



Makedonski Telekom AD – Skopje
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ANNUAL REPORT on the operations of the Group of Makedonski Telekom AD - Skopje in 2011

On 13 February 2006, Magyar Telekom Plc., the controlling owner of Makedonski Telekom AD – Skopje (the Company), (via Stonebridge Communications AD - Skopje (under liquidation), majority shareholder of the Company), announced that it was investigating certain contracts entered into by another subsidiary of Magyar Telekom Plc. to determine whether the contracts were entered into in violation of Magyar Telekom Plc. policy or applicable law or regulation. Magyar Telekom's Audit Committee retained White & Case, as its independent legal counsel to conduct the internal investigation. Subsequent to this on 19 February 2007, the Board of Directors of the Company, based on the recommendation of the Audit Committee of the Company and the Audit Committee of Magyar Telekom Plc., adopted a resolution to conduct an independent internal investigation regarding certain contracts in Macedonia.

Based on publicly available information, as well as information obtained from Magyar Telekom and as previously disclosed, Magyar Telekom's Audit Committee conducted an internal investigation regarding certain contracts relating to the activities of Magyar Telekom and/or its affiliates in Montenegro and Macedonia that totalled more than EUR 31 million. In particular, the internal investigation examined whether Magyar Telekom and/or its Montenegrin and Macedonian affiliates had made payments prohibited by U.S. laws or regulations, including the U.S. Foreign Corrupt Practices Act (the "FCPA"). The Company has previously disclosed the results of the internal investigation.

Magyar Telekom's Audit Committee informed the U.S. Department of Justice (the "DOJ") and the U.S. Securities and Exchange Commission (the "SEC") of the internal investigation. The DOJ and the SEC commenced investigations into the activities that were the subject of the internal investigation. For further information about the internal investigation, please refer to the financial statements of the Company for the year ended 31 December 2010.

In 2011, Magyar Telekom entered into final settlements with the DOJ and the SEC to resolve the DOJ's and the SEC's investigations relating to Magyar Telekom. The settlements concluded the DOJ's and the SEC's investigations.

Magyar Telekom has entered into a two-year deferred prosecution agreement (the "DPA") with the DOJ, under which Magyar Telekom was charged with a violation of the anti-bribery provisions of the FCPA and two violations of the books and records provisions of the FCPA. In accordance with the DPA, on 29 December 2011, the DOJ filed a criminal information (the "Information") setting out these charges in the U.S. District Court for the Eastern District of Virginia. Magyar Telekom has agreed to admit to the DOJ's allegations and to acknowledge responsibility for the acts as charged in the Information. Magyar Telekom has agreed to pay a criminal penalty of USD 59.6 million to cooperate with the DOJ in future investigations, to refrain from any violations of U.S. federal criminal law, to continue to operate a compliance program and to report to the DOJ annually regarding the compliance program during the term of the DPA. The DOJ will seek to dismiss the charges upon conclusion of the two-year term, unless Magyar Telekom violates the terms of the DPA.

On 29 December 2011, the SEC filed in the U.S. District Court for the Southern District of New York a Complaint (the "Complaint") and a proposed Final Judgment against Magyar Telekom (the "Final Judgment"). Without admitting or denying the allegations in the Complaint, Magyar Telekom consented to the filing of the Complaint and entry of the Final Judgment to resolve the SEC's investigation. The Complaint alleged civil violations of the FCPA's anti-bribery, books and records and internal control provisions. The Final Judgment, which was approved by the U.S. District Court for the Southern District of New York on 3 January 2012, permanently enjoined Magyar Telekom from violating these provisions and required Magyar Telekom to pay USD 25.2 million for disgorgement of profits and USD 6.0 million of prejudgment interest thereon.

The final settlements recognize the DOJ's and the SEC's consideration of Magyar Telekom's self-reporting, thorough internal investigation, remediation and cooperation with the DOJ's and the SEC's investigations. Magyar Telekom has undertaken several remedial measures to address the issues identified during the course of these investigations. These measures include steps designed to revise and enhance Magyar Telekom's internal controls, as well as the establishment of the Corporate Compliance Program. The Corporate Compliance Program promotes awareness of Magyar Telekom's

compliance policies and procedures through training, the operation of a whistleblower hotline, and monitoring of, and communications with, employees and subsidiaries of Magyar Telekom. Magyar Telekom remains fully committed to responsible corporate behaviour.

On 6 January 2012 Magyar Telekom paid a criminal penalty of USD 59.6 million pursuant to the settlement with the DOJ and on 23 January 2012 Magyar Telekom paid USD 25.2 million for disgorgement of profits and USD 6.0 million of prejudgment interest pursuant to the settlement with the SEC, totalling USD 90.8 million paid with respect to the settlements with the DOJ and the SEC.

The above-referenced settlement by Magyar Telekom and associated liability was not recorded in the consolidated financial statements of the Group. These amounts were reflected in the consolidated financial statements of Magyar Telekom and are not reflected in the consolidated financial statements of the Company.

