



Makedonski Telekom AD – Skopje  
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## ANNUAL REPORT on the operations of the Group of Makedonski Telekom AD - Skopje in 2010

*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.*

*For further information about the internal investigation, please refer to the financial statements of the Company for the year ended 31 December 2009.*

*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"). The Audit Committee indicated that it considers that, with the preparation of the Final Report based on currently available facts, White & Case has completed its independent internal investigation.*

*According to the information provided to the Company by Magyar Telekom Plc., the Final Report includes the following findings and conclusions related to Magyar Telekom's Macedonian affiliates, based upon the evidence available to the Audit Committee of Magyar Telekom Plc. and its counsel:*

- *As previously disclosed, there is evidence that certain former employees intentionally destroyed documents relating to activities undertaken in Macedonia by Magyar Telekom Plc. and its affiliates.*
- *Between 2000 and 2006 a small group of former senior executives at Magyar Telekom and Magyar Telekom's Macedonian affiliates, authorized the expenditure of approximately EUR 24 million through over twenty suspect consultancy, lobbying, and other contracts (including certain contracts between Magyar Telekom and its subsidiaries on one hand, and affiliates of a Cyprus-based consulting company on the other hand). The Final Report concludes that "the available evidence does not establish that the contracts under which these expenditures were made were legitimate."*
- *"The evidence shows that, contrary to their terms, a number of these contracts were undertaken to obtain specific regulatory and other benefits from the government of Macedonia. The Companies generally received the benefits sought and then made expenditures under one or more of the suspect contracts. There is evidence that the remaining contracts were also illegitimate and created a pool of funds available for purposes other than those stated on the face of the agreements." However, the Magyar Telekom Audit Committee's counsel did not have access to evidence that would allow it to identify the ultimate beneficiaries of these expenditures.*
- *In entering into these contracts and approving expenditures under them, the former senior executives knowingly caused, structured, or approved transactions that shared most or all of the following characteristics:*
  - *intentional circumvention of internal controls;*
  - *false and misleading corporate documents and records;*
  - *lack of due diligence concerning, and failure to monitor performance of, contractors and agents in circumstances carrying a high risk of corruption; lack of evidence of performance; and*
  - *expenditures that were not for the purposes stated in the contracts under which they were made, but rather were intended to obtain benefits for the Magyar Telekom subsidiaries that could only be conferred by government action.*
- *The Final Report states that "the Investigation did not uncover evidence showing receipt of payments by any Macedonian government officials or political party officials."*

*As previously disclosed, Magyar Telekom has taken remedial steps to address issues previously identified by the independent*

*investigation, including steps designed to revise and enhance the Magyar Telekom Group's internal controls. According to the information provided to the Company by Magyar Telekom, the Audit Committee of Magyar Telekom has not made recommendations relating to Magyar Telekom's compliance program or internal controls in connection with the issuance of the Final Report and Magyar Telekom is considering, in consultation with its Audit Committee, whether and to what extent the Final Report warrants additional remedial actions, including any personnel actions and/or changes in internal control policies and procedures at Magyar Telekom or its subsidiaries that have been or will be implemented to address the findings of 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 addition, the value of one contract of MKD 105,147 thousand capitalised within treasury shares is now corrected 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 Telemakedonia) 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. Upon completion of the independent internal investigation, the Company will inform the court on its final position in respect of the possible damage and the criminal prosecution of the accused persons. On 9 April 2010 the Company received notification from the Bureau of judicial expertise that based on the order of the Primary Court Skopje 1 Skopje the Bureau will perform expertise on the case. The expertise was performed on 11 May 2010 and the experts from Ministry of Justice of the Republic of Macedonia – Court Expertise Office – Skopje, asked from some additional documents from the Company's side in order to prepare the expertise. The Company received Notification from the Court Expertise Office – Skopje that the expertise will continue on 18 October 2010. 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. After preparation the expertise will be submitted from the responsible Judge to the Public Prosecutor. The Public Prosecutor should decide whether he/she will initiate prosecution act against accused persons or not depending on the expertise and other relevant proofs collected in the phase of investigation.*

*MOI of the RoM - Organized Crime Department, approached to the Company during August 2009, with request some additional documentation to be submitted to the MOI. The Company collected and submitted requested documentation on 27 August 2009.*

