

# **ANNUAL REPORT**

**2002**

**MALÉV RT.**

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## 1. SUMMARY

The consolidated result of Malév Rt. for the year 2002 is a loss 2,783 million HUF. Compared to 2001, the loss decreased by more than HUF 4.7 billion, in which improvement such factors as the decrease of kerosene prices and the improvement of the USD/EUR cross rate, being independent from the efforts of the Company, played a significant role.

### Industry tendencies

During 2002, the air-transport industry was strongly affected by the negative impacts of the terrorist attack of 11 September 2001 on passenger traffic and by the world economy's close-to-recession situation. By the second half of the year, the greatest airlines of the USA were shocked despite the considerable national subventions, respectively got under the supervision of trustees in bankruptcy while airlines operating on the European market hit less by the fall-back reported, just like Malév, better results than in 2001.

The international RPK<sup>1</sup> of the AEA<sup>2</sup> member airlines further decreased compared to the previous year and, at a total network level, the volume of the fallback is 2%. The AEA member airlines aligned their capacities to the dropping demand and decreased their ASK<sup>3</sup> by an average of 6.3%. The 74.9% load factor having formed as a resultant of the two effects shows a strengthening of 3.3 percentage points compared to the previous year.

The fallback in the European market that is the most important for Malév was less than the average. The RPK **within Europe** decreased by 1.1% even compared to the weak base period. However, the 65.8% load factor having formed due to the strong restraint of capacities shows a 3.1 percentage-point increase. In the **North-Atlantic** traffic worst affected by the crisis, the RPK of AEA airlines decreased by 4.8%; at the same time, the strong restraint of capacities resulted in a 79.9% load factor that is by 5.4 percentage points higher than same of the previous year.

With the fallback in passenger volumes in 2002, the average yield per one paying passenger kilometre also decreased further on in the whole sector. The decrease of the yields relates to the over-average drop of business trips, to the dynamic development of low cost airlines in the most significant short- and medium-term markets and, in the Trans-Atlantic traffic, to the further strengthening competition for passengers.

The undoubted winners of the year 2002 are the low cost airlines that gained further grounds in North America and Europe. The success of low cost airlines (Jetblue, Southwest, West Jet, Ryanair, EasyJet) indicate the quickening structural change of the whole sector that has to be taken into account with respect of the future of Malév as well.

The efficiency of airlines is determined on the revenue side by the load factor and the average incomes and, on the cost side, by the service package provided for passengers, the instrumental efficiency and the productivity of labour force. Malév's efficiency falling short of its competitors can, in an international comparison, primarily be caught in the key variables of the revenue side; the load factors and, in spite of the fact that the shortfall decreased in 2002, the specific average incomes still do not reach the same indicators of the immediate competitors. In the field of unit costs determined by instrumental efficiency and labour force productivity, Malév operates with

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<sup>1</sup> Revenue Passenger Kilometres

<sup>2</sup> Association of European Airlines

<sup>3</sup> Available Seat Kilometres

more favourable costs than the European average; at the same time the low cost companies came up with business solutions in both fields that lead to a significant cost advantage. The medium-term maintenance and strengthening of Malév's cost advantage and the improvement of the key variables of the revenue side can only collectively lead to a success.

Examining the results of the Company in 2002, the following major events and impacts have to be considered:

**The primary Malév-specific factors:**

- ✓The company restructured the traffic maintenance that has been managed by the Technical Directorate of Aeroplex of Central Europe Kft. (ACE Kft.).
- ✓Founding of Malév Express Kft. and starting the regional operation from June 2002 followed by the purchase of two aircrafts CRJ200 early autumn.
- ✓The decreasing, but still considerable operational losses of long haul flights.
- ✓Primarily, the strengthening of inland sales and the increase of the market share of the Company.

**External factors independent from the Company:**

- ✓Fallback in world economy, world trade and tourism.
- ✓The slower-than-expected industry consolidation following the serious industry crisis caused by the terror act of September 2001.
- ✓Kerosene prices lower than before on an annual average.
- ✓Effects of the favourable exchange rate (first of all, the further strengthening of EUR against to the USD).
- ✓Delay in the performance of the former owners' commitment.

In 2002, scheduled operation remained near the base level due to the unfavourable external impacts, the number of passengers carried increased by 1% and this altogether totalled 2200 thousands of traffic passengers. The number and rate of business passengers have decreased, so the revenue of carrier activities decreased by 0.3%.

In the second half of 2002, the Company expanded its network with four new destinations. Opening the flights to Bologna, Venice, Odessa and Temesvár was facilitated by putting the CRJ—200 aircraft into operation. Increasing the load factor with an average below 50% on the destinations served by the CRJ—200 aircraft is an urgent task.

All in all, the load factor increased by 5.6 percentage points but the source of this is basically the limitation of the available seats offered. The greatest positive shift took place in respect of long haul flights, which is, first of all, the result of the cancellation of the Peking and Bangkok destinations terminated in connection with returning the Boeing—767 aircraft with the registration sign LHD. In the market network, Malév improved its position; its share in this field increased to 56%.

In 2002, the revenue of the scheduled passenger carrier activity – own operation, code-share, seat rental – reached a total of HUF 83,806 million; i.e. it remained on base level. The margins of scheduled activity at direct cost level amount to a profit of HUF 4,918 million that is by HUF 6,619 million better than the base result. The profit II level including the indirect costs shows a loss of HUF 2,303 million, which is only 23% of the previous year's value.

Malév's punctuality in the 0-minute delay category increased by 9.5 percentage points and

reached a value of 65.8%. The primary reasons for delays were the overcrowded nature of European airspace and the technical availability worsening by the end of the year.

**Charter** traffic (number of flights) showed an increase of 37% compared to the base period, while operating revenues fell 2% short of the previous year's value due to the decrease of the rate of long haul flights, reaching this way an amount of HUF 5,912 million. The HUF 507 million margins of the activity show an increase of 17% compared to the base.

Due to the events in the world economy in 2002, cargo services produced 9% less revenue than in the base period, which amount is by HUF 357 million less than the value reached in the previous year. The decrease implemented through the streamlining of costs resulted in the operation's realising 24% greater profit, approaching the amount of HUF 2 billion.

In 2002, in the market of ground handling, Malév lost Air France and was adversely affected by the impacts of airline bankruptcies and the strengthening of HUF. Accordingly, the total revenue was HUF 3,445 million, which is 33% less than that of the previous year. The margins of the activity decreased considerably (by 80%) and show a profit of HUF 299 million.

The volume of into-plane fuel sale fell 11% short of the performance of the base year. Revenues dropped even to a greater extent, namely by nearly 30%. However, as a result of decreasing costs, the activity succeeded in realising 8% more margins, i.e. HUF 199 million more than in the base period.

During the year, costs dropped by 7% compared to the base value, so costs totalled HUF 108,434 million.

The balance of other revenues and expenses improved the result of activities with an amount of HUF 2,705. In comparison with the base, this improved by HUF 6,999 million, i.e. it became a loss of HUF 4,543 million. Financial transactions adjusted the result by HUF 1,536 million; out of this, Malév's net gain on the exchange rate amounted to HUF 2,436 million. In 2002, the extraordinary items made the Company's business position more favourable with HUF 224 million.

As a combined result of the above trends, Malév Rt. posted a net loss of HUF 2,783 million in the 2002 financial year.

In 2002, the owners made important personal changes in Malév's management several times, which affected the composition of the Board of Directors and the Supervisory Board. Dr. András Huszty was elected the Chairman of the Board of Directors of Malév, while Mr. Attila Virág was elected the Chairman of the Supervisory Board. A new Chief Commercial Officer and a new Chief Operation Officer and, in 2003, a new Chief Economical Officer and a Chief Financial Officer were also appointed.

It is predictable that, due to the losses in 2003, the rate of Malév's equity capital compared to the registered capital is going to drop below the 2/3 minimum prescribed by Act CXLIV of 1997 on Business Associations. Consequently, in the course of 2003, settling the situation of the capital seems to be unavoidable. Malév has initiated negotiations with the owner ÁPV Rt. and the Ministry of Finance on the timing and the means of the solution to the situation.

The weakness of the capital structure of Malév Rt., its own business position, business policy, internal economy, the unfavourable shaping of the world situation of the industry and the delay of the performance of the former owner's promises jointly led to Malév's serious financing

crisis, which was resolved only temporarily by the governmental measures taken in the period of preparing the balance and not providing any lasting solution.

Budapest, 2003

András Dunai  
Chief Financial Officer

## 2. HIGHLIGHTS

Description	Unit	2001	2002	Index (%)
<i>Turnover and capacity</i>				
Revenue passengers*	thousand	2,035	2,074	101.9%
Freight and mail carried	tons	16,870	13,416	79.5%
Revenue passenger kilometres*	million RPK	3,052	3,036	99.5%
Available seat kilometres*	million ASK	4,959	4,632	93.4%
Load factor*	%	60.0	65.5	109.2%
<i>Financial data</i>				
Net sales	million HUF	103,143	101,148	98.1%
Total revenues	million HUF	118,594	110,383	93.1%
Personnel expenses	million HUF	15,709	16,395	104.4%
Total expenses	million HUF	126,103	121,678	96.5%
Profit before taxation	million HUF	- 7,509	- 2,783	37.1%
Profit after taxation	million HUF	- 7,509	- 2,783	37.1%
Pre-tax profit as a percentage of total revenues	%	-6.33%	-2.52%	39.8%
<i>Human resources and ratios</i>				
Average statistical headcount	persons	2,776	2,610	94.0%
Revenue passenger kilometres per employee	thousand RPK/person	1,10	1,16	105.8%
Sales per employee	thousand HUF/person	37,16	38,75	104.3%
Pre-tax profit per employee	thousand HUF/person	- 2,70	- 1,07	39.4%
Total revenues per HUF 1 of personnel expenses	HUF/HUF	7,55	6,73	89.2%

\* Scheduled services and charter flights combined

\*\* Including the value of unused tickets

\*\*\* Including the capitalized value of own performance

### **3. MALÉV MILESTONES IN 2002**

The co-operation between Aeroflot and Malév started on 3 April 2002, under which scheme we are launching code-share flights between Budapest and Moscow. To date, the two companies operated their flights independent from each other. Through the co-operation project, from now on, both companies will be present in the market with two daily flights. Harmonisation of the schedules enables us to offer our passengers comfortable connections for destinations beyond Budapest and Moscow.

