006 consist of the following:

(in thousands)	**2007**	**2006**
Current:		
Credit Facility	$	$ 34,749
Amended Facilities Agreement	37,114	
Total short-term portion of long-term debt	$ 37,114	$ 34,749
Non-Current:		
Credit Facility	$	$ 115,351

Amended Facilities Agreement (1)	107,907	
2007 Notes	293,552	
2006 PIK Notes (1)	204,566	
2004 Notes (1)	206,840	
Total long-term debt	$ 812,865	$ 115,351

(1) The 2006 PIK Notes, the 2004 Notes and $114 million from the Amended Facilities Agreement were acquired in connection with the Invitel Acquisition.

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Credit Facility

On February 9, 2005, we entered into a 170 million Credit Facility Agreement (the Credit Facility), with a European banking syndicate which had three facilities. Facility A, in the amount of 84 million, was drawn down by Hungarotel on February 21, 2005 for the purpose of refinancing and terminating Hungarotel s existing debt as well as to partially finance the acquisition of the PanTel business. Facility B, in the amount of 66 million, was drawn down by PanTel on February 28, 2005 for the purpose of refinancing and terminating its existing debt at that date. Facility C, in the amount of 20 million, provided funds for the repayment of our outstanding Notes which were to mature on March 31, 2007.

Facility A and Facility B were repayable semi-annually on each June 30 and December 31 beginning on June 30, 2005 and ending on December 31, 2010. Facility C was repayable in equal installments on June 30, 2011 and December 31, 2011. The loans accrued interest at the rate of the Applicable Margin (described below) plus the EURIBOR rate for the applicable interest period. The Applicable Margin for an interest period on Facility A and Facility B loans was based on our ratio of Total Net Borrowings to EBITDA. The Applicable Margin could range from a high of 2.5% per annum to a low of 0.75% per annum. The Applicable Margin on Facility A and Facility B was 2.25% per annum as of December 31, 2006. The Applicable Margin for the Facility C loan was fixed at 2.5% per annum.

We paid a facility agency fee in the amount of 50,000 and an arrangement fee in the amount of 4.0 million under the terms of the Credit Facility. We paid the fees from the proceeds of Facilities A and B. We had to pay a commitment fee in the amount of 0.65% per annum on the undrawn amount of the Credit Facility. Only Facility C was not drawn down.

We entered into a series of agreements to secure our obligations under the Credit Facility pursuant to which we pledged all of our intangible and tangible assets, including our ownership interests in our subsidiaries. We were subject to covenants, including maintenance of certain financial statement ratios, limitations on paying dividends, borrowing funds, acquiring assets or businesses and merging and disposing of our assets. The Credit Facility contained customary representations and warranties and events of default, which could have triggered early repayment of the balance under the Credit Facility.

2007 Refinancing

In connection with the Invitel Acquisition on April 27, 2007, we completed the issuance of 200 million aggregate principal amount of floating rate senior notes maturing in 2013 (the 2007 Notes), the proceeds of which were used to partly finance the Invitel Acquisition and to refinance the Credit Facility. As part of the Invitel Acquisition, we also assumed an estimated net indebtedness on closing of 389 million (approximately $525 million at closing, the Assumed Debt). The Assumed Debt consists primarily of (i) 133 million in aggregate principal amount and accrued interest of Floating Rate Senior PIK Notes due 2013 (the 2006 PIK Notes), (ii) 145 million in aggregate principal amount of 10 3/4% Senior Notes due 2012 (the 2004 Notes), and (iii) a Facilities Agreement in the amount of 116 million, which was amended and restated in connection with the Invitel Acquisition (the Amended Facilities Agreement). In order to clarify the rights of the creditors under the various debt instruments, we entered into an amended and restated Intercreditor Agreement (the Intercreditor Agreement). Summaries of the terms and condition of the 2007 Notes, the 2006 PIK Notes, the 2004 Notes, the Amended Facilities Agreement and the Intercreditor Agreement are set forth below. The summaries do not purport to be complete and are qualified in their entirety by reference to the full text of such documents, copies of which are filed with the Securities and Exchange Commission.

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The Amended Facilities Agreement

In connection with the Invitel Acquisition on April 27, 2007, an amendment was made to the Facilities Agreement, dated August 6, 2004, between Matel, Invitel, as borrower, certain subsidiary companies as original guarantors, and certain financial institutions. The Amended Facilities Agreement provides for facilities of up to 145 million (or the euro equivalent thereof), comprised of (i) a euro amortizing term loan of 96.9 million, (ii) a Hungarian forint amortizing term loan of HUF 4,628 million (approximately 18.5 million), (iii) a revolving credit facility of 4.2 million and HUF 200 million (approximately 0.8 million), and (iv) a euro liquidity facility of 25 million. Neither the revolving facility nor the liquidity facility was drawn down in connection with the closing of the Invitel Acquisition.

Advances under the Amended Facilities Agreement bear interest for each interest period at annual rates equal to EURIBOR or BUBOR (based on the Budapest interbank offer rates) plus an applicable margin. The applicable margin is set based on the ratio of all of our senior debt to EBITDA, based on our most recently delivered quarterly management accounts and financial statements. Under the Amended Facilities Agreement, we are obligated to pay customary fees to the lenders, including an up-front fee and a commitment fee in relation to available and undrawn commitments under the revolving facility and the liquidity facility.

Our obligations under the Amended Facilities Agreement are guaranteed and are collateralized by (i) a first ranking pledge of all the share capital of the obligors, (ii) assignments of intercompany loans and any relevant cross guarantees of the obligors from time to time, (iii) a pledge of accounts by the obligors, and (iv) floating charges over all assets. Such security interests also collateralize, on a pari passu basis, all hedging obligations with respect to the Amended Facilities Agreement, the 2007 Notes and the 2004 Notes.

The Amended Facilities Agreement contains certain negative covenants that restrict us (subject to certain agreed upon exceptions) from, among other things, (i) creating or permitting to subsist any security interest over any part of our assets, (ii) merging or consolidating with or into any other person, (iii) selling, transferring, leasing, lending or otherwise disposing of any assets, (iv) incurring or permitting to be outstanding any financial indebtedness (including guarantees), (v) reducing capital or purchasing any class of our shares, (vi) making any investment, including (1) loans to any person, (2) the acquisition of indebtedness or capital or securities of any person, (3) the acquisition of the assets, property or business of any other person, or (4) the creation or acquisition of a subsidiary, (vii) entering into any derivative instruments, (viii) changing the nature of our business or amending our constitutive documents, (ix) entering into any agreement or arrangement other than on an arm s-length basis, (x) paying dividends or making any repayment, prepayment or redemption of principal under any subordinated finance documents except the issuance of the 2007 Notes or in exchange for equity of an obligor, (xi) changing the ownership structure of the Company, and (xii) maintaining any bank account that has a credit balance with any person that is not a lender under the Amended Facilities Agreement.

Additionally, the Amended Facilities Agreement requires us to maintain specified consolidated financial ratios, such as leverage ratios (total senior debt to EBITDA and total debt to EBITDA), an interest coverage ratio (EBITDA to total debt interest charges) and a fixed charge coverage ratio (EBITDA minus capital expenditure minus cash taxes to total debt charges).

Under the terms of the Amended Facilities Agreement, we are required to observe certain affirmative undertakings, including, but not limited to, undertakings relating to (i) maintenance of all relevant consents, authorizations and licenses, (ii) conduct of business, (iii) periodic financial statements, management accounts and reports, (iv) auditors and information, (v) insurance and inspection, (vi) notification of environmental claims and expenditures, (vii) compliance with laws, (viii) taxes, and (ix) maintenance of a cost capitalization policy and an interest rate hedging policy.

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The term facilities are amortizing term loans with a maturity date of June 30, 2011. No amount repaid or prepaid in relation to the term facilities may be redrawn.

The revolving facility and the liquidity facility are each repayable in an amount equal to 100% of the principal amount outstanding on June 29 and December 30 of each calendar year until the maturity date of June 30, 2011.

Subject to certain exceptions, all loans under the Amended Facilities Agreement will be required to be prepaid upon the occurrence of certain change of control events. Voluntary prepayments and cancellations are permitted.

The Amended Facilities Agreement contains certain events of default customary for senior debt financings as well as an event of default related to Matel Holdings engaging in non-holding company-related activities, the occurrence of which would preclude further borrowings under the revolving facility and permit the lenders to accelerate all outstanding loans and terminate their commitments under the facilities.

The 2007 Notes

Upon the completion of the Invitel Acquisition on April 27, 2007, we completed the issuance of the 2007 Notes. We received 189 million following the payment of financing costs associated with the issuance of the 2007 Notes in the amount of 11 million, which costs were deferred and will be amortized to interest expense using the effective interest method over the term of the 2007 Notes. The proceeds from the issuance of the 2007 Notes were used to partly finance the Invitel Acquisition and to refinance the indebtedness of Hungarotel and PanTel.

The 2007 Notes mature on February 1, 2013 and bear interest at a rate of EURIBOR plus 3.0% per annum, payable quarterly in arrears on February 1, May 1, August 1 and November 1 of each year, beginning on August 1, 2007. The 2007 Notes are guaranteed by some of our subsidiaries. The 2007 Notes and subsidiary guarantees are collateralized by second-priority liens over certain inter-company funding loans, the capital stock of some of our subsidiaries, which liens rank pari passu with the liens over such assets collateralizing our obligations under the 2004 Notes described below.

We have the option to redeem the 2007 Notes, as a whole or in part, at any time or from time to time, at redemption prices specified in the 2007 Notes indenture (the 2007 Notes Indenture). In the event of a change of control, we must make an offer to purchase the 2007 Notes at a purchase price equal to 101% of the principal amount thereof. We are also required to offer to purchase the 2007 Notes with the excess proceeds following certain asset sales at a purchase price equal to 100% of the principal amount thereof.

The 2007 Notes Indenture contains covenants restricting our ability to, among other things, (i) incur additional indebtedness or issue preferred shares, (ii) make investments and certain other restricted payments, (iii) issue or sell shares in subsidiaries, (iv) agree to restrictions on the payment of dividends by subsidiaries, (v) enter into transactions with affiliates, (vi) create certain liens, (vii) merge, consolidate or combine with other entities, (viii) layer debt, (ix) designate subsidiaries as unrestricted subsidiaries, (x) engage in unrelated business activities and (xi) impair any security interests. The 2007 Indenture also contains customary events of default, including non-payment of principal, interest, premium or other amounts, violation of covenants, bankruptcy events, cross-defaults, material judgments and invalidity of any guarantee, security document or security interest.

The 2006 PIK Notes

On October 30, 2006, Invitel Holdings issued the 2006 PIK Notes pursuant to an Indenture, dated as of October 30, 2006 (the 2006 PIK Notes Indenture). In connection with the closing of the Invitel Acquisition on

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April 27, 2007, we entered into a supplemental indenture with Invitel Holdings and the 2006 PIK Notes Indenture trustee, pursuant to which we replaced Invitel Holdings 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.

Interest on the 2006 PIK Notes is payable quarterly in cash or in the form of additional 2006 PIK Notes at an annual rate of EURIBOR plus 8.25%, reset quarterly, plus a ratchet margin, on January 15, April 15, July 15 and October 15 of each year beginning January 15, 2007. The ratchet margin is zero for the period to but excluding October 15, 2009 and 2.00% if the consolidated leverage ratio of our subsidiary Matel is greater than 2.50 to 1.00 for any interest period beginning on or after October 15, 2009. The maturity date of the 2006 PIK Notes is April 15, 2013.

Our obligations under the 2006 PIK Notes are general unsubordinated obligations and are collateralized by a first priority lien over the shares of Matel Holdings and are effectively subordinated to all existing and future debt of our subsidiaries.

We have the option to redeem the 2006 PIK Notes, as a whole or in part, at any time or from time to time, at redemption prices specified in the 2006 PIK Notes Indenture. In the event of a change of control, we must make an offer to purchase the 2006 PIK Notes at a purchase price equal to 101% of the principal amount thereof. We are also required to make an offer to purchase the 2006 PIK Notes with the excess proceeds following certain asset sales at a purchase price equal to 100% of the principal amount of thereof.

The 2006 PIK Notes Indenture contains covenants restricting our ability to, among other things, (i) incur additional indebtedness or issue preferred shares, (ii) make investments and certain other restricted payments, (iii) enter into transactions with affiliates, (iv) create certain liens, (v) enter into sale and leaseback transactions, (vi) issue or sell shares of subsidiaries, (vii) merge, consolidate or combine with other entities, (viii) designate subsidiaries as unrestricted subsidiaries, (ix) engage in unrelated business activities and (x) impair any security interests. The 2006 PIK Notes Indenture also contains customary events of default, including, among other things, non-payment of the principal, interest or premium, if any, on any 2006 PIK Notes, certain failures to comply with any covenant of the 2006 PIK Notes Indenture, certain defaults under other indebtedness, failure to pay certain indebtedness or judgments, bankruptcy or insolvency events and invalidity of any security document or security interest.

The 2004 Notes

In August 2004, Matel issued the 2004 Notes pursuant to an Indenture (the 2004 Notes Indenture) with a trustee, and, as subsidiary guarantors, Matel s subsidiaries Invitel and V-Holding.

Interest on the 2004 Notes is payable semi-annually at an annual rate of 10.75% on February 15 and August 15 of each year, beginning on February 15, 2005.

We have the option to redeem the 2004 Notes, as a whole or in part, at any time or from time to time, at redemption prices specified in the 2004 Notes Indenture. Upon certain change of control events, we are required to make an offer to purchase all of the 2004 Notes, at a purchase price equal to 101% of the principal amount thereof, plus accrued and unpaid interest to the date of purchase. We are also required to offer to purchase the 2004 Notes with the excess proceeds from certain sales of assets at 100% of the principal amount of the 2004 Notes, plus accrued and unpaid interest to the date of repurchase.

Our obligations under the 2004 Notes are guaranteed on a senior subordinated basis by some of our subsidiaries that guaranteed our obligations under the 2007 Notes and are collateralized by the same collateral securing the 2007 Notes.

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The 2004 Notes Indenture contains covenants which, among other things, limit the ability of Matel and its restricted subsidiaries to (i) incur additional indebtedness and issue preferred shares, (ii) make certain restricted payments and investments, (iii) transfer or sell assets, (iv) enter into transactions with affiliates, (v) create certain liens, (vi) create restrictions on the ability of certain subsidiaries to pay dividends or other payments to Matel, (vii) guarantee other indebtedness, (viii) enter into sale and leaseback transactions, (ix) issue or sell shares of some of our restricted subsidiaries, (x) merge, consolidate, amalgamate or combine with other entities, (xi) designate restricted subsidiaries as unrestricted subsidiaries, and (xii) engage in any business other than a permitted business. The 2004 Notes Indenture also contains customary events of default, including, among others, the non-payment of principal, interest or premium on the 2004 Notes, certain failures to perform or observe any other covenant in the 2004 Notes Indenture, the occurrence of certain defaults under other indebtedness, failure to pay certain indebtedness or judgments, bankruptcy or insolvency events and invalidity of any guarantee, security document or security interest.

Intercreditor Agreement

In order to reflect the new obligations under the 2007 Notes and previously disclosed hedging obligations and to establish the relative rights of certain of our creditors under our financing arrangements (including priority of claims and subordination), we entered into an Intercreditor Agreement with, among others, the lenders under the Amended Facilities Agreement, certain hedging counterparties, the security trustee, the trustee for the 2007 Notes and the trustee for the 2004 Notes. The Intercreditor Agreement provides that if there is an inconsistency between the provisions of the Intercreditor Agreement (regarding subordination, turnover, ranking and amendments only), and certain other documents, including the 2007 Notes Indenture governing the 2007 Notes, the Intercreditor Deed will prevail.

(9) **Short-term Debt**

Short-term debt at December 31, 2007 and 2006 consists of the following:

(in thousands)	**2007**	**2006**
Notes payable, interest at USD LIBOR + 3.5% (8.88% at December 31, 2006), due March 31, 2007 (less unamortized discount based on imputed interest rate of 5% $343,000)	$	$ 24,657
Total short-term debt	$	$ 24,657

In May 1999, we issued notes (the Notes), in an aggregate amount of $25 million with detachable warrants (the Warrants). The Notes accrued interest payable semi-annually, at the USD LIBOR rate applicable for the six month interest period plus 3.5% (8.88% at December 31, 2006). The Warrants enabled the warrant holder to purchase 2,500,000 shares of our common stock at an exercise price of $10 per share. Payment of the exercise price could be made in the form of either cash or surrender of the Notes. The exercise period commenced on January 1, 2004 and terminated on March 31, 2007.

At inception, the fair value of the Warrants was $8.8 million and was credited to additional paid-in capital, with the offsetting charge being accounted for as a discount on the Notes. Upon adoption of SFAS No. 133, the Warrants were required to be reclassified as liabilities and accounted for as derivatives with changes in fair value reported in earnings. The unamortized discount on the Notes at December 31, 2006 was approximately $0.3 million, and is reflected as a reduction of the carrying amount of the Notes.

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The fair value of the Warrants was determined using the Black-Scholes Option valuation model. The Notes and Warrants were owned by TDC as of December 31, 2006.

The Notes were canceled upon the exercise of the Warrants by TDC on March 28, 2007.

(10) **Derivative Financial Instruments**

We engage in foreign currency and interest rate hedging activities to reduce the risk that changes in currency exchange rates and interest rates will adversely affect the eventual net cash flows resulting from our debt obligations.

We do not enter into financial instruments for trading or speculative purposes. However, the derivative instruments used by us are not designated as hedges under SFAS 133 for accounting purposes and, as such, are referred to as undesignated hedges. Changes in the fair value of undesignated hedges are therefore recorded in current period earnings as a gain or loss on derivative instruments.

Interest rate risk hedging

To limit the variability of interest rates on all of our cash-pay debt, we entered into interest rate swap agreements to manage some of our fluctuations in cash flows resulting from interest rate risk. Under the terms of the interest rate swaps, we receive variable interest rate payments from the hedging counterparty and make fixed interest rate payments in the same currency, thereby creating the equivalent of fixed rate debt.

Foreign exchange rate risk hedging

To limit the impact of fluctuations between the Hungarian subsidiaries functional currency, the Hungarian forint, and the euro, we have entered into currency swap agreements and foreign exchange forward agreements, to receive euros and pay forint, thereby creating the equivalent of Hungarian forint debt obligations.

In addition to the above instruments, we use cross-currency interest rate swaps to hedge both the interest rate and the currency exposure inherent in foreign currency denominated debt instruments bearing variable interest. By entering into such transactions we receive variable interest payments in foreign currency and make fixed interest payments in Hungarian forint, the functional currency of our Hungarian subsidiaries, thereby creating the equivalent of fixed rate debt in the functional currency of our Hungarian subsidiaries. The cross currency interest rate swaps in effect are the same as the combination of interest rate swaps and foreign exchange forward contracts applied to the same underlying hedged item.

The objective of these contracts is to neutralize the impact of currency exchange rate and interest rate movements on our cash flows. However, given the inherent limitations of forecasting and the anticipatory nature of the exposures intended to be hedged, there can be no assurance that such programs will offset more than a portion of the adverse financial impact resulting from unfavorable movements in either interest or currency exchange rates.

Credit risk related to hedging

By using derivative financial instruments to hedge exposures to changes in interest rates and currency exchange rates, we expose ourself to the credit risk of the counterparty. Credit risk is the failure of the counterparty to perform its obligations under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes us, which creates a credit risk for us. When the fair value of a derivative contract is negative, we owe the counterparty and, therefore, we do not have any credit risk. Our policy requires that counterparties to our hedging activities be large and creditworthy commercial banks. We do

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not consider the risk of counterparty non-performance associated with hedge contracts to be significant. We do not require and are not required to place collateral for these financial instruments independently of our security arrangements under the Amended Facilities Agreement.

To ensure the adequacy and effectiveness of our interest rate and foreign exchange hedge positions, we continually monitor, from an accounting and economic perspective, the derivatives positions in conjunction with our underlying interest rate and foreign currency exposures.

The following table summarizes the notional amounts and respective fair values of our derivative financial instruments, which mature at varying dates, as of December 31, 2007:

(in thousands)	Notional Amount	Fair Market Value	Fair Value Change
Asset / (Liability)			
Cross currency interest rate swaps	$ 612,084	$ (35,086)	$ (32,945)
FX forward contracts		21	1,348
Interest rate swaps	23,009	(784)	(1,361)
Interest rate swaps on credit facility loan			(2,955)
Total	$ 635,093	$ (35,849)	$ (35,913)

The following table summarizes the notional amounts and respective fair values of our floating to fixed interest rate swaps, which mature at varying dates, as of December 31, 2007:

(in thousands)	Notional Amount	Fair Market Value	Maturity	Fixed Interest Rate
Asset / (Liability)				
Amended Facilities Agreement	$ 115,100	$ (5,905)	June 30, 2011	9.3790%
Amended Facilities Agreement	23,009	(784)	June 30, 2011	10.160%
2007 Notes	60,221	(2,510)	August 1, 2009	10.780%
2007 Notes	60,221	(2,918)	August 1, 2009	10.740%
2007 Notes	87,334	(4,206)	August 1, 2009	10.724%
2007 Notes	80,786	(3,891)	August 1, 2009	10.724%
2004 Notes	208,422	(15,656)	August 15, 2009	14.955%
Total Interest Rate Swaps	$ 635,093	$ (35,870)		

The notional principal amount provides one measure of the transaction volume outstanding as of the end of the period, and does not represent the amount of our exposure to market loss.

We estimate the fair values by using a model which discounts future contractual cash-flows determined based on market conditions (foreign exchange rates, yield curves in the functional currency and in the foreign currency) prevailing on the date of the valuation. The model used by us is regularly tested against third party prices for reasonableness. The fair value represents the estimated amounts that we would pay or receive to terminate the contracts as of December 31, 2007. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

Embedded derivatives

An embedded derivative is an implicit or explicit term within a contract that does not in its entirety meet the definition of a derivative instrument but affects some or all of the cash-flows or the value of other exchanges required by the contract in a manner similar to a derivative. An embedded derivative therefore is a derivative

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instrument within another contract that is not a derivative. For example, a euro denominated operating lease contract that a Hungarian subsidiary enters into for a given period of time will give rise to foreign currency exposure for that period since our Hungarian subsidiary will need to buy euro from its functional currency, the Hungarian forint, thereby having an impact on cash-flows. Therefore the series of foreign exchange forward contracts are embedded in the lease agreement, the host contract, and are accounted for separately.

Embedded derivatives are separated from the host contract and accounted for separately if (i) the economic characteristics and risks of the host contract and the embedded derivative are not clearly and closely related; (ii) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (iii) the combined instrument is not measured at fair value with changes in fair value reported through earnings. Changes in the fair value of separable embedded derivatives are recognized immediately in the statement of operations.

We review our material contracts regularly to identify embedded derivatives which require bifurcation from the host contract.

The following table summarizes the fair values of our embedded derivatives as of December 31, 2007 and 2006:

(in thousands)	**2007**	**2006** *(as restated see Note 1(c))*
Embedded derivatives	$ (617)	$ (935)

Warrants

In connection with the Warrants issued in May, 1999 (see Note 9), we were required to measure and reflect the changes in the fair value of the Warrants in earnings. The fair value of the Warrants was highly dependent on the fair value of HTCC s common stock.

The fair value of the Warrants was determined using the Black-Scholes option valuation model. The Warrants were exercised on March 28, 2007. The fair value of the Warrants at December 31, 2007, 2006 and 2005 and related fair value changes for the years then ended, are as follows:

Year	**Fair Value**	**Gain (Loss) in Fair Value**
	(in thousands)	
2007	$	$ (15,075)
2006	13,050	3,300
2005	16,350	(1,500)

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(11) **Selling, General and Administrative Expenses**

The following table presents selling, general and administrative expenses by type for the years ended December 31, 2007, 2006 and 2005:

(in thousands)	**2007**	**2006** *(as restated See Note 1(c))*	**2005**
Personnel expenses	$ 46,100	$ 24,529	$ 24,462
Other administrative expenses	19,731	6,482	9,571
Advertising and marketing costs	6,216	2,049	1,898
Network operating expenses	28,593	17,616	16,234
IT costs	7,204	2,239	1,558
Other taxes	2,285	1,226	480
Bad debt and collection costs	3,030	1,075	2,525
Legal, audit and consultant fees	5,878	4,553	4,298
Management fees	25		
Total for segments	$ 119,062	$ 59,769	$ 61,026
Backbone rental expenses	(15,548)	(9,709)	(8,148)
Network operating expenses	(18,506)	(8,748)	(7,624)
Direct personnel expenses	(18,660)	(6,211)	(7,409)
Total selling, general and administrative expenses (excluding severance expenses)	$ 66,348	$ 35,101	$ 37,845

Bad debt and collection costs for the year ended December 31, 2007 include one-time bad debt expenses as a result of an additional provision made at PanTel in the amount of $1,352,000.

Legal, audit fees and consultant expenses for the year ended December 31, 2007 include Sarbanes-Oxley and other compliance expenses amounting to $2,351,000.

Other administrative expenses for the year ended December 31, 2007 include integration costs of $9,447,000 and due diligence expenses of $684,000.

(12) **Income Taxes**

The income (loss) before income taxes by tax jurisdiction for the years ended December 31, 2007, 2006 and 2005 were as follows:

(in thousands)	**2007**	**2006** *(as restated see Note 1(c))*	**2005**
Income / (loss) before income taxes:			
United States	$ (37,456)	$ 2,928	$ (5,013)
Hungary	(57,814)	19,095	12,808
Romania	2,130	158	45

Total income before income taxes	$ (93,140)	$ 22,181	$ 7,840

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The income tax benefit (expense) is attributable to income (loss) from continuing operations and consists of the following for the years ended December 31, 2007, 2006 and 2005:

(in thousands)	**2007**	**2006** *(as restated see Note 1(c))*	**2005**
Current tax benefit (expense):			
United States	$	$	$
Romania	(80)	(64)	7
Hungary			
Corporate tax	(419)	(1,688)	(1,599)
Local business tax	(6,616)	(3,867)	(3,365)
Total current tax expense	$ (7,115)	$ (5,619)	$ (4,957)
Deferred tax benefit (expense):			
United States	$	$	$ (2,030)
Romania	(233)		
Hungary	4,008	338	539
Total deferred tax	$ 3,775	$ 338	$ (1,491)
Total income tax expense	$ (3,340)	$ (5,281)	$ (6,448)

The statutory U.S. Federal tax rate for the years ended December 31, 2007, 2006 and 2005 was 35% and the Hungarian corporate income tax rate for the years ended December 31, 2007, 2006 and 2005 was 16%. In addition to the corporate income tax rate of 16% in Hungary, a solidarity tax of 4%, introduced from September 1, 2006, has been levied on companies on top of the corporate income tax rate. A reconciliation of income tax expense at the U.S. parent company income tax rate to actual income tax benefit (expense) for the years ended December 31, 2007, 2006 and 2005 is as follows:

(in thousands)	**2007**	**2006** *(as restated see Note 1(c))*	**2005**
Income tax expense using the parent company tax rate (35% in the U.S.)	32,599	(7,763)	(2,195)
Impact of difference in tax rate of subsidiaries	(10,434)	3,152	1,608
Effect of change in tax rate		709	
Non-deductible expenses	(1,187)	(389)	(82)
Reserve on loss with no tax benefit	(17,984)	1,383	(2,882)
Local business tax and other tax, net of benefit	(6,609)	(2,524)	(2,827)
Other	275	151	(70)
Income tax expense	$ (3,340)	$ (5,281)	$ (6,448)

For U.S. Federal income tax purposes we have unused net operating loss carry forwards at December 31, 2007 of approximately $45,606,000, which expire as follows: $4,603,000 in 2010; $6,438,000 in 2011; $3,645,000 in 2012; $2,113,000 in 2018; $12,385,000 in 2019; $724,000 in 2024; $3,302,000 in 2025; $1,112,000 in 2026 and $11,284,000 in 2027. As a result of certain equity transactions, we believe that we experienced an ownership change in 1999, as defined by Section 382 of the Internal Revenue Code, which limits the annual utilization of net operating loss carry forwards. As calculated, the Section 382 limitation will not necessarily prevent the ultimate utilization of the U.S. net operating loss carry forwards although it may defer the realization of tax benefits associated with loss carry forwards originating prior to the ownership change.

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For Hungarian corporate income tax purposes, we have unused net operating loss carry forwards at December 31, 2007 of approximately $78,475,000 of which $27,543,000 expires in 2008 and $50,932,000 is not subject to expiration limitations.

We have not provided any deferred taxes for undistributed earnings of our foreign subsidiaries. As a result of valuation allowances against losses in the U.S. and in the Netherlands, the distribution of this income would not result in an incremental tax liability. Such undistributed earnings of foreign subsidiaries amounted to $8,947,000 as of December 31, 2007 and $18,131,000 as of December 31, 2006.

We file income tax returns in the U.S. while our directly owned subsidiaries file income tax returns in Hungary. The years following 2003 remain open for examination and assessment by the IRS. The APEH has audited the income tax returns of Invitel, PanTel and PanTel Technocom through 2004 and Hungarotel through 2003. We are also file tax returns in six other Central and Eastern European countries where we established subsidiaries. We are not aware of any outstanding issue or claim that is likely to be material to our financial position, cash flows or results of operations in any of the jurisdictions in which we operate.

The tax effect of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities are as follows:

	December 31	
(in thousands)	**2007**	**2006** *(as restated See Note 1(c))*
Deferred tax assets:		
Net operating loss carry forwards	$ 55,571	12,098
Property, plant and equipment	10,820	8,798
Intangible assets	2,427	2,165
Derivative financial instruments	6,865	506
Other	8,131	4,254
Total gross deferred tax assets	83,814	27,821
Less: valuation allowance	(47,854)	(15,074)
Net deferred tax assets	35,960	12,747
Deferred tax liabilities:		
Property, plant and equipment	(37,139)	(508)
Intangible assets	(8,164)	(5,300)
Derivative financial instruments	(611)	(17)
Development reserve	(1,353)	(1,398)
Other	(8,335)	(579)
Total gross deferred tax liabilities	(55,602)	(7,802)
Net deferred tax asset (liability)	$ (19,642)	4,945

In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of our deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences are deductible and loss carry forwards are utilizable. Based on the level of historical taxable income and our projections of future taxable income over the periods in which the deferred tax assets are deductible, we believe that it is more likely than not that we will realize the benefits of our deferred tax assets, net of the valuation allowance. The amount of the deferred tax asset considered realizable, however, could be reduced if

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our estimates of future taxable income during the future periods are reduced. We consider the reversal of deferred tax liabilities, projected future taxable income and tax planning in making these assessments. The net change in the total valuation allowance for the years ended December 31, 2007, 2006 and 2005 was an increase of $32,780,000, an increase of $161,000 and an increase of $3,010,000, respectively.

(13) **Commitments and Contingencies**

(a) *Concession Agreements*

We have concession agreements with the Hungarian Ministry of Economics and Transport (the Ministry) to own and operate local public telephone networks in five Hungarotel historical concession areas in Hungary. Each of the concession agreements is for a term of 25 years, ending in 2019, and provided for an eight-year exclusivity period up to November 2002. Pending negotiations with the Ministry, we expect to terminate or amend the concession agreements as these are not compatible with the liberalized telecommunications market created by the Communications Act of 2001 and the Electronic Communications Act of 2003.

Our concession agreements provide for the payment by us of annual concession fees of between 0.1% and 2.3% of net telephone service revenues depending on the concession area. We accrued the annual concession fees for 2001 of HUF 157 million (approximately $0.9 million at December 31, 2007 exchange rates), but as of December 31, 2007 have not paid this amount. The annual concession fees for 2002, which we have neither accrued for, nor paid, would total approximately HUF 142 million (approximately $0.8 million at December 31, 2007 exchange rates).

The Communications Act of 2001 replaced the concession system with a notification system under which new operators may offer telecommunications services in competition with us in our historical concession areas merely upon notification to the Communications Authority and the payment of a nominal fee of HUF 10,000 (approximately $58 at December 31, 2007 exchange rates). A new operator would require a license if it intended to use radio frequencies, build its own network or request an allocation of a number range to subscribers, but the granting of such licenses is by-and-large an administrative matter. We paid one-time concession fees to the Hungarian government when the concessions were originally granted and expected that if, after the expiration of the eight-year exclusivity periods, the state were to grant new operators rights to compete against us in our historical concession areas, such rights would have been granted following a tender, with the new operators having to pay more than a nominal fee for the rights in the same manner that we originally paid for our concessions.

The concession agreements contain an equal treatment clause that explicitly states that the Ministry should not treat the concession company in an unequal or prejudicial manner compared to other telecommunications companies. We believe that the move from the concession system to the notification system, a system in which there are effectively no barriers to entry, breached our legitimate expectation that we would continue to benefit from the one-time concession fees we paid even after the end of our exclusivity periods because any competitor would also have to make a real investment in the form of a license fee in order to compete.

Pending the outcome of the current negotiations on the mutual termination or amendment of the concession agreements, we have thus far withheld the payment of the concession fees for 2001.

For 2002 and subsequent years, we believe that we are not required to pay concession fees at all. In addition to the local loop unbundling obligations, the Communications Act imposed universal service obligations on us. These obligations were substantially restated in the Electronic Communications Act and are incorporated in a Universal Service Agreement between us and the Ministry.

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The link between the end of the concession agreements and the coming into force of the universal service obligations is recognized by Section 106(5) of the Communications Act, which states In connection with the amendment of concession agreements to ensure the provision of the universal service, the Minister may, in justified cases, reduce the concession fee payment liability or release service providers therefrom, and, in parallel with the conclusion of the universal service agreement, may initiate the termination of the concession contract by mutual agreement .

Negotiations regarding the amendment or cancellation of the concession contracts are currently in progress. We believe that the request from the Ministry to pay the annual concession fees for (a) 2001 is subject to a counterclaim by us arising as a result of the State replacing the concession system with the notification system and (b) 2002 is based on groundless arguments and is a breach of the equal treatment clause (referred to above) in the concession agreements.

Accordingly, we believe that it is unlikely that the Ministry will be able to successfully enforce the claim in respect of the annual concession fees for 2002 and thus we believe that this issue will not have a material effect on our consolidated financial position, results of operations or liquidity.

(b) *Legal Proceedings*

We are involved in various claims and legal actions arising in the ordinary course of business. In our opinion, the ultimate disposition of these matters will not have a material effect on our consolidated financial position, results of operations or liquidity.

(c) *Guarantees*

Guarantees and claims arise during the ordinary course of business from our relationships with suppliers and customers when we undertake an obligation to guarantee our performance if specified triggering events occur. Nonperformance under a contract could trigger an obligation for us. These potential claims can arise from late or non-payment to suppliers (payment guarantees) and/or late or incomplete delivery of services to customers (performance guarantees). We also provide bid guarantees to new or existing customers in connection with bids on commercial projects.

Our potential future payments under these guarantees as of December 31, 2007 are summarized as follows:

(in thousands)	**2007**
Payment guarantees	$ 6,271
Performance guarantees	$ 605
Bid guarantees	$ 32
	$ 6,908

There is no recourse provisions specifically stipulated in the guarantee contracts. Our recourse would be to investigate executed guarantees with the supplier or customer and determine at that time whether we should be reimbursed for the guarantee. None of the guarantees are secured by our assets. We are not currently aware of any exposure associated with these guarantees and thus have not recorded any liability related to these guarantees.

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(d) *Lease Commitments to Telecommunication Service Providers*

We have entered into separate agreements with various telecommunications service providers to lease lines, which have non-cancelable contract provisions in excess of one year. Our future minimum commitments under these contracts, at December 31, 2007 exchange rates, are: $4,596,000 in 2008, $4,156,000 in 2009, $3,567,000 in 2010, $2,503,000 in 2011, $1,264,000 in 2012 and $7,397,000 thereafter.

(e) *Other Lease Commitments*

We lease office and other facilities, which require minimum annual rentals.

We have entered into vehicle leases that are capital leases in nature. The net book value of vehicles held under capital leases is as follows:

(in thousands)	**December 31, 2007**	**2006**
Vehicles	$ 1,680	$ 1,513
Less: accumulated depreciation	(1,296)	(713)
Net book value included in property, plant and equipment	$ 384	$ 800

Rent expense under operating lease agreements for the years ended December 31, 2007, 2006 and 2005, was $5,709,000, $2,717,000 and $2,581,000, respectively, and is included in selling, general and administrative expenses.

Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2007 (at December 31, 2007 exchange rates) are:

(in thousands)	**Capital leases**	**Operating leases**
Year ending December 31:		
2008	$ 459	$ 2,729
2009	13	993
2010		482
2011		273
2012		33
(ii) Later years, through 2020		66
(iii) Total minimum lease payments	$ 472	$ 4,576

We have various purchase commitments for materials, supplies and other items incidental to the ordinary course of business. There are no material contractual commitments extending beyond 2008 and such commitments are not at prices in excess of current market value.

(14) **Common Stock and Cumulative Convertible Preferred Stock**

As of December 31, 2007 and 2006, we had 30,000 shares of our cumulative convertible preferred stock, with a $70 liquidation value per share, outstanding. Any holder of the cumulative convertible preferred stock is entitled to receive cumulative cash dividends payable in arrears, at an annual rate of 5%, compounded annually on the liquidation value of $70 per share. We may, at our option, redeem the Preferred Stock at any time. The

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Cumulative Convertible Preferred Stock is convertible into shares of the Company s common stock on a one for ten basis. As of December 31, 2007 and 2006, the total arrearage on the cumulative convertible preferred stock was $850,000 and $756,000, respectively, and is included in Due to Related Parties.

Redeemable Equity Securities

In connection with the Invitel Acquisition, we issued 938,550 shares of our common stock on the acquisition date to certain members of Invitel s management team (each a Manager) in payment for some of their shares in Invitel. The issuance of the common stock was made pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933. In connection with the HTCC shares they received as part of the acquisition consideration for Invitel, the Managers were also given the right, under certain circumstances, to require the Company to purchase all or part of those shares (i.e., a put right) at a specified price. If at any time after 30 days following the acquisition date, a Manager s employment is terminated without cause or due to the Manager s death or disability, the Manager or (or the Manager s estate) is entitled to require us to purchase all or part of the HTCC shares the Manager acquired in connection with the Invitel Acquisition at a per share price equal to the fair market value of such shares on the date of such termination. In addition the Manager also received unlimited piggyback registration rights in any public offering of HTCC s equity securities for our own account or for the account of any holders of our securities with registration rights. As a result of the put rights, the redemption of the shares is not within the control of the Company and, therefore, these common shares are classified as Redeemable Equity Securities within temporary equity on the balance sheet.

We reserved 3,601,284 shares as of December 31, 2007 for issuance under stock option plans, compensation agreements, and under the conversion terms applicable to our outstanding cumulative convertible preferred stock.

(15) **Stock Based Compensation**

As of December 31, 2007, we had outstanding options to purchase 80,000 shares of common stock issued from the 2002 Plan; outstanding options to purchase 100,000 shares of common stock issued from the Directors Plan; and outstanding options to purchase 390,000 shares of common stock under the 2004 Plan. Upon our stockholders approval of the 2004 Plan, we agreed not to issue any more shares from either the 2002 Plan or the Directors Plan.

We issued a total of 15,000 shares of common stock to directors of the Board of Directors for their services for the 2004/2005 Board term under the terms of the 2004 Plan. 2,000 of those shares were subsequently canceled due to a resignation in 2004 and a further 3,000 were canceled in 2005. We issued a total of 6,000 shares of common stock to directors for their service for the 2005/2006 Board term under the terms of the 2004 Plan. We issued a total of 6,000 shares of common stock to directors for their service for the 2006/2007 Board term under the terms of the 2004 Plan. 1,500 of those shares were subsequently canceled due to a resignation in 2006 and an additional 1,500 were granted due to an appointment in 2006. 500 shares were issued to a new director for his board service for the remaining 3 months of the 2006/2007 board term. We issued a total of 6,000 shares of common stock to directors for their service for the 2007/2008 Board term under the terms of the 2004 Plan. Shares issued to directors for their annual services vest over the board term. For the years ended December 31, 2007, 2006 and 2005, we had expenses of $126,000, $95,000 and $92,000 respectively, resulting from certain stock grants from our 2004 Plan to Directors.

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The following is a summary of stock options under the 2002 Plan, the Directors Plan or the 2004 Plan, referred to above, which were granted, were exercised or have expired for the three years ended December 31, 2007:

	Outstanding Options	Weighted Average Price
December 31, 2004	821,284	$ 6.79
Granted	155,000	$ 13.01
Exercised	(205,000)	$ 5.41
December 31, 2005	771,284	$ 8.41
Granted	55,000	$ 15.62
Exercised	(25,000)	$ 4.86
December 31, 2006	801,284	$ 9.01
Granted	20,000	$ 14.64
Exercised	(220,000)	$ 6.39
Cancelled	(31,284)	$ 7.55
December 31, 2007	570,000	$ 10.30

Some options issued under our stock option plans vest upon issuance. The following table summarizes information about shares subject to outstanding options as of December 31, 2007, which were issued to current or former employees, or directors pursuant to the 2002 Plan, Directors Plan or the 2004 Plan:

Options Outstanding				(1) Options Exercisable	
Number Outstanding	Range of Exercise Prices	Weighted-Average Exercise Price	Weighted-Average Remaining Life in Years	Number Exercisable	Weighted-Average Exercise Price
40,000	$ 4.72	$ 4.72	4.00	40,000	$ 4.72
80,000	$ 5.78-$6.78	$ 6.22	2.79	80,000	$ 6.22
200,000	$ 7.46-$9.39	$ 9.00	5.80	200,000	$ 9.00
175,000	$ 10.89-$13.01	$ 12.77	6.82	175,000	$ 12.77
75,000	$ 14.64-$15.62	$ 15.36	8.27	75,000	$ 15.36
570,000	$ 4.72-$15.62	$ 10.30	5.89	570,000	$ 10.30

The aggregate intrinsic value, which represents the amount by which the fair value of our common stock exceeds the option exercise prices, was $4,210,000 and $4,905,000 as of December 31, 2007 and 2006, respectively.

The weighted-average estimated fair value of stock options granted during the year ended December 31, 2007 was $14.64 per share. The weighted-average estimated fair value of stock options granted during the year ended December 31, 2006 was $8.93 per share. The total intrinsic value of stock options exercised during the year ended December 31, 2007 was $3,143,600. The total intrinsic value of stock options exercised during the year ended December 31, 2006 was $267,000. Compensation expense related to stock options granted has been recorded in selling, general and administrative expenses.

There are sufficient shares reserved for issue upon exercise of the outstanding options.

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(16) **Foreign Exchange Gains (Losses)**

We incur foreign exchange gains and losses primarily as a result of the fluctuation of the Hungarian forint, the functional currency of our Hungarian subsidiaries, mainly against the euro with respect to the euro-denominated debt held by our Hungarian subsidiaries.

(17) **Related Parties**

The net balance of receivables from and payables to related parties was a net payable to TDC in the amount of $1,400,000 at December 31, 2007. This represents cumulative preferred stock dividends in arrears payable to TDC in the amount of $850,000, an accrual of $453,000 for strategic projects; $201,000 for the costs for various individuals employed by TDC who have performed work for us and a net $104,000 receivable in connection with the transport of international voice, data and Internet traffic over the Company s and TDC s respective telecommunications networks for each other and other items.

On March 28, 2007, TDC exercised its warrants to purchase 2,500,000 shares of our Common Stock in exchange for notes issued by us and held by TDC in the principal amount of $25 million. As of December 31, 2007, TDC owned 64% of our outstanding Common Stock and 30,000 shares of our preferred stock convertible into 300,000 shares of Common Stock.

Robert Dogonowski, Jesper Theill Eriksen, Carsten Dyrup Revsbech and Henrik Scheinemann, current directors of the Company, are officers of TDC. Torben V. Holm was an employee of TDC when he served as our President and Chief Executive Officer and as the head of management s executive committee through April 2007. Alex Wurtz was also an employee of TDC when he served as our head of Corporate Business Development and as a member of management s executive committee through April 2007.

For Mr. Holm, we paid 981,371 (approximately $1.4 million) for his services for the period from May 2005 through April 2007. We were also responsible for paying other costs pertaining to Mr. Holm, including housing in Budapest and for certain of Mr. Holm s travel costs back to his home in Denmark.

For Mr. Wurtz, we paid 501,707 (approximately $0.7 million) for his services for the period from June 2005 through April 2007. We were also responsible for paying Mr. Wurtz s housing in Budapest.

All of the directors of the Company are covered by a directors and officers liability policy taken out by TDC. As of December 31, 2007, we had approximately $302,000 in expenses for our portion of the overall premium paid by TDC.

We have agreements in place with TDC, pursuant to which TDC and the Company transport international voice, data and Internet traffic for each other over our respective telecommunications networks. For the years ended December 31, 2007 and 2006, we transported these services for TDC in the amount of approximately $2,117,000 and $1,825,000, respectively, pursuant to such agreements. For the years ended December 31, 2007 and 2006, we agreed to pay TDC an amount of approximately $866,000 and $691,000, respectively, pursuant to such agreements.

(18) **Employee Benefit Plan**

Effective December 1996, we established a 401(k) salary deferral plan (the 401(k) Plan) on behalf of our U.S. employees. The 401(k) Plan is a qualified defined contribution plan, and allows participating employees to defer up to 15% of their compensation, subject to certain limitations. Under the 401(k) Plan, we have the discretion to match contributions made by the employee. No matching contributions were made by us in 2007, 2006 or 2005.

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(19) **Segments**

We manage our business based on four segments: Mass Market Voice, Mass Market Internet, Business and Wholesale segments. Our management monitors the revenue streams of these categories and operations are managed and financial performance is evaluated based on these segments (see Note 1(d) Revenue Recognition).

Substantially, all of our assets are located in Hungary and over 81% of all of our operating revenues are generated in Hungary. All of our assets are used in all of our market segments due to the nature of our operations

Segment gross margin is the measure used by our management in assessing our segments performance and how to allocate resources.

The revenue by segment and segment gross margin for the periods ended December 31, 2007, 2006 and 2005 were as follows (in thousands):

(in thousands)	**2007**	**2006** *(as restated see Note 1(c))*	**2005**
Revenue:			
Mass Market Voice	$ 108,834	$ 33,490	$ 37,083
Mass Market Internet	33,647	3,284	2,015
Business	125,888	70,645	65,167
Wholesale	116,824	81,841	75,378
Total revenue	385,193	189,260	179,643
Segment Cost of Sales:			
Mass Market Voice	(22,124)	(7,212)	(7,042)
Mass Market Internet	(5,650)	(121)	(45)
Business	(35,313)	(19,685)	(14,624)
Wholesale	(68,751)	(46,330)	(40,426)
Total segment cost of sales	(131,838)	(73,348)	(62,137)
Backbone rental expenses	(15,548)	(9,709)	(8,148)
Network operating expenses	(18,506)	(8,748)	(7,624)
Direct personnel expenses	(18,660)	(6,211)	(7,409)
Total cost of sales	(184,552)	(98,016)	(85,318)
Segment Gross Margin:			
Mass Market Voice	$ 86,710	$ 26,278	$ 30,041
Mass Market Internet	27,997	3,163	1,970
Business	90,575	50,960	50,543
Wholesale	48,073	35,511	34,952
Total segment gross margin	253,355	115,912	117,506
Backbone rental expenses	(15,548)	(9,709)	(8,148)
Network operating expenses	(18,506)	(8,748)	(7,624)
Direct personnel expenses	(18,660)	(6,211)	(7,409)

Selling, general and administrative expenses	(66,348)	(35,101)	(37,845)
Severance costs	(9,103)	(700)	(2,533)
Depreciation and amortization	(79,003)	(26,137)	(23,968)
Income from operations	46,187	29,306	29,979

For the years ended December 31, 2007, 2006 and 2005 none of our customers accounted for more than 10% of our total gross revenue.

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Revenue by country for the periods ended December 31, 2007, 2006 and 2005 were as follows (in thousands):

(in thousands)	**2007**	**2006** *(as restated see Note 1(c))*	**2005**
Revenue:			
Hungary	$ 373,311	$ 186,660	$ 179,251
Romania	11,490	1,623	204
Bulgaria	289	977	176
Slovakia			
Austria			12
Slovenia	103		
Total revenue	385,193	189,260	179,643

The net book values of long-lived assets by country as of December 31, 2007 and 2006 were as follows (in thousands):

(in thousands)	**2007**	**2006**
Long-Lived Assets:		
Hungary	$ 878,940	$ 226,979
Romania	12,196	1,347
Bulgaria	1,065	1,011
Slovakia	148	160
Austria		104
Slovenia	84	92
Total long-lived assets	892,433	229,693

(20) **Severance Costs**

Our severance expenses for year ended December 31, 2007, of $9.1 million, are primarily due to the termination costs related to the restructuring of our operations following the Invitel Acquisition. Out of our total severance cost, $643,000 was unpaid at December 31, 2007.

Our severance expenses for year ended December 31, 2006, of $0.7 million, are due primarily to the termination costs related to an officer, as well as other individually insignificant severance costs related to the workforce of the Hungarian entities.

(21) **Summary of non-cash transactions**

Cash paid interest during the years ended December 31, 2007, 2006 and 2005 was $45.0 million, $12.1 million and $10.3 million, respectively and cash paid income taxes during the years ended December 31, 2007, 2006 and 2005 was $10.2 million, $5.5 million and $4.6 million, respectively.

Summary of non-cash transactions:

During 2005 we:

- Assumed debt, on February 28, 2005, of 66M ($80.5 million at historical exchange rates) on acquisition of subsidiaries.

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Issued 106,814 net shares of Common Stock under the terms of employee stock option exercises.

Entered into capital lease arrangements concerning vehicles, the value of which at the date of lease inception was $1.4 million.

Issued 6,000 shares of Common Stock in May, which vested over a one year period, as compensation to members of the Board of Directors. The recognized compensation expense of these stock grants in 2005 amounted to $92,000.

During 2006 we:

Issued 10,204 shares of Common Stock under the terms of employee stock option exercises.

Issued 6,000 shares of Common Stock in May, cancelled 1,500 shares in September and issued an additional 1,500 shares in December, which vested in May 2007, as compensation to members of the Board of Directors. The recognized compensation expense of these stock grants in 2006 amounted to $56,000.

During 2007:

On March 28, 2007, TDC exercised its warrants for 2.5 million shares by exchanging notes in the principal amount of $25 million, which were issued by us and held by TDC. We recorded a non-cash expense of $15.1 million and $0.1 for the first quarter 2007 and 2006, respectively, relating to the change in the fair market value of the warrants.

On April 27, 2007 in connection with the acquisition of Matel Holdings as described in Note 2, we issued 938,550 shares with an assigned value of $15 million (11 million) and assumed debt of Invitel in the amount of $525 million.

On May 24, 2007 we issued 6,500 shares to directors

(22) **Subsequent Events**

As of January 1, 2008 we completed the legal consolidation of some of our Hungarian operating subsidiaries. Hungarotel, PanTel and Euroweb Hungary merged into Invitel.

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Schedule I Condensed Financial Statements of Registrant

Hungarian Telephone and Cable Corp.

Condensed Balance Sheets

(In thousands, except share data)

	2007	2006
Assets		
Cash and cash equivalents	$ 224	$ 548
Amounts due from subsidiary	2,969	2,608
Current deferred tax asset		
Prepayments and accrued income	119	2,472
Other current assets	10	57
Total current assets	3,322	5,685
Investment in subsidiary and affiliates	34,995	105,957
Long-term loan to subsidiary	177	12,495
Deferred tax asset		
Capitalized transaction costs	10,939	809
Total assets	49,433	$ 124,946
Liabilities and Stockholders Equity		
Accounts payable and accruals	$ 2,305	$ 4,882
Due to related parties	4,914	815
Total current liabilities	7,219	5,697
Stock option liability	6,070	7,220
Warrants		13,050
Long-term debt		24,657
Total liabilities	13,289	50,624
Commitments and Contingencies		
Redeemable Equity Securities	15,049	
Stockholders equity:		
Cumulative Convertible Preferred stock, $.01 par value; $70.00 liquidation value. Authorized 200,000 shares; issued and outstanding 30,000 shares in 2007 and 2006		
Common stock, $.001 par value. Authorized 25,000,000 shares; issued and outstanding 15,471,950 shares in 2007 and 12,812,665 shares in 2006	15	14
Additional paid-in capital	193,013	139,999
Accumulated deficit	(188,298)	(91,727)
Accumulated other comprehensive income (loss)	16,365	26,036
Total stockholders equity	21,095	74,322
Total liabilities and stockholders equity	$ 49,433	$ 124,946

See accompanying notes to condensed financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Schedule I Condensed Financial Statements of Registrant

Hungarian Telephone and Cable Corp.

Condensed Statements of Operations

Years ended December 31, 2007, 2006 and 2005

(In thousands, except share and per share data)

	2007	2006	2005
Management services revenues	$ 6,542	7,421	6,175
Operating expenses:			
Operating and maintenance expenses	7,947	6,467	7,153
Depreciation and amortization			
Total operating expenses	7,947	6,467	7,153
Income (loss) from operations	(1,405)	954	(978)
Other income (expenses):			
Foreign exchange gains (losses), net	1	1,310	(1,219)
Interest expense	(911)	(3,484)	(3,006)
Interest income	303	849	756
Gains (losses) from fair value changes of derivative financial instruments	(3,552)		
Gains (losses) from fair value change of warrants	(15,075)	3,300	(1,500)
Earnings in equity of subsidiaries	$ (75,833)	13,971	9,369
Net income (loss) before income taxes	(96,472)	16,900	3,422
Income tax (expense) benefit			(2,030)
Net income (loss) before cumulative effect of change in accounting principle	$ (96,472)	16,900	1,392
Cumulative effect of change in accounting principle		(373)	
Net income (loss)	(96,472)	16,527	1,392
Cumulative convertible preferred stock dividends	(99)	(105)	(105)
Net income (loss) attributable to common stockholders	$ (96,571)	16,422	1,287

See accompanying notes to condensed financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Schedule I Condensed Financial Statements of Registrant

Hungarian Telephone and Cable Corp.

Condensed Statements of Cash Flows

Years Ended December 31, 2007, 2006 and 2005

(In thousands)

	2007	2006	2005
Net cash provided by (used in) operating activities	$ (13,337)	84	218
Cash flows from investing activities:			
Acquisition of subsidiaries			(15,637)
Proceeds from sale of interest in affiliates			15,929
Acquisition of interests in affiliates			
Net cash provided by (used in) investing activities			292
Cash flows from financing activities:			
Provision of inter-company loan to subsidiary			(12,699)
Repayment of inter-company loan from subsidiary	13,014		12,290
Other	(1)		(1)
Proceeds from inter-company loan repayment			
Preferred stock dividends paid			
Proceeds from exercise of stock options			
Net cash (used in) provided by financing activities	13,013		(410)
Net increase (decrease) in cash and cash equivalents	(324)	84	100
Cash and cash equivalents at beginning of year	548	464	364
Cash and cash equivalents at end of year	$ 224	548	464

See accompanying notes to condensed financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Schedule I Condensed Financial Statements of Registrant

Hungarian Telephone and Cable Corp.

Notes to Condensed Financial Statements

Years Ended December 31, 2007, 2006 and 2005

(1) **Description of Business and Other Related Matters**

The accompanying condensed financial statements of Hungarian Telephone and Cable Corp. (HTCC or the Registrant) have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). In preparing the financial statements, management is required to make estimates and assumptions that affect reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and revenue and expenses during the reporting period. Actual results could differ from those estimates.

HTCC s only source of cash is payments under its management service agreements and dividends, if any, from its subsidiaries (the subsidiaries). The subsidiaries ability to pay dividends or make other capital distributions to HTCC is governed by applicable law, and is significantly restricted by certain obligations of the subsidiaries. The subsidiaries are borrowers and/or guarantors under a banking credit facility and Note Indentures which provide that the subsidiaries can only make distributions to HTCC for limited purposes and under restrictive conditions.

The condensed financial statements should be read in conjunction with the audited consolidated financial statements of Hungarian Telephone and Cable Corp. and its subsidiaries as of December 31, 2006 and 2007, and for the years ended December 31, 2007, 2006 and 2005, including the notes thereto, set forth in the Company s consolidated financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Schedule II Valuation Accounts of Registrant Hungarian Telephone and Cable Corp.

DESCRIPTION	Balance at the Beginning of Year	Allowance Acquired on Acquisition	Allowance for Bad Debt Expense	Translation Adjustment	Balance at the End of Year
Allowance for doubtful accounts receivable					
Year ended December 31, 2005	$ 3,305,000	$ 180,000	$ 899,000	$ (586,000)	$ 3,798,000
Year ended December 31, 2006	$ 3,798,000		$ 1,480,000	$ 330,000	$ 5,608,000
Year ended December 31, 2007	$ 5,608,000	$ 14,583,000	$ (3,672,000)	$ 1,114,000	$ 17,633,000

DESCRIPTION	Balance at the Beginning of Year	Movement During Period	Translation Adjustment	Balance at the End of Year
Allowance for deferred tax assets				
Year ended December 31, 2005	$ 11,903,000	$ 3,010,000		$ 14,913,000
Year ended December 31, 2006	$ 14,913,000	$ 161,000		$ 15,074,000
Year ended December 31, 2007	$ 15,074,000	$ 33,363,000	(583,000)	$ 47,854,000

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HUNGARIAN TELEPHONE AND CABLE CORP.

