

Report of Independent Auditors

To the Shareholders of Fotex Rt.

We have audited the accompanying financial statements of Fotex Rt. (the “Company”) and its subsidiaries (the “Group”), which comprise the consolidated balance sheet as at December 31, 2005 and the consolidated income statement, consolidated statement of changes in shareholders’ equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as of December 31, 2005, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Ernst & Young
Budapest, Hungary
March 24, 2006

Fotex Rt. and Subsidiaries
Consolidated Balance Sheets

		At December 31,	
	Notes	2005	2004
		THUF	THUF
Assets			
Current Assets:			
Cash and short term deposits	3	14,362,791	3,226,473
Available-for-sale financial assets	4	163,438	60,241
Accounts receivable and prepayments	5	2,104,773	3,054,694
Inventories	6	3,984,866	7,094,199
Total current assets		20,615,868	13,435,607
Non Current Assets:			
Property, plant & equipment	7	15,933,483	16,802,658
Intangible assets	8	2,231,612	2,639,899
Long term investments	9	306,764	375,615
Goodwill arising on acquisition	10	3,300,134	2,321,665
Total non current assets		21,771,993	22,139,837
Total assets	20	42,387,861	35,575,444
Liabilities and Shareholders' Equity			
Current Liabilities:			
Interest bearing loans and borrowings	11, 20	1,699,549	1,453,816
Accounts payable and accrued expenses	12, 20	3,659,437	5,913,166
Total current liabilities		5,358,986	7,366,982
Long Term Liabilities:			
Deferred tax liability	18, 20	79,159	60,898
Interest bearing loans and borrowings	11, 20	2,364,775	2,113,877
Total long term liabilities		2,443,934	2,174,775
Shareholders' Equity:			
Issued capital	14	7,072,365	7,072,365
Additional paid-in capital		8,710,131	8,710,131
Goodwill write-off reserve	15	(836,195)	(922,563)
Retained earnings	16	18,214,350	9,073,540
Treasury shares, at cost	14	(261,627)	(229,743)
Equity attributable to equity holders of the parent		32,899,024	23,703,730
Minority interest in consolidated subsidiaries	13	1,685,917	2,329,957
Total shareholders' equity		34,584,941	26,033,687
Total liabilities and shareholders' equity		42,387,861	35,575,444

See accompanying notes to consolidated financial statements.

Fotex Rt. and Subsidiaries
Consolidated Statements of Income

	Note	At December 31, 2005			At December 31, 2004		
		Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
		THUF	THUF	THUF	THUF	THUF	THUF
Revenue	20	21,308,456	10,007,894	31,316,350	24,353,202	14,485,363	38,838,565
Cost of sales		<u>(10,695,616)</u>	<u>(3,023,467)</u>	<u>(13,719,083)</u>	<u>(14,594,219)</u>	<u>(7,790,028)</u>	<u>(22,384,247)</u>
Gross profit		10,612,840	6,984,427	17,597,267	9,758,983	6,695,335	16,454,318
Selling, general and administration expenses	17	(11,145,960)	(6,277,582)	(17,423,542)	(11,816,919)	(5,876,173)	(17,693,092)
Interest income		118,946	17,446	136,392	82,788	84,523	167,311
Interest expense		(132,708)	(15,186)	(147,894)	(128,249)	(44,025)	(172,274)
Gain on disposal of discontinued operations	19	–	7,941,394	7,941,394	–	–	–
Income / (Loss) before income taxes		<u>(546,882)</u>	<u>8,650,499</u>	<u>8,103,617</u>	<u>(2,103,397)</u>	<u>859,660</u>	<u>(1,243,737)</u>
Income tax expense	18	<u>(246,152)</u>	<u>(134,177)</u>	<u>(380,329)</u>	<u>(334,836)</u>	<u>(186,752)</u>	<u>(521,588)</u>
Net Income / (Loss)		<u><u>(793,034)</u></u>	<u><u>8,516,322</u></u>	<u><u>7,723,288</u></u>	<u><u>(2,438,233)</u></u>	<u><u>672,908</u></u>	<u><u>(1,765,325)</u></u>
Attributable to:							
Equity holders of the parent		(1,096,171)	8,598,617	7,502,446	(2,409,982)	678,525	(1,731,457)
Minority interests	13	<u>303,137</u>	<u>(82,295)</u>	<u>220,842</u>	<u>(28,251)</u>	<u>(5,617)</u>	<u>(33,868)</u>
Net income / (loss)		<u><u>(793,034)</u></u>	<u><u>8,516,322</u></u>	<u><u>7,723,288</u></u>	<u><u>(2,438,233)</u></u>	<u><u>672,908</u></u>	<u><u>(1,765,325)</u></u>
Earnings / (Loss) per share (HUF)	25	<u><u>(15.84)</u></u>	<u><u>124.28</u></u>	<u><u>108.44</u></u>	<u><u>(34.78)</u></u>	<u><u>9.79</u></u>	<u><u>(24.99)</u></u>

See accompanying notes to consolidated financial statements.

Fotex Rt. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity

	Share Capital	Additional Paid-in Capital	Goodwill Write-off Reserve	Retained Earnings	Treasury Shares	Total	Minority Interest	Total equity
	THUF	THUF	THUF	THUF	THUF	THUF		
January 1, 2004	7,072,365	8,710,131	(1,008,931)	10,891,365	(229,743)	25,435,187	2,276,911	27,712,098
Net loss – 2004	–	–	–	(1,731,457)	–	(1,731,457)	(33,868)	(1,765,325)
Dividends to minority	–	–	–	–	–	–	(54,094)	(54,094)
Purchase of minority interest	–	–	–	–	–	–	(69,543)	(69,543)
Sales of shares to minority shareholders	–	–	–	–	–	–	200,267	200,267
Amortisation of goodwill write-off reserve	–	–	86,368	(86,368)	–	–	–	–
Other	–	–	–	–	–	–	10,274	10,274
December 31, 2004	7,072,365	8,710,131	(922,563)	9,073,540	(229,743)	23,703,730	2,329,957	26,033,687
Impact of IFRS 3 adoption (Note 10)	–	–	–	1,703,424	–	1,703,424	108,550	1,811,974
Restated January 1, 2005	7,072,365	8,710,131	(922,563)	10,776,964	(229,743)	25,407,154	2,438,507	27,845,661
Net income – 2005	–	–	–	7,502,446	–	7,502,446	220,842	7,723,288
Dividends to minority	–	–	–	–	–	–	(640,492)	(640,492)
Purchase of minority interest	–	–	–	–	–	–	(336,734)	(336,734)
De-recognition of minority interest	–	–	–	–	–	–	2,834	2,834
Amortisation of goodwill write-off reserve	–	–	86,368	(86,368)	–	–	–	–
Acquisition of treasury shares	–	–	–	–	(31,884)	(31,884)	–	(31,884)
Foreign currency translation	–	–	–	21,308	–	21,308	–	21,308

Other	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>960</u>	<u>960</u>
December 31, 2005	<u>7,072,365</u>	<u>8,710,131</u>	<u>(836,195)</u>	<u>18,214,350</u>	<u>(261,627)</u>	<u>32,899,024</u>	<u>1,685,917</u>	<u>34,584,941</u>

See accompanying notes to consolidated financial statements.