According to the information provided to the Company by Magyar Telekom Plc., on 2 December 2009, the Audit Committee of Magyar Telekom Plc., provided the Magyar Telekom's Board of Directors with a "Report of Investigation to the Audit Committee of Magyar Telekom Plc." dated 30 November 2009 (the "Final Report").

In relation to the issuance of the Final Report and the information provided to the Company by Magyar Telekom, in January 2010 the Chairman of the Company's Board of Directors requested third party legal and tax expertise for assessment of the potential accounting and tax implications arising from the transactions conducted by the Company and its subsidiary subject to the Final Report.

The external experts prepared reports (the "Reports") on their assessment and submitted the Reports to the Chairman of the Company's BoD and the Management of the Company and its subsidiary accordingly. As a result, based on the analysis of the Tax and Legal experts and information available to the Management related to the transactions subject of the Final Report, amount of MKD 248,379 thousand has been identified as potential tax impact (together with related penalty interest) as of 31 December 2009 arising from the transactions conducted by the Company and its subsidiary subject to the Final Report. In 2010 the amount related to the identified potential tax impact (together with related penalty interest) amounted to MKD 261,834 thousand out of which MKD 227,972 thousand related to the Company were paid in 2010 upon an executive decision issued by the Public Revenue Office. In the subsidiary, as of 31 December 2011 the amount related to the identified potential tax impact (together with related penalty interest) amounted to MKD 36,019 thousand. In addition, the value of one contract of MKD 105,147 thousand capitalised within treasury shares was corrected in 2009 financial statements and accounted for as though these payments had been expensed in 2006 rather than capitalized as part of treasury shares as originally reported. The other contracts that were identified by the Final Report and the reports of the tax and legal experts related to transactions undertaken by the Company and its subsidiary were expensed in the related periods (2001-2007).

In May 2008, the Ministry of Interior ("MOI") of the Republic of Macedonia ("RoM") submitted to the Company an official written request for information and documentation regarding certain payments for consultancy services and advance dividend, as well as certain procurements and contracts. In June 2008 the Company submitted copies from the requested documents. In the same period, T-Mobile Macedonia has also received similar requests for provision of certain documentation to the Ministry of Interior of RM and they were submitted accordingly.

In October 2008 the Investigation Judge from the Primary Court Skopje 1 – Skopje (the criminal court), has issued an official written order to the Company to handover certain original documentation. Later in October 2008, the Company officially and personally handed over the requested documentation. Additional MOI requests in written were submitted and the Company provided the requested documentation.

We understand, based on public information available as of 10 December 2008, that the MOI Organized Crime Department submitted the files to the Basic Public Prosecution Office of Organized Crime and Corruption, with a proposal to bring criminal charges against Attila Szendrei (former CEO of Makedonski Telekom AD - Skopje), Rolf Plath (former CFO of Makedonski Telekom AD - Skopje), Mihail Kefaloyannis (former member of the Board of Directors in Stonebridge and former member of the Board of Directors in Telemacedonia) and Zoltan Kisjuhász (former CEO of Stonebridge and former non-executive member of the Board of Directors of Makedonski Telekom AD - Skopje) on the account of a reasonable doubt for committed criminal act. These individuals are proposed to be charged with having "abuse of office and authorizations" in their position in Makedonski Telekom AD - Skopje by concluding consultancy contracts for which there was no intention or need for any services in return.

The Primary Court Skopje 1 in Skopje, Investigative Department for Organized Crime delivered a summon to the Company

in connection with the criminal charges against the above stated persons and asked for a statement whether the Company has suffered any damages on the basis of the said consultancy contracts.

After several postponements of the court hearing related to the investigation procedure handled in the Primary Court Skopje 1 Skopje, on the hearing held on 13 April 2009, the representatives of Makedonski Telekom AD Skopje declared the position of the Company that taking into consideration the ongoing independent internal investigation conducted by White & Case, approved by the Company's BoD, it was premature to preannounce any damage which may be caused by means of the implementation of the mentioned contracts or with reference to them. An expertise was performed on 11 May 2010 and the experts from Ministry of Justice of the Republic of Macedonia – Court Expertise Office – Skopje, asked for some additional documents from Company's side in order to prepare the expertise. The experts asked additional information related to certain agreements concluded in 2005 and 2006, and related invoices. The Company has collected and submitted requested information/documentation to the Court Expertise Office on 1 November 2010.

On 14 March 2011, the Company received from the Primary Court Skopje 1 a copy of the "Finding and Opinion", dated November 2010, issued by the Bureau of Judicial Expertise to the Primary Court Skopje 1 as a result of the expertise procedure. The "Finding and Opinion" addresses and contains conclusions regarding five contracts entered into with Chaptex and Cosmotelco in 2005 and 2006 and formerly reviewed by the Audit Committee of Magyar Telekom. The "Finding and Opinion" concludes that, based on these contracts, expenditures in the amount of EUR 3.975 million were made by the Company and Stonebridge to Chaptex "without evidence for performed services"; accordingly, shareholders of the Company and Stonebridge in the proportion of their shareholding, suffered damages in the aforementioned aggregate amount as result of decreased proceeds for payment of dividend in 2005 and 2006.