Condensed Consolidated Balance Sheets at September 30, 2008 and December 31, 2007

(In thousands, except share and per share data)

	September 30, 2008 *(unaudited)*	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 24,599	$ 20,897
Accounts receivable, net of allowance of $24,262 in 2008 and $17,633 in 2007	94,906	85,684
Derivative financial instruments	977	977
Prepaid expenses and accrued income	16,269	5,049
Other current assets	7,710	6,228
Total current assets	144,461	118,835
Property, plant and equipment, net of depreciation of $273,875 in 2008 and $216,090 in 2007	819,568	691,485
Goodwill, net	81,938	81,534
Intangibles assets, net of amortization of $52,060 in 2008 and $35,310 in 2007	278,916	200,948
Deferred costs	14,951	14,828
Derivative financial instruments	1,906	2,076
Other non-current assets	1,647	485
Total assets	$ 1,343,387	$ 1,110,191

See accompanying notes to condensed consolidated financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Condensed Consolidated Balance Sheets at September 30, 2008 and December 31, 2007

(In thousands, except share and per share data)

	September 30, 2008 *(unaudited)*	December 31, 2007
Liabilities and Stockholders Equity		
Current liabilities:		
Current instalments of long-term debt	$ 68,723	$ 37,114
Current obligations under capital leases	7,883	430
Accounts payable	64,369	58,797
Accrued expenses and deferred income	68,328	70,169
Derivative financial instruments	44,895	22,138
Other current liabilities	29,936	11,205
Total current liabilities	284,134	199,853
Long-term debt, excluding current instalments	947,027	812,865
Long-term obligations under capital leases, excluding current portion	6,651	13
Derivative financial instruments	2,953	17,381
Deferred tax liabilities	16,905	19,642
Deferred income	51,506	17,265
Other non-current liabilities	23,460	7,020
Total liabilities	1,332,636	1,074,039
Commitments and contingencies		
Minority interest	9	8
Redeemable equity securities	15,049	15,049
Stockholders equity (deficit):		
Cumulative convertible preferred stock, $.01 par value; $70.00 liquidation value. Authorized 200,000 shares; issued and outstanding 30,000 shares in 2008 and 2007		
Common stock, $.001 par value. Authorized 25,000,000 shares; issued and outstanding 15,487,183 shares in 2008 and 15,471,950 shares in 2007	15	15
Additional paid-in capital	193,013	193,013
Accumulated deficit	(232,238)	(188,298)
Accumulated other comprehensive income	34,903	16,365
Total stockholders equity (deficit)	(4,307)	21,095
Total liabilities and stockholders equity (deficit)	$ 1,343,387	$ 1,110,191

See accompanying notes to condensed consolidated financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

For the Three and Nine Month Periods Ended September 30, 2008 and 2007

(In thousands, except share and per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenue	$ 153,083	$ 116,139	$ 432,605	$ 258,127
Operating expenses:				
Cost of Sales (exclusive of depreciation shown below)	61,846	57,455	177,038	124,309
Selling, general and administrative	28,652	19,044	90,135	52,600
Depreciation and amortization	34,085	26,334	93,018	51,757
Total operating expenses	124,583	102,833	360,191	228,666
Income from operations	28,500	13,306	72,414	29,461
Other income (expenses)				
Foreign exchange gains (losses), net	(11,400)	(8,187)	22,722	(1,688)
Interest expense	(29,785)	(19,170)	(87,733)	(37,323)
Interest income	661	471	1,493	953
Gains (losses) on derivative financial instruments	6,348	6,573	(31,238)	(59,327)
Gains (losses) from fair value changes of warrants				(15,075)
Loss on extinguishment of debt				(2,918)
Other, net	33	(16)	(1,967)	70
Income (loss) before income taxes	(5,643)	(7,023)	(24,309)	(85,847)
Income tax benefit (expense)				
Current	(15,602)	(2,354)	(19,423)	(5,868)
Deferred	1,147	(1,783)	(129)	9,758
Total income tax benefit (expense)	(14,455)	(4,137)	(19,552)	3,890
Net income (loss) before minority interest	$ (20,098)	$ (11,160)	$ (43,861)	$ (81,957)
Minority interest	2	(1)	(1)	6
Net income (loss) after minority interest	$ (20,096)	$ (11,161)	$ (43,862)	$ (81,951)
Cumulative convertible preferred stock dividends	(26)	(21)	(78)	(72)
Net income (loss) attributable to common stockholders	(20,122)	(11,182)	(43,940)	(82,023)
Foreign currency translation adjustment	(8,465)	(4,142)	18,538	6,699
Total comprehensive income (loss)	(28,587)	(7,040)	(25,402)	(75,324)
Net income (loss) per common share:				
Basic	$ (1.23)	$ (0.68)	$ (2.68)	$ (5.40)

Diluted	$ (1.23)	$ (0.68)	$ (2.68)	$ (5.40)
Weighted average number of common shares outstanding:				
Basic	16,425,733	16,418,244	16,421,268	15,187,502
Diluted	16,425,733	16,418,244	16,421,268	15,187,502

See accompanying notes to condensed consolidated financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Condensed Consolidated Statements of Stockholders Equity (Deficit)

(In thousands, except share data)

(unaudited)

	Shares	Common Stock	Preferred Stock	Additional Paid-in Capital	Accumulated deficit	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balances at December 31, 2007	15,471,950	$ 15		$ 193,013	$ (188,298)	$ 16,365	$ 21,095
Net settlement of stock option exercise	9,233						
Issue of shares to directors	6,000						
Cumulative convertible preferred stock dividends					(78)		(78)
Net income (loss) after minority interest					(43,862)		(43,862)
Foreign currency translation adjustment						18,538	18,538
Balances at September 30, 2008	15,487,183	$ 15		$ 193,013	$ (232,238)	$ 34,903	$ (4,307)

See accompanying notes to condensed consolidated financial statements.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Condensed Consolidated Statements of Cash Flows

For the Nine Month Period Ended September 30, 2008 and 2007

(In thousands)

(unaudited)

	2008	2007
Net cash provided by / (used in) operating activities	$ 93,465	$ 52,868
Cash flows from investing activities:		
Acquisition of telecommunications network equipment and intangible assets	(81,201)	(41,310)
Acquisition of subsidiaries, net of cash acquired	(32,635)	(111,348)
Settlement of derivative financial instruments	(32,793)	2,696
Proceeds from sale of assets	2,254	2,629
Net cash provided by / (used in) investing activities	(144,375)	(147,333)
Cash flows from financing activities:		
Repayments of long-term debt	(99,566)	(166,552)
Proceeds from new long-term borrowings	166,508	272,242
Refinancing costs paid	(7,641)	(18,846)
Principal payments under capital lease obligations	(4,792)	(360)
Release of restricted cash		12,251
Net cash provided by / (used in) financing activities	54,509	98,735
Effect of foreign exchange rate changes on cash	103	1,927
Net increase in cash and cash equivalents	3,702	6,197
Cash and cash equivalents at beginning of period	20,897	18,794
Cash and cash equivalents at end of period	$ 24,599	$ 24,991

Summary of material non-cash transactions:

We had derivative financial instruments with a positive non-cash effect of $1.6 million for the nine months ended September 30, 2008.

As of September 30, 2008 we had accounts payable relating to acquisition of telecommunications network equipment and intangible assets of $8.0 million.

As of September 30, 2008 we had an amount of $2.4 million payable to Memorex minority shareholders relating to the acquisition of the 4.3% equity stake in Memorex.

On March 5, 2008, in connection with the Memorex Acquisition, we assumed net debt of $117.1 million.

On March 28, 2007, TDC exercised its warrants for 2.5 million shares at $10 per share by exchanging notes in the principal amount of $25 million, which were issued by us and held by TDC. We recorded a non-cash expense of $15.1 million for the six months ended June 30, 2007 relating to the change in the fair market value of the warrants.

On April 27, 2007 in connection with the Invitel Acquisition we issued 938,550 shares with an assigned value of $15 million and assumed debt of Invitel in the amount of $525 million.

See accompanying notes to condensed consolidated financial statements

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Notes to the Unaudited Condensed Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

(a) *Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements of Hungarian Telephone and Cable Corp. (HTCC) with its consolidated subsidiaries, HTCC Holdco I B.V. (Holdco I), HTCC Holdco II B.V. (Holdco II), Matel Holdings N.V. (Matel Holdings) Magyar Telecom B.V. (Matel), Invitel Tavkozlesi Szolgaltato zRt. (Invitel), Euroweb Romania S.A. (Euroweb Romania), Invitel International and its subsidiaries (formerly Memorex Telex Communications AG, Memorex), Invitel Telecom Kft. (Tele2 Hungary) and Invitel Technocom Kft. (Invitel Technocom) (together, the Company) include all adjustments, consisting mainly of normal recurring accruals, necessary for a fair statement of the results of the interim periods. Invitel and Memorex own and consolidate several minor non-Hungarian subsidiaries within the Central and South Eastern European region.

Unless the context requires otherwise, references in this report to the Company , we , us and our refer to Hungarian Telephone and Cable Corp. and its consolidated subsidiaries.

Results for interim periods are not necessarily indicative of the results for a full year. All inter-company balances and transactions have been eliminated.

On March 5, 2008 we acquired 95.7% of the outstanding equity in Austrian-based Memorex (the Memorex Acquisition). Memorex has operations in numerous countries within the Central and South Eastern European region, including Austria, Turkey, Slovakia, Czech Republic, Germany and Romania. The final purchase price for the 95.7% Memorex equity stake was EUR 18.8 million (approximately $28.6 million at closing) plus the assumption of debt. We refinanced a significant portion of Memorex s debt at closing. We funded the Memorex Acquisition and the refinancing of the Memorex debt with a subordinated bridge loan facility.

On August 28, 2008 we also acquired the remaining 4.3% stake of Memorex from the minority shareholders in Memorex, which gave us 100% ownership in the equity of Memorex. The final purchase price for the Memorex minority interest was EUR 1.9 million (approximately $2.9 million at closing).

The accompanying unaudited condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the U.S. (U.S. GAAP). In preparing financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions. These estimates and assumptions affect reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as revenues and expenses during the reporting period. Actual results could differ from those estimates.

The year-end condensed consolidated balance sheet data was derived from audited consolidated financial statements, but does not include all disclosures required by U.S. GAAP.

The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2007, including the notes thereto, which are filed with the Unites States Securities and Exchange Commission (SEC).

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Notes to the Unaudited Condensed Consolidated Financial Statements

(b) *Earnings per Share*

Basic earnings per share (EPS) is computed by dividing income attributable to common stockholders by the weighted average number of common shares outstanding for the period. The computation of diluted EPS is similar to the computation of basic EPS, except that the weighted average number of common shares outstanding is increased to include additional shares from the assumed exercise of stock options and warrants and the conversion of the convertible preferred stock, where dilutive. The number of additional shares is calculated by assuming that preferred securities were converted and that outstanding stock options and warrants were exercised and the proceeds were used to acquire shares of our common stock at the average market price during the reporting period.

The following is the reconciliation from basic earnings (loss) per share to diluted earnings (loss) per share for the three and the nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30		**Nine Months Ended September 30**	
($ in thousands, except share data)	**2008**	**2007**	**2008**	**2007**
Net income (loss) attributable to common stockholders (A)	$ (20,122)	$ (11,182)	$ (43,940)	$ (82,023)
plus: preferred stock dividends				
Net income (loss) (B)	$ (20,122)	$ (11,182)	$ (43,940)	$ (82,023)
Determination of shares:				
Weighted average common shares outstanding basic (C)	16,425,733	16,418,244	16,421,268	15,187,502
Assumed conversion of dilutive stock options and cumulative convertible preferred stock				
Weighted average common shares outstanding diluted (D)	16,425,733	16,418,244	16,421,268	15,187,502
Net loss per common share:				
Basic (A/C)	$ (1.23)	$ (0.68)	$ (2.68)	$ (5.40)
Diluted (B/D)	$ (1.23)	$ (0.68)	$ (2.68)	$ (5.40)

For the three months ended September 30, 2008 and 2007, preferred stock dividends of $26,000 and $21,000, respectively, and common stock equivalents and convertible preferred stock of 582,261 and 1,059,981, respectively, were excluded from the computation of diluted loss per share because the effect of their inclusion would be anti-dilutive.

For the nine months ended September 30, 2008 and 2007, preferred stock dividends of $78,000 and $72,000, respectively, and common stock equivalents and convertible preferred stock of 535,474 and 1,790,538, respectively, were excluded from the computation of diluted loss per share because the effect of their inclusion would be anti-dilutive.

(c) *Foreign Currency Translation*

We use the Hungarian forint (HUF) as the functional currency for our Hungarian subsidiaries. Our Hungarian subsidiaries assets and liabilities are translated into U.S. dollars using the exchange rates in effect at the balance sheet date. Results of operations are translated

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Notes to the Unaudited Condensed Consolidated Financial Statements

into U.S. dollars using the average exchange rates prevailing throughout the period. Euro denominated debt is re-measured into HUF with a corresponding charge to earnings as exchange gains (losses). The effects of exchange rate fluctuations on translating HUF assets and liabilities into U.S. dollars are included in accumulated other comprehensive income in stockholders equity (deficit).

We use the euro (EUR) as the functional currency of Memorex and its subsidiaries. Accordingly, foreign currency assets and liabilities of Memorex s subsidiaries are translated into EUR using the exchange rates in effect at the balance sheet date. Results of operations are translated into EUR using the average exchange rates prevailing throughout the period. The effects of exchange rate fluctuations on translating the local currency assets and liabilities of Memorex s subsidiaries into EUR are accumulated as part of foreign exchange gains (losses) in the consolidated statement of operations. The effects of exchange rate fluctuations on translating EUR assets and liabilities into U.S. dollars are included in accumulated in other comprehensive income in stockholders equity (deficit).

The translation of the subsidiaries Hungarian forint denominated balance sheets into U.S. dollars as of September 30, 2008, has been affected by the strengthening of the Hungarian forint against the U.S. dollar from 172.61 as of December 31, 2007 to 169.15 as of September 30, 2008, an approximate 2% depreciation in value of the U.S. dollar against the HUF. The average Hungarian forint/U.S. dollar exchange rates used for the translation of the subsidiaries Hungarian forint denominated statements of operations into U.S. dollars for the three months ended September 30, 2008 and 2007 were 157.15 and 183.27, respectively. The average Hungarian forint/U.S. dollar exchange rates used for the translation of the subsidiaries Hungarian forint denominated statements of operations and statements of cash flows into U.S. dollars for the nine months ended September 30, 2008 and 2007 were 162.97 and 186.73, respectively.

The translation of the subsidiaries euro denominated balance sheets into U.S. dollars as of September 30, 2008, has been affected by the weakening of the euro against the U.S. dollar from 1.47 as of December 31, 2007 to 1.44 as of September 30, 2008, an approximate 2% appreciation in value of the U.S. dollar against the euro. The average euro-U.S. dollar exchange rates used for the translation of the subsidiaries euro denominated statements of operations into U.S. dollars for the three months ended September 30, 2008 and 2007 were 1.50 and 1.37, respectively. The average euro/U.S. dollar exchange rates used for the translation of the subsidiaries euro denominated statements of operations and statements of cash flows into U.S. dollars, for the nine months ended September 30, 2008 and 2007 were 1.52 and 1.34, respectively.

(d) *Stock Based Compensation*

We have three equity compensation plans: the stock option plan that was adopted by our Board of Directors in April 1992, which was amended and renamed upon the approval of our stockholders in 2002 (the 2002 Plan); the Non-Employee Director Stock Option Plan (the Directors Plan) which was established by our Board of Directors in 1997; and the 2004 Long-Term Incentive Plan (the 2004 Plan) which was approved by our stockholders in 2004.

As of September 30, 2008, we had outstanding options to purchase 80,000 shares of common stock issued from the 2002 Plan; outstanding options to purchase 85,000 shares of common

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stock issued from the Directors Plan; and outstanding options to purchase 410,000 shares of common stock under the 2004 Plan. Upon the approval of the 2004 Plan, we agreed not to issue any more options from either the 2002 Plan or the Directors Plan.

(e) *Goodwill*

We test goodwill for impairment on an annual basis, or more often, if events or circumstances indicate that there may be impairment. In light of the recent challenging economic environment, we performed interim impairment testing as of September 30, 2008.

The estimated fair values of our operating segments were based on discounted cash flow models derived from our business plan. Based on current results, we determined that the fair values of our operating segments continue to exceed their book values and, therefore, no goodwill impairment charge was recorded as of September 30, 2008. Management will continue to monitor and evaluate the carrying value of goodwill.

(f) *Recently Adopted Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS 157 applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. In February 2008 the FASB issued a Staff Position that delays the effective date of SFAS 157. Delayed application of SFAS 157 is permitted for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. We adopted SFAS 157 as of January 1, 2008 for financial assets and liabilities. The adoption of SFAS 157 has not had a material effect on our financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159), which permits entities to choose to measure many financial instruments and certain warranty and insurance contracts at fair value on a contract-by-contract basis. SFAS 159 applies to all reporting entities and contains financial statement presentation and disclosure requirements for assets and liabilities reported at fair value as a consequence of the election. SFAS 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. We adopted SFAS 159 as of January 1, 2008. The adoption of SFAS 159 has not had a material effect on our financial position or results of operations.

In October, 2008 the FASB issued FASB Staff Position statement No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP FAS 157-3). This standard clarifies the application of FASB statement No.157, Fair Value Measurements and illustrates key considerations in determining the fair value of a financial asset when a market is not active. FSP FAS 157-3 became effective upon issuance with revisions resulting from its application to be accounted for as a change in accounting estimate in accordance with SFAS Statement No. 154, Accounting Changes and Error Corrections. The adoption of FSP FAS 157-3 has not had a material effect on our financial position or results of operations.

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(g) *Recently Issued Accounting Pronouncements*

In March 2008, the FASB issued FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 changes disclosure requirements for derivative instruments and hedging activities. SFAS 161 requires enhanced disclosures about (a) how and why derivative instruments are used, (b) how derivative and related hedged items are accounted for under FASB Statement No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We are currently assessing the impact of SFAS 161.

(2) **Related Parties**

TDC, the leading provider of communications solutions in Denmark, owns 63.9% of our outstanding common stock and 62.4% of our outstanding common stock on a fully diluted basis. Four of the seven members of our Board of Directors are officers of TDC. TDC owns 30,000 shares of preferred stock which are convertible into 300,000 shares of our common stock. We have reciprocal commercial agreements in place with TDC pursuant to which we transport international voice, data and Internet traffic over our respective telecommunications networks for each other.

The net balance of receivables from and payables to related parties was a net payable to TDC in the amount of $891,000 at September 30, 2008. This represents cumulative preferred stock dividends in arrears payable to TDC in the amount of $934,000 and a net $43,000 receivable in connection with our agreements to transport telecommunications traffic for each other.

On March 28, 2007, TDC exercised its warrants to purchase 2,500,000 shares of our common stock at $10 per share in exchange for notes issued by us and held by TDC in the principal amount of $25 million.

Torben V. Holm was an employee of TDC when he served as our President and Chief Executive Officer and as the head of management s executive committee from 2005 through April 2007. Alex Wurtz was also an employee of TDC when he served as our head of Corporate Business Development and as a member of management s executive committee from 2005 through April 2007.

For Mr. Holm, we paid EUR 981,371 (approximately $1.4 million) for his services for the period from May 2005 through April 2007. We were also responsible for paying other costs pertaining to Mr. Holm, including housing in Budapest and for certain of Mr. Holm s travel costs back to his home in Denmark.

For Mr. Wurtz, we paid EUR 501,707 (approximately $0.7 million) for his services for the period from June 2005 through April 2007. We were also responsible for paying Mr. Wurtz s housing in Budapest.

All of our directors are covered by a directors and officers liability policy taken out by TDC. As of September 30, 2008, we had approximately $125,000 in expenses for our portion of the overall premium paid by TDC.

In connection with our agreements with TDC to transport telecommunications traffic for each other, we recorded revenue in the amount of approximately $35,000 and $652,000, respectively, for the three

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months ended September 30, 2008 and 2007 and approximately $808,000 and $1,707,000 for the nine months ended September 30, 2008 and 2007, respectively, pursuant to such agreements. For the three months ended September 30, 2008 and 2007, TDC charged us approximately $206,000 and $133,000, respectively, pursuant to such agreements. For the nine months ended September 30, 2008 and 2007, TDC charged us approximately $497,000 and $641,000, respectively, pursuant to such agreements.

(3) **Acquisition of Memorex Telex Communications AG**

On March 5, 2008 we acquired 95.7% of the outstanding equity in Austrian-based Memorex Telex Communication AG (the Memorex Acquisition).

The preliminary purchase consideration for Memorex was EUR 30.1 million (approximately $45.7 million) plus the assumption of debt and transaction costs and other directly related expenses. From the preliminary purchase price EUR 17.9 million (approximately $27.2 million) was paid in cash and the remaining EUR 12.2 million (approximately $18.5 million) was paid into escrow.

Invitel and the selling shareholders of Memorex entered into an Escrow Agreement to set aside a portion of the purchase price cash consideration to cover any breach of the selling shareholders warranties or covenants and to cover any indemnity claims that we might have against the selling shareholders under the purchase agreement. The Escrow Agreement governed the terms and conditions under which the Escrow Amount is released to the selling shareholders of Memorex. Following negotiations, we entered into a Settlement Agreement with the selling shareholders pursuant to which the Escrow Agent was directed to return EUR 11.2 million (approximately $17.1 million at closing foreign exchange rate) to us and the remaining EUR 0.9 million (approximately $ 1.3 million at closing foreign exchange rate) was paid out to the selling shareholders. We received our funds on July 11, 2008.

On August 28, 2008 we also acquired the remaining 4.3% of Memorex from the minority shareholders in Memorex, which gave us 100% ownership of the equity in Memorex. The final purchase price for the Memorex minority interest was EUR 1.9 million (approximately $2.9 million at closing).

We refinanced a significant portion of Memorex s debt at closing. We funded the Memorex Acquisition and the refinancing of the Memorex debt with a subordinated bridge loan facility. We intend to either refinance our bridge loan or, if we choose not to or the market conditions make a refinancing prohibitive, convert the bridge loan to term loans maturing in 2016, which conversion right is permitted, subject to certain conditions, pursuant to the bridge loan agreement.

The primary reason for the Memorex Acquisition was Memorex s business is complementary to Invitel s existing regional wholesale data business. Memorex is a leading alternative telecommunications infrastructure and bandwidth provider in the Central and South Eastern European region and has a diversified customer base.

Under the purchase method of accounting, and in accordance with SFAS No. 141 Business Combinations , we are required to allocate the cost of an acquired business based on the estimated fair values of the assets acquired and liabilities assumed. The following represents our preliminary allocation of the purchase price paid for Memorex based on the estimated fair values of the acquired assets and liabilities assumed. The preliminary allocation of the purchase price is not necessarily indicative of the final allocation of the purchase price consideration. We intend to complete the

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valuation and establish a final purchase price allocation by December 31, 2008 following the completion of valuation studies and integration activities. The purchase price was allocated as follows:

	(in thousands)
Current assets	$ 25,936
Property, plant and equipment	134,559
Intangible assets	100,027
Deferred tax	3,858
Current and non-current liabilities	(114,646)
Long term debt assumed	(117,099)
Net assets acquired	$ 32,635
Purchase Price:	
Cash paid to shareholders	28,548
Cash paid for minority equity stake	473
Transaction costs and other directly related expenses	3,614
Total purchase price	$ 32,635

The following table presents the fair values of major components of the intangible assets acquired:

	(in thousands)	**Weighted average amortization period**
Concession rights and licences	$ 794	10 years
Customer relationships	22,745	14 years
Trademark	168	6 months
Property rights	57,542	16-20 years
Software	214	4 years
Vodafone contract	18,564	20 years
Total:	$ 100,027	

The closing of the Memorex Acquisition occurred on March 5, 2008 and the consolidated results of Memorex from that date (and the balance sheet of Memorex as at September 30, 2008) were consolidated into our financial statements for the three and nine months ended September 30, 2008.

The date of the Invitel acquisition was April 27, 2007, the date of the Tele2 Hungary acquisition was October 18, 2007 and the date of the Memorex acquisition was March 5, 2008. The following table presents our unaudited summarized consolidated financial information, on a pro-forma basis, as though HTCC, Invitel, Tele2 Hungary and Memorex had been combined at the beginning of the respective periods:

	Three months ended September 30,		**Nine months ended September 30,**	
(in thousands)	**2008**	**2007**	**2008**	**2007**

	Pro-forma	*Pro-forma*	*Pro-forma*	*Pro-forma*
Revenue	$ 153,083	$ 139,318	$ 442,774	$ 409,553
Income from operations	28,500	17,801	69,425	43,338
Foreign exchange gains (losses), net	(11,400)	(7,949)	20,444	4,845
Interest expense	(29,785)	(26,724)	(90,849)	(80,064)
Net income (loss) attributable to common stockholders	(20,122)	(13,539)	(51,478)	(97,221)
Net income (loss) per basic share	$ (1.23)	$ (0.82)	$ (3.13)	$ (6.40)

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The above unaudited pro-forma summarized combined financial information is intended for informational purposes only and is not indicative of the results of our operations had the acquisitions actually taken place at the beginning of the respective periods. The unaudited pro-forma summarized combined financial information does not include potential cost savings from operating efficiencies or synergies that may result from the acquisitions.

(4) **Short and long-term debt**

Short-term portion of long-term debt and long-term debt at September 30, 2008 and December 31, 2007 consist of the following:

(in thousands)	**September 30, 2008** *(unaudited)*	**December 31, 2007**
Memorex Turkey Loan	14,376	
Amended Facilities Agreement	54,347	37,114
Short-term portion of long-term debt	$ 68,723	$ 37,114
Amended Facilities Agreement	$ 75,991	$ 107,907
Memorex Bridge Loan	143,760	
1st Memorex Prep Loan	11,501	
2nd Memorex Prep Loan	4,313	
2007 Notes	287,520	293,552
2006 PIK Notes	221,101	204,566
2004 Notes	202,841	206,840
Long-term debt	$ 947,027	$ 812,865

In connection with the Invitel Acquisition on April 27, 2007, we completed the issuance of EUR 200 million aggregate principal amount of floating rate senior notes maturing in 2013 (the 2007 Notes), the proceeds of which were used to partly finance the Invitel Acquisition and to refinance our existing bank credit facility. As part of the Invitel Acquisition, we also assumed an estimated net indebtedness on closing of EUR 391 million (approximately $528 million at closing, the Assumed Debt). The Assumed Debt consisted primarily of (i) EUR 133 million in aggregate principal amount and accrued interest of Floating Rate Senior PIK Notes due 2013 (the 2006 PIK Notes), (ii) EUR 142 million in aggregate principal amount of 10.75% Senior Notes due 2012 (the 2004 Notes), and (iii) a Facilities Agreement in the amount of EUR 116 million, which was amended and restated in connection with the Invitel Acquisition.

In connection with the Memorex Acquisition on March 5, 2008, we entered into a EUR 100 million (approximately $158 million at closing) Bridge Loan Agreement (the Bridge Loan Agreement) and further amended and restated our Facilities Agreement (the Amended Facilities Agreement).

In order to establish the relative rights of certain of our creditors under our financing arrangements, we have entered into an amended and restated Intercreditor Agreement (the Intercreditor Agreement). Summaries of the terms and conditions of the Amended Facilities Agreement, the 2007 Notes, the 2006 PIK Notes, the 2004 Notes, the Bridge Loan Agreement and the Intercreditor Agreement are set forth below. The summaries do not purport to be complete and are qualified in their entirety by reference to the full text of such documents, copies of which are filed with the Securities and Exchange Commission. We have also summarized three loan agreements that we assumed as part of the Memorex Acquisition.

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The Amended Facilities Agreement

In connection with the Invitel Acquisition on April 27, 2007, an amendment was made to the Facilities Agreement, dated August 6, 2004 between Matel, Invitel, as borrower, certain subsidiary companies as original guarantors, and certain financial institutions. The Amended Facilities Agreement provides for facilities of up to EUR 145 million (or the euro equivalent thereof), comprised of (i) a euro amortizing term loan of EUR 96.9 million, (ii) a Hungarian forint amortizing term loan of HUF 4,628 million (approximately EUR 18.5 million), (iii) a revolving credit facility of EUR 4.2 million and HUF 200 million (approximately EUR 0.8 million), and (iv) a euro liquidity facility of EUR 25 million. As of September 30, 2008 we had undrawn lines of credit of EUR 4.2 million (approximately $6.0 million) and HUF 200 million (approximately $1.2 million) under the revolving credit facility and EUR 15 million (approximately $21.6 million) under the euro liquidity facility.

Advances under the Amended Facilities Agreement bear interest for each interest period at annual rates equal to EURIBOR (currently 4.96%) or BUBOR (currently 8.83%, based on the Budapest interbank offer rates) plus an applicable margin. The applicable margin (currently 1.5%) is set based on the ratio of all of our senior debt, as defined in the Amended Facilities Agreement, to EBITDA, based on our most recently delivered quarterly management accounts and financial statements. Under the Amended Facilities Agreement, we are obligated to pay customary fees to the lenders (annual facility agency fee of EUR 100,000 and security trustee fee of EUR 8,000) including an up-front fee and a commitment fee (currently 0.75%) in relation to available and undrawn commitments under the revolving credit facility and the liquidity facility.

Our obligations under the Amended Facilities Agreement are guaranteed and are collateralized on a senior basis by (i) a first ranking pledge of all the share capital of the obligors, (ii) assignments of intercompany loans and any relevant cross guarantees of the obligors from time to time, (iii) a pledge of accounts by the obligors, and (iv) floating charges over all assets. Such security interests also collateralize, on a *pari passu* basis, all hedging obligations with respect to the Amended Facilities Agreement, the 2007 Notes and the 2004 Notes.

The Amended Facilities Agreement contains certain negative covenants that restrict us (subject to certain agreed upon exceptions) from, among other things, (i) creating or permitting to subsist any security interest over any part of our assets, (ii) merging or consolidating with or into any other person, (iii) selling, transferring, leasing, lending or otherwise disposing of any assets, (iv) incurring or permitting to be outstanding any financial indebtedness (including guarantees), (v) reducing capital or purchasing any class of our shares, (vi) making any investment, including (1) loans to any person, (2) the acquisition of indebtedness or capital or securities of any person, (3) the acquisition of the assets, property or business of any other person, or (4) the creation or acquisition of a subsidiary, (vii) entering into any derivative instruments, (viii) changing the nature of our business or amending our constitutive documents, (ix) entering into any agreement or arrangement other than on an arm s-length basis, (x) paying dividends or making any repayment, prepayment or redemption of principal under any subordinated finance documents including the 2004 Notes, the 2007 Notes and the Bridge Loan Agreement except in accordance with the Intercreditor Agreement, (xi) changing our ownership structure, and (xii) maintaining any bank account that has a credit balance with any person that is not a lender under the Amended Facilities Agreement.

Additionally, the Amended Facilities Agreement requires us to maintain specified consolidated financial ratios, such as leverage ratios (total senior debt to EBITDA and total debt to EBITDA), an interest coverage ratio (EBITDA to total debt interest charges) and a fixed charge coverage ratio (EBITDA minus capital expenditure and cash taxes to total debt charges).

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Under the terms of the Amended Facilities Agreement, we are required to observe certain affirmative undertakings, including, but not limited to, undertakings relating to (i) maintenance of all relevant consents, authorizations and licenses, (ii) conduct of business, (iii) periodic financial statements, management accounts and reports, (iv) auditors and information, (v) insurance and inspection, (vi) notification of environmental claims and expenditures, (vii) compliance with laws, (viii) taxes, and (ix) maintenance of a cost capitalization policy and an interest rate hedging policy.

The term facilities are amortizing term loans with a maturity date of June 30, 2011. No amount repaid or prepaid in relation to the term facilities may be redrawn.

The revolving facility is repayable in an amount equal to 100% of the principal amount outstanding on June 29 and December 30 of each calendar year until the maturity date of June 30, 2010. The liquidity facility is repayable in an amount equal to 100% of the principal amount outstanding at its maturity on June 30, 2010.

Subject to certain exceptions, all loans under the Amended Facilities Agreement will be required to be prepaid upon the occurrence of certain change of control events. Voluntary prepayments and cancellations are permitted.

The Amended Facilities Agreement contains certain events of default customary for senior debt financings as well as an event of default related to Matel Holdings engaging in non-holding company-related activities, the occurrence of which would preclude further borrowings under the revolving facility and permit the lenders to accelerate all outstanding loans and terminate their commitments under the facilities.

The 2007 Notes

Upon the completion of the Invitel Acquisition on April 27, 2007, we completed the issuance of the 2007 Notes pursuant to an Indenture, dated as of April 27, 2007 (the 2007 Notes Indenture). We received EUR 189 million following the payment of financing costs associated with the issuance of the 2007 Notes in the amount of EUR 11 million, which costs were deferred and are amortized to interest expense using the effective interest method over the term of the 2007 Notes. The proceeds from the issuance of the 2007 Notes were used to partly finance the Invitel Acquisition and to refinance our credit facility.

The 2007 Notes mature on February 1, 2013, and bear interest at a rate of EURIBOR plus 3.0% per annum, payable quarterly in arrears on February 1, May 1, August 1 and November 1 of each year, beginning on August 1, 2007. The 2007 Notes are guaranteed by some of our subsidiaries. The 2007 Notes and subsidiary guarantees are collateralized by second-priority liens over certain inter-company funding loans, the capital stock of some of our subsidiaries, which liens rank *pari passu* with the liens over such assets securing our obligations under the 2004 Notes described below.

We have the option to redeem the 2007 Notes, as a whole or in part, at any time or from time to time, at redemption prices specified in the 2007 Notes Indenture. In the event of certain change of control events, we must make an offer to purchase the 2007 Notes at a purchase price equal to 101% of the principal amount thereof. We are also required to offer to purchase the 2007 Notes with the excess proceeds following certain asset sales at a purchase price equal to 100% of the principal amount thereof.

The 2007 Notes Indenture contains covenants restricting our ability to, among other things, (i) incur additional indebtedness or issue preferred shares, (ii) make investments and certain other restricted

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payments, (iii) issue or sell shares in subsidiaries, (iv) agree to restrictions on the payment of dividends by subsidiaries, (v) enter into transactions with affiliates, (vi) create certain liens, (vii) merge, consolidate or combine with other entities, (viii) layer debt, (ix) designate subsidiaries as unrestricted subsidiaries, (x) engage in unrelated business activities and (xi) impair any security interests. The 2007 Notes Indenture also contains customary events of default, including non-payment of principal, interest, premium or other amounts, violation of covenants, bankruptcy events, cross-defaults, material judgments and invalidity of any guarantee, security document or security interest.

The 2006 PIK Notes

On October 30, 2006, Invitel Holdings issued the 2006 PIK Notes pursuant to an Indenture, dated as of October 30, 2006 (the 2006 PIK Notes Indenture). In connection with the closing of the Invitel Acquisition on April 27, 2007, we entered into a supplemental indenture with Invitel Holdings and the 2006 PIK Notes Indenture trustee, pursuant to which we replaced Invitel Holdings 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.

Interest on the 2006 PIK Notes is payable quarterly in cash or in the form of additional 2006 PIK Notes at an annual rate of EURIBOR plus 8.25%, reset quarterly, plus a ratchet margin, on January 15, April 15, July 15 and October 15 of each year beginning January 15, 2007. The ratchet margin is zero for the period to but excluding October 15, 2009 and 2.00% if the consolidated leverage ratio of our subsidiary, Matel, is greater than 2.50 to 1.00 for any interest period beginning on or after October 15, 2009. The maturity date of the 2006 PIK Notes is April 15, 2013.

Our obligations under the 2006 PIK Notes are general unsubordinated obligations and are collateralized by a first priority lien over the shares of Matel Holdings and effectively subordinated to all existing and future debt of our subsidiaries.

We have the option to redeem the 2006 PIK Notes, as a whole or in part, at any time or from time to time, at redemption prices specified in the 2006 PIK Notes Indenture. In the event of certain change of control events, we must make an offer to purchase the 2006 PIK Notes at a purchase price equal to 101% of the principal amount thereof. We are also required to make an offer to purchase the 2006 PIK Notes with the excess proceeds following certain asset sales at a purchase price equal to 100% of the principal amount of thereof.

The 2006 PIK Notes Indenture contains covenants restricting our ability to, among other things, (i) incur additional indebtedness or issue preferred shares, (ii) make investments and certain other restricted payments, (iii) enter into transactions with affiliates, (iv) create certain liens, (v) enter into sale and leaseback transactions, (vi) issue or sell shares of subsidiaries, (vii) merge, consolidate or combine with other entities, (viii) designate subsidiaries as unrestricted subsidiaries, (ix) engage in unrelated business activities and (x) impair any security interests. The 2006 PIK Notes Indenture also contains customary events of default, including, among other things, non-payment of the principal, interest or premium, if any, on any 2006 PIK Notes, certain failures to comply with any covenant of the 2006 PIK Notes Indenture, certain defaults under other indebtedness, failure to pay certain indebtedness or judgments, bankruptcy or insolvency events and invalidity of any security document or security interest.

The 2004 Notes

In August 2004, Matel issued the 2004 Notes pursuant to an Indenture, dated as of August 6, 2004, (the 2004 Notes Indenture) with some of Matel s subsidiaries as guarantors.

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The 2004 Notes mature on August 15, 2012. Interest on the 2004 Notes is payable semi-annually at an annual rate of 10.75% on February 15 and August 15 of each year, beginning on February 15, 2005.

We have the option to redeem the 2004 Notes, as a whole or in part, at any time or from time to time, at redemption prices specified in the 2004 Notes Indenture. Upon certain change of control events, we are required to make an offer to purchase all of the 2004 Notes, at a purchase price equal to 101% of the principal amount thereof, plus accrued and unpaid interest to the date of purchase. We are also required to offer to purchase the 2004 Notes with the excess proceeds from certain sales of assets at 100% of the principal amount of the 2004 Notes, plus accrued and unpaid interest to the date of repurchase.

Our obligations under the 2004 Notes are guaranteed on a senior subordinated basis by some of our subsidiaries that guaranteed our obligations under the 2007 Notes and are collateralized by the same collateral securing the 2007 Notes.

The 2004 Notes Indenture contains covenants which, among other things, limit the ability of Matel and its restricted subsidiaries to (i) incur additional indebtedness and issue preferred shares, (ii) make certain restricted payments and investments, (iii) transfer or sell assets, (iv) enter into transactions with affiliates, (v) create certain liens, (vi) create restrictions on the ability of some of our subsidiaries to pay dividends or other payments to Matel, (vii) guarantee other indebtedness, (viii) enter into sale and leaseback transactions, (ix) issue or sell shares of certain restricted subsidiaries, (x) merge, consolidate, amalgamate or combine with other entities, (xi) designate restricted subsidiaries as unrestricted subsidiaries, and (xii) engage in any business other than a permitted business.

The 2004 Notes Indenture contains customary events of default, including, among others, the non-payment of principal, interest or premium on the 2004 Notes, certain failures to perform or observe any other covenant in the 2004 Notes Indenture, the occurrence of certain defaults under other indebtedness, failure to pay certain indebtedness or judgments, bankruptcy or insolvency events and invalidity of any guarantee, security document or security interest.

The Bridge Loan Agreement

In connection with the Memorex Acquisition, we entered into a EUR 100 million (approximately $152.0 million at exchange rate at the date of draw down) Bridge Loan Agreement on March 3, 2008 with our subsidiary Matel as borrower and our subsidiaries Invitel, Invitel Telecom, Invitel Technocom, Memorex and Memorex s Turkish subsidiary as guarantors. The Bridge Loan Agreement was arranged by Merrill Lynch and BNP Paribas, who are the original lenders. On March 5, 2008, the closing date of the Memorex Acquisition, we borrowed the full EUR 100 million pursuant to which we used EUR 30.1 million (approximately $43.3 million) to fund the purchase price for 95.7% of the outstanding equity in Memorex and EUR 46.6 million (approximately $70.0 million) to refinance some of Memorex s existing debt that we assumed at closing. We used EUR 7.6 million (approximately $10.9 million) to pay fees and expenses in connection with the Bridge Loan Agreement and transaction costs in connection with the Memorex Acquisition and we set aside the remaining EUR 15.7 million (approximately $22.6 million) for working capital purposes. In addition, EUR 12.1 million (approximately $17.4 million) of the EUR 30.1 million purchase price was paid into escrow. Following settlement, EUR 11.2 million (approximately $16.1 million) of the escrow balance was returned to us and added to our working capital.

The Bridge Loan Agreement loans (the Bridge Loans) mature one year following the completion of the Memorex Acquisition, on March 5, 2009 (the Initial Maturity Date). The Bridge Loans bear interest at a rate per annum equal to the sum of EURIBOR plus the applicable margin plus the

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Mandatory Cost (if any, as defined in the Bridge Loan Agreement), which is set at the beginning of each three month interest period. The applicable margin for the first six months is the greater of 4.25% per annum and 0.50% per annum over the 2007 Notes Spread to Maturity (the quoted spread over EURIBOR to maturity). For the next three months, the applicable margin is the greater of 4.75% per annum and 0.50% per annum over the 2007 Notes Spread to Maturity. For the three months up to the Initial Maturity Date, the applicable margin is the greater of 5.25% per annum and 0.50% per annum over the 2007 Notes Spread to Maturity. The interest rate may not exceed 11.5% per annum for any interest period. The current interest rate on the Bridge Loans is 9.71% per annum.

Subject to certain conditions, including our not being in default under certain provisions of the Bridge Loan Agreement at the Initial Maturity Date, we may convert the Bridge Loans to term loans (Term Loans) with a maturity date of seven years following the Initial Maturity Date (March 5, 2016, the Extended Maturity Date). The terms of the Bridge Loan Agreement will generally govern the Terms Loans, provided that certain covenants and events of default under the Bridge Loan Agreement will be replaced by covenants and events of default from the 2007 Notes Indenture. From the Initial Maturity Date (March 5, 2009) until the Extended Maturity Date (March 5, 2016), the applicable margin shall be 6.25% per annum, provided the interest rate for any three month interest period shall not exceed 11.5%. If we elect to convert the Bridge Loans to Term Loans, a lender may, upon the sale of its Term Loan to a third party, subject to certain conditions, exchange all or any portion of its Term Loan into one or more exchange notes (the Exchange Notes), which Exchange Notes will be governed by an indenture, which indenture shall contain covenants, events of default, repayment and other provisions based on those contained in the indenture governing the 2007 Notes. The Exchange Notes shall bear interest at a rate equal to 11.5% per annum.

Upon a change in our control (as defined in the Bridge Loan Agreement), each lender may require us to prepay an amount equal to 100% of the Bridge Loans outstanding plus any accrued and unpaid interest and 101% of any Term Loan outstanding plus any accrued and unpaid interest.

We may prepay the Bridge Loans, and any accrued and unpaid interest and any breakage costs, without penalty. We may prepay the Term Loans within the first four years following the Initial Maturity Date by paying the outstanding principal, and any accrued and unpaid interest and any breakage costs, plus the greater of (i) 1% of the outstanding principal amount of the Term Loan and (ii) the excess of (a) the present value at such redemption date of (x) the redemption price of such Term Loan four years after the Initial Maturity Date (March 5, 2013), plus (y) all required interest payments that would otherwise be due to be paid on such Term Loan during the period between the redemption date and the date four years after the Initial Maturity Date (March 5, 2013), computed using a discount rate equal to the German bund rate at such redemption date plus 50 basis points over (b) the then outstanding principal amount of the Term Loan. Following the fourth year after the Initial Maturity Date (March 5, 2013), we may prepay the Term Loans, plus any accrued and unpaid interest and any breakage costs, as follows: (i) at par plus 50% of the coupon through March 5, 2014, (ii) at par plus 25% of the coupon through March 5, 2015 or (iii) at par through March 5, 2016. For any Term Loans held by the original lenders, we may prepay the Terms Loans following March 5, 2013 by paying the original lenders the outstanding principal plus accrued and unpaid interest and any breakage costs.

Our obligations under the Bridge Loan Agreement are currently guaranteed by some of our subsidiaries and are collateralized by the same collateral securing the 2004 Notes and the 2007 Notes.

The Bridge Loan Agreement contains customary representations and warranties and events of default. The Bridge Loan Agreement contains covenants restricting our ability, under certain circumstances, to, among other things, (i) make certain restricted payments such as dividends or loans, (ii) create certain

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liens, (iii) merge or consolidate with other entities, (iv) borrow money other than as permitted, (v) make guarantees, (vi) make loans, acquire assets or companies other than as permitted or (vii) enter into hedging arrangements other than as permitted.

We have classified the Bridge Loans as a non-current liability in the Condensed Consolidated Financial Statements as we have the intent and the ability to either refinance the Bridge Loans prior to maturity or covert the Bridge Loans to Term Loans.

The Intercreditor Agreement

In order to establish the relative rights of certain of our creditors under our financing arrangements, including the Bridge Loan Agreement (including priority of claims and subordination), we have entered into an amended and restated Intercreditor Agreement with, among others, the lenders under the Amended Facilities Agreement and the Bridge Loan Agreement, certain hedging counterparties, the security trustee, the trustee for the 2007 Notes and the trustee for the 2004 Notes. The Intercreditor Agreement provides that if there is an inconsistency between the provisions of the Intercreditor Agreement (regarding subordination, turnover, ranking and amendments only), and certain other documents, including the 2007 Notes Indenture governing the 2007 Notes, the Intercreditor Agreement will prevail.

The Assumed Memorex Debt

In connection with the Memorex Acquisition, in addition to the Memorex debt that we refinanced with a portion of the proceeds from the Bridge Loan Agreement, we assumed approximately EUR 26.4 million (approximately $41.8 million at closing) of net debt primarily consisting of (i) a loan to Memorex s Turkish subsidiary MTCTR Memorex Telekomünikasyon Sanayi ve Ticaret Limited Sirketi (Memorex Turkey) in the amount of EUR 10 million (the Memorex Turkey Loan), (ii) a subordinated loan to Memorex in the amount of EUR 8 million (the 1st Memorex Prep Loan), (iii) a subordinated loan to Memorex in the amount of EUR 3 million (the 2nd Memorex Prep Loan) and (iv) finance leases.

The Memorex Turkey Loan is a bank loan with a current variable interest rate that is adjusted quarterly and presently equal to EURIBOR plus 2.0%. The current interest rate is 7.16%. The lender may unilaterally alter or increase the rate of interest as permitted by applicable law. The Memorex Turkey Loan matures, with the principal to be repaid in full, in November 2013. The lender may, in its discretion, require early repayment upon three days written notice. Memorex Turkey may prepay the loan in whole or in part on three days written notice. The Memorex Turkey Loan is collateralized by some of Memorex Turkey s trade receivables.

The 1st Memorex Prep Loan is an un-collateralized subordinated loan from a syndicated group of lenders. Memorex has to make an annual interest payment at the rate of 0.75% per annum and a quarterly interest payment at the rate of 6.8% per annum. The 1st Memorex Prep Loan matures, with the principal to be repaid in full, in July 2012. The lender or Memorex may require early termination of the loan upon important reasons . Important reasons that would enable the creditor to terminate the loan agreement and require early repayment include, but are not limited to, certain events such as the liquidation of Memorex, the institution of insolvency proceedings or a change-in-control of Memorex under certain circumstances. If the loan is terminated prior to maturity, Memorex would owe, in addition to the unpaid principal and accrued interest, the residual term interest consisting of the interest that would have been payable up to the original maturity date of the loan. Memorex would receive a credit against such residual interest for the hypothetical amount which the loan principal would earn if it was reinvested in bonds issued by the Republic of Austria with a residual term equal to the time remaining to the original maturity date of the loan.

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The 2nd Memorex Prep Loan is an un-collateralized subordinated loan from a syndicated group of lenders. Memorex has to make an annual interest payment at the rate of 1.0% per annum and a quarterly interest payment at the rate of 6.9% per annum. The 2nd Memorex Prep Loan matures, with the principal to be repaid in full, in December 2012. The lender or Memorex may require early termination of the loan upon important reasons . Important reasons that would enable the creditor to terminate the loan agreement and require early repayment include, but are not limited to, certain events such as the liquidation of Memorex, the institution of insolvency proceedings or a change-in-control of Memorex under certain circumstances. If the loan is terminated prior to maturity, Memorex would owe, in addition to the unpaid principal and accrued interest, the residual term interest consisting of the interest that would have been payable up to the original maturity date of the loan. Memorex would receive a credit against such residual interest for the hypothetical amount which the loan principal would earn if it was reinvested in bonds issued by the Republic of Austria with a residual term equal to the time remaining to the original maturity date of the loan.

As of September 30, 2008, we were in compliance with all financial covenants set forth in our financing arrangements.

(5) **Derivative Financial Instruments**

We have engaged in substantial foreign currency and interest rate hedging activities to reduce the risk that changes in currency exchange rates and interest rates will adversely affect the eventual net cash outflows resulting from our debt obligations.

We do not enter into financial instruments for trading or speculative purposes. However, the derivative instruments used by us are not designated as hedges under SFAS 133 for accounting purposes and, as such, are referred to as undesignated hedges. Changes in the fair value of undesignated hedges are therefore recorded in current period earnings as a gain or loss on derivative instruments.

Interest rate risk hedging

To limit the risks attributable to the variability of interest rates on a substantial portion of our cash pay debt, we entered into interest rate swap agreements (including cross-currency interest rate swap agreements) to limit the fluctuations in cash flows resulting from variable interest rates. Under the terms of the interest rate swap agreements, we have received variable interest rate payments from the hedging counterparties and made fixed interest rate payments (primarily in Hungarian forint), thereby creating the equivalent of fixed-rate debt.

Foreign currency exchange rate risk hedging

To limit the impact of fluctuations between our Hungarian subsidiaries functional currency, the Hungarian forint, and the euro, we have utilized foreign exchange forward agreements (to purchase euros with Hungarian forint) and cross-currency interest rate swap agreements to hedge both the interest rate and the currency exposure inherent in foreign currency denominated debt instruments bearing variable interest. By entering into cross-currency interest rate swap agreements we have received variable interest payments in euros and made fixed interest payments in Hungarian forint, the functional currency of our Hungarian subsidiaries, thereby creating the equivalent of fixed rate debt in the functional currency of our Hungarian subsidiaries. The cross-currency interest rate swaps in effect are the same as the combination of interest rate swaps, currency swap agreements and foreign exchange forward contracts applied to the same underlying hedged item.

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The objective of these contracts has been to neutralize the impact of currency exchange rate and interest rate movements on our cash flows. However, given the inherent limitations of forecasting and the anticipatory nature of the exposures intended to be hedged, there can be no assurance that such programs will offset more than a portion of the adverse financial impact resulting from unfavorable movements in either interest or currency exchange rates.

Credit risk related to hedging

By using derivative financial instruments to hedge exposures to changes in interest rates and currency exchange rates, we expose ourselves to the credit risk of the counterparty. Credit risk is the failure of the counterparty to perform its obligations under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes us, which creates a credit risk for us. When the fair value of a derivative contract is negative, we owe the counterparty and, therefore, we do not have any credit risk. Our policy requires that counterparties to our hedging activities be large and creditworthy commercial banks. We do not consider the risk of counterparty non-performance associated with hedge contracts to be significant. We do not require and are not required to place collateral for these financial instruments independently of our security arrangements under the Amended Facilities Agreement.

To ensure the adequacy and effectiveness of our interest rate and foreign currency exchange rate hedge positions, we continually monitor, from an accounting and economic perspective, our derivatives positions in conjunction with our underlying interest rate and foreign currency exposures.

The following table summarizes the notional amounts and respective fair values of our derivative financial instruments as of September 30, 2008:

Asset / (Liability)	Notional Amount	Fair Market Value	Fair Value Change for the Nine Months ended September 30, 2008
		(in thousands)	
Cross currency interest rate swaps	$ 583,692	$ (44,948)	$ (9,862)
FX forward contracts			(21)
Interest rate swaps	19,042	55	839
Total	$ 602,734	$ (44,893)	$ (9,044)

The following table summarizes the notional amounts and respective fair values of our floating to fixed interest rate swaps as of September 30, 2008:

Asset / (Liability)	Notional Amount	Fair Market Value	Maturity	Fixed Interest Rate
		(in thousands)		
Amended Facilities Agreement	$ 96,920	$ (5,448)	June 30, 2011	9.379%
Amended Facilities Agreement	19,042	55	June 30, 2011	10.160%
2007 Notes	58,983	(4,361)	August 1, 2009	10.780%
2007 Notes	58,983	(4,336)	August 1, 2009	10.740%
2007 Notes	85,540	(6,274)	August 1, 2009	10.724%
2007 Notes	79,126	(5,804)	August 1, 2009	10.724%
2004 Notes	204,140	(18,725)	August 15, 2009	14.955%

Total Interest Rate Swaps	$ 602,734	$ (44,893)

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The notional principal amount provides one measure of the transaction volume outstanding as of the end of the period, and does not represent the amount of our exposure to market loss.

We estimate the fair values by using a model which discounts future contractual cash-flows determined based on market conditions (foreign currency exchange rates, yield curves in the functional currency and in the foreign currency) prevailing on the date of the valuation. The model we use is regularly tested against third party prices for reasonableness. The fair value represents the estimated amounts that we would pay or receive to terminate the contracts as of September 30, 2008. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

As a result of the recent events in the global and Hungarian economies, which have led to volatile financial markets worldwide, the value of the Hungarian forint has recently depreciated in the foreign currency exchange markets against the euro. This devaluation of the Hungarian forint gave us an opportunity to unwind a significant portion of our hedging positions that we entered into in 2007, which have, since their inception, had a negative effect on our cash flows. In October 2008, we entered into numerous transactions which resulted in the effective unwinding of a substantial portion of our existing hedging arrangements. See Note 11 Subsequent Events .

Embedded derivatives

An embedded derivative is an implicit or explicit term within a contract that does not in its entirety meet the definition of a derivative instrument but affects some or all of the cash-flows or the value of other exchanges required by the contract in a manner similar to a derivative. An embedded derivative therefore is a derivative instrument within another contract that is not a derivative. For example, a euro denominated operating lease contract that one of our Hungarian subsidiaries enters into for a given period of time will give rise to foreign currency exposure for that period since our Hungarian subsidiary will need to buy euro from its functional currency, the Hungarian forint, thereby having an impact on cash-flows. Therefore, a series of foreign exchange forward contracts are embedded in the lease agreement, the host contract, and are accounted for separately.

Embedded derivatives are separated from the host contract and accounted for separately if (i) the economic characteristics and risks of the host contract and the embedded derivative are not closely related; (ii) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (iii) the combined instrument is not measured at fair value with changes in fair value reported through earnings. Changes in the fair value of separable embedded derivatives are recognized immediately in the statement of operations.

We review our material contracts regularly to identify embedded derivatives which require bifurcation from the host contract. The following table summarizes the fair values of our net liabilities relating to embedded derivatives as of September 30, 2008 and December 31, 2007:

(in thousands)	**September 30, 2008** *(unaudited)*	**December 31, 2007**
Embedded derivatives, net	$ (72)	$ (617)

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(6) **Fair value of financial assets and liabilities**

We adopted SFAS No. 157, Fair Value Measurements (SFAS 157) effective January 1, 2008 as discussed in Note 1(e), which defines fair value, establishes a framework for measuring fair value in GAAP, and requires enhanced disclosures about assets and liabilities carried at fair value and fair value measurements. SFAS 157 applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements.

SFAS 157 states that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS 157 establishes a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (i) Level 1 observable inputs such as quoted prices in active markets; (ii) Level 2 inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (iii) Level 3 unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

The three levels of the fair value hierarchy defined by SFAS 157 are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives and listed equities.

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include non-exchange-traded derivatives such as OTC forwards, options and repurchase agreements.

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Level 3 Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in the best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers needs. At each balance sheet date, we perform an analysis of all instruments subject to SFAS 157 and include in Level 3 any of those whose fair value is based on significant unobservable inputs. The following table sets forth by level, within the fair value hierarchy, our financial assets and liabilities that were accounted for at fair value on a recurring basis as at September 30, 2008:

	At fair value as of September 30, 2008			
Recurring Fair Value Measures	**Level 1**	**Level 2**	**Level 3**	**Total**
		(in thousands)		
Assets:				
Derivative financial instruments	$	$	$	$
Embedded derivatives		2,883		2,883
Other				
Total	$	$ 2,883	$	$ 2,883
Liabilities:				
Derivative financial instruments	$	$ 44,893	$	$ 44,893
Embedded derivatives		2,955		2,955
Other				
Total	$	$ 47,848	$	$ 47,848

As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

The determination of the fair values above incorporates various factors required under SFAS 157. These factors include not only the credit standing of the counterparties involved and the impact of credit enhancements (such as cash deposits, letters of credit and priority interests), but also the impact of our nonperformance risk (such as our credit risk and delivery risk) on our liabilities.

We use a similar model to value similar instruments. Valuation models utilize various inputs which include inputs derived principally from or corroborated by observable market data such as yield curves and foreign exchange rates. Judgment may be necessary to determine the source and timing of the input data used. Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2.

There were no financial assets and liabilities that were accounted for at fair value on a non-recurring basis as at September 30, 2008.

(7) **Losses from Fair Value Changes on Warrants**

In May 1999, we issued notes (the Notes) in an aggregate amount of $25 million with detachable warrants (the Warrants) to purchase 2,500,000 shares of common stock of the Company at a price of $10 per share. The Notes accrued interest at the applicable USD LIBOR rate for the six months interest periods plus 3.5%. The Notes matured in March 2007 and were canceled upon the exercise of the Warrants by TDC on March 28, 2007.

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In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, we recorded a non-cash expense of $15.1 million for the first quarter 2007 relating to the change in the fair value of our common stock, which was reflected in the change in the fair value of the Warrants. The fair market value was determined using the Black-Scholes option pricing formula as of the exercise date of the Warrants. Upon exercise on March 28, 2007, the fair market value of the Warrants of $53.1 million was recorded to Additional Paid-In Capital.

(8) **Stock Based Compensation**

We have three equity compensation plans: the stock option plan that was adopted by our Board of Directors in April 1992, which was amended and renamed upon the approval of our stockholders in 2002 (the 2002 Plan); the Non-Employee Director Stock Option Plan (the Directors Plan) which was established by our Board of Directors in 1997; and the 2004 Long-Term Incentive Plan (the 2004 Plan) which was approved by our stockholders in 2004.

As of September 30, 2008, we had outstanding options to purchase 80,000 shares of common stock issued from the 2002 Plan; outstanding options to purchase 85,000 shares of common stock issued from the Directors Plan; and outstanding options to purchase 410,000 shares of common stock under the 2004 Plan.

For the three months ended September 30, 2008, we recognized $838,000 of expense associated with stock based compensation, which was comprised of a non-cash expense relating to the revaluation option awards under FAS 123R.

For the nine months ended September 30, 2008, we recognized $874,000 of expense associated with stock based compensation, which was comprised of non-cash expense of $701,000 relating to the revaluation of outstanding option awards under FAS 123R and an expense of $173,000 related to a stock option grant.

Upon the adoption of SFAS 123R, expected volatility was based on historical volatilities. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected option life assumed at the date of grant. The expected term was calculated based on historical experience and represents the time period options actually remained outstanding. We have estimated zero forfeitures based on historical experience and the limited number of option holders.

The weighted average assumptions used in the Black-Scholes option-pricing model are as follows for the nine months ended September 30, 2008 and 2007:

	Nine months ended September 30,	
	2008	**2007**
Dividend yield	0%	0%
Risk free rate	2.93%	4.55%
Weighted average expected option life (years)	5.42	6.14
Volatility	38.63%	38.75%

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The following is a summary of stock options under the stock compensation plans referred to above, which were granted, were exercised and have expired for the nine months ended September 30, 2008:

	Outstanding Options	Weighted Average Exercise Price
December 31, 2007	570,000	$ 10.30
Granted	20,000	$ 17.14
Exercised	(15,000)	$ 6.52
September 30, 2008	575,000	$ 10.64

All options granted during the period were fully vested upon issuance.

The following table summarizes information about shares subject to outstanding options as of September 30, 2008, which were issued to current or former employees or directors pursuant to the above described stock compensation plans.

Options Outstanding				Options Exercisable	
Number Outstanding	Range of Exercise Prices	Weighted-Average Exercise Price	Weighted-Average Remaining Life in Years	Number Exercisable	Weighted-Average Exercise Price
40,000	$ 4.72-$4.72	$ 4.72	3.25	40,000	$ 4.72
65,000	$ 5.78-$6.49	$ 6.15	2.51	65,000	$ 6.15
200,000	$ 7.46-$9.39	$ 9.00	5.05	200,000	$ 9.00
175,000	$10.89-$13.01	$12.77	6.07	175,000	$12.77
75,000	$14.64-$15.62	$15.36	7.52	75,000	$15.36
20,000	$17.14-$17.14	$17.14	9.25	20,000	$17.14
575,000	$ 4.72-$17.14	$10.64	5.42	575,000	$10.64

The aggregate intrinsic value, which represents the amount by which the fair value of our common stock exceeds the option exercise prices, was $4,243,000 and $4,210,000 as of September 30, 2008 and December 31, 2007, respectively.

The weighted-average exercise price of stock options granted during the nine months ended September 30, 2008 was $17.14 per share. The weighted-average exercise price of stock options granted during the nine months ended September 30, 2007 was $14.64 per share. The total intrinsic value of stock options exercised during the nine months ended September 30, 2008 was $108,000. The total intrinsic value of stock options exercised during the nine months ended September 30, 2007 was $3,300,000. Compensation expense related to stock options granted has been recorded in selling, general and administrative expenses.