30 April 2002 is the start-up date of the Malév-Air Europe co-operation. Pursuant to the agreement, the co-operation extends to certain Spanish destinations that have not been operated by Malév so far. A further advantage is that it is possible for the first time in our airline's history to offer flights to the popular recreation resorts of the Caribbean islands.

The first flight of Malév Expressz, the regional affiliate company of Malév was launched on 11 July.

From July on, a call centre operated by the external company Sykes will manage our telephone customer service. The objective of this outsourcing project is to ensure that Malév can provide an easily available service for passengers and, this is why it chose the Hungarian affiliate of Sykes, the world's largest call centre operating venture, listed on the stock exchange.

On 1 September, we moved into the Lurdy House, Budapest. From the airport 243, while from the City 139 persons went to work in the new centre. The offices of Malév are located on some 7,200 square metres on three floors. The office has one air space, which helps connect the different working processes and establishing a new, up-to-date corporate culture. All in all, we may conclude that it is a very modern office environment with brand new furniture, multifunctional office machines, up-to-date conditions for archiving documents and a safe check-in system.

The image of Malév has changed to some extent from September: the new Malév logo designed by using the components of the old image emphasises a more dynamic market presence.

In September, we launched two new flights to Italy (Venice and Bologna) and to more to Temesvár and Odessa.

On 28 September the second self-owned CRJ—200 aircraft of Malév also arrived at Ferihegy.

In October, Malév's loyalty program was renewed; as a result of the strategic agreement concluded with the Dutch KLM and the American Northwest Airlines, our frequent flyers can collect and use their credits in a network embracing the whole world. The renewed program pays special attention to business passengers giving the greatest revenue for our airline and often flying with the most expensive tickets.

The European Commission (EC) has approved the KLM-Northwest alliance: it also officially declared in Brussels on 30 October 2003 that there was no obstacle to the alliance between KLM and Northwest Airlines. In 1996, the EC started to investigate the possible effects of alliances to be concluded between the European and American air carriers. According to the result of the investigation, the establishment of the KLM-Northwest alliance does not jeopardise free competition in Europe and the USA, as there still is a sufficient number of available alternatives through other routes. The bond between KLM and Northwest is the only European alliance enjoying the full approval of the European Commission.



#### **4. ECONOMIC EVENTS AFFECTING THE FUTURE OF MALÉV RT.**

##### **Regional airline**

One of the outstanding elements of Malév's strategy developed in 2002 and approved by the owner is the strengthening of the hub position in Budapest, the developing of the regional network, the achieving of the secondary flying points and the increasing of the frequency on heavy traffic lines. For the implementation of these tasks, a suitable aircraft type and operation model had to be selected. Market demands justified putting a maximum 50-seater aircraft into operation. From the two types present in the market, Malév has chosen the Canadian CRJ—200 aircraft and, in March 2002, Malév Rt. signed a contract on the purchase of a CRJ—200 ER aircraft. The two-jet-engine CRJ—200 ER aircraft is suitable for carrying 50 passengers for short- and middle-range flights. The first new aircraft shipped out of factory started to operate on 13 September 2002 and the second one on 1 October. In 2002, the load factor of the aircrafts was 98% and the total of hours flown was 2,072.82, which figure is considered to be a very good performance even in comparison with the world average published by the manufacturer.

Malév Express Kft. (MAx), the hundred-percent affiliate company of Malév operates the regional jets.

Malév Express Kft. established with an equity capital of HUF 3 million was registered on 27 February 2002 and the airline received the JAR-OPS1 authorisation on 12 July.

The training of skilled personnel necessary for the operation of the aircraft (pilot, serviceman, cabin attendant) took place in the training centre recommended by the manufacturer and at the highest standard. 24 pilots, 21 cabin attendants and administrative personnel of 7 persons provide the regional operation.

##### **Fleet renewal program**

The Boeing 737-300/400/500 aircraft that Malév Rt. operates at present will be replaced by B737-600/700/800, so-called "Next-Generation" aircraft in the forthcoming two years. The new planes offer more efficient operation, and, on the other hand, can also match the more advanced systems of the competitors' airlines. Under the fleet replacement project, the first NG aircraft arrived in January 2003 and a new one arrived in February and March, respectively. By the end of 2004, the fleet will receive 13 and, in 2005, 2 more new B-737 NG-s, and the Company continues to replace its present aircrafts.

The regional operation of Malév Express Kft. is also provided with a state-of-the-art fleet. The airline 100% owned by Malév Rt. and established in the summer of 2002 operates 50-seater CRJ—200 ER airplanes. In the autumn of 2002, the first two new CRJ—200 airplanes arrived, which will be followed by two more in 2003 in the fleet of Max. Malév Rt. has an option to purchase another 6 CRJ—200 aircrafts until January 2005.

## 5. THE SENIOR OFFICERS OF THE COMPANY

Up to 5 May and 31 May 2003, respectively, the members of the managing bodies of the Company had been as follows:

Body	Name
Board of Directors	József Váradi
	Dr. András Huszty
	Dr. Péter Bencze
	Dr. Zoltán Szedlacskó
	Dr. Endre Erdős
	Dr. Iván Nyíri
	Balázs Enyedy
	Dr. András Balogh
	Péter Barinkai
	György Marosi
	Dr. János Gönci
Supervisory Board	Attila Virág
	Viktor Szigetvári
	Dr. László Szlávnits
	Magdolna Költő
	József Goldfárth
	Dr. András Gálszécsy
	Béla Csorba
	Mrs. Adolf Kozek
	György Háy

At the extraordinary general meeting of Malév Rt. held on 5 May 2003 and at its general meeting of 30 May 2003, changes took place to the composition of the Board of Directors and the Supervisory Board. The newly elected members of the Board of Directors and the Supervisory Board are as follows:

Body	Name
Board of Directors	László Sándor
	Géza Fehérváry
	Dr. Miklós Polgár
	Miklós Zoltán Tátrai
	Bálint Csikós
	Magdolna Költő
Supervisory Board	Erzsébet Szombat, Mrs. Szalóki
	Dr. András Gálszécsy
	József Goldfárth
	Péter Endrődy
	Viktor Szigetvári
	Dr. László Szlávnits
	Attila Csorba
	Mrs. Adolf Kozek
	György Háy

## 6. OPERATING ENVIRONMENT

The world economic processes of 2002 were not favourable for the consolidation of the air transport industry after 11 September 2001. The economy of the USA and Europe produced poor indexes in respect of both growth and commerce. Although during the year the average fuel prices remained below the prices of the base period, they kept increasing on a continuous basis.

As expected, in 2002, the exchange rate of EUR strengthened compared to the USD and the change of the domestic exchange rate policy led to the significant appreciation of HUF. Due to the different structure of revenues and costs, the results achieved by Malév are influenced by the fluctuations of the cross rates of the two most important foreign exchanges. The strengthening of EUR against the USD improved the result of Malév by some HUF 1.3 billion as compared to 2001.

The industry still has not been able to get through the depression following 11 September 2001. In the USA, even direct national assistance could not save two renowned airlines, United Airlines and U.S. Airways from being placed under bankruptcy protection.

All in all, the global airline industry fell back with regard to the whole year. The turnover of AEA airlines measured in RPK dropped by 2%. With the smaller turnover, airlines curbed their capacities in order to improve economic profitability: they decreased the ASK by 6%.

The penetration of low cost airlines continued in the sector. Easy Jet and RyanAir keep taking more and more considerable shares from the market, and under the name Sky Europe a low cost company was established with headquarters in Bratislava, directly jeopardising Malév's position.

Integration of the alliance systems continued despite the impairment of American companies of crucial significance. The Delta – Continental – Northwest agreement anticipates that the members of the Wings alliance system are very likely to integrate into Sky Team.

### Changes of the turnover data of the Association of European Airlines (AEA)-member airlines compared to 2001

Description	Change compared to 2001		
	RPK	ASK	Load factor
	change (%)		
Europe			
- AEA average	-1.1	-5.7	3.1
- Malév	2.3	0.3	1.2
North Atlantic			
- AEA average	-4.8	-11.3	5.4
- Malév	-3.3	-6.0	1.8

## 7. COMMERCIAL POLICY

Year 2002 was the year of stagnation in the Hungarian airline market, just like in the sector all over the world. The volume of BSP (Bank Settlement Plan) sale through agents increased only by 0.8% compared to the situation in 2001, while Malév improved its sales by 4.7%. This increase resulted in Malév's improving its market share by 1.2%.

In 2002, Malév introduced a market segmentation placed on new bases, which resulted in the conclusion of differentiated contracts. The primary objective of these contracts is to increase turnover, market share and the sale of higher reservation classes.

In respect of corporate contracts, we executed portfolio purification. We terminated several hundreds of contracts that only entailed administrative work and did not produce any additional revenue. Through decreasing the number of contracts we succeeded in concentrating our resources to the turnover of companies that constitute a significant volume in the Hungarian market.

It was for the first time in 2002 that the regions worked throughout the whole year in the foreign sales system of Malév. The objective of the foreign sales policy for 2002 was to strengthen the nine eastern, the seven western and the North American regions in terms of sales. Under this program, training courses were organised in the field of different sales functions (price calculation, trade marketing, marketing communication, etc.).

According to the new market and commercial policy of the company, Malév placed pronounced emphasis on Eastern European markets. Therefore, it introduced night-stop flights to Eastern Europe and the Balkan region, which considerably increased the opportunities for network sales. The market share of each route of the eight regions was absolutely significant. In the eastern region, two new flights were commissioned: on 1 August the Temesvár and on 16 September the Odessa destinations.

In 2002, it was characteristic to the flights of the Western European region that with a 15-30% capacity decrease per route in the summer schedule period, they still succeeded in achieving a passenger number identical with that of the base period. However, as a consequence of the worsening indexes of the winter months, only a lower annual increase of 4% of the number of passengers could be achieved. Due to the very strong capacity withdrawal in the summer months, the east-west passenger flow was limited on certain routes (Paris, Stockholm, Milan, Rome and Berlin). Consequently, transit passengers flying lower reservation classes could not get any reservation for the flights.

Western Europe as a sales area exceeded the expectations. This is basically owing to the good performance of the Swiss, Belgian, French and English markets. The Dutch and German markets fell short of the revenue plan. From August on, following the termination of the leading agency contract, the results of the Italian market steadily improved, however the shortfall of the first eight months could not be compensated by the own sales of Malév. Even with the code-share operation contract concluded with the Finnish partner, a limited, respectively decreasing capacity could be experienced in the Scandinavian market, first of all on the Stockholm and Helsinki routes and, in spite of the decreasing number of passengers, the revenues of the lines decreased to a smaller extent.