*The Chairman of the Company's BoD and the Company's Management have received an information that the contents of the Final Report has also been made available to the Macedonian Public Prosecution Office. The Company's Management cannot foresee whether the Macedonian Public Prosecution Office will initiate any legal procedure or the type and scope of legal actions on the basis of the information contained in the Final Report.*

*We have become aware of no 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 2010, MKT had 340,142 PSTN lines and 38,558 ISDN channels, compared to 366,418 and 41,076 respectively, at the end of 2009. The fixed line penetration was marked with a similar movement, stabilizing at 17.2% at the end of 2010. The number of ADSL connections increased to 152,668 at the end of 2010, compared to 132,788 as of 31 December 2009. The number of IPTV customers at the end of 2010 reached 30,486 customers (including 3 Play, IPTV only and 2 MAX) compared to 14,334 customers at the end of 2009. The number of FTTH customers reached 2,127 customers at the end of 2010.

In 2010, approximately 23% of the total revenues of the Group were comprised of the voice revenues from domestic fixed line telecommunication services. The mobile services contributed with 51%, while the international telecommunication services contributed with 8% to the total revenues. The internet and data services contributed with 11% of the total revenues, while 7% 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 the increasing mobile substitution and the intensified competition on the telecommunications market. The increased revenue of MKT from international traffic is a result of the increased volume of traffic and the increased termination rates. The portion of the revenues from mobile services decreased due to the intensified competition and the decreased subscriber base. The Internet and data revenue has grown, mainly due to the increased number of ADSL subscribers and the growing number of IPTV subscribers, but it still represents a small portion of the total revenues.



In June 2006, through the Macedonian Stock Exchange, MKT acquired 9,583,878 of its own shares, representing 10% of its shares. The amount of MKD 3,738,358 thousand related to the purchase of these shares is deducted from the shareholders' equity as treasury shares. MKT has the right to reissue these shares at a later date.

In 2008, MKT adopted the T-Home brand and on 1 May 2008 it changed its legal name from AD Makedonski Telekomunikacii - Skopje into Makedonski Telekom AD – Skopje, wherein its products are now marketed under the brand T-Home.

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 1,295,285 at the end of 2010, compared to 1,381,094 at the end of 2009. 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, we especially focus on retaining the customers in order to protect our market share. 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.

The decline in the number of TMMK subscribers in 2010 is 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 2010. 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 2010, 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.

T-Mobile Macedonia introduced its first quadruple bundled product, Family Max which is a joint offer containing fixed line, mobile telephony, high speed ADSL Internet and IPTV for one monthly subscription.

## **Regulation and Pricing**

A new 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 EU regulatory framework. Furthermore, a number of strict obligations for the existing operators were stipulated.

In the second half of 2006, the Government of the Republic of Macedonia enacted a number of bylaws and rulebooks regulating various electronic communications areas. On 4 May 2007, the LEC was amended and criminal responsibility was introduced for the responsible person within the legal entity on account of not publishing the reference interconnection offer and the local loop unbundling access offer. Additional amendments of the LEC were adopted on 4 August 2008, by which the Concession Contracts of MKT, TMMK and Cosmofon (which was rebranded into ONE in November 2009), concluded pursuant to the old Telecommunications Act with the Ministry of Transport and Communications, ceased to be valid as of 4 September 2008. All the relevant provisions in favour of MKT arising from the Concession Contracts were included in the LEC amendments. On 5 September 2008, the Agency for Electronic Communications ("the Agency"), ex officio, issued a notification to MKT regarding those public electronic communication networks and/or services which have been allocated thereto under the Concession Contracts. Radiofrequency licenses were issued to the operators for the bands granted under the Concession Contracts in a

form prescribed by the LEC.

The latest changes of the LEC were amended and published in the Official Journal of the RoM No.83 on 23 June 2010. The introduced obligations were in line with the amended EU Regulatory Framework, comprising the following: opening ducts, poles and other network access remedies; accounting separation for all legal entities; an obligation for data storage for the operator in terms of keeping traffic data for a period of 24 months.

At end of 2010, changes in the RUO and RIO rulebooks were also proposed according to the changes in the LEC and the new BEREC's NGA recommendation. There is a proposed migration procedure and optional measures as fibre unbundling and fibre bit stream access.