Based on publically available information, we understand that the Public Prosecutor has filed an indictment in 2011 against Mr. Szendrei, Mr. Kisjuhász and Mr. Plath, but not against Mr. Kefaloyannis. The court hearing has taken place at the end of 2011, but it was postponed since the court could not provide presence of any of the defendants. The Company, as damaged party in this case, has not received official court invitation for the hearing.

Pursuant to the questions posed by the investigative judge, it could be concluded that the public prosecutor has addressed the Company as party damaged by the actions of the defendants. However, based on the content of the order for expertise issued by the investigative judge, and on the basis of the expert opinion, it can be concluded that now damaged parties are shareholders of the Company (Stonebridge AD Skopje, Republic of Macedonia and minority shareholders) and therefore the state budget, as the Republic of Macedonia is a shareholder in the Company. Therefore, the public prosecutor should clear out who is considered as damage party in this particular case, which is of significant importance for the position of the Company in this proceeding and its further actions. At the moment there aren't any indications that the Company could be found liable and made to pay any penalties or fines for the criminal procedure which is initiated against the individuals.

We have not become aware of any information as a result of a request from any regulators or other external parties, other than as described above, from which we have concluded that the financial statements may be misstated, including from the effects of a possible illegal act.

This Annual Report on the operation refers to the Group of Makedonski Telekom AD - Skopje, which includes Makedonski Telekom AD – Skopje (hereinafter referred to as: "MKT"), T-Mobile Macedonia AD Skopje (hereinafter referred to as: "TMMK") and the e-Macedonia Foundation – Skopje (hereinafter jointly referred as the: "the Group").

MKT is a joint stock company incorporated and domiciled in the Republic of Macedonia for the provision of telecommunication services.

The Group's immediate parent company is AD Stonebridge Communications – Skopje, under voluntary liquidation, solely owned by Magyar Telekom Plc., registered in Hungary. The ultimate parent company is Deutsche Telekom AG registered in the Federal Republic of Germany.

MKT is the primary fixed line service provider in Macedonia. Its exclusive rights in fixed line telecommunication services expired in December 2004. These exclusive rights included local, national and international long-distance public voice services, voice over IP services, leased line services and building and operating public voice network services. MKT's objectives for the forthcoming years comprise being a leading provider of technology in

Macedonia and providing quality services with attractive prices in order to be prepared for the increasing competition.

MKT provides traditional fixed line telecommunication services and content services within the scope of the fixed line network, broadband services and integrated solutions, including TV over Internet Protocol ("IPTV"). At the end of 2011, MKT had 316,025 PSTN lines and 37,016 ISDN channels, compared to 340,142 and 38,558 respectively, at the end of 2010. The fixed line penetration was marked with a similar movement, stabilizing at 15.9% at the end of 2011. The number of ADSL connections increased to 161,705 at the end of 2011, compared to 152,668 as of 31 December 2010. The number of IPTV customers at the end of 2011 reached 40,722 customers (including 3 Play, IPTV only and 2 MAX) compared to 30,486 customers at the end of 2010. The number of Fibre To The Home ("FTTH") customers reached 4,939 at the end of 2011.

In 2011, approximately 21.7% of the total revenues of the Group were comprised of the voice revenues from domestic fixed line telecommunication services. The mobile services contributed with 48.7%, while the international telecommunication services contributed with 9.3% to the total revenues. The internet and data services contributed with 11.7% of the total revenues, while 8.6% of the total revenues were derived from other services.

The revenue from domestic fixed line telecommunication services still marks a downward movement mainly due to decreased number of fixed line customers and a decrease of the outgoing traffic. The increased revenue of MKT from international incoming traffic is mainly a result of the increased termination rates. The portion of the revenues from mobile services decreased due to the intensified competition (especially in the prepaid and the business segment) and the decreased subscriber base, partly compensated by the increased revenues in Voice wholesale and Mobile internet services. The Internet and IPTV revenues have grown, mainly due to the increased number of DSL subscribers and the growing number of IPTV subscribers.

TMMK is the leading mobile service provider in Macedonia, dedicated to provide up-to-date technologies and advanced service offerings, commensurate to the highest technological and service standards of the T-Mobile Group.

TMMK had customer base of 1,265,243 at the end of 2011, compared to 1,295,285 at the end of 2010. The mobile market penetration in Macedonia is over 122 percent, which shows the trend of individuals owning multiple SIM cards. As a result of the market saturation, TMMK especially focuses on retaining the customers in order to protect the market share.

The decline in the number of TMMK subscribers in 2011 is mainly due to the very aggressive pricing offers by the competitors. The pricing offers are accompanied by strong marketing campaigns with a focus on a very low price level.

The Macedonian mobile market was characterized by highly competitive campaigns and offers in 2011. Due to the increased competitiveness and in order to prevent the churn and encourage the usage, TMMK launched various campaigns, price plans and additional services specially designed to meet the subscribers' needs, with a focus on value instead of price. These offers are targeting different customer segments.