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(9) **Selling, General and Administrative Expenses**

The following table presents selling, general and administrative expenses by type for the three and nine month periods ended September 30, 2008 and 2007:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	**2008**	**2007**	**2008**	**2007**
Personnel expenses	$ 19,456	$ 15,416	$ 53,505	$ 38,293
Other administrative expenses	5,176	6,545	15,195	12,089
Advertising and marketing costs	1,828	1,070	5,170	3,294
Network operating expenses	12,759	8,062	36,031	21,361
IT costs	3,218	2,139	9,852	4,326
Other taxes	1,070	813	2,577	1,658
Bad debt and collection costs	1,595	667	5,913	2,189
Legal, audit and consultant fees	1,350	3,147	2,960	4,411
Management fees	12	87	59	105
Other operating expenses, net	489	(179)	10,582	1,802
Total for segments	$ 46,953	$ 37,767	$ 141,844	$ 89,528
Backbone rental expenses	(6,328)	(4,621)	(17,085)	(11,846)
Network operating expenses	(6,431)	(5,341)	(18,946)	(10,916)
Direct personal expenses	(5,542)	(8,761)	(15,678)	(14,166)
Total selling, general and administrative expenses	$ 28,652	$ 19,044	$ 90,135	$ 52,600

Personnel expenses for the nine months ended September 30, 2008 and 2007 include restructuring expenses of $4.9 million and $6.8 million, respectively relating to the reorganization following the Invitel Acquisition.

Bad debt and collection costs for the nine months ended September 30, 2008 and 2007 include one-off bad debt expenses as a result of an additional provision made at Memorex in the amount of $0.3 million in 2008 and at PanTel in the amount of $1.2 million in 2007.

Legal, audit fees and consultant expenses for the nine months ended September 30, 2008 and 2007 include Sarbanes-Oxley and compliance expenses amounting to $2.1 million and $2.9 million, respectively.

Other operating expenses for the nine months ended September 30, 2008 include integration costs of $5.7 million, due diligence expenses of $2.4 million, start-up expenses relating to Memorex Turkey in the amount of $2.4 million, a provision for unused vacation days in the amount of $0.8 million and other non-recurring items of $3.6 million relating to ongoing projects. Other operating expenses for the nine months ended September 30, 2007 include integration costs of $6.2 million, due diligence expenses of $0.3 million and a provision for unused vacation days in the amount of $0.7 million.

(10) **Segment Disclosures**

We manage our business based on four segments: Mass Market Voice; Mass Market Internet, Business and Wholesale. Our management monitors the revenue streams of these segments and operations are managed and financial performance is evaluated based on these segments.

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These segments are as follows:

Mass Market Voice. The revenue generated from the fixed line voice and voice-related services provided to Mass Market customers within our historical concession areas and outside our historical concession areas in Hungary. Mass Market Voice revenue comprises monthly fees charged for accessing our 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, one-time connection and new service fees, as well as monthly fees for packages with built-in call minutes.

Mass Market Internet. The revenue generated from dial-up and DSL Internet connections provided to Mass Market customers in Hungary both inside and outside our historical concession areas. Mass Market Internet revenue comprises dial-up revenue, which is generated through a combination of time based and access fees, and DSL revenue, which is generated through a variety of monthly packages.

Business. The revenue generated from the fixed line voice, data and Internet services provided to business, government and other institutional customers nationwide. Business 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, and fees from Internet access packages. In addition, Business 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 provided on a wholesale basis to other operators or resellers. 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, fixed monthly charges for supply of dark fiber or ducts, and voice transit charges from other Hungarian and international telecommunications service providers, which are based on the number of minutes transited. The revenue of the acquired Memorex business is disclosed fully in the Wholesale segment.

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Revenue by segment and segment gross margin for the three and nine months ended September 30, 2008 and 2007 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	**2008**	**2007**	**2008**	**2007**
Revenue:				
Mass Market Voice	$ 41,785	$ 33,305	$ 127,409	$ 67,532
Mass Market Internet	14,913	11,575	43,148	21,013
Business	40,456	34,660	116,725	79,368
Wholesale	55,929	36,599	145,323	90,214
Total Revenue	$ 153,083	$ 116,139	$ 432,605	$ 258,127
Cost of sales:				
Mass Market Voice	$ 8,325	$ 6,234	$ 26,404	$ 12,792
Mass Market Internet	2,509	1,992	7,415	3,495
Business	9,390	8,179	27,632	19,606
Wholesale	23,321	22,327	63,878	51,488
Total allocated to segments	$ 43,545	$ 38,732	$ 125,329	$ 87,381
Backbone rental expenses	6,328	4,621	17,085	11,846
Network operating expenses	6,431	5,341	18,946	10,916
Direct personnel expenses	5,542	8,761	15,678	14,166
Total Cost of sales	$ 61,846	$ 57,455	$ 177,038	$ 124,309
Segment Gross margin:				
Mass Market Voice	$ 33,460	$ 27,071	$ 101,005	$ 54,740
Mass Market Internet	12,404	9,583	35,733	17,518
Business	31,066	26,481	89,093	59,762
Wholesale	32,608	14,272	81,445	38,726
Total segment gross margin	$ 109,538	$ 77,407	$ 307,276	$ 170,746
Backbone rental expenses	(6,328)	(4,621)	(17,085)	(11,846)
Network operating expenses	(6,431)	(5,341)	(18,946)	(10,916)
Direct personnel expenses	(5,542)	(8,761)	(15,678)	(14,166)
Selling, general and administrative expenses	(28,652)	(19,044)	(90,135)	(52,600)
Depreciation and amortization	(34,085)	(26,334)	(93,018)	(51,757)
Income from operations	$ 28,500	$ 13,306	$ 72,414	$ 29,461

The change in the amounts of reconciling items is primarily due to the Invitel Acquisition and the Memorex Acquisition.

Total assets by segments as of September 30, 2008 and December 31, 2007 were as follows:

(in thousands)	**September 30, 2008**	**December 31, 2007**
	(unaudited)	
Mass Market Voice	$ 431,400	$ 395,605
Mass Market Internet	220,436	194,810
Business	305,162	274,735
Wholesale	386,389	245,041
Total assets	$ 1,343,387	$ 1,110,191

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Notes to the Unaudited Condensed Consolidated Financial Statements

(11) **Subsequent Events**

Derivative financial instrument transactions

EUR 67.4 million of the outstanding principal debt balance from our Amended Facilities Agreement is denominated in euros and EUR 13.2 million is denominated in Hungarian forint. All of the 2007 Notes and the 2004 Notes are denominated in euros.

In order to reduce our exposure to the fluctuations in interest rates and the EUR/HUF currency exchange rates, we entered into cross-currency interest rate swap agreements and an interest rate swap agreement in 2007 pursuant to which we fixed a total of EUR 455.6 million of this debt balance at an average EUR/HUF currency exchange rate of EUR/HUF 261.20. We did not enter into any such arrangements with respect to the 2006 PIK Notes or the Bridge Loan Agreement.

The EUR 67.4 million outstanding balance under the Amended Facilities Agreement which is denominated in euros and the 2007 Notes provide for variable rates of interest tied to EURIBOR, which interest is payable in euros. In order to reduce our exposure to variable interest rates and fluctuations in the EUR/HUF currency exchange rate, we entered into cross-currency interest rate swap agreements pursuant to which we swapped variable rate euro interest payments for fixed rate forint payments.

The 2004 Notes provide for a fixed rate of interest which is payable in euros. In order to reduce our exposure to fluctuations in the EUR/HUF exchange rate, we entered into a cross-currency interest rate swap arrangement pursuant to which we swapped fixed rate euro interest payments for fixed rate forint payments.

The EUR 13.2 million portion of the Amended Facilities Agreement which is denominated in HUF provides for a variable rate of interest tied to BUBOR, which interest is payable in Hungarian forint. In order to reduce our exposure to a variable interest rate, we entered into an interest rate swap arrangement pursuant to which we swapped variable rate Hungarian forint interest payments for fixed rate forint payments.

Since their inception in May 2007, these arrangements have had a net negative effect to our cash flow of HUF 5.8 billion (approximately $34.3 million).

In October 2008 we entered into numerous transactions which resulted in the effective unwinding of a substantial portion of our hedging positions. We effectively terminated the cross-currency interest rate swap arrangements with respect to the 2004 Notes and the 2007 Notes. We also effectively terminated 50% of the cross-currency interest rate swap arrangement with respect to the EUR 67.4 million portion of the Amended Facilities Agreement which is denominated in euros. The aggregate cost to effectively terminate these arrangements is approximately EUR 9 million (approximately $12.9 million), payable during the term of the arrangements, (August 2009 with respect to the hedging arrangements related to the 2004 Notes and the 2007 Notes and June 2011 with respect to the hedging arrangements relating to Amended Facilities Agreement).

Legal proceedings

Three Hungarian municipalities initiated court proceedings against us in the Metropolitan Court of Budapest seeking payment in connection with an ambiguous provision in some of our concession contracts regarding the payment of local municipal taxes. On May 15, 2008 the Metropolitan Court

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HUNGARIAN TELEPHONE AND CABLE CORP. AND SUBSIDIARIES

Notes to the Unaudited Condensed Consolidated Financial Statements

ruled on our behalf and denied the claims of the municipalities. On October 30, 2008 the Metropolitan Court of Appeal overturned, in part, the lower court s ruling and awarded the municipalities HUF 919 million (approximately $5.4 million) plus interest and cost to the plaintiffs. The award is payable within 15 days of receipt of the written judgment, which we expect to receive in December 2008.

We have a right to, and plan to apply to the Hungarian Supreme Court for a special review and a suspension of the judgment. There is no guarantee that the Hungarian Supreme Court will review this case. While we plan to continue to contest this case and believe that this case is without merit, to be compliant with our accounting standards we have made a provision for this contingent liability in the amount of HUF 2.2 billion (approximately $13 million) for the period ended September 30, 2008 and it is included in income tax expense. The final amount due, if any, might be significantly decreased or increased based on the final ruling by the Hungarian Supreme Court or a different interpretation of the interest calculation.

One municipality made a claim to us, which we rejected, for HUF 57 million (approximately $0.3 million) but has not initiated any formal legal proceedings. The other municipalities that made claims to us, which we rejected, did not initiate formal legal proceedings by the legal deadline and, therefore, lost their ability to initiate formal legal proceedings.

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Report of Independent Auditors

To the Board of Directors and Shareholders of

Memorex Telex Communications AG:

We have audited the accompanying consolidated balance sheet of Memorex Telex Communications AG and its subsidiaries (the Company) as of 31 December 2007, and the related statements of consolidated income, changes in shareholders equity and of cash flows for the nine-month period ended 31 December 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

The consolidated financial statements were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. As discussed in Note 2.1, the accompanying consolidated financial statements do not include comparative figures for the prior year as required by International Accounting Standard No. 1, Presentation of Financial Statements . In our opinion, inclusion of comparative figures is necessary to obtain a proper understanding of the current period s financial statements.

In our opinion, except for the effects of the matter described in the preceding paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Memorex Telex Communications AG and now in more than its subsidiaries as of 31 December 2007, and the results of their operations and their cash flows for the nine-month period ended 31 December 2007 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

/s/ PricewaterhouseCoopers Kft.

Budapest, Hungary

8 August 2008

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Memorex Telex Communications A.G.

Consolidated Balance Sheet

As at 31 December 2007

(in thousands of EUR)	**Notes**	**At 31 December 2007**
Non-Current Assets		
Goodwill		106
Licences		201
Software		205
Indefeasable Rights of Use		26,526
Other intangible Assets	9	26,932
Land and Buildings		9,875
Network Equipment		99,853
Other		1,485
Capital Work in Progress		4,302
Property, Plant and Equipment	10	115,515
Other Non-Current Financial Assets		419
Deferred Tax Assets	19	5,750
		148,722
Current Assets		
Cash and Cash Equivalents	11	4,683
Investment in Securities		521
Trade and Other Receivables	12	12,635
Inventories		123
Prepayments and Accrued Income		840
		18,802
Total Assets		**167,524**
Equity and Liabilities		
Equity attributable to equity holders of the parent		
Share Capital	13	36,400
Reserves		84
Accumulated deficit		(6,025)
		30,459
Minority Interest		**24**
Total Equity		**30,483**
Non-Current Liabilities		
Interest Bearing Borrowings	14	11,099
Non-Current Obligation Under Capital Leases	21	8,720
Other Non-Current Liabilities	15	45,055
Deferred Tax Liabilities	19	231

		65,105
Current Liabilities		
Current Portion of Interest-Bearing Borrowings	14	49,513
Current Obligation Under Capital Leases	21	5,175
Trade and Other Payables		6,784
Provisions	16	5,370
Accrued Expenses and Deferred Income	17	5,094
		71,936
Total Liabilities		**137,041**
Total Equity and Liabilities		**167,524**

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Memorex Telex Communications A.G.

Consolidated Income Statement

For the nine months period ended 31 December 2007

(in thousands of EUR)	**Notes**	**For the nine months ended 31 December 2007**
Revenues	3	27,584
Cost of Sales	4	(4,551)
Operating Expenses	5	(18,208)
Depreciation and Amortization	7	(8,711)
Profit / (Loss) from Operations		**(3,886)**
Financial Income	8	188
Financial Expenses	8	(4,252)
Net Profit / (Loss) Before Tax		**(7,950)**
Income Tax (Expense) / Benefit	19	1,685
Net Profit / (Loss) for the Period		**(6,265)**
Attributable to:		
Equity Holders of the Parent		(6,269)
Minority Interest		4
		(6,265)

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

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Memorex Telex Communications A.G.

Consolidated Statement of Cash Flows

For the nine months period ended 31 December 2007

(in thousands of EUR)	**Notes**	**For the nine months ended 31 December 2007**
Cash Flows from Operating Activities		
Net Profit / (Loss)		(6,265)
Adjustments for Non-Cash Items:		
Interest Expense / (Income)	8	3,435
Depreciation and Amortization	7	8,711
Amortization of Deferred Borrowing Costs		140
Allowance for Bad and Doubtful Debts	5	2,094
Provisions	16	1,595
Deferred taxes	19	(1,909)
Other Non-Cash Items		517
Working Capital Changes:		
Change in Trade and Other Receivables	12	(2,778)
Change in Inventories		(44)
Change in Prepayments and Accrued Income		(278)
Change in Other Asset		1,119
Change in Trade Payables, Other Payables and Accrued Expenses		(6,866)
Result of Sale of Property, Plant and Equipment	10	(118)
Interest Paid		(2,725)
		(3,372)
Cash Flows from Investing Activities		
Purchase of Intangible Assets	9	(1,681)
Purchase of Property, Plant and Equipment	10	(10,849)
Proceeds from Sale of Property, Plant and Equipment	10	3,751
Interest Received		32
		(8,747)
Cash Flows from Financing Activities		
Proceeds from Interest Bearing Borrowings	14	18,453
Proceeds from Related Party Loans		900
Refinancing Costs	14	(197)
Principal Payments under Capital Lease Obligations		(3,464)
Repayments of Interest Bearing Borrowings		(1,486)
		14,206
Net Increase / (Decrease) in Cash and Cash Equivalents		**2,087**
Cash and Cash Equivalents at the Beginning of the Period	11	2,596
Cash and Cash Equivalents at the End of the Period		**4,683**

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

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Memorex Telex Communications A.G.

Consolidated Statement of Changes in Shareholders Equity

For the nine months period ended 31 December 2007

	Attributable to equity holders of the parent					
(in thousands of EUR)	Share Capital	Reserves	Accumulated Deficit	Total	Minority interest	Total Shareholders Equity
Balance as at 31 March 2007	**36,400**	**84**	**244**	**36,728**	**24**	**36,752**
Net result for the period			(6,269)	(6,269)		(6,269)
Total recognized income and expense for the period			(6,269)	(6,269)		(6,269)
Balance as at 31 December 2007	**36,400**	**84**	**(6,025)**	**30,459**	**24**	**30,483**

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Memorex Telex Communications A.G.

Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

1. General Information

Memorex Telex Communications AG (Memorex and, together with its subsidiaries, the Company or Group) was incorporated in Austria on April 20, 1967. The address of the headquarters of the Company is Ortsstrasse 24, A 2331 Vösendorf, Austria. Memorex was originally a reseller of IBM hardware solutions. In 1997, following a buyout of Memorex by some of its employees, Memorex repositioned its business to provide telecommunications services within the Western and Central European telecommunications markets. Through acquisitions and capital investments, Memorex has expanded its business within Central and Eastern Europe to compete with the incumbent providers or other providers of telecommunications services in the region.

As of December 31, 2007, Memorex provided wholesale data and capacity services of fiber optic cable lines in the Central and Eastern European region to other global telecommunications providers and Internet companies in such countries as Austria, Bulgaria, the Czech Republic, Italy, Romania, Slovakia, Turkey, and Ukraine.

Memorex is a stock corporation under the Austrian law, registered with the commercial register of the Regional Court of Wiener Neustadt (Maria-Theresien-Ring 5, 2700 Wiener Neustadt, Austria).

On March 5, 2008, Hungarian Telephone and Cable Corp., a U.S. company (HTCC), acquired 95.7% of the outstanding equity of Memorex through one of its subsidiaries, Invitel Távközlési ZRt. (Invitel). The purchase price paid by HTCC was EUR 18.8 million. HTCC assumed approximately EUR 23.1 million of the Company s net debt and refinanced approximately EUR 46.6 million of the Company s debt at closing.

The purpose of the financial statements is related to the acquisition of the Company by HTCC, whereby HTCC is required to file with the United States Securities and Exchange Commission (SEC) a report on Form 8-K regarding the acquisition of Memorex.

The consolidated financial statements do not include comparative figures for the prior year as required by IAS 1 Presentation of financial statements . Memorex s fiscal year ended on March 31, 2008. Given the completion date of the acquisition of Memorex, March 5, 2008, the audited financial statements provided herein present the nine-month period ended December 31, 2007, rather than the full year, as permitted by Rule 3-06 of Regulation S-X.

The consolidated financial statements were prepared by management subsequent to the acquisition of the Company by HTCC.

Shareholders

As of December 31, 2007, the stated share capital of Memorex was EUR 36,400,000 which consisted of 3,640,000 shares with a par value of EUR 10 each. Of such outstanding share capital, Joki Holding A.G., a Swiss entity owned 72.25% , 47.10 North, a Swiss company owned 20.25% , and the remaining 7.5% of the outstanding share capital was owned by individuals.

Subsidiaries

Memorex operates part of its business through its operating subsidiaries. As of December 31, 2007 Memorex s subsidiaries included: Memorex Telex Communications Bulgaria EOOD, a Bulgarian limited liability company with a registered share capital of BGN 5,200 (Memorex Bulgaria); Memorex Telex Communications CZ s.r.o., a Czech limited liability company with a registered share

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Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

capital of CZK 167,357,300 (Memorex Czech Republic); Memorex Telex Communications Italia SRL, an Italian limited liability company with a registered share capital of EUR 10,000 (Memorex Italy); Memorex Telex Communications S.R.L., a Romanian limited liability company with a registered share capital of RON 18,000 (EUR 5,000) (Memorex Romania); Memorex Telex Communications SK, Ltd., a Slovakian limited liability company with a registered share capital of SKK 57,000,000 (Memorex Slovakia); MTCTR Memorex Telekomünikasyon Sanayi ve Ticaret Limited Sirketi, a Turkish limited liability company with a registered share capital of YTL 250,000 (Memorex Turkey); and Memorex Telex Communications UA Ltd. with a registered share capital of UAH 2,272,500, a Ukranian limited liability company (Memorex Ukraine).

As of December 31, 2007, Memorex owned 100% of the outstanding equity of each of Memorex Bulgaria, Memorex Czech Republic, Memorex Italy, Memorex Romania, Memorex Slovakia and Memorex Ukraine. As of December 31, 2007, Memorex owned 95% of the outstanding equity of Memorex Turkey. The remaining 5% of the equity of Memorex Turkey is owned by an individual. Memorex holds an option to purchase such 5% equity stake from this individual at a nominal amount.

The consolidated financial statements of the Company for the year ended December 31, 2007 comprise of Memorex and its subsidiaries.

The consolidated financial statements were authorized by the Company s management for issue on August 7, 2008.

2. Significant Accounting Policies

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below.

2.1. Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB. They have been prepared in accordance with IFRS 1, First-time Adoption of IFRS, because they were prepared for the first time, for the purpose of filing financial statements related to the acquisition of the Company by HTCC, whereby HTCC is requirement to file with the United States Securities and Exchange Commission (SEC) a report on Form 8-K regarding the acquisition of Memorex.

Consolidated financial statements of the Company have not previously been published under IFRS or a previous form of GAAP. In addition, the SEC only requires one year of audited financial statements for purposes of filing this report on Form 8-K. As a result, these financial statements do not include comparative figures for the prior years as required by IAS 1 Presentation of financial statements , nor are reconciliations required to any previous form of GAAP.

2.2. Basis of Preparation

The consolidated financial statements are presented in Euro (EUR) rounded to the nearest thousand of EUR (TEUR). The consolidated financial statements have been prepared under the historical cost convention, except for financial assets and liabilities that are stated at fair value.

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Memorex Telex Communications A.G.

Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

The estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Judgments made by management in the application of IFRS that have a significant effect on the financial statements and estimates involving significant uncertainty are discussed in Note 2.20.

The accounting policies set out below have been consistently applied by the Company to all periods presented in these consolidated financial statements. Where it was necessary, accounting policies of the subsidiaries were modified to ensure consistency with the policies adopted by Memorex and its other subsidiaries.

2.3. Basis of Consolidation

2.3.1. Subsidiaries

Subsidiaries are those entities that are controlled, directly, or indirectly through its subsidiaries, by Memorex. Control exists when Memorex has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

2.3.2. Transactions eliminated on consolidation

All inter-company balances, transactions, unrealized gains and losses on transactions between Memorex and its subsidiaries have been eliminated from the consolidated financial statements.

2.4. Foreign Currency

2.4.1. Translation of financial statements

Items included in the financial statements of each of Memorex and its subsidiaries are measured in EUR as the currency of the primary economic environment in which the Company operate is the Euro (the functional currency).

2.4.2. Transactions and balances

Transactions in foreign currencies are translated to EUR at the foreign exchange rate ruling at the dates of the transactions.

Monetary assets and liabilities denominated in currencies other than the EUR at the balance sheet date are translated to the functional currency at the applicable foreign

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Memorex Telex Communications A.G.

Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

exchange rate on the day of translation. The foreign currency gain or loss on monetary items is the difference between amortised cost in EUR at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Foreign currency differences arising on translation are recognised in profit or loss, except for differences arising on the translation of available-for-sale equity instruments.

Non-monetary assets and liabilities denominated in currencies other than the EUR that are stated at historical cost are translated to the functional currency using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in currencies other than the EUR that are stated at fair value are translated at the applicable foreign exchange rates in effect on the date that the fair values were determined.

2.5. Cash and Cash Equivalents

Cash and cash equivalents comprise cash in bank balances and highly liquid call deposits with maturities of three months or less and exclude all overdrafts that are shown within borrowings in current liabilities on the face of the balance sheet.

2.6. Trade and Other Receivables

Receivables with short duration are not discounted. Receivables with long duration are recognized initially at fair value, and thereafter, they are measured at amortized cost using the effective interest rate method less accumulated impairment losses. The amounts of any impairment losses are included in operating expenses.

Amounts due and receivable from other network operators are shown net where a right of set-off exists and the amounts are intended to be settled on a net basis.

2.7. Trade and Other Payables

Trade and other payables with short duration are not discounted. Trade and other payables with long duration are initially recognized at fair value and subsequently at amortized cost using the effective interest rate method.

2.8. Inventories

Inventories consist of materials to be used in construction and repair of the network and network equipment held for sale. Inventories are carried at the lower of cost and net realizable value. Cost is based on the first-in, first-out principle and includes expenditures incurred in acquiring the inventories and bringing them to their existing condition and location. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

2.9. Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill arising in a business combination represents the excess of the cost of the acquisition over the interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. Goodwill is measured at cost less accumulated impairment losses.

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Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

Goodwill arising on the acquisition of a minority interest in a subsidiary represents the excess of the cost of the additional investment over the carrying amount of the net assets acquired at the date of exchange.

2.10. Intangible Assets

Intangible assets are stated at cost less accumulated amortization and accumulated impairment losses except for goodwill and intangible assets with indefinite useful life, which are not amortized and are stated at cost less accumulated impairment losses. After initial recognition, the Company assesses whether an intangible asset has a finite or indefinite useful life. The cost of intangible assets with a finite useful life is amortized on a straight-line basis over the period in which the asset is expected to be available for use. The rates of amortization are based on the following estimated useful lives:

Licenses and concession rights	50 years
Indefeasible Rights of Use (IRU)	5-20 years
Software	3-4 years
Other	5-12 years

Amortization of intangible assets ceases at the earlier of the date that the asset is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and the date the asset is derecognized. The amortization periods are reviewed annually at each financial year-end. Any changes arising from such review are accounted for as a change in an accounting estimate.

2.11. Property, Plant and Equipment

2.11.1. Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of overhead, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the cost of dismantling and removing the items and restoring the site on which they are located. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

Capital work in progress is stated at cost less impairment losses and represents those property, plant and equipment that have not been completed and capitalized.

2.11.2. Leased assets

Leases in terms of which the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. An asset acquired through a finance lease is measured initially at an amount equal to the lower of its fair value and the present value of the minimum lease payments at the inception of the lease. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

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Memorex Telex Communications A.G.

Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

2.11.3. Subsequent expenditure on property, plant and equipment

Expenditures incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditure, is included in the carrying amount if it is probable that future economic benefits embodied in that part will flow to the Company and its cost can be measured reliably. All other expenditures are recognized in the income statement as an expense as incurred.

2.11.4. Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the items of property, plant and equipment, and major components that are accounted for separately. Leased assets are depreciated over the shorter of the lease term or their useful lives. Land and capital work in progress are not depreciated. The estimated useful lives are as follows:

Buildings	30-50 years
Network	20-50 years
Machinery and Equipment	6-10 years
Fixtures and Fittings	3-7 years
Vehicles	5 years
Computers	3-7 years

Depreciation of property, plant and equipment ceases at the earlier of the date that the asset is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and the date the asset is derecognized.

Depreciation methods, useful lives and residual values are reviewed annually at each financial year-end. Any changes arising from such review are accounted for as a change in an accounting estimate.

2.12. Impairment

The carrying amounts of the Company s assets, other than inventories (see accounting policy note 2.8) and deferred tax assets (see accounting policy note 2.18), are reviewed as of each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset s recoverable amount is estimated.

For goodwill and intangible assets with an indefinite useful life or not available for use, the recoverable amount is estimated annually, irrespective of whether any indication of impairment exists. An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable asset group that generates cash flows that are largely independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit or group of units on a pro rata basis. Impairment losses are recognized in the income statement.

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Memorex Telex Communications A.G.

Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value. Any cumulative loss in respect of an available-for-sale financial asset recognized previously in equity is transferred to profit and loss. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets that share similar credit risk characteristics are assessed collectively in groups.

2.12.1. Calculation of recoverable amount

The recoverable amount of the Company s investments in financial assets carried at amortized cost is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. Receivables with a short duration are not discounted. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

The recoverable amount of other assets or cash-generating units is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

2.12.2. Reversal of impairment

An impairment loss in respect of a held-to-maturity security or receivable and available-for-sale financial asset that is a debt security is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognized. The reversal is recognized in profit or loss. For available-for-sale financial asset that is an equity security, the reversal is recognized directly in equity. An impairment loss in respect of goodwill is not reversed. In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and there has been an indication that the impairment has decreased or no longer exists.

An impairment loss is reversed only to the extent that the asset s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

2.13. Interest Bearing Borrowings

Interest bearing borrowings are recognized initially at fair value, less discounts and attributable transaction costs. Subsequent to initial recognition, interest bearing borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the income statement over the period of the borrowings on an effective interest basis.

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2.14. Provisions

A provision is recognized in the balance sheet when the Company has a legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognized when Company has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

2.15. Revenue Recognition

Revenue from all goods and services are shown net of VAT, rebates and discounts. Revenue from services are recognized when services are provided. Revenue from the sale of goods is recognized when the significant risks and rewards of ownership of products sold have been transferred to the buyer. The Company considers the various elements of subscriber arrangements to be separate earnings processes for IFRS purposes and recognizes the revenue for each of the deliverables as earned.

Revenue from contracts relating to Indefeasible Rights of Use (IRU) contain installation fees, one-off or up-front fees, monthly fees and maintenance fees. One-off or up-front fees of IRU contracts are deferred over the term of the related contract. Installation fees, monthly fees and maintenance fees are charged periodically as specified in the related contract and the revenue is recognized straight line over the life of the related contract.

Revenue from the sale of ducts and other network equipment is recognized in revenue and the related cost is recognized in cost of sales when significant risk and rewards of ownership has been transferred.

Revenues and cost of sales from other network operators are shown net where a right of set-off exists and the amounts are intended to be settled on a net basis.

2.16. Net Financial Costs

Net financial costs comprise interest expense on borrowings, interest income on funds invested, dividend income, foreign exchange gains and losses and impairment losses on financial investments.

Interest income is recognized in the income statement as it accrues, taking into account the effective yield on the asset.

2.17. Lease payments

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made in respect of operating leases are charged to the income statement on a straight-line basis over the lease term and included in operating expenses.

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Leases for property, plant and equipment under which the Group has substantially all the risks and rewards of ownership, are classified as finance leases. Lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding lease liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

2.18. Income taxes

Income tax expense comprises current and deferred taxes. Income tax expense is recognized in profit or loss 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 tax payable on taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred tax is provided for using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for items that probably will not be reversed in the foreseeable future. The amount of deferred tax provided for is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using the appropriate tax rate enacted or substantively enacted at the balance sheet date.

Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed as of each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realized.

2.19. Pension Costs and Employee Benefits

Contributions are made to the local pension, health and unemployment programs at the applicable statutory rates in effect during the year, based on gross salary payments. The cost of social security payments is charged to the income statement in the same period when the related salary cost incurred. The Company has no obligation for pension or other post employment benefits beyond the government programs.

2.20. Key sources of estimation uncertainty

The Company makes estimates and assumptions concerning the future. The estimates and assumptions that have a significant risk of affecting the carrying amounts of assets and liabilities in the financial statements within the next financial year are described below.

2.20.1. Deferred tax assets

The Company recognizes deferred tax assets in its balance sheet relating to tax loss carry forwards. The recognition of such deferred tax assets is subject to the utilization of tax loss carry forwards. The utilization of certain amounts of such tax loss carry forwards is subject to statutory limitations and is dependent on the amount of future taxable income of the Company. The Company has recognized deferred tax assets relating to tax loss carry forwards based on estimated future taxable income. If the future taxable income of such subsidiaries were to significantly differ from the amounts that were estimated, such differences could impact the amount of deferred tax assets and income tax expense of the Company.

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2.20.2. Provision for impairment of trade and other receivables

The Company calculates a provision for impairment of trade and other receivables to cover the estimated losses resulting from customers not making the required payments when due. The estimates used in evaluating the adequacy of the provision for impairment of trade and other receivables 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.

The Company considers that the accounting estimate related to the provision for impairment of trade and other receivables is a critical accounting estimate since it involves assumptions about future customer behavior and the resulting future cash collections. If the financial condition of customers or the economic environment in which they operate were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the provision recognized as at December 31, 2007.

2.20.3. Depreciation

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 as described in Note 2.10 and Note 2.11.4.

The Company considers that the accounting estimate related to the determination of the useful lives of assets is a critical accounting estimate since it involves assumptions about technology evolutions in an innovative industry. Further, due to the significant weight of long-lived assets in the asset base of the Company, the impact of any changes in these assumptions could be material to the Company s financial position, as well as the results of its operations.

2.21. New Accounting pronouncements

IAS 23 Borrowing Costs , revised was issued in March 2007. The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 1, 2009. The Company is currently assessing the impact of the amended standard on its financial statements.

IAS 1 Presentation of Financial Statements , revised was issued in September 2007 and is effective for annual periods beginning on or after January 1, 2009. The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate

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income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Company expects the revised IAS 1 to affect the presentation of its financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

IAS 27 Consolidated and Separate Financial Statements , revised was issued in January 2008 and is effective for annual periods beginning on or after 1 July 2009. The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously minority interests) even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent s ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Company is currently assessing the impact of the amended standard on its consolidated financial statements.

3. Revenue

(in thousands of EUR)	**For the nine months ended 31 December 2007**
Austria	17,542
International	10,042
Revenue	**27,584**

International revenue for the nine months period ended December 31, 2007 includes revenue generated by Memorex Turkey in the amount of EUR 3,108 thousand, Memorex Czech Republic in the amount of EUR 3,218 thousand, Memorex Slovakia in the amount of EUR 1,116 thousand, Memorex Ukraine in the amount of EUR 1,254 thousand. The remaining EUR 1,346 thousand of international revenue was generated by Memorex s smaller subsidiaries.

4. Cost of Sales

(in thousands of EUR)	**For the nine months ended 31 December 2007**
Access type charges	(4,487)
Other cost of sales	(64)
Total Cost of Sales	**(4,551)**

Access type charges include fees paid to other telecommunication operators for the use of their access network to reach customers beyond the coverage of our network.

Access type charges predominantly include leased line services, internet connectivity costs, and rental fees paid for DSL access and local loop unbundling (LLU).

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5. Operating Expenses

(in thousands of EUR)	**For the nine months ended 31 December 2007**
Personnel expenses	(2,674)
Headcount-related costs	(1,472)
Advertising and marketing costs	(110)
Network operating expenses	(7,321)
IT costs	(264)
Local operating and other taxes	(243)
Bad debt expense	(2,094)
Provision for legal cases	(1,612)
Legal and audit fees	(77)
Consultant expenses	(577)
Turkey start up expenses	(1,532)
Other operating expenses, net	(232)
Total Operating Expenses	**(18,208)**

Personnel expenses include salaries and related taxes and contributions and other personnel expenses. See Note 6 for details.

Network operating expenses include the maintenance costs of the Company s telecommunication infrastructure and its license and rental fees.

Significant portion of the bad debt expense for the nine months ended December 31, 2007 is not expected to re-occur in future years.

Provision for legal cases of EUR 1,612 thousand for the nine months ended December 31, 2007 includes amounts provided for in relation to legal claims against the Company. See Note 18 for details.

Consultant expenses of EUR 577 thousand for the nine months ended December 31, 2007 were related to non-recurring legal expenses.

Turkey start-up expenses of EUR 1,532 thousand relate to costs associated with establishing the Company s business presence in Turkey such as rental, administrative and personnel expenses.

6. Personnel Expenses

(in thousands of EUR)	**For the nine months ended 31 December 2007**
Salaries	(2,225)
Social security and other contributions	(447)
Personnel related expenses	(2)

Total Personnel Expenses	**(2,674)**

The Company had 115 employees as of December 31, 2007.

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7. Depreciation and Amortization

(in thousands of EUR)	For the nine months ended 31 December 2007
Amortization	(2,265)
Depreciation	(6,446)
Total Depreciation and Amortization	**(8,711)**

8. Net Financial Cost

(in thousands of EUR)	For the nine months ended 31 December 2007
Interest income	188
Financial Income	**188**
Third party interest expense	(3,623)
Amortization of deferred borrowing costs	(139)
Interest expense	(3,762)
Net foreign exchange (loss)/gain	(383)
Other financial expense	(107)
Financial Expense	**(4,252)**
Net Financial Cost	**(4,064)**

All interest income for the nine months period ended December 31, 2007 relates to cash and cash equivalents.

9. Intangible Assets

Movements during the period in the Company s intangible assets were as follows:

(in thousands of EUR)	Licenses	Software	Indefeasable Rights of Use	Total Intangible Assets
Cost as at 31 March 2007	**255**	**699**	**36,690**	**37,644**
Additions during the period		4	1,275	1,279

Cost as at 31 December 2007	**255**	**703**	**37,965**	**38,923**
Accumulated amortization as at 31 March 2007	**(42)**	**(383)**	**(9,301)**	**(9,726)**
Amortization charge for the period	(12)	(115)	(2,138)	(2,265)
Accumulated amortization as at 31 December 2007	**(54)**	**(498)**	**(11,439)**	**(11,991)**
Carrying value as at 31 March 2007	**213**	**316**	**27,389**	**27,918**
Carrying value as at 31 December 2007	**201**	**205**	**26,526**	**26,932**

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10. Property, Plant and Equipment

Movements during the period in the Company s property, plant and equipment were as follows:

(in thousands of EUR)	Land and Buildings	Network and Equipment	Other	Capital Work In Progress	Total Property, Plant and Equipment
Cost as at 31 March 2007	**12,558**	**150,567**	**992**	**(358)**	**163,759**
Additions during the period	821	8,244	1,323	8,569	18,957
Disposals during the period		(4,093)	(256)	(3,909)	(8,258)
Cost as at 31 December 2007	**13,379**	**154,718**	**2,059**	**4,302**	**174,458**
Accumulated amortization as at 31 March 2007	**(3,127)**	**(49,628)**	**(324)**		**(53,079)**
Depreciation charge for the period	(377)	(5,749)	(320)		(6,446)
Disposals during the period		512	70		582
Accumulated amortization as at 31 December 2007	**(3,504)**	**(54,865)**	**(574)**		**(58,943)**
Carrying value as at 31 March 2007	**9,431**	**100,939**	**668**	**(358)**	**110,680**
Carrying value as at 31 December 2007	**9,875**	**99,853**	**1,485**	**4,302**	**115,515**

Network and Equipment includes all tangible assets associated with the telecommunication network and related equipment. Other assets include other non-telecom equipment, fixtures and fittings, vehicles and computers.

Capital Work in Progress includes property, plant and equipment in the course of construction. After completion, such assets are put into operation (capitalized) and are transferred to the appropriate fixed asset categories. No depreciation is charged on capital work in progress.

11. Cash and Cash Equivalents

(in thousands of EUR)	At 31 December 2007
Cash on hand and in banks	4,683
Total Cash and Cash Equivalents	**4,683**

The breakdown of the Cash and Cash Equivalents of EUR 4,683 thousand as of December 31, 2007 by currency is as follows:

the EUR denominated part is EUR 3,752 thousand or approximately 80%,

the TRY denominated part is EUR 618 thousand or approximately 13%,

the SKK denominated part is EUR 111 thousand or approximately 2%,

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the UAH denominated part is EUR 136 thousand or approximately 3% and

the EUR 66 thousand or approximately 2% is denominated in various currencies.

As of December 31, 2007 the Company had bank overdrafts in the amount of EUR 1,242 thousand. Bank overdrafts are classified as other current liabilities.

12. Trade and Other Receivables

(in thousands of EUR)	**At 31 December 2007**
Trade accounts receivable	5,357
Other receivables	10,106
	15,463
Provision for impairment	(2,828)
Total Trade and Other Receivables	**12,635**

Trade accounts receivable are mostly denominated in EUR. Out of the total Trade accounts receivable the EUR denominated part is EUR 2,703 thousand, the TRY denominated part is EUR 2,092 thousand and the remaining is denominated in various other currencies.

Movements in the allowance for bad and doubtful accounts are included as Bad debt expense within Operating expenses.

Other receivables include short term loans given to shareholders, advances to suppliers and prepaid taxes.

13. Shareholders Equity

As of December 31, 2007, the stated share capital of Memorex was EUR 36,400,000 which consisted of 3,640,000 shares with a par value of EUR 10 each. The entire share capital has been issued and fully paid.

As at December 31, 2007 minority interest was related to the 5% investments held in Memorex Turkey by an individual. Memorex holds an option to purchase such 5% equity stake from this individual at a nominal amount.

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14. Interest Bearing Borrowings

(in thousands of EUR)	**At 31 December 2007**
Current Portion of Interest Bearing Borrowings	
Volksbank Revolver Loan	1,102
BACA Loan	863
RLB Revolver Loan	5,163
First RLB Term Loan	79
Second RLB Term Loan	1,195
SHN Revolver Loan	888
SHN Term Loan	791
Second SHN Term Loan	976
First HAAB Term Loan	1,123
Second HAAB Term Loan	2,909
PULS 1 Notes	10,000
PULS 2 Notes	7,500
First BAWAG Term Loan	155
Second BAWAG Term Loan	1,502
Third BAWAG Term Loan	3,500
Related Party Loan	3,900
YAPI Loan	8,000
Other	716
	50,362
Deferred borrowing costs	(849)
Current Portion of Interest Bearing Borrowings	**49,513**
Non-Current Portion of Interest Bearing Borrowings	
PREPS 1 Loan	8,000
PREPS 2 Loan	3,000
Other	99
Non-Current Portion of Interest Bearing Borrowings	**11,099**

Volksbank Loan

On April 24, 2000, Memorex entered into a collateralized revolving loan agreement with Volksbank Niederoesterreich-Mitte, an Austrian bank (Volksbank), pursuant to which Memorex received a EUR 363,364 revolving line of credit (the Volksbank Revolver). Interest was payable quarterly at a fixed interest rate of 6.5% per annum. The initial maturity date for the Volksbank Revolver was May 30, 2000. Memorex and Volksbank subsequently agreed to increase the revolving line of credit to EUR 726,728 and extended the maturity date to an indefinite date. The Volksbank Revolver was collateralized by a customer contract. As of December 31, 2007, Memorex had EUR 1,101,995 outstanding under the Volksbank Revolver. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Volksbank Revolver were paid off and the Volksbank Revolver was terminated.

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BACA Loan

On October 13, 2005, Memorex entered into a collateralized revolving loan agreement with Bank Austria Creditanstalt, an Austrian bank (BACA), pursuant to which Memorex received a revolving line of credit in the amount of EUR 900,000 (the BACA Revolver). Interest was payable quarterly at a fixed interest rate of 4.25% per annum. The BACA Revolver had a final maturity date of September 30, 2010. The BACA Revolver was collateralized by a pledge of certain Memorex bank accounts held at BACA. As of December 31, 2007, Memorex had EUR 863,109 outstanding under the BACA Revolver. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the BACA Revolver were paid off and the BACA Revolver was terminated.

Raiffeisen Loans

On October 25, 2004, Memorex entered into a collateralized revolving loan agreement (the RLB Revolver) with Raiffeisen Landesbank Oberoesterreich, an Austrian bank (RLB), pursuant to which Memorex received a EUR 3 million revolving line of credit at variable rate of interest equal to 2.75% over EURIBOR, which rate was reset quarterly. The RLB Revolver had an initial maturity date of October 31, 2005 which was extended pursuant to an oral agreement with no fixed maturity date. The RLB Revolver was collateralized by certain real property owned by Memorex in Austria. As of December 31, 2007, Memorex had EUR 5,163,390 outstanding under the RLB Revolver. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the RLB Revolver were paid off and the RLB Revolver was terminated.

On December 27, 2005, Memorex entered into an un-collateralized term loan agreement with RLB in the amount of EUR 1.5 million (the First RLB Term Loan). The First RLB Term Loan was repayable in quarterly installments beginning in March 2006 with a final maturity date of March 31, 2010. 30% of the outstanding balance accrued interest at the rate of 4.2% per annum and the remaining 70% of the outstanding balance accrued interest at the rate of 2.4% per annum. RLB had a right to terminate the First RLB Term Loan in the event that certain shareholders of Memorex owned less than 51% of the outstanding equity of Memorex. As of December 31, 2007, Memorex had EUR 79,412 outstanding under the First RLB Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the First RLB Term Loan were paid off and the First RLB Term Loan was terminated.

On May 11, 2006, Memorex entered into a collateralized term loan agreement with RLB in the amount of EUR 2.5 million (the Second RLB Term Loan). The Second RLB Term Loan was repayable in quarterly installments beginning in June 2006 with a final maturity date of June 30, 2008. The outstanding balance accrued interest at a variable rate, reset quarterly, equal to 2.5% above EURIBOR. The Second RLB Term Loan was collateralized by an agreement by Memorex to allow RLB to take over certain customer contracts in which customers owed Memorex funds. As of December 31, 2007, Memorex had EUR 1,194,852 outstanding under the Second RLB Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Second RLB Term Loan were paid off and the Second RLB Term Loan was terminated.

SPK Loans

On October 27, 2005, Memorex entered into a collateralized revolving loan agreement (the SHN Revolver) with Sparkasse Herzogenburg Neulengbach, an Austrian bank (SHN), pursuant to which

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Memorex received a EUR 900,000 revolving line of credit at a fixed interest rate of 4.375% per annum. Interest was repayable quarterly beginning in March 2006 with a final maturity date of October 26, 2010. The SHN Revolver was collateralized by certain real property owned by Memorex in Germany. SHN retained the right to require Memorex to assign contracts as additional security for the SHN Revolver. As of December 31, 2007, Memorex had EUR 888,322 outstanding under the SHN Revolver. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the SHN Revolver were paid off and the SHN Revolver was terminated.

On May 2, 2001, Memorex entered into a 10-year collateralized term loan agreement with SHN in the amount of EUR 872,000 (the First SHN Term Loan). The First SHN Term Loan was repayable in monthly installments beginning on July 5, 2001 with a final maturity date of July 5, 2011. The outstanding balance on the First SHN Term Loan accrued interest at a rate of 5.875% per annum. The First SHN Term Loan was collateralized by certain real property owned by Memorex in Austria. As of December 31, 2007, Memorex had EUR 790,897 outstanding under the First SHN Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the First SHN Term Loan were paid off and the First SHN Term Loan was terminated.

On October 19, 2004, Memorex entered into a six-year collateralized term loan agreement with SHN in the amount of EUR 1,090,000 (the Second SHN Term Loan). The Second SHN Term Loan was repayable in monthly installments beginning on April 5, 2005 with a final maturity date in February 2011. The outstanding balance on the Second SHN Term Loan accrued interest at a fixed rate of 3.375% for the first year and accrued interest for the remainder of the term at a variable interest rate, that was reset quarterly, equal to 1.255% over EURIBOR. The Second SHN Term Loan was collateralized by certain real property owned by Memorex in Austria and certain customer contracts. As of December 31, 2007, Memorex had EUR 976,365 outstanding under the Second SHN Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Second SHN Term Loan were paid off and the Second SHN Term Loan was terminated.

HAAB Loans

On July 4, 2005, Memorex entered into a five-year collateralized term loan agreement with Hypo Alpe-Adria Bank, an Austrian bank (HAAB), in the amount of EUR 2 million (the First HAAB Term Loan). The First HAAB Term Loan was repayable in 20 quarterly installments beginning on October 1, 2005 with a final maturity date in 2010. The outstanding balance on the First HAAB Term Loan accrued interest at a variable rate reset quarterly, equal to 3.25% over EURIBOR. The First HAAB Term Loan was collateralized by certain real property owned by Memorex in Austria and was personally guaranteed by two former Memorex executive officers. As of December 31, 2007, Memorex had EUR 1,122,906 outstanding under the First HAAB Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the First HAAB Term Loan were paid off and the First HAAB Term Loan was terminated.

On August 11, 2006, Memorex entered into a six-year collateralized term loan agreement with HAAB in the amount of EUR 3.6 million (the Second HAAB Term Loan). The Second HAAB Term Loan was repayable in 24 quarterly installments beginning on September 30, 2006 with a final maturity date in 2012. The outstanding balance on the First HAAB Term Loan accrued interest at a variable rate, that was reset quarterly, equal to 3.25% over EURIBOR. The Second HAAB Term Loan was collateralized by certain real property owned by Memorex in Austria and was personally guaranteed by two former Memorex executive officers. As of December 31, 2007, Memorex had EUR 2,909,247 outstanding

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under the Second HAAB Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Second HAAB Term Loan were paid off and the Second HAAB Term Loan was terminated.

PULS Notes

On August 7, 2006, Memorex issued notes (the PULS 1 Notes) in the aggregate amount of EUR 10 million to HSBC Trinkaus & Burkhardt, an investment entity based in Germany (HTB). The PULS 1 Notes were to mature on July 15, 2013. Interest was paid quarterly starting in October 2006 at a fixed rate of 7.58% per annum. As of December 31, 2007, Memorex had EUR 10,000,000 outstanding under the PULS 1 Notes. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the PULS 1 Notes were paid off and the PULS 1 Notes were terminated.

On April 30, 2007, Memorex issued notes (the PULS 2 Notes) in the aggregate amount of EUR 7.5 million to HTB. The PULS 2 Notes were to mature on July 14, 2014. Interest was paid quarterly starting in July 2007 at a fixed rate of 7.89% per annum. As of December 31, 2007, Memorex had EUR 7,500,000 outstanding under the PULS 2 Notes. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the PULS 2 Notes were paid off and the PULS 1 Notes were terminated.

BAWAG Loans

On March 29, 2005, Memorex entered into an un-collateralized five-year term loan agreement with Bank Fur Arbeit Und Wirtshaft an Austrian bank (BAWAG), in the amount of EUR 320,000 (the First BAWAG Term Loan). The First BAWAG Term Loan was repayable in 60 monthly installments with a final maturity date of April 1, 2010. The outstanding balance accrued interest at the rate of 5.5% per annum. As of December 31, 2007, Memorex had EUR 154,710 outstanding under the First BAWAG Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the First BAWAG Term Loan were paid off and the First BAWAG Term Loan was terminated.

On June 7, 2006, Memorex entered into a collateralized ten-year term loan agreement with BAWAG in the amount of EUR 1.7 million (the Second BAWAG Term Loan). The Second BAWAG Term Loan was repayable in monthly installments starting August 1, 2006 with a final maturity date of July 1, 2016. The outstanding balance accrued interest at the rate of 5.71% per annum. The Second BAWAG Term Loan was collateralized by Memorex s equity holding in two of its subsidiaries, Memorex Czech Republic and Memorex Slovakia. As of December 31, 2007, Memorex had EUR 1,502,345 outstanding under the Second BAWAG Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Second BAWAG Term Loan were paid off and the Second BAWAG Term Loan was terminated.

On December 22, 2006, Memorex entered into a collateralized term loan agreement with BAWAG in the amount of EUR 3.5 million (the Third BAWAG Term Loan). The Third BAWAG Term Loan was repayable in quarterly installments starting on March 31, 2007 with a final maturity date of June 30, 2008. The outstanding balance accrued interest at a variable rate of 1.5% over EURIBOR, which was reset quarterly (if the rate changed by more than 0.25%). The Third BAWAG Term Loan was collateralized by 25% of the outstanding equity holdings in Memorex which was held by certain Memorex shareholders. As of December 31, 2007, Memorex had EUR 3,500,000 outstanding under the

Memorex Telex Communications A.G.

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Third BAWAG Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Third BAWAG Term Loan were paid off and the Third BAWAG Term Loan was terminated.

Related Party Loans

On November 18, 2004, Memorex entered into a two-year collateralized term loan agreement with an individual pursuant to which Memorex borrowed EUR 3.0 million (the Aigner Term Loan). The Aigner Term Loan was originally repayable by November 2006 but the maturity date was extended to June 2007 and further extended to June 2008. For the first two years, interest was payable monthly at an interest rate of 10.0% per annum. After November 2006, the Aigner Term Loan accrued interest at a rate of 5.3% per annum and the rate was reset back to 10.0% beginning in July 2007. The Aigner Term Loan was collateralized by certain of Memorex s telecommunications rights of way within Austria. As of December 31, 2007, Memorex had EUR 3,000,000 outstanding under the Aigner Term Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Aigner Term Loan were paid off and the Aigner Term Loan was terminated.

Memorex received a loan from one of its shareholders in the amount of EUR 900,000 (the Shareholder Loan). There was no written agreement as to any terms of the Shareholder Loan. As of December 31, 2007, Memorex had EUR 900,000 outstanding under the Shareholder Loan. Upon the acquisition of Memorex by HTCC on March 5, 2008, all amounts then due and payable under the Shareholder Loan were paid off and the Shareholder Loan was terminated.

Yapi Loan

On October 30, 2007, Memorex Turkey entered into a collateralized term loan with YapiKredi Bank, a Turkish bank (Yapi) in the amount of EUR 10 million (Yapi Term Loan). The Yapi Term Loan is repayable in quarterly installments beginning November 2008 with a final maturity date in November 2013. The outstanding balance on the Yapi Terms Loan accrues interest at a variable rate, payable and reset quarterly, equal to 2.0% over EURIBOR. Yapi may unilaterally alter or increase the rate of interest as permitted by applicable law and require early repayment upon three days written notice. The Yapi Term Loan is collateralized by some of Memorex Turkey s trade receivables. As of December 31, 2007, Memorex Turkey had EUR 8,000,000 outstanding under the Yapi Term Loan.

Yapi has also issued letters of credit, for the benefit of Memorex Turkey, in the amount of approximately EUR 833,000 to numerous Turkish municipal departments guaranteeing any losses, damages or violations that may occur during the construction by Memorex Turkey of parts of its telecommunications network in Turkey. Approximately EUR 800,000 of such amount has an unlimited term.

Preps Loans

On June 3, 2005, Memorex entered into an un-collateralized, subordinated loan with Preps Austrian Private Funding 2005-1 Limited, a private Austrian investment entity (Preps 1) in the amount of EUR 8 million (the First Preps Loan). The First Preps Loan matures in July 2012. Memorex has to make an annual interest payment at the rate of 0.75% per annum and a quarterly interest payment at the rate of 6.8% per annum. Preps 1 may require early termination of the First Preps Loan upon the incurrence of an important reason . Important reasons that would enable the creditor to terminate the

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loan agreement and require early repayment include, but are not limited to, certain events such as the liquidation of Memorex, the institution of insolvency proceedings or a change-in-control of Memorex under certain circumstances. If the First Preps Loan is terminated prior to maturity, Memorex would owe, in addition to the unpaid principal and accrued interest, the residual term interest consisting of the interest that would have been payable up to the original maturity date of the loan. Memorex would receive a credit against such residual interest for the hypothetical amount which the loan principal would earn if it was reinvested in bonds issued by the Republic of Austria with a residual term equal to the time remaining to the original maturity date of the loan. As of December 31, 2007, Memorex had EUR 8 million outstanding under the First Preps Loan.

On August 12, 2005, Memorex entered into an un-collateralized, subordinated loan with Preps 2005-2 plc, a private Irish investment entity (Preps 2) in the amount of EUR 3 million (Second Preps Loan). The Second Prep Loan matures in December 2012. Memorex has to make an annual interest payment at the rate of 1.0% per annum and a quarterly interest payment at the rate of 6.9% per annum. Preps 2 may require early termination of the Second Preps Loan upon the occurrence of an important reason . Important reasons that would enable the creditor to terminate the loan agreement and require early repayment include, but are not limited to, certain events such as the liquidation of Memorex, the institution of insolvency proceedings or a change-in-control of Memorex under certain circumstances. If the Second Preps Loan is terminated prior to maturity, Memorex would owe, in addition to the unpaid principal and accrued interest, the residual term interest consisting of the interest that would have been payable up to the original maturity date of the loan. Memorex would receive a credit against such residual interest for the hypothetical amount which the loan principal would earn if it was reinvested in bonds issued by the Republic of Austria with a residual term equal to the time remaining to the original maturity date of the loan. As of December 31, 2007, Memorex had EUR 3 million outstanding under the First Preps Loan.

As of December 31, 2007 the book value of interest bearing borrowings approximates their fair value.

15. Other Non-Current Liabilities

(in thousands of EUR)	**At 31 December 2007**
Deferred Income	44,950
Other non-current liabilities	105
Total Other Non-Current Liabilities	**45,055**

Deferred revenue relates to IRU contracts with other international telecommunications and capacity providers.

16. Provisions

(in thousands of EUR)	**At 31 December 2007**
Provision for litigations	5,359
Other	11

Total Provisions	**5,370**

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The amount of provisions made approximates the expected outflows of economic benefits. Increases in provisions for the nine months period ended December 31, 2007 amounted to EUR 1,612 thousand. There was no cash payments or other reductions during the nine months period ended December 31, 2007.

17. Accrued Expenses and Deferred Income

(in thousands of EUR)	**At 31 December 2007**
Accrued expenses	3,981
Accrued interest	428
Deferred income	685
Total Accrued Expenses and Deferred Income	**5,094**

Accrued expenses include accruals for corporate and other taxes and bonus payments.

18. Commitments and Contingencies

During the nine months period ended December 31, 2007 the Company entered into several purchase contracts and commitments for future capital expenditures (including the purchase of new equipment or upgrading existing equipment). Current projects to which such capital commitments relate to include investment in the Company s international network. Capital commitments are expected to be realized during the course of the next six months.

The Company has finance lease agreements that expire over the next 4 years. The future minimum lease payments arising from such finance leases are as follows: EUR 5,175 thousand in 2008 and EUR 5,346 thousand in 2009, EUR 2,899 thousand in 2010 and EUR 475 thousand in 2011.

On December 20, 2007, the majority shareholder of Memorex entered into an agreement with Invitel Távközlési Szolgáltató ZRt. (Invitel), a subsidiary of Hungarian Telephone and Cable Corp., to sell 95.7% of the outstanding equity in Memorex.

The tax authorities have carried out full scope tax audits at the Company through various years. The tax authorities may at any time inspect the books and records within six years subsequent to the reported tax year and may impose additional tax assessments and penalties. The Company s management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

Legal cases

Telekomunikacjs Kolejowa Sp. Z.o.o., a Polish company (TKS), initiated legal proceedings in Austria against the Company in connection with a contractual dispute regarding an agreement pursuant to which Memorex leased telecommunication equipment from TKS. TKS seeks lease costs in the amount of EUR 730,000 plus legal costs.

BT Austria GmbH, an Austrian company (BT Austria), has raised claims against the Company in connection with an agreement pursuant to which Memorex provided services to BT Austria. BT Austria seeks to reclaim payments made to Memorex in the amount of approximately EUR

556,000. No formal legal proceedings have been initiated in this matter.

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Business Consulting and Controlling Beteiligungs GmbH, an Austrian company (BCC), initiated legal proceedings in Austria against the Company seeking approximately EUR 640,000 pursuant to an earlier court settlement.

An individual initiated legal proceedings in Austria against the Company seeking EUR 1,613 thousand in connection with a consulting agreement.

KPNQwest Asset Slovakia s.r.o., a Slovakian entity (KPNQWEST) initiated legal proceedings against the Company in Slovakia asserting KPNQwest s ownership s right relating to an agreement to transfer assets from KPNQwest to Memorex Slovakia. KPNQwest won a judgment in the lower court which judgment Memorex Slovakia has appealed. During the appeal process, KPNQwest expanded its claims.

BT Germany, a German entity (BT Germany), initiated legal proceedings against the Company in Germany regarding an agreement pursuant to which BT Germany was to provide services to Memorex. The Company settled this claim in 2008 for EUR 285,000.

The Company has a dispute with Slovak Telecom relating to an agreement pursuant to which the parties provided services to each other. Slovak Telecom is claiming EUR 220,000.

T-Systems Pragonet, a.s. (Pragonet) initiated proceedings against the Company with the Czech Telecommunications Authority seeking fees in connection with certain services allegedly provided to the Company. The Czech Telecommunications Authority awarded Pragonet EUR 544,000. Memorex Czach Republic has appealed this ruling.

KPNQwest Services Ireland Limited, a company in receivership, has initiated legal proceedings against the Company in Europe seeking EUR 262,000 plus interest and costs for services allegedly provided to the Company. The Company is contesting this claim.

The Company is contesting these matters. Based on advice from outside counsel, the Company has a recognized a provision in its accounts in an amount deemed appropriate to cover its potential obligations in these ongoing legal matters. The Company is involved in other legal proceedings in the normal course of business. Based on legal advice, management does not expect the outcome of these legal matters to have a material effect on the Company s financial position, results of operations or liquidity.

19. Taxation

The Income tax (expense) / benefit for the period comprises:

(in thousands of EUR)	**For the nine months ended 31 December 2007**
Current tax	(153)
Local tax	(71)
Deferred tax	1,909
Income Tax (Expense) / Benefit	**1,685**

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For the nine month period ended 31 December 2007

Memorex is resident for tax purposes in Austria and is taxed at the rate of 25%. Current tax is calculated by the enacted tax rates applicable for the different tax jurisdictions the Memorex subsidiaries operate, as follows:

Memorex Bulgaria of 10%,

Memorex Czech Republic of 24%,

Memorex Italy of 33%,

Memorex Romania of 16%,

Memorex Slovakia of 19%,

Memorex Turkey of 20% and

Memorex Ukraine of 25%.