#### Regulation of Fixed Line Business

On 31 December 2004, MKT's monopoly rights on the Macedonian telecommunications market expired, thus making it possible for other network and service providers to enter the Macedonian telecommunications markets, upon the submission of a notification to the Agency and the registration thereof. Due to the new notification procedure introduced by the Agency in November 2009 and the obligation for re-notification of the entities, until 4 January 2011 the Agency had registered 144 network operators and 21 providers of public fixed telephone services.

Under the LEC, MKT has been designated as a Significant Market Power ("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, local bit-stream access, wholesale line rental and wholesale leased lines. The changes in the by-laws for bit-stream access, made on 7 June 2010, resulted with decreased fees for bit-stream access and introduction of technical specifications for new services (IPTV, VoIP and VoD). Therefore, the wholesale partners will be more competitive on the broadband market. Furthermore, a new Rulebook on access and use of specific network assets was published by the Agency on 7 December 2010, with which an obligation was imposed on MKT to offer access to ducts and dark fibre.

During 2010, the Agency imposed the following remedies related to RIO and RUO: sharing costs for IC links and symmetry of fixed termination rates between the operators.

During December 2010, the Agency published the results from its own developed LRIC Bottom - up costing model. On 17 January 2011, the Agency sent a Decision letter to MKT for changing the wholesale fees included in the Reference Interconnection Offer ("RIO").

The latest changes in RUO with the decrease of the one-off fees were published in March 2010, after the Agency's approval. On 16 April 2007, MKT signed the first RUO based unbundling agreement with an alternative fixed network operator. On 17 January 2011, the Agency sent a Decision letter to MKT for changing the wholesale fees included in the Reference Offer for Unbundled Access to Local Loop ("RUO").

Based on Article 41 of the LEC, the Agency initiated the procedure for analyses of the relevant markets. MKT was announced as an SMP on all relevant markets in terms of the fixed segment. MKT and the fixed alternative operators were assigned as operators with Significant Market Power ("SMP") on the market for termination calls in their networks (the relevant market 9 from the former European Commission recommendation). The reference offers from the alternative operators (ONE, OnNet and Neotel) are approved and published accordingly. New remedy streams were imposed, such as intensifying retail regulation (especially for bundles), VoIP and NGA networks. On 7 May 2010, the Agency brought a final decision for the value of WACC and it was determined for MKT, TMMK and ONE. New WACC rates decreased to:

- For MKT WACC (pre-tax) it shall be 13.40%;
- For TMMK and ONE, WACC (pre-tax) it shall be 14.00%

Number portability was implemented on MKT's and TMMK's networks and the commercial start of the service in Macedonia took place on 1 September 2008.

On 30 June 2009, the Agency enacted a Decision for setting the maximal amount of the one-time fee for the number portability service for fixed and mobile operators, in the amount of 200 Macedonian denars (approximately 3.25 EUR), which was previously established individually by the operators.

A new Numbering Plan was enacted in November 2009. The major changes incorporate an abbreviated, premium rate and free phone numbers to be assigned only to operators and service providers, but not to end users. MKT will continue hosting numbers upon the prior consent of the end users to which the numbers were assigned.

In 2007, the Agency granted six regional and two national authorizations for radio frequency utilization in the 3.4-3.6 GHz band for the implementation of fixed wireless access, WiMAX.

Based on the analysis and the Agency's program for 2011, the Agency is planning to impose retail price regulation on MKT.

The SMP operators are obliged to keep separate accounting records for their wholesale and retail activities.

#### Regulated retail prices

As of 2008, the fixed voice market in Macedonia has become highly competitive. The new fixed line operators Cosmofon and OnNet (now ONE) launched fixed line and bundled services at decreased prices. The major CATV (Cabletel and Telekabel) and other alternative operators also started to offer fixed voice and bundled products at attractive prices.

Until August 2008, the regulatory framework for the retail tariff regulation for MKT was provided for in the Concession Contract. With the changes of the LEC published on 4 August 2008, the existing Concession Contracts of MKT, including the retail price cap regulation, are no longer valid as of 4 September 2008.

