



Makedonski Telekom AD – Skopje
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ANNUAL REPORT on the operations of the Group of Makedonski Telekom AD - Skopje in 2012

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 previous years.

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 Company. 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 (T-Mobile Macedonia) 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 2012, the amount of MKD 36,724 thousand related to the identified potential tax impact, together with related penalty interest, in the subsidiary was paid 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 was corrected in 2009 consolidated financial statements and was 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, the subsidiary 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 and accordingly the Group did not record any provision.

On 23 February 2012 the Company received a request for documentation from the Financial Police Office of the Ministry of Finance of RoM related to certain consultancy contract and underlying documentation, which were also provided to White & Case during the internal investigation. The Company responded to the request accordingly.

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. 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 2012, MKT had 296,592 PSTN lines and 33,660 ISDN channels, compared to 316,025 and 37,016 respectively, at the end of 2011. The fixed line penetration was marked with a similar movement, stabilizing at 14.9% at the end of 2012. The number of ADSL connections increased to 169,798 at the end of 2012, compared to 161,705 as of 31 December 2011. The number of IPTV customers at the end of 2012 reached 67,475 customers (including 3 Play, IPTV only and 2 MAX) compared to 40,722 customers at the end of 2011. The number of Fibre to the Home ("FTTH") customers reached 12,548 at the end of 2012.

In 2012, approximately 19.7% of the total revenues of the Group were comprised of the voice revenues from domestic fixed line telecommunication services. The mobile service revenues contributed with 47.7%, while the fixed line international telecommunication services contributed with 10.4% to the total revenues. The fixed line internet and data services contributed with 12.1% of the total revenues, while 10.1% of the total fixed and mobile revenues were derived from other services.

The revenue from domestic fixed line telecommunication services still marks a downward movement, mainly due to the decreased number of fixed-line customers and a decrease of the outgoing traffic. Slight decrease of MKT revenues from international incoming traffic, mainly as a result of the lower incoming minutes from fixed and mobile termination. The portion of the revenues from mobile services decreased due to the intensified competition and the decreased subscriber base, partly compensated by the increased revenues from domestic mobile operators and mobile internet services. Fixed line internet revenues remained stable even though the competition from cable operators is intensifying. IPTV revenues have grown mainly due to 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..

TMMK had a customer base of 1,181,437 at the end of 2012, compared to 1,265,243 at the end of 2011. The mobile market penetration in Macedonia is over 108 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 2012 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 2012. 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 2012, 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 a price of EUR 37,300,000 (excluding VAT) and sale of three office buildings of MKT and the Headquarters of TMMK at a 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 both Companies (MKT and TMMK). The difference in the 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 – was completed in 2012 and the transaction was accordingly reflected in the accounting records in 2012. The details of the transaction and the financial effects are disclosed in the Explanatory notes to the Consolidated Annual Accounts and the Financial statements of MKT for 2012.

Sustainable rationalization of costs and increase of efficiency by consolidation of business space and employees, improvement of the quality of the 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 the main rationales behind the New Accommodation Plan.

Regulation and Pricing

The Macedonian law concerning the 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 Infomedia DOO Skopje were designated as Universal Service ("US") providers. MKT was designated as a US provider for fixed telephony services, public payphones and equivalent access for disabled end-users, while R3 Infomedia DOO Skopje was designated as a US provider for unique subscriber directory and directory enquiry. The operators were obliged to start providing the services from 1 January 2012 and to do so for the following five years. MKT started providing the services based on the US designation.

The amendments of the LEC published in the Official Gazette of RoM No.13/2012 on 27 January 2012 comprised the following: obligation for presentation of Calling Line Identification Presentation ("CLIP") and location data for emergency calls, obligation for free-of-charge SMS for promotion of cultural heritage of the Republic of Macedonia, discretionary 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, the annual fees to the Agency should be in line with the Agency's annual budget.

The amendments of the LEC published in the Official Gazette of the RM No. 59/2012 on 11 May 2012 introduced an auctioning procedure for assignment of radiofrequencies. The amendments of the LEC published in the Official Gazette of the RM No.123/2012 on 2 October 2012 imposed an obligation to the mobile operators for

free-of-charge transmission of SMS messages of the Ministry of Education and Science's project E-School Diary.

