



CONTENTS

STATEMENT BY THE CHAIRMAN	2
THE BOARD OF DIRECTORS	5
THE SUPERVISORY BOARD	6
TOURISM IN HUNGARY, IN CZECH REPUBLIC AND IN SLOVAKIA	7
FIGURES AND RATIOS IN HOTEL BUSINESS – 2005	10
REPORT OF THE BOARD OF DIRECTORS	14
INTRODUCTION	14
CHANGES IN THE DANUBIUS GROUP	14
BALANCE SHEET	15
STATEMENT OF INCOME	16
RECONSTRUCTION WORKS, RENEWALS	18
SHAREHOLDERS' STRUCTURE	20
TRADING ON THE BUDAPEST STOCK EXCHANGE	21
REPORT OF THE SUPERVISORY BOARD	22
AUDITOR'S REPORT	24
CONSOLIDATED BALANCE SHEET	25
CONSOLIDATED STATEMENT OF INCOME	26
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY	27
CONSOLIDATED STATEMENT OF CASH FLOWS	28
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	29
BUSINESS OVERVIEW 2006	58



STATEMENT BY THE CHAIRMAN

Dear Shareholders,

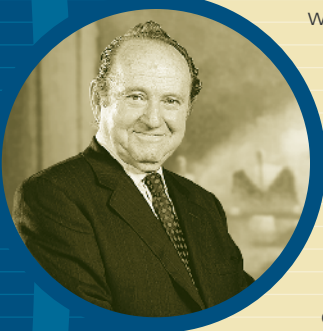
2005 saw a slow pick up of the tourism in the region, which, thankfully, was not disturbed by any unexpected events of terrorism or natural disaster. Danubius still had to face many challenges and difficulties, but nevertheless achieved a revenue of 42.8 billion Forint and an operating profit of 6.6 billion, which exceeded last years by 24%. So at operating level, the company made encouraging progress.

In mentioning some highlights of the year, the hotels in Budapest should come first. These, in spite of the huge competition experienced in recent years, took full advantage of the increased number of travellers using low cost airlines and our Budapest hotels increased their market share of foreign guest nights. They achieved an exceptionally high average occupancy and still managed to increase average rates. In the future we will focus on continuing to realise higher average rates, not by significantly increasing our prices, but by changing our circle of guests. By modifying our marketing priorities, we expect a change in the mix of our guests so as to increase the number of guests with more spending power and preferring quality services.

Much attention was paid to reconstruction works in 2005 too. We have concentrated on projects enabling the improvement of standards and the increase of quality. The reconstruction of Hotel Astoria, for example, will soon be completed as a result of which this special historical building, located in the heart of Budapest, will be entirely renewed. There are also plans for several other significant projects. In the Hungarian spa hotels, mainly health spa departments and rooms were refurbished during 2005, so as to meet the increased competition from the new spa and wellness hotels built in recent years. It is encouraging to report that 2005 saw a revival of interest in our countryside spa hotels. Our task now is to increase revenues by raising average rates.

The Marienbad hotels also performed very well. They managed to compensate the loss of domestic turnover with more guests from new markets and Germany and this favourably affected both average rates and revenues. This trend continues to be the number one goal of our reconstruction programme including a further increase in the quality of the hotels and the development of health spa and swimming pool facilities.

Work has started on the reconstruction of the Thermia Palace in Piestany and after completion we will be able to offer a truly luxurious health spa hotel. The figures of the Piestany hotels were better in 2005, both in terms of occupancy and average rates, but cost pressures meant that operating profit remained unchanged. We believe our sub-





STATEMENT BY THE CHAIRMAN

stantial investments to improve quality and facilities will enable us to attract new guests and improve performance, similar to past experience in the Czech Republic.

Whilst operating profit in the Romanian hotels did not go up in 2005, interest in the Sovata resort is increasing and average rates were more favourable. With the likely entry of Romania into the EU, long-term prospects for Sovata remain encouraging.

An important development in 2005 was the purchase of 25% share in the company owning the Danubius Hotel Regents Park. The remaining 75% is owned by CP Holdings Ltd and Danubius is contracted to provide various management support services. The number of UK guests visiting Hungary is growing by the year and Danubius Hotel Regents Park will increase awareness of the Danubius brand both in this important feeder market and more generally given the level of international tourism and business in London. As in the past, we are continuing to look for the right opportunities to extend the international reach of the Danubius brand.

The 2005 results reflect an entire year's performance of the Gundel restaurant and winery purchased in 2004. Co-operation with the hotels of Danubius is increasing with a view to maximising mutual benefits.

The changes of the Forint against the Euro modify the operating profit of the group significantly every year. In 2005 the Forint weakened against the Euro; consequently when revaluing our loans we had to record a significant – unrealised – exchange rate loss, the result of which was that profit after tax was only 56% of last year's. All this had an even greater relative impact on our profits, because due to the strengthening of the Forint one year ago we reported exchange rate gains in 2004.

Looking at this unfavourable situation and bearing in mind the long-term goals of the group, the Annual General Meeting decided not to pay dividend out of the 2005 profit. It is our belief that it is a sensible decision also from shareholder's view to reinvest earnings for the future development of the Danubius Group.

Danubius still has great scope for development in the future. The recent successful privatisation of Budapest Airport to British Airports Authority is an example that there is great belief in the potential of Budapest for tourism and as a regional hub. However, we must also remain wary of international factors such as energy prices and the poor economies of several European countries, which will have an adverse effect on our business.

Danubius has a unique position in the health spa industry in Europe and many wonderful historic properties of real character. Our task now and in the coming years is to capitalise on these strengths and, in so doing, to produce a better return for all shareholders.



STATEMENT BY THE CHAIRMAN

Finally, it has to be mentioned that an important change took place in 2006: Mr Sándor Betegh who has shown loyalty and commitment to Danubius over a career of 30 years with the company retired as CEO on 1 March. Dr Imre Deák, his deputy for many years, has taken over and will provide important continuity for the company. In today's highly challenging world, Danubius must work harder than ever to control costs and to be more creative on the market, in order to remain one step ahead of the competition. To achieve this, the company elaborated a new strategy the details of which are shown in the business overview for 2006. The management and staff have committed themselves to improve quality and performance, and in doing so, hopefully they can continue to rely on your support as shareholders.

A handwritten signature in black ink, appearing to read 'Bernard Schreier'.

Sir Bernard Schreier,
Chairman of the Board



THE BOARD OF DIRECTORS



Sir Bernard Schreier

Chairman of the Board;
Chairman and Chief Executive Officer of
CP Holdings Limited and subsidiaries, and Investor Holding Rt.;
Vice President of Bank Leumi Plc.



Iris Gibbor

Director of CP Holdings Ltd.



John Smith

Joint Managing Director of CP Holdings
Ltd. and subsidiaries



Robert Levy

Joint Managing Director of CP Holdings
Ltd. and subsidiaries



Sándor Betegh

Chief Executive Officer of
Danubius from 1990 till 2006



Dr. Imre Deák

Senior Vice President of Danubius
from 1990,
Chief Executive Officer from 2006



János Tóbiás

Vice President, Finance of
Danubius as of 1991



Ing. Lev Novobilsky

General Manager of
Léčebné Lázně a.s.



József László

District Manager of Scandinavian Airlines
for Hungary for 35 years; currently guest
lecturer at Budapest Business School



Dr. István Fluck

General Vice President of FEM,
Director and Chief Physician of
Budapest Spa Rt.



THE SUPERVISORY BOARD



Tibor Antalpéter

Chairman of the Supervisory Board
from 18 October 2002
Ambassador of the Republic of Hungary
to London from 1990 to 1995



Dr. Gábor Boér

Deputy Chief Executive Officer of
Investor Holding Rt. since 1990,
Chief Executive Officer of
Interag Holding Rt. since 1997



Mrs. Erzsébet Surányi

Worked in the Ministry of Finance
from 1967 to 2000; currently Senior Counsellor
in Administration and Tax Advisor



Dr. András Gálszécsy

Retired minister



TOURISM

IN HUNGARY, IN CZECH REPUBLIC AND IN SLOVAKIA

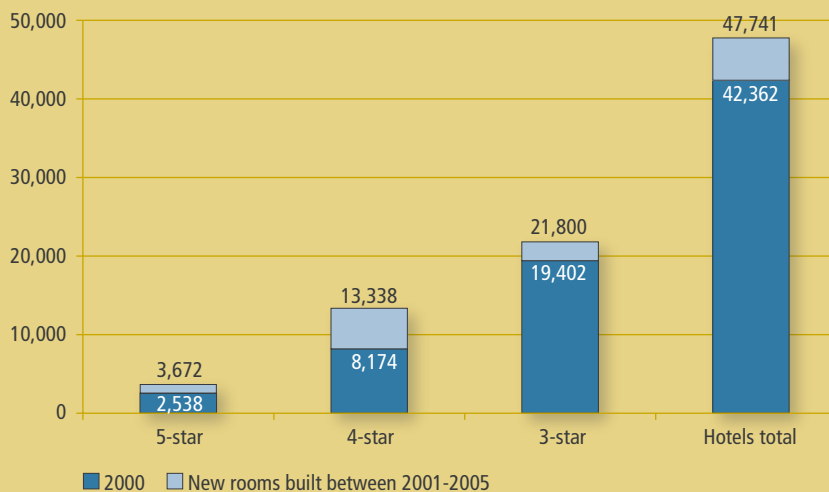
2005

experienced a continued upswing of the tourism **worldwide**. Following the dynamic expansion in 2004, the number of international tourist arrivals (+5.5%) went up registering the most arrivals ever. Turnover increased in all continents, however, the performance of Europe and especially Central–Eastern Europe has not reached the average. The majority of the 4% pick up in the region was registered in leisure tourism principally owing to the expansion of low cost airlines. Experience shows that negative elements (e.g. natural disasters and terrorism) had only regional impact without any global effect. Forecast for the year 2006 shows that growing energy prices, the connected depreciation, terrorism and worries caused by the bird flue will continue to determine development. This is expected to approach the level prognosticated for the long term, which is 4-5% worldwide but increase is likely to be a lower 3% in Europe.

According to **Hungarian** statistical data, hotels performed better compared to the entire accommodation sector. This also reflects the fact – also show by hotel figures – that demand is shifting towards quality accommodation. The main trends have not changed as opposed to 2004: the volume of demands and gross revenues of the sector went up alongside further increase of offers.

Hotel room capacities are growing from year to year, in the last five years they went up by 12.7%. Substantial increase was experienced in the four and five-star categories and in the recent years on the market of spa and wellness hotels as well (20% more hotels are operating in these two categories together than a year ago).