According to the LEC and the newly enacted bylaw pertaining to retail price regulation, the Agency may prescribe one of the following manners of retail regulation of fixed telephony services:

- Price cap;
- Individual price approval;
- Cost based prices; or
- Benchmark prices

In the middle of 2010, the Agency introduced Guidelines on Price Squeeze Testing. With such regulation, the Agency intends to have a stronger impact on the retail pricing schemes of all national operators and thus to establish some basic rules regarding price squeeze issues. This is one of the main targets of the Agency annual program for 2011.

Regarding the individual pricing offers, especially tenders, MKT is faced with a constant pressure from the competitors and it is under observation by the Competition Authority and the Agency.

#### Regulated Wholesale Prices

The Long Run Incremental Costs methodology ("LRIC") was introduced as cost obligation in 2007.

With the latest changes and the published results, the interconnection fees were decreased, both for IC links and for traffic services: origination, termination and transit. The new fees are based on the Bottom-up LRIC model developed by the Agency and they are expected to be applicable earliest from March 2011.

The Agency imposed new decreased monthly fees for local loop unbundling (“LLU”). The current monthly fee for LLU from MKD 430 will be decreased to MKD 331.08 (23% decrease). The new wholesale fees are based on the Bottom-up LRIC model developed by the Agency and they are expected to be applicable earliest from March 2011.

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. From 2007, TMMK and Cosmofon (now ONE) were designated with an SMP status, 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 submitted the Reference Interconnection Offer (“RIO”) to the Agency on 29 February 2008. Based on the second round analysis of call termination services in public mobile communication networks (market 16 from the former European Commission recommendation), on 30 July 2010, TMMK received a Decision for changing the RIO by which the MTR was defined with a glide path decrease in a timeframe of four years (until 2013). In September 2010, the price for the national MTR was decreased to 3.2 MKD and it will continue decreasing by 0.1 MKD each year down to 2.9 MKD/min by September 2013. At the same time, the Agency regulated the MTR’s for ONE and VIP with a respective 4 year glide path, while introducing asymmetry between all three mobile operators which will lead to equal MTR of 2,9 MKD in September 2013. On 7 July 2010, the Agency concluded the market analysis of the market for access and call origination service in the public mobile communication networks (market 15 from the former European Commission recommendation) and on 28 July 2010 it brought a decision by which TMMK was designated with SMP status on Market 15 and several obligations were imposed thereto. As a result of the SMP designation, TMMK was obliged to prepare and publish a Referent Access Offer (“RAO”). TMMK submitted the offer to the Agency on 28 August 2010. The Agency requested certain changes of the RAO. TMMK prepared and sent the changed offer on 27 October.

According to the information from the Agency published on 11 November 2010 and the analyses of the Market 15, a virtual mobile operator was announced with the assignment of 100,000 numbers to WTI Macedonia for the provision of services.

In November 2007, the Agency published a public tender for granting one license for 3G radiofrequencies utilization. Cosmofon (now ONE) won the tender and started the 3G commercial operations from 12 August 2008. On 2 September 2008, a decision for granting three 3G licences for a one-off fee in the amount of 10 million EUR each was published. On 15 September 2008, a new tender for additional three 3G licenses was published. TMMK won one license which was granted to it on 17 December 2008, for which TMMK paid EUR 10 million as a one-off fee. TMMK started commercial operations of the 3G services on 11 June 2009. The validity of the license is 10 years i.e. until 17 December 2018, with a possibility for an extension for 20 years in accordance with the LEC.

On 10 January 2009, a public tender for awarding two licences for 2G radiofrequencies in the 1800 MHz band was published. TMMK was awarded one license on 6 June 2009. TMMK paid EUR 2 million as a one-off fee for the 2G license in the 1800 MHz band. The validity period is 10 years, with a possibility for an extension for 20 years in accordance with the LEC. Furthermore, on 10 January 2009, a tender for one license in the 1800-1805 MHz for broadband wireless access on the whole territory of the Republic of Macedonia was published. The one-off fee was set at EUR 30,000. On 5 May 2009, the Agency brought a Decision under which it pronounced Mobik Telekomunikacii as the best bidder on the tender.