In 2011, TMMK introduced several products that differentiate TMMK on the mobile market and provide additional value for the customers.

TMMK is continuously working on creating a market demand for mobile Internet and stimulating mobile data usage via device/data price plans.

In 2011, MKT and TMMK started the implementation of the New Accommodation Plan proposed by the MKT and TMMK joint Group Real Estate Committee, that envisages an exchange of assets by purchase of a new Office Building in Skopje downtown at price of EUR 37,300,000 (excluding VAT) and sale of three office buildings of

MKT and the Headquarters of TMMK at total price of EUR 21,150,000 (excluding VAT) to the same Investor, based on the respective resolutions and conclusion of the MKT Board of Directors (Resolution No.20/2011 dated 22 March 2011; Resolution No.47/2011 dated 21 December 2011; and the BoD Conclusion per minutes of the meeting held on 22 July 2011), the Resolution of the MKT Shareholders' Assembly (Arch. No. 02-137047/1 dated 14 April 2011) and the resolutions of the TMMK Board of Directors (Resolution 17/2011 dated 22 March 2011; and Resolution 41/2011 dated 21 December 2011), and obtained in accordance with the Statutes of the both Companies (MKT and TMMK). The difference in amount of EUR 16,150,000 between the above stated purchasing and selling price is to be paid by MKT in six equal yearly instalments. The first payment is to become due after MKT and TMMK have obtained co-ownership of the new Office Building. Upon the respective resolutions, a Contract and Annex to this Contract related to the sale of the office buildings and the purchase of the new Office Building were signed.

The exchange of the buildings – takeover of the new Office Building and hand over of the three MKT buildings and the Headquarters of TMMK - is planned to happen in 2012 once the new Office Building is turnkey ready, constructed and finalized respecting all requirements of MKT and TMMK.

Sustainable rationalization of costs and increase of efficiency by consolidation of business space and employees, improvement of quality of working place in accordance with the international standards and optimization of the operating expenses through reduction of the maintenance costs and avoidance of additional investments in renovation of the of the three MKT buildings and the Headquarters of TMMK, decrease of rent costs, are considered as main rationales behind the New Accommodation Plan.

Regulation and Pricing

Macedonian law concerning electronic communications (Law on Electronic Communications - "LEC") was enacted on 5 March 2005. Thus, by means of certain transitional provisions, the country's telecommunication regulations were harmonized with the European Union ("EU") regulatory framework. Furthermore, a number of strict obligations for the existing operators were stipulated.

On 29 June 2011 MKT and R3 info media DOO Skopje were designated as Universal service ("US") providers. MKT was designated as US provider for fixed telephone services, public payphones and equivalent access for disabled end users, while R3 info media DOO Skopje was designated as US provider for unique subscriber directory and directory enquiry. Operators were obliged to start providing the services from 1 January 2012 and to do so for the next five years. MKT started providing the services based on US designation.

The latest amendments of the LEC were published in the Official Gazette of RoM No.13/2012 on 27 January 2012 comprising the following: obligation for presentation Calling Line Identification Presentation ("CLIP") and location data for emergency call, obligation for free of charge SMS for promotion of cultural heritage of Republic of Macedonia, discretion right of the Agency for Electronic Communications ("the Agency") to impose accounting separation obligation to certain operators with Significant Market Power ("SMP"), creation of electronic register for the telecommunication terminal equipment for mobile communication services by the Agency, control and measurement of the quality parameters of the public communications services by the Agency which should be in line with the recommendations and standards of the EU and fostering the IP exchange development. Also annual fees to the Agency should be in line with the Agency's annual budget.

Currently the Agency is developing general strategy for the period of next five years (2012-2017). Publishing of the official document for Agency strategy is expected by the end of the first quarter in 2012. Main focus of the Agency strategy are: fostering of wholesale and retail services regulation, introduction of pure Long Run Incremental Cost ("LRIC") for fixed and mobile voices, SMS etc, Next Generation Networks ("NGN") and FTTH regulation in line with NGN recommendation and reframing and frequency allocation for 4G services.

Regulation of Fixed Line Business

In line with the new notification procedure introduced by the Agency in November 2009 and the obligation for re-notification of the entities, until 30 September 2011 the Agency had registered 42 providers of public fixed telephone services.

Under the LEC, MKT has been designated as a SMP operator on the market of fixed line voice telephone networks and services, including the market of access to the networks for data transmission and leased lines. MKT as an SMP operator has the obligation to enable its subscribers to access publicly available telephone services of any interconnected operator with an officially signed interconnection contract.

According to current by-laws, MKT has an obligation to publish reference offers for the wholesale products for interconnection, Unbundling Local Loop ("ULL"), local Bit Stream Access ("BSA"), Wholesale Line Rental ("WLR") and wholesale leased lines. Furthermore, a new Rulebook on access and use of specific network assets was published by the Agency on 7 December 2010, by which an obligation was imposed on MKT to offer access to ducts and dark fibre. Initial Fibre to the "x" ("FTTx") regulation was introduced in the second quarter of 2011 with the obligation for Referent Access Offer ("RAO") for ducts and dark fibre imposed on MKT by the Agency. The approved reference offer was published on 5 December 2011 and is fully in line with the introduced Rulebook for specific network access and elements and applicable as of 1 January 2012.