On 5 April 2012 the Agency published the general Regulatory strategy for the period of the next 5 years (2012-2016). The official document is "Five years regulatory strategy of AEC". Main focuses of the strategy are: fostering of wholesale and retail services regulation, introduction of methodology of pure Long Run Incremental Costs ("LRIC") for fixed and mobile voice services, SMS, etc., Next Generation Access ("NGA") and Fibre to the Home ("FTTH") regulation in line with NGA recommendation and refarming and frequency allocation for 4G services.

In December 2012, the Agency has announced starting of the new round of market analyses on wholesale markets: 4- Call origination, 5- Call termination and 6- Call transit services in public telephone networks on fix location. The final document is expected to be published in the first quarter of 2013.

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 2012 the Agency had registered 43 providers of public fixed telephony services.

Under the LEC, MKT has been designated as an SMP operator on the market of fixed line voice telephony 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 the current bylaws, 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 Reference 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.

In 2012, most of the existing Rulebooks were implemented or amended by the Agency: retail price regulation; technical, usage and other conditions for relevant types of electronic communication networks and infrastructure, associate infrastructure capacities and facilities; determination of calculation method for number usage and annual fees; assignment of numbers and series of numbers from the numbering plan; general terms and conditions; cultural SMS; educations (school info) SMS; "underground cabling"; Local bit-stream access; wholesale leased lines; minimal set of leased lines.

In August 2012 the Agency published the draft results from its own-developed LRIC Bottom-up costing model for Local Bit-stream (cost based) and for retail and wholesale Leased Lines, ducts and dark fibre and minimal set of leased lines (cost based). As a result, the Agency brought a decision for decrease of the fees and approved the changed Reference offer for provision of physical access and usage of electronic communication infrastructure and associated facilities (ducts and dark fibre). New fees will be implemented from 1 February 2013.

The Reference offers for Wholesale digital leased lines ("WS DLL"), Local Bit-stream access and Minimal set of leased lines were also approved by the Agency and new changed methodologies of calculation of prices (length-dependent) were implemented. The WS DLL and Local Bit-stream access fees have been decreased as of 1 December 2012 and the fees for minimal set of leased lines from 1 January 2013.

The latest changes in the Reference 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 made towards a ported number. The signal is unified for all operators.

Based on the new amended changes in the LEC 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 a process for development and implementation of the methodology for retail price regulation. The applied methodology shall be price squeeze. For that purpose, the Agency has engaged Analysis Mason as consultants for the development of a methodology for price squeeze testing.

With the amendments of the Rulebook for retail regulation, the Agency specified the manner and procedure for regulation of the retail prices for fixed voice telephony networks and services of the operator with significant market power on the relevant retail markets. The ex-ante retail regulation is based on price squeeze methodology. These activities have resulted in price decrease of some wholesale and retail services of MKT. On the retail side, the standard monthly subscription for business customers was decreased (on equal level with the residential one). On the wholesale side there were changes in the fees for interconnection (termination and origination), Unbundled Local Loop, Bit-stream access and wholesale line rental.

The Agency publicly announced the Final Document for implementation of LRIC Bottom-up model for regulated retail prices for Minimal set of leased lines. The Minimal set is linked to the Wholesale Leased lines new monthly fees according to the LRIC Bottom-up model with additional mark up from 11 to 20%.

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 for mobile telephony, MKT and TMMK are faced with a constant pressure from the competitors which are in a position to offer lower prices, usually below costs, in order to increase their customer base as a result of the 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 Reference Interconnection Offer (“RIO”) changes in line with the decision of the Agency 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 links and administration and maintenance of interconnection agreements. The 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 the proposed modifications of MKT WLR Reference Offer and BSA Offer applicable as of 1 January 2012. The IP MATERIO (Internet Protocol Reference Interconnection Offer of MKT) is in a phase of preparation and submission to the Agency, in advance to the process of introduction of IP Interconnection. Other fixed operators are ready for IP Interconnection, whereas the mobile operators cause certain delay in the introduction of IP Interconnection with mobile network.