Increase of the number of hotel rooms in the period 2001-2005

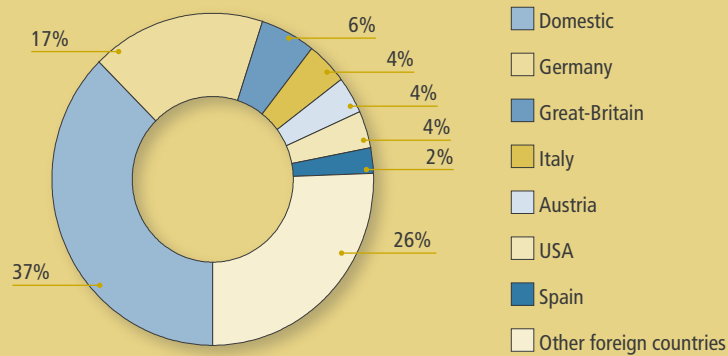




TOURISM

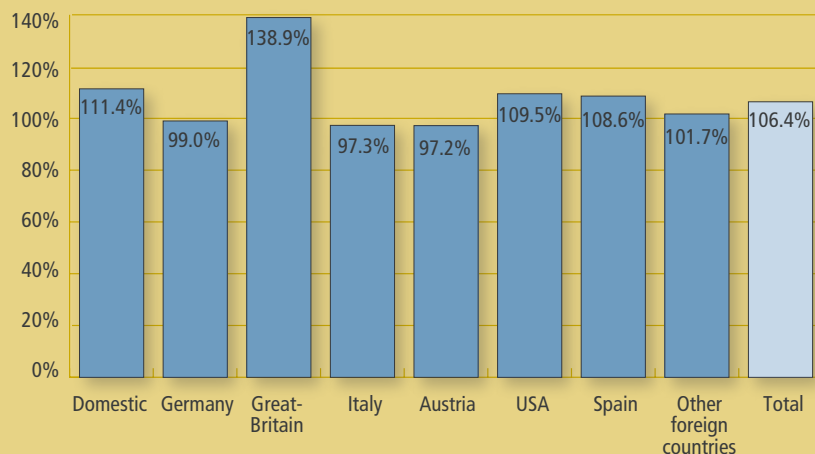
The number of hotel guests went up by 8.6% but owing to a further shortening of the length of stay the increase of guest nights was less (6.4%). The number of domestic guests increased to a greater extent (+11.5% guest nights) while the foreign clientele expanded by merely 3.5%. The number of guests arriving from the German language area remains to be the highest, however, their number went down by approx. 2% in 2005, while the circle of British (+39%), Irish and Spanish guests expanded significantly. This, on the one hand, is caused by the weakening of the German economy, on the other hand by the change of travelling habits: the formerly popular bus tours were overshadowed by low cost airlines gaining ground.

Distribution of guestnights in hotels in 2005



8

Change of guestnights in hotels (2005/2004)



Hotel room occupancy in 2005 was 48.2%, 1.8% higher than a year ago, the highest in the past five years. Occupancy reached its peak in the four- and five star hotels but in the

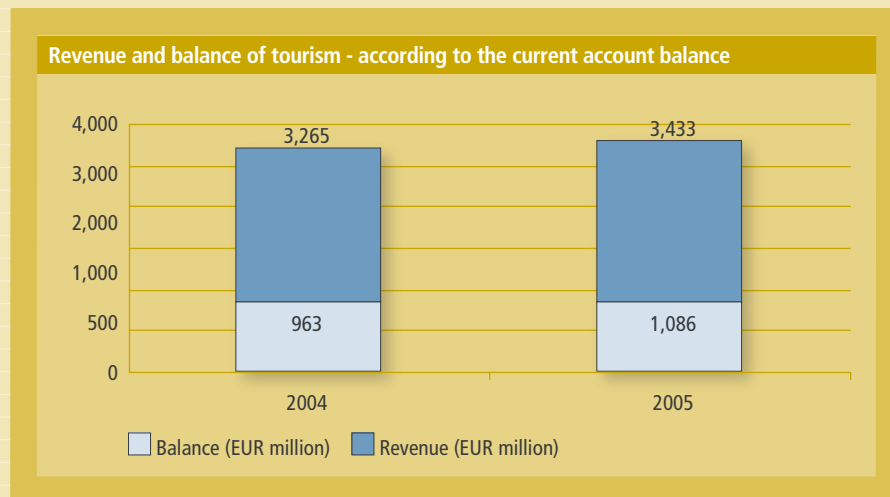


TOURISM

four star hotels, considering the past five year period, 2005 was not the best year, which is explained by the fact that capacity increased in this category the most (+63%).

The 15% growth of gross room revenues is arising partly from the 6.4% increase of the number of guest nights, partly from the increase of average rates. Gross average rates went up by 11.7% and room rates increased in the spa hotels to the same extent.

The tourism industry closed 2005 with a balance of EUR 1 billion with a revenue of EUR 3,433 million, 12.8% up compared to 2004.



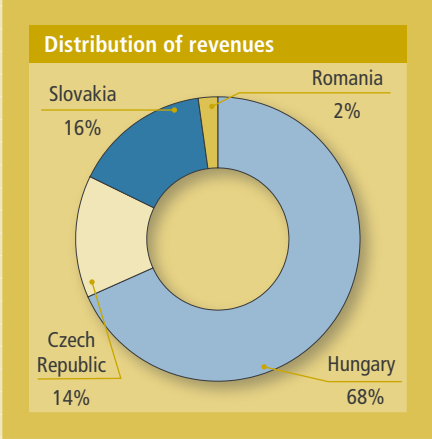
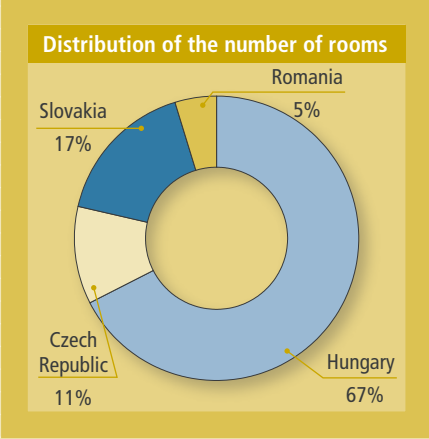
The trend experienced one year ago in the **Czech Republic** continued in 2005. The airline turnover developed further, which is confirmed by the fact that the number of airline guests increased significantly (by 13%). Demand for the hotel rooms went up (+1.1% guest nights): the fall in domestic guest number (-5%) was compensated by the growing number of foreign guest nights (+4.6%). The number of German and British guests representing the major share of guests remained at 2004 level, still the number of guests went up from Hungary, the Netherlands, Russia and major overseas markets.

The performance of tourism improved substantially at national level in **Slovakia**, since alongside approx. 30% growth of revenues the balance of tourism more than doubled. The statistics show that 11.3% more foreign tourists crossed the border than a year ago but unfortunately this brought only moderate growth (4.2%) for accommodation providers. Czech guests spent 28% of foreign guest nights, however, their number went down by 4% in 2005. But then the number of German, Polish and Hungarian guest nights, also representing a high ratio, went up. Due to a 3.5% shortfall of domestic guest nights, however, total demand did not increase. In addition, the supply side also improved; the number of hotel rooms went up.

Source: Hungarian, Czech and Slovakian Statistical Office, National Bank, Magyar Turizmus Zrt.



FIGURES AND RATIOS IN HOTEL BUSINESS – 2005



	Hungarian hotels	Czech hotels	Slovakian hotels	Romanian hotels
Number of rooms	5,610	911	1,431	400
Occupancy	69.1%	80.8%	72.7%	48.8%
Average rate (HUF)	11,309	14,565	6,040	5,509
Number of staff	2,913	680	1,407	233
Average number of staff/rooms	0.52	0.75	0.98	0.58
Profit of rooms department (HUF million)	11,556	2,798	1,656	338
Profit of F&B (HUF million)	2,595	243	421	146
Profit of spa department (HUF million)	1,026	698	1,196	68
Profit of other minor departmental (HUF million)	-28	115	-586	48
Departmental profit (HUF million)	15,149	3,854	2,687	600
Profit margin	54.6%	68.2%	42.7%	65.2%

Hungarian hotels achieved 69.1% occupancy in 2005, 3.3% higher than one year earlier. Average rates were HUF 11 309, surpassing that of 2004 by 4.9% and calculating in Euro it shows an even higher increase of 6.4%. We managed to fulfil the volume and average rate growth targeted in the business policy for 2005.

The improvement of the performance of the hotels continued in Q4, especially in terms of average rates. Owing to the seasonal characteristic of hotels, both occupancy and average rates are usually lower in Q4 than in Q3 but this year the increase in average rates started in Q3 continued till the end of the year. This way we achieved in the last three months of the year 0.6% higher average rates than in the July-September period as opposed to the even 10% decrease experienced in earlier years.

The revenues of all departments went up, room and spa sales were remarkable. Hungarian hotels achieved a total revenue of HUF 27.4 billion, surpassing last year's by 6.6%. General costs went up to a smaller extent by 4.8% and almost 70% of the HUF 345 million surplus was due to the increase of the sum spent on energy. Besides those



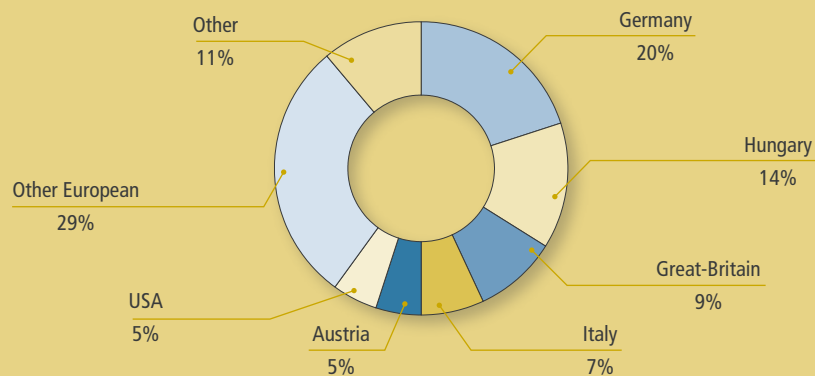
FIGURES AND RATIOS IN HOTEL BUSINESS – 2005

mentioned above, departmental profitability also went up and we achieved HUF 7.59 billion profit at gross operating level in 2005, 11.3% more than last year.