The Agency announced development of Bottom - up LRIC model by consultants for ducts, dark fibre and leased lines also. In 2012 price cuts for these services are expected as well.

The latest changes in the Referent Unbundled Offer ("RUO") were published on 21 June 2011 in line with the amended bylaw with shortened deadlines for provisioning of services and introduction of unbundling of non active local loops.

In September 2011 new Number Portability ("NP") procedures were applied for all operators in Macedonia. The entire exchange of the data on NP between the operators is implemented through the central database ("CDB") with shorter deadlines for porting - two days in fixed network and one day in mobile network. As of 1 September 2011 MKT and TMMK introduced beep signal which informs the customers that their call is toward ported number. The signal is unified for all operators.

Based on the new amended changes in ECL from 27 January 2012 not all SMP operators are obliged to keep separate accounting records for their wholesale and retail activities.

Regulated retail prices

The Agency started process for development and implementation of the methodology for retail price regulation. Applied methodology shall be price squeeze. For that purpose, the Agency has engaged Analysys Mason as consultants to develop methodology for price squeeze testing.

Since MKT is designated as SMP on relevant retail market 1- Access to publicly available telephone network at fixed location for residential and non-residential customers and market 2 - Publicly available telephone services at fixed location for residential and non-residential customers, MKT is expected to be the most affected operator in the retail price regulation.

These activities are expected to result in price decrease of some retail services (business monthly fee, fixed-to mobile, international outgoing calls). By the end of 2011 MKT submitted all data requested by the Agency for development of price squeeze model and methodology for retail price regulation. More intensive retail regulation is expected as of May 2012.

Retail ADSL service on standalone basis (so called Naked DSL) was launched in November 2011. Regarding the individual pricing offers, especially tenders, both for fixed and mobile telephony, MKT and TMMK are faced with a constant pressure from the competitors which are in position to offer lower prices usually below costs in order to increase their customer base as a result of under regulation.

Regulated Wholesale Prices

MKT has a cost based price obligation for the Regulated wholesale services, using LRIC. The results from the Bottom - up LRIC costing model are implemented as of 1 April 2011 which resulted in reduction of the monthly fee for ULL and interconnection rates (for origination, termination and transit), as well as reduction of the monthly fees for interconnection links and collocation. On 21 November 2011 MKT published its Referent Interconnection Offer ("RIO") changes in line with the Agency decision for LRIC based monthly fees for leasing of physical collocation and virtual collocation. The Agency also approved new monthly fees for managing, maintenance and support of signalling link and administration and maintenance of interconnection agreements. RIO changes are applicable from 1 December 2011 for all Interconnection Partners.

As of 1 November 2011 MKT stopped offering PSTN and ISDN services for its customers as well as for its Wholesale Partners and all newly committed services are based on Internet Protocol ("IP") technology. In line with the PSTN migration of MKT network, the Agency approved proposed modifications of MKT WLR Reference Offer and BSA Offer applicable as of 1 January 2012. In parallel MKT will harmonize the process of PSTN migration with the Wholesale operators.

The Agency imposed new decreased monthly fees for Local Loop Unbundling ("LLU"). The current monthly fee for LLU is MKD 331.08.

On 5 December 2011 MKT published its amended BSA offer. The terminology of all services in the offer is harmonised with MKT retail terminology and PSTN migration of MKT network. In line with this a possibility for migration towards other BSA levels or Standalone BSA was introduced. All wholesale customers are obliged to have Integrated Access Device ("IAD") due to the fact that all MKT services will be IP based. Amended offer are applied from 1 January 2012.

On the public meeting held on 14 October 2011 the Agency presented detailed plan for Bottom - up LRIC model developed by consultants which is expected to result in changes of BSA pricing models and will modify service description. The Agency stated that prices will be set on a level of an efficient operator and initial LRIC Bottom - up results are expected in the first quarter of 2012. On 29 December 2011, the Agency published inception report for development of a Bottom - up LRIC Model for Bit stream Services. By the end of January 2012 MKT submitted to the Agency all data requested in details for development of a Bottom - up LRIC Model for Bit stream Services.

The level of the wholesale regulated prices directly depends on MKT's retail regulated prices.

Regulation of Mobile Business

The retail services provided by the mobile network operators in Macedonia are currently not subject to price regulation. Since 2007, TMMK and ONE have been designated with an SMP status on the market for voice call termination services in mobile communication networks, whereby several obligations were imposed on them, such as: interconnection and access, non-discrimination in interconnection and access, accounting separation and price control and cost accounting.