In the second half of the year, Malév commissioned two new flights to the Italian region, to

Venice and Bologna.

## 8. FREQUENT FLYER PROGRAM

### Malév Duna Club

On 1 January 2002, the membership of some 25 thousand inactive frequent flyers ceased to exist. Thus, during 2002, the number of members of the frequent flyer program increased from 56,237 to 64,758 passengers, which still proves the popularity of the program. At the end of the year, the distribution of figures was as follows: Blue 54,902, Silver 6,389, Gold 3,467.

In 2002, the total turnover produced by frequent flyers was approx. HUF 7 billion, while the value of bonus tickets issued to them amounted to approx. HUF 1 billion.

In March 2002, a database shift and, in October, a software replacement took place, the latter strongly increasing the competitiveness of the program. In November, the English-language version was completed and thus enabled the use of the software also by foreign offices, while the service became available at every service points in Budapest.

Since November 2002, the handling of frequent flyers' calls has been taken over by the call centre of Malév, providing a uniformly high-standard management of calls.

We could see the effects of the KLM frequent flyer contract, concluded at the end of 2001 for Duna Club members, as early as in 2002, greatly expanding the opportunities provided only by the single co-operation project with Alitalia. In May 2002, Air Europa, then in August 2002 Northwest Airlines became frequent flyer members of Malév.

During 2002, preparations were made for involving the commercial partners in the Duna Club program, implementation of which will take place gradually during 2003.

### Breakdown of passenger flows

Description	2001		2002	
	number of passengers thousand persons	share %	number of passengers thousand persons	share %
Eastern Europe	437	20.1%	512	22.7%
Western Europe	1,397	64.3%	1,440	63.9%
Mediterranean	195	9.0%	164	7.3%
<b>Short haul</b>	<b>2,029</b>	<b>93.5%</b>	<b>2,116</b>	<b>93.9%</b>
Long haul	142	6.5%	138	6.1%
<b>TOTAL</b>	<b>2,171</b>	<b>100.0%</b>	<b>2,254</b>	<b>100.0%</b>

## **9. HUMAN RESOURCES**

Malév Rt. continued its state-of-the-art organisational development and maintained the new human resources management principles and methods conceived under the human resources strategy accepted in 2001. For the implementation of the strategy of Malév Rt., it is essential to develop an organisation able to flexibly comply with the changing market conditions and to efficiently operate human resources economy, both of which have to hold their ground in an international comparison.

### **Organisation development activity**

At the beginning of 2002, the human resources organisation of Malév was renewed with an objective to establish a modern strategy-focused human resources activity suitable for international practice and to develop systems supporting the business processes of the company.

In order to increase the efficiency of operation, on 1 May, Malév Rt. integrated the engineering service, maintenance-planning, aircraft-operation and traffic maintenance, logistical and contract-conclusion activities, and the quality assurance procedures thereof, from ACE Kft. into its own organisation (Technical Directorate).

During the year, the field of commerce was also restructured, turning from a stiff, hierarchical and product-focused organisation into a more efficient, up-to-date and client-oriented multifunctional organisation in order to achieve the business objectives, to increase efficiency and to manage changes.

### **Satisfaction test**

In order to support the Restructuring Program, since 2001 Malév Rt. have continuously been testing the satisfaction of their employees. In 2002, two such tests were accomplished: in May and August 2002, within the framework of the survey “The Best Working Place”. The outcome of these surveys confirmed the opinion of Malév’s management, namely that the development of the performance evaluation and career-management systems have to be given priority.

### **Performance Management System**

On the basis of the managers’ Performance Management System, the development and the preparation for the introduction of the company-level Performance Evaluation System (PES) started in 2002.

### **Training and related costs**

In 2002, Malév spent HUF 139,479 / person on the employees’ training. This gives a total of 14,725 training days (117,800 hours) attended altogether by 5,424 participants. Therefore, one participant spent an average of 2.7 days on training. This means 5.5 training days per employee.

In order to further promote the skilfulness and development of the members of the management, we have elaborated a manager-training program at the end of 2002. The objective of the manager training program was to improve the following skills and competencies of managers: up-to-date management knowledge, presentation skills, business writing, negotiation skills and project management. The program will be implemented in 2003-2004.

### **Labour relationships**

Labour relationships at Malév Rt. are excellent; Malév Rt. has an effective Collective Contract, Operational Agreement and Labour Safety Agreement in place.

In the course of 2002, two representative trade unions initiated collective labour debates. The negotiations were completed by an agreement between the trade union and the employer, which enabled the company to avoid any strikes.

### **Recruitment and Selection**

In 2002, Malév Rt. spent HUF 56 million on recruiting, which amount includes the advertising costs and the search fee of consulting firms. The majority of the required labour force was found through the mediation of consultants, but the rate of positions filled through advertisements and internal movements is also significant. On the basis of the strategic objectives of the company, special attention was paid to recruitment and selection managers and front-line co-workers over the past period.

## **10. HEADCOUNT**

In 2002, the average statistical headcount of Malév Rt. decreased by 6% compared to the base period.

Since 1 May 2002, Malév has taken over from ACE Kft. the traffic maintenance and aircraft service activities. This means that Malév performs the former activities through establishing its own organisation and, simultaneously, the 312 employees previously performing the activities in question at ACE Kft. were taken over by Malév Rt. In addition, some 245 persons joined Malév during the year. At the same time, in the course of 2002, 468 persons left the company, out of whom 295 employees were affected by collective dismissal.

#### **Average statistical headcount**

<b>Description</b>	<b>2001 employees</b>	<b>2002 employees</b>	<b>Index %</b>
Full-time	2,694	2,471	91.7
Part-time	82	139	169.5
<b>TOTAL</b>	<b>2,776</b>	<b>2,610</b>	<b>94.0</b>

## 11. FLEET

In 2002, Malév operated four types of aircraft in its core business: two Boeing—767-200ER aircrafts, fifteen Boeing-737-300/400/500s, six Fokker—70s and three CRJ—100/200s (not over the entire period). After a roughly one-year operation, Malév grounded the B—767-300ER aircraft with registration sign HA-LHD and returned it the lessor on 16 January. Malév put into operation a CRJ—100 (on 11 July), two CRJ—200-s (on 10 and 27 September) in order to launch regional operation. After the arrival of the two other aircrafts, we returned the CRJ—100 on October 11.

As the result of the fleet development activity, in 2002, Malév possessed orders for 18 Boeing NG aircrafts and 2 CRJ—200 planes, delivery of which will be due in 2003 and 2004.

The number of airplanes in operation increased from 23 at the beginning of the year (1 grounded, 3 put into operation) to 25 by the end of the period under review.

### Fleet composition

Description	Number of aircraft in operation	Number of aircraft in delivery	Options
Fokker-70	6		
Boeing—737-300 (*)	7		
Boeing— 737-400 (*)	6		
Boeing—737-500 (*)	2		
Boeing—767-200ER (**)	2		
Boeing—737-600/700/800		18	
Bombardier—CRJ200ER		2	6

\* The lease agreement of the aircraft will expire in 2003/2004. In light of the high average age (12-14 years) and the substantial costs of ownership, the Board of Directors, acting upon management recommendation, decided to return the aircraft and enter into a lease agreement for Boeing 737-600/700/800 Next-Generation aircraft under exceptionally favourable terms.

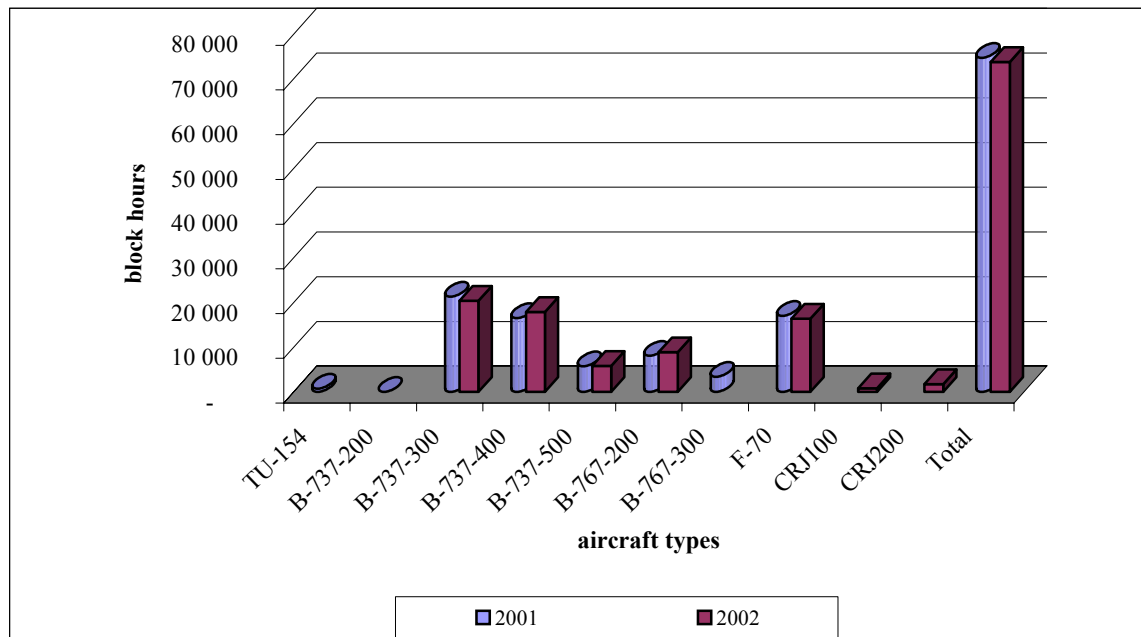
\*\* The two Boeing 767-200ER aircraft are included in the books of Malco LLC, a wholly owned subsidiary.

### Characteristic features of aircraft types in operation

Description	Fokker-70	B-737-300	B-737-400	B-737-500	B-767-200ER	CRJ-200
Maximum take-off weight	36.74 t	61 t	68 t	59 t	175.5 t	23 t
Passengers (business & economy)	75	128	146	111	197	50
Typical cruise speed	856 km/h	860-930 km/h	860-930 km/h	860-930 km/h	880-940 km/h	860-930 km/h
Maximum range	2,000 km	3,970 km	4,077 km	4,700 km	12,700 km	2,978 km
Engines	Rolls R. Tay Mk 62015	CFM 56	CFM 56	CFM 56	CF6-80C2	CF34-3B1

### Breakdown of block hours by aircraft type





## 12. PUNCTUALITY

Taking commercial aspects into account when analysing delayed flights, Malév takes Malév and code-share scheduled flights as a basis. In delay statistics, any deviation over zero minutes of a flight from its scheduled departure time must be regarded as a delay. In addition to the above, statistics are also compiled about delays over 15 minutes.