The Budapest hotels produced an outstanding performance in 2005. They recorded 73.1% occupancy, 4.3% higher compared to the previous year, owing principally to the widening guest circle of the low cost airlines. This is reflected by the fact that British guest nights in our Budapest hotels went up by 41%, in certain hotels by more than 50% and the increasing number and share of Irish, Scandinavian and Spanish guests is also considerable. In line with our plans we managed to increase average rates (+6.1%), however, there are still reserves in this respect in the market.

2005 was a difficult year for our country spa hotels. The luring effect of the favourable air travel decreased the number of traditional bus tours at the same time the capacity surplus of the recent years caused very keen rate competition. The occupancy of the country spa hotels of Danubius was 73%, exceeding the previous period by 5.4%, which can be recorded as a positive result considering the great number of new market participants. Experience shows that the guests preferring traditional health services, having tried the newly opened hotels return to our ones. The market competition put a pressure primarily on prices: while our average rates went down by 11.5%, average spending fell back only by 5.5% in 2005 but in the last quarter of the year favourable changes unfolded on this market.

Distribution of guestnights in our Hungarian hotels



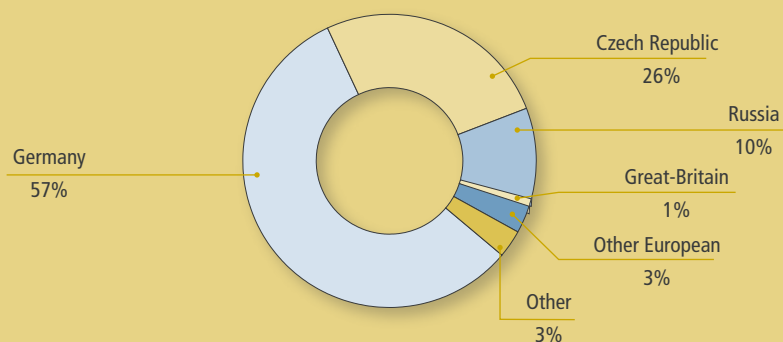
Occupancy in the **Czech hotels** was 80.8% in 2005, 5.5% higher than in the previous year. The number of guest nights spent by Russian and Israeli guests was up significantly and an increase was recorded from Germany too (+11%). The HUF weakened against the CZK, therefore the performance of the hotels shows a better picture when calculated into HUF. Average rates calculated in CZK went up by 2.6%, while average spending was down by 2.2% compared to the previous period. Out of the main departmental units only the revenues from room sales improved (by 8.6% calculated in CZK) while profits from F&B and spa were lagging behind compared to 2004. As to general costs, administrative costs and the sum spent on energy also increased (+10 and +25% re-



FIGURES AND RATIOS IN HOTEL BUSINESS – 2005

spectively). At gross operating profit level – calculated in local currency – the Marienbad hotels achieved 2% increase, contributing to the group level GOP by HUF 2.36 billion (HUF +200 million compared to the previous year).

Distribution of guestnights in our hotels in the Czech Republic



12

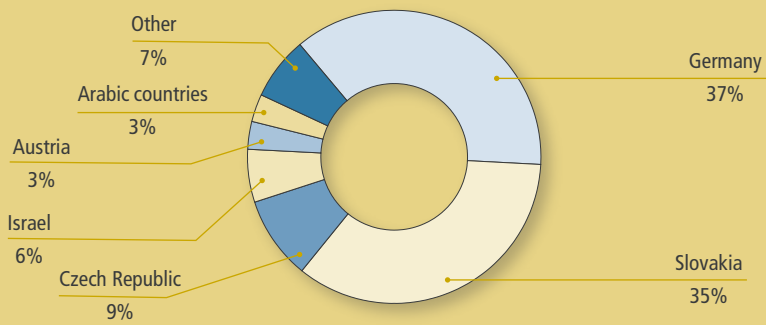
The **Slovakian hotels** achieved an occupancy of 72.7%, 0.4% higher than in the previous year. Average time spent in the Slovakian hotels is especially long, it exceeded 10 days even in 2005, however, in the last year it fell back considerably (–1.5 days). This is the reason why the guest nights went down by 2.7% while the number of guests was up by 10.5%. Owing to the strengthening of “full service hotel operations” the domestic and Czech guest circle narrowed down (–12.3% and –8.2%). Formerly the number of domestic guest nights was leading the list but in 2005 German guests spent more time in the Slovak hotels (their number stagnated compared to the previous year) and Israeli guest nights represent an increasingly greater share (6%).

The HUF weakened against the SKK too therefore the performance of the hotels shows a better picture in this case when calculated into HUF. Average rates calculated in SKK were up by 5.9% and average spending by 3.5%. Room and F&B sales recorded improving figures but spa results were lagging behind (alongside a fall in revenue and costs). Marketing expenditures grew the most in general costs and the energy cost was also significantly higher (+19%). All in all, the Slovakian subsidiary contributed to group results by HUF 954 million GOP.



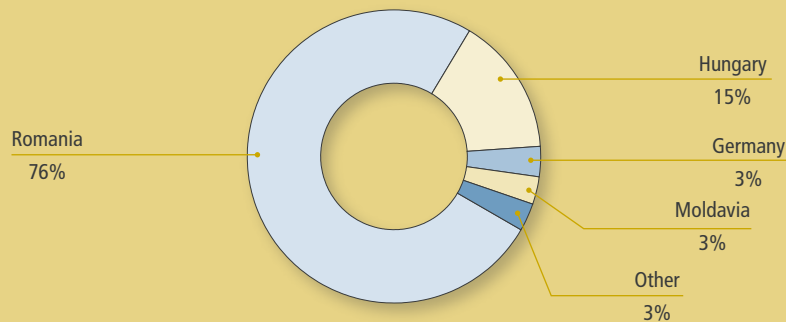
FIGURES AND RATIOS IN HOTEL BUSINESS – 2005

Distribution of guestnights in our hotels in Slovakia



The **Romanian hotels** recorded 48.8% occupancy and HUF 5 509 average rate in 2005. In addition to the approx. 20% (HUF 147 million) increase of revenues, departmental profits went up by about 30%. The majority of guests are Hungarians or domestic, representing 46% and 32% respectively in Hotel Sovata. The number of domestic guest nights was up by more than 20% in 2005, unfortunately Hungarian guest nights fell back by the same extent but the German ones increased significantly (by 81%).

Distribution of guestnights in our hotels in Romania





REPORT OF THE BOARD OF DIRECTORS

INTRODUCTION

According to international tourist statistics the growth continued in 2005 and the number of international tourist arrivals recorded a worldwide peak. This shows that various terrorist attacks and natural disasters during the year had no negative global effect. The rate growth reached the yearly level of 5.5% worldwide in 2005 and it was 4% in Central-Eastern-Europe. It is forecasted to reach a worldwide growth of 4-5% in 2006.

Demand has become lively in Hungary as well: the number of hotel guestnights increased by 6.4%, and there were 8.7% more guestnights registered at the spa hotels. At the same time, capacity has increased too, overall, there are 3.5% more room operating than a year earlier, and supply is of a wider scale especially in case of the spa hotels (+9.4%). Price increase commenced on the market, and thus, over the year-end, average hotel room rate exceeded that of the previous year by 11.3%.

The operating profit of the Danubius Group increased by 24.1%: the turnover of the Budapest hotels was remarkable while spa hotels faced market difficulties - both in Hungary and abroad -, still contributing to the improvement of group operating profits.

Profit before tax and minority interest was lagging behind the previous year's by 27.3% as the HUF weakened by 2.8% against the Euro in one year and we had to record a HUF 379 million non-realised exchange rate loss last year against the HUF 989 million non-realised exchange rate gain of 2004. This extent of difference (HUF 1.37 billion) could not be compensated even by the significant improvement of our business results.

14

CHANGES IN THE DANUBIUS GROUP

The number of affiliated companies increased in August 2005 with **CP Regents Park Two Limited** in which Danubius acquired 25% interest and concluded a cooperation package agreement with its major shareholder CP Holdings Ltd. concerning Danubius Hotel Regents Park, London. The Q3 and Q4 reports already show the related management support fee revenues and financial expenditures.

In October 2005 the merger of **Danubius Beta Hotels Kft. and Danubius Hotel Operation and Services Private Co. Ltd.** was registered. Beta was formerly a 100% owned subsidiary of Danubius Hotels Rt. It was responsible for the activities of smaller, mainly two and three-star hotels operating primarily on a franchise basis. Following the transformation, Danubius Hotel Operation and Services Private Co. Ltd. undertakes this activity as general successor.

In November 2005 the Danubius Group acquired 1.75% shares which Smrdaky Local Government held in **Slovenské Liečebné Kúpele Piestany a.s.**, and the total share of the group has increased to 89.96%. In December the Group increased its share in **Preventív-Security Zrt.**, the company responsible for the security of the Hungarian hotels from 32.75% to 78.60% so the firm is consolidated again.



REPORT OF THE BOARD OF DIRECTORS

The changes in 2004 had an impact on the evaluation of last year's performance: The performance of Gundel and Bagolyvár as well as the winery was first consolidated in the 2004 Q4 data, therefore when comparing the 2005 performance of the Group to the basic data this difference will have to be taken into consideration. The merger of the Hungarian subsidiaries in September 2004 had no effect on the group level profits, but the direct ownership and operation of the properties produced a decrease in the depreciation.

BALANCE SHEET (IFRS, CONSOLIDATED, AUDITED)

Assets HUF million	2004 31 December	2005 31 December	Index
Total current assets	6,761	6,814	100.8%
Total non-current assets	65,431	72,350	110.6%
Total assets	72,192	79,164	109.7%

Liabilities and Shareholders' Equity HUF million	2004 31 December	2005 31 December	Index
<i>Total current liabilities</i>	<i>10,167</i>	<i>9,300</i>	<i>91.5%</i>
<i>Total long-term liabilities</i>	<i>18,609</i>	<i>20,961</i>	<i>112.6%</i>
Total liabilities	28,776	30,261	105.2%
<i>Equity excluding minority interest</i>	<i>40,520</i>	<i>46,092</i>	<i>113.8%</i>
<i>Minority interest</i>	<i>2,896</i>	<i>2,811</i>	<i>97.1%</i>
Total shareholders' equity	43,416	48,903	112.6%
Total liabilities and shareholders' equity	72,192	79,164	109.7%

Consolidated asset value was HUF 79.16 billion on 31 December 2005, HUF 6.97 billion higher compared to the previous period. This growth is partly owing to the changes in the IFRS stipulations, as the negative goodwill has been reclassified to retained earnings (to the tune of HUF 3.7 billion). Owing to the acquisition of shares in the London hotel, asset value went up by HUF 1.8 billion and the involvement of Preventív-Security Zrt. into the consolidation also increased asset value by HUF 331 million.