## Macedonia and the European Union

The Republic of Macedonia signed the Stabilization and Association Agreement with the European Union 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 European Union. 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, the competition on the electronic communications markets increased as a result of the liberalisation process, to the benefit of the consumers. The Director of the Agency was appointed in an open competition procedure. The Agency adopted implementing legislation on retail tariffs, bit-stream access and wholesale line rental. The laws regulating the issues related to authorisations in terms of construction works and the right of way are unclear, particularly in terms of the division of the responsibilities between the Ministry of Transport and Communications and the municipalities. This hinders the investments in the telecommunications networks. In the area of electronic communications, the country is now well advanced.

### **Competition**

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

Telekom Slovenije purchased 100% of the shares of Cosmofon and became the owner of two major competitors, Cosmofon and OnNet, and it is now offering various services under the brand name One: mobile and fixed voice, mobile and fixed broadband internet and TV. In June 2008, Telekom Slovenije started an aggressive fixed voice offer ALLO, which is when the first major impact in the fixed voice happened. In August 2008, they started to offer services based on 3G technology. In November 2009, Telekom Slovenije launched a TV service based on DVB-T under the brand Boom TV. Since then, Telekom Slovenije has been present in all main telecommunication services: mobile, fixed voice, broadband and TV.

The CaTV 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, since Q4 2008, some of them also started offering fixed voice services. Telekabel and Cabletel are the biggest CaTV providers among over 70 active CaTV operators trying to gain nation-wide role.

The third major competitor is the mobile operator VIP which has limited its services to mobile base services only. With an aggressive pricing policy they have achieved a significant user market share since the entry (18,2% in Q3 2010, source: Report for electronic communication development Q3 2010, Agency for Electronic Communications). VIP has a Global System for Mobile Communications ("GSM") license only, compared to T-Mobile and One who have GSM with Universal Mobile Telecommunications System ("UMTS").

Number portability has become available as of 1 September 2008, allowing faster and easier fluctuation among different operators, and contributing to a better competitive environment. In addition, there is a possibility of new entrants on the mobile market in the form of a virtual mobile operator (MVNO) and a national roaming operator (NR).

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 in fixed voice (76%; source internal best expert estimates); fixed broadband internet (51%; source internal best expert estimates) and mobile market share (58%, source: Report for electronic communication development Q3 2010, Agency for Electronic Communications). MKT entered the TV market in November 2008 with its first triple play offer 3Max (a combination of fixed voice, broadband internet and IPTV). By the end of 2010, the IPTV market share of MKT was estimated to approximately 8% of the total TV market (source: internal best expert estimates).

## Marketing and Sales

Operating in such a highly competitive environment in all telecommunication segments, MKT is focused on introducing and promoting new services and retaining the existing customers. The main focus in 2010 was put on the sales and/or 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. The IPTV services are continuously extended with new content and features. Several activities for the single voice users were introduced during 2009 by offering attractive loyalty contracts, which continued in 2010 and managed to stabilize the churn and to increase the loyalty customer base.

MKT remains the leader in innovations. The launching of the first three-screen campaign within the Group provided a unique experience for the customers – the World Championship 2010 was exclusively covered on all 3 media – Internet, Mobile TV and IPTV in High Definition.

On the mobile services market, as a response to the aggressive price movements of the competition, new tariff portfolios for the residential family and business segment were created, which attracted 84.000 customers in less than 6 months. In percentage, 20% of the total post-paid base in the TMMK community are using the new tariffs. One of the main focuses was also the mobile data segment, where we showed an increase of approximately 60% in 2010 compared to 2009.

MKT has developed different sales channels in order to serve the customers from different segments. MKT uses a direct sales channel, such as own retail network, direct sales agents and key account managers; 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.

The main sales channel is the MKT and TMMK shop network. There are 46 joint shops (43 shops and 3 kiosks). Since 1 October 2010, all shops have been offering the complete TMMK and MKT product portfolio under the same conditions and with the same customer service level. A new retail DT concept was introduced in four shops in 2010. One of the shops was also redesigned as a “café and shop”, in addition to the one opened on 23 January 2009.

Another channel of the distribution network of TMMK and MKT is the dealers' cooperation. At the end of 2010, the network consisted of 11 master dealers with 105 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 dealer shops. In addition, prepaid vouchers are also available in more than 6,500 kiosks which sell prepaid packages without handsets.