In 2002, the over-zero-minute category punctuality of all Malév flights further improved, increasing by 9.45 percentage points and reaching 65.75%.

Whereas in 2001, 8,776 Malév flights – own operation and code-share combined – had suffered a delay, this figure dropped to 7,375 occasions in 2002, implying a 16% improvement.

The number of delays attributable to the Company had stood at 4,498 in 2001; this figure was reduced to 3,574 in 2002, representing an improvement of 21% in comparison with the previous year. In this category, the punctuality indicator also came up 5.8 percentage points to 83%.

Last year, a progress could also be seen in the category of delays not attributable to the Company; punctuality improved by 3.7 percentage points and the number of delayed flights decreased by some 11%.

Also a significant improvement can be observed in respect of delay times. Total delay time decreased by 26%, while the number of delay minutes per flight decreased by about 31% in comparison with the data of the base year. The time per one delayed flight decreased by 11%.

Among the most frequent reasons for delay over the previous year, the number of delays caused by slot control, waiting for connection, weather conditions and aircraft rotation also decreased. However, these negative features still play a significant role.

In the over-fifteen-minute delay category, a significant improvement may also be observed; the punctuality index came up 7.64 percentage points to the value of 86%. The number of delayed flights improved by 31%, the total delay time improved by 30% and the delay time per one flight by 34%, compared to the situation in the previous year. In the category of the over-fifteen-minute delays, a slight (1-3%) worsening may be observed in the number of delay minutes per one delayed flight. In respect of delays both attributable to and not attributable to the Company, the punctuality index exceeded 90% in 2002, its accurate rate in respect of the former one was 90% and that of the latter one was 94%.

Description	2001	2002	Index
<b>Delays not attributable to Malév</b>			
Number of delayed flights	4,278	3,801	88.85%
Punctuality (%)	78.70%	82.35%	3.65%
<b>Delays attributable to Malév</b>			
Number of delayed flights	4,498	3,574	79.46%
Punctuality (%)	77.60%	83.40%	5.80%
<b>Total delays</b>			
Number of delayed flights	8,776	7,375	84.04%
Punctuality (%)	56.30%	65.75%	9.45%

## **13. QUALITY ASSURANCE**

### **Certificates**

In 2002, Malév Rt. successfully renewed its Aircraft Operation Licence and, in respect of its maintenance organisation, it obtained the Operation Licence. The Civil Aviation Authority issued both licences according to the relative aviation industry requirements, namely regulations JAR OPS1 and JAR-145.

Our Company's ISO 9001 certification and the periodical review of the ISO 9002-certified into-plane fuelling services were completed successfully and the validity of our certifications is maintained.

### **Quality Management System**

In 2002, we started to adjust our quality management system according to the requirements of the ISO 9001:2000 standard. We further developed our Service Monitoring System and introduced the Operation Monitoring System measuring the efficiency of the operating system. Continuously measuring approximately one hundred quality parameters, the two measuring systems provide an objective view of the satisfaction of our passengers and our efficiency.

### **Flight Safety Management System**

In 2002, the accident-prevention and flight safety program of our Company expanded with further elements. For the efficient handling of flight safety data, we introduced the BASIS (British Airways Safety Information System) software applied by nearly one hundred airlines. In order to develop prevention activity, we launched the FOQA (Flight Operation Quality Assurance) program performing the evaluation of flight data.

The above results mean that the quality and flight safety management systems of our Company, its operating system and business activity comply with the international industry and general requirements and standards. With the introduction of the monitoring systems we created the conditions to continuously improve our operation and the satisfaction of our passengers.

## 14. AVIATION SECURITY

Gaining and retaining the confidence of air passengers is a top business priority. Therefore, the Company designs, develops and uses a broad range of security procedures through which it aims to eliminate on the ground, i.e. prior to the start of a flight, any risk factor that may pose a threat to security.

One of the principal elements in the overall criteria is that the airline be familiar with the security situation of the destinations of its flights and adjust the levels of security measures accordingly. For this purpose we have established daily communication with the police and other authorities as well as the Ministry of Foreign Affairs. The analysis and evaluation of the information received then helps identify the flights in respect of which special, more rigorous procedures must be applied in addition to general security measures, such an examination by the bomb squad before each flight, or checking the identity and authorisation of anybody who comes aboard on official duty.

The measures introduced following the events on 11 September 2001 to improve efficiency are still in force. We installed extra surveillance cameras in various areas of the airport – both those used by and those off limits to passengers – and also introduced enhanced equipment that totally screens every item of checked baggage and all dispatched freight and mail. Screening is performed using equipment capable of taking multilayer X-ray photographs and which sends an automatic warning message if any dangerous or unusually shaped object or material – or a potential weapon – is detected. The contents of the identified piece of baggage is, subject to its nature, then repeatedly examined by the bomb squad or – in the presence of the passenger – by passenger security personnel, as appropriate.

In respect of our New York flight, we apply the highly strict security regulations required by the US Federal Aviation Administration (FAA), whereby in addition to hand luggage and passenger scanning that accompanies entry to the transit area, we carry out continuous checks at the boarding gate as well, using manual examination as well as metal detectors. The system detects any potential weapon, including objects that could be used for stabbing or cutting, and allows them to be immediately eliminated. The crew is not permitted to take such items aboard either, and crew check-in is also performed through the passenger route, with the security procedure applied there as well.

Illegal acts have to be prevented on ground through the introduction of aviation security measures and their orderly execution. Malév Rt. meets its safety obligations prescribed by domestic and international legal regulations, and it also further tightens the security measures if required by actual emergency. In the case of the occurrence of any illegal acts, the safety of human lives is given priority.

Malév Rt. operates international flights only to airports where the aviation security regulations of the International Civil Aviation Organisation (ICAO) concerning international airports and requirements included within the Eight Points of the International Air Transport Association (IATA) are fully enforced.

A precondition for performing the airline aviation security measures at a satisfactory standard is to acquire the necessary security know-how, its continuous updating and the regular control of compliance therewith. In the course of 2002, a total of 670 persons (flight crew, cabin attendants,

service personnel) were provided with basic aviation security and knowledge refreshment training in more than 50 sessions.

In 2002, some 480 complex aviation security audits were performed in the course of the preparation of our flights to New York, Toronto and Tel-Aviv. The audits covered the activity of all services taking part in ground handling. We found that the preparation of flights was performed both on the ground and on board according to the effective technological regulations.

In the course of the year, there were 8 telephone bomb scares against our aircraft, out of which on one occasion we identified a person initiating four calls. The telephone exchange at the airport is equipped with a call-tracing system, which on several occasions has enabled us to identify the hoaxer making the threat, so the number of such calls has fallen to a minimum. The investigations ordered as a consequence of threats and performed by the bomb squad always produced a negative result.

Baggage handling has an extraordinary importance from aviation security and property protection aspects. In the course of the year we supervised 21 overall baggage identification procedures, several times revealed baggage handling irregularities and asked for investigation and correcting measures from the competent services. We made baggage handling procedures a closed system, strengthened their supervision and control, as a consequence of which measures baggage handling indexes improved. In this field, according to the rating of the Association of European Airlines, in 2002 Malév Rt. got the seventh rank amongst the 21 member-airlines.

All aircraft undergo technical safety as well as security checks before every flight, fuel quality is checked regularly, and security seals are used on doors and other possible points of entry to ensure that planes remain sterile during longer stoppages as well. We have tightened the rules applicable to staying in the cockpit, and the cockpit door is securely locked during flight. Malév is also consulting the manufacturer of its aircraft to make sure that cockpit doors are reinforced against unauthorised access.

Malév maintains continuous contact and regularly exchanges information with international security organisations and the security arms of other airlines in order to co-ordinate and integrate the latest experience and procedures.

## 15. BUSINESS OPERATIONS

### Carrier operations

The number of passengers Malév carried in 2002 was basically equal to the year-earlier figure and approached 2.2 million.

The number of business passengers dropped by 15% in comparison with the previous year; their ratio fell from last year's 9% to 7.6%. With the exception of long haul flights, the rate of business passengers was everywhere lower, but the most considerable decrease took place in the Eastern European region.

From the beginning of the summer-schedule period, Malév ceased to operate the flights to Damascus, Oslo and Manchester, due to efficiency reasons. The Company restarted its flights to Munich and Madrid with a new and more competitive schedule. From the middle of the year the fleet expanded with two new CRJ—200 aircraft and this facilitated to enlarge the route network in the Eastern European region with two new destinations, respectively (Venice, Bologna, Temesvár and Odessa).

In the overall network of Malév, the market share increased from 50.3% to 56%.

In the network of Malév, the load factor is 65.5% that means an increase of 5.6 percentage points compared to that of the base year.

During the same period the turnover of AEA (Association of European Airlines) member airlines within Europe dropped by 1.1%, while their load factor increased by 3.1% to 65.8%.

### Combined carrier operations

Description	Unit	2001	2002
Number of flights	pieces	21,375	21,505
Block hours	hours	72,725	71,809
Revenue passengers	thousand	2,035	2,074
Revenue passenger kilometres	million km	3,400	3,445
Available seat kilometres	million km	4,959	4,632
Load factor	%	60	65,5
Freight and mail carried	ton	16,870	13,416

## **Scheduled services**

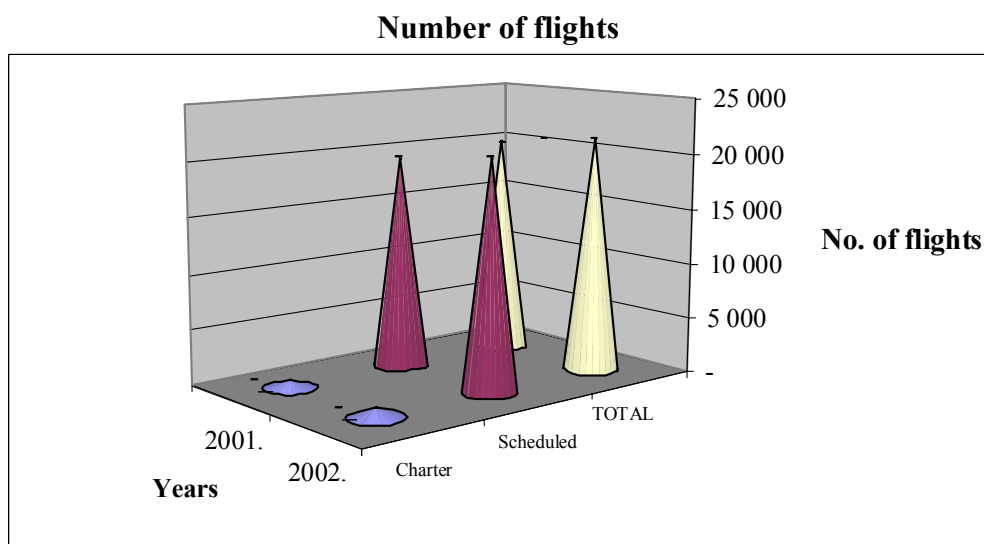
66% of all passengers travelled to the Western European destinations considered as the major market of Malév and, in 2002, the rate of growth was 4% compared to the base value achieved in this region. This passenger volume was reached having a 4% increase in the number of flights and 2% fallback in the ASK, so the load factor rose by 6.3 percentage points.