Deferred tax is calculated by using the liability method. Deferred tax is calculated on temporary differences between accounting and tax values, for which reversal is probable in the future. Deferred tax is calculated by the enacted tax rates applicable for the different tax jurisdictions the subsidiaries operate in, as detailed above.

Deferred tax assets / liabilities are attributable to the following items:

	At 31 December 2007	
(in thousands of EUR)	**Assets**	**Liabilities**
Tax loss carried forward	2,636	
Property, plant and equipment	2,504	230
Deferred Financial Charges	(212)	
Finance Leasing	(507)	62
Bad debt expense	763	
Litigation reserve	538	
Other	28	(61)
	5,750	**231**
Net Deferred Tax Asset / (Liability)	**5,519**	

Deferred tax assets and liabilities are determined by the legal entities of the Group. Deferred tax is calculated at the rate of 25%.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. The Company has total tax loss carry forwards in the amount of EUR 2,636 thousand at December 31, 2007. As at December 31, 2007 out of the total tax loss carry forwards Memorex Austria represents EUR 2,484 thousand and the remaining relates to other smaller subsidiaries of the Group. The expiry of these tax losses are not subject to any statutory expiry limitations. It is considered that the reduction in the cost base of the Company realized to date and the tax planning opportunities available to the Company, make it probable that sufficient future taxable profits will be available against which the tax loss carry forwards can be utilized.

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Reconciliation of effective tax rate is as follows:

(in thousands of EUR)	**For the nine months ended 31 December 2007**
Net profit / (loss) before tax	(7,950)
Income tax using the parent company corporate tax rate	1,988
Effect of tax rates in foreign jurisdictions	(34)
Other income taxes paid	(71)
Impact of tax-deductibility of other income taxes	18
Tax on non-deductible expenses	67
Timing differences for which no deferred tax is recognised	3
Tax loss not previously recognized	(272)
Other	(14)
Income Tax (Expense) / Benefit	**1,685**

20. Financial Risk Management

20.1.1. Financial risk factors

The Company is exposed to a variety of financial risks, including market risk, credit risk and liquidity risk. These risks were managed under principles provided by the Board of Directors of Memorex. Following the acquisition of Memorex by HTCC on March 5, 2008, HTCC s written risk management policy is now applicable to the Company.

20.1.2. Market risk

The Company operates internationally and is exposed to foreign exchange risk arising from various currency exposures. The Company generates its revenues predominantly in euros, while part of the costs to generate such revenue is incurred in various local currencies, in foreign operations. Since most of the costs are incurred by the parent company Memorex in EUR in Austria, the Company considered the foreign currency risk immaterial and, therefore, did not enter into a hedging program.

The classification of receivables by currencies is as follows:

(in thousands of EUR)			**At 31 December 2007**			
Carrying amount as at December 31, 2007	**EUR**	**TRY**	**CZK**	**SKK**	**Other**	**Total**
Trade receivables from third parties	2,703	2,092	146	101	315	5,357

Total	**2,703**	**2,092**	**146**	**101**	**315**	**5,357**

Sensitivity analysis

The Company is exposed to the foreign currency risk arising from transactions performed with counterparties outside of the European Union and with the Company s purchases in local currencies. The foreign currency risk is measured against the functional currency (EUR) as at the balance sheet date when the financial assets and liabilities are translated to EUR applying the appropriate exchange rate.

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The sensitivity analysis considers only unpaid financial assets and liabilities denominated in foreign currency and it measures the impact from the recalculation of these items as at the balance sheet date using the appropriate exchange rates as of December 31, 2007. The Company considers the movements of exchange rates against the EUR in the following period by +10% (appreciation of the EUR against the various currencies) and -10% (depreciation of the EUR against the various currencies) as possible.

The sensitivity analysis on exchange rate changes is prepared for individual currencies on the assumption that there is no movement in the exchange rates of other currencies.

The following table presents the impact on profit and loss before tax of an appreciation (+10%) or depreciation (-10%) of EUR to foreign currencies:

	EUR depreciation by 10%		
Currency	**TRY**	**CZK**	**SKK**
Increase/ (decrease) in profit and loss before tax	232,457	16,237	11,194

	EUR appreciation by 10%		
Currency	**TRY**	**CZK**	**SKK**
Increase/ (decrease) in profit and loss before tax	-232,457	-16,237	-11,194

Sensitivity to interest rates

The Company is exposed to interest rate risk mainly in relation to its short and long term debt and short term deposits as part of cash and cash equivalents. The Company assumes the possible movements of the yield curve in the following period by +/- 100 basis points.

For short and long term loans receivable the impact on the profit and loss before tax is determined on the basis of a defined change in the interest rate, which would have arisen at the beginning of the accounting period and is based on the assumption that no other changes in the interest rate occurred during the entire accounting period. Other financial assets including cash and cash equivalents are not considered to be materially sensitive to interest rates.

The following table presents the possible impact on profit and loss before tax of an expected increase (+100 basis points) or decrease of interest rates:

(in thousands of EUR)	**Interest rate increased by 100 basis points**	**Interest rate decreased by 100 basis points**
Increase/ (decrease) in profit or loss before tax	164	-164

20.1.3. Credit risk

The Company has policies in place to ensure that sales are made to customers who meet the Company s criteria for credit eligibility and have adequate credit history. The Company predominantly focuses on reputable international carriers and large credit-worthy corporations in order to minimize the credit risk.

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Financial insolvency of a counterparty may result in immediate losses to the Company with an adverse impact on the Company s financial position. As a consequence, the Company manages the credit risk by: (a) the careful selection of credit-worthy counterparties; (b) advance payments; (c) the regular netting of accounts receivable with its accounts payable; (d) by the disconnection of counterparties in case of non-payment; and (e) standard financial market instruments such as bank guarantees.

The maximum exposure to credit risk is calculated as the gross carrying amount of the above mentioned financial assets less any impairment losses.

Aging of accounts receivables and the respective impairment is shown as follows:

(in thousands of EUR)				**At 31 December 2007**			
	not overdue	**1-30 days**	**31-90 days**	**91-180 days**	**181-360 days**	**over 360 days**	**Total**
Trade receivables from third parties	2,312	521	646	1,354	278	245	5,356
Payables to third parties	818	1,244	1,345	665	842	353	5,267

20.1.4. Liquidity risk

Prudent liquidity management implies maintaining sufficient cash. In order to ensure that the Company is in position to fulfill its payment obligations when they become due, the Company prepares short and long-term cash-flow forecasts.

21. Finance and Operating Leases

The Company has operating leases relating to IRU contracts with other telecommunications service operators. These contracts can be modified or cancelled in the normal course of business.

Raiffeisen Finance Leases

In 2005, the Company entered into several leases with Raiffeisen Impuls Delta-Mobilienleasing GmbH (Raiffeisen), a German entity.

On March 1, 2005, the Company entered into a lease agreement with Raiffeisen pursuant to which the Company leases network cards for use in Germany and the Czech Republic (the First Raiffeisen Lease Agreement). The First Raiffeisen Lease Agreement is governed by Austrian law and has an unlimited term with monthly payments of EUR 27,000 in addition to an EUR 484,000 pre-payment (based on an acquisition cost of EUR 1.9 million). The monthly payments may be adjusted based on the three month EURIBOR rate. The Company is responsible for insuring the network cards and must pay all applicable fees and taxes. The First Raiffeisen Lease Agreement may be terminated by either party upon six months notice. Memorex waived its right to terminate the agreement for the initial five years. Raiffeisen may terminate the agreement if the Company terminates or sells the business and would be entitled to damages equal to the outstanding payments until the earliest date upon which the Company could terminate the agreement plus the residual value of the network cards.

On March 1, 2005, the Company entered into a lease agreement with Raiffeisen pursuant to which the Company leases network cards for use in Vienna (the Second Raiffeisen Lease Agreement). The

Memorex Telex Communications A.G.

Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

Second Raiffeisen Lease Agreement is governed by Austrian law and has an unlimited term with fixed monthly payments of EUR 7,000 in addition to a EUR 129,000 pre-payment (based on an acquisition cost of EUR 516,000). The Company is responsible for insuring the network cards and must pay all applicable fees and taxes. The Second Raiffeisen Lease Agreement may be terminated by either party upon six months notice. Memorex waived its right to terminate the agreement for the initial five years. Raiffeisen may terminate the agreement if the Company terminates or sells the business and would be entitled to damages equal to the outstanding payments until the earliest date upon which the Company could terminate the agreement plus the residual value of the network cards.

On July 27, 2005, the Company entered into a lease agreement with Raiffeisen pursuant to which the Company leases network cards (the Third Raiffeisen Lease Agreement). The Third Raiffeisen Lease Agreement is governed by Austrian law and has an unlimited term with monthly payments of EUR 78,000 in addition to a EUR 1.4 million pre-payment (based on an acquisition cost of EUR 5.7 million). The monthly payments may be adjusted based on the three month EURIBOR rate. The Company is responsible for insuring the network cards and must pay all applicable fees and taxes. The Third Raiffeisen Lease Agreement may be terminated by either party upon six months notice. Memorex waived its right to terminate the agreement for the initial five years. Raiffeisen may terminate the agreement if the Company terminates or sells the business and would be entitled to damages equal to the outstanding payments until the earliest date upon which the Company could terminate the agreement plus the residual value of the network cards.

Other Lease Agreements

On January 11, 2001, the Company entered into a lease agreement with Sext Z Immobilien Leasing GmbH., which was last amended as of May 21, 2008 (the Property Lease), pursuant to which the Company leases office and storage space in Austria. The Property Lease is for an unlimited term and the current monthly rent is EUR 8,592 thousand, which rate is adjusted bi-annually per the six month EURIBOR rate. Either party may terminate the Property Lease upon six months notice but each party waived their right to terminate the Property Lease until December 31, 2012. The lessor may still terminate the Property Lease upon a change-in-control of Memorex which would adversely affect the financial position of the lessor (as defined in the Property Lease) and be entitled to any outstanding amounts due under the Property Lease (including the lease payments up until the date that the Company could terminate the Property Lease). The Property Lease also provides Memorex with a right to purchase the property.

Net book value of the finance leases of network and equipment and cars as follows:

	At 31 December 2007	
(in thousands of EUR)	**Network Equipment**	**Car**
Gross Book Value	27,176	793
Accumulated Depreciation	(8,319)	(179)
Net Book Value	**18,857**	**614**

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Notes to the Consolidated Financial Statements

For the nine month period ended 31 December 2007

Non-cancellable financial leases are payable as follows:

	At 31 December 2007	
(in thousands of EUR)	**Present Value**	**Total Minimum Lease Payment**
1 year or less	5,175	5,992
2-5 years	8,720	9,301
After 5 years		
Total Finance Leases	**13,895**	**15,293**

22. Related Party Transactions

Related parties at December 31, 2007 include Memorex s subsidiaries, as well as Joki A.G., the majority shareholder of Memorex and other individuals who are minority owners of the Company and key management.

The Company had outstanding receivables against Joki A.G. in the amount of EUR 1,750 thousand, the former CEO of Memorex in the amount of EUR 1,365 thousand and other minority owners in the aggregate amount of EUR 1,143 thousand.

As at December 31, 2007 the Company had a payable toward Mr. Mayerhofer, Supervisory Board member of the Company, in the amount of EUR 900,000 for services provided.

There were no other material related party transactions between the Company and any other related parties during the nine months period ended December 31, 2007 other than disclosed earlier in these notes or described below.

Salaries and other short-term employee benefits paid to key management personnel amounted to EUR 337 thousand for the nine months period ended December 31, 2007.

There have been no termination benefits, post-employment benefits or other long-term benefits paid to key management personnel during the nine months period ended December 31, 2007.

There have been no loans or guarantees provided to key management personnel during the nine months period ended December 31, 2007.

23. Subsequent Events

On March 5, 2008, Hungarian Telephone and Cable Corp., a U.S. company (HTCC), completed its acquisition through one of its subsidiaries of 95.7% of the outstanding equity of Memorex. HTCC paid EUR 18.8 million to the selling shareholders of Memorex for their 95.7% equity interest. HTCC assumed approximately EUR 23.1 million of the Company s net debt at closing and refinanced approximately EUR 46.6 million of the Company s debt at closing.

In accordance with Austrian law, HTCC initiated the necessary legal procedures to cash out the minority shareholders of Memorex who hold 4.3% of the outstanding equity in Memorex. In accordance with such procedures, an Austrian court appointed a local auditor to audit the proposed cash compensation for the minority shareholders. The court appointed auditor approved the cash compensation for the minority shareholders. At a Memorex shareholders meeting on July 18, 2008, the purchase by HTCC of the minority shareholders stake in Memorex was approved. Memorex is now expected to go to the Austrian commercial register in August 2008 to register the minority shareholder buyout at which point HTCC will own 100% of Memorex.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Unaudited Pro Forma Condensed

Statement of Operations

The following unaudited pro forma condensed statement of operations has been prepared to give effect to the acquisition by Hungarian Telephone and Cable Corp. (HTCC , and together with its subsidiaries, the Company) of Memorex Telex and Communications A.G. and its subsidiaries (Memorex) on March 5, 2008 (the Memorex Acquisition), using the purchase method of accounting and the assumptions and adjustments described in the accompanying notes to the unaudited pro forma condensed combined statement of operations. This unaudited pro forma condensed statement of operations was prepared as if the Memorex Acquisition had been completed as of January 1, 2007. This unaudited pro forma condensed statement of operations also reflects the acquisition of Matel Holdings N.V. and Tele2 Hungary as if acquired as of January 1, 2007. In this statement of operations, we sometimes refer to Matel Holdings N.V. as Invitel .

The unaudited pro forma condensed statement of operations is based upon the respective historical consolidated financial statements of the Company and Memorex. This unaudited pro forma condensed statement of operations should be read in conjunction with: (i) HTCC s Annual Report for the year ended December 31, 2007 included in this proxy statement/prospectus; (ii) HTCC s Quarterly Report for the quarter ended March 31, 2008; (iii) Memorex s audited financial statements for the nine months ended December 31, 2007, included in this proxy statement/prospectus; and (iv) the accompanying notes to the unaudited pro forma condensed statement of operations. The financial statements of Memorex for the nine months ended December 31, 2007 have been prepared under International Financial Reporting Standards (IFRS) as issued by IASB and presented in euros (EUR), whereas all amounts for Memorex for the year ended December 31, 2007 included herein have been presented in U.S. dollars and prepared in accordance with accounting principles generally accepted in the United States (US GAAP).

The unaudited pro forma condensed statement of operations includes adjustments, which are based upon preliminary estimates, to reflect the allocation of the purchase price to the acquired assets and assumed liabilities of Memorex, Tele2 Hungary and Matel Holdings N.V. The preliminary allocation of the purchase price of Memorex is subject to change pending the completion of the final valuation study and allocation of the purchase consideration. The Company intends to complete this valuation and establish a final purchase price allocation in connection with its audited financial statements for the year ended December 31, 2008.

The unaudited pro forma condensed statement of operations is intended for informational purposes only and, in the opinion of management, are not necessarily indicative of the financial position or results of operations of the Company had the acquisition of Tele2 Hungary, Matel Holdings N.V. and Memorex actually been effected as of the date indicated, nor are they indicative of the Company s future financial position or results of operations.

The unaudited pro forma condensed statement of operations does not include potential cost savings from operating efficiencies or synergies that may result from the Memorex Acquisition.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Unaudited Pro Forma Combined Statement of Operations

for the year ended December 31, 2007

(in thousands of US dollars, except for share data)

(in thousands, except share and per share data)	Pro Forma HTCC December 31, 2007	Pro Forma Memorex December 31, 2007	Pro Forma Adjustments		Pro Forma Combined
Revenue	$ 505,239	$ 51,584	$ (2,676)	a	$ 554,147
Operating expenses:					
Cost of sales	227,095	8,618	(2,415)	a	233,298
Selling, general and administrative	113,067	29,945	(261)	a	142,751
Depreciation and amortization	114,307	17,710	(6,653)	d	125,364
Total operating expenses	454,469	56,273	(9,329)		501,413
Income from operations	50,770	(4,689)	6,653		52,734
Other income (expenses):					
Foreign exchange gains / (losses), net	411	(629)			(218)
Interest expense	86,932	6,183	11,409	b	104,524
Interest income	1,837	309			2,146
Fair value gains / (losses) on derivatives	(68,161)				(68,161)
Other gains / (losses), net	(535)	(175)			(710)
Net income before income taxes	(102,610)	(11,367)	(4,756)		(118,733)
Current tax	(9,258)	(606)			(9,864)
Deferred tax	6,985	3,065	951	c	11,001
Income tax (expense) / benefit	(2,273)	2,459	951		1,137
Minority interest	5	(6)			(1)
Net income	$ (104,878)	$ (8,914)	$ (3,805)		(117,597)
Cumulative convertible preferred stock dividends	(99)				(99)
Net income attributable to common stockholders	(104,977)	(8,914)	(3,805)		(117,696)
Foreign currency translation adjustment	(9,671)				(9,671)
Total comprehensive income / (loss)	$ (114,648)	$ (8,914)	$ (3,805)		$ (127,367)
Earnings per common share basic	$ (6.77)				$ (7.60)
Earnings per common share diluted	$ (6.77)				$ (7.60)
Weighted average number of common shares outstanding basic	15,495,764				15,495,764
Weighted average number of common shares outstanding diluted	15,495,764				15,495,764

See accompanying notes to unaudited pro forma condensed combined financial statements.

HUNGARIAN TELEPHONE AND CABLE CORP.

Notes to Unaudited Pro Forma Condensed Statement of Operations

The unaudited pro forma condensed statement of operations included herein has been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Certain information and certain footnote disclosures normally included in the financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to such rules and regulations; however, management believes that the disclosures are adequate to make the information presented not misleading.

(1) **Basis of Pro Forma Presentation**

On December 20, 2007, Invitel Távközlési Szolgáltató ZRt. (Invitel), a 100% owned subsidiary of HTCC, signed an agreement to purchase 95.7% of the outstanding equity of Memorex. The preliminary purchase price for Memorex was EUR 30.1 million plus the assumption of debt. The Company used a discounted cash flow methodology and comparable trading multiples in determining the purchase price.

On March 5, 2008 the Company completed the Memorex Acquisition. The total preliminary purchase consideration for Memorex was EUR 90.9 million (approximately $138.1 million) including the assumption of debt, transaction costs and other directly related expenses. The total preliminary purchase consideration of EUR 90.9 million included: (i) the payment of cash in the amount of EUR 17.9 million (approximately $27.2 million at closing), (ii) the payment of cash into escrow (the Escrow Amount) in the amount of EUR 12.1 million (approximately $18.4 million at closing), (iii) a receivable from escrow in the amount of EUR 11.2 million (approximately $17.1 million at closing foreign exchange rate) (iv) the assumption of net debt of EUR 69.7 million (approximately $105.8 million at closing); and (v) transaction costs and other directly related expenses of EUR 2.4 million (approximately $3.7 million at closing).

Invitel and the selling shareholders of Memorex entered into an Escrow Agreement to set aside a portion of the purchase price cash consideration to cover any breach of the selling shareholders warranties or covenants and to cover any indemnity claims that Invitel might have against the selling shareholders under the purchase agreement.

On July 4, 2008, Invitel agreed to a settlement with respect to its claims under the Escrow Agreement and the Escrow Amount was reduced by EUR 11.2 million (approximately $17.1 million), which amount reduced the total purchase consideration for Memorex. The remaining balance of the Escrow Amount of EUR 0.9 million (approximately $1.4 million) was released to the selling shareholders.

The unaudited pro forma combined statement of operations for the year ended December 31, 2007 give effect to the Memorex Acquisition as if it had occurred on January 1, 2007. Historical transactions between HTCC and Memorex have been eliminated through the pro forma adjustments.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Notes to Unaudited Pro Forma Condensed Statement of Operations

(2) Purchase Price Allocation

The following represents the preliminary allocation of the purchase price paid for Memorex based on the book values of the acquired assets and assumed liabilities of Memorex as of March 5, 2008. The preliminary allocation of the purchase price is subject to change pending the completion of the final allocation of the purchase consideration. The Company intends to complete this valuation and establish a final purchase price allocation in connection with its audited financial statements for the year ended December 31, 2008.

($ in thousands)	**March 5, 2008**
Current assets	31,107
Property, plant and equipment	120,201
Intangible assets	76,871
Deferred tax	4,835
Current and non-current liabilities	(94,897)
Net assets acquired	138,117
Purchase Price:	
Cash paid to shareholders	27,223
Cash to escrow account	18,402
Receivable from escrow account	(17,077)
Assumption of debt	105,879
Transaction costs and other directly related expenses	3,690
Preliminary purchase price	138,117

The following table presents the fair values of major components of intangible assets acquired and the weighted average amortization periods of such intangible assets recorded in the preliminary purchase price allocation:

(in thousands)	**March 5, 2008**	**Weighted average amortization period**
Concession rights and licenses	$ 713	10 years
Customer relationships	20,433	14 years
Trademark	151	6 months
Property rights	38,704	16-20 years
Software	192	4 years
Vodafone contract	16,678	20 years
Total:	**$ 76,871**	

The purchase price for Memorex was arrived at by arms length negotiations between the Company and the sellers. The total purchase consideration as at June 30, 2008 was EUR 90.9 million (approximately $138.1 million at closing), which included: (i) the payment of cash in the amount of EUR 17.9 million (approximately $27.2 million at closing), (ii) the payment into Escrow in the amount of EUR 12.1 million (approximately $18.4 million at closing); (iii) a receivable from Escrow in the amount of EUR 11.2 million (approximately $17.1 million at closing foreign exchange rate); (iv) the assumption of net debt of EUR 69.7 million (approximately $105.9 million at closing); and (v) transaction costs and other directly related expenses of EUR 2.4 million (approximately $3.7 million at closing foreign exchange rate).

The allocation of the purchase price paid for Tele2 Hungary and Matel Holdings N.V. is described on pages F-25 and F-23, respectively.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Notes to Unaudited Pro Forma Condensed Statement of Operations

Under the purchase method of accounting, the preliminary purchase price is allocated to the net assets based upon their estimated fair value as of the date of the Memorex Acquisition.

The purchase price allocation presented above is preliminary and a final allocation of the purchase price will be based upon the actual fair values and useful lives of the net assets acquired, as well as liabilities assumed as of the date of the Memorex Acquisition after the final valuation of the Memorex assets and liabilities are completed. We do not expect to recognize any new assets or liabilities that were not already recognized in the Memorex valuation and we are not aware of any material uncertainties regarding the effect of amortization periods on our valuation. The final purchase price allocation and the useful lives of intangible assets presented above are not expected to change significantly after the Memorex valuation has been completed.

(3) Pro Forma Adjustments

The unaudited pro forma combined statement of operations gives effect to the following pro forma adjustments:

a) Represents the elimination of inter-company transactions between HTCC and Memorex for the twelve months ended December 31, 2007.

b) Interest expense is adjusted to take effect of the additional interest expense as a result of the refinancing transaction as follows:

($ thousands)	**Notional Amount**	**Interest expense for the year ended December 31, 2007**	**Impact of a 1/8 interest rate hike**
Amended Credit Facilities HUF (i)	$ 25,513	$ 2,227	$ 2,256
Amended Credit Facilities EUR (ii)	135,464	7,242	7,400
2004 Notes (iii)	208,422	20,868	21,111
2007 Notes (iv)	293,552	20,643	20,985
Bridge Loan (v)	146,776	15,721	15,892
Yapi Loan	11,742	721	734
Preps 1 Loan	11,742	826	839
Preps 2 Loan	4,403	324	329
Total Cash Interest Expense		68,572	69,546
2006 PIK Notes	194,769	22,437	22,663
Total Interest Expense		91,009	92,209
HTCC historic interest expense		(3,937)	(3,937)
Invitel historic interest expense		(44,450)	(44,450)
Memorex historic interest expense		(6,183)	(6,183)
Total Incremental Interest for the year ended December 31, 2007		$ 36,439	$ 37,639

Total Incremental Cash Interest for the year ended December 31, 2007	$ 14,002	$ 14,977
From this:		
recorded in the pro forma income statement of HTCC	2,593	3,365
recorded as pro forma adjustment as a result of the Memorex acquisition	11,409	11,611

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HUNGARIAN TELEPHONE AND CABLE CORP.

Notes to Unaudited Pro Forma Condensed Statement of Operations

The calculation of pro forma incremental cash interest expense of HTCC for the year ended December 31, 2007 is shown in the following table:

($ thousands)	Notional Amount	Interest expense for the year ended December 31, 2007	Impact of a 1/8 interest rate hike
Amended Credit Facilities HUF (i)	$ 25,513	$ 2,227	$ 2,256
Amended Credit Facilities EUR (ii)	135,464	7,242	7,400
2004 Notes (iii)	208,422	20,868	21,111
2007 Notes (iv)	293,552	20,643	20,985
Total Cash Interest Expense		50,980	51,752
2006 PIK Notes	194,769	22,437	22,663
Total Interest Expense		73,417	74,415
HTCC historic interest expense		(3,937)	(3,937)
Invitel historic interest expense		(44,450)	(44,450)
Total Incremental Interest for the year ended 31 December 2007		$ 25,030	$ 26,028
Total Incremental Cash Interest for the year ended 31 December 2007		$ 2,593	$ 3,365

(i) Interest expense on the Amended Credit Facilities HUF has been calculated based on an average annual interest rate of 9.37%.

(ii) The interest expense on the Amended Credit Facilities EUR has been calculated based on an average annual interest rate of 5.74%.

(iii) Interest expense on the 2004 Notes has been estimated based on an annual interest rate of 10.75%.

(iv) Interest expense on the 2007 Notes has been estimated based on an annual interest rate of 7.55%.

(v) The Company funded the Memorex Acquisition and the refinancing of the Memorex debt with a subordinated Bridge Loan facility. Interest expense on the Bridge Loan was calculated based on an average annual interest rate of 11.5%.

c) Represents the net deferred tax effect of pro forma adjustments using the effective tax rate of 20%.

d) Represents the increase in depreciation and amortization expense due to (i) the amortization of newly identified intangible assets using the straight line method; (ii) the amortization of the fair value adjustments of existing intangible assets using the straight line method and (iii) the depreciation of the fair value adjustments of property, plant and equipment using the straight line method.

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HUNGARIAN TELEPHONE AND CABLE CORP.

Notes to Unaudited Pro Forma Condensed Statement of Operations

Reconciliation of Pro Forma Income Statement of HTCC for the year ended December 31, 2007 to the Consolidated Statements of Operations and Comprehensive Income (Loss) in its Annual Report for the year ended December 31, 2007

(in thousands, except share and per share data)	Audited HTCC December 31, 2007	Pro Forma Adjustments	Pro forma HTCC December 31, 2007	
Revenue	$ 385,193	$ 120,046	$ 505,239	a
Operating expenses:				
Cost of sales	184,552	42,543	227,095	b
Selling, general and administrative	75,451	37,616	113,067	c
Depreciation and amortization	79,003	35,304	114,307	d
Total operating expenses	339,006	115,463	454,469	
Income from operations	46,187	4,583	50,770	
Other income (expenses):				
Foreign exchange gains / (losses), net	(6,481)	6,892	411	e
Interest expense	64,152	22,780	86,932	f
Interest income	1,295	542	1,837	g
Fair value gains / (losses) on derivatives	(69,106)	945	(68,161)	h
Other gains / (losses), net	(883)	348	(535)	i
Net income before income taxes	(93,140)	(9,470)	(102,610)	
Current tax	(7,115)	(2,143)	(9,258)	j
Deferred tax	3,775	3,210	6,985	k
Income tax (expense) / benefit	(3,340)	1,067	(2,273)	
Minority interest	8	(3)	5	
Net income	$ (96,472)	$ (8,406)	$ (104,878)	
Cumulative convertible preferred stock dividends	(99)		(99)	
Net income attributable to common stockholders	(96,571)	(8,406)	(104,977)	
Foreign currency translation adjustment	(9,671)		(9,671)	
Total comprehensive income / (loss)	$ (106,242)	$ (8,406)	$ (114,648)	
Earnings per common share basic	$ (6.23)		$ (6.77)	
Earnings per common share diluted	$ (6.23)		$ (6.77)	
Weighted average number of common shares outstanding basic	15,495,764		15,495,764	
Weighted average number of common shares outstanding diluted	15,495,764		15,495,764	

a) Represents adjustments for the (i) four months of operating revenues of Invitel ($90.2 million), (ii) ten months of operating revenues of Tele2 Hungary ($35.2 million), and (iii) elimination of inter-company transactions between HTCC, Invitel and Tele2 Hungary ($5.3 million).

b) Represents adjustments for the (i) four months of cost of sales of Invitel ($27.6 million), (ii) ten months of cost of sales of Tele2 Hungary ($19.8 million), and (iii) elimination of inter-company transactions between HTCC, Invitel and Tele2 Hungary ($4.9 million).

c) Represents adjustments for the (i) four months of selling, general and administrative expenses of Invitel ($26.2 million), (ii) ten months of selling, general and administrative expenses of Tele2 Hungary ($12.0 million), and (iii) elimination of inter-company transactions between HTCC, Invitel and Tele2 Hungary ($0.6 million)).

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HUNGARIAN TELEPHONE AND CABLE CORP.

Notes to Unaudited Pro Forma Condensed Statement of Operations

d) Represents adjustments for the (i) four months of depreciation and amortization expenses of Invitel ($29.1 million), and (ii) ten months of depreciation and amortization expenses of Tele2 Hungary ($0.9 million).

e) Represents adjustments for the (i) four months of foreign exchange gains of Invitel ($6.9 million), (ii) ten months of foreign exchange losses of Tele2 Hungary ($0.1 million), and (iii) elimination of inter-company transactions between HTCC, Invitel and Tele2 Hungary ($0.1 million).

f) Represents adjustments for the (i) four months of interest expense of Invitel ($13.9 million), (ii) elimination of inter-company transactions between HTCC, Invitel and Tele2 Hungary ($0.8 million), (iii) interest expense of 2006 PIK Notes for the period ended April 30, 2007 ($6.8 million), and (iv) effect of the additional interest expense as a result of the refinancing transaction ($2.9 million).

g) Represents adjustments for the (i) four months of interest income of Invitel ($0.4 million), (ii) ten months of interest income of Tele2 Hungary ($0.2 million), and (iii) elimination of inter-company transactions between HTCC, Invitel and Tele2 Hungary ($0.1 million).

h) Represents four months of fair value gains on derivatives of Invitel in the amount of $0.9 million.

i) Represents adjustments for the (i) four months of other financial losses of Invitel ($0.5 million), and (ii) elimination of inter-company transactions between HTCC, Invitel and Tele2 Hungary ($0.8 million).

j) Represents adjustments for the (i) four months of current tax expense of Invitel ($1.8 million), and (ii) ten months of current tax expense of Tele2 Hungary ($0.3 million).

k) Represents (i) four months of deferred tax benefit of Invitel ($1.6 million), and (ii) the net deferred tax effect of pro forma adjustments ($1.6 million)

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HUNGARIAN TELEPHONE AND CABLE CORP.

Notes to Unaudited Pro Forma Condensed Statement of Operations

Reconciliation of the Pro Forma Statement of Operations of Memorex for the year ended December 31, 2007 to the IFRS Consolidated Income Statement of Memorex as at December 31, 2007

(in thousands)	**Audited IFRS Memorex for the nine months ended December 31, 2007 in EUR**	**IFRS Memorex for the nine months ended December 31, 2007 in USD**	**Adjustments in USD**	**US GAAP Pro forma Memorex for the year ended December 31, 2007 in USD**	
Revenue	27,584	$ 37,709	$ 13,875	$ 51,584	c
Operating expenses:					
Cost of sales	4,551	6,222	2,396	8,618	c
Selling, general and administrative	18,208	24,891	5,054	29,945	c
Depreciation and amortization	8,711	11,908	5,802	17,710	a
Total operating expense	31,470	43,021	13,252	56,273	
Income from operations	(3,886)	(5,313)	624	(4,689)	
Other income (expenses):					
Foreign exchange gains / (losses), net	(383)	(524)	(105)	(629)	c
Interest expense	3,763	5,144	1,039	6,183	c
Interest income	188	257	52	309	c
Other gains / (losses), net	(106)	(145)	(30)	(175)	c
Income before income taxes	(7,950)	(10,869)	(498)	(11,367)	
Current tax	(224)	(306)	(300)	(606)	c
Deferred tax	1,909	2,609	456	3,065	b
Income tax (expense) / benefit	1,685	2,303	156	2,459	
Minority interest	(4)	(6)	0	(6)	c
Net income / (loss) after tax	(6,269)	$ (8,572)	$ (342)	$ (8,914)	

The pro forma statement of operations of Memorex for the year ended December 31, 2007 was translated from EUR to USD using the exchange rate of 1.37 EUR/USD that was the average exchange rate for the year ended December 31, 2007.

a) Represents (i) depreciation expense for the three months ended March 31, 2007 in the amount of $3.5 million and (ii) additional depreciation accounted for under US GAAP in the amount of $2.3 million due to higher asset base relating to the reversal of certain impairment charges.

b) Represents (i) deferred tax expense for the three months ended March 31, 2007 in the amount of $0.1 million and (ii) the deferred tax benefit arising from of the reversal of the impairment of property, plant and equipment and intangible assets under US GAAP in the amount of $0.6 million.

c) Represents the impact of IFRS unaudited results for the three months ended March 31, 2007.

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MATEL HOLDINGS NV

CONSOLIDATED

FINANCIAL STATEMENTS

FOR THE YEARS ENDED 31 DECEMBER 2006 AND 2005

(PRESENTED IN EUROS)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Matel Holdings N.V.

We have audited the accompanying consolidated balance sheets of Matel Holdings N.V. and its subsidiaries as of December 31, 2006 and 2005, and the related consolidated income statements, consolidated cash flow statements, and consolidated statements of changes in shareholders equity for each of the years in the two-year period ended December 31, 2006 prepared in accordance with International Financial Reporting Standards. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Matel Holdings N.V. and its subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2006, in conformity with International Financial Reporting Standards.

International Financial Reporting Standards vary in certain significant respects from U.S. generally accepted accounting principles. Information relating to the nature and effect of such differences is presented in Note 30 to the consolidated financial statements.

/s/ KPMG Hungária Kft.

Budapest, Hungary

June 7, 2007

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Matel Holdings NV

Consolidated Balance Sheets

As at 31 December 2006 and 2005

(in thousands of EUR)	**Notes**	**At 31 December 2006**	**At 31 December 2005**
Non-Current Assets			
Intangible Assets	11	31,964	10,734
Property, Plant and Equipment	12	273,391	284,349
Other Non-Current Financial Assets		106	63
Deferred Tax Assets	24	5,565	6,806
		311,026	301,952
Current Assets			
Cash and Cash Equivalents	13	13,627	29,222
Trade and Other Receivables	14	20,995	18,271
Derivative Financial Instruments	17	1,455	381
Inventories		367	206
Prepayments and Accrued Income		789	1,087
		37,233	49,167
Total Assets		**348,259**	**351,119**
Equity and Liabilities			
Equity attributable to equity holders of the parent			
Share Capital	15	63	63
Capital Reserve	15	673	
Hedging Reserve	15	376	(21)
Cumulative Translation Reserve	15	(993)	(1,075)
Retained Earnings	15	49,648	44,317
		49,767	**43,284**
Minority Interest		16	14
Total Equity		**49,783**	**43,298**
Non-Current Liabilities			
Interest Bearing Borrowings	16	232,762	252,997
Other Non-Current Liabilities	18	32	
Deferred Tax Liabilities	24	60	
		232,854	252,997
Current Liabilities			
Current Portion of Interest-Bearing Borrowings	16	23,830	16,518
Trade and Other Payables		21,672	17,560
Derivative Financial Instruments	17	2,327	5,057
Provisions	19	884	22

Accrued Expenses and Deferred Income	20	16,909	15,667
		65,622	54,824
Total Liabilities		**298,476**	**307,821**
Total Equity and Liabilities		**348,259**	**351,119**

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

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Matel Holdings NV

Consolidated Income Statements

For the years ended 31 December 2006 and 2005

(in thousands of EUR)	**Notes**	**For the year ended 31 December 2006**	**2005**
Revenue	4	185,606	181,343
Cost of Sales	5	(57,103)	(48,910)
Operating Expenses	6	(54,669)	(51,473)
Depreciation and Amortization	8	(37,955)	(49,021)
Cost of Restructuring	9	(1,813)	(2,046)
Profit / (Loss) from Operations		**34,066**	**29,893**
Financial Income	10	4,878	7,814
Financial Expenses	10	(31,943)	(38,647)
Net Profit / (Loss) Before Tax		**7,001**	**(940)**
Income Tax (Expense) / Benefit	24	(1,668)	(1,481)
Net Profit / (Loss) for the Period		**5,333**	**(2,421)**
Attributable to:			
Equity Holders of the Parent		5,331	(2,421)
Minority Interest		2	
		5,333	**(2,421)**

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

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Matel Holdings NV

Consolidated Cash Flow Statements

For the years ended 31 December 2006 and 2005

(in thousands of EUR)	**Notes**	**For the year ended 31 December 2006**	**2005**
Cash Flows from Operating Activities			
Net Profit / (Loss) Before Tax		7,001	(940)
Adjustments for Non-Cash Items:			
Interest Expense / (Income)		26,920	28,522
Depreciation and Amortization	8,11,12	37,955	49,021
Fair Value of Derivative		(3,333)	(5,984)
Allowance for bad and doubtful debts	6	855	1,070
Provisions	19	839	(541)
Change in Investments in Associates			
Unrealized Foreign Exchange (Gain) / Loss		3,092	5,189
Other Non-Cash Items		662	(645)
Working Capital Changes:			
Change in Trade and Other Receivables	14	(814)	1,124
Change in Inventories		79	(28)
Change in Prepayments and Accrued Income		817	1,149
Change in Trade and Other Payables and Accrued Expenses and Deferred Income		(2,636)	905
Result of Sale of Property, Plant and Equipment	12	478	(77)
Income Taxes		(176)	
Interest Paid		(25,647)	(29,404)
Net Cash Flow Provided by / (Used in) Operating Activities		**46,092**	**49,361**
Cash Flows from Investing Activities			
Purchase of subsidiaries, net of cash acquired	3	(23,866)	
(Purchase) / Disposal of Trading Investments, Net			2,857
Purchase of Intangible Assets	11	(6,978)	(7,833)
Purchase of Property, Plant and Equipment	12	(16,672)	(15,862)
Proceeds from Sale of Property, Plant and Equipment	12	44	379
Interest Received		987	1,610
Net Cash Flow Provided by / (Used in) Investing Activities		**(46,485)**	**(18,849)**
Cash Flows from Financing Activities			
Proceeds from Issue of High Yield Bonds, Net of Discount and Bond Issue Costs			
Proceeds from Interest Bearing Borrowings	16	4,000	
Share Premium Repayment			(7,365)
Dividend payment			(135)
Repayments of Interest Bearing Borrowings	16	(18,299)	(19,199)
Net Cash Flow Provided by / (Used in) Financing Activities		**(14,299)**	**(26,699)**
Effect of Exchange Rate Changes on Cash and Cash Equivalents		(903)	(750)

Net Increase / (Decrease) in Cash and Cash Equivalents		**(15,595)**	**3,063**
Cash and Cash Equivalents at the Beginning of the Period	13	29,222	26,159
Cash and Cash Equivalents at the End of the Period		**13,627**	**29,222**

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

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Matel Holdings NV

Consolidated Statements of Changes in Shareholders Equity

For the years ended 31 December 2006 and 2005

(in thousands of EUR)	Notes	Share Capital	Capital Reserve	Hedging Reserve	Cumulative Translation Reserve	Retained Earnings	Total	Minority interest	Total Shareholders Equity
		Attributable to equity holders of the parent							
Balance as at 1 January 2005		**63**	**7,365**			**46,873**	**54,301**	**14**	**54,315**
Cash flow hedges:	17								
Effective portion of change in fair value of cash flow hedges				(21)			(21)		(21)
Translation adjustment for the period					(1,075)		(1,075)		(1,075)
Net income recognized directly in equity				(21)	(1,075)		(1,096)		(1,096)
Net result for the period						(2,421)	(2,421)		(2,421)
Total recognized income and expense for the period				(21)	(1,075)	(2,421)	(3,517)		(3,517)
Capital increase / (decrease)			(7,365)				(7,365)		(7,365)
Dividend payment						(135)	(135)		(135)
Balance as at 31 December 2005		**63**		**(21)**	**(1,075)**	**44,317**	**43,284**	**14**	**43,298**
Cash flow hedges:	17								
Effective portion of change in fair value of cash flow hedges				470			470		470
Deferred tax on fair value of cash flow hedges				(94)			(94)		(94)
Net change in fair value of cash flow hedges transferred to profit / loss				21			21		21
Translation adjustment for the period					82		82		82
Net income recognized directly in equity				397	82		479		479
Share buy-back									
Net result for the period						5,331	5,331	2	5,333
Total recognized income and expense for the period				397	82	5,331	5,810	2	5,812
Employee share option scheme	15		673				673		673
Balance as at 31 December 2006		**63**	**673**	**376**	**(993)**	**49,648**	**49,767**	**16**	**49,783**

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

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Matel Holdings NV

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1. General Information

Matel Holdings N.V. (Matel Holdings or the Company) was incorporated in the Netherlands Antilles on 27 December 2000 as a limited liability company and has its statutory seat at 45 Pareraweg Willemstad, Curacao the Netherlands Antilles.

Matel Holdings acts as a holding company and is the 100% owner of Magyar Telecom B.V. (Matel). Matel Holdings is engaged in telecommunication related activities in Hungary and in Romania, primarily through its telecommunication service provider, INVITEL ZRt. (INVITEL) and other service companies, such as EuroWeb Internet Szolgáltató ZRt. and EuroWeb Romania S.A., which provide Internet access and value added services. The consolidated financial statements of the Group for the year ended 31 December 2006 comprise Matel Holdings and its subsidiaries (collectively, the Group). These financial statements are prepared to satisfy certain external reporting requirements but are not intended for statutory filing purposes.

Matel Holdings, through its subsidiary INVITEL is the incumbent provider of fixed line telecommunications services to residential and business customers in the geographical areas where it had exclusive licenses through the end of 2002 representing approximately 14% of Hungary s population (historical concession areas). The Group also provides fixed line telecommunications services in the remainder of Hungary as an alternative telecommunications operator.

Matel issued High Yield Bonds on 6 August 2004 that were listed on the Luxembourg Stock Exchange on 24 August 2005 (see Note 16).

Shareholders

Matel Holdings is 100% owned by Invitel Holdings N.V. (Invitel Holdings). Invitel Holdings was incorporated in the Netherlands Antilles on 10 October 2006 as a limited liability company and has its statutory seat at 45 Pareraweg Willemstad, Curacao the Netherlands Antilles.

Invitel Holdings N.V. is jointly owned by EEIF (Matel) B.V. (33.33%), GMT (Matel) B.V. (33.33%) and the remainder by certain management personnel of INVITEL. EEIF (Matel) B.V. is owned by AIG Emerging Europe Infrastructure Fund LP and Emerging Europe Infrastructure Fund CV (AIG) and GMT (Matel) B.V. is owned by funds managed by GMT Communications Partners Limited (GMT). AIG is now advised by Emerging Markets Partnership (EMP), which is a private equity investment firm focused on Central and Eastern Europe. GMT is a private equity investment group focusing on the communications sector in Europe.

EEIF (Matel) B.V. and GMT (Matel) B.V. indirectly acquired Matel on 13 May 2003 from Vivendi Telecom International S.A.

Subsidiaries

INVITEL (former name: Vivendi Telecom Hungary Rt. or VTH Rt.) was incorporated on 20 September 1995 as a joint stock company under the laws of Hungary. The authorized share capital of INVITEL is HUF 20,000,000,000 (approximately EUR 80 million).

The shareholders of INVITEL are Matel (91.68%) and 38 municipalities (in an aggregate of 0.02%) with INVITEL holding 8.30% of its own shares.

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For the years ended 31 December 2006 and 2005

INVITEL as the principal operating company of the Group provides mass-market voice and Internet services to residential customers and voice, data and Internet services to business customers as well as wholesale services to other telecommunications operators.

INVITEL primarily operates in nine geographical areas in Hungary, which comprise Szeged, Szentes, Gödöllo, Vác, Jászberény, Dunaújváros, Esztergom, Veszprém and Szigetszentmiklós and continues to expand its activities outside these historical concession areas.

EuroWeb Internet Szolgáltató ZRt. (Euroweb Hungary) was incorporated on 2 January 1997 as a joint stock company under the laws of Hungary. The authorized share capital of Euroweb Hungary is HUF 20,000,000 (approximately EUR 80 thousand). The 100% shareholder of Euroweb Hungary is INVITEL.

EuroWeb Romania S.A. (Euroweb Romania) is domiciled in Romania and was registered with the Romanian Trade Register as a joint-stock company in March 1998 and commenced activities in November 1998. The authorized share capital of Euroweb Romania is RON 3,207,383. The shareholders of Euroweb Romania are INVITEL (99.96%) and individuals (0.04%).

V-Holding ZRt. (V-Holding) was incorporated on 1 April 1999 as a joint stock company under the laws of Hungary. The authorized share capital of V-Holding is HUF 28,000,000. The shareholders of V-Holding are INVITEL (holding one share) and Matel (holding all of the remaining shares).

INVITEL invested in **Pécsi Hírközlési Infrastruktúra Rt.** (75%) and **Székesfehérvári Hírközlési Infrastruktúra Kft.** (50%) in 2002 jointly with the related local municipalities in Pécs and Székesfehérvár, in connection with the liberalization of the telecommunication market to gain access to subscribers from these major cities. INVITEL obtained the remaining stake in Székesfehérvári Hírközlési Infrastruktúra Kft. and Pécsi Hírközlési Infrastruktúra Rt. from the municipalities on 18 May 2005 and 17 June 2005, respectively. The two companies were merged into V-Holding on 31 January 2006, which continues as the legal successor of the two companies. The merger had no impact on the consolidated financial statements as the mergers took place using the net book values as they appeared in the consolidated financial statements of Matel.

The consolidated financial statements of the Group for the year ended 31 December 2006 comprise Matel Holdings and its subsidiaries.

The consolidated financial statements were authorized by the Group s management for issue on 8 February 2007.

2. Significant Accounting Policies

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below.

2.1. Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB. These are the Group s first consolidated financial statements and IFRS 1 has been applied (see Note 28).

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For the years ended 31 December 2006 and 2005

2.2. Basis of Preparation

The consolidated financial statements are presented in Euro (EUR) rounded to the nearest thousand of EUR (TEUR). The consolidated financial statements have been prepared under the historical cost convention, except for the following assets and liabilities that are stated at fair value: derivative financial instruments and investments in securities. The methods used to measure fair values are discussed in the accounting policy notes below.

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

The estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Judgments made by management in the application of IFRS that have significant effect on the financial statements and estimates involving significant uncertainty are discussed in Note 2.25.

The accounting policies set out below have been consistently applied by all Group entities to all periods presented in these consolidated financial statements. Where it was necessary, accounting policies of the subsidiaries were modified to ensure consistency with the policies adopted by the Group.

2.3. Basis of Consolidation

2.3.1. Subsidiaries

Subsidiaries are those entities that are controlled, directly or indirectly through its subsidiaries, by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

2.3.2. Transactions eliminated on consolidation

All inter-group balances, transactions, unrealized gains and losses on transactions between Group companies have been eliminated from the consolidated financial statements.

2.3.3. Transactions with entities under common control

Business combinations arising from transfers of interests in entities that are under the common control of the shareholder that control the Group are accounted for as if the acquisition had occured at the beginning of the earliest comparative period presented,

Matel Holdings NV

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For the years ended 31 December 2006 and 2005

or, if later, at the date that the common control was established. For this purpose comparatives are restated, if applicable. The components of equity of the acquired entities are added to the same components within Group equity except that any share capital of the acquired entities is recognised as part of reserves. Any cash paid for the acquisition is recognized directly in equity.

2.4. Foreign Currency

2.4.1. Translation of financial statements

Items included in the financial statements of each of the Group s entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The functional currency of the Hungarian subsidiaries of Matel Holdings is the Hungarian Forint (HUF), the functional currency of the Romanian subsidiary of Matel Holdings is the Romanian Lei (RON) and the functional currency of Matel Holdings and Matel is the Euro (EUR).

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition that are measured in currencies other than the EUR are translated into EUR at foreign exchange rates ruling at the balance sheet date. Revenues and expenses of transactions measured in currencies other than the EUR are translated into EUR at rates approximating to the foreign exchange rates ruling at the date of the transactions. Equity amounts have been translated at historical exchange rates. Exchange rate translation differences are reported as a component of shareholders equity as non-distributable cumulative translation reserve. When foreign operations are disposed, in part or in full, the relevant amount of the reserve is transferred to profit or loss.

2.4.2. Transactions and balances

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at the foreign exchange rate ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the foreign exchange rate ruling at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the translation of available-for-sale equity instruments.

Non-monetary assets and liabilities denominated in foreign currencies that are stated at historical cost are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates ruling at the dates when the fair values were determined.

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For the years ended 31 December 2006 and 2005

2.5. Cash and Cash Equivalents

Cash and cash equivalents comprise cash in bank balances and highly liquid call deposits with maturities of three months or less and exclude all overdrafts that are shown within borrowings in current liabilities on the face of the balance sheet.

Bank overdrafts that are repayable on demand and form an integral part of the Group s cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

2.6. Financial Investments

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group s contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Group commits itself to purchase or sell the asset.

When the Group has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortized cost using the effective interest method, less impairment losses.

Other investments held by the Group are classified as being available-for-sale and are stated at fair value, and changes therein, other than impairment losses and foreign exchange gains and losses on available-for-sale monetary items, are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss. The fair value of investments available-for-sale is determined by reference to their quoted bid price at the balance sheet date. The fair value of financial instruments held-for-trading is determined with reference to their quoted bid price at the balance sheet date.

The Group has not designated any financial instrument as at fair value through profit or loss other than derivative financial instruments that do not qualify for hedge accounting.

2.7. Trade and Other Receivables

Receivables are recognized initially at fair value, and subsequently thereafter they are measured at amortized cost using the effective interest rate method less accumulated impairment losses. Receivables with a short duration are not discounted. The amounts of any impairment losses are included in operating expenses.

Amounts due and receivable from other network operators are shown net where a right of set-off exists and the amounts are intended to be settled on a net basis.

2.8. Trade and Other Payables

Trade and other payables are initially recognized at fair value and subsequently at amortized cost.

Matel Holdings NV

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2.9. Inventories

Inventories consist of materials to be used in construction and repair of the telephone network, as well as telephone merchandise held for sale. Inventories are carried at the lower of cost and net realizable value. Cost is based on the first-in, first-out principle and includes expenditures incurred in acquiring the inventories and bringing them to their existing condition and location. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

2.10. Intangible Assets

Intangible assets are stated at cost less accumulated amortization and accumulated impairment losses except for goodwill and intangible assets with indefinite useful life which are not amortized and are stated at cost less accumulated impairment losses. After initial recognition it is assessed whether an intangible asset has a finite or indefinite useful life. The cost of intangible assets with a finite useful life is amortized on a straight-line basis over the period in which the asset is expected to be available for use. The rates of amortization are based on the following estimated useful lives:

Concession Rights and Licenses	see below
Software	3 years
Property Rights	3-6 years
Subscriber Acquisition Costs	1-3 years
Other	5-12 years

Amortization of intangible assets ceases at the earlier of the date that the asset is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and the date the asset is derecognized. The amortization periods are reviewed annually at each financial year-end. Any changes arising from such review are accounted for as a change in an accounting estimate.

2.10.1. Concession rights and licenses

Concession rights and licenses represent amounts paid for the right to provide fixed line telecommunications services in certain geographical areas of Hungary (historical concession areas) on the basis of concession contracts signed by the Company and the Hungarian state. Up to 31 December 2004 these rights were amortized over the 25-year term provided for in the concession contracts signed in 1994 and 1995. Upon adoption of the revised IAS 38 *Intangible Assets* on 1 January 2005, concession rights were written-off as these rights no longer met the definition of intangible asset under revised IAS 38.

2.10.2. Goodwill

As part of its transition to IFRSs, Matel Holdings elected to restate only those business combinations that occurred on or after 1 January 2005. In respect of acquisitions prior to 1 January 2005, goodwill represents the amount recognised under the Matel Holdings previous accounting framework.

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For the years ended 31 December 2006 and 2005

Prior to 2006 Matel Holdings did not prepare consolidated financial statements and elected not to restate its acquistion of Matel in accordance with IFRS 3. In relation to its 31 December 2006 consolidated financial statements (and consequently in the Group s 31 December 2006 financial statements), Matel Holdings used the carrying amounts of the assets and liabilities as recognized in the consolidated financial statements of Matel at 1 January 2005 (Matel Holdings date of transition to IFRSs) in preparing its opening balance sheet at that same date.

All business combinations, except for transactions with entities under common control (see Note 2.3.3) on or after 1 January 2005 are accounted for by applying the purchase method. Goodwill arising in a business combination represents the excess of the cost of the acquisition over the Group s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. Goodwill on acquisition of subsidiaries is included among Intangible Assets. Goodwill is measured at cost less acumulated impairment losses.

Goodwill arising on the acquisition of a minority interest in a subsidiary represents the excess of the cost of the additional investment over the carrying amount of the net assets acquired at the date of exchange.

2.10.3. Software

Software is stated at the cost incurred to acquire and bring to use the specific software less accumulated amortization and impairment losses.

2.10.4. Property Rights

Property rights represent amounts paid for the right to use third party property for the placement of telecommunication equipment. Property rights are stated at cost less accumulated amortization and impairment losses.

2.10.5. Subscriber Acquisition Costs

Subscriber acquisition costs include sales commissions paid to internal sales force and third parties in relation to fixed term subscriber contracts and are amortized over the period of the related subscriber contracts. Subscriber acquisition costs are stated at cost less accumulated amortization and impairment losses.

2.10.6. Other intangible assets

Other intangible assets include brand names and the value of customer relationships lists that were acquired by the Group. Other intangible assets are stated at cost less accumulated amortization and impairment losses.

2.11. Property, Plant and Equipment

2.11.1. Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the

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cost of materials, direct labour and an appropriate proportion of overheads, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the cost of dismantling and removing the items and restoring the site on which they are located. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment. Capital work in progress is stated at cost less impairment losses and represents those property, plant and equipment that have not been completed and capitalized.

2.11.2. Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. An asset acquired by way of finance lease is measured initially at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Other leases are operating leases and the leased assets are not recognised on the Group s balance sheet. The Group adopted IFRIC 4 Determining whether an Arrangement Contains a Lease , which is mandatory for annual periods beginning on or after 1 January 2006, in its 2006 consolidated financial statements.

2.11.3. Subsequent expenditure on property, plant and equipment

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditure is included in the carrying amount if it is probable that future economic benefits embodied in that part will flow to the Group and its cost can be measured reliably. All other expenditure is recognized in the income statement as an expense as incurred.

2.11.4. Depreciation

Depreciation is charged to the 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. Leased assets are depreciated over the shorter of the lease term or their useful lives. Land and capital work in progress are not depreciated. The estimated useful lives are as follows:

Buildings	17-50 years
Network	7-30 years
Machinery and Equipment	7-10 years
Fixtures and Fittings	7 years
Vehicles	5 years
Computers	3 years

Depreciation of property, plant and equipment ceases at the earlier of the date that the asset is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and the date the asset is derecognized.

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Depreciation methods, useful lives and residual values are reviewed annually at each financial year-end. Any changes arising from such review are accounted for as a change in an accounting estimate.

2.12. Impairment

The carrying amounts of the Group s assets, other than inventories (see accounting policy note 2.9) and deferred tax assets (see accounting policy note 2.23), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset s recoverable amount is estimated.

For goodwill and intangible assets with an indefinite useful life or not available for use, the recoverable amount is estimated annually, irrespective of whether any indication of impairment exists. An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis. Impairment losses are recognized in the income statement.

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value. Any cumulative loss in respect of an available-for-sale financial asset recognized previously in equity is transferred to profit and loss. Individually significant financial assets are tested for impairment on a individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

2.12.1. Calculation of recoverable amount

The recoverable amount of the Group s investments in financial assets carried at amortized cost is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. Receivables with a short duration are not discounted. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

The recoverable amount of other assets or cash-generating units is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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2.12.2. Reversal of impairment

An impairment loss in respect of a held-to-maturity security or receivable and available-for-sale financial asset that is a debt security is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognized. The reversal is recognized in profit or loss. For an available-for-sale financial asset that is an equity security, the reversal is recognized directly in equity. An impairment loss in respect of goodwill is not reversed. In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and there has been an indication that the impairment has decreased or no longer exists.

An impairment loss is reversed only to the extent that the asset s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

2.13. Derivative Financial Instruments

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investing activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading derivatives.

Derivative financial instruments are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Attributable transaction costs are recognized in profit or loss when incurred. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates qualifying derivatives as either: (1) hedges of the fair value of recognized assets or liabilities or a firm commitment (fair value hedges), or (2) hedges of the exposure to variability in cash-flows that is (a) attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction and (b) could affect profit or loss (cash-flow hedges).

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as risk management objectives and its strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash-flows of hedged items.

At 1 January 2005, the Group, based on the provisions of the amended IAS 32 *Financial Instruments: Disclosure and Presentation* and the amended IAS 39 *Financial Instruments: Recognition and Measurement* , reviewed the classification of derivative financial instruments that were entered into before 2005 and the accounting treatment thereof. Based on the detailed review of the contracts and putting into place of various procedures to meet the hedging requirements of IAS 39, the Group designated qualifying derivative contracts into hedging relationships with the underlying assets, liabilities and firm commitments as of 1 January 2005.

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As a result of the formal designation of the derivative contracts as hedges, the accounting treatment thereof was changed since the effective date of the hedge designation and was applied prospectively.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognised immediately in profit or loss.

2.13.1. Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognized in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Changes in the fair value of derivatives that are designated to hedge the change in the fair value of unrecognized firm commitments are recognized in the income statement. The corresponding change in the fair value of the unrecognized firm commitment is recognized as other asset or liability against the income statement.

2.13.2. Cash-flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash-flow hedges are recognized in equity. The gain or loss relating to the ineffective portion is recognized immediately in the income statement. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

The gain or loss relating to the effective portion of the hedging instrument is recognized in the statement of changes in shareholder s equity. The ineffective portion of the derivative instrument is recognized in the income statement among Financial Expenses / Financial Income.

2.13.3. Trading derivatives

Derivatives that do not qualify for hedge accounting are classified as trading derivatives. Changes in the fair value of trading derivatives are recognized in the income statement.

2.13.4. Fair value estimation

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

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The fair value of forward exchange contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate.

For other OTC derivative agreements with its selected hedging counter-parties, the fair value of OTC financial instruments is determined by using valuation techniques. The Group uses present value calculations using assumptions that are based on market conditions prevailing on each balance sheet date.

2.14. Interest Bearing Borrowings

Interest bearing borrowings are recognized initially at fair value, less discounts and attributable transaction costs. Subsequent to initial recognition, interest bearing borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the income statement over the period of the borrowings on an effective interest basis.

2.15. Provisions

A provision is recognized in the balance sheet when the Group has a legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognized when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

2.16. Revenue Recognition

Revenues from all goods and services are shown net of VAT, rebates and discounts. Revenue from services are recognized when services are provided (see further description below). Revenue from the sale of goods is recognized when the significant risks and rewards of ownership of products sold have been transferred to the buyer. For products, the transfer of risks and rewards usually occurs when they are delivered to the customer. The Group considers the various elements of subscriber arrangements to be separate earnings processes for IFRS purposes and recognizes the revenue for each of the deliverables at their invoiced amounts.