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

In 2010, the direct agents put a strong emphasis on the sale of Fiber to the Home (“FTTH”) products for the residential and Small-Office-Home-Office and Small and Medium Enterprises (“SOHO”/“SME”) customers. The direct sales agents 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 especially for the SME segment. 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.



Marketing based on customer needs and habits is used to build strong customer relations. Loyalty schemes and handset upgrade programs are also increasingly used in order to increase the customer satisfaction and to decrease the customer churn rate.

### **Research and Development**

MKT continues to maintain its network at a high technological level in order to provide a solid base for a wide range of products and services that will satisfy the customers' demands. In the next development period, the main focus will be on network development in all segments: Access, Transport and Service Platforms.

FTTH is foreseen as the main direction for the development of fixed access network. Beside Skopje, FTTH is planned to be implemented in other regions in the country as well.

The increasing demand for video and data services requires increasing the capacity of the transport network. The IP/MPLS Network, as a base for the transport of IP services, will continue to be developed and extended in accordance with the expected traffic growth. An additional focus will be put on QoS, thus increasing the network security and availability.

The DWDM network is the main transport for IP/MPLS and Ethernet traffic. The further network development is in the direction of implementing a new Optical Transport Network.

In terms of Service Platforms, the main focus will be on the development of IPTV with new applications and an IMS Platform. The IMS Platform will be used:

- For the provision of VoIP as part of the 2Play and 3Play services;
- For the provision of new services and applications in the future; and
- As a base for PSTN network migration towards the entire IP network.

In the next development period, the migration towards the NGN IP-based network will continue with increased broadband penetration, followed by the implementation of NGOSS.

Research and development projects at TMMK are being implemented in close cooperation with the suppliers and the state educational institutions.

In co-operation with the local partners, TMMK has developed solutions for handling low balance prepaid customers, as well as a solution that will enable us to offer Unstructured Supplementary Service Data ("USSD") based services.

In 2010, TMMK was the first operator to offer full quadruple play product on the Macedonian market, encompassing mobile voice and data, fixed line voice, broadband Internet and TV in one product.

In co-operation with its partners TMMK has launched Mobile Payment services, as well as successfully completed the e-commerce development, thus enabling the residential customers to pay invoices through the TMMK web site. The next development phase will focus on the e-shop, allowing purchase of products on the Internet with payment cards.

TMMK is working on implementing 3G-based services for their subscribers. The first service that was implemented in June 2010 was mobile TV.

TMMK is implementing the VPN service in the network. The VPN is an Intelligent Network ("IN") based service, which is targeting the business subscribers with advanced services.

### **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 2010 were:

- Implementation of a common exchange and domain - The domain @telekom.mk has been established as common domain for the MKT Group, all TMMK users/servers are migrated to @telekom.mk domain and all MKT and TMMK mails are migrated to Common Exchange 2010;
- Integration and implementation of a common corporate IT network - Interconnection between the MKT and TMMK corporate network infrastructure and building a new common corporate network infrastructure. A common network provides a stable, highly available, reliable and secure network infrastructure and improves the functioning of all business critical applications and processes;
- Development of Target IT Architecture for the CRM, Billing and ERP domains and alignment with the Deutsche Telekom standards;
- In order to provide reliable premises for the installation of HW equipment for the new IT and OSS systems, the Data Center has been extended with additional 160 m2 which will satisfy the needs for Data Center space in the next 4 years.

IT has taken a significant role in the implementation of the new of Fix/Mobile Converged products and services:

- "Family +" – first fully fledged corporate 4Play package including fixed line, mobile line, broadband DSL and MaxTV;
- Three screen TV streaming for FIFA 2010 – Football on HD on MaxTV, mobile streaming and Internet streaming;
- Joint Loyalty Program;
- E-commerce and instalment payment.

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. The first phase of the implementation of an Identity and Central Access Rights Management System was finished with the integration of all MKT IT systems containing customer data, and it is planned to continue with the other MKT systems and extension for the TMMK IT systems as well.

The CRM and Billing domain was in the focus during 2010.

In 2010, the T-Mobile Billing System upgrade project was finished, which brought new rating and billing enablers into our product portfolio, like cost control, split billing, enhanced roaming rating, etc.

During 2010, MKT and TMMK started a three year project for the 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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