The turnover of the Eastern European region increased by 5%. 21% of the scheduled passenger volume travelled in this region. The rise of the number of passengers in the region was accompanied by a 20% increase in the number of flights. The ASK grew to a smaller extent, by 8%. The load factor increased minimally, by 0.2 percentage points. The market share was by 71.7%, i.e. by 2.1 percentage points larger than in 2001.

The turnover of the Mediterranean region decreased by 18% in comparison with 2001; this region gave 7% of the passenger volume. (The same rate was 9% in 2001. The reason is that, according to the modified hub policy of Malév, it defined its major connection routes in east-west instead of north-south direction.) The turnover of each route decreased in the region with the exception of Tel-Aviv. Along with the 13% decrease\* in the number of flights the load factor improved by 2.1 percentage points. Forming of the market share in this region is unfavourable; it reflects our withdrawing from the market; the position of Malév worsened by 4.1 percentage points compared to the base year.

On long haul flights, the number of travellers dropped in comparison with the previous year; 7% less people travelled than in the base year. The major reason for the fallback is the 12% decrease in the number of flights (in the first half of 2001 the Bangkok and Peking flights were still operating.) The turnover of North American flights continuously operating in both years increased by 17%. This is demonstrated by the increase of the load factor by 8.4 percentage points. The market share of Malév's long haul network improved by 4.2 percentage points in comparison with the base year; in 2002 both the Toronto and New York routes were flown only by Malév.

All in all, the number of scheduled flights, compared to that of the previous year, increased to a greater extent, namely by 6%, than the 1% rise in the passenger volume, however, due to the effects of the change in the fleet structure and the network, the ASK dropped by 7% and so the load factor of Malév improved by 5.6 percentage points.



### Charter services

The number of charter flights increased by 37% compared to the base year.

Short and medium haul charter flights run on Boeing—737-400 and other narrow-bodied aircraft, among which the most significant are the domestically launched charter chains hauling Hungarian tourists to the Mediterranean region. Greece remained the number one target of tourists with Corfu, Heraklion, Rhodes and Kos being the major destinations. Other popular tourist destinations are Spain and Turkey where the outstanding charter destinations are Palma de Mallorca, Barcelona, Malaga, Ibiza, Antalya and Dalaman. Beside these charter chains were operating to Italy, Malta, Egypt, Tunisia, Cyprus and Jordan. In 2002 one eastbound chain operated to Gurjev.

Operation of the Boeing—767-200 has been shifting to an ever-larger extent towards the scheduled destinations, nevertheless, there were more possibilities to launch long haul charter flights in 2002 than in the base year. As regards the number of flights, operation of the B—767-200 rose from 86 to 91 and Boeing—767-200 aircraft flew long haul flights (Bangkok, Mombassa-Durban) in a total of 12 times and it flew 17 times to Corfu, 18 times to Heraklion, 28 times to Tenerife and 16 times to other short and medium haul destinations.

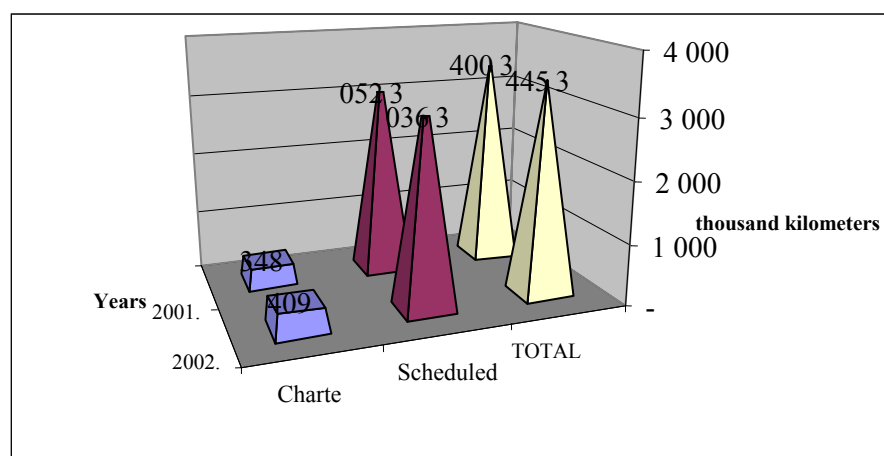
Charter services also include government flights, which totalled 12 in 2002.

### Charter services

Description		2001	2002	02/01 %
Number of flights	pieces	659	905	137.3
Block hours	hours	4,296	5,046	117.6
Passengers carried	thousand	160	222	138.8
Available seat kilometres	million km	441		



## Passenger kilometres



## Cargo services

In 2002, global economic recession and a 20-40% decrease in average prices characterised the cargo business. As regards the turnover, the loss of traffic not routable to scheduled flights due to the termination of loss-making scheduled cargo flights and rotating the small-cargo-capacity, therefore unfavourable CRJ— and Fokker—70 aircraft to Eastern European destinations, resulted in a further fallback.

In respect of cargo, the two major markets of scheduled services are New York and Toronto. Despite the decrease of the frequency of flights, the former one still kept its leading role (17%) within Malév's cargo services even by having a smaller capacity than in the base year.

Scheduled cargo services produced a substantial loss; therefore, from 1 January 2002, we terminated them in respect of every former destination, improving the total margins of cargo services.

In mail traffic, the Company succeeded in gaining customers through adjusting average prices to market demands and to generate a greater turnover, thereby increasing revenues. Similarly to scheduled cargo (freight) traffic, mail traffic is also dominated by the New York, Frankfurt and London routes.

Charter services (transporting cargo on chartered aircraft) suffered a further, considerable drop in comparison with the base period due to the narrowing market possibilities of consignors.

In respect of road transport, due to efficient capacity management, we introduced a starting minimum-weight limitation as a consequence of which we diverted a substantial part of traffic to the scheduled field where it was possible.

Malév cargo handling in Budapest serves the majority of airport cargo traffic and, as of 2002, it expanded its scope of services with providing transportation to the Airport Business Park.

### Freight and mail carried

Description	2001 tons	2002 tons	Index
On scheduled aircraft	11,562	9,748	84.3%
Mail	2,267	3,003	132.5%
On scheduled cargo aircraft	1,091	2	0.2%
Charter	57	8	14.5%
Trucks	1,894	655	34.6%
<b>TOTAL</b>	<b>16,870</b>	<b>13,416</b>	<b>79.5%</b>

### None-core businesses

#### *Ground handling*

In Malév's operation, ground handling plays a dual role. By serving aircraft other than its own, Malév considerably increases its revenues and improves the efficiency of the personnel and equipment serving Malév's passengers and fleet.

Revenues can be rated in three major groups: service of other aircraft and their passengers, operation of passenger lounges and service of the passengers of other airlines.

In the course of 2002, the Company succeeded in keeping its position against the competitors in the service market despite the fact that from 2002 it is not Malév serving Air France, one of the airlines coming to Budapest most frequently. Ground handling was adversely affected by the market's airline bankruptcies (Swissair and Sabena, out of which only the latter's successor restarted its operation, but with less frequency) and the fact that several airlines (Olympic Airways, Air Baltic, Air Bosnia, Balkan) terminated operation in Budapest. As a result of the above, the 12,535 aircraft served show a 19% decrease compared to previous year's data.

In lounges reserved for the government and VIP persons, Malév served more than 15% less revenue delegations than the previous year. 22% less revenue passengers used the services of passengers lounges (Duna, Sky, Millennium) than a year earlier.

#### Key indicators of ground handling operations

Description	2001	2002
Number of other aircraft served	15,424	12,535
Number of Malév aircraft served	16,102	17,549
Average number of employees	906	782

#### *Into-plane fuel services*

The major part, i.e. 96% of the turnover of the services comes from kerosene sale to foreign airlines, by which exceeded the quantity plan by 30%. Forming of the results was positively influenced, firstly by the flexible operation-dependant tanking policy and,

secondly, by acquiring several airlines as new partners (Moldavian Airlines, Carpatair and the most significant Travel Service). Thirdly, in the period under review we also succeeded in concluding contracts with several airlines operating charter chains. The orders of ad hoc flights mean a significant quantity taken.

The other area of this operation is the sale of kerosene as well as other fuels and lubricants to domestic airlines. In the base year a considerable fallback was showing in comparison with the base period. Also from the extent of fallback appears the market's stagnation resulting, on the one hand, from more inland companies going bankrupt and, on the other hand, from the fact that several of the enterprises still operating already use aircraft fuelled with gasoline.