Along with the retail price repositioning of the bundle packages, in May 2012, the monthly fees for ULL decreased to MKD 210.

On 5 December 2011 MKT published its amended BSA offer. The terminology of all services in the offer is harmonised with the 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. The amended offer is applied from 1 January 2012.

On the public meeting held on 14 October 2011, the Agency presented a detailed plan for Bottom-up LRIC model developed by consultants, which is expected to result in changes of the BSA pricing models and which will modify the service description.

On 29 December 2011, the Agency published an inception report for the 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.

In October 2012 the Agency publicly announced the Final Documents for implementation of Bottom-up LRIC modelled regulated wholesale services, in terms of:

- Wholesale Leased lines (terminating and backbone parts)
- Bit-stream Access (level 2, 3 and 4)
- Specific network elements ducts and dark fibre.

The new prices are cost-based as described in the Bottom-up LRIC model, the impact is lower monthly fees (cost based) than previously set. The monthly fees from Level 4 of Bit-stream access retain the retail minus approach as a resale offer.

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 was planned to 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.

In May 2012, the Agency made a revision of the calculation of MTR of all three mobile operators and imposed new glide path. As from 1 June 2012 until 31 August 2013, TMMK's MTRs were set at 3.0 MKD/min., while ONE and VIP Operator's MTRs were set at 4.0 MKD/min. MTR symmetry to 1.2 MKD/min. calculated using Bottom-up LRIC+ will be applied from 1 September 2013, and a further decrease to 0.9 MKD/min. calculated using Bottom-up pure LRIC will be applied from 1 September 2014.

In July 2010, the Agency concluded market analysis of the market for access and call origination service in the 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 the 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 TMMK 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, the Agency announced 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 band. In accordance with the national radiofrequency assignment plan, the 790 – 862 MHz band 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.

Based on the received requests by interested parties, in August 2012, a Public Tender with a Public Auction for one radiofrequency license of 2 x 10 MHz in 790 - 862 MHz band (LTE) for public mobile services was published. Since the minimum number of two interested operators for the auction to take place was not met, in September 2012 the tender was re-opened under a procedure without public auction. The due date for submission of bids was 24 October 2012. The tender was unsuccessful because no existing or new operator submitted a bid.

Also based on the received requests by interested parties, in July 2012, a Public Tender for radiofrequencies of 2 x 10 MHz at 1800 MHz (GSM, DCS and IMT-2000/UMTS) for public mobile services was published and concluded in September 2012. VIP Operator won the license. Approximately at the same time, VIP Operator acquired modification of the existing licences for mobile services at 900 MHz and 1800 MHz allowing implementation of UMTS in these bands.

In October 2012, TMMK acquired modification of the existing radiofrequency licences for mobile services at 900 MHz and 1800 MHz allowing implementation of UMTS in these bands.

In October 2012, the Agency requested changes of TMMK’s RIO in the direction of allowing termination of transited traffic into TMMK’s network. This intervention of the Agency was made in the RIOs of all operators in order to enable wider space for transit of traffic.

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 2012, Progress can be reported on the information society and media, notably in the area of electronic communications and information society services. In the case of audiovisual policy, the activities of the Broadcasting Council increased, but a non-discriminatory approach needs to be ensured. Adoption of a media law in line with EU acquis remains a priority. The country partly meets its priorities in the area of the information society and media. Overall, the preparations in this area are moderately 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 Slovenia is offering various services under the brand name ONE: mobile and fixed voice, mobile and fixed broadband internet and TV. In May 2012 ONE launched prepaid mobile offer followed with an aggressive marketing campaign and significantly increased their customer base, as well as market share to 23.3% (source: Report for electronic communication development Q3 2012, the Agency). In the fixed segment ONE offered low price triple play bundles (fix voice/internet/TV). However, the number of their TV customers declined to 37,862 in Q3 2012 compared to 49,003 in Q3 2011 (source: Report for electronic communication development Q3 2012, the Agency).