Fotex Rt. and Subsidiaries
Consolidated Statements of Cash Flows

	Year ended December 31,	
	2005	2004
	THUF	THUF
Cash flows from operating activities:		
Income / (Loss) before minority interest and income taxes	8,103,617	(1,243,737)
Depreciation and amortisation	1,514,529	1,709,286
Impairment of goodwill	154,640	232,573
Unrealised foreign currency loss / (gain)	32,703	(149,179)
Fixed asset retirement	152,396	231,229
Retirement and provision on inventory and receivables	956,712	244,201
Other investment retirement	-	27,400
Gain on disposal of subsidiaries	(7,941,394)	-
Profit on disposal of fixed assets and intangibles	(382,890)	(104,074)
Profit on disposal of other investment	(24,502)	(200)
Interest income	(136,392)	(167,311)
Interest expense	147,894	172,274
Changes in assets and liabilities:		
Accounts receivable and prepayments	(844,730)	914,471
Inventory	557,363	1,261,454
Accounts payable and accrued expenses	1,863,531	(3,219,701)
Cash generated from operations	4,153,477	(91,314)
Interest paid	(174,250)	(153,399)
Income tax paid	(263,479)	(348,980)
Net cash flow from / (used) operating activities	3,715,748	(593,693)
Cash flows from investing activities:		
Purchase of tangible and intangible assets	(2,804,812)	(3,655,666)
Sale of tangible and intangible assets	685,610	552,808
Purchase of state bonds	(22,866)	-
Sale of state bonds	-	211,491
Interest received	81,644	170,823
Acquisition of Polish business line	-	(215,245)
Acquisition of subsidiaries net of cash acquired	(24,295)	(47,554)
Purchase of shares in subsidiaries from minority shareholders	(326,559)	-
Proceeds from disposal of subsidiaries	9,854,624	-
Net cash flow used in / provided from investing	7,443,346	(2,983,343)
Cash flows from financing activities:		
Net purchase / sale of treasury shares	(31,884)	-
Dividends paid to minority	(640,492)	(54,094)
Increase in debt	3,802,119	2,010,045
Decrease in debt	(3,152,519)	(1,489,018)
Net cash flow provided by / used in financing	(22,776)	466,933
Change in cash and cash equivalents	11,136,318	(3,110,103)
Cash and cash equivalents at beginning of year	3,226,473	6,336,576
Cash and cash equivalents at end of year	14,362,791	3,226,473
See accompanying notes to consolidated financial statements.		

Fotex Rt. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2005
All amounts in HUF '000 unless otherwise indicated

1. General

Fotex Elso Amerikai-Magyar Vagyonkezelő Részvénytársaság (“Fotex” or the “Company”) is a company limited by shares incorporated under the laws of the Republic of Hungary. The Company is primarily the holding company of a Group of subsidiaries incorporated in Hungary and Cyprus and engaged in a variety of retailing, wholesaling, manufacturing, property management and other activities. The registered office of Fotex is located at Nagy Jenő utca 12, 1126 Budapest, Hungary. The ownership of principal consolidated subsidiaries, after considering indirect shareholdings, is:

<u>Subsidiary:</u>	<u>Principal Activities:</u>	<u>% Holding</u>	
		<u>2005</u>	<u>2004</u>
Ajka Kristály Kft. (Ajka)	Crystal manufacturing and retail	100.0	93.1
Alfa Örs Kft. (Alfa)	Property management	-	99.2
Azúr Rt.	Household and cosmetic goods retailing	99.0	73.8
Azúr Ingatlanhasznosító Kft.	Property management	100.0	-
Balaton Bútorgyár Rt. (Balaton)	Furniture retailer	86.6	86.1
Bebufa Kft.	Furniture manufacturer	86.6	-
Dália Kft.	Kitchen furniture manufacturer	99.9	99.9
Domus Rt.	Furniture retailer	56.6	56.6
DVD Rent Kft.	DVD rental	100.0	7.0
Europrizma Kft.	Advertising	99.6	89.5
Europtic Kft.	Advertising	100.0	100.0
Fotex 2000 Kft.	Photographic, mobile phone and optical retailing	100.0	92.4
Fotex Cosmetics Kft.	Cosmetics wholesale and retail	100.0	85.0
F-O Optika-Fotó Kft. (formerly Fotex Optika Kft.)	Optical wholesaling, retailing, photographic retailing	-	96.3
Fotex Records Kft.	Music retailer	100.0	79.2
Fotexnet Kft.	Internet retail and other services	97.8	81.4
Fotex Polska sp. Z o.o.	Optical wholesaling, retailing, photographic retailing	-	49.1
Fotex Ceska s.r.o.	Optical wholesaling, retailing, photographic retailing	-	49.1
Hungaroton Records Kft.	Music publishing and music retailing	99.4	99.4
Hungaroton Music Rt.	Music archive	98.2	98.2
Keravill Rt.	Electrical goods retailer	-	99.7
Keringatlan Kft.	Property management	100.0	99.2
Kontúr Rt.	Property management	99.8	97.2
Kontúr Papír Kft. (Kontúr Papír)	Stationery retailer	99.8	92.5
Kontúr Lakásfelsz. Kft. (Kontúr Lakás)	Home furnishing retailer	99.8	97.1
Primo Rt.	Clothing retailing and wholesaling	99.9	93.3
Sigma Kft.	Property services	75.1	99.6
Szivárvány Rt. (Szivárvány)	Property management	-	99.2
Upington Investments Ltd.	Investment holding	100.0	-

Fotex Rt. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2005
All amounts in HUF '000 unless otherwise indicated

1. General (continued)

The consolidated financial statements of Fotex Rt. and Subsidiaries for the year ended December 31, 2004 were authorised for issue in accordance with a resolution of the directors on March 24, 2006.

2. Significant Accounting Policies

Basis of presentation

The consolidated financial statements have been prepared on a historical cost basis except for the measurement at fair value of available-for-sale financial assets. The accounting policies have been consistently applied by the Company and are consistent with those used in the previous year.

Statement of compliance

The members of the Group maintain their official accounting records and prepare their individual financial statements in accordance with the accounting regulations of Hungary and Cyprus. The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and all applicable IFRS's that have been adopted by the EU. IFRS comprise standards and interpretations approved by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC").

Effective January 1 2005, the change in the Hungarian Accounting Act allows the Group to prepare its consolidated financial statements in accordance with IFRS that have been adopted by the EU. At this particular time, due to the endorsement process of the EU, and the activities of the Group, there is no difference in the policies applied by the Group between IFRS and IFRS that have been adopted by the EU.

Basis of consolidation

The consolidated financial statements comprise the financial statements of Fotex and its material subsidiaries (the "Group") as at 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions that are recognized in assets, are eliminated in full.

Subsidiaries acquired during the year are consolidated from the date on which control over the net assets and operations of the acquiree is effectively transferred to the Group. Subsidiaries disposed of are consolidated up to the date of the disposal, the date at which control over the net assets and operations of the subsidiary effectively ceased.

The equity and net income attributable to minority interests are shown as separate items in the consolidated financial statements.

Fotex Rt. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2005
All amounts in HUF '000 unless otherwise indicated

2. Significant Accounting Policies (continued)

Changes in accounting policies

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on January 1, 2005. The Group has early adopted IFRS 5 in 2004, which has resulted in a change in accounting policy on the recognition of a discontinued operation for 2004. The changes in accounting policies result from the adoption of the following new or revised Standards:

Early adopted Standards:

- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Not early adopted Standards:

- IFRS 3 Business Combinations, IAS 36 (revised) Impairment of Assets and IAS 38 (revised) Intangible Assets
- IAS 21 (revised) The Effects of Changes in Foreign Exchange Rates.

The principal effects of these changes in policies are discussed below.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

The Group has applied IFRS 5 prospectively in accordance with the transitional provision of IFRS 5, which has resulted in a change in accounting policy on the recognition of a discontinued operation. Under the superseded IAS 35, the Group would have recognized a discontinued operation at the earlier of:

- The date the Group enters into a binding sale agreement; and
- The date the board of directors have approved and announced a formal disposal plan.

IFRS 5 requires a component of an entity to be classified as discontinued when the criteria to be classified as held for sale have been met or it has been disposed of. An item is classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. Such a component represents a separate major line of business or geographical area of operations, is part of a single co-ordinated major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale. The result of this change in accounting policy is that a discontinued operation is recognised by the Group at a later point than under IAS 35 due to strict criteria in IFRS 5.