A portion of the revenue received is paid to other operators for the use of their networks. These revenues and costs are shown gross in the consolidated income statement.

The Group s main operating revenue categories are as follows:

Mass Market Voice. The revenue generated from the fixed line voice and voice-related services provided to mass-market customers in the historical concession areas (Mass Market Voice In) and out of the historical concession areas (Mass Market Voice Out). Mass Market Voice Revenue comprises time based call charges, subject to a minimum monthly fee charged for

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accessing the network and time based fixed-to-mobile, local, long distance and international call charges, interconnect charges on calls terminated in the Group s network, monthly fees for value added services, subsidies, one-off connection and new service fees, as well as monthly fees for packages with built-in call minutes. Mass Market Voice In revenue also includes access calls to dial-up ISPs networks at local call tariffs and revenue from providing DSL access to other ISPs, but revenue from bundled Internet call and Internet services is recorded under Mass Market Internet.

Mass Market Internet. The revenue generated from dial-up and DSL Internet connections provided to mass-market customers nationwide both inside and outside the historical concession areas. Mass Market Internet comprises dial-up revenue, which is generated through a combination of time based and access fees, and DSL revenue, which is generated through a variety of monthly packages.

Business. The revenue generated from the fixed line voice, data and Internet services provided to business, government and other institutional customers nationwide. Business revenue comprises access charges, monthly fees, time based fixed-to-mobile, local, long distance and international call charges, interconnect charges on calls terminated in the Group s network, monthly fees for value added services, Internet access packages and regular data transmission services. Business revenues include the same components as Mass Market Voice In and Mass Market Internet revenues and include, in addition, 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 provided on a wholesale basis to a selected number of resellers to use the Group s 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.

Revenue from connection fees are recognized upon service activation. Revenue from monthly fees charged for accessing the network is recognized in the month during which the customer is permitted to access the network. Traffic revenue is recognized in the period of the related usage. Leased line and data transmission revenue is recognized in the period of usage or of the service available to the customer. Revenue from prepaid call services is deferred when the prepaid package is sold to the customers and is recognized when the calls are made.

2.17. Universal Service Subsidies and Obligations

Prior to 2004 the Group was entitled to receive a subsidy from the Universal Service Fund to compensate for the provision of discounted subscription packages. At the same time the Group was obliged to pay into the fund an amount determined based on its revenues. No subsidies have been recognized after 2004 due to the uncertainty of the universal service legislation.

2.18. Government grants

Government grants are recognized in the balance sheet initially as deferred income when there is reasonable assurance that it will be received and that the Group will comply with the

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conditions attached to it. Grants that compensate the Group for expenses incurred are recognized as revenue in the income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognized in the income statement as other operating income on a systematic basis over the useful life of the asset.

2.19. Pension Costs and Employee Benefits

Contributions are made to the Hungarian and Romanian pension, health and unemployment schemes at the statutory rates in force during the year, based on gross salary payments. The cost of social security payments is charged to the income statement in the same period when the related salary cost incurred. The Group has no obligation for pension or other post employment benefits beyond the government programs.

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognized for the amount expected to be paid under short-term cash bonuses or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

2.20. Share Capital

2.20.1. Ordinary shares

Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity.

2.20.2. Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity until cancelled.

2.20.3. Share-based compensation

The Group had an employee share ownership program (ESOP) for senior executives, under which Matel Holdings, the shareholder of Matel, granted stock options to senior executives of INVITEL for the purchase of non-voting C shares representing up to 5% of the ordinary shares of Matel Holdings. The options vested immediately and were exercisable on issue. The maximum number of options issuable under the ESOP has been issued at 31 December 2006.

The fair value of options granted is recognized as an employee expense over the vesting period with a corresponding increase in equity. The Group believes that the value of these options was represented almost entirely by their intrinsic value at the grant date because these options were issued with the intention that they should be immediately exercised by the senior executives, the options could not be settled net in

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cash, were for unlisted shares, and were not transferable. Therefore, the fair value of the options was measured at grant date using the estimated fair value of the underlying shares determined in accordance with the valuation guidelines set out in the European Private Equity and Venture Capital Association Guidelines.

The options vest immediately and are exercisable on issue.

2.21. Net Financial Costs

Net financial costs comprise interest expense on borrowings, interest income on funds invested, dividend income, foreign exchange gains and losses and impairment losses on financial investments. Gains and losses resulting from the changes in the fair values of derivative financial instruments are recognized as net financial expense, other than the effective portion of cash-flow hedges being recognized in hedging reserve in equity.

Interest income is recognized in the income statement as it accrues, taking into account the effective yield on the asset.

Dividend income is recognized in the income statement on the date that the Group s right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

2.22. Lease payments

Payments made in respect of operating leases are charged to the income statement on a straight-line basis over the lease term and included in operating expenses.

Lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding lease liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

2.23. Income taxes

Income tax expense comprises current and deferred taxes. Income tax expense is recognized in profit or loss 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 tax payable on taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred tax is provided for using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that they probably will not reverse in the foreseeable future. The amount of deferred

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tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using the appropriate tax rate enacted or substantively enacted at the balance sheet date.

Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend.

2.24. Segment reporting

A business segment is a distinguishable component of the Group engaged in providing related products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

The Group has four business segments that are identified in the accounting policy relating to revenue (see accounting policy Note 2.16 on revenue recognition). The Group s primary format for segment reporting is based on business segments.

Allocation of revenues and cost of sales into business segments is based on management information collected in the information systems of the Group. The Group considers segment results at the gross margin level used for management reporting purposes and its current information systems do not report operating expenses on a segment basis. Non-current assets and related depreciation as well as capital expenditure are allocated into segments based on the services for which they are or will be utilized. Allocation of non-current liabilities was based on the allocation of assets, which they finance. Elements of working capital have been allocated based on revenues to which they relate. Unallocated assets include other non-current financial assets and deferred tax and unallocated liabilities include borrowings, finance leases and other liabilities relating to financing.

2.25. Key sources of estimation uncertainty

The Group makes estimates and assumptions concerning the future. The estimates and assumptions that have a significant risk of affecting the carrying amounts of assets and liabilities in the financial statements within the next financial year are described below.

2.25.1. Deferred tax assets

The Group recognizes deferred tax assets in its balance sheet relating to tax loss carry forwards. The amount of such deferred tax assets recognized in the balance sheet was EUR 6,300 thousand and EUR 7,256 thousand at 31 December 2006 and 2005, respectively. The recognition of such deferred tax assets is subject to the utilization of tax loss carry forwards. The utilization of certain amounts of such tax loss carry forwards is subject to statutory limitations and is dependent on the amount of future taxable income of the Group companies, in particular INVITEL and Euroweb

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Hungary. The Group has recognized deferred tax assets relating to tax loss carry forwards based on estimated future taxable income of INVITEL and Euroweb Hungary according to approved business plans for these entities. If the future taxable income of INVITEL and Euroweb Hungary were to significantly differ from the amounts that were estimated, such differences could impact the amount of deferred tax assets and income tax expense of the Group.

2.25.2. Allowance for bad and doubtful accounts

The Group calculates an allowance for bad and doubtful accounts receivable to cover the estimated losses resulting from the inability of its customers to make required payments when due. Provision for bad debts recognised in the balance sheet amounted to EUR 10,269 thousand and EUR 9,167 thousand at 31 December 2006 and 2005, respectively. The estimates used in evaluating the adequacy of the allowance for bad and 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.

The Group considers that the accounting estimate related to the allowance for bad and doubtful accounts receivable is a critical accounting estimate since it involves assumptions about future customer behavior and the resulting future cash collections. If the financial condition of customers or the economic environment in which they operate were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the provision recognized as at 31 December 2006.

2.25.3. Impairment of property, plant and equipment, intangible assets and goodwill

In determining impairment, the Group considers a number of factors, among others, future revenues and expenses, technological obsolescence and discontinuation of services.

The Group recognised an impairment loss of EUR 186 thousand and EUR 165 thousand for the year ended 31 December 2006 and 2005, respectively, as disclosed in Note 8.

The Group considers that the accounting estimate related to asset impairment is a critical accounting policy due to the need to make assumptions regarding the above factors and the material impact that recognising impairment could have on the financial position and results of the Group.

2.25.4. Depreciation

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 as described in Note 2.10 and Note 2.11.4.

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The Group considers that the accounting estimate related to the determination of the useful lives of assets is a critical accounting estimate since it involves assumptions about technology evolutions in an innovative industry. Further, due to the significant weight of long-lived assets in the asset base of the Group, the impact of any changes in these assumptions could be material to the Group s financial position, as well as the results of operations.

2.26. Comparative information

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

2.27. New accounting pronouncements

A number of new Standards, Amendments to Standards and Interpretations are not yet effective as at 31 December 2006, and have not been applied in preparing these consolidated financial statements. The Group plans to adopt these pronouncements when they become effective. Of these pronouncements, potentially the following will have an impact on the Group s operations.

IFRS 7 *Financial Instruments: Disclosures* and the Amendment to IAS 1 *Presentation of Financial Statements: Capital Disclosures* , which are effective for annual periods beginning on or after 1 January 2007, will require increased disclosure about the significance of financial instruments for an entity s financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks and increased disclosure in respect of the Group s capital. The Group expects that the significant additional disclosures required will relate to its financial risk management objectives, policies and processes, and share capital.

IFRS 8 *Operating Segments* , which is effective from 1 January 2009, requires segment disclosure based on the components of the entity that management monitors in making decisions about operating matters. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Group expects the new Standard to significantly alter the presentation and disclosure of its operating segments in the consolidated financial statements.

IFRIC 9 *Reassessment of Embedded Derivatives* , which is effective for annual periods beginning on or after 1 June 2006 requires that a reassessment of whether an embedded derivative should be separated from the underlying host contract should be made only when there are changes in the terms of the contract that significantly modify the cash flows that otherwise would be required under the contract. The Group has not yet completed its analysis of the impact of the new Interpretation.

IFRIC 10 *Interim Financial Reporting and Impairment* , which is effective for annual periods beginning on or after 1 November 2006 prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, investments in equity instruments or financial assets carried at cost. The Group does not expect the Interpretation to have any impact on the consolidated financial statements.

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3. Acquisition of Subsidiaries

On 20 December 2005 INVITEL entered into a share purchase and sale agreement with Euroweb International Corp. (Euroweb International) to purchase 100% of Euroweb International s interest in Euroweb Hungary and Euroweb Romania.

Following the necessary approvals of shareholders of the companies and the relevant competition authorities and a report of an independent auditor about the indebtedness of Euroweb Hungary and Euroweb Romania, the transaction was completed on 23 May 2006.

Through the transaction INVITEL purchased 19,996 series A common shares and 3 series B preference shares all of which have a nominal value of HUF 1,000 and represent 100% minus one share of the issued share capital and voting rights in Euroweb Hungary and 6,411,968 common shares all of which have a nominal value of RON 0.50 and represent 99.96% of the issued capital and voting rights in Euroweb Romania.

The purchase consideration for the two companies amounted to USD 30 million (approximately EUR 24 million). As part of the purchase consideration INVITEL also capitalized certain consultant expenses directly related to the transaction including the cost of legal, technical and financial due diligence amounting to HUF 186 million (approximately EUR 732 thousand). For the purpose of the purchase price allocation the purchase consideration has been split between Euroweb Hungary and Euroweb Romania pro rata based on the valuations of the two companies according to their Long Term Business Plans (LTBP) excluding potential synergies arising from the transaction. According to the LTBP valuations the purchase price has been allocated as 48.8% and 51.2% between Euroweb Hungary and Euroweb Romania, respectively.

Pre-acquisition carrying amounts were determined based on applicable IFRSs immediately before the acquisition. The values of assets, liabilities and contingent liabilities recognized on acquisition are their estimated fair values. Fair values of the assets were determined using different valuation techniques depending on the nature of the assets. Items of existing property, plant and equipment and intangible assets were valued using the Depreciated Replacement Cost and Sales Comparison valuation methods. Intangible assets were valued using multi-period-excess-earnings method in the case of customer related intangible assets, and relief-from-royalty method in the case of marketing related intangible assets and the reproduction cost method for software. Newly identified intangibles consist of customer relationship, brand names and software.

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The assets and liabilities of the subsidiaries acquired are summarized in the below table. The below amounts represent the recognition of the business combination in the Group s consolidated financial statements:

	EuroWeb Internet Szolgáltató Zrt.		EuroWeb Romania S.A.		Total	
(in thousands of EUR)	**Book Value**	**Fair Value**	**Book Value**	**Fair Value**	**Book Value**	**Fair Value**
Property, plant and equipment	1,720	1,130	3,505	3,693	5,225	4,823
Intangible assets	711	2,321	57	2,094	768	4,415
Liabilities	(7,353)	(7,353)	(233)	(233)	(7,586)	(7,586)
Inventory	54	54	186	186	240	240
Trade and other receivables	2,486	2,486	895	895	3,381	3,381
Cash and cash equivalents	7,389	7,389	160	160	7,549	7,549
Deferred taxes	1,128	924	(67)	(513)	1,061	411
Trade and other payables	(3,487)	(3,487)	(2,017)	(2,017)	(5,504)	(5,504)
Net assets acquired	**2,648**	**3,464**	**2,486**	**4,265**	**5,134**	**7,729**
Goodwill		8,373		8,157		16,530
Total purchase consideration		11,837		12,422		24,259
Less: cash acquired		(253)		(140)		(393)
Net cash outflow		11,584		12,282		23,866

The Group recognised EUR 16,530 thousands goodwill on the acquisition of EuroWeb Hungary and EuroWeb Romania. Goodwill recognized relates to customer relationships for which no value could be assigned, value of assembled workforce, business relationships and agreements as well as future synergies with INVITEL s Internet and communications business. An impairment test for such goodwill recognized will be performed once a year in line with the accounting policy of the Group (see Note 2.12).

The acquisition date was 23 May 2006. Profit/(loss) after tax of Euroweb Hungary and Euroweb Romania from 23 May 2006 to 31 December 2006 included in the net profit for the period of the Group amounts to a loss of EUR 378 thousand and a profit of EUR 242 thousand, respectively.

Pro-forma revenue of the combined entity for the period ended 31 December 2006 would have been EUR 197,808 thousand had the acquisition taken place on 1 January 2006.

Pro-forma net loss for the period of the combined entity for the period ended 31 December 2006 would have been EUR 2,677 thousand had the acquisition taken place on 1 January 2006.

The impairment test for such goodwill arising from the above business combination was performed during the fourth quarter in line with the accounting policy of the Group (see Note 2.12). The two companies have been identified as two individual cash-generating units. The recoverable amounts of these cash-generating units have been determined based on both fair value less cost to sell and their value-in-use. Values in use were determined based on cash flow projections for Euroweb Hungary and Euroweb Romania reflecting the financial business plans approved by management of the Group covering the fiscal period from 2007 through 2011.

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Value-in-use was determined by discounting the future cash flows generated from the continuing use of the unit and was based on the following key assumptions:

Cash flows were projected based on actual operating results and the upcoming five years from 2007 through 2011 of the long-term business plan. Cash flows beyond 2011 were extrapolated into perpetuity using a constant growth rate of zero percent.

The Euroweb Romania plan was prepared in US dollars and the exchange rate to translate it to Hungarian forints was assumed to be 200 HUF/USD.

A pre-tax discount rate of 10% was applied in determining the recoverable amount of the units. The discount rate was estimated based on INVITEL s weighted average cost of capital.

The values assigned to the key assumptions represent management s assessment of future trends in the industry and are based on both external sources and internal sources.

The actual purchase price of the companies paid to Euroweb International (less costs to sell) was also used to determine the fair value. The higher of the fair value less costs to sell and the value-in-use was used to determine the recoverable amount, which were then compared to the carrying amount.

As a result of the impairment test no impairment was accounted for.

4. Revenues

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**
Mass Market Voice	77,363	89,131
Mass Market Internet	24,367	20,031
Business	54,636	44,826
Wholesale	29,240	27,355
Total Revenues	**185,606**	**181,343**

5. Cost of Sales

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**

Sales commissions	(2,822)	(1,732)
Interconnect expenses	(37,739)	(39,122)
Access type charges	(14,546)	(6,371)
Other cost of sales	(1,996)	(1,685)
Total Cost of Sales	**(57,103)**	**(48,910)**

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6. Operating Expenses

(in thousands of EUR)	**For the year ended 31 December 2006**	**2005**
Personnel expenses	(22,268)	(19,512)
Headcount-related costs	(7,040)	(7,475)
Advertising and marketing costs	(3,094)	(2,591)
Network operating expenses	(12,275)	(12,550)
IT costs	(3,821)	(3,533)
Local operating and other taxes	(3,711)	(3,792)
Bad debt expense	(855)	(1,070)
Collection costs	(1,397)	(1,264)
Legal and audit fees	(74)	(394)
Consultant expenses	(644)	
Management fee	(576)	(644)
Due diligence expense	(425)	(184)
USF provision	466	(602)
IP TV and tax penalty	(506)	
Other costs, net	(421)	69
	(56,641)	(53,542)
Less: Capitalised costs	1,972	2,069
Total Operating Expenses	**(54,669)**	**(51,473)**

Network operating expenses include the maintenance costs of the Group s telecommunication infrastructure and its license and rental fees, which rental fees amounted to EUR 3,109 thousand and EUR 2,620 thousand for the year ended 31 December 2006 and 2005, respectively.

Bad debt expense for the year ended 31 December 2005 is net of EUR 724 thousand, a reversal relating to a receivable recovered in 2005.

Capitalized costs include labour and overhead expenses associated with the construction of property, plant and equipment.

7. Personnel Expenses

(in thousands of EUR)	**For the year ended 31 December 2006**	**2005**
Salaries	(12,152)	(11,382)
Social security and other contributions	(4,048)	(3,978)
Personnel related expenses	(1,053)	(1,609)
Management bonuses	(1,034)	
Share-based payments	(673)	
Contracted employees and expatriate costs	(1,316)	(1,390)
Bonuses and charges	(1,929)	(1,125)

Severance payments	(63)	(28)
Total Personnel Expenses	**(22,268)**	**(19,512)**

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The number of employees was 927 and 768 at 31 December 2006 and 2005, respectively. Due to the acquisition of subsidiaries (see Note 3) the number of employees of the Group increased by 181.

Personnel expenses for the period ended 31 December 2006 include expenses relating to executive share based compensation in the amount of EUR 673 thousand (see Note 2.20.3).

8. Depreciation and Amortization

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**
Amortization	(7,169)	(6,620)
Depreciation	(30,600)	(31,329)
Impairment loss	(186)	(165)
Derecognition of concession rights		(10,907)
Total Depreciation and Amortization	**(37,955)**	**(49,021)**

Concession rights were derecognized as of 1 January 2005 due to the adoption of revised IAS 38 effective from 1 January 2005 under which standard the rights no longer met the definition of an intangible asset.

The impairment loss of EUR 186 thousand for the year ended 31 December 2006 mainly related to the impairment of office buildings (EUR 46 thousand) and impairment of subscriber acquisition costs (EUR 140 thousand).

The impairment loss of EUR 165 thousand for the year ended 31 December 2005 mainly related to the impairment of a billing system and removal of public pay phones.

9. Cost of Restructuring

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**
Severance	(38)	
Cost of reorganization	(1,775)	(2,046)
Total Cost of Restructuring	**(1,813)**	**(2,046)**

The Cost of reorganization in the amount of EUR 1,775 thousand for the year ended 31 December 2006 represents reorganization and restructuring expenses mainly related to the integration of Euroweb Hungary after its acquisition by INVITEL. The cost of restructuring mainly included relocation expenses, termination expenses of lease contracts and termination benefits paid.

The Cost of reorganization in the amount of EUR 2,046 thousand recorded in 2005 mainly included termination benefits paid to employees related to the rationalization of INVITEL company structure and consolidating locations of the business across geographical areas. The provision was fully utilized in 2006.

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10. Net Financial Costs

(in thousands of EUR)	For the year ended 31 December 2006	2005
Interest income	970	1,576
Fair value change of forward contracts		922
Fair value change of swap contracts	3,290	4,965
Fair value change of hedged items	618	351
Financial Income	**4,878**	**7,814**
Related party interest expense		
Third party interest expense	(26,289)	(28,412)
Bond discount	(233)	(233)
Amortization of deferred borrowing costs	(1,367)	(1,453)
Interest expense	(27,889)	(30,098)
Net foreign exchange (loss)/gain	(3,055)	(8,144)
Fair value change of securities		(127)
Fair value change of forward contracts	(773)	
Other financial expense	(226)	(278)
Financial Expense	**(31,943)**	**(38,647)**
Total Net Financial Costs	**(27,065)**	**(30,833)**

All interest income in 2006 and 2005 relates to cash and cash equivalents. See Note 17 for information about financial instruments at 31 December 2006 and identified financial risks.

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11. Intangible Assets

Movements during the period in the Group s intangible assets were as follows:

(in thousand of EUR)	Concession Rights and Licenses	Software	Property Rights	Goodwill	Subscriber Acquisition Costs	Other	Total Intangible Assets
Cost as at 1 January 2005	**17,887**	**35,714**	**13,003**	**134**			**66,738**
Additions during the period		2,998	2,387		2,448		7,833
Disposals during the period	(17,777)						(17,777)
Effect of exchange rates	(110)	(710)	(305)	(3)			(1,128)
Cost as at 31 December 2005		**38,002**	**15,085**	**131**	**2,448**		**55,666**
Accumulated amortization as at 1 January 2005	**(7,054)**	**(32,020)**	**(6,991)**				**(46,065)**
Amortization charge for the period		(3,716)	(2,156)		(748)		(6,620)
Impairment for the period	(10,907)	(14)					(10,921)
Disposals during the period	17,777						17,777
Effect of exchange rates	184	568	145				897
Accumulated amortization as at 31 December 2005		**(35,182)**	**(9,002)**		**(748)**		**(44,932)**
Carrying value as at 1 January 2005	**10,833**	**3,694**	**6,012**	**134**			**20,673**
Carrying value as at 31 December 2005		**2,820**	**6,083**	**131**	**1,700**		**10,734**
Cost as at 1 January 2006		**38,002**	**15,085**	**131**	**2,448**		**55,666**
Acquisition of subsidiaries		1,166	310	16,530		2,940	20,946
Additions during the period		2,622	1,647		2,708		6,977
Disposals during the period		(83)	(11)				(94)
Revarsal				(125)			(125)
Effect of exchange rates		(36)	(119)	683	91	9	628
Cost as at 31 December 2006		**41,671**	**16,912**	**17,219**	**5,247**	**2,949**	**83,998**
Accumulated amortization as at 1 January 2006		**(35,182)**	**(9,002)**		**(748)**		**(44,932)**
Amortization charge for the period		(2,505)	(2,252)		(2,185)	(227)	(7,169)
Impairment for the period					(140)		(140)
Disposals during the period		93					93
Effect of exchange rates		47	158		(91)		114
		(37,547)	**(11,096)**		**(3,164)**	**(227)**	**(52,034)**

Accumulated amortization as at 31 December 2006						
Carrying value as at 1 January 2006	**2,820**	**6,083**	**131**	**1,700**		**10,734**
Carrying value as at 31 December 2006	**4,124**	**5,816**	**17,219**	**2,083**	**2,722**	**31,964**

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INVITEL and its predecessor companies in 1994 and 1995 concluded 25-year concession contracts to provide fixed line telecommunication services in certain geographical areas in Hungary (historic concession areas). In March 2002 INVITEL ZRt. signed a Universal Service Agreement with the Information and Communication Ministry that effectively replaced the obligations contained in previous concession contracts. The concession contracts were terminated in April 2004. The related concession rights were written off as of 1 January 2005 due to adoption of revised IAS 38 under which standard the rights no longer met the definition of an intangible asset (see Note 8).

Goodwill relates to acquisitions undertaken by the Group. Additions to goodwill relate to the acquisition of Euroweb Hungary and Euroweb Romania by INVITEL on 23 May 2006 (see Note 3).

The Company capitalized subscriber acquisition costs (mainly sales commissions) in the amount of EUR 2,708 thousand and EUR 2,448 thousand during the year ended 31 December 2006 and 2005, respectively and charged the related amortization in the amount of EUR 2,185 thousand and EUR 748 thousand for the period ended 31 December 2006 and 2005, respectively.

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12. Property, Plant and Equipment

Movements during the period in the Group s property, plant and equipment were as follows:

(in thousands of EUR)	Land and Buildings	Network and Equipment	Other	Capital Work In Progress	Total Property, Plant and Equipment
Cost as at 1 January 2005	**4,953**	**498,750**	**20,859**	**5,347**	**529,909**
Additions during the period		709		15,039	15,748
Transfers from capital WIP	29	11,451	958	(12,438)	
Disposals during the period	(243)	(4,105)	(449)	(14)	(4,811)
Effect of exchange rates	(90)	(9,445)	(394)	(133)	(10,062)
Cost as at 31 December 2005	**4,649**	**497,360**	**20,974**	**7,801**	**530,784**
Accumulated depreciation as at 1 January 2005	**(1,180)**	**(205,347)**	**(17,441)**		**(223,968)**
Depreciation charge for the period	(263)	(29,301)	(1,765)		(31,329)
Impairment for the period		(124)	(26)		(150)
Disposals during the period	243	3,830	440		4,513
Effect of exchange rates	22	4,133	344		4,499
Accumulated depreciation as at 31 December 2005	**(1,178)**	**(226,809)**	**(18,448)**		**(246,435)**
Carrying value as at 1 January 2005	**3,773**	**293,403**	**3,418**	**5,347**	**305,941**
Carrying value as at 31 December 2005	**3,471**	**270,551**	**2,526**	**7,801**	**284,349**
Cost as at 1 January 2006	**4,649**	**497,360**	**20,974**	**7,801**	**530,784**
Additions during the period				18,308	18,308
Acquisition of subsidiaries	60	3,800	433	530	4,823
Transfers from capital WIP	91	15,660	853	(16,604)	
Disposals during the period	(67)	(652)	(816)		(1,535)
Effect of exchange rates	(38)	(3,846)	(193)	51	(4,026)
Cost as at 31 December 2006	**4,695**	**512,322**	**21,251**	**10,086**	**548,354**
Accumulated depreciation as at 1 January 2006	**(1,178)**	**(226,809)**	**(18,448)**		**(246,435)**
Depreciation charge for the period	(265)	(28,929)	(1,273)		(30,467)
Impairment for the period	(30)	(1)	(15)		(46)
Disposals during the period	62	171	788		1,021
Effect of exchange rates		824	140		964

Accumulated depreciation as at 31 December 2006	**(1,411)**	**(254,744)**	**(18,808)**		**(274,963)**
Carrying value as at 1 January 2006	**3,471**	**270,551**	**2,526**	**7,801**	**284,349**
Carrying value as at 31 December 2006	**3,284**	**257,578**	**2,443**	**10,086**	**273,391**

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Network and Equipment includes all tangible assets associated with the telecommunication network and related equipment.

Other assets include other non-telecom equipment, fixtures and fittings, vehicles and computers.

Capital Work in Progress includes property, plant and equipment in the course of construction. After completion, such assets are put into operation (capitalized) and are transferred to the appropriate fixed asset categories. No depreciation is charged on capital work in progress.

Total value of assets with useful life less than one year amounting to EUR 133 thousand and nil in 2006 and 2005, respectively, were written off directly to depreciation.

13. Cash and Cash Equivalents

	At 31 December	
(in thousand of EUR)	**2006**	**2005**
Cash on hand and in banks	937	1,277
Cash deposits	12,690	27,945
Total Cash and Cash Equivalents	**13,627**	**29,222**

Out of the total of Cash and Cash Equivalents of EUR 13,627 thousand at 31 December 2006, the EUR denominated part is EUR 2,776 thousand or 20%, the HUF denominated part is EUR 10,635 thousand or 78%, the USD denominated part is EUR 56 thousand or 1%, and the RON denominated part is EUR 160 thousand or 1%.

Out of the total of Cash and Cash Equivalents of EUR 29,222 thousand at 31 December 2005, the EUR denominated part is EUR 1,038 thousand or 4%, and the HUF denominated part is EUR 28,184 thousand or 96%.

The effective interest rate for cash and cash equivalents was 5.0% in the year period ended 31 December 2006 and 6.3% in the year ended 31 December 2005.

14. Trade and Other Receivables

	At 31 December	
(in thousands of EUR)	**2006**	**2005**
Trade accounts receivable	29,807	26,191
Allowance for bad and doubtful accounts	(10,269)	(9,167)
Other receivables	1,457	1,247
Total Trade and Other Receivables	**20,995**	**18,271**

Trade accounts receivable are mostly denominated in HUF. Out of the total Trade accounts receivable the HUF denominated part is EUR 28,486 thousand and the RON denominated part is EUR 831 thousand.

All receivables fall due within one year, except that long overdue receivables, which are overdue by more than 1 year, are carried in the Trade accounts receivable balance in the amount of

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EUR 8,470 thousand at 31 December 2006 and EUR 6,862 thousand at 31 December 2005 as the current Hungarian legislation places restrictions on the write off of receivables as a tax-deductible expense until sufficient proof exists for the receivable to be cleared from the accounts.

Movements in the allowance for bad and doubtful accounts are included as Bad debt expense within Operating expenses.

Other receivables include advances to suppliers and prepaid taxes.

15. Shareholders Equity

At 31 December 2006 the authorized share capital of Matel Holdings was EUR 120,000 divided into 57,000 ordinary A shares, 57,000 ordinary B shares and 6,000 ordinary C shares with a par value of EUR 1.00 each. At 31 December 2006 the issued share capital of Matel Holdings was EUR 63,000. The issued capital is fully paid in.

The Group had an employee share ownership program (ESOP) for senior executives, whereby Matel Holdings, the shareholder of Matel, could issue stock options to senior executives of INVITEL up to 5% of the ordinary shares of Matel Holdings. Matel Holdings issued in 2003 and 2004 options for the purchase of shares representing 4.15% of its outstanding shares. The senior executives exercised the options upon issue and entered into shareholder agreements (the Agreements).

During the year ended 31 December 2006 Matel Holdings N.V granted further options for the purchase of non-voting C shares representing 0.85% of Matel Holdings N.V ordinary shares. With this grant the maximum number of options issuable under the ESOP has been issued. These shares are subject to the Agreements previously entered into. The Group has assessed the options as meeting the definition of equity settled share based payments under IFRS 2. The Agreements prescribe the use of the valuation guidelines set out in the European Private Equity and Venture Capital Association Guidelines to determine fair value. Based on these guidelines the Group has determined that the shares were purchased by the senior executives at approximately EUR 673 thousand below fair value. As these options vested upon issue, the EUR 673 thousand has been recorded among capital reserve in the second quarter of 2006.

On 30 October 2006 following the issue of the senior PIK notes the shareholders contributed their shareholdings in Matel Holdings into Invitel Holdings as a share premium contribution. The net proceeds from the issue of the PIK notes were used by Invitel Holdings for the repurchase of certain of its shares, as a result of which Invitel Holdings is owned in equal parts by EEIF, GMT and INVITEL management.

The Cumulative translation reserve comprises all foreign exchange differences arising from the translation into EUR of the financial statements of foreign operations whose functional currency is not EUR.

The Hedging reserve includes the fair value movements of the effective portions of hedging derivatives designated as cash-flow hedges.

As at 31 December 2006 and 31 December 2005 minority interest related to the 0.02% investments held in INVITEL by local municipalities and the 0.04% investments held in Euroweb Romania by individuals.

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16. Interest Bearing Borrowings

(in thousands of EUR)	At 31 December 2006	2005
Current Portion of Interest Bearing Borrowings		
Secured bank facility loan		
- HUF	3,448	2,736
- EUR	18,329	14,401
Current Portion of Investment credit facility	2,666	
Deferred borrowing costs	(613)	(619)
	23,830	**16,518**
Interest Bearing Borrowings		
Secured bank facility loan		
- HUF	15,639	19,274
- EUR	83,129	101,457
Investment credit facility		
High yield bonds, net of discount	140,689	140,456
Deferred borrowing costs	(6,695)	(8,190)
Total Interest Bearing Borrowings	**232,762**	**252,997**

Secured Bank Facility Loan

Facilities

On 6 August 2004 INVITEL signed a multi-currency term and revolving credit facility agreement (the Facilities Agreement) with a bank syndicate, amounting to EUR 165 million (the Secured Bank Facility Loan). The transaction cost of EUR 4.4 million reduced the initial amount of the loan, and as such are included in the effective interest rate calculation.

Based on the Facilities Agreement INVITEL is provided with the following facilities. Under Facility A , INVITEL borrowed an initial amount of EUR 134,303 thousand, under Facility B , INVITEL borrowed an initial amount of HUF 6,416,533 thousand, the equivalent of EUR 25,697 thousand at the initial drawdown of the loan, under Facility C , INVITEL is provided with a revolving credit facility of (i) EUR 4,197 thousand and (ii) HUF 200 517 thousand, the equivalent of EUR 803 thousand. However the total outstanding amount of Facilities A , B and C cannot exceed the total amount of EUR 165 million. Facility C has not yet been utilized.

The current and non-current portion of the Secured Bank Facility Loan by Facility A and Facility B are detailed in the following table:

	At 31 December 2006			At 31 December 2005		
(in thousands of EUR)	Current	Non-Current	Total	Current	Non-Current	Total
Secured bank facility loan						
Facility A	18,329	83,129	101,458	14,401	101,457	115,858
Facility B	3,448	15,639	19,087	2,736	19,274	22,010

Total Secured Bank Facility Loan	**21,777**	**98,768**	**120,545**	**17,137**	**120,731**	**137,868**

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Interest

The Secured Bank Facility Loan bears a floating interest charge comprising of the applicable EURIBOR and BUBOR rate, a margin and the Mandatory Cost. The Mandatory Cost is an addition to the interest rate to compensate Lenders for the cost of compliance with (a) the requirements of the Bank of England and/or the Financial Services Authority (or, in either case, any other authority which replaces all or any of its functions) or (b) the requirements of the European Central Bank or the central bank of Hungary. The Mandatory Cost is expressed as a percentage rate per annum. It is represented to be a reasonable determination of the cost of complying with the minimum reserve requirements of the European Central Bank or (as the case may be) the central bank of Hungary in respect of loans made from that Facility Office. No Mandatory Cost has been payable since the refinancing on 6 August 2004.

From the initial utilization date of 6 August 2004 of the Secured Bank Facility Loan until the date falling twelve months after, the margin related to any interest period is a minimum of 2.25% per annum. The margin depends on the ratio of Senior Debt to Twelve Month Consolidated EBITDA (each as defined in the Facilities Agreement) ratio of Matel. The margin at 31 December 2006 is at 1.75% per annum and was 1.75% at 31 December 2005.

Interest payments are due on a monthly, quarterly or semi-annual basis depending on the decision of Matel.

The effective interest rate on the Secured Bank Facility Loan Facility A was approximately 5.61% at 31 December 2006 and approximately 5.17% at 31 December 2005. The effective interest rate on the Secured Bank Facility Loan Facility B was approximately 10.13% at 31 December 2006 and approximately 10.18% at 31 December 2005.

Repayment and maturity of the Secured Bank Facility Loan

Repayment of Facility A and B loans is made on a quarterly basis commencing from 31 December 2004 with a final repayment date of 30 June 2011. Principal repayments are made on an increasing basis.

On 15 February 2005 the Group pre-paid EUR 7, 500 thousamd (HUF 1 831 million) of the secured bank facility loan.

The remaining contractual repayments as at 31 December 2006 are as follows:

(thousands of EUR) **Year**	**Annual repayment in the % of the original outstanding amount**	**Facility A**	**Facility B**	**Total**
2007	13.65%	18,329	3,448	21,777
2008	15.84%	21,275	4,004	25,279
2009	17.55%	23,566	4,433	27,999
2010	19.98%	26,839	5,049	31,888
2011	8.53%	11,448	2,154	13,602
	75.55%	**101,457**	**19,088**	**120,545**

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Financial covenants

The Facilities Agreement prescribes certain financial covenants to be complied with on a quarterly basis. These are the following until 31 December 2007:

Total Debt to Twelve Month Consolidated EBITDA

It shall not exceed the following ratios in any periods indicated:

31 March 2007	4.25:1
30 June 2007	4.25:1
30 September 2007	4.25:1
31 December 2007	4.00:1

Senior Debt to Twelve Month Consolidated EBITDA

It shall not exceed the following ratios in any periods indicated:

31 March 2007	2.00:1
30 June 2007	1.75:1
30 September 2007	1.75:1
31 December 2007	1.75:1

Total Debt Interest Cover

It shall not be less than the following ratios in any periods indicated:

31 March 2007	2.50:1
30 June 2007	2.50:1
30 September 2007	2.75:1
31 December 2007	3.00:1

Total Fixed Charge Service Cover

It shall not be less than the following ratios in any periods indicated:

31 March 2007	1.05:1
30 June 2007	1.05:1
30 September 2007	1.05:1
31 December 2007	1.05:1

Covenants on distribution

Matel is permitted to make dividend payments, other distributions, payment of interest and prepayment of the Related Party Subordinated Loan (together distribution) from any Excess Cash-Flow as follows:

If the Total Debt to Twelve Months Consolidated EBITDA is more than 3.00:1, the Company shall apply an amount of the Excess Cash Flow as mandatory prepayment of the Secured Bank Facility Loan equal to the amount of the distribution made.

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If the Total Debt to Twelve Months Consolidated EBITDA is less than 3.00:1, no mandatory prepayment of the loan is required however the amount that can be distributed is limited to 50% of the Excess Cash-Flow.

The Group was in compliance with all covenants as at 31 December 2006.

Guarantee and security

The obligations of INVITEL, as the primary borrower of the Secured Bank Facility Loan, are guaranteed on a senior basis by Matel and V-Holding.

In accordance with the Facilities Agreement a Floating Charge has been registered on all the assets of the Group in the Register of Charges by the Hungarian Chamber of Notaries. The maximum amount of the charge is EUR 165 million plus costs, charges and expenses pursuant to the Facilities Agreement.

Furthermore, Matel established a Security Deposit of its shares in INVITEL and V-Holding to secure all the obligations of the Group towards the lenders of the Secured Bank Facility Loan, and Matel Holdings established a Security Deposit of its shares in Matel.

In addition a pledge was established on all present and future bank accounts of the Group, the maximum principal amount of which is EUR 165 million plus costs, charges and expenses as stipulated in the Facilities Agreement to secure obligations.

High Yield Bonds

On 6 August 2004, Matel issued high yield bonds (the HY Bonds), in the aggregate principal amount of EUR 142 million. The issue was at 98.682% of the face value and resulted in cash proceeds of EUR 140.1 million. The cost of issuance of EUR 6.7 million has been deferred over the term of the HY Bonds, using the effective interest rate method.

The HY Bonds bear a fixed interest charge of 10.75%, payable on a semi-annual basis on 15 February and 15 August each year. The final maturity of the HY Bonds is on 15 August 2012. The HY Bonds were first listed on the Luxembourg Stock Exchange on 24 August 2005. The quotes can be found on the official website of the Luxembourg Stock Exchange under security label MagyTel .

The effective interest rate on the HY Bond was approximately 12% as at 31 December 2006 and 31 December 2005.

Redemption option

At the option of Matel, it may redeem some or all of the HY Bonds on or after 15 August 2008 at the redemption prices as follows, plus accrued and unpaid interest:

Year	Redemption price
2008	105.375%
2009	103.583%
2010	101.792%
2011 and thereafter	100.000%

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At any time prior to 15 August 2008, Matel may redeem some or all of the HY Bonds at a redemption price equal to 100% of their principal amount plus a make-whole premium, together with accrued and unpaid interest up to the redemption date. In addition, at any time prior to 15 August 2007 Matel may redeem up to 35% of the aggregate principal amount of the HY Bonds at a redemption price of 110.75% of their principal amount, plus accrued and unpaid interest, if any to the redemption date, if a certain public equity offering occurs. The make-whole premium (Applicable Redemption Premium) means, with respect to any HY Bond on any redemption date, the excess of: a) the present value at such redemption date of (x) the redemption price of such HY Bond at August 15, 2008 (according to the table Redemption Options on or after 15 August 2008, plus (y) all required interest payments that would otherwise be due to be paid on such HY Bond during the period between the redemption date and August 15, 2008 (excluding accrued but unpaid interest), computed using a discount rate equal to the Bund Rate at such redemption date plus 50 basis points; over b) the outstanding principal amount of the HY Bond.

The early redemption of the HY Bonds cannot occur before the discharge of the Senior Bank Facility unless the majority of the lenders previously consented.

Covenants

Limitation on debt

In accordance with the HY Bond Indenture Matel will be permitted to incur additional debt if (i) after giving effect of the incurrence of such debt and the application of the proceeds thereof, on a pro-forma basis, no default or event of default would occur or be continuing and (ii) the Consolidated Leverage Ratio for Matel would be less than 5.0 to 1.0. The Consolidated Leverage Ratio is defined as the outstanding debt of Matel on a consolidated basis to the pro forma EBITDA for the period of the most recent four consecutive fiscal quarters.

Covenants on distribution

The aggregate amount of all restricted payments, including dividends or any other distributions, principal and interest payments of the Related Party Subordinated Loan prior to any scheduled payment or maturity date, shall not exceed 50% of Matel s consolidated adjusted net income on a cumulative basis during the period beginning on the date of the Indenture and ending on the last day of the last fiscal quarter ending prior to the date of such proposed payment.

In accordance with the HY Bond indenture the aggregate amount of any other restricted payments shall not exceed EUR 8 million.

Guarantee and security

The obligations of Matel under the HY Bonds are guaranteed on a senior subordinated basis by INVITEL and V-Holding.

A security deposit over the shares of Matel in INVITEL and V-Holding, and over the funding loan from Matel to INVITEL of the proceeds from the issuance of the HY Bonds, ranking second after the security deposit established pursuant to the Facilities Agreement, the Indenture and the related inter-creditor arrangements has been established in favour of the HY Bond holders.

Matel was in compliance with all covenants as at 31 December 2006.

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Investment Credit Facility

Facilities

On 11 May 2006 INVITEL signed a EUR 9,000 thousand credit facilities agreement (the Investment Credit Facilities Agreement) with HVB Bank Hungary Zrt.

Based on the Investment Credit Facilities Agreement INVITEL is provided with the following facilities. Under the Investment Loan Facility , INVITEL was provided with a total amount of EUR 8,000 thousand facility which was available for drawdown until 31 December 2006. The Investment Loan Facility was only available for financing the acquisition of the Euroweb entities (see in Note 3). On 23 May 2006 INVITEL drew EUR 4,000 thousand of the total available amount of EUR 8,000 thousand. The remaining part was not drawn by 31 December 2006 therefore it is no longer available. Until 31 December 2006 INVITEL repaid EUR 1,334 thousand of the outstanding loan. After such repayment the outstanding balance of the Investment Credit Facility loan was EUR 2,666 thousand at 31 December 2006.

Under the Revolving Credit Facility , INVITEL was provided with a total amount of EUR 1,000 thousand facility available for general corporate purposes. The Revolving Credit Facility is available for drawdown in both EUR and HUF. As at 31 December 2006, no amount was drawn under this facility.

Interest

Both facilities bear a floating interest charge comprising of the applicable EURIBOR and BUBOR rate and a margin of 0.24% and 0.21% for the Investment Loan Facility and the Revolving Credit Facility, respectively.

An interest payment was due on 31 December 2006 on the Investment Loan Facility. Thereafter, interest is payable on a quarterly basis until maturity. On the Revolving Credit Facility interest is payable weekly, monthly or quarterly, depending on the decision of INVITEL.

The effective interest rate of the Investment Loan was 3.63% as at 31 December 2006.

Repayment and maturity of the Investment Loan

The remaining balance of the Investment Loan is repayable in two equal installments on 31 March 2007 and 30 September 2007. All amounts outstanding under the Revolving Credit Facility need to be repaid on 22 May 2007.

Guarantee and security

The Credit Facilities were provided on an unsecured basis to Matel. However INVITEL shall procure that its obligations under the Investment Credit Facilities Agreement do and will rank at least *pari passu* with all its other present and future unsecured and unsubordinated obligations. In addition INVITEL shall not permit to exist any encumbrance over all or any part of its respective present and future undertakings, assets, rights or revenues to secure or prefer any of their present and future indebtedness, other than a Permitted Encumbrance as defined in the and under the terms of the Facilities Agreement (see above).

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Deferred Borrowing Costs

The current and non-current portion of deferred borrowing costs by Facility A and Facility B and the HY Bonds are detailed in the following table:

	At 31 December 2006			At 31 December 2005		
(in thousands of EUR)	**Current**	**Non-Current**	**Total**	**Current**	**Non-Current**	**Total**
Deferred borrowing costs						
Facility A	(515)	(1,801)	(2,316)	(520)	(2,338)	(2,858)
Facility B	(98)	(345)	(443)	(99)	(447)	(546)
High Yield Bond		(4,549)	(4,549)		(5,405)	(5,405)
Total Deferred Borrowing Cost	**(613)**	**(6,695)**	**(7,308)**	**(619)**	**(8,190)**	**(8,809)**

17. Financial Instruments

Financial instruments carried on the balance sheet include cash and bank balances, investment in securities, trade and other receivables, trade payables, leases receivables and payables and borrowings. The Group also has derivative financial instruments that reduce the exposure to fluctuations in foreign currency exchange and interest rates and manage credit risk.

Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. The Group generally does not require collateral in respect of financial assets. The Group is not exposed to any significant concentration of credit risk as its customer base is widely spread.

Investments are allowed in EUR or HUF denominated securities, which are freely negotiable, marketable and (1) are rated at least AA by Standard & Poor s Corporation or Aa2 by Moody s Investor Services, Inc. or (2) are issued by the Republic of Hungary. Transactions involving derivative financial instruments are with counter-parties with whom the Group has a signed netting agreement as well as high credit ratings. Given their high credit ratings, management does not expect any counter-party to fail to meet its obligations with respect to its derivative financial instruments.

The Group has made provisions of EUR 10,269 thousand and EUR 9,167 thousand for overdue receivables at 31 December 2006 and 2005, respectively. Besides the risk on receivables the maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet. Due to the nature of the services provided by the Group there are no significant concentrations of credit risk.

Liquidity risk

In accordance with the Treasury Policy of the Company as approved by the Board of Directors, a prudent liquidity management is maintained by means of holding sufficient amounts of cash and marketable securities that are available for making all operational and debt service related payments when those become due. In addition the Company has a EUR 5 million revolving bank facility as

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part of the EUR 165 million Senior Bank Facility (see Note 16). The revolving facility can be drawn partly in euro and in Hungarian Forints until the final maturity of the Senior Bank Facility. In addition the Company has an EUR 1 million revolving facility as part of the EUR 9 million Investment Loan (see Note 16) being available for drawdown until 22 May 2007. None of the revolving facilities have been utilized yet.

The Group only invests in highly liquid assets, which are readily convertible into cash.

Interest rate risk

The Group s investments in fixed-rate debt securities and its fixed-rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The Group s investments in variable-rate debt securities and its variable-rate borrowings are exposed to a risk of change in cash flows due to changes in interest rates.

The Group is exposed to interest rate cash flow risk since a portion of the interest of its Interest Bearing Borrowings is based on variable inter-bank rates. To reduce its interest rate cash flow risk the Group entered into Interest Rate Swap Agreements based on standard ISDA agreements in which the floating EURIBOR rates were charged to swapped for fixed EUR rates.

In 2001 the Group entered into agreements with BNP Paribas Paris (BNP) and with Royal Bank of Scotland (RBS , hereinafter referred to as the 2001 Interest Rate Swap) and the total notional amount of the agreements are as follows:

31/12/2004	30/06/2005	EUR 170 million
30/06/2005	30/12/2005	EUR 155 million
30/12/2006	30/06/2006	EUR 140 million
30/06/2006	29/12/2006	EUR 120 million

Based on the agreements the floating rate of 6 month EURIBOR was swapped to a fixed rate of 5.50% from 1 January 2004 until 29 December 2006.

In March 2006 the Group continued the execution of its Hedging Program and entered into two 1 year interest rate swap agreements with BNP in order to reduce its interest rate risk the Group, for the following periods and notional amounts:

29/12/2006	30/03/2007	EUR 101 million
30/03/2007	29/06/2007	EUR 97 million
29/06/2007	28/09/2007	EUR 92 million
28/09/2007	28/12/2007	EUR 88 million

Based on the agreements the floating rate of 3 month EURIBOR has been swapped to a fixed rate of 3.43% from 1 January 2007 until 28 December 2007, thereby hedging 100% of the interest rate risk related to the EUR tranche of the Senior Bank Facility Loan (hereinafter the 2006 Interest Rate Swap) for the period of the swap agreements.

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Based on the existing hedging policy not less than 50 percent of the outstanding amount of the Secured Bank Facility Loan has to be hedged to cover interest rate risk, for the period of a minimum of two years.

	Notional amount		Fair value	
(in thousands of EUR)	**At 31 December 2006**	**At 31 December 2005**	**At 31 December 2006**	**At 31 December 2005**
Interest rate swaps	101,457	140,000	470	(3,484)

	Notional amount		Fair value	
(in thousands of EUR)	**At 31 December 2006**	**At 31 December 2005**	**At 31 December 2006**	**At 31 December 2005**
Interest rate swaps hedging	101,457	119,000	470	(2,961)
Interest rate swaps non hedging		21,000		(523)
	101,457	140,000	470	(3,484)

As described in Note 2.13 the Group, based on its review of the classification of its interest rate derivative portfolio and the putting into place of various procedures to meet the hedging requirements of IAS 39, has applied cash-flow hedge accounting for the portion designated into the hedging relationship as from 1 January 2005. 85% of the notional amount of the 2001 Interest Rate Swap has been designated into the hedging relationship. The change in the fair value of the interest rate swap is recognized as follows:

(i) 15% of the change in the fair value (portion not designated to the hedging relationship) of the interest rate swap is recognized in the income statement as net financial expense.

(ii) The effective portion of the fair value change is recognized in equity as cash-flow hedge reserve.

(iii) The remaining amount of the fair value change (ineffective portion) is recognized in the income statement as net financial expense.

Based on the measurement of hedge effectiveness as of 31 March 2005, the 2001 Interest Rate Swap was no longer considered as effective. The notional amount and the fair value thereof were classified to the non-hedging category from that date.

The 2006 Interest Rate Swap have been designated into the hedging relationship in their full amount at inception, as they are expected to effectively hedge the interest rate exposure due in 2007 due to the matching of principal terms.

Foreign currency risk

Most of the Group s recurring revenue is denominated in HUF, but its Secured Bank Facility Loan is 84% denominated in EUR and only 16% in HUF. In addition the HY Bond is also denominated in EUR, thus, the Group incurs significant foreign currency risk.

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According to the existing Hedging Policy the Group hedges at least 50 percent of the scheduled repayment of the EUR Secured Bank Facility Loan and the interest payment of the HY Bond due within the next two years. The Group uses forward exchange contracts to hedge its foreign currency risk by purchasing forward EUR contracts at a fixed price. The forward exchange contracts have maturities from 15 February 2007 to 28 December 2007.

	Notional amount		Fair value	
(in thousands of EUR)	At 31 December 2006	At 31 December 2005	At 31 December 2006	At 31 December 2005
Foreign exchange forward hedging	40,988	37,377	(2,327)	(1,536)
Foreign exchange forward non-hedging				
	40,988	37,377	(2,327)	(1,536)

As described in Note 2.13 the Group, based on its review of the classification of its foreign exchange forward portfolio and the putting into place various procedures to meet the hedging requirements of IAS 39, has applied fair value hedge accounting for the contracts designated into hedging relationships as from 1 January 2005. All forward foreign exchange contracts are stated at their fair value and the profit or loss resulting from the changes in the fair value has been recognized in the income statement as net financial expenses.

The fair value changes relating to changes in exchange rates on unrecognized firm commitments designated in fair value hedges is recognized as a derivative financial asset or liability against net financial expenses.

Reconciliation of derivative fair values

The tables below provide a reconciliation of the fair value of the derivative contracts outstanding at the reporting date to the balance sheet. As at the reporting date the fair value of derivatives were recognized in the balance sheet as Derivative Financial Instruments or as Other Non-Current Asset/Liability depending on the maturity of the contracts. As described in Note 2.13 Derivative Financial Instruments the Company applies hedge accounting since 1 January 2005. As a result the fair value of hedged items (firm commitments) is also recognized in the balance sheet as Derivative Financial Instruments or as Other Non-Current Asset/Liability depending on the maturity of the item being hedged.

	At 31 December 2006		
(in thousands of EUR)	Positive	Negative	Net
Fair value of fx forward contracts current		2,327	(2,327)
Fair value of fx forward contracts non-current			
Fair value of IRS contracts current	470		470
Fair value of IRS contracts non-current			
	470	**2,327**	**(1,857)**

	At 31 December 2005		
(in thousands of EUR)	Positive	Negative	Net

Fair value of fx forward contracts current	26	1,562	(1,536)
Fair value of fx forward contracts non-current			
Fair value of IRS contracts current		3,484	(3,484)
Fair value of IRS contracts non-current			
	26	**5,046**	**(5,020)**

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Fair value of financial instruments is presented in the balance sheet as follows:

(in thousands of EUR)	At 31 December 2006	2005
Positive fair value of fx forward contracts current		26
Positive fair value of IRS contracts current	470	
Fair value of hedged items (current)	985	355
Current Derivative Financial Instruments Assets	**1,455**	**381**

(in thousands of EUR)	At 31 December 2006	2005
Negative fair value of fx forward contracts current	2,327	1,562
Negative fair value of IRS contracts current		3,484
Fair value of hedged items (current)		11
Current Derivative Financial Instruments Liabilities	**2,327**	**5,057**

Fair values

The net carrying amounts of financial assets including cash, receivables and payables reflect reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

The market value of the bonds was 112.50%, EUR 159.8 million as at 31 December 2006 as quoted on the Luxembourg Stock Exchange.

The fair value of the Secured Bank Facility Loan approximates the carrying amounts in the financial statements due to (i) the variable interest paid on this debt being re-priced at least on a semi-annual basis and (ii) the fact that the risk premium component of the interest paid to the bank syndicate reflects the credit risk of the Company as it changes in accordance with the Senior Debt to EBITDA ratio.

The fair value of the Investment Loan Facility approximates the carrying amounts in the financial statements due to the variable interest paid on this debt being re-priced at least on a quarterly basis.

18. Other Non-Current Liabilities

(in thousands of EUR)	At 31 December 2006	2005
Fair value of interest rate swap deals		3,484
Fair value of foreign exchange forward deals		1,573
Financial lease	32	
Less amounts transferred to current liabilities		(5,057)

Total Other Non-Current Liabilities	**32**	

19. **Provisions**

	At 31 December	
(in thousands of EUR)	**2006**	**2005**
Provision for restructuring	879	
Provision for legal cases	5	22
Total Provisions	**884**	**22**

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Provision for restructuring at 31 December 2006 relates to the expected costs arising from current plans of restructuring of Euroweb Hungary in connection with its acquisition by INVITEL and relocation of its premises.

Provision for legal cases relates to ongoing legal cases with former employees. These legal cases are expected to be closed during the next two years.

The amount of provisions made approximates the expected outflows of economic benefits.

20. Accrued Expenses and Deferred Income

	At 31 December	
(in thousands of EUR)	**2006**	**2005**
Accrued expenses	8,874	7,815
Accrued interest	6,254	5,743
Deferred income	1,781	2,109
Total Accrued Expenses and Deferred Income	**16,909**	**15,667**

21. Operating Leases

Non-cancellable operating lease rentals are payable as follows:

	At 31 December	
(in thousands of EUR)	**2006**	**2005**
1 year or less	5,298	5,097
2-3 years	5,932	6,154
4-5 years	3,728	4,978
After 5 years	4,783	7,871
Total Non-cancellable Lease Rentals Payable	**19,741**	**24,100**

22. Capital Commitments

During the period ended 31 December 2006 the Group entered into several purchase contracts and commitments for future capital expenditures (including the purchase of new equipment or upgrading existing equipment).

The value of such capital commitments was EUR 1,972 thousand and EUR 2,040 thousand at 31 December 2006 and 2005, respectively in the case of INVITEL. Current projects to which such capital commitments relate to include investment in information systems and customer service related infrastructure, data and voice transmission equipment, and access network construction. Capital commitments are expected to be realized during the course of the six months.

Euroweb Romania has finance lease agreements that expire over the next three years. The future minimum lease payments arising from such finance leases are as follows: EUR 65 thousand in 2007 and EUR 32 thousand in 2008.

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As at 31 December 2006 the Group had the following outstanding payment guarantees:

(in thousands of EUR)		At 31 December 2006	
Beneficiary	**Amount**	**Maturity**	**Guarantee issuer**
Hungarotel Távközlési ZRt.	51	05/10/2007	Kereskedelmi és Hitelbank ZRt.
	51		

(in thousands of EUR)		At 31 December 2005	
Beneficiary	**Amount**	**Maturity**	**Guarantee issuer**
Einkaufs-Center Arkaden PécsKG Magyarország Fióktelep	4	31/12/2006	HVB Hungary Bank ZRt.
Magyar Telekom NyRt.	218	04/07/2006	Kereskedelmi és Hitelbank ZRt.
Magyar Telekom NyRt.	3,089	17/10/2006	Kereskedelmi és Hitelbank ZRt.
	3,311		

23. Contingencies

The Group is involved in legal proceedings in the normal course of business. Based on legal advice, management does not expect the outcome of these cases to have a material effect on the Group s financial positions.

The Group accounts for termination services provided by mobile operators at regulated interconnection rates. The mobile service providers have ongoing legal cases against the regulator with respect to such termination fees. Management of the Group believes that the outcome of such disputes will not have a significant impact on the consolidated financial statements of Matel Holdings, and accordingly no provision has been recorded in the consolidated financial statements for the possible return of amounts arising from reduced regulated interconnection rates.

24. Taxation

The Income taxes (charge) / benefit for the period comprises:

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**
Current tax	(176)	(49)

Deferred tax	(1,492)	(1,432)
Income Tax (Expense) / Benefit	**(1,668)**	**(1,481)**

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Matel Holdings is resident for tax purposes in the Netherlands Antilles. Matel Holdings is regarded as an off-shore company for taxation purposes in the Netherlands Antilles. The Company is taxed based on a tax ruling issues by local tax authorities for the period of 1 January 2003 through 31 December 2008. According to such tax ruling, income earned by the Company is taxed at the rate of 2.4% 3% and capital gains will be exempt from tax.

Matel is resident for tax purposes in the Netherlands and is subject to Dutch corporate income tax on its net worldwide income. As of 1 January 2006, the corporate income tax rate is 29.6% instead of the former rate of 31.5%. Profits up to EUR 22,689 are subject to 25.5% corporate income tax as of 1 January 2006, instead of the former rate of 27%.

Since Matel s subsidiaries are subject to the participation exemption in Article 13 of the Dutch Corporate Income Tax Act, dividends received from the subsidiaries will not be subject to Dutch corporate income tax upon meeting the relevant criteria. It is not expected that Matel will derive any significant income from its investments in its subsidiaries in Hungary.

Matel is required to remit 8.3% withholding tax on dividends paid to its shareholders. Under certain conditions, the Dutch dividend withholding tax rate would be reduced if Matel distributed dividends to its shareholders out of dividends that it has received from its subsidiaries, providing the latter have been subject to a dividend withholding tax.

INVITEL, V-Holding and Euroweb Hungary are tax residents in Hungary and are taxed at flat corporate income tax rate of 16% valid for the years 2006 and 2005. The tax basis is the adjusted unconsolidated pre-tax profits of INVITEL.