Cash and cash equivalents went down by only HUF 33 million. This is partly due to the change in the loans. Cash and cash equivalents were however increased partly by the release of the collateral amount tied up on a separate account in connection with the investment obligation of the Slovakian company. This regrouping is responsible for a part of the decrease in other non-current assets.

The increase in accounts receivable (+194 million HUF) and advance payments from guests (+67 million HUF) are connected to the recovery of the turnover. The income tax receivables line indicates a decrease owing to the use of the advance tax surplus payment of the Hungarian company that was terminated by way of merger in 2004.

The net value of fixed assets went up by HUF 2.1 billion in line with the completed investments less accounted depreciation.



REPORT OF THE BOARD OF DIRECTORS

Pursuant to the new IFRS stipulations, investments in the associated companies are shown on a separate line. In the previous period this line showed the value of investment in Preventív-Security Zrt. This company is entirely consolidated at the end of 2005 due to the share purchase in December. The closing value of investments in associated companies in 2005 (HUF 1 763 million) is the value of the investment in CP Regents Park Two Ltd.

The value of provisions increased by HUF 131 million, which was created by the Hungarian and Slovakian companies.

The Group had Euro 79.9 million and GBP 5.1 million long-term loan on 31 December 2005. The former ROL loan was converted into Euro in July. Our GBP loan taken out from CP Holdings Ltd. was spent on the financing of the share purchase in London.

The entire loans increased by HUF 936 million compared to the previous year, due to the new GBP loan and the loans taken out for the Czech and Slovak reconstruction projects. The Hungarian mother company repaid a significant amount of loan (approx. EUR 9.3 million) in the past year. Both the long-term and short-term loans were affected by the changes in the rate of the Euro.

16

The value of own capital went up with a total of HUF 5.49 billion because of reclassifying the negative goodwill and putting the profit to retained earnings. The translation reserve increased by about HUF 1.1 billion due to the big exchange rate fluctuations.

STATEMENT OF INCOME (IFRS, CONSOLIDATED, AUDITED)

HUF million	2004	2005	Index
Total operational revenue	38,847	42,785	110.1%
Total operational costs and expenses	33,521	36,173	107.9%
Operational profit	5,326	6,612	124.1%
Depreciation	4,179	4,324	103.5%
Interest received and other financial revenues	256	57	22.3%
Interest paid and other financial expenditures	-838	-843	100.6%
Share of profit (loss) of associates		6	
Profit from ordinary activities before unrealised foreign currency gain (loss)	565	1,508	266.9%
Unrealised foreign currency gain (loss)	989	-379	
Profit from ordinary activities before income tax and minority interests	1,554	1,129	72.7%



REPORT OF THE BOARD OF DIRECTORS

HUF million	2004	2005	Index
Current tax expense	358	431	120.4%
Deferred tax benefit	-371	-183	
Net profit after tax	1,567	881	56.2%
Attributable to equity holders of the parent	1,590	817	51.4%
Attributable to minority interest	-23	64	
Net profit for the year	1,567	881	56.2%

The Group achieved at consolidated level HUF 42.79 billion operating revenue in 2005, 10.1% higher than in the previous year. Lángastronómia Kft. contributed to the profit of the group with its entire year of operation, while in 2004 it was consolidated only in the last quarter causing + HUF 1.48 billion difference in revenue. In addition to this the Hungarian hotels recorded surplus revenue of approx. HUF 1.54 billion and revenue of the foreign subsidiaries went up by HUF 919 million. So revenues in 2005 exceed that of the previous year by HUF 3.94 billion.

In terms of geographical segments the Hungarian company represents the greatest ratio in departmental revenues by 68.3% while 15.5% was produced by the Slovakian, 13.9% by the Czech, and 2.3% by the Romanian subsidiaries.

The operating costs went up by a total 7.9%, and also grew – calculated without Gundel – in the Hungarian, Czech and Slovakian subsidiaries by 3-4%. Efficiency improved in room and F&B sales but we experienced moderate fall back in the spa. General costs were up – with the exception of the Hungarian companies – exceeding the average cost increase. Other expenditures at consolidated level decreased by HUF 100 million, the majority of which was recorded in the Czech and Slovakian companies because of the decrease of the VAT that is to be accounted as expenditure compared to 2004.

The gross operating profit of the Group was HUF 6.61 billion in 2005, 24.1% higher, that is, HUF 1.29 billion higher than last year and is made up of the following items:

Improvement in the Hungarian companies (excluding Gundel)	+ 710 million HUF
Surplus of the contribution of Gundel	+ 192 million HUF
Improvement in the Czech companies	+ 413 million HUF
Set back in the Slovakian company	-6 million HUF
Set back in the Romanian company	-25 million HUF

Depreciation at consolidated level is 3.5% higher than last year. Significant investments were carried out in the Czech and Slovak subsidiaries in the past period, therefore 24% and 20% increases were recorded, but depreciation in the Hungarian companies was 7.7% lower owing to the change in the rates because of the direct management of the properties.

Interest costs did not change considerably, but the value of received interests decreased to its fifth, because owing to our loan repayment obligation we had less cash compared



REPORT OF THE BOARD OF DIRECTORS

to 2004 and interest rates were also lower. The share from profit of associated companies line is in connection with the CP Regents Park Two Limited.

Under the effect of all the above mentioned, the ordinary activities of the Group in 2005 – before minority interests – was HUF 1.51 billion, which is significantly higher than last year's HUF 565 million. Unfortunately, the profit after accounting exchange rate differences decreased to HUF 1.13 billion, by 27%. The reason for this is that the HUF weakened against the Euro, consequently we had to account HUF 379 million unrealised exchange rate loss on our loans, receivables and liabilities against the significant unrealised rate gain in 2004.

Net profit was HUF 881 million in 2005 as opposed to the HUF 1 567 million in 2004.

RECONSTRUCTION WORKS, RENEWALS

This year our attention continued to be focused on the technical improvement of our hotels as well as the increase of the quality of guest areas. Such works have been completed particularly in the spa hotels. We spent a total of HUF 2 224 million on reconstruction works **in our Hungarian hotels** in 2005.

At the beginning of the year the hotel lobby underwent major refurbishments in the **Hilton Budapest**. Alongside the renewal of the engineering background, the lobby bar was replaced and a brighter lounge area of more modern design was created with magnificent view over the Danube.

We continued the reconstruction of the historical wing of **Hotel Astoria** this year, too. In the spring we finished the complete refurbishment of the rooms and corridors on the upper three floors and several changes have been implemented with the aim of improving and increasing the comfort and services of the building. The reconstruction of the three lower guest floors was started in Q4, one guest floor was completed till the year-end and works are scheduled to be completed in 2006.

In order to enhance the efficiency of the patisserie production, a central patisserie has been arranged in the **Grand Hotel Hungária**, to provide the Budapest hotels with semi-finished products. The new confectionery workshop is furnished with modern machines and equipment.

In the kitchen on the restaurant level of **Hotel Stadion** the equipment for the new cooking island was installed and a new cooling chamber was also built in.

In **Hotel Helia** and **Hotel Flamenco** we have extended and reconstructed the swimming pool and sauna areas, which became necessary because of the increased guest turnover.

In addition to those listed, we have completed bathroom refurbishments, carpet changes, and elevator modernisations in several **Budapest hotels** (Astoria, Flamenco, Béke, Budapest, Stadion, Grand Hotel Hungária, Thermal Hotel Margitsziget).

In our **country hotels** the reconstruction of the health-spa areas continues to claim priority.

In the framework of this project we expanded the spa reception area in **Thermal Hotel Aqua** in Hévíz and through building an outside annex we have established four new treatment rooms adjacent to the mud packing room renewed last year and a further 30 guest rooms were refurbished. Continuing the spreading of the new Danubius beauty



REPORT OF THE BOARD OF DIRECTORS

brand, Emporium, first launched in the Lövér in Sopron, a new 300sqm beauty salon was arranged in **Thermal Hotel Hévíz**. In this same hotel we built a multifunction conference room complex of exclusive finish.

In **Sárvár** with the aim of cutting energy costs we replaced the city district heating service by building a boiler house. The swimming pool area has been re-arranged and it now boasts a new rest area, sauna and aroma chamber and a new exit was opened up to a brand new terrace.

In **Thermal Hotel Bük** we have executed the complete reconstruction of the entire 6th floor: reconstruction and refurbishing the rooms and bathrooms and renewing the corridors. Considering the former part reconstructions too, 60% of the rooms have been completed.

The garden surrounding **Hotel Lövér** in Sopron has a new landscape, a new garden pool, pétanque and children's play ground was arranged as well as new walk ways with flood lights.

The **Balaton hotels** have been successful in winning state subsidy with the help of which we have scoured the bottom of the lake at the beach areas. Before the beginning of the high season the room refurbishment of 59 rooms was completed in Hotel Helikon in Keszthely while in Hotel Annabella in Balatonfüred 66 bathrooms were successfully refurbished and a new conference room was added. In the Marina a new exit to the beach was established for disabled guests partly from application funds.

The first phase of the overall reconstruction of **Hotel Nádor** in Pécs came to an end. The facade was renewed and the structure of the building was strengthened and the modern underground parking area to park 65 cars was opened.

In **Marienbad** we continued the upgrading of hotel rooms and the widening of services. In Hotel Pacifik we refurbished a number of room units and we constructed a swimming pool together with a spa department. In Hotel Villa Butterfly a congress room and new hotel entrance were built and a new swimming pool and whirlpool were also developed. A new pipe for mineral water was established which makes it possible to offer new treatments in this hotel from 2006. External works (e.g. cleaning of the facade of Hotel Hvezda started) and renewing of certain sections of the heating system were carried out. The refurbishment of Centralni Lázně was launched in December, which includes 107 rooms, the restaurants, kitchen and balneo area. For the reconstruction and refurbishment works we spent a total of CZK 161 million (HUF 1.4 billion) in 2005.

We spent SKK 199 million (HUF 1.3 billion) on reconstructions and renewals in **Piestany and Smrdaky** in 2005. Following the completion of the reconstruction of Hotel Palace, the two most significant projects were the renewal of the outdoor and indoor pool area as well as the overall reconstruction of the kitchen in Hotel Balnea Esplanade. A new entrance hall was established in the II. spa block, some massage rooms were refurbished and we had the future design of the lobby and corridors planned. Plans for the reconstruction of Thermia Palace are completed and the tender procedures were started.