## 16. FINANCIAL DATA

### Malév Rt. 2002 Balance Sheet

No.	<u>Malév Rt. balance sheet</u>	31 December	31 December	
	<u>ASSETS</u>	2001	2002	Index
	<u>[thousand HUF]</u>			
1	2	3	4	5
<b>A.</b>	<b>Fixed assets (I+II+III)</b>	<b>26,947,937</b>	<b>34,641,717</b>	<b>128.55%</b>
<b>I.</b>	<b>I. Intangible assets (1+..+7)</b>	<b>1,845,995</b>	<b>1,918,634</b>	<b>103.93%</b>
1	Capitalised value of formation & restructuring	1,080,634	1,145,139	105.97%
2	Capitalised value of research & development	0	0	-
3	Rights	3,087	2,033	65.86%
4	Patents and trademarks	762,274	771,462	101.21%
5	Goodwill	0	0	-
6	Advances on intangible assets	0	0	-
7	Adjustments to the value of intangible assets	0	0	-
<b>II.</b>	<b>Tangible assets (1+..+7)</b>	<b>18,398,714</b>	<b>27,675,025</b>	<b>150.42%</b>
1	Real estate and related rights	2,620,792	2,814,005	107.37%
2	Technical equipment, machinery, vehicles	11,661,262	18,184,646	155.94%
3	Other equipment, fittings, vehicles	2,170,157	2,600,990	119.85%
4	Breeding stock	0	0	-
5	Capital expenditure	492,546	883,951	179.47%
6	Advances on capital investments	23,945	1,761,421	7356.11%
7	Adjustments to the value of tangible assets	1,430,012	1,430,012	100.00%
<b>III.</b>	<b>Financial investments (1+..+7)</b>	<b>6,703,228</b>	<b>5,048,058</b>	<b>75.31%</b>
1	Long-term participations in subsidiary undertakings	5,535,246	4,519,284	81.65%
2	Long-term loans to subsidiary undertakings	543,010	0	0.00%
3	Other long-term participations	213,820	198,900	93.02%
4	Long-term loans to associated undertakings	0	0	-
5	Other long-term loans	45,345	56,191	123.92%
6	Long-term debt securities	365,807	273,683	74.82%
7	Adjustments to the value of investment securities	0	0	-
<b>B.</b>	<b>Current assets (I+II+III+IV)</b>	<b>28,527,703</b>	<b>24,665,175</b>	<b>86.46%</b>
<b>I.</b>	<b>Inventories (1+..+6)</b>	<b>1,012,923</b>	<b>1,464,323</b>	<b>144.56%</b>
1	Materials	967,572	1,450,777	149.94%
2	Work in progress and semi-finished products	0	0	-
3	Other livestock	0	0	-
4	Finished products	0	0	-
5	Goods	45,351	13,546	29.87%
6	Advances on inventories	0	0	-
<b>II.</b>	<b>Receivables (1+..+5)</b>	<b>19,192,240</b>	<b>20,812,677</b>	<b>108.44%</b>
1	Accounts receivable (trade debtors)	8,748,614	9,169,166	104.81%
2	Receivables from subsidiary undertakings	3,609,703	4,019,414	111.35%
3	Receivables from associated undertakings	0	0	-
4	Bills of exchange receivables	0	0	-
5	Other receivables	6,833,923	7,624,097	111.56%
<b>III.</b>	<b>Securities (1+..+4)</b>	<b>38,007</b>	<b>44,652</b>	<b>117.48%</b>
1	Participations in subsidiary undertakings	0	0	-
2	Other participations	0	15,742	-
3	Treasury stock	0	0	-
4	Debt securities held for trading purposes	38,007	28,910	76.06%
<b>IV.</b>	<b>Cash and cash equivalents (1+2)</b>	<b>8,284,533</b>	<b>2,343,523</b>	<b>28.29%</b>
1	Cash and checks	978,435	782,805	80.01%
2	Bank deposits	7 306 098	1 560 718	21.36%
<b>C.</b>	<b>Prepayments and accrued income (1+2+3)</b>	<b>3,365,263</b>	<b>3,797,367</b>	<b>112.84%</b>
1	Accrued income	525,971	2,139,130	406.70%
2	Costs and expenses paid in advance	2,839,292	1,658,237	58.40%
3	Deferred expenses	0	0	-
	<b>Total assets</b>	<b>58,840,903</b>	<b>63,104,259</b>	<b>107.25%</b>

No.	<u>Malév Rt. balance sheet</u>	31 December	31 December	
	<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	2001	2002	Index
	<u>[thousand HUF]</u>			
1	2	3	4	5
<b>D.</b>	<b>Stockholders' equity (I+II+III+IV+V+VI+VII)</b>	<b>11,890,176</b>	<b>9,107,162</b>	<b>76.59%</b>
<b>I.</b>	<b>Registered capital</b>	<b>11,692,308</b>	<b>11,692,308</b>	<b>100.00%</b>
	- of which: par value of stock repurchased	0	0	-
<b>II.</b>	<b>Unpaid equity capital (-)</b>	0	0	-
<b>III.</b>	<b>Capital reserve</b>	<b>13,960,284</b>	<b>13,960,284</b>	<b>100.00%</b>
<b>IV.</b>	<b>Profit reserve</b>	<b>-8,763,988</b>	<b>-16,337,566</b>	<b>-</b>
<b>V.</b>	<b>Committed reserve</b>	<b>1,080,633</b>	<b>1,145,139</b>	<b>105.97%</b>
<b>VI.</b>	<b>Valuation reserve</b>	<b>1,430,012</b>	<b>1,430,012</b>	<b>100.00%</b>
<b>VII.</b>	<b>Retained earnings</b>	<b>-7,509,073</b>	<b>-2,783,015</b>	<b>37.06%</b>
<b>E.</b>	<b>Provisions (I+2+3)</b>	<b>497,956</b>	<b>188,945</b>	<b>37.94%</b>
1	Provisions for anticipated liabilities	497,956	188,945	37.94%
2	Provisions for future costs	0	0	-
3	Other provisions	0	0	-
<b>F.</b>	<b>Liabilities (I+II+III)</b>	<b>40,497,274</b>	<b>51,769,987</b>	<b>127.84%</b>
<b>I.</b>	<b>Subordinated liabilities (1+2+3)</b>	<b>0</b>	<b>0</b>	<b>-</b>
1	Subordinated liabilities to subsidiary undertakings	0	0	-
2	Subordinated liabilities to associated undertakings	0	0	-
3	Subordinated liabilities to other undertakings	0	0	-
<b>II.</b>	<b>Long-term liabilities (1+..+8)</b>	<b>75,896</b>	<b>4,914,559</b>	<b>6,475.39%</b>
1	Long-term loans received	0	0	-
2	Convertible bonds	0	0	-
3	Debts related to bonds issued	0	0	-
4	Capital investment and development loans	0	4,914,559	-
5	Other long-term credit	0	0	-
6	Long-term liabilities to subsidiary undertakings	0	0	-
7	Long-term liabilities to associated undertakings	0	0	-
8	Other long-term liabilities	75,896	0	-
<b>III.</b>	<b>Short-term liabilities (1+..+8)</b>	<b>40,421,378</b>	<b>46,855,428</b>	<b>115.92%</b>
1	Short-term loans	13,305,019	15,399,750	115.74%
	- of which: convertible bonds	0	0	-
2	Short-term credit	1,000,000	6,282,768	628.28%
3	Advances received	648,322	430,451	66.39%
4	Accounts receivable (trade creditors)	11,952,198	13,904,234	116.33%
5	Bills of exchange payable	0	0	-
6	Short-term liabilities to subsidiary undertakings	727,708	569,833	78.31%
7	Short-term liabilities to associated undertakings	0	0	-
8	Other short-term liabilities	12,788,132	10,268,392	80.30%
<b>G.</b>	<b>Accruals and deferred income (1+2+3)</b>	<b>5,955,496</b>	<b>2,038,165</b>	<b>34.22%</b>
1	Income received in advance	4,198,251	488,460	11.63%
2	Accrued expenses	1,678,764	1,438,669	85.70%
3	Deferred income	78,481	111,036	141.48%
	<b>Total liabilities and stockholders' equity</b>	<b>58,840,903</b>	<b>63,104,259</b>	<b>107.25%</b>

## Malév Rt. 2002 Income Statement type "A"

thousand HUF

No.	Description	2001 (thousand HUF)	2002 (thousand HUF)	Index
1	2	3	4	5
1.	Domestic sales, net	23,848,616	25,963,141	108.87%
2.	Export sales, net	79,294,778	75,185,208	94.82%
<b>I.</b>	<b>Net sales (1.+2.)</b>	<b>103,143,394</b>	<b>101,148,349</b>	<b>98.07%</b>
3.	Capitalised value of assets manufactured	404,896	37,221	9.19%
4.	Change in inventories produced	0	0	-
<b>II.</b>	<b>Capitalised value of own performance (3.+4.)</b>	<b>404,896</b>	<b>37,221</b>	<b>9.19%</b>
<b>III.</b>	<b>Other revenues</b>	<b>5,083,146</b>	<b>7,668,209</b>	<b>150.86%</b>
	of which: depreciation re-posted	396,529	194,622	49.08%
5.	Cost of materials	17,382,874	12,891,701	74.16%
6.	Cost of material-type services used	71,751,460	66,699,845	92.96%
7.	Cost of other services	1,690,534	3,209,445	189.85%
8.	Cost of goods sold	3,724,411	1,859,179	49.92%
9.	Cost of services sold	2,202,625	3,163,595	143.63%
<b>IV.</b>	<b>Material expenses (5.+...+9.)</b>	<b>96,751,904</b>	<b>87,823,765</b>	<b>90.77%</b>
10.	Salaries and wages	6,660,673	7,345,773	110.29%
11.	Other employee costs	5,755,817	5,691,527	98.88%
12.	Social security and other contributions	3,292,996	3,357,796	101.97%
<b>V.</b>	<b>Personnel expenses (10.+11.+12.)</b>	<b>15,709,486</b>	<b>16,395,096</b>	<b>104.36%</b>
<b>VI.</b>	<b>Depreciation</b>	<b>3,900,193</b>	<b>4,214,639</b>	<b>108.06%</b>
<b>VII.</b>	<b>Other expenses</b>	<b>3,511,998</b>	<b>4,963,052</b>	<b>141.32%</b>
	of which: amortisation	935,672	1,848,746	197.58%
<b>A.</b>	<b>Operating profit/(loss) (I.+...+VII.)</b>	<b>-11,242,145</b>	<b>-4,542,773</b>	<b>40.41%</b>
13.	Dividend and profit share received (receivable)	43,908	65,238	148.58%
	of which: received from subsidiary undertakings	43,908	39,500	89.96%
14.	Capital gains on participations sold	5,239,420	15,080	0.29%
	of which: received from subsidiary undertakings	0	0	-
15.	Interest and capital gains on financial investments	209,458	198,028	94.54%
	of which: received from subsidiary undertakings	193,310	88,628	45.85%
16.	Other interest and similar income received (receivable)	43,538	133,558	306.76%
	of which: received from subsidiary undertakings	0	81,191	-
17.	Other income from financial transactions	4,705,615	9,400,247	199.77%
<b>VIII.</b>	<b>Financial income (13.+14.+15.+16.+17.)</b>	<b>10,241,939</b>	<b>9,812,151</b>	<b>95.80%</b>
18.	Loss on financial investments	0	0	-
	of which: paid to subsidiary undertakings	0	0	-
19.	Interest and similar expense payable	1,159,022	747,807	64.52%
	of which: paid to subsidiary undertakings	874	0	-
20.	Amortisation of participations, securities and bank deposits	0	145,136	-
21.	Other expenses on financial transactions	5,471,464	7,383,602	134.95%
<b>IX.</b>	<b>Financial expenses (18.+19.+20.+21.)</b>	<b>6,630,486</b>	<b>8,276,545</b>	<b>124.83%</b>
<b>B.</b>	<b>Financial profit/(loss) (VIII.-IX.)</b>	<b>3,611,453</b>	<b>1,535,606</b>	<b>42.52%</b>
<b>C.</b>	<b>Ordinary profit/(loss) (+-A.+B)</b>	<b>-7,630,692</b>	<b>-3,007,167</b>	<b>39.41%</b>
<b>X.</b>	<b>Extraordinary income</b>	<b>125,686</b>	<b>228,194</b>	<b>181.56%</b>
<b>XI.</b>	<b>Extraordinary expenses</b>	<b>4,067</b>	<b>4,042</b>	<b>99.39%</b>
<b>D.</b>	<b>Extraordinary profit/(loss) (X.-XI.)</b>	<b>121,619</b>	<b>224,152</b>	<b>184.31%</b>
<b>E.</b>	<b>Profit before taxation (+-C.+D)</b>	<b>-7,509,073</b>	<b>-2,783,015</b>	<b>37.06%</b>
<b>XII.</b>	<b>Taxation</b>	<b>0</b>	<b>0</b>	<b>-</b>
<b>F.</b>	<b>Profit after taxation (+-E.-XII)</b>	<b>-7,509,073</b>	<b>-2,783,015</b>	<b>37.06%</b>
22.	Profit reserve used for dividends or profit sharing	0	0	-
23.	Dividends and profit share paid (approved)	0	0	-
<b>G.</b>	<b>Net profit/(loss) (+-F+22.-23.)</b>	<b>-7,509,073</b>	<b>-2,783,015</b>	<b>37.06%</b>