Other major competitor is the mobile operator VIP which has limited its services to mobile based services only. With an aggressive pricing policy, which continued in 2012 as well, they have achieved a significant market share of 27.2% (source: Report for electronic communication development Q3 2012, the Agency). VIP purchased 3G licence in August 2012, and added 3G services to their portfolio, which enables them to be more competitive on the mobile Internet market.

The cable operators also have a significant role in 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 are the biggest cable providers among over 70 active cable operators. 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 has positioned itself on the market as an operator with very attractive service portfolio and has reached significant market growth.

The product portfolio of all operators is driven by bundle products. Cable operators are bundling their TV offer with internet and fixed voice services. The fixed voice service of the cable operators is usually perceived as a 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 the overall market is price sensitive, the price perception plays a major role in the customers' choice and thus the cable operators' offers are seen as more competitive than MKT's in terms of prices.

The trend of NP increased in 2012, for both mobile and fixed numbers. By the end of 2012 there were 102,095 fixed ported numbers and 90,109 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 2012 MKT has fixed voice market share (including wholesale) of 72.8%, fixed broadband internet market share

(including wholesale) of 54% and TV market share of 17% (source: internal best expert estimates). In the third quarter of 2012 the market share of TMMK was 49.5% (source: Report for electronic communication development in the third quarter of 2012, 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 new services and on the retention of the existing customers. Marketing activities based on customer needs and habits are performed in order 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 2012 on the fixed market was put on the repositioning of the fix portfolio by introducing more benefits for the customers within the bundled double and triple play services, as well as in the single voice product tariff options. Several major campaigns were launched for achieving the planned sales results and for increasing the awareness of the benefits provided with the services. In addition, mobile internet service was introduced as part of the bundles. The IPTV services are continuously extended with new content and features – exclusive UEFA content, TV library, etc. All these actions resulted in an increase of the IPTV customer base by 66% as of 31 December 2012 compared to 2011. According to the internal best expert estimates, in the fourth quarter of 2012, MKT became the operator with the highest market share on the pay-TV market in Macedonia, achieving largest number of TV customers.

The increased FTTH coverage and benefits of the fibre-based product offers improved the customer base over fibre for 154% as of 31 December 2012 compared to 2011.

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”, weekly packages containing voice, SMS and Internet). One of the main focuses in 2012 was the mobile data segment, where voice data bundles for both residential and business customers were enriched with additional value: more minutes within own network and Internet traffic volume. The attractive handsets offers contribute to the gross additions and retention in both the prepaid and the post-paid segment.

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 freelancers; on-line sales channel and call centre which performs telesales.

Since November 2011 the MKT call centre started operationally to perform sales activity (with pre-arranged delivery at home. During 2012, the same process was established for mobile portfolio. Also, IP Multimedia Subsystem (“IMS”) migration and activity related to it were performed by the call centre.

In September 2012 a Save Desk program was created in TMMK as a tool for decreasing the number of voluntary churners. Subscribers are contacted after their request for contact termination and special offers/services for contract prolongation are proposed.

The main sales channels are the MKT and TMMK shops. There are 42 joint shops (41 shops and 1 kiosk). On 4 October 2012 a new shop was open in Skopje City Mall (according to the latest DT 2010+ shop concept). 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 2012, the network consisted of 10 master dealers with 60 shops as TMMK partners and 8 master dealers with 70 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 4,000 kiosks which sell prepaid packages without handsets. Since May 2011 the customers were given an opportunity to renew their contracts in the dealers' shops.

Technicians took active role as salesmen for the fixed portfolio in the last quarter in 2012. During 2012 this channel was established as a regular sales channel after piloting in 2010 and 2011.

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 2012, 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 the complete MKT and TMMK portfolio.

Research and Development

MKT and TMMK, as technological leaders in telecommunication market in Macedonia, continuously strive to build and maintain a network that is technologically advanced, flexible, and cost-efficient, with determined objective to satisfy our users' demands and expectations. In 2012, we have proceeded with development of all network segments: Access, Core and Transport Networks as well as Service Platforms.