TMMK's first RIO was approved by the Agency in July 2008. Based on the second round analysis of call termination services in public mobile communication networks on 30 July 2010, TMMK received a Decision for changing the RIO by which the Mobile Termination Rate ("MTR") was defined with a glide path decrease in a timeframe of four years (until 2013). In September 2011, the price for the national MTR was decreased to 3.1

MKD/min and it will continue decreasing by 0.1 MKD/min each year down to 2.9 MKD/min by September 2013. At the same time, the Agency regulated the MTRs for ONE and VIP (VIP was designated with SMP on this market in the second round analysis) with a four year glide path, while introducing asymmetry between all three mobile operators which will lead to equal MTR of 2.9 MKD/min in September 2013. In September 2011, ONE and VIP also decreased their MTRs respectively to the Agency's decisions for each of them.

In July 2010, the Agency concluded market analysis of the market for access and call origination service in public mobile communication networks and brought a decision by which TMMK was designated with SMP status on this market. As a result of the SMP designation, TMMK was obliged to prepare and publish RAO. TMMK's RAO was approved by the Agency on 27 November 2010.

According to the information from the Agency published on 11 November 2010 and the analyses of the access and call origination market, a virtual mobile operator was announced with the assignment of 100,000 numbers to WTI Macedonia for the provision of services.

ONE won the first tender for 3G radiofrequencies published by the Agency in November 2007 and started 3G commercial operations on 12 August 2008. TMMK won a license for 3G radiofrequencies on the second tender published by the Agency in September 2008 and started 3G commercial operations on 11 June 2009.

On 6 June 2009, TMMK acquired a 2G license in 1800 MHz band, on a public tender published by the Agency on 10 January 2009, thus obtaining additional spectrum for 2G services.

In March 2011, the Agency concluded a market analysis of the market of SMS termination services, and in May 2011 all three mobile operators T-Mobile, ONE and VIP, were designated with SMP status on the SMS termination market. In June 2011 all three mobile operators submitted draft RIOs with the SMS termination service included, and in July 2011 the RIOs were approved by the Agency.

In October 2011, a public call for submission of requests for acquiring a radiofrequency license for mobile services in 790 – 862 MHz as well as in the 1800 MHz were published by the Agency. In accordance with the national radiofrequency assignment plan, the 790 – 862 MHz shall be used for Long Term Evolution ("LTE"), and the Global System for Mobile Communications ("GSM") frequency bands at 900 MHz and 1800 MHz may be used for Universal Mobile Telecommunications System ("UMTS") (3G) technology. The due date for submission of the requests for acquiring licences in the two bands was 1 December 2011. TMMK submitted requests for both calls. No results were published so far.

Macedonia and the European Union

The Republic of Macedonia signed the Stabilization and Association Agreement with the EU and its Member States on 9 April 2001. The Macedonian Parliament ratified the Agreement on 12 April 2001, reaffirming the strategic interest and the political commitment to the integration with the EU. The Stabilization and Association Agreement was ratified and it has been in force since 1 April 2004.

On 17 December 2005, the EU decided to grant the Republic of Macedonia an EU candidate status. Following the candidate status, the EU must set a date for the start of the negotiations regarding the full accession, encompassing all aspects of the EU membership, including trade, environment, competition and health. Macedonia, as a candidate country, should harmonize its legislation with the EU.

On 14 October 2009, the European Commission issued the 2009 Progress Report. Macedonia received a recommendation from the European Commission for the opening of the accession negotiations. The country made significant progress and substantially addressed the key reform priorities, known as eight plus one benchmarks.

Based on the Progress Report issued in October 2011 progress was made in the field of electronic communications and information society services. Alignment with the EU *acquis* is advancing and most of the key competitive safeguards were introduced. The country's approximation with Digital Agenda Europe actions is progressing. Some progress can be reported in the area of audiovisual policy, including an Action Plan for full digital switch-over and use of the digital dividend. However, the country only partially meets the EU requirements in this area. Further efforts are necessary with regard to the capacity of the Broadcasting Council whose ability to monitor the market effectively remains inadequate.

Competition

The competition in the telecommunications business is well developed in almost all segments. Several main players shape the telecommunications market in Macedonia.

Telekom Slovenia is offering various services under the brand name ONE: mobile and fixed voice, mobile and fixed broadband internet and TV. During 2011 ONE offered several bundled portfolios, both in fixed and mobile segment, with unlimited minutes in its own mobile network and specific offer for free of charge calls from fixed ONE line toward ONE mobile network. ONE also launched the cheapest single fix voice offer on the market in 2011.

Other major competitor is the mobile operator VIP which has limited its services to mobile base services only. With an aggressive pricing policy, which continued in 2011 they have achieved a significant market share of 24.30% and thus surpassed ONE which has market share of 22.38% (source: Report for electronic communication development Q3 2011, the Agency). VIP has a GSM license only, compared to T-Mobile and ONE which have GSM and UMTS licences.

The Cable operators also have a significant role on the telecommunications market and, as providers of cable television as their main service, they are well established on the Macedonian market. Most of them offer internet broadband services and fixed voice services. Telekabel and Blizoo (former Cabletel, rebranded in Blizoo in last quarter of 2011) are the biggest Cable providers among over 70 active Cable operators trying to gain nation-wide role. Blizoo offers Hybrid Fibre Coaxial ("HFC") services – optic near your home with very high data rate for internet services and digital television. With aggressive marketing approach and low pricing schemes and discounts, currently Blizoo have positioned itself on the market as an operator with very attractive service portfolio and has reached significant market growth in a very short time.