In **Sovata**, the bathing platform at Lake Medve and several health treatment rooms have been renewed and some works have been completed on the lake-beach at Lake Mogyorósi with the aim of increasing quality. Plans for a part of the works to be im-



REPORT OF THE BOARD OF DIRECTORS

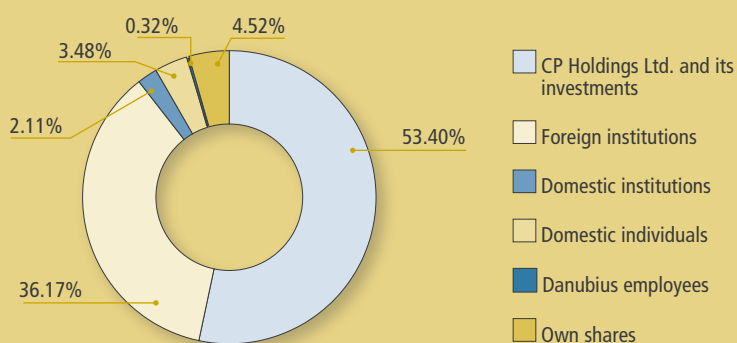
plemented in 2006 were completed: for the strengthening of the lake-beach at Lake Mogyorósi and the renewal of certain catering outlets on the beach at Lake Medve.

SHAREHOLDERS' STRUCTURE

According to 31st December 2005 data, 53.4% of the subscribed capital made up of 8,285,437 ordinary shares is owned by domestic and foreign investments of CP Holdings Ltd., of which shares over 5% are owned by Interag Rt. (29.38%), CP Holdings Ltd. (17.90%) and Israel Tractors (6.12%).

Foreign financial investors own a further 36.17% of the shares of which British Empire Securities and General Trust Plc. represents 6.29% of shareowners. The shares of the employees of the company represent 0.32%, and the company continues to own 4.52% own shares. Domestic private persons, institutions and pension funds own 5.59% of the equities.

Shareholders' structure on 31st December 2005



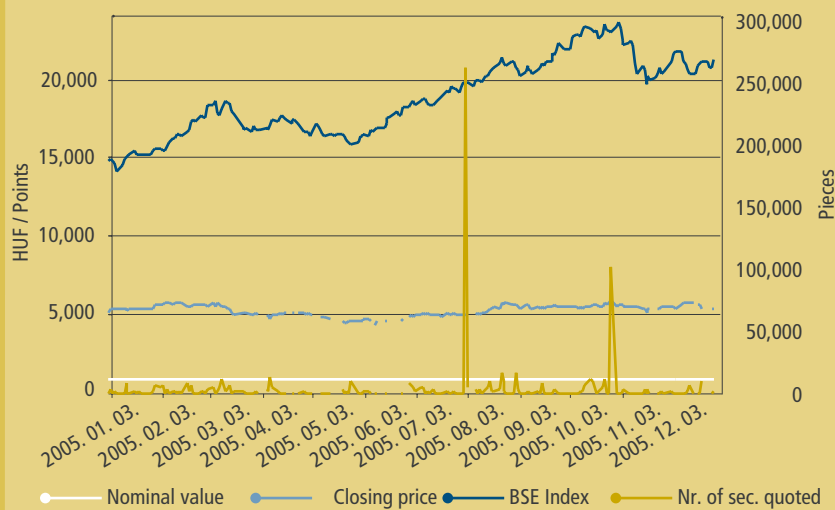


REPORT OF THE BOARD OF DIRECTORS

TRADING ON THE BUDAPEST STOCK EXCHANGE

	2004	2005
Number of trading days	252	252
Number of deals	3,448	2,582
Number of securities traded	1,042,541	909,710
Value of securities traded (HUF million)	4,145.0	4,891.4
Average price (HUF)	3,976	5,377
Minimum price (HUF)	3,200	4,355
Maximum price (HUF)	5,600	6,000
Closing price (HUF)	5,160	5,845

Trading of Danubius shares on BSE in 2005





REPORT OF THE SUPERVISORY BOARD

REPORT OF THE SUPERVISORY BOARD OF DANUBIUS HOTELS RT. ON THE 2005 BALANCE SHEET OF THE COMPANY AND THE REPORT OF THE BOARD OF DIRECTORS

The Supervisory Board of Danubius pursued its activities by holding regular committee meetings with the minimum 3 members in the first three months of the 2005 business year, then after the Annual General Meeting in April it was completed and strengthened by Dr. András Gálszéczy. The Supervisory Board submits its account to the AGM based on the report of the Board of Directors, the report of the independent Auditor and the regular interim control of the operation of the company.

The Supervisory Board received, during the year, from the Board and the management of the company all the necessary information to fulfil its task; the chairman of the Supervisory Board attended regularly the meetings of the Board of Directors. It was given the opportunity to obtain the indispensable details needed to control the operation of the company and perform its supervisory activity.

According to the Supervisory Board, the work of the Board of Directors and the measures taken were in line with the prevailing legal regulations, the Articles of the company and other internal rules. The information system and the domestic regulations can ensure the transparency and the continuous control of the operation of the company.

The Board of Directors kept the Supervisory Board regularly informed through the management about the plans of the Rt. It was deemed as a positive development that the expansion of the company has not stopped; further acquisitions took place with particular mention of the importance of the part ownership and management contract in the Regents Park Hotel in London, by which Danubius stepped over the boundaries of Central and Eastern Europe. (The realisation of the transaction was discussed and supported by the SB in an extraordinary meeting.) The Supervisory Board appreciated that the company took advantage of the favourable development in tourism from the town hotels' point of view and achieved a significant profit increase. This made it possible to compensate the weaker performance of the rural and spa hotels.

During 2005, in line with the accepted work schedule the Supervisory Board reviewed four times the economic result, the financial position and the business outlook of the company on the basis of the quarterly flash reports prepared for the Budapest Stock Exchange. Apart from that special attention was paid to the following subjects:

- the organisation of the sales and marketing activity,
- the tasks stemming from recommendation of the Budapest Stock Exchange concerning corporate governance,
- review of the HR policy; the situation in replacements and successions; vocational trainings,
- the reorganisation of Gundel restaurant and vinery, incorporation into the Danubius system,
- implementation of the reconstructions decided by the Board of Directors.



REPORT OF THE SUPERVISORY BOARD

In compliance with the relevant rules, the Supervisory Board discussed and approved the documents presented to the Annual General Meeting in 2005. On every occasion the accrual report of the internal controllers has been dealt with.

On the basis of the studied reports of the company and the auditors as well as the information obtained at the meetings of the committee the Supervisory Board concluded that the company:

- has pursued its activities by fully observing the prevailing acts and legal provisions,
- has met its financial obligations in line with the plan,
- has implemented the capital expenditure and reconstruction projects according to a proper schedule, despite the economic difficulties, in order to neutralise the increasing competition.

The Supervisory Board agrees with and proposes for approval the report of the Board of Directors about the year 2005 and supports its policy for 2006.

The Supervisory Board proposes to the AGM to accept the 2005 annual report prepared by Danubius Hotels Rt. in accordance with the Hungarian Accounting Act with HUF 56 519.625 million total assets and HUF minus 972.276 million result after tax. At the same time it also proposes to approve the consolidated report prepared in line with the international accounting system (IFRS) with HUF 79 164 million total assets and HUF 881 million profit after tax.

Considering the volume of investments and its financing requirements the Supervisory Board agrees with the proposal of the Board of Directors concerning the allocation of the achieved profit.

Budapest, 19th April 2005

Tibor Antalpéter
Chairman of the Supervisory Board



AUDITOR'S REPORT



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To the Shareholders of Danubius Hotel and Spa Rt.

We have audited the accompanying consolidated balance sheet of Danubius Hotel and Spa Rt ("the Company") as at 31 December 2005 which shows total assets of HUF 79,164 million and total shareholders' equity of HUF 48,903 million and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the year then ended, being components of the Company's 2005 Consolidated Annual Report. The Consolidated Annual Report and the Consolidated Business Report are the responsibility of the Company's management. Our responsibility is to express an opinion on the Consolidated Annual Report based on our audit. In addition it is our responsibility to assess whether the accounting information included in the Consolidated Business Report is consistent with that contained in the Consolidated Annual Report.

We conducted our audit in accordance with Hungarian Standards on Auditing issued by the Hungarian Chamber of Auditors, which are substantially consistent with International Standards on Auditing, and applicable law and regulations in Hungary. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Consolidated Annual Report is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Consolidated Annual Report. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall Consolidated Annual Report presentation. Our work with respect to the Consolidated Business Report was limited to the afore-mentioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. We believe that our audit provides a reasonable basis for our opinion.

We have audited the Company's Consolidated Annual Report, its components and elements and their documentary support in accordance with Hungarian Standards on Auditing and gained sufficient and appropriate evidence that the Consolidated Annual Report has been prepared in accordance with the International Financial Reporting Standards as adopted by the EU. In our opinion, the Consolidated Annual Report gives a true and fair view of the consolidated financial position of Danubius Hotel and Spa Rt and its subsidiaries as at 31 December 2005 and of the consolidated result of their operations for the year then ended in accordance with the International Financial Reporting Standards as adopted by the EU. The Consolidated Business Report is consistent with the Consolidated Annual Report.

Budapest, 20 March 2006

KPMG Hungária Kft.
Chamber registration number: 000202

David Thompson
Partner

Péter Szabó
Registered Auditor
Identification number: 005301

This is an English translation of the Independent Auditors' Report on the 2005 IFRS Consolidated Annual Report of Danubius Hotel and Spa Rt. issued in Hungarian. If there are any differences, the Hungarian language original prevails. This report should be read in conjunction with the complete IFRS Consolidated Annual Report it refers to.