Fotex Rt. and Subsidiaries
Notes to Consolidated Financial Statements
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2. Significant Accounting Policies (continued)

Changes in accounting policies (continued)

IFRS 3 Business Combinations, IAS 36 Impairment of Assets and IAS 38 Intangible Assets

IFRS 3 applies to accounting for business combinations for which the agreement date is on or after 31 March 2004. Upon acquisition the Group initially measures the identifiable assets, liabilities and contingent liabilities acquired at their fair values as at the acquisition date hence causing any minority interest in the acquiree to be stated at the minority's proportions of the net fair values of those items.

Additionally, the adoption of IFRS 3 and IAS 36 (revised) has resulted in the termination of annual goodwill amortisation and implementation of testing for impairment annually at the cash generating unit level (unless an event occurs during the year which required the goodwill to be tested more frequently) from 1 January 2005. The transitional provisions of IFRS 3 have required the Group to eliminate, at 1 January 2005, the carrying amount of accumulated amortisation of HUF 2,070,346 with a corresponding entry to goodwill.

In case of acquisitions on or after 31 March 2004, any excess of the Company's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired entity over the cost of the business combination (previously known as negative goodwill) are recognised directly in the consolidated income statement. The transitional provisions of IFRS 3 have required the Group to derecognise at 1 January 2005 the carrying amount of negative goodwill of HUF 1,703,424 with a corresponding adjustment to the opening balance of retained earnings.

Moreover, as required by the revised IAS 38, the useful life of intangible assets acquired in a business combination are now assessed at the individual asset level as having either a finite or indefinite life. Where an intangible asset has a finite life, it is amortised over its useful life. Amortisation years and methods for intangible assets with finite useful lives are reviewed at the earlier of annually or where an indicator of impairment exists. Intangibles assessed as having indefinite useful lives are not amortised, as there is no foreseeable limit to the year over which the asset is expected to generate net cash inflows for the Group. However, intangibles with indefinite useful lives are reviewed annually to ensure the carrying value does not exceed the recoverable amount.

IAS 21 The Effects of Changes in Foreign Exchange Rates

As of 1 January 2005, the Group adopted IAS 21 (revised). As a result, any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are now treated as assets and liabilities of the foreign operation and translated at the closing rate. In accordance with the transitional provisions of IAS 21 this change is applied prospectively. In addition, goodwill acquired in a business combination prior to 1 January 2005 and fair value adjustments arising on that acquisition are deemed to be assets and liabilities of the parent company. This change in accounting policy has no significant impact as at 31 December 2005.

Fotex Rt. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2005
All amounts in HUF '000 unless otherwise indicated

2. Significant Accounting Policies (continued)

Changes in accounting policies (continued)

The following standards are adopted by the Group but have not been disclosed in details as they have no significant impact as at 31 December, 2005:

- IAS 1 Presentation of Financial Statements
- IAS 2 Inventories
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 Events After the Balance Sheet Date
- IAS 16 Property, Plant and Equipment
- IAS 17 Accounting for Leases
- IAS 21 The Effects of Changes in Foreign Exchange Rates
- IAS 24 Related-Party Disclosures
- IAS 27 Consolidated and Separate Financial Statements
- IAS 28 Accounting for Investments in Associates
- IAS 31 Financial Reporting of Interests in Joint Ventures
- IAS 32 Financial Instruments: Disclosures and Presentation
- IAS 39 Financial Instruments: Recognition and Measurement
- IAS 40 Investment Property
- IFRS 2 Share-Based Payment

Significant accounting estimates

Estimation uncertainty

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the amounts reported in the financial statements. Although these estimates are based on the management's best knowledge of current events and actions, actual results may differ from those estimates. The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Impairment of Goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2005 is HUF 3,300,134 (2004: HUF 2,321,665). More details are given in Note 10.

Fotex Rt. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2005
All amounts in HUF '000 unless otherwise indicated

2. Significant Accounting Policies (continued)

Cash and cash equivalents

Cash and short term deposits in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less. Cash and cash equivalents comprise cash in hand, deposits held at call with banks, investments in marketable securities that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

For the purposes of the cash flow statement, cash and cash equivalents consist of cash on hand and deposits in banks, net of outstanding bank overdrafts.

Foreign currency translation

The consolidated financial statements are presented in HUF, which is the Company's functional and presentation currency. Each entity in the group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to profit or loss with the exception of differences on foreign currency borrowings that provide a hedge against a net investment in a foreign entity. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in profit or loss. Tax charges and credits attributable to exchange differences on those borrowings are also dealt with in equity. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Inventory

Inventory is stated at the lower of cost or net realisable value on a weighted average basis after making allowance for any obsolete or slow-moving items. The value of work in progress and finished goods includes an applicable portion of direct materials, labour and overheads in manufacturing subsidiaries.

Trade receivables

Trade and other receivables are recognized and carried at original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when the collection of the full amount is no longer probable. Receivables from related parties are recognized and carried at cost.

Trade and other payables

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All amounts in HUF '000 unless otherwise indicated

Liabilities for trade and other amounts payable are carried at cost, which is the fair value of the consideration to be paid in the future for goods and services received, whether or not invoiced to the Group. Payables to related parties are recognized and carried at cost.

2. Significant Accounting Policies (continued)

Property, plant and equipment

Property, plant and equipment are stated at purchase price or production cost less accumulated depreciation and any impairment in value. Production costs for self-constructed assets include the cost of materials, direct labour and an appropriate proportion of production overheads.

Replacements and improvements, which prolong the useful life or significantly improve the condition of the asset are capitalised. Maintenance and repairs are recognised as an expense in the period in which they are incurred.

Freehold land is not depreciated.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

	Years
Buildings	50
Plant and equipment	7-12.5
Vehicles	5
Computer equipment	3

The cost of properties retired or otherwise disposed of, together with the accumulated depreciation provided thereon, is eliminated from the accounts. The net gain or loss is recognised as other operating income or expense.

The carrying amounts of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If such an indication exists and where the carrying value exceeds the recoverable amount, the assets or cash generating units are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs. Impairment losses are recognised in the income statement in the selling, general and administration expenses line item.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Fotex Rt. and Subsidiaries
Notes to Consolidated Financial Statements
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2. Significant Accounting Policies (continued)

Investments

All investments are initially recognized at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on investments held for trading are recognised in income.

Other long-term investments, which are intended to be held to maturity, such as bonds, are subsequently measured at amortised cost. Amortised cost is calculated by taking into account over the period to maturity any discount or premium on acquisition. For investments carried at amortised cost, any gain or loss is recognised in income when the investment is derecognised or impaired, as well as through the amortisation process.

For investments actively traded in organised financial markets fair value is determined by reference to the market price. For investments where there is no market price or the market price is considered to be an unreliable indicator, fair value is estimated on the basis of the market price of comparable investments or by reference to the expected future cash flows. Where fair value cannot be reliably measured for certain investments, such investments are measured at amortised cost.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as an interest expense.

Pensions

All pensions are either funded privately by employees or the state via certain social security charges included in the gross cost of the employees wage.

2. Significant Accounting Policies (continued)

Intangible assets

Intangible assets consist of purchased shop rental rights, merchandising and media rights and an archive of recorded music, production know-how and franchise fees and are amortised using the straight-line method over their estimated useful lives that range from 5 to 23 years. Merchandising and media rights are reviewed for impairment annually or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired.

Investment in an associate

The Group's investment in its associate is accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture. Under the equity method, the investment in the associate is carried in the balance sheet at cost plus postacquisition changes in the Group's share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. After application of the equity method, the Group determines whether it is necessary to recognise any additional impairment loss with respect to the Group's net investment in the associate. The income statement reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes and discloses this, when applicable, in the statement of changes in equity. The reporting dates of the associate and the Group are identical and the associates' accounting policies conform to those used by the Group for like transactions and events in similar circumstances.