## Revenues

- Carrier operations

- In 2002, scheduled passenger carrier revenues remained on the base level, reaching altogether HUF 80.6 billion, taking into account beyond own operation revenues generated on code-share flights operated with partner airlines, as well.

There were contradictory processes influencing the generation of net revenues compared to the base period. Increase of the number of passengers had HUF 1 billion and price increase and change in the tariff composition had HUF 1,4 billion positive effect but all these were consumed by the decrease of the foreign exchange rate.

The significant drop in the number of business passengers caused a decrease in the revenue of passenger services: while the number of passengers flying economy class shows a 4% increase, the drop in the volume of people using higher level services is 15%. The rate of business passengers decreased from 9% to 7.6%.

The average revenue dropped from the base year's HUF 34,300 to HUF 33,000 what is also reflected by the change of specific yields (yield = revenue/revenue passengers kilometre) used in international practice. Compared to the values of 2001, the gross yield in HUF decreased by 3%, while the same in USD increased by 10% to USD 0.094 in 2002.

In 2002, out of its scheduled passenger services, Malév realised a total of HUF 4.3 billion revenue through seat rental and code-share services, which falls short of the year-earlier value by 16%. The drastic 66% fallback of revenues coming from the Zurich destination caused by the bankruptcy of Swissair played a significant role in the decrease. The code-share operation with CSA of the flights to Prague still works but in another (free share) construction and this influences only the revenues. During the base year Malév concluded new seat rental contracts with Aeroflot and LOT (from the time of the introduction of the winter schedule this contract was modified to be a free sale code-share contract) for the Moscow and Warsaw destinations). Also a new contract was concluded with Swiss replacing the liquidated Swissair. The number of code-share flights between Budapest and Paris increased and, since the summer schedule in 2002, the code-share operation has been expanded with a business class. At the same time, the contracts regarding the Sofia (Balkan) and Riga (Air Baltic) flights were terminated.

There was no significant shift in the structure of passengers and revenues. Nearly two-thirds of the passengers carried and the revenues generated continued to come from Western European markets, while Eastern European destinations accounted for about 17%.

- Revenues on charter services

The number of charter flights rose by 37% compared to the base year. Revenues fell 2% short of the base year's value resulting in a total of HUF 5.9 billion.

Domestic charter chains carrying Hungarian tourists to the Mediterranean region continue to be the most significant ones. The operation of Boeing—767 aircraft keeps to

an ever-greater extent shifting towards scheduled destinations, nevertheless, in 2002 there were more opportunities to launch long haul charter flights.

Compared to the base year, the number of these flights is 42% higher, what results a revenue increase of 24%. Revenue of other narrow-bodied charter services was HUF 4,948 million that falls 6% short of the plan. This is caused by the shift of aircraft types towards wide-bodied aircraft.

Revenue provided by the Boeing—767 charter services is HUF 962 million, which is 53% less than the value of the base year. The dropout of the Japan charter caused the shortfall of the revenue of the aircraft type.

Total revenue of the services exceeded the plan by 7% accompanied by a 6% increase in the number of flights. Revenues decreased by 2% in comparison with the base year. In 2002 the profit of charter services was HUF 507 million, which, compared to the base, is a 17% improvement, compared to the plan, however, the shortfall is 23%.

- Revenue of cargo services

The effect of the events in September 2001 continued to be experienced in the cargo market, which, falling 9% short of the base year, achieved HUF 3.7 billion in year 2002. In 2002, an approximately 20-40% rate of price drop, varying market by market, and the fallback of the demand for cargo charters characterised the industry. The forming of Malév's route network and the fleet's cargo capacity also negatively influenced the cargo services. Malév's cargo strategy focused on profit-maximisation, so, despite the limits mentioned above in relation to revenue increasing, the margins of cargo services could considerably be increased by terminating the loss-making charter flights from 1 January 2002, saving other costs and increasing mail revenues. This way, the profit increased by some 21% in comparison with the base period.

- Non-core business

- Revenue of ground handling

The role of ground handling is dual in Malév's operation, as, beside the service of own aircraft, it increases Malév's revenues by serving other aircraft.

Revenues can be rated in three major groups: service of foreign aircraft and their passengers, operation of passengers-lounges and catering for the passengers of foreign airlines' flights. In 2002 revenues originating from all these services amounted to HUF 3.5 billion and fell significantly, 31% short of the base. This can mainly be explained by the 19% fallback in the number of flights served. However, revenues were also influenced by the terrorist acts on 11 September 2001 (drop in the traffic, airlines going bankrupt) and the termination of the contract concluded with one of the most important partners, Air France.

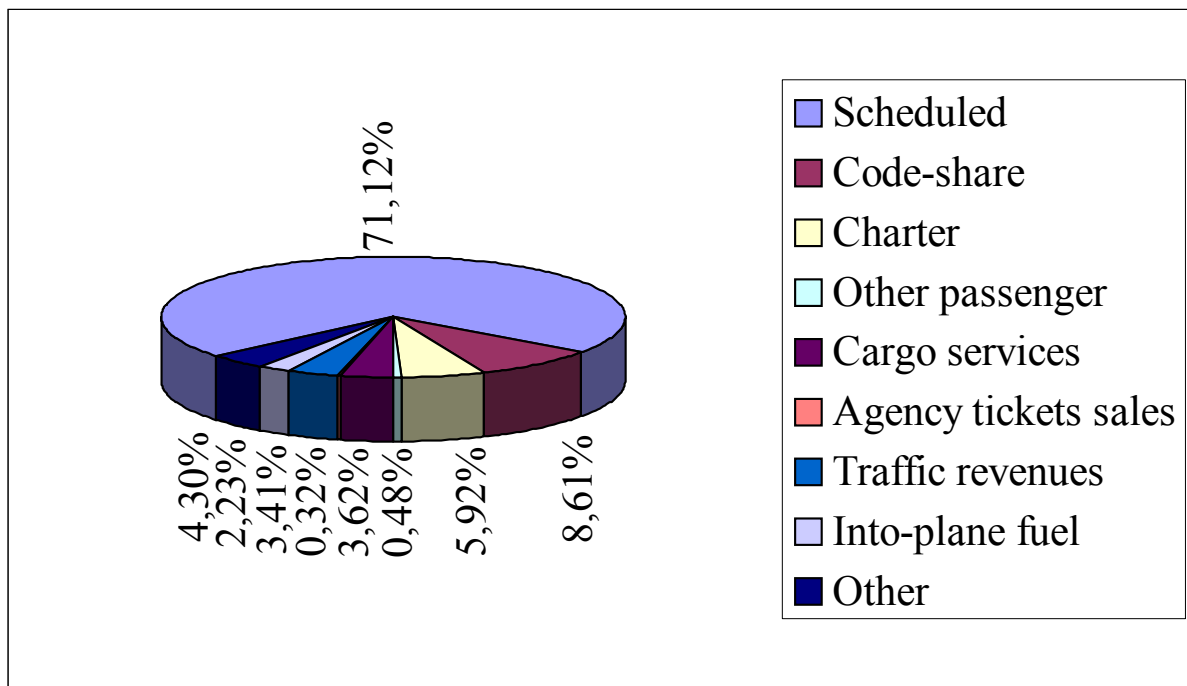


- Revenue of into-plane fuel sales

During the period under review, the average fuel price was 87%, the quantity sold 89% and the exchange rate of the USD 90% of the base year. As a consequence of the cumulative effect of all these, in 2002 the price revenue of Malév's into-plane fuel sales amounted to HUF 2,3 billion being 29% less than in year 2001.

At the same time, in the course of the year the most significant consumer of Malév purchased fuel in excess of plans, we succeeded in concluding contracts with several airlines operating new scheduled flights (Moldavian Airlines, a Carpatair, Travel Service) and a number of airlines operating charter chains and, furthermore, in the period under review we also received more occasional orders than planned. So in 2002 Malév's market share at Ferihegy improved by 10% and continues to be the market leader.

**Breakdown of revenues (%)**



## Costs

In 2002, **fuel** prices kept steadily decreasing. At annual level, the rate of fallback of the price of Ferihegy kerosene used by Malév for own purposes was nearly 13% in comparison with the base. As a result of kerosene prices drifting in a favourable direction, Malév's savings originating from price-changes amounted to nearly HUF 2 billion. The change in exchange rates decreased costs with a further amount of HUF 1,5 billion. In the year under review, Malév-operated aircraft drew 169 thousand tons of fuel being 94% of the consumption in the base period and resulting in HUF 0.9 billion savings. As a consequence of all these, fuel costs decreased by 27% compared to the base period and amounted to HUF 11.5 billion in 2002.