KPMG Hungária Kft., a Hungarian limited liability company incorporated under the Hungarian Companies Act is a member of KPMG International, a Swiss cooperative. Company registration: Budapest, no. 01-09-063183



CONSOLIDATED BALANCE SHEET

D Danubius Hotel and Spa Rt. and Subsidiaries

Consolidated Balance Sheet

(All amounts in million HUF)

	Notes	At December 31,	
		2005	2004
Assets			
Cash and cash equivalents	3	2,363	2,396
Accounts receivable	4	1,889	1,695
Other receivables and prepayments	5	1,489	1,435
Income tax receivable	20	189	391
Inventory	6	884	844
Total current assets		6,814	6,761
Property, plant and equipment	7	67,687	65,573
Intangible assets	8	2,111	(1,857)
Investments in associates	9	1,763	31
Other non-current assets	10	235	1,282
Deferred tax assets	20	554	402
Total non-current assets		72,350	65,431
Total assets		79,164	72,192
Liabilities and Shareholders' Equity			
Trade accounts payable		2,327	2,093
Advance payments from guests		433	366
Income tax payable		215	262
Other payables and accruals	12	2,716	2,535
Interest-bearing loans and borrowings	13	2,769	4,202
Provisions	11	840	709
Total current liabilities		9,300	10,167
Interest-bearing loans and borrowings	13	17,609	17,068
Loan from related party	28	1,828	-
Deferred tax liabilities	20	1,524	1,541
Total non-current liabilities		20,961	18,609
Total liabilities		30,261	28,776
Shareholders' Equity			
Share capital	15	8,285	8,285
Capital reserve		7,435	7,435
Treasury shares	15	(1,162)	(1,162)
Retained earnings		29,134	24,666
Translation reserve		2,400	1,296
Attributable to equity holders of the parent		46,092	40,520
Minority interests	14	2,811	2,896
Total shareholders' equity		48,903	43,416
Total liabilities and shareholders' equity		79,164	72,192

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



CONSOLIDATED STATEMENT OF INCOME

Danubius Hotel and Spa Rt. and Subsidiaries

Consolidated Statement of Income

(All amounts in million HUF)

	Notes	Year ended December 31,	
		2005	2004
Revenue			
Rooms		20,462	18,591
Food and beverage		14,371	12,502
Spa		5,242	5,050
Other departmental revenues		2,454	2,398
Interest income		57	256
Other revenue	17	256	306
Total revenue	30	42,842	39,103
Costs and expenses			
Rooms		4,114	3,904
Food and beverage		10,319	9,183
Spa		2,254	2,168
Other departmental expenses		2,837	2,679
Administrative and general	18	15,328	14,166
Interest expense		843	838
Foreign currency loss / (gain)		379	(989)
Depreciation and amortisation		4,324	4,179
Other expenses	19	1,321	1,421
Total costs and expenses		41,719	37,549
Share of profit of associates		6	–
Profit before tax		1,129	1,554
Current tax expense	20	431	358
Deferred tax benefit	20	(183)	(371)
Net profit after tax		881	1,567
Attributable to:			
Equity holders of the parent		817	1,590
Minority interest	14	64	(23)
Net profit for the year		881	1,567
Earnings per share (expressed in HUF per share)	21	103	201



CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Danubius Hotel and Spa Rt. and Subsidiaries

Consolidated Statement of Changes in Shareholders' Equity

(All amounts in million HUF)

	Notes	Attributable to equity holders of the parent					Total	Minority Interest	Total equity
		Share Capital	Capital Reserve	Treasury Shares	Retained Earnings	Translation Reserve			
December 31, 2003		8,285	7,435	(1,162)	23,076	1,250	38,884	2,462	41,346
Minority share in subsidiary acquired		–	–	–	–	–	–	462	462
Share in subsidiary purchased from minority shareholders		–	–	–	–	–	–	(5)	(5)
<i>Subtotal: transactions with equity holders</i>		–	–	–	–	–	–	457	457
Net profit for the year		–	–	–	1,590	–	1,590	(23)	1,567
Translation of foreign subsidiaries		–	–	–	–	46	46	–	46
<i>Subtotal: income and expense for the year</i>		–	–	–	1,590	46	1,636	(23)	1,613
December 31, 2004		8,285	7,435	(1,162)	24,666	1,296	40,520	2,896	43,416
Dividend paid by subsidiaries to minority shareholders		–	–	–	–	–	–	(8)	(8)
Minority share in subsidiary acquired		–	–	–	–	–	–	29	29
Share in subsidiary purchased from minority shareholders		–	–	–	–	–	–	(172)	(172)
<i>Subtotal: transactions with equity holders</i>		–	–	–	–	–	–	(151)	(151)
Net profit for the year		–	–	–	817	–	817	64	881
Derecognition of previously recognised negative goodwill		–	–	–	3,651	–	3,651	–	3,651
Translation of foreign subsidiaries		–	–	–	–	1,104	1,104	2	1,106
<i>Subtotal: income and expense for the year</i>		–	–	–	4,468	1,104	5,572	66	5,638
December 31, 2005		8,285	7,435	(1,162)	29,134	2,400	46,092	2,811	48,903

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



CONSOLIDATED STATEMENT OF CASH FLOWS

Danubius Hotel and Spa Rt. and Subsidiaries

Consolidated Statement of Cash Flows

(All amounts in million HUF)

	Notes	Year ended December 31,	
		2005	2004
Cash flows from operating activities:			
Net profit for the year after minorities		817	1,590
Adjustments for:			
Income tax	20	248	(13)
Minority interest	14	64	(23)
Income from associates		(6)	–
Interest income		(57)	(256)
Interest expense		843	838
Depreciation and amortisation		4,324	4,179
Foreign exchange (gain) / loss		379	(989)
Gain on sale of fixed assets	17	(121)	(71)
Changes in assets and liabilities:			
Accounts receivable and other receivables		81	(105)
Inventory		(34)	(21)
Accounts payable and other current liabilities		392	1,025
Cash generated from operations		6,930	6,154
Interest paid		(817)	(866)
Corporate income tax paid		(531)	(247)
Net cash provided by operations		5,582	5,041
Cash flows from investing activities:			
Purchase of fixed assets and intangible assets		(5,282)	(6,048)
Cash paid on acquisition of minority shares		(172)	(5)
Acquisition of subsidiary, net of cash acquired	27	(82)	(1,807)
Interest received		79	278
Investment in associate	9	(1,775)	–
Proceeds on sale of fixed assets		187	198
Decrease in restricted cash		1,031	(465)
Other cash inflows		12	26
Net cash used in investing activities		(6,001)	(7,823)
Cash flows from financing activities:			
Net increase / (decrease) in long-term debt		(1,094)	1,358
Payment of finance lease liabilities		(125)	(120)
Related party loan received, net	9	1,740	–
Net cash provided by / (used in) financing activities		521	1,238
Increase / (decrease) in cash and cash equivalents		102	(1,544)
Cash and cash equivalents at beginning of year		2,224	3,768
Cash and cash equivalents at end of year, net	3	2,326	2,224



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

1 The Company and its recent history

Danubius Hotel and Spa Rt. ("Danubius" or "the Company") is a company limited by shares which is incorporated under the laws of the Republic of Hungary. The Company and its subsidiaries (the "Group") provide hospitality services in Hungary, Czech Republic, Slovakia and Romania, with an emphasis on 3, 4 and 5 star spa and city hotels. The Company's shares are listed on the Budapest Stock Exchange. At 31 December 2005, 53.4% of the Company's shares were owned by CP Holdings Limited, a UK private company, and companies controlled by CP Holdings Limited.

Danubius is a holding company. A wholly owned subsidiary, Danubius Szállodaüzemeltető és Szolgáltató Zrt., owns and operates the Group's hotel properties in Hungary.

Danubius has a 95.36% shareholding in Léčebné Lázně a.s., a company which owns and operates hotels in Marienbad, Czech Republic and a 100% shareholding in Gama 45 s.r.o which owns a hotel in Marienbad.

Danubius owns 56.43% of the shares of Salina Invest SA, a holding company which owns a 93.97% interest in Balneoclimaterica SA. Balneoclimaterica SA owns a hotel and real estate complex in Sovata, Romania. Danubius has a 53.03% effective interest in Balneoclimaterica SA.

The Group has an 88.60% effective shareholding (2004: 87.1%) in Slovenské Liečebné Kúpele Piestany a.s. ("Piestany"), a Slovakian company which owns and operates hotels in Piestany and Smrdaky.

In 2004 Danubius acquired a 66.67% shareholding in Lángastronómia Kft., a company which owns and operates the Gundel and Bagolyvár restaurants in Budapest and wineries in the Tokaj and Eger regions (see note 26).

In August 2005, Danubius acquired a 25% interest in CP Regents Park Two Limited – which owns and operates the Danubius Hotel Regents Park, London and concluded a cooperation agreement with the 75% shareholder in that company, CP Holdings Limited (see note 9).

In October 2005 Danubius Beta Hotels Kft., a wholly owned subsidiary operating 2 and 3 star hotels on a franchise basis was merged at book value into Danubius Szállodaüzemeltető és Szolgáltató Zrt.

In December 2005 Danubius acquired an additional 45.85% interest in Preventiv-Security Zrt., a company, which provides security services, resulting in a 78.6% shareholding at December 31, 2005 (see note 27).



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

2 Significant accounting policies

Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") adopted by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB, as well as in accordance with IFRS as adopted by the EU further to the IAS Regulation (EC 1606/2002).

Basis of preparation

The consolidated financial statements are prepared in Hungarian Forint (HUF) and are presented in millions of Forints.

The consolidated financial statements are prepared under the historical cost convention.

The accounting policies have been consistently applied by the Group enterprises and are consistent with those used in the previous year.

30

The Company has applied IFRS 3 "Business Combinations" and IAS 36 "Impairment of Assets" (revised 2004) in accounting for the acquisition of Lángastronómia Kft. (see note 26).

The financial statements were authorised for issue by the Board of Directors on March 20, 2006.

Use of estimates and assumptions

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 31.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The consolidated financial statements include the financial statements of the Company and its significant subsidiaries after elimination of all material inter-company transactions and balances, including any unrealised gains.

Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds the carrying amount of the associate, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

Investments

Investments in which the Group has less than 20% ownership are carried at cost, less provision for impairment.

The Company's principal subsidiary companies are as follows:

Name	Principal Activity	Country of Incorporation	Group interest held at December 31, 2005	Group interest held at December 31, 2004
Danubius Szállodaüzemeltető és Szolgáltató Zrt.	Hotel operator	Hungary	100%	100%
Lángastronómia Kft.	Restaurant operator	Hungary	66.67%	66.67%
Preventív-Security Zrt.	Security	Hungary	78.6%	32.75%
Léčebné Lázně a.s.	Hotel operator	Czech Republic	95.36%	95.36%
Gama 45 s.r.o	Hotel owner	Czech Republic	100%	100%
Slovenské Liečebné Kúpele Piestany a.s.	Hotel operator	Slovakia	88.85%	87.10%
Salina Invest SA	Holding company	Romania	56.43%	56.43%
SC Balneoclimaterica SA	Hotel operator	Romania	53.03%	53.03%

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Financial statements of foreign operations

The Group's foreign operations are not considered an integral part of the Company's operations. Accordingly, the assets and liabilities of foreign operations are translated to HUF at foreign exchange rates ruling at the balance sheet date. Goodwill and any fair value adjustments arising on consolidation are treated as assets and liabilities of the reporting entity and therefore are not retranslated. The revenues and expenses of foreign operations are translated to HUF at the average exchange rate for the year. Foreign exchange differences arising on translation are recognised directly in equity.

Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the measurement currency of the relevant company at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the measurement currency at foreign exchange rates ruling at the dates the fair value was determined.

32

Property, plant and equipment

Items of property, plant and equipment are stated at cost or deemed cost less accumulated depreciation (see below) and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads.

Depreciation

Depreciation is provided using the straight-line method. The depreciation rates used by the Group are from 2% to 5% for buildings and leasehold improvements and 14.5% to 33% for machinery and equipment. Land and capital projects in progress are not depreciated.

Refurbishment

Significant refurbishment costs which increase the future economic benefits embodied in the item of property, plant and equipment are capitalised and depreciated in accordance with the policy described above. All other costs are recognised in the income statement as an expense as incurred.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation (see above) and impairment losses.

Intangible assets

Goodwill

Business combinations are accounted for by applying the purchase method. Goodwill arising on an acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill arising in respect of business combinations which occurred prior to 31 March 2004 is stated at cost less accumulated amortisation and impairment losses. Goodwill arising in respect of business combinations which occurred on or after 31 March 2004 is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is no longer amortised but is tested annually for impairment.

Negative goodwill

Negative goodwill arising on an acquisition which occurred prior to 31 March 2004 represents the excess of the fair value of the net identifiable assets acquired over the cost of acquisition. To the extent that negative goodwill related to an expectation of future losses and expenses that were identified in the plan of acquisition and could be measured reliably, but which had not yet been recognised, it was recognised in the income statement when the future losses and expenses were recognised. Any remaining negative goodwill, but not exceeding the fair values of the non-monetary assets acquired, was recognised in the income statement over the weighted average useful life of those assets that were depreciable/amortisable. Negative goodwill in excess of the fair values of the non-monetary assets acquired was recognised immediately in the income statement.

In 2004 the carrying amount of negative goodwill was deducted from the carrying amount of intangible assets. The carrying amount of negative goodwill at 1 January 2005, that arose from business combinations which occurred before 31 March 2004 was derecognised on 1 January 2005 with a corresponding adjustment to the opening balance of retained earnings in compliance with IFRS 3 Business Combinations.

Other intangible assets

Other intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses (see below). Where the Group has the legal right to use a particular property the value of these rights is amortised over the term



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

for which the Group holds the rights. These include property rights on Margaret Island, Budapest which are being amortised over 100 years.

Debt securities

Debt securities are classified as held to maturity and are stated at amortised cost. Investments held to maturity are recognised/derecognised on the day they are transferred to/by the Group.

Inventory

Inventory is stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated selling expenses. The cost of inventory is determined on the weighted average cost basis and includes expenditure incurred in acquiring the inventory and bringing it to its existing location and condition.

Cash and cash equivalents

Cash equivalents are liquid investments with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Trade and other receivables

Trade and other receivables are stated at their amortised cost less impairment losses (see below).

Impairment

The carrying amounts of the Group's assets, other than inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement. Impairment losses, other than in respect of goodwill, are reversed when there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Trade and other payables

Trade and other payables are initially measured at fair value and then subsequently at amortised cost.

Interest-bearing loans

Interest-bearing loans are stated at their amortised cost, being the net proceeds received. Loan interest is recognized on an accrual basis and expensed when incurred. Loans denominated in foreign currencies at the balance sheet date are translated at the year-end rates of exchange.

Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity. Repurchased shares are classified as treasury shares and presented as a deduction from total equity.

Revenue recognition

Goods sold and services rendered

Room revenue (based on completed guest nights), food and beverage, spa revenue and other departmental revenues are each recognised as the service is provided, net of VAT.

Rental income

Rental income from property is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Interest income

Interest income is recognised in the income statement as it accrues, taking into account the effective yield on the asset.

Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted, or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. No temporary differences are recognised on the initial recognition of goodwill. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Pension Plan

The Company operates a defined contribution pension plan for Hungarian employees. Pension costs are charged against profit in the period in which the contributions are payable. The assets of the fund are held in a separate trustee administered fund.

Fair value of financial instruments

The carrying values of financial instruments approximate fair values due to either the short-term duration or the proximity of interest rates of the various instruments to market rates.

Segment reporting

Group operations are presented in respect of geographical areas only. Management considers that it operates in a single business segment, hotel and hospitality operations.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

New accounting pronouncements

New standards, amendments to Standards and Interpretations not yet effective as at 31 December 2005 have not been applied in preparing these consolidated financial statements. The Company does not expect that any of these pronouncements will have a significant impact on the Company's financial statements.

3 Cash and cash equivalents

	December 31,	
	2005	2004
Cash in hand and at bank	2,363	2,363
Marketable securities	–	33
Cash and cash equivalents	2,363	2,396
Overdraft (see note 13)	(37)	(172)
Cash and cash equivalents, net (per cash flow statement)	2,326	2,224

4 Accounts receivable

	December 31,	
	2005	2004
Trade receivables	2,280	2,036
Allowance for doubtful receivables	(391)	(341)
	1,889	1,695

5 Other receivables and prepayments

	December 31,	
	2005	2004
Receivables from non-consolidated subsidiaries	39	29
Prepayments and accrued income	674	605
VAT receivables	197	383
Other receivables	579	418
	1,489	1,435



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

6 Inventory

	December 31,	
	2005	2004
Food and beverages	372	289
Wine in barrels	232	203
Materials	205	284
Goods for resale	75	68
	884	844

7 Property, plant and equipment

	Land	Buildings and improvements	Furniture, fittings and equipment	Capital projects in progress	Total
Cost/Valuation:					
December 31, 2004	9,491	72,965	18,006	1,788	102,250
Acquisitions through business combinations	–	5	44	–	49
Effect of movements in exchange rates	233	1,580	426	97	2,336
Additions	4	3,664	1,094	210	4,972
Disposals	(16)	(94)	(644)	(2)	(756)
December 31, 2005	9,712	78,116	18,926	2,093	108,847
Depreciation:					
December 31, 2004	–	22,711	13,966	–	36,677
Effect of movements in exchange rates	–	613	345	5	963
Depreciation charge for year	–	2,503	1,707	–	4,210
Disposals	–	(94)	(596)	–	(690)
December 31, 2005	–	25,733	15,422	5	41,160
Net book value:					
December 31, 2004	9,491	50,254	4,040	1,788	65,573
December 31, 2005	9,712	52,383	3,504	2,088	67,687

The net book value of property, plant and equipment pledged was HUF 25,177 million as at 31 December 2005 (HUF 27,382 million as at 31 December 2004). Further information about assets pledged as security for mortgages is given in note 13.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

The Group leases air conditioning equipment under a finance lease agreement. At the end of the lease the Group has the option to purchase the equipment at a beneficial price. At 31 December 2005, the net carrying amount of the leased equipment was HUF 393 million (2004: HUF 469 million). The leased equipment secures lease obligations (see note 13).

8 Intangible assets

	Goodwill	Negative goodwill	Land usage rights	Software and other intangibles	Total
Cost:					
December 31, 2004	1,146	(5,095)	537	1,377	(2,035)
Acquisitions through business combinations	117	–	–	1	118
Effect of movements in exchange rates	–	–	–	4	4
Additions	–	–	58	251	309
Disposals	–	–	–	(2)	(2)
Offset goodwill depreciation against cost	(168)	–	–	–	(168)
Derecognition of negative goodwill	–	5,095	–	–	5,095
December 31, 2005	1,095	–	595	1,631	3,321
Depreciation:					
December 31, 2004	168	(1,444)	102	996	(178)
Effect of movements in exchange rates	–	–	–	–	–
Amortisation charge for year	–	–	11	103	114
Relating to disposals	–	–	–	(2)	(2)
Offset goodwill depreciation against cost	(168)	–	–	–	(168)
Derecognition of negative goodwill	–	1,444	–	–	1,444
December 31, 2005	–	–	113	1,097	1,210
Net book value:					
December 31, 2004	978	(3,651)	435	381	(1,857)
December 31, 2005	1,095	–	482	534	2,111

At 31 December 2005 intangible assets include HUF 462 million, net of amortisation (2004: HUF 435 million) for land usage rights relating to two hotels on Margaret Island held under licenses given by the Municipality of Budapest.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Positive goodwill relates to the following acquisitions:

	December 31,	
	2005	2004
Léčebné Lázně a.s.	565	565
Lángastronómia Kft. (see note 26)	413	413
Preventív-Security Zrt. (see note 27)	117	–
Total positive goodwill	1,095	978

On 1 January 2005 the accumulated amortisation of positive goodwill was offset against its gross book value in compliance with IFRS 3 “Business combinations”.

Negative goodwill related to the following acquisitions:

	December 31,	
	2005	2004
HungarHotels	–	2,993
Hotel Hélia	–	154
Gama 45 s.r.o.	–	407
Slovenské Liečebné Kúpele Piestany a.s.	–	1,541
Accumulated amortisation	–	(1,444)
Total negative goodwill	–	3,651

As of January 1, 2005 Danubius adopted IFRS 3 “Business Combinations” and derecognised the negative goodwill with a corresponding adjustment to the opening balance of retained earnings.

40

9 Investments in associates

	Country	Ownership	
		2005	2004
CP Regents Park Two Limited	United Kingdom	25%	–
Preventív-Security Zrt. (see note 27)	Hungary	–	32.75%

In August 2005, Danubius acquired a 25% interest in CP Regents Park Two Limited which owns and operates the Danubius Hotel Regents Park, a 4 star city hotel in London. The investment was acquired from CP Holdings Limited for GBP 5.1 million and CP Holdings Limited provided a loan of GBP 5.1 million to finance the acquisition.

The Company’s share of post acquisition total recognised loss in the above Associate for the year ended 31 December 2005 was HUF 12 million. Included in other revenue is a management support fee of HUF 54 million from this Associate for 2005. The interest expense was HUF 43 million on the loan received from CP Holdings Limited and a loan arrangement fee of HUF 36 million was paid to CP Holdings Limited.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Summary financial information on associate – 100 percent:

2005 In thousand GBP	Assets	Liabilities	Equity	Revenues	Loss
CP Regents Park Two Limited	59,352	39,124	20,228	4,799	(178)

10 Other non-current assets

	December 31,	
	2005	2004
Investments in non-consolidated subsidiaries	178	183
Loans given to employees	17	7
Long-term receivable	22	50
Restricted cash	–	1,031
Other investments, unquoted	18	11
	235	1,282

The non-consolidated subsidiaries are:

Name	Principal activity	2005		2004	
			Share %		Share %
Marcali Szálloda Kft.	Hotel	121	50.2	121	50.2
Kastélykert Kft.	Hotel	43	100	43	100
Hungaria Hotel und Reisen GmbH.	Travel agency	9	100	9	100
Sopron Szakképző Iskola	College	5	100	5	100
Nádor Konferencia-központ	Conference organiser	–	100	3	100
Hotel Kastély Kft.	Hotel	–	50	2	50
		178		183	

The above subsidiaries are immaterial to the Group and have not been consolidated.