As of 1 September 2006, a new tax (the Solidarity Tax) was introduced in Hungary on top of the 16% corporate income tax. The rate of Solidarity Tax is 4%. The basis of Solidarity Tax is the unconsolidated adjusted pre-tax profit. Tax losses carried forward cannot be offset against the basis of Solidarity Tax.

Euroweb Romania is tax resident in Romania. The Romanian corporate income tax rate is 16% in 2006.

Deferred tax assets are attributable to the following items:

	Assets		**Liabilities**	
(in thousands of EUR)	**31 December 2006**	**31 December 2005**	**31 December 2006**	**31 December 2005**
Tax loss carried forward	6,300	7,256		
Other non-current financial assets		557	98	68
Interest bearing borrowings			1,374	1,328
Intangible assets	626	624	674	
Trade and other receivables				16
Provisions	173		43	83
Property, plant and equipment	21		35	60
Due diligence expenses				76
Deferred foreign exchange loss	669			
	7,789	**8,437**	**2,224**	**1,631**
Net Deferred Tax Assets	**5,565**	**6,806**		

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For the years ended 31 December 2006 and 2005

Deferred tax liabilities are attributable to the following items:

	Assets		Liabilities	
(in thousands of EUR)	**31 December 2006**	**31 December 2005**	**31 December 2006**	**31 December 2005**
Accrued Expenses and Deferred Income			118	
Reserves			20	
Provisions	23			
Other Non-Current liabilities	12			
Property, plant and equipment	43			
	78		**138**	
Net Deferred Tax Liabilities			**60**	

Deferred tax assets and liabilities are determined by the legal entities of the Group. Deferred tax is calculated at the Hungarian statutory tax rate of 16% or 20% as applicable for INVITEL and Euroweb Hungary and at the statutory tax rate of Romania of 16% in the case of Euroweb Romania.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. The Group has tax loss carry forwards in the amount of EUR 39,937 thousand at 31 December 2006. Tax loss carry forwards of EUR 921 thousand will expire in 2007 and EUR 19,858 thousand will expire in 2008. Of the tax loss carry forwards EUR 19,158 thousand is not subject to any statutory expiry limitations. Tax losses expiring in 2007 have not been provided for as deferred tax assets.

It is considered that the reduction in the cost base of the Group companies realized to date and the tax planning opportunities available to the companies, make it probable that sufficient future taxable profits will be available against which the tax loss carry forwards can be utilized.

Reconciliation of effective tax rate is as follows:

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**
Net profit / (loss) before tax	7,001	(940)
Income tax using the parent company corporate tax rate	(110)	28
Solidarity tax paid	(125)	
Effect of tax rates in foreign jurisdictions	(34)	(1,462)
Tax on non taxable income and non-deductible expenses	427	(576)
Tax losses and timing differences for which no deferred tax is recognized	(1,645)	1,131
Effect of change in tax rate	(181)	
Under / (over) provided in prior years		(602)
Income Tax (Expense) / Benefit	**(1,668)**	**(1,481)**

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25. Related Party Transactions

Related parties at 31 December 2006 include the Group s subsidiaries, as well as EEIF (AIG) and GMT as owners and key management personnel of the Group.

There were no related party transactions between the Group and related parties during the periods presented, other than disclosed earlier in these notes or described below.

EEIF and GMT provide management and consultancy services to the Group and charged EUR 517 thousand during the year ended 31 December 2006 and EUR 506 thousand during the year ended 31 December 2005 for such services. The Group had EUR 73 thousand payable at 31 December 2006, and had, no outstanding management fees payable to EEIF and GMT at 31 December 2005.

Salaries and other short-term employee benefits paid to key management personnel amounted to EUR 3,302 thousand and EUR 1,675 thousand for the year ended 31 December 2006 and 2005, respectively. Share based compensation expense recognized relating to such compensation granted to key management personnel amounted to EUR 673 thousand for the year ended 31 December 2006 (nil in 2005).

There have been no termination benefits, post-employment benefits or other long-term benefits paid to key management personnel during the periods ended 31 December 2006 and 2005. There have been no loans or guarantees provided to key management personnel during the periods ended 31 December 2006 and 2005.

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26. Segment Reporting

Transfers between segments of the Group are measured at fair value. The following table presents a summary of operating results by business segment for the year ended 31 December 2006 and 2005 :

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**
Revenue		
Mass Market Voice	77,363	89,131
Mass Market Internet	24,367	20,031
Business	54,727	44,826
Wholesale	29,528	27,355
Inter-segment elimination	(379)	
Total revenue	**185,606**	**181,343**
Cost of Sales		
Mass Market Voice	(13,715)	(12,873)
Mass Market Internet	(4,050)	(2,879)
Business	(18,208)	(11,735)
Wholesale	(21,454)	(21,423)
Inter-segment elimination	324	
Total cost of sales	**(57,103)**	**(48,910)**
Segment gross margin		
Mass Market Voice	63,648	76,258
Mass Market Internet	20,317	17,152
Business	36,519	33,091
Wholesale	8,074	5,932
Inter-segment elimination	(55)	
Total segment gross margin	**128,503**	**132,433**
Unallocated operating expenses	(54,669)	(51,473)
Unallocated depreciation and amortization	(37,955)	(49,021)
Unallocated cost of restructuring	(1,813)	(2,046)
Profit / (Loss) from operations	**34,066**	**29,893**
Depreciation and amortization		
Mass Market Voice	(23,586)	(30,057)
Mass Market Internet	(2,539)	(3,321)
Business	(7,576)	(9,457)
Wholesale	(620)	(925)
Total segment depreciation	(34,321)	(43,760)

Unallocated depreciation	(3,634)	(5,261)
Total depreciation and amortization	**(37,955)**	**(49,021)**
Impairment loss		
Mass Market Voice	(170)	(78)
Mass Market Internet	(4)	(44)
Business	(12)	(41)
Wholesale		(2)
Total impairment loss	**(186)**	**(165)**

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For the years ended 31 December 2006 and 2005

(in thousands of EUR)	At 31 December 2006	2005
Capital expenditure		
Mass Market Voice	6,934	9,845
Mass Market Internet	6,546	6,707
Business	9,149	6,194
Wholesale	1,021	949
Total capital expenditure	**23,650**	**23,695**
Assets		
Mass Market Voice	201,638	209,837
Mass Market Internet	23,642	24,537
Business	72,841	67,194
Wholesale	8,470	8,122
Inter-segment elimination	(496)	
Total segment assets	306,095	309,690
Unallocated assets	42,164	41,429
Total assets	**348,259**	**351,119**
Liabilities		
Mass Market Voice	15,368	16,318
Mass Market Internet	4,957	3,666
Business	13,490	8,206
Wholesale	6,104	5,010
Inter-segment elimination	(496)	
Total segment liabilities	39,423	33,200
Unallocated liabilities	259,053	274,621
Total liabilities	**298,476**	**307,821**

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For the years ended 31 December 2006 and 2005

The following table presents a summary of operating results of the Group by geographical segment for the period ended 31 December 2006, 2005:

(in thousands of EUR)	**For the year ended 31 December 2006**	**2005**
Revenue		
Hungary	180,562	181,343
Romania	5,423	
Inter-segment elimination	(379)	
Total revenue	**185,606**	**181,343**
Cost of Sales		
Hungary	(54,783)	(48,910)
Romania	(2,644)	
Inter-segment elimination	324	
Total cost of sales	**(57,103)**	**(48,910)**
Segment gross margin		
Hungary	125,779	132,433
Romania	2,779	
Inter-segment elimination	(55)	
Total segment gross margin	**128,503**	**132,433**
Unallocated operating expenses	(54,669)	(51,473)
Unallocated depreciation and amortization	(37,955)	(49,021)
Unallocated cost of restructuring	(1,813)	(2,046)
Profit / (Loss) from operations	**34,066**	**29,893**
Depreciation and amortization		
Hungary	(34,006)	(43,760)
Romania	(315)	
Total segment depreciation	(34,321)	(43,760)
Unallocated depreciation	(3,634)	(5,261)
Total depreciation and amortization	**(37,955)**	**(49,021)**
Impairment loss		
Hungary	(186)	(165)
Romania		
Total impairment loss	**(186)**	**(165)**

Capital expenditure		
Hungary	22,200	23,695
Romania	1,450	
Total capital expenditure	**23,650**	**23,695**

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For the years ended 31 December 2006 and 2005

(in thousands of EUR)	At 31 December 2006	2005
Assets		
Hungary	299,594	309,690
Romania	6,997	
Inter-segment elimination	(496)	
Total segment assets	306,095	309,690
Unallocated assets	42,164	41,429
Total assets	**348,259**	**351,119**
Liabilities		
Hungary	37,444	33,200
Romania	2,475	
Inter-segment elimination	(496)	
Total segment liabilities	39,423	33,200
Unallocated liabilities	259,053	274,621
Total liabilities	**298,476**	**307,821**

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27. Expenses by function

The following table presents a summary of expenses by function of the Group for the period ended 31 December 2006 and 2005:

	For the year ended 31 December	
(in thousands of EUR)	**2006**	**2005**
Revenue	**185,606**	**181,343**
Cost of sales	**(57,103)**	**(48,910)**
Depreciation and amortization	(34,321)	(43,760)
Personnel expenses	(5,915)	(4,906)
Headcount related costs	(1,250)	(1,084)
Network operating expenses	(12,275)	(12,550)
Distribution costs	**(53,761)**	**(62,300)**
Depreciation and amortization	(3,634)	(5,261)
Bad debt expense	(855)	(1,070)
Collection costs	(1,397)	(1,264)
Legal and consultant fees	(74)	(394)
Consultant expenses	(644)	
Advertising and marketing costs	(3,094)	(2,591)
Personnel expenses	(16,353)	(14,606)
Headcount related costs	(5,790)	(6,390)
IT costs	(3,821)	(3,533)
Cost of reorganization	(1,813)	(2,046)
Due diligence expense	(425)	(184)
Capitalised costs	1,972	2,069
Administrative expenses	**(35,928)**	**(35,270)**
Management fee	(576)	(644)
Local operating and other taxes	(3,711)	(4,394)
Other costs, net	(461)	68
Other expenses	**(4,748)**	**(4,970)**
Profit from operations	**34,066**	**29,893**

28. First Time Adoption of IFRS

These financial statements are Matel Holding s first consolidated financial statements prepared in accordance with IFRS. The comparatives presented in these financial statements are the comparatives presented in Matel Holdings financial statements for the year ended 31 December 2006 (see Note 2.1).

Matel Holdings prepared annual financial statements in accordance with IFRS for the first time for the year ended 31 December 2006, although Matel, the 100% subsidiary of Matel Holdings had prepared consolidated financial statements under IFRS in previous years.

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For the years ended 31 December 2006 and 2005

The accounting policies set out in Note 2 have been applied in preparing the annual financial statements of Matel Holdings for the year ended 31 December 2006, the comparative information presented in these financial statements for the year ended 31 December 2005 and in the preparation of an opening IFRS balance sheet at 1 January 2005 (the date of transition of Matel Holdings).

When preparing its IFRS opening balance sheet as of 1 January 2005, Matel Holdings elected to use the exemption provided by IFRS 1 not to restate the acquisition of Matel as the business combination which occurred before the date of transition to IFRS. Therefore, assets and liabilities of Matel are recognized and measured in the opening IFRS balance sheet of Matel Holdings at the amounts reflected in Matel s IFRS balance sheet as at 1 January 2005. Deemed goodwill was calculated by comparing the cost of the initial investment in the separate financial statements of Matel Holdings to the net assets of Matel under IFRS at the date of transition and as a result negative goodwill of EUR 31,395 thousand was recorded against retained earnings in the opening IFRS balance sheet of Matel Holdings.

29. Subsequent Events

On 9 January 2007 Invitel Holdings signed an agreement with Hungarian Telephone and Cable Corp. (HTCC) to sell 100% of its share in Matel Holdings and thereby indirectly 99.98% of the shares of INVITEL for a total consideration, including the assumption of net indebtedness on closing, of EUR 470 million. The transaction is subject to customary closing conditions including receipt of Hungarian and Romanian regulatory approvals and is expected to close in the first half of 2007.

On 20 April 2007 HTCC received the necessary approvals from the Hungarian Competition Office and the Romanian regulatory authorities relating to the Acquisition.

Floating Rate Senior Notes

On 27 April 2007, HTCC Holdco II B.V. (HTCC Holdco II), a 100% subsidiary of HTCC issued Floating Rate Senior Notes (the 2007 Notes), in the aggregate principal amount of EUR 200 million (the Offering).

The gross proceeds from the Offering were loaned partly to PanTel and Hungarotel (subsidiaries of HTCC) in order to refinance indebtedness of such subsidiaries (the Proceeds Loans) and were partly used to finance the Acquisition.

On 27 April 2007 HTCC completed the Acquisition of Matel Holdings. Upon completion of the Acquisition, HTCC Holco I, a 100% subsidiary of HTCC and the 100% owner of HTCC Holdco II acquired all of the outstanding shares of Matel Holdings, Matel s 100% parent company. Concurrently with the consummation of the Acquisition, HTCC Holdco II transfered to Matel substantially all of its assets, consisting of equity interests in Hungarotel, PanTel and PanTel Technocom. In consideration for the transfer of such assets by HTCC Holdco II to Matel, Matel assumed all of the indebtedness and other obligations of HTCC Holdco II under the 2007 Notes.

The issue was at face value and resulted in cash proceeds of EUR 200 million. The cost of issuance of EUR 21 million will be deferred over the term of the 2007 Notes and will be recognised in the income statement using the effective interest rate method.

Application has been made to list the 2007 Notes to the Official List of the Luxembourg Stock Exchange and to trade the Notes on the Euro MTF, the alternative market of the Luxembourg Stock Exchange.

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The 2007 Notes bear a variable interest charge of EURIBOR plus 3.0%. Interest on the 2007 Notes will accrue from the date of issuance and will be payable quarterly in arrears on 1 February, 1 May, 1 August and 1 November of each year, beginning on 1 August 2007. The final maturity of the 2007 Notes is on 1 February 2013.

PIK Notes

On 27 April 2007, in connection with the closing of the Acquisition, HTCC Holdco I entered into a supplemental bond indenture with Invitel Holdings as issuer and the Bank of New York as trustee relating to the PIK Notes (the PIK Indenture). Pursuant to the PIK Indenture, HTCC Holdco I replaced Invitel Holdings as the issuer of the PIK Notes and assumed all of the rights and obligations of the issuer.

Secured Bank Facility Loan

On 27 April 2007, in connection with the closing of the Acquisition, an amendment was made to the Facilities Agreement between Matel, INVITEL as borrower, certain Group companies as original guarantors, BNP Paribas and Credit Suisse First Boston International as arrangers, certain banks and financial institutions as original lenders, BNP Paribas as agents and BNP Paribas Trust Corporation UK Limited as security trustee. The Amended Facilities Agreement provides facilities of up to EUR 145 million, comprised of (i) an euro amortizing Term Loan of EUR 96.9 million, (ii) a Hungarian Forint amortizing Term Loan of HUF 4 628 million (approximately EUR 18 million, (iii) a Revolving Facility of EUR 4.2 million and HUF 200 million (approximately EUR 800 thousand), and (iv) an euro Liquidity Facility of EUR 25 million. Neither the Revolving Facility in item (iii) nor the Liquidity Facility in item (iv) were drawn down in connection with the Acquisition.

Intercreditor agreement

In order to reflect the new obligations under the 2007 Notes and hedging obligations and to establish the relative rights of certain of its creditors under the new financing arrangements described above, Hungarotel, PanTel and PanTel Technocom joined the Intercreditor Agreement with, among others, the lenders under the Amended Facilities Agreement, certain hedging counterparties, the security trustee, the trustee for the holders of the 2007 Notes and the trustee for the High Yield Bonds. The Intercreditor Agreement provides that if there is inconsistency between the provisions of the Intercreditor Agreement (regarding subordination, turnover, ranking and amendments only), and certain documents, including the Indenture governing the 2007 Notes, the Intercreditor Agreement will prevail.

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30. Reconciliation between International Financial Reporting Standards (IFRS) to United States Generally Accepted Accounting Principles (US GAAP)

The Company s consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, which differ in certain respects from US GAAP. The principal differences between IFRS and US GAAP are presented below, together with explanations of the adjustments that affect consolidated net profit for the years ended 31 December 2006 and 2005 and total shareholder s equity as of 31 December 2006 and 2005.

		For the year ended 31 December	
	Note	**2006**	**2005**
Net profit / (loss) attributable to equity holders of the parent under IFRS		5,331	(2,421)
Net profit / (loss) attributable to minority interest under IFRS	a	2	
Net profit / (loss) for the period under IFRS		**5,333**	**(2,421)**
Adjustments for US GAAP			
Business Combinations			
Fair value adjustments	b	2,048	13,334
Restructuring charges and cost of business acquisition	b	1,170	
Revenue recognition	c	(31)	(18)
Capitalization of interest expense	d	320	124
Push-down of PIK Notes	e	(2,741)	
Embedded derivatives	f	579	243
Subscriber acquisition costs	g	(129)	(571)
Tax effect of US GAAP adjustments	h	(167)	(2,098)
Total US GAAP adjustments on net profit / (loss) for the period		**1,049**	**11,014**
Net profit / (loss) for the period under US GAAP		**6,382**	**8,593**
Net profit / (loss) attributable to equity holders of the parent (net income or loss) under US GAAP		6,380	8,593
Net profit / (loss) attributable to minority interest under US GAAP		2	
Other comprehensive income		67	601
Total comprehensive income		**6,449**	**9,194**

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	Note	As at 31 December 2006	2005
Shareholders equity under IFRS		49,767	43,284
Minority interest under IFRS	a	16	14
Total equity under IFRS		**49,783**	**43,298**
Adjustments for US GAAP			
Business Combinations			
Fair value adjustments	b	(4,906)	(6,954)
Restructuring charges and cost of business acquisition	b	1,170	
Revenue recognition	c	(1,124)	(1,093)
Capitalization of interest expense	d	465	145
Push-down of PIK Notes	e	(121,804)	
Embedded derivatives	f	1,642	1,063
Subscriber acquisition costs	g	24	153
Tax effect of US GAAP adjustments	h	866	1,033
Other comprehensive income		395	182
Total US GAAP adjustments to total equity		**(123,272)**	**(5,471)**
Minority interest under US GAAP		(16)	(14)
Total equity under US GAAP		**(73,505)**	**37,813**

Notes to the US GAAP Reconciliation

Note (a): Minority Interest

In contrast to IFRS, minority interests are deducted in the determination of US GAAP net income and excluded from total equity. Therefore, adjustments were recorded to decrease total equity for EUR 16 thousand and EUR 14 thousand as of 31 December 2006 and 2005, respectively.

Note (b): Business Combinations

Purchase Price Allocation

Matel was acquired by Matel Holdings on 23 May 2003. For IFRS purposes, no push-down accounting is required and as a consequence no fair value adjustments were recorded to the book value of assets at the date of acquisition.

US GAAP requires the cost of acquiring the business to be allocated to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. Any excess of purchase cost over the fair values assigned to the acquired net assets is reported as goodwill. If the fair value assigned to the acquired nets assets is greater than the purchase cost the negative goodwill reduces the long term assets proportionately. The remaining negative goodwill, if any, is then written off to the income statement. Under US GAAP such purchase accounting adjustments are required to be pushed down in the separate financial statements of the acquired entity.

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Matel Holdings NV

Notes to the Consolidated Financial Statements

For the years ended 31 December 2006 and 2005

Application of US GAAP under SFAS 141 and 142 require Matel to identify, measure and to separately account for intangible assets such as licenses and customer relationships. For this purpose, independent valuations were prepared on the assets and liabilities of Matel at the date of acquisition using estimates and assumptions provided by management. Resulting fair value adjustments were recorded under US GAAP.

As a result of the above purchase price allocation and fair value adjustments, differences in the amortization of intangible assets in the income statement were EUR 2,048 thousand and EUR 13,334 thousand for the years ended 31 December 2006 and 2005, respectively.

Debt Issuance Costs

In connection with the acquisition of Matel in 2003, Matel s debt was refinanced. Under IFRS the refinancing was considered to be an extinguishment of debt and accordingly, the prior debt issuance costs were written-off to financial expenses upon refinancing. Under US GAAP such costs were included in the 2003 purchase price allocation in accordance with EITF 98-1 *Valuation of Debt Assumed in a Purchase Business Combination* . As a result Matel capitalized debt issuance costs relating to its 2003 acquisition as part of the purchase price allocation discussed above.

Restructuring Charges and Costs of Business Combination

During Matel s acquisition by Matel Holdings in 2003, Matel recorded restructuring expenses for costs of headcount reduction and costs relating to the change in ownership. Under EITF 95-3 *Recognition of Liabilities in Connection with a Purchase Business Combination* , involuntary termination of employees and relocation of employees should be recognized as liabilities assumed in a purchase combination and included in the purchase price allocation if the costs meet the qualifying criteria.

In addition, under FASB Statement No. 141 *Business Combinations* (FAS 141), the direct external costs of business combinations include direct out-of-pocket costs or incremental costs that are related to the business combination and should also be part of the purchase price allocation. Based on the guidance in EITF 95-3 and FAS 141, Matel capitalized restructuring charges and costs of business combination during purchase accounting relating to its 2003 acquisition as part of the purchase price allocation described above. All amounts capitalized for restructuring charges were utilized in full by the first quarter of 2004.

In addition, during the acquisition of Euroweb Hungary in 2006 by INVITEL, a restructuring provision was recorded against income under IFRS relating to a real-estate lease, where early termination was planned and severance payments for redundant employees. As stated above, EITF 95-3 requires that the costs of a plan to exit an activity and involuntarily terminate employees of an acquired company to be recognized as liabilities assumed in a purchase business combination and included in the allocation of the acquisition cost if specific criteria were met. The specific criteria were met at the time of the acquisition of Euroweb Hungary. Based on this guidance, a US GAAP adjustment was recorded to equity to capitalize these costs during purchase accounting in the amount of EUR 1,170 thousand.

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Matel Holdings NV

Notes to the Consolidated Financial Statements

For the years ended 31 December 2006 and 2005

Note (c): Revenue Recognition

Under IFRS, connection fee revenue, which are fees charged to customers when they order voice, data and Internet services to connect them to the network and for the associated equipment, is recorded to income when invoiced. The directly related costs of customer connections are capitalized and amortized over the expected customer relationship period. US GAAP requires both the connection fee revenue and the associated costs to be recognized over the expected customer relationship period. As the directly associated costs relating to the connection revenue are already capitalized and amortized under IFRS, the Company recorded a net US GAAP adjustment decreasing profit before tax in the amount of EUR 31 thousand and EUR 18 thousand for the years ended 31 December 2006 and 2005, respectively to give effect to the deferral of such revenue over the expected customer relationship period, net of the amortization of connection fees deferred in prior periods.

At 31 December 2006 and 2005 the Company had deferred revenue relating to connection fees of EUR 1,124 thousand and EUR 1,093 thousand, respectively.

Note (d): Capitalization of Interest Expense

Under both IFRS IAS 38 *Intangible Assets*, and US GAAP SOP 98-1 *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, costs were capitalized during the previous three years for the development of a billing system. However, under IFRS no interest has been capitalized based on the policy choice available under IFRS. US GAAP FAS 34 *Capitalization of Interest Costs*, requires interest to be capitalized, if material, when borrowings are outstanding and an extended period of time is required to get the assets ready for their intended use regardless of whether the borrowings were taken directly for capital investment projects. The criteria of FAS 34 has been meet for the software assets relating to the billing system and US GAAP adjustments to capitalize interest have been recorded accordingly.

The Company capitalized interest expense under US GAAP amounting to EUR 320 thousand and EUR 124 thousand under US GAAP for the years ended 31 December 2006 and 2005, respectively. Equity is increased by EUR 465 thousand and EUR 145 thousand at 31 December 2006 and 2005, respectively, as a result of capitalizing qualifying interest expense under US GAAP.

Note (e): Push-Down of PIK Notes

In October 2006, Invitel Holdings issued EUR 125 million of PIK Notes due in 2013. The PIK Notes are secured by the shares of Matel Holdings and are subordinated to all existing and future borrowings of the Group and allow for interest to be paid in the form of additional notes or cash. Under IFRS, the PIK Notes are shown in the financial statements of Invitel Holdings and are not pushed down to Matel. However, under US GAAP, SAB Topic 5J, certain circumstances exist that require the debt of the holding company to be pushed down to a subsidiary.

Matel Holdings shares are collateral for the PIK Notes and as part of the anticipated acquisition of Matel Holdings by HTCC the PIK Notes will become part of the obligations of HTCC. Therefore, the Group applied push-down accounting with respect to the PIK Notes and related interest charges and recorded an adjustment under US GAAP to net profit of EUR 2,741 thousand for the year ended 31 December 2006 and an adjustment to recognize the liability and decrease equity of EUR 121,804 thousand at 31 December 2006.

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Matel Holdings NV

Notes to the Consolidated Financial Statements

For the years ended 31 December 2006 and 2005

Note (f): Embedded Derivatives

The revised interpretation of IAS 39 *Financial Instruments: Recognition and Measurement* , does not consider contracts denominated in a currency that is not the functional currency of either of the contracting parties as a separable host contract and embedded derivative if the contract s currency is widely used in that market. Therefore, under IFRS, the Company has not recognized or re-measured contracts where the currency of the contract is not in the functional currency of either of the contracting parties but widely used when providing services covered by the contract. However, under FASB Statement No. 133 *Accounting for Derivative Instruments and Hedging Activities* , the existence of a currency that is not the functional currency of either contracting party may require derivative accounting to be applied. Based on the above, US GAAP adjustments were recorded to IFRS to account for the contracts that met the criteria of an embedded derivative under FAS 133. The Company recorded adjustments to IFRS to recognize and re-measure the contracts to fair value, which resulted in an increase to net profit of EUR 579 thousand and EUR 243 thousand for the years ended 31 December 2006 and 2005, respectively. Total equity was increased by EUR 1,642 thousand and EUR 1,063 thousand at 31 December 2006 and 2005, respectively relating to the cumulative effects of recording the embedded derivatives in accordance with US GAAP.

Note (g): Subscriber Acquisition Costs

During 2006 and 2005 the Company capitalized subscriber acquisition costs which are directly related to customer contracts in accordance with IAS 38 *Intangible Assets* , and amortizes these costs over the life of the contract or expected customer relationship period. Such costs were not capitalized in 2004 under IFRS. The guidance under US GAAP supports the capitalization of such costs and no differences were determined between IFRS and US GAAP relating to the capitalization of subscriber acquisition costs. As 2004 costs were not capitalized under IFRS an adjustment to capitalize these costs under US GAAP was recorded. As a result, equity was increased by EUR 24 thousand and EUR 153 thousand at 31 December 2006 and 2005, respectively. The related amortization of subscriber acquisition costs capitalized under US GAAP in 2004 was charged to the income statement and net profit was decreased by EUR 129 thousand and EUR 571 thousand for the years ended 31 December 2006 and 2005, respectively.

Note (h): Tax Effect of US GAAP Adjustments

The tax effect of US GAAP adjustments represent the temporary differences created as a result of applying US GAAP.

Cash Flow Statement

Under IFRS, the Company prepares and reports financial information on its cash flows under IAS 7 *Cash Flow Statements* . Since the information is required under IAS 7 is similar to the content and presentation of cash flow information prepared under US GAAP under FASB Statement No. 95 *Statement of Cash Flows* , no additional information or different presentation is required of cash flow information for the Company.

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Matel Holdings NV

Notes to the Consolidated Financial Statements

For the years ended 31 December 2006 and 2005

Recently Issued Accounting Pronouncements

Effective 1 January 2006, we adopted SFAS No. 123(R), Share-Based Payment (SFAS 123(R)), which revises SFAS No. 123, Accounting for Stock-Based Compensation.

In May 2005, the Financial Accounting Standards Board (FASB), as part of an effort to conform to international accounting standards, issued SFAS No. 154 *Accounting Changes and Error Corrections* (SFAS 154), which was effective for us beginning on 1 January 2006. SFAS 154 requires that all voluntary changes in accounting principles be retrospectively applied to prior financial statements as if that principle had always been used, unless it is impracticable to do so. When it is impracticable to calculate the effects on all prior periods, SFAS 154 requires that the new principle be applied to the earliest period practicable. The adoption of SFAS 154 did not have a material effect on our financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48 *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109, Accounting for Income Taxes* (FIN 48), which clarifies the accounting for uncertainty in income taxes. FIN 48 establishes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 are effective beginning 1 January 2007, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the effect that the adoption of FIN 48 will have on its consolidated results of operations and financial position or cash flows.

In September 2006, the FASB issued SFAS Statement No. 157 *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. This Statement applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after 15 November 2007, and interim periods within those years. Earlier application is encouraged, provided the entity has not yet issued financial statements, including financial statements for any interim period for that fiscal year. The Company is currently evaluating the effect that the adoption of SFAS 157 will have on its consolidated results of operations and financial position or cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective for companies with fiscal years ending after 15 November 2006 and is required to be adopted by the Company in its fiscal year ending 31 December 2006. The adoption of SAB 108 did not have a material effect on our financial position or results of operations.

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MAGYAR TELECOM BV

CONSOLIDATED

INTERIM FINANCIAL STATEMENTS

FOR THE THREE MONTH PERIOD ENDED 31 MARCH 2007

(PRESENTED IN EUROS)

(unaudited)

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Magyar Telecom BV

CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(unaudited)

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Magyar Telecom BV

Consolidated Interim Balance Sheet

As at 31 March 2007

(in thousands of EUR)	**Notes**	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Non-Current Assets			
Intangible Assets	10	32,867	31,964
Property, Plant and Equipment	11	274,623	273,391
Other Non-Current Financial Assets, including Derivatives		138	106
Deferred Tax Assets	23	4,488	5,565
		312,116	311,026
Current Assets			
Cash and Cash Equivalents	12	8,058	13,608
Trade and Other Receivables	13	18,672	20,995
Derivative Financial Instruments	16	1,460	1,455
Inventories		460	367
Prepayments and Accrued Income		1,130	789
		29,780	37,214
Total Assets		**341,896**	**348,240**
Equity and Liabilities			
Equity attributable to equity holders of the parent			
Share Capital	14	92,201	92,201
Capital Reserve	14	122,110	122,110
Hedging Reserve	14	345	376
Cumulative Translation Reserve	14	(32,827)	(34,308)
Accumulated Losses		(145,094)	(149,170)
		36,735	**31,209**
Minority Interest		17	16
Total Equity		**36,752**	**31,225**
Non-Current Liabilities			
Interest Bearing Borrowings	15	246,104	251,342
Other Non-Current Liabilities	17	273	32
Deferred Tax Liabilities	13	100	60
		246,477	251,434
Current Liabilities			
Current Portion of Interest-Bearing Borrowings	15	23,322	23,830
Trade and Other Payables		18,465	21,653
Derivative Financial Instruments	16	2,624	2,327

Accrued Expenses and Deferred Income	19	13,320	16,887
Provisions	18	936	884
		58,667	65,581
Total Liabilities		**305,144**	**317,015**
Total Equity and Liabilities		**341,896**	**348,240**

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

Magyar Telecom BV

Consolidated Interim Income Statement

For the three month period ended 31 March 2007

(unaudited)

(in thousands of EUR)	**Notes**	**For the three months ended 31 March 2007**	**2006** *As Restated (Note 2.2.1)*
Revenues	3	49,270	43,128
Cost of Sales	4	(15,296)	(11,301)
Gross Margin		**33,974**	**31,827**
Operating Expenses	5	(13,471)	(11,987)
Depreciation and Amortization	7	(10,107)	(9,217)
Cost of Restructuring	8	(162)	(184)
Profit / (Loss) from Operations		**10,234**	**10,439**
Financial Income	9	2,877	3,419
Financial Expenses	9	(6,883)	(24,270)
Net Profit / (Loss) Before Tax		**6,228**	**(10,412)**
Income Tax (Expense) / Benefit	23	(2,151)	1,256
Net Profit / (Loss) for the Period		**4,077**	**(9,156)**
Attributable to:			
Equity Holders of the Parent		4,076	(9,153)
Minority Interest		1	(3)
		4,077	**(9,156)**

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

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Magyar Telecom BV

Consolidated Interim Cash Flow Statement

For the three month period ended 31 March 2007

(unaudited)

(in thousands of EUR)	**Notes**	**For the three months ended 31 March 2007**	**2006**
Cash Flows from Operating Activities			
Net Profit / (Loss) Before Tax		6,228	(10,412)
Adjustments for Non-Cash Items:			
Interest Expense / (Income)		6,482	6,044
Depreciation and Amortization	7,10,11	10,107	9,217
Fair Value of Derivative		248	(1,965)
Allowance for bad and doubtful debts	13	66	328
Provisions	18	52	17
Change in Investment in Associates			
Unrealized Foreign Exchange (Gain) / Loss		(3,580)	16,926
Other Non-Cash Items		278	820
Working Capital Changes:			
Change in Trade and Other Receivables	13	2,257	1,602
Change in Inventories		(93)	(122)
Change in Prepayments and Accrued Income		(338)	(153)
Change in Trade and Other Payables and Accrued Expenses and Deferred Income		(2,486)	(3,395)
Result of Sale of Property, Plant and Equipment	11	(113)	(3)
Result of Sale of Intangible Assets	10		
Income Taxes		(967)	(627)
Interest Paid		(10,010)	(9,375)
Net Cash Flow Provided by / (Used in) Operating Activities		**8,131**	**8,902**
Cash Flows from Investing Activities			
Purchase of subsidiaries, net of cash acquired			
(Purchase) / Disposal of Trading Investments, Net			
Purchase of Intangible Assets	10	(2,608)	(1,810)
Purchase of Property, Plant and Equipment	11	(5,049)	(4,636)
Proceeds from Sale of Property, Plant and Equipment	11	182	13
Proceeds from Sale of Intangible Assets	10		
Interest Received		169	363
Net Cash Flow Provided by / (Used in) Investing Activities		**(7,306)**	**(6,070)**
Cash Flows from Financing Activities			
Proceeds from Issue of High Yield Bonds, Net of Discount and Bond Issue Costs			
Proceeds from Interest Bearing Borrowings	15		
Repayment of Related Party Subordinated Loan	15		
Repayments of Interest Bearing Borrowings	15	(6,791)	(3,857)
Net Cash Flow Provided by / (Used in) Financing Activities		**(6,791)**	**(3,857)**

Effect of Exchange Rate Changes on Cash and Cash Equivalents		416	(2,644)
Net Increase / (Decrease) in Cash and Cash Equivalents		**(5,550)**	**(3,669)**
Cash and Cash Equivalents at the Beginning of the Year	12	13,608	29,112
Cash and Cash Equivalents at the End of the Period		**8,058**	**25,443**

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

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Magyar Telecom BV

Consolidated Interim Statement of Changes in Shareholders Equity

For the three month period ended 31 March 2007

(unaudited)

Attributable to equity holders of the parent

(in thousands of EUR)	Notes	Share Capital	Capital Reserve	Hedging Reserve	Cumulative Translation Reserve	Accumulated Losses	Total	Minority interest	Total Shareholders Equity
Balance as at 31 December 2005		**92,201**	**121,437**	**(21)**	**(34,389)**	**(152,934)**	**26,294**	**14**	**26,308**
Cash flow hedges:	16								
Effective portion of change in fair value of cash flow hedges				57			57		57
Net change in fair value of cash flow hedges transferred to profit / loss				21			21		21
Transferred to initial carrying amount of hedged items									
Translation adjustment for the period					(2,792)		(2,792)		(2,792)
Tax on items taken directly to or transferred from equity									
Net income recognized directly in equity				78	(2,792)		(2,714)		(2,714)
Net result for the period						(9,153)	(9,153)	(3)	(9,156)
Total recognized income and expense for the period				78	(2,792)	(9,153)	(11,867)	(3)	(11,870)
Balance as at 31 March 2006		**92,201**	**121,437**	**57**	**(37,181)**	**(162,087)**	**14,427**	**11**	**14,438**
Balance as at 31 December 2006		**92,201**	**122,110**	**376**	**(34,308)**	**(149,170)**	**31,209**	**16**	**31,225**
Cash flow hedges:	16								
Effective portion of change in fair value of cash flow hedges				432			432		432
Deferred tax on fair value of cash flow hedges				(87)			(87)		(87)
Net change in fair value of cash flow hedges transferred to profit / loss				(376)			(376)		(376)
Transferred to initial carrying amount of hedged items									
Translation adjustment for the period					1,481		1,481		1,481
Tax on items taken directly to or transferred from equity									
Net income recognized directly in equity				(31)	1,481		1,450		1,450
Net result for the period						4,076	4,076	1	4,077
Total recognized income and expense for the period				(31)	1,481	4,076	5,526	1	5,527
Employee share option scheme									

Balance as at 31 March 2007	**92,201**	**122,110**	**345**	**(32,827)**	**(145,094)**	**36,735**	**17**	**36,752**

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

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Magyar Telecom BV

Notes to the Unaudited Consolidated Interim Financial Statements

1. General Information

Magyar Telecom B.V. (Matel or the Company) was incorporated in the Netherlands on 17 December 1996 as a limited liability company and has its statutory seat in Amsterdam (Laan Kronenburg 8, 1183 Amstelveen, The Netherlands).

Matel is engaged in telecommunication related activities in Hungary and in Romania, primarily through its telecommunications service provider, INVITEL ZRt. (INVITEL) and other service companies, such as EuroWeb Internet Szolgáltató ZRt. and EuroWeb Romania S.A. (collectively, Euroweb), providing Internet access and value added services. The consolidated interim financial statements for the period ended 31 March 2007 comprise of Matel and its subsidiaries (collectively, the Group). These interim financial statements are prepared to satisfy certain external reporting requirements but are not intended for statutory filing purposes.

Matel, through its subsidiary INVITEL is the incumbent provider of fixed line telecommunications services to residential and business customers in the geographical areas where it had exclusive licenses through the end of 2002 representing approximately 14% of Hungary s population (historical concession areas). The Group also provides fixed line telecommunications services in the remainder of Hungary as an alternative telecommunications operator.

Matel issued High Yield Bonds on 6 August 2004 that were listed on the Luxembourg Stock Exchange on 24 August 2005 (See Note 15).

Shareholders

The 100% shareholder of Matel is Matel Holdings N.V. (Matel Holdings). Matel Holdings was incorporated on 27 December 2000 under the laws of the Netherlands Antilles and has its statutory seat under Kaya W.F.G. Mensing 14, Curacao, The Netherlands Antilles. Matel Holdings is 100% owned by Invitel Holdings N.V. (Invitel Holdings). Invitel Holdings was incorporated in the Netherlands Antilles on 10 October 2006 as a limited liability Company and has its statutory seat under 45 Pareraweg Willemstad, Curacao the Netherlands Antilles.

Invitel Holdings was jointly owned by EEIF (Matel) B.V. (33.33%), GMT (Matel) B.V. (33.33%) and the remainder by certain management personnel of INVITEL. EEIF (Matel) B.V. is owned by AIG Emerging Europe Infrastructure Fund LP and Emerging Europe Infrastructure Fund CV (AIG) and GMT (Matel) B.V. is owned by funds managed by GMT Communications Partners Limited (GMT). AIG is now advised by Emerging Markets Partnership (EMP), which is a private equity investment firm focused on Central and Eastern Europe. GMT is a private equity investment group focusing on the communications sector in Europe.

EEIF (Matel) B.V. and GMT (Matel) B.V. indirectly acquired Matel on 13 May 2003 from Vivendi Telecom International S.A.

On 9 January 2007 Invitel Holdings signed an agreement with Hungarian Telephone and Cable Corp. (HTCC) to sell 100% of its share in Matel Holdings and thereby indirectly 99.98% of the shares of INVITEL (the Acquisition) for a total consideration, including the assumption of net indebtedness on closing, of EUR 470 million (see Note 27).

Magyar Telecom BV

Notes to the Unaudited Consolidated Interim Financial Statements

Subsidiaries

INVITEL (former name: Vivendi Telecom Hungary Rt. or VTH Rt.) was incorporated on 20 September 1995 as a joint stock company under the laws of Hungary. The authorized share capital of INVITEL is HUF 20,000,000,000 (approximately EUR 80 million).

The shareholders of INVITEL are Matel (91.68%) and 38 municipalities (in an aggregate of 0.02%) with INVITEL holding 8.30% of its own shares.

INVITEL as the principal operating company of the Group provides mass-market voice and Internet services to residential customers and voice, data and Internet services to business customers as well as wholesale services to other telecommunications operators.

INVITEL primarily operates in nine geographical areas in Hungary, which comprise Szeged, Szentes, Gödöllo, Vác, Jászberény, Dunaújváros, Esztergom, Veszprém and Szigetszentmiklós and continues to expand its activities outside these historical concession areas.

EuroWeb Internet Szolgáltató ZRt. (Euroweb Hungary) was incorporated on 2 January 1997 as a joint stock company under the laws of Hungary. The authorized share capital of Euroweb Hungary is HUF 20,000,000 (approximately EUR 80 thousand). The 100% shareholder of Euroweb Hungary is INVITEL.

EuroWeb Romania S.A. (Euroweb Romania) is domiciled in Romania and was registered with the Romanian Trade Register as a joint-stock company in March 1998 and commenced activities in November 1998. The authorized share capital of Euroweb Romania is RON 3,207,383 (approximately EUR 1,600 thousand). The shareholders of Euroweb Romania are INVITEL (99.96%) and individuals (0.04%).

V-Holding ZRt. (V-Holding) was incorporated on 1 April 1999 as a joint stock company under the laws of Hungary. The authorized share capital of V-Holding is HUF 28,000,000 (approximately EUR 112 thousand). The shareholders of V-Holding are INVITEL (holding one share) and Matel (holding all of the remaining shares).

INVITEL invested in **Pécsi Hírközlési Infrastruktúra Rt.** (75%) and **Székesfehérvári Hírközlési Infrastruktúra Kft.** (50%) in 2002 jointly with the related local municipalities in Pécs and Székesfehérvár, in connection with the liberalization of the telecommunication market to gain access to subscribers from these major cities. INVITEL obtained the remaining stake in Székesfehérvári Hírközlési Infrastruktúra Kft. and Pécsi Hírközlési Infrastruktúra Rt. from the municipalities on 18 May 2005 and 17 June 2005, respectively. The two companies were merged into V-Holding on 31 January 2006, which continues as the legal successor of the two companies. The merger has no impact on the consolidated interim financial statements as the mergers took place using the net book values as they appeared in the consolidated interim financial statements of Matel.

The consolidated interim financial statements were authorized by the Group s management for issue on 27 April 2007.

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Magyar Telecom BV

Notes to the Unaudited Consolidated Interim Financial Statements

2. Significant Accounting Policies

The significant accounting policies adopted in the preparation of the consolidated interim financial statements are set out below.

2.1. Statement of Compliance

The consolidated interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB.

2.2. Basis of Preparation

The consolidated interim financial statements are presented in Euro (EUR) rounded to the nearest thousand of EUR (TEUR). The Group also prepares separate consolidated interim financial statements in Hungarian Forint.

The consolidated interim financial statements have been prepared under the historical cost convention, except for the following assets and liabilities that are stated at fair value: derivative financial instruments and investments in securities. The methods used to measure fair values are discussed in the accounting policy notes below.

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

The estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Judgments made by management in the application of IFRSs that have significant effect on the consolidated interim financial statements and estimates involving significant uncertainty are discussed in Note 2.24.

The accounting policies set out below have been consistently applied by all Group entities to all periods presented in these consolidated interim financial statements. Where it was necessary, accounting policies of the subsidiaries were modified to ensure consistency with the policies adopted by the Group.

2.2.1. Change in accounting policy

From 1 January 2007 the Group has changed its accounting policy to disclose the Hungarian local business tax as income taxes as it was established that this tax has the characteristics of an income tax rather than an operating expense. In previous periods, this tax was disclosed among operating expenses.

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Magyar Telecom BV

Notes to the Unaudited Consolidated Interim Financial Statements

This change in the disclosure of Hungarian local business tax had a decreasing impact on operating expenses and an equivalent increase in income taxes in the comparative figures in the income statement for the period ended 31 March 2006. The change resulted in no impact on net income or equity.

	For the three months ended 31 March 2006	
(in thousands of EUR)	**Local operating and other taxes**	**Current tax**
	(unaudited)	
As reported	(1,007)	
Change in accounting policy	627	(627)
As restated	**(380)**	**(627)**

2.3. Basis of Consolidation

2.3.1. Subsidiaries

Subsidiaries are those entities that are controlled, directly or indirectly through its subsidiaries, by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated interim financial statements from the date that control commences until the date that control ceases.

2.3.2. Transactions eliminated on consolidation

All inter-group balances, transactions, unrealized gains and losses on transactions between Group companies have been eliminated from the consolidated interim financial statements.

2.3.3. Transactions with entities under common control

Business combinations arising from transfers of interests in entities that are under the common control of the shareholders that control the Group are accounted for as if the acquisition had occured at the beginning of the earliest comparative period presented, or, if later, at the date that the common control was established. For this purpose comparatives are restated. The components of equity of the acquired entities are added to the same components within Group equity except that any share capital of the acquired entities is recognised as part of reserves. Any cash paid for the acquisition is recognized directly in equity.

2.4. Foreign Currency

2.4.1. Translation of financial statements

Items included in the financial statements of each of the Group s entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The functional currency of the Hungarian subsidiaries of

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Matel is the Hungarian Forint (HUF), the functional currency of the Romanian subsidiary of Matel is the Romanian Lei (RON) and the functional currency of Matel is the Euro (EUR).

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition that are measured in currencies other than the EUR are translated into EUR at foreign exchange rates ruling at the balance sheet date. Revenues and expenses of transactions measured in currencies other than the EUR are translated into EUR at rates approximating to the foreign exchange rates ruling at the date of the transactions. Equity amounts have been translated at historical exchange rates. Exchange rate translation differences are reported as a component of shareholders equity as non-distributable cumulative translation reserve. When foreign operations are disposed, in part or in full, the relevant amount of the reserve is transferred to the income statement.

The balance sheets of the Hungarian subsidiaries of Matel have been translated into EUR at the period end exchange rate (31 March 2007: 249.95 HUF/EUR, 31 March 2006: 267.95 HUF/EUR. The balance sheets of Euroweb Romania have been translated into EUR at the period end exchange rate (31 March 2007: 74.23 HUF/RON, 31 March 2006: 75.68 HUF/RON).

2.4.2. Transactions and balances

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at the foreign exchange rate ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the foreign exchange rate ruling at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Foreign currency differences arising on retranslation are recognised in the income statement, except for differences arising on the translation of available-for-sale equity instruments.

Non-monetary assets and liabilities denominated in foreign currencies that are stated at historical cost are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates ruling at the dates when the fair values were determined.

2.5. Cash and Cash Equivalents

Cash and cash equivalents comprise cash in bank balances and highly liquid call deposits with maturities of three months or less and exclude all overdrafts that are shown within borrowings in current liabilities on the face of the balance sheet.

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2.6. Financial Investments

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through the income statement, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group s contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Group commits itself to purchase or sell the asset.

When the Group has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortized cost using the effective interest method, less impairment losses.

Other investments held by the Group are classified as being available-for-sale and are stated at fair value, and changes therein, other than impairment losses and foreign exchange gains and losses on available-for-sale monetary items, are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to the income statement. The fair value of investments available-for-sale is determined by reference to their quoted bid price at the balance sheet date. The fair value of financial instruments held-for-trading is determined with reference to their quoted bid price at the balance sheet date.

The Group has not designated any financial instrument as at fair value through the income statement other than derivative financial instruments that do not qualify for hedge accounting.

2.7. Trade and Other Receivables

Receivables are recognized initially at fair value, and subsequently thereafter they are measured at amortized cost using the effective interest rate method less accumulated impairment losses. Receivables with a short duration are not discounted. The amounts of any impairment losses are included in operating expenses.

Amounts due and receivable from other network operators are shown net where a right of set-off exists and the amounts are intended to be settled on a net basis.

2.8. Trade and Other Payables

Trade and other payables are initially recognized at fair value and subsequently at amortized cost.

2.9. Inventories

Inventories consist of materials to be used in construction and repair of the telephone network, as well as telephone merchandise held for sale. Inventories are carried at the lower of cost or

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net realizable value. Cost is based on the first-in, first-out principle and includes expenditures incurred in acquiring the inventories and bringing them to their existing condition and location. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

2.10. Intangible Assets

Intangible assets are stated at cost less accumulated amortization and accumulated impairment losses except for goodwill and intangible assets with indefinite useful life which are not amortized and are stated at cost less accumulated impairment losses. After initial recognition it is assessed whether an intangible asset has a finite or indefinite useful life. The cost of intangible assets with a finite useful life is amortized on a straight-line basis over the period in which the asset is expected to be available for use. The rates of amortization are based on the following estimated useful lives:

Software	3 years
Property Rights	3-6 years
Subscriber Acquisition Costs	1-3 years
Other	5-12 years

Amortization of intangible assets ceases at the earlier of the date that the asset is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and the date the asset is derecognized. The amortization periods are reviewed annually at each financial year-end. Any changes arising from such review are accounted for as a change in an accounting estimate.

2.10.1. Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill arising in a business combination represents the excess of the cost of the acquisition over the Group s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. Goodwill on acquisition of subsidiaries is included among Intangible Assets. Upon the adoption of IFRS 3 *Business Combinations* by the Group effective 1 January 2005, goodwill is no longer amortized, instead it 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*. Goodwill is allocated into cash generating units for the purposes of impairment testing.

2.10.2. Software

Software is stated at the cost incurred to acquire and bring to use the specific software less accumulated amortization and impairment losses.

2.10.3. Property Rights

Property rights represent amounts paid for the right to use third party property for the placement of telecommunication equipment. Property rights are stated at cost less accumulated amortization and impairment losses.

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2.10.4. Subscriber Acquisition Costs

Subscriber acquisition costs include sales commissions paid to internal sales force and third parties in relation to fixed term subscriber contracts and are amortized over the period of the related subscriber contracts. Subscriber acquisition costs are stated at cost less accumulated amortization and impairment losses.

2.10.5. Other intangible assets

Other intangible assets include brand names and the value of customer relationships that were acquired by the Group. Other intangible assets are stated at cost less accumulated amortization and impairment losses.

2.11. Property, Plant and Equipment

2.11.1. Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of overheads, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the cost of dismantling and removing the items and restoring the site on which they are located. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment. Capital work in progress is stated at cost less impairment losses and represents those property, plant and equipment that have not been completed and capitalized.

2.11.2. Leased assets

The Group adopted IFRIC 4 *Determining whether an Arrangement Contains a Lease* on 1 January 2006. Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. An asset acquired by way of finance lease is measured initially at an amount equal to the lower of its fair value or the present value of the minimum lease payments at inception of the lease. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Other leases are operating leases and the leased assets are not recognised on the Group s balance sheet.

2.11.3. Subsequent expenditure on property, plant and equipment

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditures are included in the carrying amount if it is probable that future economic benefits embodied in that part will flow to the Group and its cost can be measured reliably. All other expenditure is recognized in the income statement as an expense as incurred.

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2.11.4. Depreciation

Depreciation is charged to the 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. Leased assets are depreciated over the shorter of the lease term or their useful lives. Land and capital work in progress are not depreciated. The estimated useful lives are as follows:

Buildings	17-50 years
Network	7-30 years
Machinery and Equipment	7-10 years
Fixtures and Fittings	7 years
Vehicles	5 years
Computers	3 years

Depreciation of property, plant and equipment ceases at the earlier of the date that the asset is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and the date the asset is derecognized. Depreciation methods, useful lives and residual values are reviewed annually at each financial year-end. Any changes arising from such review are accounted for as a change in an accounting estimate.

2.12. Impairment

The carrying amounts of the Group s assets, other than inventories (see accounting policy note 2.9) and deferred tax assets (see accounting policy note 2.22), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset s recoverable amount is estimated. For goodwill and intangible assets with an indefinite useful life or not available for use, the recoverable amount is estimated annually, irrespective of whether any indication of impairment exists. An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis. Impairment losses are recognized in the income statement.

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value. Any cumulative loss in respect of an available-for-sale financial asset recognized previously in equity is transferred to the income statement. Individually significant financial assets are tested

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for impairment on a individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

2.12.1. Calculation of recoverable amount

The recoverable amount of the Group s investments in financial assets carried at amortized cost is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. Receivables with a short duration are not discounted. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

The recoverable amount of other assets or cash-generating units is the greater of their fair value less costs to sell or value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

2.12.2. Reversal of impairment

An impairment loss in respect of a held-to-maturity security or receivable and available-for-sale financial asset that is a debt security is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognized. The reversal is recognized in the income statement. For an available-for-sale financial asset that is an equity security, the reversal is recognized directly in equity. An impairment loss in respect of goodwill is not reversed. In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and there has been an indication that the impairment has decreased or no longer exists.

An impairment loss is reversed only to the extent that the asset s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

2.13. Derivative Financial Instruments

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investing activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading derivatives.

Derivative financial instruments are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Attributable transaction costs are recognized in the income statement when incurred.

The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates qualifying derivatives as either: (1) hedges of the fair value of recognized assets or

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liabilities or a firm commitment (fair value hedges), or (2) hedges of the exposure to variability in cash-flows that is (a) attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction and (b) could affect the income statement (cash-flow hedges).

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as risk management objectives and its strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash-flows of hedged items.

At 1 January 2005, the Group, based on the provisions of the amended IAS 32 *Financial Instruments: Disclosure and Presentation* and the amended IAS 39 *Financial Instruments: Recognition and Measurement*, reviewed the classification of derivative financial instruments that were entered into before 2005 and the accounting treatment thereof. Based on the detailed review of the contracts and putting into place of various procedures to meet the hedging requirements of IAS 39, the Group designated qualifying derivative contracts into hedging relationships with the underlying assets, liabilities and firm commitments as of 1 January 2005.

As a result of the formal designation of the derivative contracts as hedges, the accounting treatment thereof was changed since the effective date of the hedge designation and was applied prospectively.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through the income statement. Changes in the fair value of separable embedded derivatives are recognised immediately in the income statement.

2.13.1. Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognized in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Changes in the fair value of derivatives that are designated to hedge the change in the fair value of unrecognized firm commitments are recognized in the income statement. The corresponding change in the fair value of the unrecognized firm commitment is recognized as other asset or liability against the income statement.

2.13.2. Cash-flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash-flow hedges are recognized in equity. The gain or loss relating to the ineffective portion is recognized immediately in the income statement. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount

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recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to the income statement in the same period that the hedged item affects the income statement.

The gain or loss relating to the effective portion of the hedging instrument is recognized in the statement of changes in shareholder s equity. The ineffective portion of the derivative instrument is recognized in the income statement among Financial expenses / Financial income.

2.13.3. Trading derivatives

Derivatives that do not qualify for hedge accounting are classified as trading derivatives. Changes in the fair value of trading derivatives are recognized in the income statement.

2.13.4. Fair value estimation

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

The fair value of forward exchange contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate.

For other OTC derivative agreements with its selected hedging counter-parties, the fair value of OTC financial instruments is determined by using valuation techniques. The Group uses present value calculations using assumptions that are based on market conditions prevailing on each balance sheet date.

2.14. Interest Bearing Borrowings

Interest bearing borrowings are recognized initially at fair value, less discounts and attributable transaction costs. Subsequent to initial recognition, interest bearing borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the income statement over the period of the borrowings on an effective interest basis.

2.15. Provisions

A provision is recognized in the balance sheet when the Group has a legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

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A provision for restructuring is recognized when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

2.16. Revenue Recognition

Revenues from all goods and services are shown net of VAT, rebates and discounts. Revenue from services is recognized when services are provided (see further description below). Revenue from the sale of goods is recognized when the significant risks and rewards of ownership of products sold have been transferred to the buyer. For products, the transfer of risks and rewards usually occurs when they are delivered to the customer. The Group considers the various elements of subscriber arrangements to be separate earnings processes for IFRS purposes and recognizes the revenue for each of the deliverables at their invoiced amounts.

A portion of the revenue received is paid to other operators for the use of their networks. These revenues and costs are shown gross in the consolidated interim income statement.

The Group s main operating revenue categories are as follows:

Mass Market Voice. The revenue generated from the fixed line voice and voice-related services provided to mass-market customers in the historical concession areas (Mass Market Voice In) and out of the historical concession areas (Mass Market Voice Out). Mass Market Voice Revenue comprises time based call charges, subject to a minimum monthly fee charged for accessing the network and time based fixed-to-mobile, local, long distance and international call charges, interconnect charges on calls terminated in the Group s network, monthly fees for value added services, subsidies, one-off connection and new service fees, as well as monthly fees for packages with built-in call minutes. Mass Market Voice In revenue also includes access calls to dial-up ISPs networks at local call tariffs and revenue from providing DSL access to other ISPs, but revenue from bundled Internet call and Internet services is recorded under Mass Market Internet.

Mass Market Internet. The revenue generated from dial-up and DSL Internet connections provided to mass-market customers nationwide both inside and outside the historical concession areas. Mass Market Internet comprises dial-up revenue, which is generated through a combination of time based and access fees, and DSL revenue, which is generated through a variety of monthly packages.

Business. The revenue generated from the fixed line voice, data and Internet services provided to business, government and other institutional customers nationwide. Business revenue comprises access charges, monthly fees, time based fixed-to-mobile, local, long distance and international call charges, interconnect charges on calls terminated in the Group s network, monthly fees for value added services, Internet access packages and regular data transmission services. Business revenues include the same components as Mass Market Voice In and Mass Market Internet revenues and include, in addition, 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 provided on a wholesale basis to a selected number of resellers to use the Group s excess network capacity. Wholesale

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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.

Revenue from connection fees are recognized upon service activation. Revenue from monthly fees charged for accessing the network is recognized in the month during which the customer is permitted to access the network. Traffic revenue is recognized in the period of the related usage. Leased line and data transmission revenue is recognized in the period of usage or of the service available to the customer. Revenue from prepaid call services is deferred when the prepaid package is sold to the customers and is recognized when the calls are made.

2.17. Government grants

Government grants are recognized in the balance sheet initially as deferred income when there is reasonable assurance that those will be received and that the Group will comply with the conditions attached to it. Grants that compensate the Group for expenses incurred are recognized as revenue in the income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognized in the income statement as other operating income on a systematic basis over the useful life of the asset.

2.18. Pension Costs and Employee Benefits

Contributions are made to the Hungarian and Romanian pension, health and unemployment schemes at the statutory rates in force during the year, based on gross salary payments. The cost of social security payments is charged to the income statement in the same period when the related salary cost incurred. The Group has no obligation for pension or other post employment benefits beyond the government programs.

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognized for the amount expected to be paid under short-term cash bonuses or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

2.19. Share Capital

2.19.1. Ordinary shares

Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity.

2.19.2. Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity until cancelled.

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2.19.3. Share-based compensation

The Group had an employee share ownership program (ESOP) for senior executives, whereby Matel Holdings, the 100% shareholder of Matel, granted stock options to senior executives of INVITEL for the purchase of non-voting C shares representing up to 5% of the ordinary shares of Matel Holdings. The options vested immediately and were exercisable on issue. The maximum number of options issuable under the ESOP was issued at 31 December 2006.

The fair value of options granted is recognized as an employee expense over the vesting period with a corresponding increase in equity. The Group believes that the value of these options was represented almost entirely by their intrinsic value at the grant date because the options were issued with the intention that they should be immediately exercised by the senior executives, the options could not be settled in cash, the options were for unlisted shares, and were not transferable. Therefore, the fair value of the options was measured at the grant date using the estimated fair value of the underlying shares determined in accordance with the valuation guidelines set out in the European Private Equity and Venture Capital Association Guidelines.