In 2012 we continued with expanding FTTH as a powerful network for sustainable future. FTTH Network enables greater efficiency, and stands as a foundation for profitable growth in growth areas like cloud computing, entertainment, business services, etc. We have finished 2012 with 88,068 FTTH Homes Passed, covering 15% of the Households in Macedonia. There is 54% increase of homes passed in 2012 compared to 2011.

ADSL capacities were also extended during 2012, covering 45% of the households with the installed ports.

The increasing demand for video and data services requires extension of the transport network capacity. During 2012, the capacities of IP/ Multi-protocol label switching ("MPLS") network were extended according to the traffic increase.

In terms of Service Platforms, the main focus in MKT was the development of IPTV with new applications and support of the rapid growth of IPTV customers. During 2012 MKT expanded its footprint in the TV business, activated Pay-per-View services (per match/monthly/season) and for this built-up dedicated studio. UEFA content was delivered in high HD quality. The number of TV customers is increased as well.

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. At the end of 2012, the total number of migrated customer was 165,860. The area of host Gevgelija is the first migrated PSTN area to all IP at the end of 2012.

In 2012, MKT continued with the 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.

During 2012, a Radio Access Network (“RAN”) Modernization trial project was successfully realized. Additionally, modernization of microwave links was in the focus during 2012. In the Core network, all TMMK subscribers have been migrated to the new MSC Blade Cluster servers. This leads to big improvements in the local node service availability and stability mechanisms.

In 2011, the implementation of M-Wallet project started as a base for mobile payment services. During 2012, the implementation of the project continued. Commercial launch is planned for 2013. Additionally, new services/features are implemented such as Smart SMS, Intelligent Border roaming, etc.

As part of the “Internet Everywhere” project, MKT and TMMK extend the network reaching 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 the operational efficiency, implementation of Alarm Umbrella and Trouble Ticketing System started in 2011 and continued during 2012. At the end of the year, 37 systems were integrated with Alarm Umbrella and 6 systems integrated with with Trouble Ticketing.

In line with the determination to be a technology leader in the country and even broader in the region, in 2013, MKT and TMMK will continue with the 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

Consolidation and modernization of the IT systems and infrastructure, while reducing the complexity of the IT architecture and improving the IT security standards was the main focus in 2012. The goal was to improve the support and automation of the corporate processes and to improve the One Company customer experience.

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 2012 were:

- Consolidation of the SAP systems for MKT and TMMK - Migration (rollout) of TMMK system into a separate organizational elements in the existing SAP system of MKT and thus enabling a functional and process alignment between the two legal entities.
- Implementation of a T-Number in the Call Centre - Consolidation of all Call Centre numbers to one number for residential and one number for business customers, which leads to improvement of the customer experience as they should remember only one number and can be served for all information and services with one call.
- Upgrade of the Retail Billing system for fix customers and consolidation of HW platforms with the mobile retail billing – the main benefits of this project are the lower maintenance costs, the possibility to implement the additional functionalities introduced in the latest Rating and Billing Manager version as well as the possibility to replace the customized enhancements by core functionalities present in the latest Rating and Billing Manager version.

- Implementation of fix and mobile portfolio repositioning into MKT and TMMK business support systems (billing and customer care systems).
- The consolidation of the Data Centre infrastructure continues in the direction of virtualization of server, storage and network resources, thus enabling a solid ground for implementation of Cloud concepts for internal use as well as for product offering for external customers.

IT has taken a significant role in the implementation of the new Fix/Mobile Converged products/services and development of ICT concept. In 2012, the MKT Group developed an ICT strategy concept focusing on the development of ICT revenues, with performed market analysis and strategic positioning. The execution of this strategy concept began in 2012 with several successful implementations of Custom Cloud solutions mainly for the Public Sector and identified a potential for additional customers in the Large Enterprise Sector, as well as implementation of pilot cloud products for the general SME and residential market segments. Within this initiative, we have enlarged our resource pools with implementation of virtualization technologies and we are continuing with the implementation of the automation and self-service layers in the upcoming period.

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.

In the course of 2012, MKT and TMMK continued with the activities of the project for implementation of a new consolidated CRM system. This system should enable a comprehensive view of customers and further sharpen the customer focus of MKT and TMMK.

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