Goodwill

Goodwill on acquisition is initially measured at cost being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired.

As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units expected to benefit from the combination's synergies. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount an impairment loss is recognised. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

2. Significant Accounting Policies (continued)

Income taxes

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax liabilities are recognised for all taxable temporary differences:

- except where the deferred income tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets and unused tax losses can be utilised:

- except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

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Income tax relating to items recognised directly in equity are recognised in equity and not in the income statement.

2. Significant Accounting Policies (continued)

Other taxes

The Companies are paying local business tax, to local municipalities based on the physical location of the operations in Hungary. The base of the local business tax is the revenue as decreased by the cost of goods sold, raw material expenses and certain other expense items. Local business tax is classified into selling general and administration expenses.

Issued capital

Issued share capital is recorded at the nominal value of shares outstanding at the balance sheet date. The excess of proceeds from issuance of share capital over nominal value is recognised as share premium.

Treasury shares

Fotex shares repurchased are included in shareholders' equity and are classified as treasury shares. Gains and losses on sale of treasury shares, and differences on repurchase, are credited or debited to retained earnings. According to current Hungarian regulations, such gains are available for distribution.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

Interest

Revenue is recognised as the interest accrues (using the effective interest method that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument) to the net carrying amount of the financial asset.

Dividends

Revenue is recognised when the shareholders' right to receive the payment is established.

Rental income

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Rental income arising on investment properties is accounted for on a straight-line basis over the lease term on ongoing leases.

2. Significant Accounting Policies (continued)

Segment reporting

Segment results include revenue and expenses directly attributable to a segment and the relevant portion of enterprise revenue and expenses that can be allocated on a reasonable basis to a segment, whether from external transactions or from transactions with other segments of the Group. Inter-segment transfer pricing is based on cost plus an appropriate margin, as specified by Group policy. Segment results are determined before any adjustments for minority interest.

The Group performs the majority of its activity in one geographical segment (Hungary) consequently no geographical segment information is disclosed.

Segment assets and liabilities comprise those operating assets and liabilities that are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets are determined after deducting related allowances that are reported as direct offsets in the Group's balance sheet.

Corporate and other items mainly comprise general and administrative expenses that relate to the group as a whole, assets not directly attributable to the operations of the segments such as short and long term investments and liabilities that are incurred for financing rather than operating purposes.

Capital expenditure represents the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant and equipment).

Earnings per share

Basic earnings per share data is calculated based on the weighted average number of shares outstanding during the period excluding treasury shares held by the Company. Fully diluted earnings per share is calculated based on the weighted average number of shares outstanding as calculated for basic earnings per share and as adjusted for giving effect to the assumed issuance of all potentially dilutive securities. Net income is adjusted in the fully diluted earnings per share calculation for any income or expense associated with the potentially dilutive securities.

2. Significant Accounting Policies (continued)

Financial instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and other liabilities approximate their fair value due to their short term to maturity. The Group has no significant concentrations of credit risk.

Loans and borrowings are initially recognised at cost. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost. As all loans bear variable rate interest, their fair value approximates the book value. In determining estimates of the fair value of financial instruments, the Group makes assumptions regarding current market interest rates, considering the term of the instrument and its risk. Current market interest rates are generally selected from a range of potentially acceptable rates and, accordingly, other effective rates and/or fair values are possible.

The de-recognition of a financial instrument takes place when the Group no longer controls the contractual rights that comprise the financial instrument, which is normally the case when the instrument is sold, or all the cash flows attributable to the instrument are passed through to an independent third party.

Subsequent Events

Events accruing after the year end that provide additional information about the Group's position at the balance sheet date (adjusting events), are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

Issued but not yet effective International Financial Reporting Standards

At the date of authorisation of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

- IAS 1 (amended 2005) Presentation of Financial Statements
- IAS 19 (amended 2004) Employee Benefits
- IAS 21 (amended 2005) The Effects of Changes in Foreign Exchange Rates
- IAS 39 (amended 2005) Financial Instruments: Recognition and Measurement – The Fair Value Option

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- IAS 39 (amended 2005) Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions
- IFRS 4 Insurance Contracts
- IFRS 7 Financial Instruments: Disclosures
- IFRIC 4 Determining whether an Arrangement contains a Lease
- IFRIC 5 Right to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and

2. Significant Accounting Policies (continued)

Issued but not yet effective International Financial Reporting Standards (continued)

Electronic Equipment

- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
- IFRIC 8 Scope of IFRS 2
- IFRIC 9 Reassessment of Embedded Derivatives

The Group expects that adoption of the pronouncements listed above will have no impact on the Group's financial statements in the period of initial application.

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3. Cash and short term deposits

Cash includes fixed deposits of THUF 11,253,513 (December 31, 2004 THUF 1,223,189) at rates ranging from 2% to 6.2% (2004 0.5% to 10.0%).

As at 31 December 2005, the Group has HUF 443 million restricted cash as security for rental deposits received.

4. Available-for-sale financial assets

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Government securities	160,006	59,809
Other short term investments	3,432	432
Total short term investments	<u>163,438</u>	<u>60,241</u>

5. Accounts Receivable and Prepayments

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Trade receivables	1,362,144	1,927,255
Taxes recoverable	258,764	695,266
Receivables from non consolidated subsidiaries	21,007	111,413
Other receivables and prepayments	643,567	653,550
Provision for doubtful debts	(180,709)	(332,790)
Total accounts receivable and prepayments	<u>2,104,773</u>	<u>3,054,694</u>

6. Inventory

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Products held for resale and finished goods	4,072,876	6,586,793
Raw materials and consumables	434,795	653,534
Work in progress	501,576	400,630
Provision for inventory	(1,024,381)	(546,758)
Total inventory	<u>3,984,866</u>	<u>7,094,199</u>

Management identified a number of companies in which slow moving inventory has been experienced. Based on a review management concluded that a provision of THUF 1,024,381 for gross value of THUF 2,153,465 (December 31, 2004 THUF 546,758 for gross value of THUF 2,058,898) is appropriate.

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7. Property, plant and equipment

Activity in property, plant and equipment for the year ended December 31, 2005 was as follows:

	Land, Buildings and Improvements	Furniture, Fixtures and Equipment	Construction in Progress	Total
	THUF	THUF	THUF	THUF
Cost:				
January 1, 2005	15,422,249	9,153,595	1,231,994	25,807,838
Additions	3,422,822	376,098	(1,063,369)	2,735,551
Disposal of subsidiaries	(1,370,320)	(2,746,850)	(97,566)	(4,214,736)
Disposals and write downs	(222,622)	(702,090)	–	(924,712)
December 31, 2005	<u>17,252,129</u>	<u>6,080,753</u>	<u>71,059</u>	<u>23,403,941</u>
Depreciation:				
January 1, 2005	(2,658,455)	(6,346,725)	–	(9,005,180)
Depreciation expense	(537,228)	(898,001)	–	(1,435,229)
Disposal of subsidiaries	345,960	1,996,587	–	2,342,547
Disposals and write downs	80,705	546,699	–	627,404
December 31, 2005	<u>(2,769,018)</u>	<u>(4,701,440)</u>	<u>–</u>	<u>(7,470,458)</u>
Net book value:				
December 31, 2005	<u>14,483,111</u>	<u>1,379,313</u>	<u>71,059</u>	<u>15,933,483</u>
December 31, 2004	<u>12,763,794</u>	<u>2,806,870</u>	<u>1,231,994</u>	<u>16,802,658</u>

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7. Property, plant and equipment (continued)

Activity in property, plant and equipment for the year ended December 31, 2004 was as follows:

	Land, Buildings and Improvements	Furniture, Fixtures and Equipment	Construction in Progress	Total
	THUF	THUF	THUF	THUF
Cost:				
January 1, 2004	14,467,805	8,849,307	180,284	23,497,396
Additions	1,529,970	883,556	1,118,761	3,532,287
Acquisition of subsidiaries	114,852	105,059	557	220,468
Disposals and write downs	(690,378)	(684,327)	(67,608)	(1,442,313)
December 31, 2004	<u>15,422,249</u>	<u>9,153,595</u>	<u>1,231,994</u>	<u>25,807,838</u>
Depreciation:				
January 1, 2004	(2,236,236)	(5,973,651)	–	(8,209,887)
Depreciation expense	(606,455)	(938,378)	–	(1,544,833)
Acquisition of subsidiaries	(11,470)	(34,940)	–	(46,410)
Disposals and write downs	195,706	600,244	–	795,950
December 31, 2004	<u>(2,658,455)</u>	<u>(6,346,725)</u>	<u>–</u>	<u>(9,005,180)</u>
Net book value:				
December 31, 2004	<u>12,763,794</u>	<u>2,806,870</u>	<u>1,231,994</u>	<u>16,802,658</u>
December 31, 2003	<u>12,231,569</u>	<u>2,875,656</u>	<u>180,284</u>	<u>15,287,509</u>

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8. Intangible Assets

Activity in intangible assets for the year ended December 31, 2005 was as follows:

	Media and merchandising rights	Other	Total
	THUF	THUF	THUF
Cost:			
January 1, 2005	1,834,520	2,072,457	3,906,977
Additions	–	69,261	69,261
Disposal of subsidiaries	–	(1,245,320)	(1,245,320)
Disposals and write downs	–	(217,352)	(217,352)
December 31, 2005	<u>1,834,520</u>	<u>679,046</u>	<u>2,513,566</u>
Amortisation:			
January 1, 2005	(80,920)	(1,186,158)	(1,267,078)
Amortisation expense	–	(79,300)	(79,300)
Disposal of subsidiaries	–	1,113,909	1,113,909
Disposals and write downs	–	(49,485)	(49,485)
December 31, 2005	<u>(80,920)</u>	<u>(201,034)</u>	<u>(281,954)</u>
Net book value:			
December 31, 2005	<u>1,753,600</u>	<u>478,012</u>	<u>2,231,612</u>
December 31, 2004	<u>1,753,600</u>	<u>886,299</u>	<u>2,639,899</u>

“Other” primarily consists of rental rights for retail operations.

Media and merchandising rights’ useful life was re-assessed at 1 January 2005 by the management. As it was decided that it has an indefinite useful life, the amortization was discontinued. Management annually assesses the carrying value of media and merchandising rights’ in the Group’s books and makes appropriate adjustments for any impairment of these assets.

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8. Intangible Assets (continued)

Activity in intangible assets for the year ended December 31, 2004 was as follows:

	Media and merchandising rights	Other	Total
	<u>THUF</u>	<u>THUF</u>	<u>THUF</u>
Cost:			
January 1, 2004	1,834,520	2,174,599	4,009,119
Additions	–	123,379	123,379
Acquisition of subsidiaries	–	7,594	7,594
Disposals and write downs	–	(233,115)	(233,115)
December 31, 2004	<u>1,834,520</u>	<u>2,072,457</u>	<u>3,906,977</u>
Amortisation:			
January 1, 2004	(7,539)	(1,293,842)	(1,301,381)
Amortisation expense	(73,381)	(91,072)	(164,453)
Acquisition of subsidiaries	–	(759)	(759)
Disposals and write downs	–	199,515	199,515
December 31, 2004	<u>(80,920)</u>	<u>(1,186,158)</u>	<u>(1,267,078)</u>
Net book value:			
December 31, 2004	<u>1,753,600</u>	<u>886,299</u>	<u>2,639,899</u>
December 31, 2003	<u>1,826,981</u>	<u>880,757</u>	<u>2,707,738</u>

9. Long Term Investments

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Non consolidated subsidiaries	236,414	236,414
Investment in associated company	27,590	27,590
Long term securities	6,938	51,750
Other	35,822	59,861
Total long term investments	<u>306,764</u>	<u>375,615</u>

Long term investments are held until maturity based on the intention of the Group. The non consolidated subsidiaries are not material for consolidation purposes.

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10. Goodwill arising on Acquisition

Activity in goodwill (purchased as part of prior business combinations) was as follows for the years ended December 31:

	Goodwill	Negative goodwill	Total
At January 1, 2004			
Gross book value	7,225,428	(3,063,351)	4,162,077
Accumulated depreciation and impairment	<u>(3,190,401)</u>	<u>1,352,628</u>	<u>(1,837,773)</u>
Net book value	<u>4,035,027</u>	<u>(1,710,723)</u>	<u>2,324,304</u>
Year ended December 31, 2004			
Additions	255,736	(7,658)	248,078
Amortisation charge for the year	(389,038)	156,465	(232,573)
Disposals	<u>(18,144)</u>	<u>–</u>	<u>(18,144)</u>
Closing net book value of the year	<u>3,883,581</u>	<u>(1,561,916)</u>	<u>2,321,665</u>
At December 31, 2004			
Gross book value	7,346,766	(2,954,755)	4,392,011
Accumulated depreciation and impairment	<u>(3,463,185)</u>	<u>1,392,839</u>	<u>(2,070,346)</u>
Net book value	<u>3,883,581</u>	<u>(1,561,916)</u>	<u>2,321,665</u>
Year ended December 31, 2005			
	Goodwill	Negative goodwill	Total
Effect of a subsequent change in the earlier purchase consideration of a subsidiary	–	(141,508)	(141,508)
Gross book value of negative goodwill	<u>–</u>	<u>(1,703,424)</u>	<u>(1,703,424)</u>
Opening gross book value as restated – after offsetting accumulated amortization, impairment against goodwill and reclassification of negative goodwill (Effect of IFRS 3)	3,883,581	–	3,883,581
Opening net book value as restated	3,883,581	–	3,883,581
Additions	35,708	–	35,708
Disposal	(464,515)	–	(464,515)
Impairment charge for the year	<u>(154,640)</u>	<u>–</u>	<u>(154,640)</u>
Closing net book value	<u>3,300,134</u>	<u>–</u>	<u>3,300,134</u>
At December 31, 2005			
Gross book value	5,525,120	–	5,525,120
Accumulated depreciation and impairment	<u>(2,224,986)</u>	<u>–</u>	<u>(2,224,986)</u>
Net book value	<u>3,300,134</u>	<u>–</u>	<u>3,300,134</u>

Management periodically assesses the carrying value of goodwill in the Group's books and makes appropriate adjustments for any impairment of these assets.

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10. Goodwill arising on Acquisition (continued)

A summary of negative goodwill included is shown below:

Negative goodwill	2005 THUF	2004 THUF
Keringatlan	–	560,842
Domus	–	259,260
Azúr	–	74,238
Dália	–	92,162
Kontúr	–	552,230
Hungaroton Records	–	23,184
Total	–	1,561,916

As required by the transitional provisions of IFRS 3 the carrying amount of negative goodwill was derecognised at January 1, 2005 with a corresponding adjustment to the opening balance of retained earnings.