2.20. Net Financial Costs

Financial costs comprise interest expense on borrowings, interest income on funds invested, amortization of bond discount and deferred borrowing costs, fair value change of derivative financial instruments, dividend income, foreign exchange gains and losses and impairment losses on financial investments.

Gains and losses resulting from the changes in the fair values of derivative financial instruments are recognized in financial costs, other than the effective portion of cash-flow hedges being recognized in hedging reserve in equity.

Interest income is recognized in the income statement as it accrues, taking into account the effective yield on the asset.

Dividend income is recognized in the income statement on the date that the Group s right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

2.21. Lease payments

Payments made in respect of operating leases are charged to the income statement on a straight-line basis over the lease term and included in operating expenses.

Lease payments made under finance leases are apportioned between finance expenses and the reduction of the outstanding lease liability. Finance expenses are allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

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2.22. 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 tax payable on taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred tax is provided for using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that they probably will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using the appropriate tax rate enacted or substantively enacted at the balance sheet date.

Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend.

2.23. Segment reporting

A business segment is a distinguishable component of the Group engaged in providing related products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

The Group has four business segments that are identified in the accounting policy relating to revenue (see accounting policy Note 2.16 on revenue recognition). The Group s primary format for segment reporting is based on business segments.

Allocation of revenues and cost of sales into business segments is based on management information collected in the information systems of the Group. The Group considers segment results at gross margin level and its current information systems do not report operating expenses on a segment basis. Non-current assets and related depreciation as well as capital expenditure are allocated into segments based on the services for which they are or will be utilized. Allocation of non-current liabilities was based on the allocation of assets, which they finance. Elements of working capital have been allocated based on revenues to which they

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relate. Unallocated assets include other non-current financial assets and deferred tax and unallocated liabilities include borrowings, finance leases and other liabilities relating to financing.

2.24. Key sources of estimation uncertainty

The Group makes estimates and assumptions concerning the future during the preparation of financial statements. The estimates and assumptions that have a significant risk of affecting the carrying amounts of assets and liabilities in the consolidated interim financial statements within the next financial year are described below.

2.24.1. Deferred tax assets

The Group recognizes deferred tax assets in its balance sheet relating to tax loss carry forwards. The amount of such deferred tax assets recognized in the balance sheet was EUR 5,225 thousand and EUR 6,300 thousand at 31 March 2007 and 31 December 2006, respectively. The recognition of such deferred tax assets is subject to the utilization of tax loss carry forwards. The utilization of certain amounts of such tax loss carry forwards is subject to statutory limitations and is dependent on the amount of future taxable income of the Group companies, in particular INVITEL and Euroweb Hungary. The Group has recognized deferred tax assets relating to tax loss carry forwards based on estimated future taxable income of INVITEL and Euroweb Hungary according to approved business plans for these entities. If the future taxable income of INVITEL and Euroweb Hungary were to significantly differ from the amounts that were estimated, such differences could impact the amount of deferred tax assets and income tax expense of the Group.

2.24.2. Allowance for bad and doubtful accounts

The Group calculates an allowance for bad and doubtful accounts receivable to cover the estimated losses resulting from the inability of its customers to make required payments when due. Allowance for bad debts recognized in the balance sheet amounted to EUR 10,332 thousand, EUR 10,269 thousand at 31 March 2007 and 31 December 2006, respectively. The estimates used in evaluating the adequacy of the allowance for bad and 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.

The Group considers that the accounting estimate related to the allowance for bad and doubtful accounts receivable is a critical accounting estimate since it involves assumptions about future customer behavior and the resulting future cash collections. If the financial condition of customers or the economic environment in which they operate were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the provision recognized as at 31 March 2007.

2.24.3. Impairment of property, plant and equipment, intangible assets and goodwill

In determining impairment, the Group considers a number of factors, among others, future cash flows, technological obsolescence and discontinuation of services.

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The Group recognized impairment loss of EUR 64 thousand and EUR nil thousand for the period ended 31 March 2007 and 2006, respectively, as disclosed in Note 7. The Group considers that the accounting estimate related to asset impairment is a critical accounting policy due to the need to make assumptions regarding the above factors and the material impact that recognising impairment could have on the financial position and results of the Group.

2.24.4. Depreciation

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 as described in Note 2.10 and Note 2.11.4.

The Group considers that the accounting estimate related to the determination of the useful lives of assets is a critical accounting estimate since it involves assumptions about technology evolutions in an innovative industry. Further, due to the significant weight of long-lived assets in the asset base of the Group, the impact of any changes in these assumptions could be material to the Group s financial position, as well as the results of operations.

2.25. Comparative information

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

2.26. New accounting pronouncements

A number of new Standards, Amendments to Standards and Interpretations are not yet effective as at 31 March 2007, and have not been applied in preparing these consolidated interim financial statements. The Group plans to adopt these pronouncements when they become effective. Of these pronouncements, potentially the following will have an impact on the Group s operations.

IFRS 8 *Operating Segments* , which is effective from 1 January 2009, requires segment disclosure based on the components of the entity that management monitors in making decisions about operating matters. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Group expects the new Standard to significantly alter the presentation and disclosure of its operating segments in the consolidated interim financial statements.

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3. Revenue

(in thousands of EUR)	For the three months ended 31 March 2007	2006
Mass Market Voice	18,004	20,305
Mass Market Internet	7,435	5,875
Business	15,609	10,464
Wholesale	8,222	6,484
Total Revenue	**49,270**	**43,128**

4. Cost of Sales

(in thousands of EUR)	For the three months ended 31 March 2007	2006
Sales commissions	(587)	(619)
Interconnect expenses	(9,166)	(8,444)
Access type charges	(4,897)	(1,786)
Other cost of sales	(646)	(452)
Total Cost of Sales	**(15,296)**	**(11,301)**

5. Operating Expenses

(in thousands of EUR)	For the three months ended 31 March 2007	2006 *As Restated (Note 2.2.1)*
Personnel expenses (see Note 6)	(5,701)	(4,729)
Headcount-related costs	(1,678)	(1,697)
Advertising and marketing costs	(555)	(660)
Network operating expenses	(3,500)	(2,974)
IT costs	(1,056)	(963)
Local operating and other taxes	(400)	(380)
Bad debt expense	(66)	(328)
Collection costs	(406)	(352)
Legal and audit fees	(69)	(36)

Consultant expenses	(69)	(76)
Management fee	(137)	(131)
Due diligence expense	(112)	(297)
IP TV and tax penalty	(181)	
Other costs, net	(7)	36
	(13,937)	(12,587)
Less: Capitalised costs	466	600
Total Operating Expenses	**(13,471)**	**(11,987)**

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Network operating expenses include the maintenance costs of the Group s telecommunication infrastructure and its license and rental fees. Telecommunication infrastructure rental fees amounted to EUR 1,441 thousand and EUR 954 thousand for the period ended 31 March 2007 and 2006, respectively.

Other costs, net include sundry charges and the profit or loss on sale of property, plant and equipment ans intangible assets.

Capitalized costs include labour and overhead expenses associated with the construction of property, plant and equipment.

6. Personnel Expenses

	For the three months ended 31 March	
(in thousands of EUR)	**2007**	**2006**
Salaries	(3,287)	(2,701)
Social security and other contributions	(1,126)	(925)
Personnel related expenses	(459)	(350)
Contracted employees and expatriate costs	(354)	(323)
Bonuses and charges	(463)	(412)
Severance payments	(12)	(18)
Total Personnel Expenses	**(5,701)**	**(4,729)**

The number of employees was 912 and 783 at 31 March 2007 and 2006, respectively. Due to the acquisition of Euroweb in May 2006 the number of employees of the Group increased by 181.

7. Depreciation and Amortization

	For the three months ended 31 March	
(in thousands of EUR)	**2007**	**2006**
Amortization	(2,221)	(1,536)
Depreciation	(7,822)	(7,681)
Impairment loss	(64)	
Total Depreciation and Amortization	**(10,107)**	**(9,217)**

The impairment loss of EUR 64 thousand for the period ended 31 March 2007 related to the impairment of certain DSL equipment.

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8. Cost of Restructuring

(in thousands of EUR)	For the three months ended 31 March 2007	2006
Cost of reorganization	(162)	(184)
Total Cost of Restructuring	**(162)**	**(184)**

The Cost of reorganization in the amount of EUR 162 thousand and EUR 184 thousand for the period ended 31 March 2007 and 31 March 2006, respectively mainly includes termination benefits paid to employees related to the rationalization of the company structure and consolidating locations of the business across geographical areas.

9. Financial Costs

(in thousands of EUR)	For the three months ended 31 March 2007	2006
Interest income	172	337
Fair value change of forward contracts		3,082
Net foreign exchange (loss)/gain	2,705	
Financial Income	**2,877**	**3,419**
Related party interest expense	(436)	(398)
Third party interest expense	(5,811)	(5,576)
Bond discount	(57)	(57)
Amortization of deferred borrowing costs	(350)	(350)
Interest expense	(6,654)	(6,381)
Net foreign exchange (loss)/gain		(16,133)
Fair value change of forward contracts	(229)	
Fair value change of swap deals		(123)
Fair value change of hedged items		(1,531)
Other financial expense		(102)
Financial Expense	**(6,883)**	**(24,270)**
Total Financial Costs	**(4,006)**	**(20,851)**

All interest income recorded for the period ended 31 March 2007 and 2006 relates to cash and cash equivalents. Fair value changes of forward contracts, swap contracts and hedged items relate to fair values of financial instruments (see Note 16.)

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10. Intangible Assets

Movements during the period in the Group s intangible assets were as follows:

(in thousands of EUR)	Software	Property Rights	Goodwill	Subscriber Acquisition Costs	Other	Total Intangible Assets
Cost as at 1 January 2006	**38,002**	**15,085**	**131**	**2,448**		**55,666**
Additions during the period	561	528		721		1,810
Disposals during the period	(1)					(1)
Effect of exchange rates	(2,367)	(946)	(8)	(186)		(3,507)
Cost as at 31 March 2006	**36,195**	**14,667**	**123**	**2,983**		**53,968**
Accumulated amortization as at 1 January 2006	**(35,182)**	**(9,002)**		**(748)**		**(44,932)**
Amortization charge for the period	(543)	(541)		(452)		(1,536)
Impairment for the period						
Disposals during the period	1					1
Effect of exchange rates	2,194	572		68		2,834
Accumulated amortization as at 31 March 2006	**(33,530)**	**(8,971)**		**(1,132)**		**(43,633)**
Carrying value as at 1 January 2006	**2,820**	**6,083**	**131**	**1,700**		**10,734**
Carrying value as at 31 March 2006	**2,665**	**5,696**	**123**	**1,851**		**10,335**
Cost as at 1 January 2007	**41,671**	**16,912**	**17,219**	**5,247**	**2,949**	**83,998**
Additions during the period	938	599		1,071		2,608
Disposals during the period						
Effect of exchange rates	493	345	276	102	165	1,381
Cost as at 31 March 2007	**43,102**	**17,856**	**17,495**	**6,420**	**3,114**	**87,987**
Accumulated amortization as at 1 January 2007	**(37,547)**	**(11,096)**		**(3,164)**	**(227)**	**(52,034)**
Amortization charge for the period	(712)	(577)		(831)	(101)	(2,221)
Impairment for the period						
Disposals during the period						
Effect of exchange rates	(447)	(339)		(65)	(14)	(865)
Accumulated amortization as at 31 March 2007	**(38,706)**	**(12,012)**		**(4,060)**	**(342)**	**(55,120)**
Carrying value as at 1 January 2007	**4,124**	**5,816**	**17,219**	**2,083**	**2,722**	**31,964**
Carrying value as at 31 March 2007	**4,396**	**5,844**	**17,495**	**2,360**	**2,772**	**32,867**

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11. Property, Plant and Equipment

Movements during the period in the Group s property, plant and equipment were as follows:

(in thousands of EUR)	**Land and Buildings**	**Network and Equipment**	**Other**	**Capital Work In Progress**	**Total Property, Plant and Equipment**
Cost as at 1 January 2006	**4,649**	**497,360**	**20,974**	**7,801**	**530,784**
Additions during the period		(6)		3,743	3,737
Transfers from capital WIP	61	3,173	95	(3,329)	
Disposals during the period	(5)	(19)	(152)		(176)
Effect of exchange rates	(288)	(30,690)	(1,286)	(500)	(32,764)
Cost as at 31 March 2006	**4,417**	**469,818**	**19,631**	**7,715**	**501,581**
Accumulated depreciation as at 1 January 2006	**(1,178)**	**(226,809)**	**(18,448)**		**(246,435)**
Depreciation charge for the period	(63)	(7,320)	(298)		(7,681)
Impairment for the period					
Disposals during the period		14	152		166
Effect of exchange rates	76	14,289	1,138		15,503
Accumulated depreciation as at March 2006	**(1,165)**	**(219,826)**	**(17,456)**		**(238,447)**
Carrying value as at 1 January 2006	**3,471**	**270,551**	**2,526**	**7,801**	**284,349**
Carrying value as at 31 March 2006	**3,252**	**249,992**	**2,175**	**7,715**	**263,134**
Cost as at 1 January 2007	**4,695**	**512,322**	**21,251**	**10,086**	**548,354**
Additions during the period				4,923	4,923
Transfers from capital WIP	5	4,243	380	(4,628)	
Disposals during the period	(12)	(187)	(258)		(457)
Effect of exchange rates	73	8,042	318	170	8,603
Cost as at 31 March 2007	**4,761**	**524,420**	**21,691**	**10,551**	**561,423**
Accumulated depreciation as at 1 January 2007	**(1,411)**	**(254,744)**	**(18,808)**		**(274,963)**
Depreciation charge for the period	(73)	(7,393)	(356)		(7,822)
Impairment for the period		(64)			(64)
Disposals during the period		129	258		387
Effect of exchange rates	(23)	(4,034)	(281)		(4,338)
Accumulated depreciation as at March 2007	**(1,507)**	**(266,106)**	**(19,187)**		**(286,800)**
Carrying value as at 1 January 2007	**3,284**	**257,578**	**2,443**	**10,086**	**273,391**

Carrying value as at 31 March 2007	**3,254**	**258,314**	**2,504**	**10,551**	**274,623**

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Network and Equipment includes all tangible assets associated with the telecommunication network and related equipment.

Other assets include other non-telecom equipment, fixtures and fittings, vehicles and computers.

Capital Work in Progress includes property, plant and equipment in the course of construction. After completion, such assets are put into operation (capitalized) and are transferred to the appropriate fixed asset categories. No depreciation is charged on capital work in progress.

12. Cash and Cash Equivalents

(in thousand of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Cash on hand and in banks	7,653	919
Cash deposits	405	12,689
Total Cash and Cash Equivalents	**8,058**	**13,608**

Out of the total of Cash and Cash Equivalents of EUR 8,058 thousand at 31 March 2007, the EUR denominated part is EUR 4,776 thousand or 59%, the HUF denominated part is EUR 3,165 thousand or 39%, the USD denominated part is EUR 62 thousand or 1%, and the RON denominated part is EUR 55 thousand or 1%.

Out of the total of Cash and Cash Equivalents of EUR 13,608 thousand at 31 December 2006, the EUR denominated part is EUR 2,757 thousand or 20%, the HUF denominated part is EUR 10,635 thousand or 78%, the USD denominated part is EUR 56 thousand or 1%, and the RON denominated part is EUR 160 thousand or 1%.

The effective interest rate for cash and cash equivalents was 5.8% in the period ended 31 March 2007 and 5.0% in the period ended 31 December 2006.

13. Trade and Other Receivables

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Trade accounts receivable	27,074	29,807
Allowance for bad and doubtful accounts	(10,332)	(10,269)
Other receivables	1,930	1,457
Total Trade and Other Receivables	**18,672**	**20,995**

Trade accounts receivable are mostly denominated in HUF.

All receivables fall due within one year, except that long overdue receivables, which are overdue by more than one year, are carried in the Trade accounts receivable balance in the amount of EUR 8,526 thousand at 31 March 2007 and EUR 8,470 million at 31 December 2006 as the current Hungarian legislation places restrictions on the write off of receivables as a tax-deductible expense until sufficient proof exists for the receivable to be cleared from the accounts.

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Movements in the allowance for bad and doubtful accounts are included as Bad debt expense within Operating expenses.

Other receivables include advances to suppliers and prepaid taxes.

14. Shareholders Equity

At 31 March 2007 the authorized share capital of Matel was EUR 408,600,000 divided into 90,000,000 ordinary shares with a par value of EUR 4.54 each. At 31 March 2007 the issued share capital of Matel was EUR 92,201,227. The issued capital is fully paid in.

The Group had an employee share ownership program (ESOP) for senior executives, whereby Matel Holdings, the 100% shareholder of Matel, could issue stock options to senior executives of INVITEL up to 5% of the ordinary shares of Matel Holdings, represented by non-voting C shares.

During 2003 and 2004 Matel Holdings issued options for the purchase of shares representing 4.15% of its outstanding shares. The senior executives exercised the options upon issue and entered into shareholder agreements (the Agreements).

During the year ended 31 December 2006 Matel Holdings granted further options for the purchase of non-voting C shares representing 0.85% of Matel Holdings ordinary shares. With this grant the maximum number of options issuable under the ESOP has been issued. The non-voting C shares were held equally by the holders of the A and B shares until exercise of the option issued under the employee share ownership program. These shares are subject to the Agreements previously entered into. The Group has assessed the options as meeting the definition of equity settled share based payments under IFRS 2. The Agreements prescribe the use of the valuation guidelines set out in the European Private Equity and Venture Capital Association Guidelines to determine fair value. The shares issued under the ESOP were purchased by the senior executives from the holders of the A and B Matel Holdings shares at approximately EUR 673 thousand below fair value. As these options vested upon issue, EUR 673 thousand has been recorded among capital reserve in the second quarter of 2006.

On 30 October 2006 Invitel Holdings issued Floating Rate Senior PIK Notes (the PIK Notes). Following the issue of the PIK Notes the shareholders contributed their shareholdings in Matel Holdings into Invitel Holdings as a share premium contribution. The net proceeds from the issue of the PIK Notes were used by Invitel Holdings for the repurchase of certain of its shares as a result of which Invitel Holdings is owned in equal parts by EEIF, GMT and INVITEL management.

The balance of Capital reserve of EUR 122,110 thousand at 31 March 2007 and 31 December 2006 includes the amounts of share capital of former legal entities merged into Matel. There is no restriction for distribution regarding these amounts. During the second quarter of 2006 an amount of EUR 673 thousand was credited to Capital reserve relating to executive share based compensation described above.

The Cumulative translation reserve comprises all foreign exchange differences arising from the translation into EUR of the financial statements of foreign operations whose functional currency is not EUR.

The Hedging reserve includes the fair value movements of the effective portions of hedging derivatives designated as cash-flow hedges.

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As at 31 March 2007 and 31 December 2006 minority interest related to the 0.02% investments held in INVITEL by local municipalities and the 0.04% investments held in Euroweb Romania by individuals.

15. Interest Bearing Borrowings

(in thousands of EUR)	At 31 March 2007 *(unaudited)*	At 31 December 2006
Current Portion of Interest Bearing Borrowings		
Secured bank facility loan		
- HUF	3,629	3,448
- EUR	18,983	18,329
Current Portion of Investment credit facility	1,333	2,666
Deferred borrowing costs	(623)	(613)
	23,322	**23,830**
Interest Bearing Borrowings		
Secured bank facility loan		
- HUF	14,888	15,639
- EUR	77,892	83,129
Investment credit facility		
Related party subordinated loan	19,016	18,580
High yield bonds, net of discount	140,747	140,689
Deferred borrowing costs	(6,439)	(6,695)
Total Interest Bearing Borrowings	**246,104**	**251,342**

Secured Bank Facility Loan

Facilities

On 6 August 2004 INVITEL signed a multi-currency term and revolving credit facility agreement (the Facilities Agreement) with a bank syndicate, amounting to EUR 165 million (the Secured Bank Facility Loan). The transaction cost of EUR 4.4 million reduced the initial amount of the loan, and as such are included in the effective interest rate calculation.

Based on the Facilities Agreement INVITEL is provided with the following facilities. Under Facility A , INVITEL borrowed an initial amount of EUR 134,303 thousand, under Facility B , INVITEL borrowed an initial amount of HUF 6,416,533 thousand, the equivalent of EUR 25,697 thousand at the initial drawdown of the loan, under Facility C , INVITEL is provided with a revolving credit facility of (i) EUR 4,197 thousand and (ii) HUF 200,517 thousand, the equivalent of EUR 803 thousand. However the total outstanding amount of Facilities A , B and C cannot exceed the total amount of EUR 165 million. Facility C has not yet been utilized.

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The current and non-current portion of the Secured Bank Facility Loan by Facility A and Facility B are detailed in the following table:

	At 31 March 2007			At 31 December 2006		
(in thousands of EUR)	Current	Non-Current	Total	Current	Non-Current	Total
		(unaudited)				
Secured bank facility loan						
Facility A	18,983	77,892	96,875	18,329	83,129	101,458
Facility B	3,629	14,888	18,517	3,448	15,639	19,087
Total Secured Bank Facility Loan	**22,612**	**92,780**	**115,392**	**21,777**	**98,768**	**120,545**

Interest

The Secured Bank Facility Loan bears a floating interest charge comprising of the applicable EURIBOR and BUBOR rate, a margin and the mandatory cost. The Mandatory Cost is an addition to the interest rate to compensate Lenders for the cost of compliance with (a) the requirements of the Bank of England and/or the Financial Services Authority (or, in either case, any other authority which replaces all or any of its functions) or (b) the requirements of the European Central Bank or the central bank of Hungary. The Mandatory Cost is expressed as a percentage rate per annum. It is represented to be a reasonable determination of the cost of complying with the minimum reserve requirements of the European Central Bank or (as the case may be) the central bank of Hungary in respect of loans made from that Facility Office. No Mandatory Cost has been payable since the refinancing on 6 August 2004.

From the initial utilization date of 6 August 2004 of the Secured Bank Facility Loan until the date falling twelve months after, the margin related to any interest period is a minimum of 2.25% per annum. The margin depends on the ratio of Senior Debt to Twelve Month Consolidated EBITDA (each as defined in the Facilities Agreement) ratio of Matel. The margin at 31 March 2007 is at 1.75% per annum and was 1.75% per annum at 31 December 2006.

Interest payments are due on a monthly, quarterly or semi-annual basis depending on the decision of the Company.

The effective interest rate on the Secured Bank Facility Loan Facility A was approximately 5.55% at 31 March 2007 and approximately 5.61% at 31 December 2006. The effective interest rate on the Secured Bank Facility Loan Facility B was approximately 10.20% at 31 March 2007 and approximately 10.13% at 31 December 2006.

On 27 April 2007, in connection with the Acquisition, the Facilities Agreement was amended and restated (see Note 27).

High Yield Bonds

On 6 August 2004, the Company issued high yield bonds (the HY Bonds), in the aggregate principal amount of EUR 142 million. The issue was at 98.682% of the face value and resulted in cash proceeds of EUR 140.1 million. The cost of issuance of EUR 6.7 million has been deferred over the term of the HY Bonds and is recognised in the income statement using the effective interest rate method.

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The HY Bonds bear a fixed interest charge of 10.75%, payable on a semi-annual basis on 15 February and 15 August each year. The final maturity of the HY Bonds is on 15 August 2012. The HY Bonds were first listed on the Luxembourg Stock Exchange on 24 August 2005. The quotes can be found on the official website of the Luxembourg Stock Exchange under security label MagyTel .

The effective interest rate on the HY Bonds was approximately 11.91% as at 31 March 2007 and approximately 12% as at 31 December 2006.

Redemption option

At the option of the Company, it may redeem some or all of the HY Bonds on or after 15 August 2008 at the redemption prices as follows, plus accrued and unpaid interest:

Year	Redemption price
2008	105.375%
2009	103.583%
2010	101.792%
2011 and thereafter	100.000%

At any time prior to 15 August 2008, the Company may redeem some or all of the HY Bonds at a redemption price equal to 100% of their principal amount plus a make-whole premium, together with accrued and unpaid interest up to the redemption date. In addition, at any time prior to 15 August 2007 the Company may redeem up to 35% of the aggregate principal amount of the HY Bonds at a redemption price of 110.75% of their principal amount, plus accrued and unpaid interest, if any to the redemption date, if a certain public equity offering occurs. The make-whole premium (Applicable Redemption Premium) means, with respect to any HY Bonds on any redemption date, the excess of: a) the present value at such redemption date of (x) the redemption price of such HY Bonds at August 15, 2008 (according to the table Redemption Options on or after 15 August 2008, plus (y) all required interest payments that would otherwise be due to be paid on such HY Bonds during the period between the redemption date and 15 August 2008 (excluding accrued but unpaid interest), computed using a discount rate equal to the Bund Rate at such redemption date plus 50 basis points; over b) the outstanding principal amount of the HY Bonds.

The early redemption of the HY Bonds cannot occur before the discharge of the Senior Bank Facility unless the majority of the lenders previously consented.

Covenants

Limitation on debt

In accordance with the HY Bonds Indenture (the Indenture) the Company will be permitted to incur additional debt if (i) after giving effect of the incurrence of such debt and the application of the proceeds thereof, on a pro-forma basis, no default or event of default would occur or be continuing and (ii) the Consolidated Leverage Ratio for the Company would be less than 5.0 to 1.0. The Consolidated Leverage Ratio is defined as the outstanding debt of the Company on a consolidated basis to the pro forma EBITDA for the period of the most recent four consecutive fiscal quarters.

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Covenants on distribution

The aggregate amount of all restricted payments, including dividends or any other any other distributions, principal and interest payments of the Related Party Subordinated Loan prior to any scheduled payment or maturity date, shall not exceed 50% of the Company s consolidated adjusted net income on a cumulative basis during the period beginning on the date of the Indenture and ending on the last day of the last fiscal quarter ending prior to the date of such proposed payment.

In accordance with the Indenture the aggregate amount of any other restricted payments shall not exceed EUR 8 million.

Guarantee and security

The obligations of the Company under the HY Bonds are guaranteed on a senior subordinated basis by INVITEL and V-Holding.

A security deposit over the shares of the Company in INVITEL and V-Holding, and over the funding loan from the Company to INVITEL of the proceeds from the issuance of the HY Bonds, ranking second after the security deposit established pursuant to the Facilities Agreement, the Indenture and the related inter-creditor arrangements has been established in favour of the HY Bonds holders.

The Company was in compliance with all covenants as at 31 March 2007.

Investment Credit Facility

Facilities

On 11 May 2006 INVITEL signed a EUR 9,000 thousand credit facilities agreement (the Investment Credit Facilities Agreement) with HVB Bank Hungary Zrt.

Based on the Investment Credit Facilities Agreement INVITEL is provided with the following facilities. Under the Investment Loan Facility , INVITEL was provided with a total amount of EUR 8,000 thousand facility which was available for drawdown until 31 December 2006. The Investment Loan Facility was used for financing the acquisition of Euroweb. On 23 May 2006 INVITEL drew EUR 4,000 thousand of the total available amount of EUR 8,000 thousand. The remaining part was not drawn by 30 June 2006 therefore it is no longer available. Until 31 March 2007 INVITEL repaid EUR 2,667 thousand of the outstanding loan. After such repayment the outstanding balance of the Investment Credit Facility loan was EUR 1,333 thousand at 31 March 2007.

Under the Revolving Credit Facility , INVITEL was provided with a total amount of EUR 1,000 thousand facility available for general corporate purposes. The Revolving Credit Facility is available for drawdown in both EUR and HUF. As at 31 March 2007 no amount was drawn under this facility.

Interest

Both facilities bear a floating interest charge comprising of the applicable EURIBOR and BUBOR rate and a margin of 0.24% and 0.21% for the Investment Loan Facility and the Revolving Credit Facility, respectively.

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An interest payment was due on 30 June 2006 on the Investment Loan Facility. Thereafter, interest is payable on a quarterly basis until maturity. On the Revolving Credit Facility interest is payable weekly, monthly and quarterly, depending on the decision of INVITEL.

The effective interest rate of the Investment Loan was 3.63% as at 31 March 2007 and 3.63% at 31 December 2006.

Repayment and maturity of the Investment Loan

The remaining balance of the Investment Loan is repayable on 30 September 2007. All amounts outstanding under the Revolving Credit Facility need to be repaid on 22 May 2007.

Guarantee and security

The Investment Credit Facilities were provided on an unsecured basis to the Company. However INVITEL procured that its obligations under the Investment Credit Facilities Agreement do and will rank at least *pari passu* with all its other present and future unsecured and unsubordinated obligations. In addition, INVITEL does not permit to exist any encumbrance over all or any part of its respective present and future undertakings, assets, rights or revenues to secure or prefer any of their present and future indebtedness, other than a Permitted Encumbrance as defined in the and under the terms of the Facilities Agreement (see above).

Related Party Subordinated Loan

On 6 August 2004 part of the proceeds of the Secured Bank Facility Loan and HY Bonds issue were used to partially repay the Related Party Subordinated Loan provided by Matel Holdings to the Company. On 6 August 2004 the outstanding amount was reduced by the repayment of EUR 64,700 thousand, to EUR 24,900 thousand.

On 6 August 2004 a restated loan agreement was concluded between Matel Holdings and the Company for the outstanding amount of the loan. The Related Party Subordinated Loan bears a fixed interest charge of 9.75%, which is compounded annually. The loan is to be repaid in full including the compounded interest at maturity, on 15 August 2013.

The Related Party Subordinated Loan is subordinated with respect to the obligation from the Secured Bank Facility Loan and the HY Bonds.

The Company repaid EUR 7,500 thousand of the outstanding Related Party Subordinated Loan to Matel Holdings on 15 February 2005. This repayment included a principal loan repayment of EUR 6,726 thousand and repayment of accrued interest carried in the loan balance of EUR 774 thousand.

The outstanding balance of related party subordinated loan was EUR 19,016 thousand and EUR 18,580 thousand as at 31 March 2007 and 31 December 2006, respectively, including accrued interest of EUR 882 thousand and EUR 446 thousand as at 31 March 2007 and 31 December 2006, respectively.

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Deferred Borrowing Costs

The current and non-current portion of the deferred borrowing costs by Facility A and Facility B and the HY Bonds are detailed in the following table:

	At 31 March 2007			At 31 December 2006		
(in thousands of EUR)	Current	Non-Current *(unaudited)*	Total	Current	Non-Current	Total
Deferred borrowing costs						
Facility A	(523)	(1,701)	(2,224)	(515)	(1,801)	(2,316)
Facility B	(100)	(325)	(425)	(98)	(345)	(443)
Bond		(4,413)	(4,413)		(4,549)	(4,549)
Total Deferred Borrowing Cost	**(623)**	**(6,439)**	**(7,062)**	**(613)**	**(6,695)**	**(7,308)**

16. Financial Instruments

Financial instruments carried on the balance sheet include cash and bank balances, investment in securities, trade and other receivables, trade payables, leases receivables and payables and borrowings. The Group also has derivative financial instruments that reduce the exposure to fluctuations in foreign currency exchange and interest rates and manage credit risk.

Credit risk

The Group has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. The Group generally does not require collateral in respect of financial assets. The Group is not exposed to any significant concentration of credit risk as its customer base is widely spread.

Investments are allowed in EUR or HUF denominated securities, which are freely negotiable, marketable and (1) are rated at least AA by Standard & Poor s Corporation or Aa2 by Moody s Investor Services, Inc. or (2) are issued by the Republic of Hungary. Transactions involving derivative financial instruments are with counter-parties with whom the Group has a signed netting agreement as well as high credit ratings. Given their high credit ratings, management does not expect any counter-party to fail to meet its obligations with respect to its derivative financial instruments.

The Group has made provisions of EUR 10,332 thousand and EUR 10,269 thousand for overdue receivables at 31 March 2007 and 31 December 2006, respectively. Besides the risk on receivables the maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet. Due to the nature of the services provided by the Group there are no significant concentrations of credit risk.

Liquidity risk

In accordance with the Treasury Policy of the Group as approved by the Board of Directors, a prudent liquidity management is maintained by means of holding sufficient amounts of cash and marketable securities that are available for making all operational and debt service related payments

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when they become due. In addition the Company has a EUR 5,000 thousand revolving bank facility as part of the EUR 165 million Senior Bank Facility (see Note 15). The Revolving Facility can be drawn partly in EUR and in HUF until the final maturity of the Senior Bank Facility Loan. In addition the Company has an EUR 1,000 thousand Revolving Facility as part of the EUR 9,000 thousand Investment Loan (see Note 15) being available for drawdown until 22 May 2007. None of the revolving facilities have been utilized yet.

The Group only invests in highly liquid assets, which are readily convertible into cash.

Interest rate risk

The Group s investments in fixed-rate debt securities and its fixed-rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The Group s investments in variable-rate debt securities and its variable-rate borrowings are exposed to a risk of change in cash flows due to changes in interest rates.

The Group is exposed to interest rate cash flow risk since a portion of the interest of its Interest Bearing Borrowings is based on variable inter-bank rates. To reduce its interest rate cash flow risk the Group entered into Interest Rate Swap Agreements based on standard ISDA agreements in which the floating EURIBOR rates were swapped for fixed EUR rates.

In 2001 the Group entered into agreements with BNP Paribas Paris (BNP) and with Royal Bank of Scotland (RBS , hereinafter referred to as the 2001 Interest Rate Swap) and the total notional amount of the outstanding are as follows:

31/12/2004	30/06/2005	EUR 170 million
30/06/2005	30/12/2005	EUR 155 million
30/12/2006	30/06/2006	EUR 140 million
30/06/2006	29/12/2006	EUR 120 million

Based on the agreements the floating rate of six month EURIBOR was swapped to a fixed rate of 5.50% from 1 January 2004 until 29 December 2006.

In March 2006 the Group continued the execution of its Hedging Program and entered into two one year interest rate swap agreements with BNP for the following periods and notional amounts:

29/12/2006	30/03/2007	EUR 101 million
30/03/2007	29/06/2007	EUR 97 million
29/06/2007	28/09/2007	EUR 92 million
28/09/2007	28/12/2007	EUR 88 million

Based on the agreements the floating rate of three month EURIBOR has been swapped to a fixed rate of 3.43% from 1 January 2007 until 28 December 2007, thereby hedging 100% of the interest rate risk related to the EUR tranche of the Senior Bank Facility Loan (hereinafter the 2006 Interest Rate Swap) for the period of the swap agreements.

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Based on the existing hedging policy not less than 50 percent of the outstanding amount of the Secured Bank Facility Loan has to be hedged to cover interest rate risk, for the period of a minimum of two years.

	Notional amount		Fair value	
(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Interest rate swaps hedging	96,875	101,457	432	470
Interest rate swaps non hedging				
	96,875	101,457	432	470

As described in Note 2.13 the Group, based on its review of the classification of its interest rate derivative portfolio and the putting into place of various procedures to meet the hedging requirements of IAS 39, has applied cash-flow hedge accounting for the portion designated into the hedging relationship as from 1 January 2005. 85% of the notional amount of the 2001 Interest Rate Swap has been designated into the hedging relationship. The change in the fair value of the interest rate swap is recognized as follows:

(i) 15% of the change in the fair value (portion not designated to the hedging relationship) of the interest rate swap is recognized in the income statement as net financial expense.

(ii) The effective portion of the fair value change is recognized in equity as cash-flow hedge reserve.

(iii) The remaining amount of the fair value change (ineffective portion) is recognized in the income statement as net financial expense.

Based on the measurement of hedge effectiveness as of 31 March 2005, the 2001 Interest Rate Swaps were no longer considered effective. As a consequence all subsequent changes in the fair value of the 2001 Interest Rate Swaps were recognized directly in the income statement.

The 2006 Interest Rate Swap have been designated into the hedging relationship in their full amount at inception, as they are expected to effectively hedge the interest rate exposure due in 2007 due to the matching of principal terms.

Foreign currency risk

Most of the Group s recurring revenue is denominated in HUF, but its Secured Bank Facility Loan is 84% denominated in EUR and only 16% in HUF. In addition the HY Bonds, the PIK Notes and the Related Party Subordinated Loan are also denominated in EUR, thus, the Group incurs significant foreign currency risk.

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According to the existing Hedging Policy the Group hedges at least 50 percent of the scheduled repayment of the EUR Secured Bank Facility Loan and the interest payment of the HY Bonds due within the next two years. The Group uses forward exchange contracts to hedge its foreign currency risk by purchasing forward EUR contracts at a fixed price. The forward exchange contracts have maturities from 29 June 2007 to 15 February 2008.

		Notional amount		Fair value	
(in thousands of EUR)		**At 31 March 2007** *(unaudited)*	**At 31 December 2006**	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Foreign exchange forward	hedging	29,948	40,988	(2,624)	(2,327)
Foreign exchange forward	non-hedging				
		29,948	40,988	(2,624)	(2,327)

As described in Note 2.13 the Group, based on its review of the classification of its foreign exchange forward portfolio and the putting into place various procedures to meet the hedging requirements of IAS 39, has applied fair value hedge accounting for the contracts designated into hedging relationships as from 1 January 2005. All forward foreign exchange contracts are stated at their fair value and the income statement resulting from the changes in the fair value has been recognized in the income statement as net financial expenses.

The fair value changes relating to changes on unrecognized firm commitments designated in fair value hedges is recognized as a derivative financial asset or liability against financial costs.

Reconciliation of derivative fair values

The tables below provide a reconciliation of the fair value of the derivative contracts outstanding at the reporting date to the balance sheet. As at the reporting date the fair value of derivatives were recognized in the balance sheet as Derivative Financial Instruments or as Other Non-Current Asset/Liability depending on the maturity of the contracts. As described in Note 2.13 the Company applies hedge accounting since 1 January 2005. As a result, the fair value of hedged items (firm commitments) is also recognized in the balance sheet as Derivative Financial Instruments or as Other Non-Current Asset/Liability depending on the maturity of the item being hedged.

		At 31 March 2007		
(in thousands of EUR)		**Positive**	**Negative** *(unaudited)*	**Net**
Fair value of fx forward contracts	current		2,624	(2,624)
Fair value of fx forward contracts	non-current			
Fair value of IRS contracts	current	432		432
Fair value of IRS contracts	non-current			
		432	**2,624**	**(2,192)**

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	At 31 December 2006		
(in thousands of EUR)	**Positive**	**Negative**	**Net**
Fair value of fx forward contracts current		2,327	(2,327)
Fair value of fx forward contracts non-current			
Fair value of IRS contracts current	470		470
Fair value of IRS contracts non-current			
	470	**2,327**	**(1,857)**

Fair value of non-current derivative financial instruments is presented in the balance sheet as follows:

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Positive fair value of fx forward contracts current		
Positive fair value of IRS contracts current	432	470
Fair value of hedged items (current)	1,028	985
Current Derivative Financial Instruments Assets	**1,460**	**1,455**

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Negative fair value of fx forward contracts current	2,624	2,327
Negative fair value of IRS contracts current		
Fair value of hedged items (current)		
Current Derivative Financial Instruments Liabilities	**2,624**	**2,327**

Fair values

The net carrying amounts of financial assets including cash, receivables and payables reflect reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

The market value of the HY Bonds was 111%, EUR 157,620 thousand as at 31 March 2007 as quoted on the Luxembourg Stock Exchange.

The fair value of the Secured Bank Facility Loan approximates the carrying amounts in the financial statements due to (i) the variable interest paid on this debt being re-priced at least on a semi-annual basis and (ii) the fact that the risk premium component of the interest paid to the bank syndicate reflects the credit risk of the Company as it changes in accordance with the Senior Debt to EBITDA ratio.

The shareholder loan bears fixed interest of 9.75% which is compounded on an annual basis. The fair value of the loan was approximately EUR 16.2 thousand at 31 March 2007, based on the net present value of future cash-flow using the estimated market rate and credit risk premium.

The fair value of the Investment Loan Facility approximates the carrying amounts in the financial statements due to the variable interest paid on this debt being re-priced at least on a quarterly basis.

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17. Other Non-Current Liabilities

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Financial lease	273	32
Total Other Non-Current Liabilities	**273**	**32**

18. Provisions

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Provision for restructuring	930	879
Provision for legal cases	6	5
Total Provisions	**936**	**884**

Provision for restructuring at 31 March 2007 relates to the expected costs arising from current plans of restructuring of Euroweb Hungary in connection with its acquisition by INVITEL and relocation of its premises.

Provision for legal cases relates to ongoing legal cases with former employees. These legal cases are expected to be closed during the next two years.

The amount of provisions made approximates the expected outflows of economic benefits.

19. Accrued Expenses and Deferred Income

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Accrued expenses	9,067	8,852
Accrued interest	1,934	6,254
Deferred income	2,319	1,781
Total Accrued Expenses and Deferred Income	**13,320**	**16,887**

20. Operating Leases

Total operating leases are payable as follows:

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
1 year or less	5,964	5,298
2-3 years	6,358	5,932
4-5 years	3,312	3,728
After 5 years	4,594	4,783
Total Operating Leases	**20,228**	**19,741**

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21. Capital Commitments

During the period ended 31 March 2007 the Group entered into several purchase contracts and commitments for future capital expenditures (including the purchase of new equipment or upgrading existing equipment).

The value of such capital commitments was EUR 2,774 thousand at 31 March 2007, and EUR 1,972 thousand at 31 December 2006 in the case of INVITEL. Current projects to which such capital commitments relate to include investment in information systems and customer service related infrastructure, data and voice transmission equipment, and access network construction. Capital commitments are expected to be realized during the course of the year.

Euroweb Romania has finance lease agreements that expire over the next two years. The future minimum lease payments arising from such finance leases are as follows: EUR 39 thousand in 2007 and EUR 37 thousand in 2008.

As at 31 March 2007 and 31 December 2006 the Group had the following outstanding payment guarantees:

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*		
Beneficiary	**Amount**	**Maturity**	**Guarantee issuer**
TeliaSonera International Carrier Hungária Távközlési Kft.	617	15/01/2008	Kereskedelmi és Hitelbank ZRt.
Hungarotel Távközlési ZRt.	51	05/10/2007	Kereskedelmi és Hitelbank ZRt.
Magyar Telecom Nyrt.	466	31/03/2007	Kereskedelmi és Hitelbank ZRt.
Einkaufs-Center Arkaden Pécs KG Magyarország Fióktelep	4	31/12/2007	Kereskedelmi és Hitelbank ZRt.
	1,138		

(in thousands of EUR)	**At 31 December 2006**		
Beneficiary	**Amount**	**Maturity**	**Guarantee issuer**
Hungarotel Távközlési ZRt.	51	05/10/2007	Kereskedelmi és Hitelbank ZRt.
	51		

22. Contingencies

The Group is involved in legal proceedings in the normal course of business. Based on legal advice, management does not expect the outcome of these cases to have a material effect on the Group s financial positions.

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The Group accounts for termination services provided by mobile operators at regulated interconnection rates. The mobile service providers have ongoing legal cases against the regulator with respect to such termination fees. Management of the Group believes that the outcome of such disputes will not have a significant impact on the consolidated interim financial statements of Matel, and accordingly no provision has been recorded in the consolidated interim financial statements for the possible return of amounts arising from reduced regulated interconnection rates.

23. Taxation

The Income taxes (expense) / benefit for the period comprises:

	For the three months ended 31 March	
(in thousands of EUR)	**2007**	**2006** *As Restated (Note 2.2.1)*
Current tax	(967)	(627)
Deferred tax	(1,184)	1,883
Income Tax (Expense) / Benefit	**(2,151)**	**1,256**

Matel is resident for tax purposes in the Netherlands and is subject to Dutch corporate income tax on its net worldwide income. As from 1 January 2007 the corporate income tax rate was reduced to 25.5% from 29.6%. Profits up to EUR 25,000 are subject to a rate of 20% and profits between EUR 25,000 and EUR 60,000 are taxed at 23.5%.

Since Matel s subsidiaries are subject to the participation exemption in Article 13 of the Dutch Corporate Income Tax Act, dividends received from the subsidiaries will not be subject to Dutch corporate income tax upon meeting the relevant criteria. It is not expected that Matel will derive any significant income from its investments in its subsidiaries in Hungary.

Matel is required to remit 8.3% withholding tax on dividends paid to its shareholders. Under certain conditions, the Dutch dividend withholding tax rate would be reduced if Matel distributed dividends to its shareholders out of dividends that it has received from its subsidiaries, providing the latter have been subject to a dividend withholding tax.

INVITEL, V-Holding and Euroweb Hungary are tax resident in Hungary and are taxed at flat corporate income tax rate of 16%. The tax basis is the adjusted unconsolidated pre-tax profit.

As of 1 September 2006, a new tax (the Solidarity Tax) was introduced in Hungary on top of the 16% corporate income tax. The rate of Solidarity Tax is 4%. The basis of Solidarity Tax is the unconsolidated adjusted pre-tax profit. Tax losses carried forward cannot be offset against the basis of the Solidarity Tax.

Euroweb Romania is tax resident in Romania. The Romanian corporate income tax rate is 16%.

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Deferred tax assets are attributable to the following items:

(in thousands of EUR)	Assets		Liabilities	
	31 March 2007 *(unaudited)*	**31 December 2006**	**31 March 2007** *(unaudited)*	**31 December 2006**
Tax loss carried forward	5,225	6,300		
Other non-current financial assets			132	98
Interest bearing borrowings			1,328	1,374
Intangible assets	608	626	684	674
Provisions	120	173		43
Property, plant and equipment	16	21		35
Deferred foreign exchange loss	663	669		
	6,632	**7,789**	**2,144**	**2,224**
Net Deferred Tax Assets	**4,488**	**5,565**		

Deferred tax liabilities are attributable to the following items:

(in thousands of EUR)	Assets		Liabilities	
	31 March 2007 *(unaudited)*	**31 December 2006**	**31 March 2007** *(unaudited)*	**31 December 2006**
Accrued Expenses and Deferred Income			116	118
Reserves			36	20
Provisions	12	23		
Other Non-Current liabilities		12		
Property, plant and equipment	40	43		
	52	**78**	**152**	**138**
Net Deferred Tax Liabilities			**100**	**60**

Deferred tax assets and liabilities are determined by the legal entities of the Group. Deferred tax is calculated at the Hungarian statutory tax rate of Hungary of 16% and in specific cases with additional 4% of solidarity tax for INVITEL and Euroweb Hungary and at the statutory tax rate of Romania of 16% in the case of Euroweb Romania.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. The Group has tax loss carry forwards in the amount of EUR 33,601 thousand at 31 March 2007. Tax loss carry forwards of EUR 936 thousand will expire in 2007 and EUR 20,348 thousand will expire in 2008. Of the tax loss carry forwards EUR 12,317 thousand is not subject to any statutory expiry limitations. Tax losses expiring in 2007 have not been provided for as deferred tax assets.

It is considered that the reduction in the cost base of the Group realized to date and the tax planning opportunities available to the companies, make it probable that sufficient future taxable profits will be available against which the tax loss carry forwards can be utilized.

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Reconciliation of effective tax rate is as follows:

(in thousands of EUR)	For the three months ended 31 March **2007**	**2006** *As Restated (Note 2.2.1)*
Net profit / (loss) before tax	6,228	(10,412)
Income tax using the parent company corporate tax rate	(1,424)	3,478
Solidarity tax paid	(298)	
Effect of tax rates in foreign jurisdictions	715	(1,659)
Local business tax	(645)	(627)
Tax on non-taxable income and non-deductible expenses	110	(63)
Tax losses and timing differences for which no deferred tax is recognized	(546)	(122)
Tass loss not previously recognized	(2)	122
Under / (over) provided in prior years	(61)	127
Income Tax (Expense) / Benefit	**(2,151)**	**1,256**

24. Related Party Transactions

Related parties at 31 March 2007 include the Group s subsidiaries, as well as Invitel Holdings, Matel Holdings, EEIF, GMT and key management personnel of the Group.

There were no related party transactions between the Group and related parties during the periods presented, other than disclosed earlier in these notes or described below.

EEIF and GMT provide management and consultancy services to the Group and charged EUR 137 thousand and EUR 132 thousand during the period ended 31 March 2007 and 2006 respectively for such services. Matel had EUR 128 thousand and EUR 73 thousand payable to EEIF and GMT at 31 March 2007 and 31 December 2006, respectively.

Matel Holdings charged to the Group the cost of the 2004 refinancing in the amount of EUR 617 thousand (see Note 15). The outstanding payable balance relating to these charges was EUR 624 thousand and EUR 620 thousand at 31 March 2007 and 31 December 2006, respectively.

Matel has incurred interest expense on Related Party Subordinated Loans in the amount of EUR 436 thousand and EUR 398 thousand for the period ended 31 March 2007 and 2006, respectively. The interest is payable to Matel Holdings and is capitalized onto the outstanding loan balance on an annual basis.

Salaries and other short-term employee benefits paid to key management personnel amounted to EUR 485 thousand and EUR 457 thousand for the period ended 31 March 2007 and 2006, respectively.

There have been no share based compensation, termination benefits, post-employment benefits or other long-term benefits paid to key management personnel during the periods ended 31 March 2007 and 2006. There have been no loans or guarantees provided to key management personnel during the periods ended 31 March 2007 and 2006.

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25. Segment Reporting

Transfers between segments of the Group are measured at fair value. The following table presents a summary of operating results of the Group by business segment for the period ended 31 March 2007 and 2006:

	For the three months ended 31 March	
(in thousands of EUR)	**2007**	**2006**
Revenue		
Mass Market Voice	18,005	20,305
Mass Market Internet	7,466	5,875
Business	15,660	10,464
Wholesale	8,328	6,484
Inter-segment elimination	(189)	
Total revenue	**49,270**	**43,128**
Cost of Sales		
Mass Market Voice	(3,220)	(3,229)
Mass Market Internet	(1,507)	(898)
Business	(4,783)	(2,647)
Wholesale	(5,920)	(4,527)
Inter-segment elimination	134	
Total cost of sales	**(15,296)**	**(11,301)**
Gross margin		
Mass Market Voice	14,785	17,076
Mass Market Internet	5,959	4,977
Business	10,877	7,817
Wholesale	2,408	1,957
Inter-segment elimination	(55)	
Total gross margin	**33,974**	**31,827**
Depreciation and amortization		
Mass Market Voice	(6,216)	(5,852)
Mass Market Internet	(681)	(637)
Business	(2,026)	(1,783)
Wholesale	(181)	(162)
Total segment depreciation	(9,104)	(8,434)
Unallocated depreciation	(1,003)	(783)
Total depreciation and amortization	**(10,107)**	**(9,217)**
Impairment loss		

Mass Market Voice		
Mass Market Internet	(64)	
Business		
Wholesale		
Total impairment loss	**(64)**	
Capital expenditure		
Mass Market Voice	2,016	1,882
Mass Market Internet	2,185	2,425
Business	2,397	1,936
Wholesale	1,059	203
Total capital expenditure	**7,657**	**6,446**

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The following table presents a summary of the assets and liabilities of the Group by business segment at 31 March 2007 and 31 December 2006:

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Assets		
Mass Market Voice	202,092	201,638
Mass Market Internet	24,349	23,642
Business	71,042	72,841
Wholesale	9,074	8,470
Inter-segment elimination	(884)	(496)
Total segment assets	305,673	306,095
Unallocated assets	36,223	42,145
Total assets	**341,896**	**348,240**
Liabilities		
Mass Market Voice	11,858	15,368
Mass Market Internet	4,901	4,957
Business	10,842	13,490
Wholesale	5,601	6,104
Inter-segment elimination	(476)	(496)
Total segment liabilities	32,726	39,423
Unallocated liabilities	272,418	277,592
Total liabilities	**305,144**	**317,015**

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The following table presents a summary of operating results of the Group by geographical segment for the period ended 31 March 2007 and 2006:

	For the three months ended 31 March	
(in thousands of EUR)	**2007**	**2006**
Revenue		
Hungary	46,949	43,128
Romania	2,510	
Inter-segment elimination	(189)	
Total revenue	**49,270**	**43,128**
Cost of Sales		
Hungary	(14,407)	(11,301)
Romania	(1,023)	
Inter-segment elimination	134	
Total cost of sales	**(15,296)**	**(11,301)**
Gross margin		
Hungary	32,542	31,827
Romania	1,487	
Inter-segment elimination	(55)	
Total gross margin	**33,974**	**31,827**
Depreciation and amortization		
Hungary	(8,931)	(8,434)
Romania	(173)	
Total segment depreciation	(9,104)	(8,434)
Unallocated depreciation	(1,003)	(783)
Total depreciation and amortization	**(10,107)**	**(9,217)**
Impairment loss		
Hungary	(64)	
Romania		
Total impairment loss	**(64)**	
Capital expenditure		
Hungary	7,487	6,446
Romania	170	

Total capital expenditure	**7,657**	**6,446**

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The following table presents a summary of the assets and liabilities of the Group by geographical segment at 31 March 2007 and 31 December 2006:

(in thousands of EUR)	**At 31 March 2007** *(unaudited)*	**At 31 December 2006**
Assets		
Hungary	298,659	299,594
Romania	7,898	6,997
Inter-segment elimination	(884)	(496)
Total segment assets	305,673	306,095
Unallocated assets	36,223	42,145
Total assets	**341,896**	**348,240**
Liabilities		
Hungary	30,860	37,444
Romania	2,342	2,475
Inter-segment elimination	(476)	(496)
Total segment liabilities	32,726	39,423
Unallocated liabilities	272,418	277,592
Total liabilities	**305,144**	**317,015**

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26. Expenses by function

The following table presents a summary of expenses by function of the Group for the period ended 31 March 2007 and 2006:

	For the three months ended 31 March	
(in thousands of EUR)	**2007**	**2006**
Revenue	49,270	43,128
Cost of sales	(15,296)	(11,301)
Gross margin	**33,974**	**31,827**
Depreciation	(9,104)	(8,434)
Personnel expenses	(1,555)	(1,297)
Headcount related costs	(278)	(239)
Network operating expenses	(3,500)	(2,974)
Distribution costs	**(14,437)**	**(12,944)**
Depreciation	(1,003)	(783)
Bad debt expenses	(66)	(328)
Collection costs	(406)	(352)
Legal and audit fees	(69)	(36)
Consultant expenses	(69)	(76)
Advertising and marketing costs	(555)	(660)
Personnel expenses	(4,146)	(3,433)
Headcount related costs	(1,400)	(1,457)
IT costs	(1,056)	(963)
Cost of reorganization	(162)	(184)
Due diligence expense	(112)	(297)
Capitalised costs	466	600
Administrative expenses	**(8,578)**	**(7,969)**
Management fee	(137)	(131)
Local operating and other taxes	(400)	(380)
Other costs, net	(188)	36
Other expenses	**(725)**	**(475)**
Profit from operations	**10,234**	**10,439**

27. Subsequent Events

On 20 April 2007 HTCC received the necessary approvals from the Hungarian Competition Office and the Romanian regulatory authorities relating to the acquisition of 100% of the shares in Matel Holdings.

Floating Rate Senior Notes

On 27 April 2007, HTCC Holdco II B.V. (HTCC Holdco II), a 100% subsidiary of HTCC issued Floating Rate Senior Notes (the 2007 Notes), in the aggregate principal amount of EUR 200 million (the Offering).

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The gross proceeds from the Offering were loaned partly to PanTel and Hungarotel (subsidiaries of HTCC) in order to refinance indebtedness of such subsidiaries (the Proceeds Loans) and were partly used to finance the Acquisition.

On 27 April 2007 HTCC completed the acquisition of Matel Holdings, whereby HTCC Holco I, a 100% subsidiary of HTCC and the 100% owner of HTCC Holdco II acquired all of the outstanding shares of Matel Holdings, Matel s 100% parent company (the Acquisition). Concurrently with the consummation of the Acquisition, HTCC Holdco II transferred to Matel substantially all of its assets, consisting of equity interests in Hungarotel, PanTel and PanTel Technocom and inter-company loans. In consideration for the transfer of such assets by HTCC Holdco II to Matel, Matel assumed all of the indebtedness and other obligations of HTCC Holdco II under the 2007 Notes.

The issue was at face value and resulted in cash proceeds of EUR 200 million. The cost of issuance of EUR 21 million will be deferred over the term of the 2007 Notes and will be recognised in the income statement using the effective interest rate method.

Application has been made to list the 2007 Notes to the Official List of the Luxembourg Stock Exchange and to trade the Notes on the Euro MTF, the alternative market of the Luxembourg Stock Exchange.

The 2007 Notes bear a variable interest charge of EURIBOR plus 3.0%. Interest on the 2007 Notes will accrue from the date of issuance and will be payable quarterly in arrears on 1 February, 1 May, 1 August and 1 November of each year, beginning on 1 August 2007. The final maturity of the 2007 Notes is on 1 February 2013.

Redemption option

At the option of Matel, it may redeem some or all of the 2007 Notes on or after 15 August 2008 at the redemption prices as follows, plus accrued and unpaid interest:

Year	Redemption price
2008	100.00%
2009	102.00%
2010	101.00%
2011 and thereafter	100.00%

At any time prior to 15 August 2008, Matel may redeem some or all of the 2007 Notes at a redemption price equal to 100% of their principal amount plus an Applicable Redemption Premium , together with accrued and unpaid interest up to the redemption date. The Applicable Redemption Premium means, with respect to any 2007 Note on any redemption date, the greater of: a) 1% of the then outstanding principal amount of the 2007 Notes and b) the excess of (i) the present value at such redemption date of (x) the redemption price of such 2007 Note at 15 August 2008 (assuming that the interest rate per annum on the 2007 Note applicable on the date on which the notice of redemption was given was in effect for the entire period) during the period between the redemption date and 15 August 2008 (excluding accrued but unpaid interest), computed using a discount rate equal to the Bund Rate at such redemption date plus 50 basis points; over (ii) the then outstanding principal amount of the 2007 Notes.

Matel is not required to make any mandatory redemption with respect to the 2007 Notes. However, under certain circumstances, Matel may be required to offer to purchase the 2007 Notes, such as change

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of control or in the event of certain asset sales. In the event of change of control, Matel must make an offer to purchase the 2007 Notes at a purchase price equal to 101% of the principal amount plus accrued and unpaid interest to the date of such purchase.

Covenants

In accordance with the 2007 Notes Indenture Matel will limited, among other things, in: (i) incurring additional indebtedness and issuing preferred shares, (ii) making investments and certain other restricted payments, (iii) issue or selling shares in its subsidiaries, (iv) transferring or selling assets and entering into sale and leaseback transactions.

Limitation on debt

Matel and any of its subsidiaries will only be permitted to incur additional debt if (i) after giving effect of the incurrence of such debt and the application of the proceeds thereof, on a pro-forma basis, no default or event of default would occur or be continuing and (ii) the Consolidated Leverage Ratio for Matel would be less than 5.0 to 1.0. The Consolidated Leverage Ratio is defined as the outstanding debt of Matel on a consolidated basis to the pro forma EBITDA for the period of the most recent four consecutive fiscal quarters.

Covenants on distribution

The aggregate amount of all restricted payments, including dividends or any other any other distributions, principal and interest payments of the Related Party Subordinated Loan prior to any scheduled payment or maturity date, shall not exceed 50% of Matel s consolidated adjusted net income on a cumulative basis during the period beginning on 1 January 2006 and ending on the last day of the last fiscal quarter ending prior to the date of such proposed payment.

In accordance with the 2007 Notes Indenture the aggregate amount of any other restricted payments shall not exceed EUR 20 million.

Guarantee and security

The obligations of Matel under the 2007 Notes are guaranteed on a senior subordinated basis by INVITEL, Hungarotel, PanTel, PanTel Technocom, Euroweb Hungary, Euroweb Romania and V-Holding.

A security deposit has been established in favour of the 2007 Note holders over the shares of Matel, the shares of Matel, held directly or indirectly in INVITEL and V-Holding, Euroweb Hungary, Euroweb Romania, Hungarotel, PanTel and PanTel Technocom. The 2007 Notes are also secured by the Proceeds Loans and the Related Party Subordinated Loan between Matel and INVITEL dated 6 August 2004.