Up to the end of April 2002, Malév had its fleet fully **maintained** and **repaired** by ACE Kft. Commencing from 1 May 2002, traffic maintenance and aircraft-service activities were taken over by Malév. This means that the Company performs the aforesaid activities through setting up its own organisation and costs of the activity appear shared amongst the various costs incurred Malév.

In 2002, the repair-maintenance cost of the aircraft, without any value-adding renovation, was HUF 6.1 billion. This sum includes a fee of HUF 2.6 billion for the maintenance-repair of the aircraft and an amount of HUF 131 million covering the cost of repair abroad, these amounts being less than in the base period. The maintenance cost reserve of the aircraft was also below the base value by 13%, most of all due to the termination of the lease contract of the Boeing—767-300 aircraft grounded in the period under review.

Due to the change in fleet composition, the **lease charge** paid after the aircraft decreased by HUF 2.4 billion in the year under review as compared to the previous year. A decrease resulted from the cessation of the lease charge of the Boeing—767-300 grounded and the favourable movement of the exchange rate generated substantial savings in costs.

The **purchase price of goods sold** is primarily based upon the fuel cost of sales. The amount of the base period included about HUF 850 million incurred due to the sale of aircraft-related expendable supplies to ACE Kft.

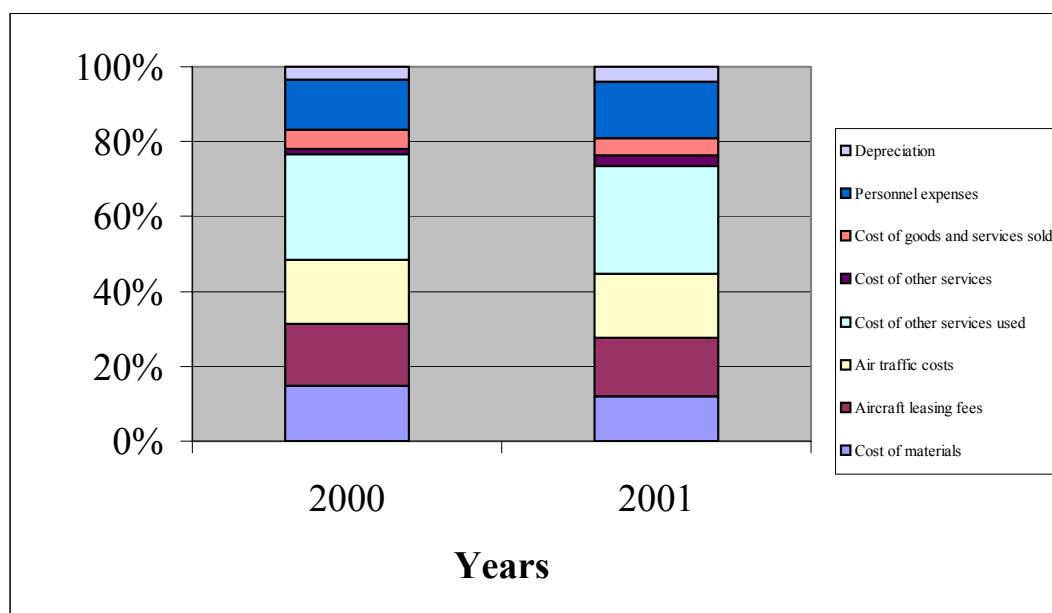
As a result of wage bargains, the extent of the rise was 4.6% in 2002 but it was not accompanied by any payroll increase as its effect was compensated by headcount streamlining. At the same time, the fact that certain aircraft-related technical activities and experts performing them were taken back from ACE Kft. by Malév implied the increase of **wage costs**.

In 2002, the amount of **handling fees** was HUF 6,917 million, i.e. 11% less than in the base year, as, under agreements concluded with service providers, Malév managed to achieve rate cuts at several destinations and the number of flights performed with Boeing—767 aircraft was also lower. Malév continues to make efforts to replace the former agreements with contracts concluded with cheaper service providers ensuring better quality.

**Landing fees** are officially fixed prices. Therefore, Malév can not influence this cost item. In comparison with 2001, this cost decreased by 3% and reaches HUF 5,099 million. The main reason for the decrease compared to the base is the considerable strengthening of HUF. This was balanced by the elimination from 1 January 2002 of the 10% discount provided to large consumers, which still existed in the base year.

Malév has no control over the **route charges** as they are regulated by the competent authorities and IATA. These costs show a 5% decrease in comparison with the base year, as the number of long haul flight was lower and HUF also strengthened, while from 1 April 2002 the Eurocontrol price increase became effective, on the contrary.

### Breakdown of costs (%)



**17. OWNERSHIP STRUCTURE**

No.	Description	31 December 2001		31 December 2002	
		Registered capital (thousand HUF)	Stake (%)	Registered capital (thousand HUF)	Stake (%)
1	ÁPV Rt.	11,449,437	97.9228	11,449,437	97.9228
2	Other companies	59,330	0.5074	59,330	0.5074
	<i>Municipalities:</i>				
3	- Balatonlelle	68,447	0.5854	68,447	0.5854
4	- Budapest, 5 <sup>th</sup> district	27,330	0.2338	27,330	0.2338
5	- Budapest 18 <sup>th</sup> district	37,939	0.3245	37,939	0.3245
	<i>Other:</i>				
6	Unions	530	0.0045	585	0.0050
7	Individuals	49,295	0.4216	48,490	0.4147
8	Non-treasury stock	-	-	750	0.0064
9	Treasury stock	-	-	-	-
10	<b>Total (1+.....+9)</b>	<b>11,692,308</b>	<b>100.0000</b>	<b>11.692.308</b>	<b>100,0000</b>

## 18. CASH FLOW

Cash-flow statement:

Description	2001 change thousand HUF	2002 change thousand HUF
<b>I. Cash flow from ordinary activities</b>	<b>-6,990,282</b>	<b>-5,585,979</b>
1. Profit before taxation	-7,509,073	-2,783,015
2. Depreciation posted	3,900,193	4,214,639
3. Amortisation and reverse posting	539,144	1,799,260
4. Difference between provisions made and used	463,510	-309,011
5. Profit/(loss) on the sale of fixed assets	-5,552,158	-811,608
6. Change in accounts payable	-1,479,222	1,952,036
7. Change in other short-term liabilities	-1,017,096	-2,895,486
8. Change in accruals and deferred income	3,253,960	-3,917,331
9. Change in accounts receivable	2,367,888	-541,794
10. Change in current assets (excl. accounts receivable and cash)	-1,367,480	-1,835,232
11. Change in prepayments and accrued income	-633,684	-432,104
12. Tax paid (on profits)	-70,252	-596
13. Dividend and profit share paid		
14. Correction of amortisation posted for cash	113,988	
15. Correction of dividend received		-25,737
<b>II. Cash flow from investment activities</b>	<b>1,180,552</b>	<b>-13,114,204</b>
15. Purchase of fixed assets	-6,732,111	-14,985,470
16. Sale of fixed assets	7,174,320	1,801,620
17. Dividend received	738,343	69,646
<b>III. Cash flow from financial transactions</b>	<b>10,619,101</b>	<b>12,759,173</b>
18. Proceeds from the issue of stock and capital raising	9,200,000	
19. Proceeds from the issue of bonds and other debt securities		
20. Credit draw-down and loans taken out	11,931,331	30,910,225
21. Cancellation, termination and withdrawal of long-term loans and deposits	230,000	543,010
22. Cash assets received		
23. Retirement of stock, capital reduction		
24. Repayment of bonds and other debt securities		
25. Repayment of credit and loans	-10,045,116	-18,618,166
26. Long-term loans and bank deposits	-773,010	
27. Cash assets disposed		
28. Change in liabilities to founders and other LT liabilities	75,896	-75,896
<b>IV. Increase/(decrease) in cash ( I. II. III.)</b>	<b>4,809,371</b>	<b>-5,941,010</b>

## 19. INVESTMENTS

### Subsidiaries and affiliated undertakings

No.	DESCRIPTION	Equity thousand HUF	Reg. capital thousand HUF	Profit reserve thousand HUF	Last net profit thousand HUF	Malév stake at par value thousand HUF	Malév stake at book value thousand HUF	Compa ny stake %
Subsidiaries								
1	MALCO LLC 1209 Orange Str. Wilmington, Delaware 19801. USA	3,663,808	3,652,320	1,412,881	-1,401,393	3,652,320	3,652,320	100%
2	Aeroplex of Central Europe (ACE) Kft. 1185 Bp. Ferihegyi Repülőtér 1.	388,331	462,000	525,472	-807,598	462,000	761,964	100%
3	Malév Air Tours (MAT) Kft. 1051 Bp., Október 6 utca 19.	110,110	62,888	5,667	16,443	62,888	88,000	100%
4	Pannon Air Cargo Nemzetközi Szállítmányozó és Vámügynök Kft. 1185 Bp., Ferihegyi repülőtér 1.	67,112	5,000	55,231	0	5,000	5,000	100%
5	Galileo Hungary Kft. 1137 Bp., Pozsonyi út 10.	157,372	3,000	65,740	88,632	3,000	3,000	100%
6	Air Budapest Club Kft. 1185 Bp., Nagybecskerek utca 30.	13,000	3,000	10,000	0	3,000	3,000	100%
7	Malév Utasszolgálati Kft. 1051 Bp., Roosevelti tér 2.	7,368	3,000	4,368	0	3,000	3,000	100%
8	Malév Express Kft. 11185 Bp., Nagybecskerek utca 30.	5,244	3,000	-58,286	2,244	3,000	3,000	100%
	<b>TOTAL (1+...+8)</b>	<b>4,412,345</b>	<b>4,194,208</b>	<b>2,021,073</b>	<b>-2,101,672</b>	<b>4,194,208</b>	<b>4,519,284</b>	

## Other associated undertakings

Description	Registered stake		Malév stake		Malév stake
	EUR '000	HUF '000	at par value	at book value	
			HUF '000	HUF '000	%
<b>Lufthansa Technik Budapest Kft. (LHTB)</b> 1185 Budapest, Ferihegyi repülőtér	5,000	1,271,100	190,660	190,660	15.0%
<b>Hungaroring Sport Rt.</b> 2146 Mogyoród, Pf. 10		1,286,000	40,700	8,140	3.2%
<b>EX – SELL Oktatási és Kutatást Segítő Közhasznú Társaság</b>  1054 Budapest, Alkotmány u. 9-11.		5,800	100	100	1.7%
<b>Total:</b>	<b>5,000</b>	<b>2,562,900</b>	<b>231,460</b>	<b>198,900</b>	