11. Interest bearing loans and borrowings

	2005 THUF	2004 THUF
Short term interest bearing loans and borrowings		
Ajka USD, EUR revolving loans with monthly interest of LIBOR plus 1.25%	915,757	822,433
Azúr HUF overdraft with monthly interest at BUBOR plus 0.55%, secured by inventory	–	39,783
Balaton EUR current assets loan with interest of 0.6%	21,529	–
Hungaroton Music HUF overdraft with monthly interest at BUBOR plus 0.55%, secured by cash collateral of Hungaroton Records	–	3,645
DVDRent – Plaza Park HUF loan with interest of 13.5%-os	40,000	–
Current portion of long term interest bearing loans and borrowings	703,367	456,247
Others (Keringatlan)	18,896	131,708

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Total short term interest bearing loans and borrowings	<u>1,699,549</u>	<u>1,453,816</u>
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11. Interest bearing loans and borrowings (continued)

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Long term interest bearing loans and borrowings		
Fotex 2000 Capital expenditure loan secured by machinery and inventory with monthly interest at EURIBOR plus 0.7%, due date May 29, 2006	–	88,908
Keringatlan EUR investment loan secured by mortgage on certain properties at 4,19-4.63%, due date September 29, 2008; Sugár project loan with monthly interest at EURIBOR plus 1%, secured by income from rental fee and mortgage on Sugár, due date June 30, 2011	3,014,936	2,410,042
Ajka EUR investment loan secured by tangible assets with interest at LIBOR plus 1% due in 1-3 years	53,206	71,174
Total	<u>3,068,142</u>	<u>2,570,124</u>
less: Portion due within one year	(703,367)	(456,247)
Total long term interest bearing loans and borrowings	<u>2,364,775</u>	<u>2,113,877</u>

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11. Interest bearing loans and borrowings (continued)

Bank borrowings analysis by currency	2005 THUF	2004 THUF
Hungarian Forint	58,896	62,840
US Dollar	451,094	354,367
Euro	3,554,334	3,139,674
Swiss Franc	-	10,812
	<u> </u>	<u> </u>
 Total borrowings	 <u><u>4,064,324</u></u>	 <u><u>3,567,693</u></u>

As at December 31, 2005, the Group had THUF 80,000 overdraft facilities, USD 4,350,000 revolving loan facilities and EUR 13,441,600 available loan facilities. As security for the overdraft facilities and other investment and working capital loans, the Group provided a total of THUF 4,567,308 of mortgages and pledges and totally THUF 536,797 in different currencies lien in favour of the lending banks as at December 31, 2005. In addition, there is THUF 240,000 mortgage as coverage for a EUR 221,277 bank guarantee. The Group has cash guarantees of THUF 120,000 and EUR 304,381, in respect of Group companies at December 31, 2005.

	Book value of assets as at December 31, 2005	Mortgages and pledges as at December 31, 2005
	THUF	THUF
Inventories	2,074,650	1,400,000
Technical equipments	523,500	50,000
Properties	4,422,097	3,117,308
Total	<u><u>7,020,247</u></u>	<u><u>4,567,308</u></u>

12. Accounts Payable and Accrued Expenses

	2005 <u>THUF</u>	2004 <u>THUF</u>
Trade payables	1,717,918	3,253,372
Taxes payable	255,050	814,809
Advances from customers	140,283	229,230
Accrued expenses	360,208	516,772
Payable to employees	123,692	274,529
Payable to shareholders	24,562	37,295
Other miscellaneous payables	1,037,724	787,159

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Total accounts payable and accrued expenses	<u>3,659,437</u>	<u>5,913,166</u>
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13. Minority Interest

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Balance at beginning of year	2,329,957	2,276,911
Dividends paid to minority shareholders	(640,492)	(54,094)
Purchase from minority shareholder	(336,734)	(56,646)
Other	109,510	10,274
Minority interest relating to subsidiaries disposed of during the year	2,834	–
Minority interest relating to subsidiaries purchased during the year	–	(12,887)
Sales of interest to new minority shareholders	–	200,267
Income / (loss) attributable to minorities	220,842	(33,868)
Balance at end of year	<u>1,685,917</u>	<u>2,329,957</u>

14. Share Capital

The authorised and issued share capital is THUF 7,072,365. The par value of the shares is HUF 100. At December 31, 2005 the Company's issued share capital consists of 70,723,650 shares (December 31, 2004 70,723,650 shares). Of the issued shares, 1,536,960 shares costing THUF 261,627 (December 31, 2004, 1,430,320 shares costing THUF 229,743) are held in treasury.

15. Goodwill Write-off Reserve

In 1990, in connection with the transformation of the Company to an Rt. and associated increase in share capital, certain intangible assets of Fotex (principally the "Fotex" name) were valued by an independent appraisal at approximately HUF 2,2 billion. This amount is shown as an intangible asset in the Company's Hungarian statutory financial statements and is amortised over 25 years. This amount is not shown as an asset, rather as a deduction from shareholders' equity in these financial statements.

16. Retained Earnings

Retained earnings available for distribution are based on the financial statements of the Company prepared in accordance with Hungarian Accounting Standards, as opposed to these financial statements that are prepared under International Financial Reporting Standards. The distributable reserves according to Hungarian Accounting Standards of Fotex at December 31, 2005 amount to THUF 3,263,893 (December 31, 2004 THUF 1,179,345).

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17. Selling, General and Administration Expenses

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Personnel expense	7,254,869	7,810,680
Material type costs	6,726,058	5,892,218
Other expenses	1,928,086	2,048,335
Depreciation and amortisation	1,514,529	1,941,859
Total selling, general and administration expenses	<u>17,423,542</u>	<u>17,693,092</u>
Discontinued operations	(6,277,582)	(5,876,173)
Continuing operations	<u><u>11,145,960</u></u>	<u><u>11,816,919</u></u>

18. Income Taxes

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Current income tax expense	(227,891)	(70,713)
Deferred income tax	(18,261)	(264,123)
Income tax expense	<u>(246,152)</u>	<u>(334,836)</u>

The effective income tax rate varied from the statutory income tax rate due to the following items:

	<u>2005</u>	<u>2004</u>
	THUF	THUF
Income / (Loss) before minority interest and income taxes	<u>7,723,288</u>	<u>(1,765,325)</u>
Tax at statutory rate of 16%	1,235,726	(282,452)
Effect of tax losses for which no corresponding deferred tax asset recognised	159,882	671,258
Differences arising from Cyprus tax rates	(1,181,563)	-
Other permanent differences	32,107	(53,970)
Income tax expense	<u><u>246,152</u></u>	<u><u>334,836</u></u>

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18. Income Taxes (continued)

Fotex and its subsidiaries are subject to periodic audit by the Hungarian Tax Authority (“APEH”). Because the application of tax laws and regulations to many types of transactions is susceptible to varying interpretations, amounts reported in the financial statements could be changed at a later date upon final determination by APEH.

As further described in Note 19, the group disposed of its shareholding in Fotex Optika Kft. This was executed via Upington, a Cyprus Holding company with an effective tax rate of 0% on capital gain.

From January 1, 2004 the enacted rate of corporate income tax was reduced to 16%.

Deferred tax assets and deferred tax liabilities at December 31, 2005 and 2004 are attributable to the items detailed in the tables below:

	Consolidated balance sheet		Consolidated income statement	
	2005 THUF	2004 THUF	2005 THUF	2004 THUF
Deferred income tax liabilities				
Accelerated depreciation for tax purposes	(17,697)	(67,924)	50,227	(67,924)
Eliminated intercompany transactions	(51,770)	(57,195)	5,425	(40,145)
Capitalisations	(20,628)	(38,224)	17,596	42,292
Fair value adjustments on acquisition	(36,725)	(39,550)	2,825	4,998
Gross deferred income tax liabilities	(126,820)	(202,893)		
Deferred income tax assets				
Eliminated intercompany transactions	47,661	61,995	(14,334)	(167,697)
Provision on inventory, receivables and software	–	80,000	(80,000)	(38,161)
Gross deferred income tax assets	47,661	141,995		
Deferred income tax			(18,261)	(266,637)
Net deferred income tax liability	(79,159)	(60,898)		

Certain Group companies have tax losses that are available to be carried forward and offset against taxable income of the companies in future years as shown below:

Expiry	THUF
Indefinite	832,467
2006	355,226

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2007	1,105,559
2008	538,927
2009	2,300,134
2010	402,525
Total	<u>5,534,838</u>

18. Income Taxes (continued)

Deferred tax assets have not been recognised in respect of these losses as they may not be used to offset taxable profits elsewhere in the Group and they have arisen in subsidiaries that have been loss-making for some time.