The product portfolio of all Operators is driven by bundle products. Cable operators are successfully bundling their TV offer with internet and fixed voice services. The fixed voice service of the Cable operators is usually perceived as value added service as the Cable operators are charging very low access fee or presenting the fixed voice service as free of charge and including also free traffic in their own network bundled in the offer. As overall market is price sensitive, the price perception plays major role in the customers' choice thus cable operators' offers are seen as more competitive than MKTs in terms of prices.

The trend of NP is stable for 2011, for both mobile and fixed numbers. By the end of 2011 there are 76,762 fixed ported numbers and 59,354 mobile ported numbers in total (source: The Agency official web site).

With all the main telecommunication services of MKT and TMMK, such as providing different bundle offers – a combination of different services, MKT and TMMK still have the biggest market share. As at 31 December 2011 MKT has fixed voice market share (including wholesale) of 76%, fixed broadband internet market share (including wholesale) of 57% and TV market share of 10% (source: internal best expert estimates). In the third quarter of 2011 the market share of TMMK was 53.32% (source: Report for electronic communication development Q3 2011, the Agency). The Agency uses the market share calculation method based on the total number of active SIM cards which were used in the previous three months.

Marketing and Sales

Operating in a highly competitive environment in all telecommunication segments, MKT and TMMK are focused on introducing and promoting new services and retaining the existing customers. Marketing activities based on customer needs and habits are performed to build strong customer relations. Loyalty schemes and handset upgrade programs are also intensively used in order to increase the customer satisfaction and to decrease the customer churn rate.

The main focus in 2011 on the fixed market was put on the sales and migrations to the bundled double and triple play services, through several major campaigns for achieving the planned sales results, as well as for increasing the awareness of the benefits provided with the services. Activities for the single voice users offering new attractive tariff models with loyalty contracts continued in 2011 which managed to increase the loyalty customer base. In addition, the IPTV services are continuously extended with new content and features.

On the mobile services market, as a response to the aggressive price movements of the competition, new concepts and offers for the post-paid and prepaid segment were created (Option "0" and Pre-Paid loyalty). One of the main focuses in 2011 was the mobile data segment, where voice and data bundles for both residential and business customers were introduced.

In 2011 intensive promotion of internet usage on all platforms was made (fixed, mobile and hotspot access) with the "Internet Everywhere" program. The aim of the program is to increase mobile internet revenues, to drive fixed broadband differentiation and to increase customer satisfaction.

MKT and TMMK have developed different sales channels in order to serve the customers from different segments. MKT and TMMK use a direct sales channel, such as own retail network, direct sales agents, account managers (for Small and Medium Enterprises ("SME") and VIP residential customers), and key account managers (for large business customers); indirect sales channel based on indirect master dealers with their own network of shops, partner shops and free lancers; on-line sales channel and call centre which performs telesales.

Since November 2011 MKT call centre started operationally to perform sales activity (with pre-arranged delivery at home. Also IP Multimedia Subsystem ("IMS") migration and activity related to it were performed by call centre.

The main sales channels are the MKT and TMMK shops. There are 45 joint shops (42 shops and 3 kiosks). All shops are offering the complete TMMK and MKT product portfolio under the same conditions and with the same customer service level.

Another channel of the distribution network of TMMK and MKT is the dealers' cooperation. At the end of 2011, the network consisted of 13 master dealers with 95 shops as TMMK partners and 15 master dealers with 116 shops as MKT partners. The majority of the master dealers' shops are joint shops offering the full MKT and TMMK portfolio, except for cash collection. TMMK's prepaid and post-paid packages (with or without handsets) are available in all dealers' shops. In addition, prepaid vouchers are also available in more than 6,000 kiosks which sell prepaid packages without handsets. Since May 2011 the customers were given an opportunity to renew their contracts in the dealers' shops.

A part of the MKT product portfolio (e.g. telephone sets, TV sets, computers, printers, network equipment) is available to the customers using payment by instalments through their telephone bill.

In addition, TMMK is using subsidized handsets and a high quality service as strong tools for customer retention and churn prevention both in the residential and the business segment.

In 2011, the direct agents put a strong emphasis on the sale of FTTH products for the residential and Small-Office-Home-Office ("SOHO") customers. The account managers and key account managers are deeply involved in the

sale of telecommunication and Internet services with customized Information and Communication Technologies (“ICT”) solutions and data services. Since September 2011 they are working as joint agents/account managers offering complete MKT and TMMK portfolio.

Research and Development

MKT and TMMK continue to maintain fixed and mobile telecommunication networks at a high technological level in order to meet requirements for growing subscriber base and to provide a solid base for a wide range of products and services that will satisfy the customers’ demands. During 2011, development continued in all segments of the network: Access, Transport and Service Platforms.