PIK Notes

On 27 April 2007, in connection with the closing of the Acquisition, HTCC Holdco I entered into a supplemental bond indenture with Invitel Holdings as issuer and the Bank of New York as trustee relating to the PIK Notes (the PIK Indenture). Pursuant to the PIK Indenture, HTCC Holdco I replaced Invitel Holdings as the issuer of the PIK Notes and assumed all of the rights and obligations of the issuer.

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HTCC Holdco I s obligations under the PIK Notes are general unsubordinated obligations of HTCC Holdco I and are secured by a first priority lien over the shares of Matel Holdings and effectively subordinated to all existing and future debt of HTCC Holdco I s subsidiaries. In the event of change in control, HTCC Holdco I must make an offer to purchase the PIK Notes at a purchase price equal to 101% of the principal amount thereof. HTCC Holdco I is also required to make an offer to purchase the PIK Notes with the excess proceeds following certain asset sales at a purchase price equal to 101% of the principal amount thereof.

The PIK Indenture contains covenants restricting HTCC Holdco I s ability to, among other things, (i) incur additional indebtedness or issue preferred shares, (ii) make investments and certain other restricted payments, (iii) enter into transactions with affiliates, (iv) create certain liens, (v) enter into sales and leaseback transactions, (vi) issue or sell shares of HTCC Holdco I s restricted subsidiaries, (vii) merge, consolidate or combine with other entities, (viii) designate restricted subsidiaries as unrestricted subsidiaries, (ix) engage in unrelated business activities and (x) impair any security interests.

The PIK Indenture also contains customary events of default, including, among other things, non-payment of the principal, interest or premium, if any, on any PIK Notes, certain failures to comply with any of the covenants in the PIK Indenture, certain defaults under other indebtedness, failure to pay certan indebtedness or judgments, bankruptcy or insolvency events and invalidity of any security document or security interest.

Secured Bank Facility Loan

On 27 April 2007, in connection with the closing of the Acquisition, an amendment was made to the Facilities Agreement between Matel, INVITEL as borrower, certain Group companies as original guarantors, BNP Paribas and Credit Suisse First Boston International as arrangers, certain banks and financial institutions as original lenders, BNP Paribas as agents and BNP Paribas Trust Corporation UK Limited as security trustee. The Amended Facilties Agreement provides facilities of up to EUR 145 million, comprised of (i) an euro amortizing Term Loan of EUR 96.9 million, (ii) a Hungarian Forint amortizing Term Loan of HUF 4,628 million (approximately EUR 18 million), (iii) a Revolving Facility of EUR 4.2 million and HUF 200 million (approximately EUR 800 thousand), and (iv) an euro Liquidity Facility of EUR 25 million. Neither the Revolving Facility in item (iii) nor the Liquidity Facility in item (iv) were drawn down in connection with the Acquisition.

Interest

Advances under the Amended Facilities Agreement bear interest for each interest period at annual rates equal to EURIBOR or BUBOR plus an applicable margin. The applicable margin is set based on the ratio of INVITEL s senior debt to EBITDA, based on its most recently delivered monthly management accounts. Under the Amended Facilities Agreement, INVITEL is obliged to pay customary fees to the lenders, including an up-front fee and a commitment fee in relation to available and undrawn commitments under the revolving facility.

Guarantees

The obligations of INVITEL under the Amended Facilities Agreement are guaranteed on a senior basis by Matel, V-Holding, Euroweb Hungary, Euroweb Romania, Hungarotel, PanTel and PanTel Technocom. Additionally, INVITEL s obligations under the Amended Facilities Agreement are secured,

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subject to Hungarian, Dutch, Dutch Antilles and Romanian law, by (i) a first ranking pledge of all the share capital of the obligors, (ii) assignments of intercompany loans and any relevant cross guarantees of the obligors from time to time, (iii) a pledge of accounts by the obligors, and (iv) floating charges over all assets. Such security interests also secure, on a *pari passu* basis, all hedging obligations with respect to the Amended Facilities Agreement, the 2007 Notes and the High Yield Bonds.

Covenants

The Amended Facilities Agreement requires the obligors to maintain specified consolidated financial ratios, such as leverage ratios (total senior debt to EBITDA and total debt to EBITDA), an interest coverage ratio (EBITDA to total debt interest charges) and a fixed charge coverage ratio (EBITDA minus cash taxes to total debt charges).

Additionally, the Amended Facilities Agreement contains certain negative covenants that restrict the obligors and certain of their affiliated entities from, among other things, (i) creating or permitting to subsist any security interest over any part of its assets, (ii) merging or consolidating with or into any other person, (iii) selling, transferring, leasing, lending or otherwise disposing of any assets, (iv) incurring or permitting to be outstanding any financial indebtedness (including guarantees), (v) reducing capital or purchasing any class of their respective shares, (vi) making any investment, (vii) entering into any derivative instruments, (viii) changing the nature of their respective business or amending their respective constitutive documents, (ix) entering into any agreement or arrangement other than on an arm s-length basis, (x) paying dividends or making any repayment, prepayment or redemption of principal under any subordinated finance documents except the issuance of the 2007 Notes or in exchange for equity of an obligor, (xi) changing the ownership structure of the Group, and (xii) maintaining any bank account that has credit balance with any person that is not a lender under the Amended Facilities Agreement.

Under the terms of the Amended Facilities Agreement, the obligors and certain of their affiliated entities are required to observe certain affirmative undertakings, including, but not limited to, undertakings relating to (i) maintenance of relevant consents, authorizations and licenses, (ii) conduct of business, (iii) periodic financial statements, management accounts and reports, (iv) auditors information, (v) insurance and inspection, (vi) notification of environmental claims and expenditures, (vii) compliance with laws, (viii) taxes, and (ix) maintenance of a cost capitalization policy and an interest rate hedging policy.

Repayment

The Term Loans matures on 30 June 2011 and the Revolving Facility and Liquidity Facility mature on 30 June 2010. No amount repaid or prepaid in relation to the Term Loans may be redrawn.

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The Term Loans are amortizing term loans. The outstanding amounts under these Term Loans will be required to be repaid in the installments and the dates as follows:

Date	Repayment Installment
30 June 2007	3.50%
30 September 2007	3.50%
31 December 2007	3.50%
31 March 2008	4.00%
30 June 2008	4.00%
30 September 2008	4.00%
31 December 2008	4.25%
31 March 2009	4.50%
30 June 2009	4.50%
30 September 2009	4.50%
31 December 2009	4.50%
31 March 2010	5.00%
30 June 2010	5.00%
30 September 2010	5.00%
31 December 2010	5.00%
31 March 2011	5.50%
30 June 2011	5.50%

The Revolving Facility and the Liquidity Facility are each repayable in an amount equal to 100% of the principal amount outstanding on 29 June and 30 December of each calendar year until the maturity date of 30 June 2010.

Subject to certain exceptions, all loans under the Amended Facilities Agreement will be required to be prepaid upon the occurrence of certain change of control events. Voluntary prepayments and cancellations are permitted.

Events of default

The Amended Facilities Agreement contain certain events of default customary for senior debt financings as well as an event of default related to Matel Holdings engaging in non-holding company-related activities, the occurrence of which would preclude further borrowings under the Revolving Facility and permit the lenders to accelerate all outstanding loans and terminate their commitments inder the Amended Facilities Agreement.

Intercreditor agreement

In order to reflect the new obligations under the 2007 Notes and hedging obligations and to establish the relative rights of certain of its creditors under the new financing arrangements described above, Hungarotel, PanTel and PanTel Technocom joined the Intercreditor Agreement with, among others, the lenders under the Amended Facilities Agreement, certain hedging counterparties, the security trustee, the trustee for the holders of the 2007 Notes and the trustee for the High Yield Bonds. The Intercreditor Agreement provides that if there is inconsistency between the provisions of the Intercreditor Agreement (regarding subordination, turnover, ranking and amendments only), and certain documents, including the Indenture governing the 2007 Notes, the Intercreditor Agreement will prevail.

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ANNEX A

AGREEMENT AND PLAN OF MERGER

AMONG

HUNGARIAN TELEPHONE AND CABLE CORP.,

INVITEL HOLDINGS A/S,

AND

INVITEL SUB LLC

Dated as of November 27, 2008

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AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER (this Agreement), dated as of November 27, 2008, among HUNGARIAN TELEPHONE AND CABLE CORP., a Delaware corporation (HTCC Delaware), INVITEL HOLDINGS A/S, a Danish company (Invitel Denmark), and INVITEL SUB LLC, a Delaware limited liability company (Merger Sub).

WHEREAS, the Board of Directors of HTCC Delaware has determined that it is advisable and in the best interests of HTCC Delaware and its stockholders that HTCC Delaware effectively migrate to Denmark so that Invitel Denmark will be the new holding company, as the successor in all respects to HTCC Delaware, for the businesses of HTCC Delaware and its subsidiaries taken as a whole;

WHEREAS, Invitel Denmark has been organized by HTCC Delaware as a wholly owned direct subsidiary of HTCC Delaware, and the Board of Directors of HTCC Delaware has nominated, designated, elected and approved the initial directors of Invitel Denmark;

WHEREAS, Merger Sub has been organized by Invitel Denmark as a Delaware single member limited liability company;

WHEREAS, the Board of Directors of HTCC Delaware and the Board of Directors and management of Invitel Denmark have determined that is advisable and in the best interests of HTCC Delaware and Invitel Denmark, respectively, for HTCC Delaware to transfer all of its assets to Invitel Denmark in consideration for the issuance of ordinary shares, par value 0.01 per ordinary share (Invitel Denmark Ordinary Shares), in the capital of Invitel Denmark to HTCC Delaware and the assumption by Invitel Denmark of all obligations and liabilities of HTCC Delaware, on the terms and subject to the conditions set forth in this Agreement;

WHEREAS, the Board of Directors of HTCC Delaware has determined that it is in the best interests of HTCC Delaware and its stockholders, and has approved and declared it advisable, that HTCC Delaware enter into this Agreement and consummate the merger of HTCC Delaware with and into Merger Sub, on the terms and subject to the conditions set forth in this Agreement (the Merger);

WHEREAS, Merger Sub, through the approval by Invitel Denmark, as the sole member of Merger Sub, has approved the Merger;

WHEREAS, pursuant to the Merger, each outstanding share of common stock, par value $0.001 per share (HTCC Delaware Common Stock), of HTCC Delaware, other than those shares of HTCC Delaware Common Stock held by HTCC Delaware or any direct or indirect wholly-owned subsidiary of HTCC Delaware, shall be automatically converted into the right to receive one American depositary share, representing one Invitel Denmark Ordinary Share (each an Invitel Denmark ADS); provided that a holder of HTCC Delaware Common Stock will be permitted to elect to receive Invitel Denmark Ordinary Shares instead of Invitel Denmark ADSs, subject to the terms and conditions set forth in this Agreement; and

WHEREAS, the consummation of the Merger requires, among other things, the adoption of this Agreement by the affirmative vote of a majority of the stock of HTCC Delaware entitled to vote (the HTCC Delaware Shareholder Approval);

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NOW, THEREFORE, the parties agree as follows:

ARTICLE I

ASSET AND LIABILITY TRANSFER

SECTION 1.1. Transfer of Assets. Upon the terms and subject to the conditions set forth in this Agreement:

(a) prior to the Effective Time (as defined below), HTCC Delaware shall sell, assign, transfer, convey and deliver to Invitel Denmark, and Invitel Denmark shall purchase and assume, all of the assets, rights, properties, claims, contracts and business of HTCC Delaware, of every kind, nature, character and description, tangible and intangible, real, personal or mixed, wherever located, other than the Delayed Rights (as defined below) and other than the right to receive the Invitel Denmark Ordinary Shares issued in accordance with Section 1.3; and

(b) immediately after the Effective Time, Merger Sub shall sell, assign, transfer, convey and deliver to Invitel Denmark, and Invitel Denmark shall purchase and assume all right, title and interest of Merger Sub (both individually and as the Surviving Entity (as defined below)) in, to, under and arising out of this Agreement (the Delayed Rights and, together with the assets, rights, properties, claims, contracts and business referred to in Section 1.1(a), the HTCC Assets). As of the time of transfer, risk of loss as to the HTCC Assets shall pass from HTCC Delaware to Invitel Denmark.

SECTION 1.2. Transfer and Assumption of Liabilities. Upon the terms and subject to the conditions set forth in this Agreement:

(a) prior to the Effective Time, Invitel Denmark shall assume and agree to pay, perform and discharge when due, all debts, liabilities and obligations whatsoever of HTCC Delaware, whether arising before or after the time of transfer, and whether known or unknown, fixed or contingent, accrued or un-accrued, all to the extent the same are unpaid, undelivered or unperformed at such time, other than the Delayed Obligations (as defined below); and

(b) immediately following the Effective Time, Invitel Denmark shall assume and agree to pay, perform and discharge when due, all debts, liabilities and obligations of Merger Sub (both individually and as the Surviving Entity), in, to, under or arising out of this Agreement or the transactions contemplated hereby, whether arising before or after such time, and whether known or unknown, fixed or contingent, accrued or un-accrued, all to the extent the same are unpaid, undelivered or unperformed at such time (the Delayed Obligations and, together with the debts, liabilities and obligations referred to in Section 1.2(a), the HTCC Liabilities).

SECTION 1.3. Consideration for Transfer of Assets. As consideration for the transfer of the HTCC Assets contemplated by Section 1.1(a) and the agreement to accept the transfer of the Delayed Rights contemplated by Section 1.1(b), Invitel Denmark shall assume and agree to assume the HTCC Liabilities in accordance with Section 1.2, and, prior to the Effective Time, Invitel Denmark shall issue and deliver to HTCC Delaware a number of Invitel Denmark Ordinary Shares equal to the number of shares of HTCC Delaware Common Stock issued and outstanding and to be issued and outstanding at the Effective Time, all of which shall, upon issuance, be validly issued, fully paid and non-assessable.

SECTION 1.4. Additional Documentation. Each party agrees to do all acts and things and to execute and deliver all such further written instruments, including without limitation powers of attorney, contribution agreements, transfer instruments, bills of sale, receipts and other documents, which may be governed by such laws as may be considered necessary or desirable by the parties executing the same, as may be reasonably required in order to consummate and make effective the transfer of the HTCC Assets and the assumption of the HTCC Liabilities in accordance with this Agreement.

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ARTICLE II

THE MERGER

SECTION 2.1. The Merger. Upon the terms and subject to the conditions of this Agreement and in accordance with the Delaware General Corporation Law (the DGCL) and the Delaware Limited Liability Company Act (the DLLC Act), at the Effective Time (as defined below), HTCC Delaware shall be merged with and into Merger Sub. As a result of the Merger, the separate corporate existence of HTCC Delaware shall cease and Merger Sub shall continue as the surviving entity of the Merger (the Surviving Entity).

SECTION 2.2. Effective Time. Subject to the provisions of Article V, the closing of the Merger (the Merger Closing) shall take place on the Closing Date (as defined below) immediately after the transfer of the HTCC Assets, other than the Delayed Rights, and the assumption of the HTCC Liabilities, other than the Delayed Obligations, unless the parties shall mutually agree upon a different place or a later time for the Merger Closing. At the Merger Closing, the parties hereto shall cause the Merger to be consummated by filing a certificate of merger (the Certificate of Merger) with the Secretary of State of the State of Delaware, in such form as required by, and executed and acknowledged in accordance with, the relevant provisions of the DGCL and the DLLC Act (the date and time of the filing of the Certificate of Merger with the Secretary of State of the State of Delaware, or such later time as is specified in the Certificate of Merger and as is agreed to by the parties hereto, being hereinafter referred to as the Effective Time) and shall make all other filings or recordings required under the DGCL and the DLLC Act in connection with the Merger.

SECTION 2.3. Effects of the Merger. The Merger shall have the effects set forth in this Agreement and the applicable provisions of the DGCL and DLLC Act. Without limiting the generality of the foregoing and subject thereto, at the Effective Time, all the property, rights, privileges, immunities, powers and franchises of HTCC Delaware and Merger Sub shall vest in the Surviving Entity and all debts, liabilities and duties of HTCC Delaware and Merger Sub shall become the debts, liabilities and duties of the Surviving Entity.

SECTION 2.4. Certificate of Formation and Limited Liability Company Agreement. (a) At the Effective Time, the certificate of formation of Merger Sub in effect immediately prior to the Effective Time shall be the certificate of formation of the Surviving Entity until thereafter amended as provided by law.

(b) At the Effective Time, the limited liability company agreement of Merger Sub in effect immediately prior to the Effective Time shall be the limited liability company agreement of the Surviving Entity until thereafter amended in accordance with its terms and as provided by law.

SECTION 2.5. Officers. As of the Effective Time, the officers of HTCC Delaware immediately prior to the Effective Time shall be the officers of the Surviving Entity, each to hold office until the earlier of his or her resignation or removal.

SECTION 2.6. Conversion of Capital Stock. At the Effective Time, by virtue of the Merger and without any action on the part of HTCC Delaware, Merger Sub or the holders of any of the following securities:

(a) HTCC Delaware Common Stock. Each share of HTCC Delaware Common Stock issued and outstanding immediately prior to the Effective Time (each, a Common Share), other than any Cancelled Shares (as defined herein), shall be converted into the right to receive one Invitel Denmark ADS; provided that, if a holder of one or more Common Shares makes a proper election in such holder s Letter of Transmittal (as defined herein) to receive an Invitel Denmark Ordinary Share in respect of such Common Shares, then such holder shall be entitled to receive Invitel Denmark Ordinary Shares instead of Invitel Denmark ADSs in respect of such Common Shares (the Common Stock Merger Consideration).

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(b) Series A Preferred Stock. Each share of Series A Preferred Stock, par value $0.01 per share, of HTCC Delaware issued and outstanding (and not converted into Common Shares prior to the Effective Time), if any, immediately prior to the Effective Time (each, a Preferred Share and, together with the Common Shares, the Shares) shall immediately prior to the Effective Time be converted into the right to receive the amounts provided in the certificate of designation of the Series A Preferred Stock upon a merger of HTCC Delaware (such amount, the Preferred Stock Merger Consideration).

(c) Shares Held by HTCC Delaware or any Subsidiary of HTCC Delaware. Each Share held in treasury by HTCC Delaware or held by any direct or indirect subsidiary of HTCC Delaware immediately prior to the Effective Time, if any (collectively, the Cancelled Shares), shall, by virtue of the Merger and without any action on the part of the holder thereof, be cancelled without any conversion thereof and no payment or distribution shall be made with respect thereto.

(d) Merger Sub Membership Interest. The sole membership interest in Merger Sub held by Invitel Denmark immediately prior to the Effective Time shall be converted into and become the sole membership interest in Surviving Entity.

SECTION 2.7. Establishment of Invitel Denmark ADSs, Exchange of Stock and Certain Additional Matters. (a) Prior to the Effective Time, Invitel Denmark, HTCC Delaware and a depositary selected by HTCC Delaware (the Depositary) will enter into a Deposit Agreement (the Deposit Agreement) among Invitel Denmark, HTCC Delaware, the Depositary and the holders and beneficial owners from time to time of Invitel Denmark ADSs, which will be evidenced by depositary receipts (Invitel Denmark ADRs). Invitel Denmark, as the successor to HTCC Delaware in accordance with Article I, shall pay for all Danish stamp duties, stamp duty reserve tax and other similar taxes and similar levies imposed in connection with the issuance or creation of the Invitel Denmark ADSs to be delivered in the Merger and any Invitel Denmark ADRs in connection therewith and any other Danish stamp duty, stamp duty reserve tax or other similar Danish governmental charge (or any interest or penalties thereon) that may be payable by Invitel Denmark pursuant to the Deposit Agreement.

(b) Prior to the mailing to the stockholders of HTCC Delaware of the prospectus/proxy statement included in the registration statement on Form F-4 of Invitel Denmark (the Registration Statement) that becomes effective under the U.S. Securities Act of 1933, as amended, in connection with the transactions contemplated by this Agreement, HTCC Delaware shall select a bank or trust company to act as exchange agent in connection with the Merger (the Exchange Agent) for the purpose of exchanging certificates representing Common Shares (Certificates) or Common Shares represented by book-entry (Book-Entry Shares) for Invitel Denmark ADRs (or, if a proper election is made as described herein, Invitel Denmark Ordinary Shares).

(c) The Exchange Agent shall act as the agent for each holder of Common Shares to receive the Common Stock Merger Consideration which such holder shall become entitled to receive with respect to such holder s Common Shares pursuant to this Article II.

(d) Invitel Denmark (as the successor to the Surviving Entity in accordance with this Agreement) shall deposit, or cause the Depository to deposit, with the Exchange Agent, from time to time, that number of Invitel Denmark ADRs and Invitel Denmark Ordinary Shares, as applicable, in any denominations as the Exchange Agent shall specify, as are deliverable pursuant to this Article II in respect of Common Shares for which Certificates or Book-Entry Shares have been properly delivered to the Exchange Agent.

(e) Promptly after the Effective Time, Invitel Denmark shall cause to be mailed to each record holder, as of the Effective Time, of Common Shares (i) a form of letter of transmittal (the Letter of Transmittal) (which shall specify that delivery shall be effected, and risk of loss and title to the Certificates held by such holder representing such Common Shares shall pass, only upon proper delivery of the Certificates to the Exchange Agent or, in the case of Book-Entry Shares, upon adherence to the procedures set forth in the Letter of Transmittal) and (ii) instructions for use in effecting the surrender of the Certificates or, in the case of

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Book-Entry Shares, the surrender of such Common Shares, for payment of the Common Stock Merger Consideration therefor, including instructions concerning the making of the election to receive Invitel Denmark Ordinary Shares instead of Invitel Denmark ADSs evidenced by one or more Invitel Denmark ADRs.

(f) Each holder of Common Shares shall be entitled to receive in exchange for such holder s Common Shares, and upon surrender to the Exchange Agent of a Certificate or Book-Entry Shares, as applicable, together with a Letter of Transmittal, duly completed and validly executed in accordance with the instructions thereto, and such other documents as may be required pursuant to such instructions, the number of Invitel Denmark ADSs (or, if a proper election has been made in such Letter of Transmittal, Invitel Denmark Ordinary Shares) specified by such holder in accordance with the Letter of Transmittal into which such holder s Common Shares represented by such holder s properly surrendered Certificates or Book-Entry Shares, as applicable, were converted in accordance with this Article II.

(g) No interest shall be paid or accrued for the benefit of holders of the Certificates or Book-Entry Shares on the Common Stock Merger Consideration payable in respect of the Certificates or Book-Entry Shares. If delivery of the Common Stock Merger Consideration is to be made to a person other than the person in whose name the surrendered Certificate is registered, it shall be a condition of delivery that the Certificate so surrendered shall be properly endorsed or shall be otherwise in proper form for transfer and that the person requesting such delivery shall have paid to the Exchange Agent any transfer and other taxes required by reason of the delivery of the Common Stock Merger Consideration to a person other than the registered holder of the Certificate surrendered or shall have established to the satisfaction of the Exchange Agent that such tax either has been paid or is not applicable. Until so surrendered, each Certificate or Book-Entry Share shall, after the Effective Time, represent for all purposes only the right to receive upon such surrender the Common Stock Merger Consideration as contemplated by this Article II.

(h) At the Effective Time, the stock transfer books of HTCC Delaware shall be closed and thereafter there shall be no further registration of transfers of Shares that were outstanding prior to the Effective Time. After the Effective Time, Certificates or Book-Entry Shares presented to the Surviving Corporation for transfer shall be cancelled and exchanged for the Common Stock Merger Consideration provided for, and in accordance with the procedures set forth, in this Article II.

(i) Subject to mandatory provisions of applicable Danish law, any Invitel Denmark ADSs (or Invitel Denmark Ordinary Shares) to be delivered to holders of Common Shares that remains unclaimed by any former holder of Common Shares nine months after the Effective Time (Unclaimed Securities) shall be treated in accordance with this Section 2.7(i), and the parties undertake and agree to take all reasonable actions in order to give effect to these provisions in accordance with applicable Danish law. Any Unclaimed Securities shall be held by the Exchange Agent (or a successor agent appointed by Invitel Denmark) or shall be delivered to Invitel Denmark (and/or to the Depositary upon the instruction of Invitel Denmark and held by the Depositary subject to the instruction of Invitel Denmark in an account or accounts designated for this purpose). Invitel Denmark shall not be liable to any former holder of Common Shares for any securities properly delivered or any amount properly paid by the Depositary, the Exchange Agent or its nominee, as the case may be, to a public official pursuant to applicable abandoned property, escheat or similar law. If any Certificate or Book-Entry Shares has not been surrendered prior to two years after the Effective Time (or immediately prior to an earlier date on which the Common Stock Merger Consideration in respect of the Certificate or Book-Entry Shares would otherwise escheat to or become the property of any governmental entity), any cash, share dividends and distributions otherwise payable in respect of the Certificate or Book-Entry Shares shall, to the extent permitted by applicable law, become the property of Invitel Denmark, free and clear of all claims or interest of any person previously entitled thereto.

(j) No dividends or other distributions with respect to Invitel Denmark ADSs or Invitel Denmark Ordinary Shares deliverable with respect to the Common Shares shall be paid to the holder of any un-surrendered Certificates or Book-Entry Shares until those Certificates or Book-Entry Shares are surrendered as provided in

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this Article II. Upon surrender, there shall be issued and/or paid to the holder of the Invitel Denmark ADSs or Invitel Denmark Ordinary Shares deliverable in exchange therefor, without interest, (A) at the time of surrender, the dividends or other distributions payable with respect to those Invitel Denmark ADSs or Invitel Denmark Ordinary Shares with a record date on or after the date of the Effective Time and a payment date on or prior to the date of this surrender and not previously paid and (B) at the appropriate payment date, the dividends or other distributions payable with respect to those Invitel Denmark ADSs or Invitel Denmark Ordinary Shares with a record date on or after the date of the Effective Time but with a payment date subsequent to surrender.

(k) In the event that any Certificate shall have been lost, stolen or destroyed, upon the holder s compliance with the replacement requirements established by the Exchange Agent, including, if necessary, the posting by the holder of a bond in customary amount as indemnity against any claim that may be made against it with respect to the Certificate, the Exchange Agent shall deliver in exchange for the lost, stolen or destroyed Certificate the applicable Common Stock Merger Consideration payable in respect of the Common Shares represented by the Certificate pursuant to this Article II.

(l) Notwithstanding anything in this Agreement to the contrary, Invitel Denmark and the Exchange Agent shall be entitled to deduct and withhold from the any consideration payable to any former holder of Common Shares pursuant to this Agreement any amounts as may be required to be deducted and withheld with respect to the making of such payment under the U.S. Internal Revenue Code of 1986, as amended, or under any provision of state, local or non-U.S. tax law. To the extent that amounts are so withheld and paid over to the appropriate taxing authority, the payor shall be treated as though it withheld an appropriate amount of the type of consideration otherwise deliverable pursuant to this Agreement to any former holder of Common Shares, sold this consideration for an amount of cash equal to the fair market value of the consideration at the time of the deemed sale and paid these cash proceeds to the appropriate taxing authority.

SECTION 2.8. Stock Option and Award Plans. HTCC Delaware currently maintains and sponsors plans and agreements providing for the grant or award to its employees of options or other rights to purchase or receive HTCC Delaware Common Stock (the Employee Stock Plans). HTCC Delaware also maintains and sponsors plans and agreements providing for the grant or award to its directors of options or other rights to purchase or receive HTCC Delaware Common Stock (the Director Stock Plans). In accordance with the Employee Stock Plans and the Director Stock Plans, the parties shall take all actions necessary or desirable in order that, immediately following the Effective Time, the Employee Stock Plans and the Director Stock Plans shall be amended and revised to:

(i) provide that Invitel Denmark will continue the sponsorship of the Employee Stock Plans and assume sponsorship of the Director Stock Plans;

(ii) all options to acquire shares of HTCC Delaware Common Stock (HTCC Delaware Options) then outstanding and unexercised immediately prior to the Effective Time shall thereafter represent the right to acquire, on the same terms and conditions as were applicable under the HTCC Delaware Stock Options prior to the Effective Time (except as otherwise specifically provided herein), that number of Invitel Denmark Ordinary Shares equal to the number of shares of HTCC Delaware Common Stock subject to such HTCC Delaware Options held by such individual, at a price per share (rounded up, if necessary to a one-hundredth of a cent) equal to the per share exercise price specified in such HTCC Delaware Option. Such exercise price shall be converted from U.S. Dollars to Euros based on the average of two exchange rates quoted to HTCC Delaware, from two financial institutions to be selected by HTCC Delaware (which financial institutions may be lenders under the HTCC Delaware group s senior credit facility agreements) as calculated by the Board of Directors of HTCC Delaware or by the Chief Financial Officer of HTCC Delaware (provided that such Chief Financial Officer is not the holder of any HTCC Delaware Options) on the Closing Date. Such calculation shall be binding on HTCC Delaware, Invitel Denmark and the holders of the HTCC Delaware Options (and the Invitel

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Denmark Options (as defined below)) and their respective successors, in the absence of manifest error. Such rights shall hereinafter be referred to as Invitel Denmark Options .

ARTICLE III

SUCCESSION

SECTION 3.1. Succession. The parties to this Agreement intend that, upon consummation of the transactions contemplated in this Agreement, Invitel Denmark shall be the successor to, and be substituted for, HTCC Delaware, with the same effect as if HTCC Delaware had merged with and into Invitel Denmark, and Invitel Denmark were the surviving corporation in such merger, all as if Section 259 of the DGCL had applied to such merger.

ARTICLE IV

CLOSING

SECTION 4.1. Closing. Subject to the provisions of Article V, the closing of the transactions in this Agreement, including without limitation the transactions contemplated by Articles I and II hereof (the Closing), shall take place at such place and time, after February 2, 2009, as shall be agreed by the parties. The date on which the Closing actually occurs is hereinafter referred to as the Closing Date .

ARTICLE V

CONDITIONS PRECEDENT

SECTION 5.1. Conditions to Each Party s Obligation to Effect the Closing and the Merger. The respective obligation of each party to effect the transactions contemplated hereby at the Closing (including without limitation the Merger) is subject to the satisfaction or waiver of each of the following conditions:

(a) The HTCC Delaware Shareholder Approval shall have been obtained.

(b) Each holder of a Preferred Share shall have, either:

(i) properly and validly converted its Preferred Shares into shares of HTCC Delaware Common Stock prior to the Closing; or

(ii) delivered to HTCC Delaware a duly executed written waiver (in form and substance satisfactory to HTCC Delaware) of:

(A) notice of such holder s appraisal rights under Section 262 of the DGCL in connection with the transactions contemplated by this Agreement; and

(B) any and all other rights and claims such holder has or may have under Section 262 of the DGCL in connection with the transactions contemplated by this Agreement.

(c) All required consents, waivers and amendments shall have been obtained in respect of (i) the senior credit facilities agreement, dated August 6, 2004, between Invitel (as borrower), Matel (as guarantor), BNP Paribas (as coordinator), BNP Paribas and Credit Suisse First Boston (as arrangers), certain lenders, BNP Paribas and BNP Paribas Hungary (as agents) and BNP (as security trustee) and (ii) the bridge loan agreement, dated March 3, 2008, among Matel (as borrower), Invitel, Invitel Telecom, Invitel Technocom, Memorex and Memorex Turkey (as guarantors), and Merrill Lynch and BNP Paribas (as arrangers and lenders), so that the transactions contemplated hereby will not result in any default, event of default or acceleration of any indebtedness thereunder.

(d) The Registration Statement and a registration statement on Form F-6 with respect to the Invitel Denmark ADSs shall have become effective and no stop order suspending the effectiveness of the Registration Statement or such registration shall then be in effect, and no proceeding for that purpose shall then be threatened by the SEC or shall have been initiated by the SEC and not concluded or withdrawn, and all state securities or blue sky permits or approvals required to consummate the Merger shall have been received.

(e) The Invitel Denmark ADSs shall have been authorized for listing on the NYSE Alternext U.S. LLC or another U.S. national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc., subject in each case to notice of official issuance.

(f) All filings and notices required to be made prior to the Closing with, and all material consents, approvals, permits and authorizations required to be obtained prior to the Closing from, any court or governmental or regulatory authority or agency in the United States or any non-U.S. jurisdiction, or other person in connection with the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby shall have been made or obtained (as the case may be).

(g) No temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction or other legal restraint or prohibition preventing the consummation of the Closing or any of the other transactions contemplated hereby shall be in effect.

ARTICLE VI

TERMINATION, AMENDMENT AND WAIVER

SECTION 6.1. Termination. This Agreement may be terminated at any time prior to the Closing, whether before or after the HTCC Delaware Shareholder Approval, by action of the Board of Directors of HTCC Delaware and by Invitel Denmark and Merger Sub.

SECTION 6.2. Effect of Termination. In the event of termination of this Agreement as provided in Section 6.1, this Agreement shall forthwith become void and have no effect, without any liability or obligation on the part of any party hereto, other than the provisions of this Article VI and Article VII.

SECTION 6.3. Amendment. This Agreement may be amended by the parties at any time before or after the HTCC Delaware Shareholder Approval; provided, however, that, after any such approval, there shall not be made any amendment that alters or changes the amount or kind of securities to be received by holders of HTCC Delaware Common Stock in the Merger or alters or changes any other terms and conditions of this Agreement if any of the alterations or changes, alone or in the aggregate, would materially adversely affect the holders of shares of HTCC Delaware Common Stock. This Agreement may not be amended except by an instrument in writing signed on behalf of each of the parties.

SECTION 6.4. Waiver. At any time prior to the Closing, the parties may waive compliance by the other parties with any of the agreements or conditions contained in this Agreement. Any agreement on the part of a party to any such waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party. The failure of any party to this Agreement to assert any of its rights under this Agreement or otherwise shall not constitute a waiver of such rights.

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SECTION 6.5. Procedure For Termination, Amendment, Extension or Waiver. A termination of this Agreement pursuant to Section 6.1, an amendment of this Agreement pursuant to Section 6.3 or a waiver pursuant to Section 6.4 shall, in order to be effective, require action by the Board of Directors of HTCC Delaware and/or by Invitel Denmark and Merger Sub.

ARTICLE VII

GENERAL PROVISIONS

SECTION 7.1. Notices. All notices, requests, claims, demands and other communications under this Agreement shall be in writing and shall be deemed given if delivered personally, telecopied (which is confirmed) or sent by overnight courier (providing proof of delivery) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

(a) If to HTCC Delaware

1201 Third Avenue

Suite 3400

Seattle, Washington 98101-3034

Attention: General Counsel and Secretary

Telecopy: +1 (206) 583-0359

-and-

Invitel

Puskas Tivadar u.8-10

2040 Budapest

Hungary

Attention: Chief Executive Officer

Telecopy: +36 (1) 801 1555

(b) If to Invitel Denmark:

c/o Invitel

Puskas Tivadar u.8-10

2040 Budapest

Hungary

Attention: Chief Executive Officer

Telecopy: +36 (1) 801 1555

(c) If to Merger Sub:

c/o Invitel

Puskas Tivadar u.8-10

2040 Budapest

Hungary

Attention: Chief Executive Officer

Telecopy: +36 (1) 801 1555

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In each case, a copy (for information only) shall be provided to:

Simpson Thacher & Bartlett LLP

CityPoint

One Ropemaker Street

London

EC2Y 9HU

Attention: Michael Wolfson

Telecopy: +44 20 7275 6502

SECTION 7.2. Entire Agreement; No Third-Party Beneficiaries. This Agreement (including the documents and instruments referred to herein) (a) constitutes the entire agreement and supersedes all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter of this Agreement and (b) is not intended to confer upon any person other than the parties any rights or remedies.

SECTION 7.3. Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Delaware regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

SECTION 7.4 Counterparts. The parties may execute this Agreement in counterparts, each of which is deemed an original and all of which constitute one agreement.

[Agreement continued on next page.]

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be signed by their respective officers thereunto duly authorized, all as of the date first written above.

HUNGARIAN TELEPHONE AND CABLE CORP.

By: /s/ Henrik Scheinemann
Name: Henrik Scheinemann
Title: Chairman

INVITEL HOLDINGS A/S

By: /s/ Henrik Scheinemann
Name: Henrik Scheinemann
Title: Chairman

By: /s/ Robert Bowker
Name: Robert Bowker
Title: Chief Financial Officer

INVITEL SUB LLC

By: INVITEL HOLDINGS A/S, its sole member

By: /s/ Henrik Scheinemann
Name: Henrik Scheinemann
Title: Authorized Representative

By: /s/ Robert Bowker
Name: Robert Bowker
Title: Authorized Representative

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FORM

VEDTÆGTER/ARTICLES OF ASSOCIATION

for/of Invitel Holdings A/S

CVR-nummer 31586224/company reg.no. 31586224

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VEDTÆGTER/ARTICLES OF ASSOCIATION

		The English version is a translation of the Danish. In case of any discrepancies, the Danish version shall be the governing text.
1.	**NAVN**	**NAME**
	Selskabets navn er Invitel Holdings A/S.	The name of the company is Invitel Holdings A/S.
2.	**HJEMSTED**	**REGISTERED OFFICE**
	Selskabets hjemsted er Københavns Kommune.	The registered office of the company is situated in the Municipality of Copenhagen.
3.	**FORMÅL**	**OBJECTS**
	Selskabets formål er direkte eller via datterselskaber at drive enhver form for kommunikations-, service-, forlags- og medievirksomhed, investering, finansiering, rådgivning, handel samt anden i forbindelse hermed stående virksomhed, eventuelt i form af joint ventures med andre selskaber, samt al virksomhed, som efter bestyrelsens skøn er beslægtet hermed.	The objects of the company are to carry on all business either directly or indirectly through subsidiaries within the area of communications, services, directories, media, investment, financing, advisory services, trade and other related business, if appropriate in the form of joint ventures with other companies and to undertake, perform and carry on all such other things as the board of directors deems incidental to the attainment of such objects.
4.	**SELSKABETS KAPITAL**	**SHARE CAPITAL**
	Selskabets aktiekapital udgør EUR [*] fordelt på aktier á EUR 0,01 eller multipla heraf.	The share capital of the company is EUR [*] divided into shares of EUR 0.01 or any multiple thereof.
5.	**BEMYNDIGELSE TIL AT UDSTEDE TEGNINGSOPTIONER**	**AUTHORISATION TO ISSUE WARRANTS**
	Bestyrelsen er bemyndiget til ad én eller flere gange at udstede tegningsoptioner, der giver ret til at tegne aktier for indtil nominelt EUR 50.000. Aktierne har en stk. størrelse på EUR 0,01.	The board of directors is authorised on one or more occasions to issue warrants to subscribe for shares (each share having a nominal value of EUR 0.01) at a nominal value of up to EUR 50,000 in the company.
	Bemyndigelsen er gældende til og med den 31. december 2013.	The authorisation shall be effective until and including 31 December 2013.
	Selskabets aktionærer skal ikke have fortegningsret ved udstedelse af tegningsoptioner i henhold til denne bemyndigelse, idet tegningsoptionerne skal udstedes til fordel for bestyrelsen, direktionen og øvrige ledende medarbejdere i selskabet og dets datterselskaber efter bestyrelsens nærmere beslutning.	The shareholders of the company shall have no pre-emption right in connection with the issue of warrants according to this authorisation, as the warrants shall be issued in favour of directors, officers and/or employees of the company or its subsidiaries, as determined by the board of directors.

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	Tegningsoptionerne skal give ret til at tegne aktier til mindst markedskursen på tildelingstidspunktet. Tegningsoptioner, som udstedes til erstatning for optionsprogrammer overtaget fra Hungarian Telephone and Cable Corp. i forbindelse med selskabets overtagelse af samtlige dette selskabs rettigheder og forpligtelser, kan dog give ret til at tegne aktier til den oprindelige tegningskurs, uanset om denne er under markedskursen på tildelingstidspunktet. Hvis den oprindelige tegningskurs konverteres til Euro, foretages konverteringen på grundlag af valutakursen på tidspunktet for udnyttelse af tegningsoptionerne.	The warrants shall entitle the holder to subscribe for shares at a price being as a minimum the market price at the time when they are granted. Warrants issued as substitution for warrant programs assumed by the Company as part of the transfer of all rights and obligations from Hungarian Telephone and Cable Corp. may, however, entitle the holder to subscribe for shares at the original subscription price irrespective of whether it is below the market price at the time of the grant of the warrants. If the original subscription price is converted into Euro, the conversion shall be made on the basis of the exchange rate at the date of exercise of the warrants.
	I øvrigt fastsætter bestyrelsen de nærmere vilkår for tegningsoptioner, der udstedes i henhold til bemyndigelsen.	The board of directors shall determine the specific terms of the warrants issued according to the authority.
6.	**BEMYNDIGELSE TIL AT FORHØJE AKTIEKAPITALEN**	**AUTHORISATION TO INCREASE THE SHARE CAPITAL**
	Bestyrelsen er bemyndiget til ad en eller flere gange at forhøje aktiekapitalen ved tegning af nye aktier (herunder i forbindelse med udnyttelse af tegningsoptioner) med indtil EUR 100.000. Aktierne skal udstedes til mindst markedskursen på beslutningstidspunktet. Aktier, som udstedes ved udnyttelse af warrants, som udstedes til erstatning for optionsprogrammer overtaget fra Hungarian Telephone and Cable Corp. i forbindelse med selskabets overtagelse af samtlige dette selskabs rettigheder og forpligtelser, kan dog have en tegningskurs svarende til den oprindelige tegningskurs, uanset om denne er under markedskursen på beslutningstidspunktet. Hvis den oprindelige tegningskurs konverteres til Euro, foretages konverteringen på grundlag af valutakursen på tidspunktet for udnyttelse af tegningsoptionerne.	The board of directors is authorised to increase the share capital of the company in one or more issues (including in connection with the exercise of warrants) of a total nominal sum of up to EUR 100,000. The minimum price shall be the market price at the time of the decision to increase the share capital. Shares issued by exercise of warrants issued as substitution for warrant programs assumed by the Company as part of the transfer of all rights and obligations from Hungarian Telephone and Cable Corp. may, however, have a subscription price equal to the original subscription price irrespective of whether it is below the market price at the time of the decision to increase the share capital. If the original subscription price is converted into Euro, the conversion shall be made on the basis of the exchange rate at the date of exercise of the warrants.
	Bemyndigelsen gælder indtil den 31. december 2013, men kan fornyes for en eller flere perioder på indtil fem år ad gangen.	The authorisation is valid until 31 December 2013, but can be renewed for one or more periods of up to five years each.
	De nye aktier skal være omsætningspapirer og skal udstedes til ihændehaver. Der skal ikke gælde indskrænkninger i de nye aktiers omsættelighed. Bestyrelsen kan beslutte, at de hidtidige aktionærers fortegningsret helt eller delvis ikke skal gælde, og at forhøjelsen helt eller delvis skal kunne ske på anden måde end ved kontant indbetaling.	The new shares shall be negotiable instruments and shall be issued to bearer. No restrictions shall apply to the transferability of the shares. The board of directors can decide that the pre emptive right of the shareholders shall not or only in part apply and that the increase of the share capital may in part or in full be made by other means than cash payment.

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7.	**SELSKABETS AKTIER**	**SHARES**
7.1	Selskabets aktier udstedes til ihændehaver, men kan noteres på navn i selskabets aktiebog.	All shares shall be issued to bearer, but may be registered in the bearer s name in the company s register of shareholders.
7.2	Aktierne er omsætningspapirer og der gælder ingen indskrænkninger i omsætteligheden.	The shares shall be negotiable instruments and no restrictions shall apply to their transferability.
7.3	Ingen aktier skal have særlige rettigheder.	No share shall carry any special rights.
7.4	Selskabets aktiebog kan efter bestyrelsens valg føres enten hos selskabet eller hos en af bestyrelsen uden for selskabet udpeget aktiebogfører. Selskabets bestyrelse har valgt at selskabets aktiebog pt. føres af VP Investor Services A/S (VP Services A/S), Helgeshøj Allé 61, P.O. Box 20, 2630 Taastrup, Danmark.	At the discretion of the board of directors, the company s register of shareholders must be kept either by the company or by an external registrar nominated by the board of directors. The board of directors has chosen that the company s register of shareholders for the time being is kept by VP Investor Services A/S (VP Services A/S), Helgeshøj Allé 61, P.O. Box 20, 2630 Taastrup, Denmark.
7.5	Aktierne udstedes gennem Værdipapircentralen A/S.	The shares shall be issued via Værdipapircentralen A/S (VP Securities Centre).
7.6	Aktierne kan mortificeres uden dom i overensstemmelse med de til enhver tid værende lovgivningsregler om mortifikation af omsætningspapirer.	Share certificates may be cancelled without a court order pursuant to the statutory rules on cancellation of negotiable instruments in force from time to time.
7.7	Aktiebogen er tilgængelig for aktionærerne ved inspektion på selskabets hjemsted.	The register of shareholders is accessible for inspection by the shareholders at the registered office of the company.
8.	**GENERALFORSAMLINGEN,** **KOMPETENCE, STED OG INDKALDELSE**	**POWERS, LOCATION AND CONVENING** **OF GENERAL MEETINGS**
8.1	Generalforsamlingen har den højeste myndighed i alle selskabets anliggender, inden for de grænser lovgivningen og disse vedtægter fastsætter.	The general meeting of shareholders has supreme authority in all matters and things pertaining to the company subject to the limits set by statute and by these Articles.
8.2	Selskabets generalforsamlinger skal afholdes på selskabets hjemsted, i Storkøbenhavn eller i Budapest. Den ordinære generalforsamling skal afholdes hvert år i så god tid, at den reviderede og godkendte årsrapport kan indsendes til Erhvervs- og Selskabsstyrelsen, så den er modtaget i styrelsen inden 5 måneder efter regnskabsårets udløb.	General meetings shall be held at the registered office of the company, in the Greater Area of Copenhagen or in Budapest. Annual general meetings shall be held in time for the audited and adopted annual report to be submitted to and received by the Danish Commerce and Companies Agency within five months after expiry of the financial year.
8.3	Ekstraordinær generalforsamling til behandling af et bestemt angivet emne skal indkaldes senest 2 uger efter, at det skriftligt er begæret af aktionærer, der ejer 1/10 af aktiekapitalen.	Extraordinary general meetings shall be convened within two weeks after receipt of a written requisition to transact any particular business submitted by shareholders representing one tenth of the share capital.

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8.4	Generalforsamlinger indkaldes af bestyrelsen med mindst 10 dages og højst 4 ugers varsel ved offentliggørelse via Erhvervs- og Selskabsstyrelsens informationssystem. Indkaldelsen skal indeholde dagsordenen for generalforsamlingen. Hvis der skal forhandles forslag, hvis vedtagelse kræver særlig majoritet, skal dette fremhæves i indkaldelsen og forslagets fulde ordlyd skal angives heri.	General meetings shall be convened by the board of directors by publication via the Danish Commerce and Companies Agency s information system, giving no less than ten days and no more than four weeks notice. The notice shall include the agenda of the general meeting. If any proposed resolution whose adoption is subject to a qualified majority of votes is to be considered by the meeting, this shall be stated in the notice together with the full text of the resolution.
8.5	Forslag fra aktionærerne til behandling på generalforsamlingen skal være skriftlige og være modtaget af bestyrelsen i så god tid, at emnet kan optages på dagsordenen.	Any proposals from the shareholders to be considered at the general meeting shall be submitted in writing to the board of directors in time to permit such proposals to be included in the agenda.
9.	**GENERALFORSAMLINGEN, DAGSORDEN**	**AGENDA OF GENERAL MEETINGS**
9.1	Senest 8 dage før generalforsamlingen skal dagsordenen og de fuldstændige forslag, der skal behandles på generalforsamlingen, og for den ordinære generalforsamlings vedkommende tillige revideret årsrapport fremlægges til eftersyn for aktionærerne på selskabets kontor og samtidig sendes til enhver noteret aktionær, som har fremsat begæring herom.	No later than eight days before the general meeting, the agenda, the complete proposals to be considered at the general meeting and, provided it is not an extraordinary general meeting, the audited annual report shall be made available for inspection by the shareholders at the office of the company and sent to any registered shareholder upon request.
9.2	På den ordinære generalforsamling skal dagsordenen mindst være følgende:	The agenda of the annual general meeting shall at least include the following items:
	1. Bestyrelsens beretning om selskabets virksomhed i det forløbne regnskabsår	1. The directors report on the activities of the company during the past financial year
	2. Godkendelse af den reviderede årsrapport	2. Adoption of the audited annual report
	3. Meddelelse af decharge til bestyrelsen og direktionen	3. Resolution to discharge the board of directors and the management of its responsibilities
	4. Godkendelse af vederlag til bestyrelsen	4. Adoption of remuneration to the board of directors
	5. Anvendelse af overskud eller dækning af underskud i henhold til den godkendte årsrapport	5. Resolution on the distribution of the profit or loss recorded in the annual report adopted by the general meeting
	6. Valg af bestyrelsesmedlemmer og eventuelle suppleanter	6. Appointment of directors and any alternate directors
	7. Valg af revisor(er)	7. Appointment of auditor(s)
	8. Eventuelle forslag fra bestyrelsen og/eller aktionærerne	8. Any proposals from the board of directors and/or shareholders.

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10.	**GENERALFORSAMLINGEN, STEMMERET OG MØDERET**	**GENERAL MEETINGS, VOTING RIGHTS, AND RIGHT OF ATTENDANCE**
10.1	Hvert aktiebeløb på EUR 0,01 giver ti stemmer.	Each share of EUR 0.01 carries ten votes.
10.2	Hver aktionær har ret til at møde på generalforsamlingen, når han senest 3 dage forud for dennes afholdelse har anmodet om at få udleveret adgangskort på selskabets kontor. Egenskab af aktionær godtgøres ved, at dennes adkomst er noteret i aktiebogen, eller ved forevisning af dokumentation fra aktionærens kontoførende institut eller anden tilfredsstillende dokumentation, hvilken dokumentation på tidspunktet for anmodning om adgangskort højst må være 14 dage gammel. For at få udleveret adgangskort skal aktionæren endvidere afgive skriftlig erklæring om, at aktierne ikke er eller vil blive overdraget til andre, inden generalforsamlingen er afholdt.	Each shareholder is entitled to attend the general meeting, provided that he has requested an admission card from the company s office not later than 3 days prior to the relevant meeting. In order to document his right as a shareholder, the shareholder must be registered in the company s register of shareholders or present relevant documentation from his account holding institution or other satisfactory documentation, which documentation must have been issued within 14 days prior to his request for an admission card. In addition, in order to receive an admission card a shareholder shall submit a written statement to the effect that his shares have not, or will not, be transferred to any third parties prior to the general meeting.
10.3	Hver aktionær er berettiget til at deltage i generalforsamlingen sammen med en rådgiver eller ved fuldmægtig, som kan udøve stemmeret på aktionærens vegne. Fuldmagten skal være skriftlig, dateret og må ikke være givet for mere end 1 år.	Each shareholder may attend the general meeting with an adviser or be represented by a proxy holder, who may exercise the voting right on behalf of the shareholder. The instrument of proxy shall be in writing and duly dated, and shall be issued for no more than one year.
11.	**GENERALFORSAMLINGEN, DIRIGENT, BESLUTNINGER OG PROTOKOL**	**GENERAL MEETINGS, CHAIRMAN, RESOLUTIONS AND MINUTE BOOK**
11.1	Bestyrelsen udpeger en dirigent, der leder forhandlingerne og afgør alle spørgsmål vedrørende sagernes behandling og stemmeafgivning.	The board of directors shall elect a chairman to preside at the meeting and to determine all questions pertaining to the transaction of business and the voting thereat.
11.2	På generalforsamlingen træffes alle beslutninger ved simpelt flertal, medmindre andet følger af aktieselskabsloven eller disse vedtægter.	Unless otherwise provided for by the Danish Companies Act (aktieselskabsloven) or in the Articles of Association, all resolutions at the general meeting shall be adopted by a simple majority of votes.
11.3	Over forhandlingerne på generalforsamlingen føres en protokol, der underskrives af dirigenten.	A summary of the business transacted at the general meeting shall be entered in a minute book and shall be signed by the chairman of the meeting.
11.4	Senest 14 dage efter generalforsamlingens afholdelse skal protokollen eller en bekræftet udskrift heraf være tilgængelig for aktionærerne på selskabets kontorer, og tilstilles enhver aktionær, der har fremsat skriftlig begæring derom.	Not later than 14 days after a general meeting has been held, the minutes of the general meeting or a certified transcript thereof shall be available for inspection by the shareholders at the company s office, and any shareholder shall have a copy thereof upon a written request.

12.	**BESTYRELSE**	**BOARD OF DIRECTORS**
12.1	Selskabet ledes af en bestyrelse på 3-9 medlemmer valgt af generalforsamlingen for tiden indtil næste ordinære generalforsamling. For hvert bestyrelsesmedlem kan tillige vælges en personlig suppleant.	The company shall be managed by a board of directors consisting of 3-9 members elected by the general meeting to hold office until the next annual general meeting. An alternate director may be appointed for each director.
12.2	Bestyrelsen vælger en formand og en næstformand. En direktør må ikke vælges til formand eller næstformand.	The board of directors elects a chairman and a vice-chairman. A registered manager may not be appointed chairman or vice-chairman.
12.3	Bestyrelsen er beslutningsdygtig, når over halvdelen af samtlige bestyrelsesmedlemmer er til stede. Bestyrelsens beslutninger træffes ved simpelt flertal. Formandens eller i dennes fravær næstformandens stemme er afgørende ved stemmelighed.	The board meeting shall constitute a quorum when more than half of the directors are present. Resolutions by the board of directors shall be passed by a simple majority of votes. In case of equality of votes, the chairman or in his/her absence, the vice-chairman shall have the casting vote.
12.4	Bestyrelsen skal i overensstemmelse med aktieselskabslovens § 56, stk. 7 vedtage en forretningsorden om udførelsen af sit hverv.	Pursuant to section 56, paragraph 7 of the Danish Companies Act the board of directors shall draw up rules of procedure governing the performance of its duties.
12.5	Referater af bestyrelsesmøder skal indsættes i en protokol, som skal underskrives af de bestyrelsesmedlemmer, som er til stede på møderne.	Minutes of the board meetings shall be entered in a minute book and shall be signed by the directors present.
13.	**DIREKTION**	**MANAGEMENT**
	Bestyrelsen ansætter 1-3 direktører til at varetage den daglige ledelse af selskabets virksomhed.	The board of directors shall appoint 1-3 registered managers to be in charge of the day-to-day operations of the company.
14.	**TEGNINGSREGEL**	**POWER TO BIND THE COMPANY**
	Selskabet tegnes af et bestyrelsesmedlem i forening med et andet bestyrelsesmedlem eller med en registreret direktør, af to registrerede direktører i forening eller af den samlede bestyrelse.	The company is bound by the signature of one director together with another director or a registered manager, by the joint signatures of two registered managers or by all the directors.
15.	**REVISION**	**AUDITING**
	Selskabets årsrapport revideres af en eller to statsautoriserede eller registrerede revisorer valgt af generalforsamlingen for tiden indtil næste ordinære generalforsamling.	The annual report of the company shall be audited by one or two state-authorised public accountant(s) or registered public accountant(s) appointed at the general meeting for the period until the next annual general meeting.
16.	**REGNSKABSÅR, ÅRSRAPPORT MV.**	**FINANCIAL YEAR, ANNUAL REPORT, ETC.**
16.1	Selskabets regnskabsår er kalenderåret. Første regnskabsår løber fra stiftelsen den 1. juli 2008 til den 31. december 2009.	The financial year of the company shall be the calendar year. The first financial year runs from the incorporation on 1 July 2008 to 31 December 2009.

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16.2	Årsrapporten skal give et retvisende billede af selskabets aktiver og passiver, dets finansielle stilling samt resultatet, jf. årsregnskabsloven.	The annual report shall give a true and fair view of the assets and liabilities of the company, its financial position and profit and loss, cf. the Danish Financial Statements Act (årsregnskabsloven).
17.	**EKSTRAORDINÆRT UDBYTTE**	**EXTRAORDINARY DIVIDEND**
	Efter afgivelse af selskabets første årsrapport er bestyrelsen bemyndiget til at træffe beslutning om uddeling af ekstraordinært udbytte i det omfang dette af bestyrelsen skønnes forsvarligt under hensyn til selskabets og koncernens økonomiske stilling.	Following the presentation of the company s first annual report, the board of directors may make extraordinary distributions of dividend to the extent the board of directors deems it prudent considering the financial position of the company and the group.
	Således vedtaget på generalforsamlingen den [dag, måned, år].	Adopted by the general meeting on [dag, måned, år].
	Som dirigent:	Chairman:
	Navn:	Name:

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PROXY **PROXY**

HUNGARIAN TELEPHONE AND CABLE CORP.

(The Company)

SPECIAL MEETING OF STOCKHOLDERS

To Be Held on February 24, 2009

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned, revoking all prior proxies, hereby appoints HENRIK SCHEINEMANN and PETER T. NOONE, and each of them, with full power of substitution in each, as proxies for the undersigned, to represent the undersigned and to vote all the shares of Common Stock of the Company which the undersigned would be entitled to vote, as fully as the undersigned could vote and act if personally present, at the Special Meeting of Stockholders (the Meeting) to be held on February 24, 2009, at 10 a.m. local time, at Simpson, Thacher & Bartlett LLP, 425 Lexington Avenue, New York, NY 10017-3954, U.S.A. or at any adjournment or postponement thereof.

Should the undersigned be present and elect to vote at the Meeting or at any adjournments or postponements thereof, and after notification to the Secretary of the Company at the Meeting of the stockholder s decision to terminate this proxy, then the power of such attorneys or proxies shall be deemed terminated and of no further force and effect. This proxy may also be revoked by sending a written notice of revocation to the proxy agent or by duly executing a proxy bearing a later date and delivering it to the proxy agent before the Meeting.

The Board of Directors recommends a vote FOR Item 1 below. To vote in accordance with the Board s recommendations, just sign on the reverse side and mark the appropriate box. The shares represented by this proxy will be voted as directed by the stockholder, but if no instructions are specified as to any item or all items on a properly executed proxy, this proxy will be voted to approve such item(s) on the reverse side. If any other business is presented at the Meeting, this proxy will be voted by those named in this proxy in their best judgment. At the present time, the Board of Directors knows of no other business to be presented at the Meeting.

CONTINUED AND TO BE SIGNED ON REVERSE SIDE

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THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR ITEM 1

Please mark

your votes

like this

	FOR	AGAINST	ABSTAIN
ITEM 1. To adopt the Agreement and Plan of Merger among the Company, Invitel Holdings A/S, and Invitel Sub LLC whereby there will be a transfer of the assets of the Company to, and assumption of its liabilities by, Invitel Holdings A/S in exchange for newly issued shares of Invitel Holdings A/S, and whereby the company will effectively change its place of incorporation from Delaware to Denmark by merging the Company with Invitel Sub LLC, which will be the surviving entity and become a wholly-owned, indirect subsidiary of Invitel Holdings A/S, and pursuant to which each share of the Company will automatically be converted into the right to receive one Invitel Holdings A/S ADS representing one ordinary share of Invitel Holdings A/S, unless elected to receive Invitel Holdings A/S ordinary shares, and whereby all current stockholders of the Company will become shareholders of Invitel Holdings A/S.			

I plan to attend the meeting

COMPANY ID:

PROXY NUMBER:

ACCOUNT NUMBER:

Please sign exactly as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.

Signature: **Signature:** **Date:**

THIS IS YOUR PROXY, YOUR VOTE IS IMPORTANT Mark, sign and date your proxy card and return it in the postage-paid envelope.