19. Discontinued operations

On 15st December, 2005 the Company disposed of its consolidated subsidiary Fotex Optika Kft., operating in the optical and the photographic segments. The subsidiary had a majority share in two foreign subsidiaries, Fotex Ceska and Fotex Polska, that also operate in the optical segment which formed part of the overall disposal.

Furthermore, the voluntary liquidation that commenced in 2004 transferred to a mandatory liquidation in March 2005 for Keravill Rt., operating in the electrical segment. Keravill Rt. has therefore been deconsolidated from the group at 31 December, 2005. This mandatory liquidation is expected to be completed with no material impact upon the group during 2006.

	<u>2005</u>
Net cashflow of disposed subsidiaries	THUF
Operating	1,023,921
Investing	(210,458)
Financing	(1,226,066)
Net cash outflow	<u>(412,603)</u>
Net assets disposed of:	
Cash	325,846
Accounts receivable and prepayments	1,801,171
Inventory	1,732,487
Fixed assets	2,016,623
Accounts payable and accrued expenses	(4,105,970)
Goodwill	464,515
	<u>2,234,672</u>
Minority interest of net assets	4,404
Consideration received:	
Cash	10,180,470
Profit on disposal	<u>7,941,394</u>

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Net cash inflow on disposal:	
Cash received	10,180,470
Net cash disposed of with subsidiary	<u>(325,846)</u>
Net cash outflow	<u><u>9,854,624</u></u>

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20. Segment Information

	2005	2004
	THUF	THUF
Revenue (a):		
Furniture	7,410,760	8,865,473
Electrical, household goods and cosmetics	4,409,532	6,665,964
Crystal and glass	3,087,136	3,189,074
Music	1,287,412	1,262,840
Photographic products and services	861,372	1,489,348
Clothing	532,513	538,211
Advertising	278,306	427,333
Corporate and other	5,134,266	3,263,480
Inter-segment elimination	(1,692,841)	(1,348,521)
Revenue from continuing operations	<u>21,308,456</u>	<u>24,353,202</u>
Revenue from discontinued operations	10,007,893	14,485,363
Revenue from operations	<u><u>31,316,349</u></u>	<u><u>38,838,565</u></u>

- (a) Revenue relating to crystal and glass products are principally foreign currency sales, Other sales are generally Hungarian Forint sales.

Net profit / (loss) before tax:		
Furniture	(46,603)	1,634
Electrical, household goods and cosmetics	(188,674)	(610,565)
Crystal and glass	(736,981)	(439,356)
Music	(138,406)	(52,971)
Photographic products and services	24,509	63,294
Clothing	5,128	(26,628)
Advertising	(99,317)	(63,635)
Corporate and other	633,462	(975,170)
Net (loss) before tax from continuing operations	<u>(546,882)</u>	<u>(2,103,397)</u>
Net gain from discontinued operations	8,650,499	859,660
Net profit / (loss) relating from operations	<u><u>8,103,617</u></u>	<u><u>(1,243,737)</u></u>

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20. Segment Information (continued)

Total Assets:	2005	2004
Furniture	5,363,383	5,718,543
Electrical, household goods and cosmetics	1,901,260	4,047,106
Optical products and services	11,028	5,701,124
Crystal and glass	2,771,478	3,612,944
Music	899,455	1,027,607
Photographic products and services	166,282	898,965
Clothing	725,430	680,814
Advertising	254,582	157,028
Corporate and other	30,702,540	14,288,198
Inter-segment elimination	(407,577)	(556,885)
Total assets	<u>42,387,861</u>	<u>35,575,444</u>
	2005	2004
Liabilities:	THUF	THUF
Furniture	1,073,514	1,156,603
Electrical, household goods and cosmetics	790,487	1,886,018
Optical products and services	746	1,208,018
Crystal and glass	1,371,919	1,293,274
Music	272,247	270,097
Photographic products and services	79,798	300,728
Clothing	86,298	79,225
Advertising	43,319	65,360
Corporate and other	4,488,470	3,778,821
Inter-segment elimination	(403,878)	(493,387)
Liabilities	<u>7,802,920</u>	<u>9,547,757</u>
Capital expenditure:		
Furniture	82,057	203,082
Electrical, household goods and cosmetics	57,670	190,522
Optical products and services	256,787	775,285
Crystal and glass	183,622	246,919
Music	6,585	21,637
Photographic products and services	13,799	93,375
Clothing	1,835	14,176
Advertising	2,139	4,366
Corporate and other	2,131,057	1,982,925
Capital expenditure	<u>2,735,551</u>	<u>3,532,287</u>

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20. Segment Information (continued)

Depreciation and amortisation:		
Furniture	155,027	184,585
Electrical, household goods and cosmetics	144,846	235,509
Optical products and services	391,797	313,455
Crystal and glass	238,860	252,087
Music	23,412	31,066
Photographic products and services	31,613	65,404
Clothing	4,716	5,161
Advertising	2,525	4,058
Corporate and other	521,733	617,961
Depreciation and amortisation	<u>1,514,529</u>	<u>1,709,286</u>

21. Financial instruments

Currency management

The financial instruments that potentially subject the Company to currency risk consist principally of foreign currency trade receivables, payables and loans in foreign currency.

Credit risk

Financial instruments, which potentially subject the Company to significant concentrations of credit risk, consist principally of cash, short term investments and the related accounts receivable. The Company's cash is primarily held with major banks located in Hungary. Accounts receivable are presented net of allowances for doubtful receivables. Credit risk is limited due to the dispersion across geographical areas and customers. Accordingly, the Company has no significant concentrations of credit risk.

Fair values

At December 31, 2005 and 2004 the carrying amounts of cash, short-term investments, accounts receivable, short term borrowings, accounts payable and accrued expenses approximated their fair values due to the short term maturities of these assets and liabilities. Receivables are stated after making allowance for doubtful debts.

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22. Investments in subsidiaries

During 2004 the Group acquired a direct interest of 51% interest in Fotex Ceska, an unlisted company based in the Czech Republic. This resulted in a goodwill figure of THUF 19,122.

	<u>2004</u>
Assets	
Cash and bank	12,251
Inventory	79,055
Accounts receivables and prepayments	31,999
Long-term loans	16,202
Tangible and intangible assets	<u>174,081</u>
	313,588
Liabilities	
Current liabilities	339,886
Long term loans	-
	<u>339,886</u>
Minority interest	(12,887)
Fair value of net assets acquired	(13,412)
Net goodwill arising on acquisition	19,122
Consideration	
Cash	<u>5,710</u>
Total consideration	5,710
The cash inflow on acquisition is as follows:	
Net cash acquired with subsidiary	(12,251)
Cash paid	<u>5,710</u>
Net cash inflow / (outflow)	<u><u>6,541</u></u>

From the date of acquisition, Fotex Ceska contributed a loss of THUF 47,701 to the net loss of the Group. On December 15, 2005 Fotex disposed of its interest in Fotex Ceska (see note 19).

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22. Investments in subsidiaries (continued)

During the year Fotex entered into certain transactions and mergers as further described below:

- Alfa Örs Kft. and Szivárvány Rt. were merged into Keringatlan Kft.
- Bebufa Kft. representing the manufacturing part of Balaton Rt. This company was spun out of Balaton Rt.
- Keravill Rt. was formally liquidated and had been deconsolidated at year end of 2005, resulting in an insignificant impact on the financial statements.
- Upington Investment Ltd. was established to hold Fotex's investment in Fotex Optika Kft. and certain intangibles held by the Group.
- Azúr Ingatlanhasznosító Kft. representing certain real estates held by Fotex Optika Kft. was spun off as a separate entity prior to disposal.
- The Group increased its holding in DVD Rent Kft. by 99.2%.
- The Group purchased further minority interest in Ajka Kristály Kft., Azúr Rt., Europrizma Kft., Fotex 2000 Kft., Fotex Cosmetics Kft., Fotexnet Kft., Keringatlan Kft., Kontúr Rt., Kontúr Papír Kft., Kontúr Lakásfelsz. Kft. and Primo Rt. during the year to reach nearly 100% ownership and full control.