The main activities related to the access network in 2011 were:

- Extension of fixed Broadband access through extension of ADSL capacities and extension of capacities and coverage of FTTH network;
- Start of Radio Access Network (“RAN”) modernization project.

In the fix access network the existing copper-wire network is used as basis for providing broadband services based on DSL technologies. In order to support higher speed of Internet packages and IPTV services, ADSL2+ technology is used. At the end of 2011, total number of installed ASDL 2+ ports was 219,600.

FTTH is foreseen as the main direction for the development of fixed access network. Beside Skopje, FTTH is implemented in other regions in the country as well. At the end of 2011, the total number of Homes passed was 57,050.

At the end of 2011, the 2G radio access network consisted of 582 base stations sites providing 99.9% population coverage. The 3G radio access network consisted of 173 NodeBs sites providing 80% population coverage allowing the subscribers to use high speed mobile Internet. In 2011 RAN modernization project started. .

The increasing demand for video and data services requires extension of the transport network capacity. During 2011, capacities of IP/MPLS network are extended according to the traffic increase. Taking into consideration increasing trend of IP services, activities for provisioning of Quality of Service (QoS) started during 2011 and are planned to be finalised in 2012. Additionally, in order to improve security of the services, extension and upgrade of Intrusion prevention system was done.

In terms of Service Platforms, the main focus in MKT is the development of IPTV with new applications and implementation of IMS Platform. During 2011 some of the additional benefits introduced for IPTV users were additional channels, Facebook on TV, additional functionalities provided by new IPTV client etc.

The IMS Platform was commercially launched in 2011 and it is used for the provisioning of VoIP as part of the 2Play and 3Play services and as a base for PSTN network migration towards the all IP network.

IMS offers possibilities that can be used in future for the provision of new services and applications, converged fixed and mobile services, multimedia services, etc., bringing increased customer satisfaction and improved live style.

Based on new IMS platform, modernization of the fixed telephone network and migration of PSTN towards all IP Network started in 2011 using broadband access.

In 2011, MKT continued with extension of Ethernet over the copper and optic cable capacities for provisioning of data services for business customers. This extension enabled support of new business customers, modernization

of Time Division Multiplex ("TDM") network with migration of the existing business users towards "All IP" network.

In 2011 TMMK implemented the VPN service in the network. The VPN is an Intelligent Network ("IN") based service, which is targeting the business subscribers with advanced services. In 2011 implementation of M-Wallet project started as a base for mobile payment services.

In order to protect Mobile network from SMS spamming and spoofing as well as to create solid security foundation, SMS firewall is implemented.

During 2011 as part of the "Internet Everywhere" project, MKT and TMMK have created a network with 500 Hot Spot locations across Macedonia. At these locations, in an easy and simple manner via Wi-Fi, citizens can connect to the best and fastest internet from their favourite places: coffee bars, restaurants, hotels, beaches, shopping malls, taxi vehicles and in the public city transport.

In order to increase operational efficiency, implementation of Alarm Umbrella and Trouble Ticketing System started in 2011 and it will continue during 2012. The systems will be connected to the equipment used in the fixed and mobile networks.

In line with the determination to be technology leader in the Country and even broader in the region, in 2012 MKT and TMMK will continue development of the network in order to provide high quality services, increased customer satisfaction, increased network availability, increased operational efficiency and secure long-term evolution.

Information technology

Following the corporate integration strategy, the IT areas of MKT and TMMK have been focused on the consolidation of the IT systems and infrastructure, while reducing the complexity of the IT architecture and improving the IT security standards.

Integration of the IT infrastructure and architecture is a prerequisite for the implementation of common processes on MKT Group level and increasing the process efficiency.

The main achievements in 2011 were:

- Implementation of common Interconnect Billing System for MKT and TMMK which enabled consolidation of the data and processes in the Interconnect, International and Wholesale business domain.
- Consolidation of Mediation systems for MKT and TMMK - migration of MKT Mediation system into Mediation Zone system of TMMK, which was already using DT standards. Implementation of such solution improved the efficiency by reducing the processing time and thus decreasing operational costs.
- Implementation of Identity and Central Access Rights Management System for MKT. The system provides automatic user accounts creation in IT applications, central access rights management and single sign-on for all IT systems/applications in MKT IT environment. The project continues in 2012 with integration of TMMK IT systems.
- Implementation of Business Process Management System (common workflow for MKT and TMMK) for more accurate and faster processing of business critical activities and increased visibility into operational efficiencies and bottlenecks. The implementation of common workflow management system will support unification of the processes in MKT and TMMK.

IT has taken a significant role in the implementation of the new of Fix/Mobile Converged products/services and development of ICT concept.



The IT security standards have been improved by implementing several security relevant systems that decrease the operational risks and improve customer and personal data protection. Starting from 2010 MKT and TMMK are working on the project for implementation of a new consolidated CRM system as part of the Deutsche Telekom Group NG CRM Project. This system should enable a 360-degree customer insight and further sharpen the customer focus of MKT and TMMK.

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