23. Operating Leases

The Group leases retail sites within the "Duna Plaza" and "MOM Park" shopping centres located in Budapest, and other shopping centers in Budapest, Győr, Kecskemét, Székesfehérvár, Szombathely, Pécs, Szeged and Debrecen based on non-cancellable operating lease agreements. The "Duna Plaza" agreement, extended in 1999, allowed and committed the Group to rent the retail outlets until September 2009. From September 2001 the Group leases retail sites within "MOM Park", the relating contract has a term of 7 years. In 2003 the Group extended the lease for one of the other centres until December 2007. The Group has the option to extend the lease of two other centres until 2008 in which the Group reduced the area rented in 2000.

The rental fees are denominated in Euros and are increased by the customer price index reported by the European Union's Statistical Office commencing from January 1, 2000 in case of "Duna Plaza", from January 1, 2002 in case of "MOM Park" and from January 1, 2000 or 2001 in the case of other centres. The Group also leases office space in Fotex Plaza as described in note 27. At present the Group is committed to pay the following minimum rentals:

2005	Fotex Plaza	Duna Plaza	MOM Park	Other centers and shops	Total
	THUF	THUF	THUF	THUF	THUF
Operating lease commitment					
2006	214,407	307,425	236,011	38,613	796,456
2007	–	286,767	236,011	22,826	545,604
2008	–	286,767	170,057	16,626	473,450
2009	–	209,772	–	12,335	222,107
Thereafter	–	–	–	–	–

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Total	<u>214,407</u>	<u>1,090,731</u>	<u>642,079</u>	<u>90,400</u>	<u>2,037,617</u>
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23. Operating Leases (continued)

Operating lease payments for the year ended December 31, 2005 amounted to THUF 311,897 (December 31, 2004 THUF 312,688) for Duna Plaza, THUF 236,908 (December 31, 2004 THUF 240,917) for "MOM Park" and THUF 77,878 for the other centers and shops (December 31, 2004 THUF 188,982).

The Group rents a significant portion of its retail shop premises from local municipalities. These rentals may be cancelled by the lessor with a notice period of at least one year. In the event the lessor terminates the lease it must provide similar rented properties to the lessee for a minimum period of time depending upon the date of the original lease contract. For leases entered into before 1994 this minimum period runs to 2005, and for leases entered into after 1994 the period is six years from the date of the lease contract.

Under certain circumstances the Group has the right to acquire the premises at a value mutually agreed with the municipality. During 2005 the Group exercised such rights acquiring certain premises at a total purchase price of THUF 568,530 and plans expenditure of THUF 136,833 for 2006.

24. Commitments

Fotex Rt. has concluded a contract with FTC. In accordance with this contract FTC will provide advertisement services for Fotex Rt, at a value of THUF 100,000 in each of the years of 2004, 2005 and 2006.

25. Earnings Per Share

Basic earnings per share

Basic earnings per share is calculated by dividing the net income attributable to shareholders by the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Company and held as treasury shares:

	<u>2005</u>	<u>2004</u>
Net profit / (loss) attributable to equity holders from continuing operations (THUF)	7,502,446	(1,731,457)
Loss attributable to equity holders from discontinued operations (THUF)	—	—
Net profit / (loss) attributable to shareholders (THUF)	<u>7,502,446</u>	<u>(1,731,457)</u>
Weighted average number of shares in issue during the year	<u>69,186,690</u>	<u>69,293,330</u>
Basic earnings / (loss) per share (HUF)	<u>108.44</u>	<u>(24.99)</u>

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The diluted earnings per share agrees with basic earnings per share in 2005 and 2004 as there is no dilution effect in these years.

26. Related Party Transactions

Principal related parties

Gábor Várszegi, Chairman of the Board of Fotex, directly or indirectly controls a part of the voting shares of Blackburn International Inc. ("Blackburn"), a Panamanian company and Zurich Investments Inc., ("Zurich") a British Virgin Islands company, Blackburn has a controlling interest in Fotex Ingatlan Kft. ("Fotex Ingatlan") and Plaza Park Kft. ("Plaza Park"). At December 31, 2005, Blackburn controls 17.1% of the Company's share capital (December 31, 2004, 17.1%), Zurich controls 14.1% (December 31, 2004, 14.1%), Fotex Ingatlan controls 17.6% (December 31, 2004, 17.6%), Bank Ausztria controls 14% (December 31, 2004, 14%) and Plaza Park 1.4% (December 31, 2004, 1.4%). These companies are considered to be related parties.

Related party rental transactions

Agreements with Fotex Ingatlan for office accommodation were modified in January, 2000. In case of Plaza Park the new agreement allows and commits the Group companies to rent office accommodation until January 2007 when the Group companies have the option to extend the rental contract. Rental agreements with Fotex Ingatlan were modified to an indefinite term renting period. Rental fees are increased annually by the average of the general rates of inflation in the EU, the United States and Switzerland. Rental and other related fees paid to Fotex Ingatlan for 2005 were THUF 115,306 (2004: THUF 99,937) and to Plaza Park THUF 301,571 (2004: THUF 357,891).

Compensation of key management personnel of the Group

The management received short term employee benefits of THUF 30,000 for 2005 (2004: THUF 30,000).

2005 transactions

An unsecured short term loan of THUF 220,000 was provided by Plaza Park to the Company that was repaid in the course of the year. An unsecured short term loan of THUF 40,000 was granted to DVD-Rent that is in the balance sheet of DVD-Rent as at 31 December 2005. Interest expense paid on the amount was THUF 5,212. Plaza Park Kft. sold its interest in DVD Rent to Fotex Rt. for THUF 40,000, which was paid after the balance sheet date.

Domus Rt. paid Fotex Ingatlan THUF 46,250 as commission after the sale of an office building, Fotex Rt. purchased shares in the consolidated Group company Ajka Kristály for THUF 146,000 and in the consolidated Group company Fotex 2000 for THUF 32,196, from Blackburn International.

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26. Related Party Transactions (continued)

2004 transactions

Prior period unsecured short term loans of THUF 120,000 and of THUF 30,000 provided by Plaza Park to Fotex Rt and to Fotex Cosmetics, respectively, were repaid in 2004. Interest expense for the period was THUF 1,890.

In 2004 Optika sold a shop located in Budapest to Fotex Ingatlan. The sale price of the shop was THUF 127,200. Optika has concluded a rental contract with Fotex Ingatlan related to this shop, pursuant to which Optika pays a monthly rental fee of Euro 25 per square meter.

In 2004 Fotex 2000 sold a shop located in Budapest to Fotex Ingatlan. The sale price of the shop was THUF 20,000.

27. Post Balance Sheet Events

Further to the Capital Markets Act, on 12 December 2005, Fotex Rt submitted a public offer to the National Financial Supervisory Authority for approval of HUF 1,600 per share for all the shares of Domus Kereskedelmi Rt which are not held by Fotex Rt. The National Financial Supervisory Authority approved the transaction. The approval period was 30 calendar days which started on 2 January 2006 and ended on 31 January 2006. Further to the bid, Fotex has accepted a valid offer to buy 22,914 registered shares with voting rights of a face value of 1,000 each. The consideration for the shares was transferred by Fotex on 3 February 2006 based on the underlying share purchase agreements to the shareholders that accepted the offering. As a result of additional purchase transactions on the stock exchange the Fotex Group had acquired 1,610,828 Domus shares by the preparation of the financial statements, i.e. 98.64% of the total shares. Of this, 1,150,601 shares (70.45%) are held directly by Fotex Rt.

In March 2006, the HUF 915,757 revolving loan of Ajka Kristály Kft from CIB Bank was redeemed by an intra-group loan from Upington Investment Ltd.