The long term receivable relates to proceeds from the sale of a hotel in Romania and is due in six instalments with the final instalment due on 1 October 2007. The long-term receivable is presented at discounted value.

As at 31 December 2004 other non-current assets included HUF 1,031 million cash held on deposit for the restricted purpose of financing reconstruction at Piestany. The restriction was cancelled in 2005 as part of the renegotiation of the bank loans.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

11 Provisions

	Acquisition of Piestany	Retirement provision	Other	Total
Balance at 31 December 2004	610	54	45	709
Provision made during the year	26	200	–	226
Provision used during the year	–	(95)	–	(95)
Balance at 31 December 2005	636	159	45	840

In 2002 a provision for legal cases of HUF 621 million was provided at the acquisition of Piestany from which HUF 11 million was utilized in 2003 as a result of a lost legal case. In 2005 this provision increased by HUF 26 million due to the change of foreign exchange rates.

At December 31, 2004 retirement provisions comprised a provision of HUF 54 million for obligations related to termination and long service benefits agreed in 2003 for employees in Slovakia. In 2005 this retirement provision increased by HUF 200 million to cover the retirement benefits granted to certain members of management in Hungary. Out of the additional provision HUF 95 million was used in November 2005. At December 31, 2005 the other provision was HUF 45 million in respect of various legal cases.

42

12 Other payables and accruals

	December 31,	
	2005	2004
Payroll	643	685
Social security	439	408
Taxes payable	467	630
Accrued expenses	624	476
Other	543	336
	2,716	2,535

13 Interest-bearing loans and borrowings

Non-current liabilities	December 31,	
	2005	2004
Secured bank loans	17,430	16,753
Finance lease liabilities	179	315
	17,609	17,068

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Current liabilities	December 31,	
	2005	2004
Current portion of secured bank loans	2,596	3,905
Bank overdrafts	37	172
Total current bank loans	2,633	4,077
Current portion of finance lease liabilities	136	125
	2,769	4,202

The finance lease liabilities are in respect of air conditioning equipment installed in certain Hungarian hotels, and are payable as follows:

	December 31, 2005			December 31, 2004		
	Minimum Lease Payments	Interest	Principal	Minimum Lease Payments	Interest	Principal
Within 1 year	160	24	136	160	35	125
1 to 2 years	191	12	179	160	24	136
2 to 5 years	–	–	–	191	12	179
over 5 years	–	–	–	–	–	–
Total debt	351	36	315	511	71	440
Amounts due in less than one year	(160)	(24)	(136)	(160)	(35)	(125)
	191	12	179	351	36	315

The Group's bank loans fall due for repayment, as follows:

	December 31,	
	2005	2004
Within 1 year	2,633	4,077
1 to 2 years	3,358	3,209
2 to 5 years	9,209	9,534
over 5 years	4,863	4,010
Total debt	20,063	20,830
Amounts due in less than one year	(2,633)	(4,077)
	17,430	16,753



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

	December 31,	
	2005	2004
Danubius Hotel and Spa Rt.		
1. MKB long term Euro loans at interest rate of (3 months) EURIBOR + 0.75%, secured by mortgages on certain hotels in Hungary.	–	4,621
2. MKB long term Euro loans at interest rate of (3 months) EURIBOR + 0.95%, secured by mortgages on certain hotels in Hungary.	–	2,485
3. OTP long term Euro loan at interest rate of (3 months) EURIBOR + 0.95% secured by mortgages on certain hotels in Hungary.	–	10,094
4. MKB long term Euro loan at interest rate of (3 months) EURIBOR + 0.75%	–	844
5. Bank overdraft	37	114
6. OTP long term Euro loan at interest rate of (3 months) EURIBOR + 0.95% secured by mortgages on Hotel Erzsébet and Hotel Radisson SAS Béke	1,091	–
7. OTP long term Euro loan at interest rate of (3 months) EURIBOR + 0.95% secured by mortgages on Hotel Radisson SAS Béke, Hotel Astoria, Grand Hotel Hungária, Hotel Stadion, Thermal Hotel Aqua, Thermal Hotel Hévíz	7,953	–
8. MKB long term Euro loan at interest rate of (3 months) EURIBOR + 0.95% secured by mortgages on Hotel Radisson SAS Béke, Hotel Astoria, Grand Hotel Hungária, Hotel Stadion, Thermal Hotel Aqua, Thermal Hotel Hévíz	7,123	–
Léčebné Lázně a.s.		
1. ČSOB long term reconstruction Euro loan at interest rate of (3 months) EURIBOR + 0.95% secured by mortgages on hotels in the Czech Republic.	912	–
2. Komerční Banka overdraft secured by fixed assets and by blank bill of exchange	–	58
Slovenské Liečebné Kúpele Piestany a.s.		
1. Short term bank loan in SKK and Euro at interest rate of BRIBOR + 0.65%, secured by mortgages on land and buildings in Slovakia.	28	663
2. Long term bank loan in Euro at interest rate of BRIBOR + 1.3%, secured by mortgages on land and buildings.	2,347	1,359
Sovata		
Long term bank loan, at interest rate of (6 months) EURIBOR + 4.5%, secured by a first mortgage on Sovata Hotel and bank accounts of Balneoclimaterica with the Romanian Commercial Bank.	560	577
Other bank loans	12	15
Total debt	20,063	20,830

LIBOR was 2.486%, EURIBOR was 2.488% and BRIBOR was 3.74% at December 31, 2005.
(LIBOR was 2.154%, EURIBOR was 2.174% and BRIBOR was 6.06% at December 31, 2004.)

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

14 Minority Interests

	December 31,	
	2005	2004
Lángastronómia Kft.	504	469
Preventív-Security Zrt.	29	–
Léčebné Lázně a.s.	447	417
Slovenské Liečebné Kúpele Piestany a.s.	1,133	1,321
Salina Invest SA and SC Balneoclimaterica SA	698	689
	2,811	2,896

	December 31,	
	2005	2004
Opening balance at 1 January	2,896	2,462
Income attributable to minority shareholders	64	(23)
Translation of foreign subsidiaries	2	–
Share in subsidiary purchased from minority shareholders	(172)	(5)
Minority share in subsidiary acquired	29	462
Dividend paid by subsidiaries to minority shareholders	(8)	–
Closing balance at 31 December	2,811	2,896

In 2005 Preventív-Security Zrt. was consolidated as the Group's interest in that company increased from 32.75% to 78.6% (see note 27).

In 2005 the Group increased its effective shareholding in Piestany from 87.1% to 88.6%.

In 2004 a controlling interest was acquired in Lángastronómia Kft. (see note 26).

15 Share Capital

	December 31,	
	2005	2004
Ordinary shares	8,285	8,285

The registered share capital at December 31, 2005 consists of 8,285,437 (2004: 8,285,437) authorised, issued and fully paid ordinary shares, each of par value HUF 1,000.

At December 31, 2005, the Company owned 374,523 of its own shares (Treasury shares) which cost HUF 1,162 million (2004: 374,523 shares, which cost HUF 1,162 million).

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

16 Retained Earnings

Dividends are available for distribution from the Company's retained earnings calculated according to Hungarian Accounting Law. The amount available for distribution as dividends at December 31, 2005 is HUF 20,932 million (2004: HUF 21,904 million).

If dividends are paid to non-resident shareholders, a withholding tax of up to 20% must be paid. The rate applicable is dependent on the country of residence of the shareholder, on the period and on the number of shares held. The withholding tax is also payable by individual shareholders who are resident in Hungary (resident legal entities are exempt).

17 Other revenue

	2005	2004
Gain on sale of fixed assets	121	71
Proceeds from insurance claims	40	35
Other revenue	95	200
	256	306

46

18 Administrative and general expenses

	2005	2004
Payroll and related costs	6,008	5,491
Utility costs	3,390	2,829
Maintenance expenses	1,588	1,603
Management fees to CP Holdings Ltd. (related party)	315	310
Management fees to hotel chains (Hilton, Radisson SAS)	140	123
Marketing expenses	655	672
Bank and insurance fees	459	523
Commissions and discounts provided	81	52
Professional and membership fees	289	292
Telecommunication charges	198	194
Rental expense	405	547
Security costs	260	250
Miscellaneous expenses	1,540	1,280
	15,328	14,166

The group had 5,620 employees as at 31 December 2005 (5,608 as at 31 December 2004).

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

19 Other expenses

	2005	2004
Local taxes	756	713
Other taxes	357	386
Doubtful debt and other provisions	208	322
	1,321	1,421

20 Income tax

The tax charge / (benefit) for the year comprises:

	2005	2004
Current tax	431	358
Deferred tax	(183)	(371)
	248	(13)

The deferred tax charge / (benefit) comprises:

	2005	2004
Origination and reversal of temporary differences	(169)	(148)
Reduction in tax rate	–	(143)
Benefit of tax losses recognized	(14)	(80)
	(183)	(371)

47

A reconciliation of the difference between the income tax expense and taxation at the statutory tax rate, is shown in the following table:

	2005		2004	
Profit before tax and minority interest		1,129		1,554
Income tax using the Hungarian corporation tax rate	16,0%	181	16,0%	249
Effect of different tax rates in foreign jurisdictions		88		47
Non-deductible expenses		52		35
Tax exempt revenues		(12)		(23)
Tax incentives not recognised in the income statement		(61)		(25)
Effect of tax losses utilised / (deferred)		13		(207)
Effect of tax rate changes (decreases) in foreign jurisdictions		(31)		(143)
Others		18		54
		248		(13)

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Deferred tax assets and liabilities

Deferred tax assets and liabilities as at 31 December 2005 and 31 December 2004 are attributable to the following:

	Assets		Liabilities	
	2005	2004	2005	2004
Property, plant and equipment	50	89	1,428	1,408
Repairs and maintenance provision	–	–	255	390
Legal provisions	121	115	–	–
Other items	117	45	–	–
Tax loss carry forwards	424	410	–	–
	712	659	1,683	1,798
Offset of assets and liabilities within individual legal entities	(159)	(257)	(159)	(257)
	553	402	1,524	1,541

Deferred tax liabilities are recognised in respect of the differences between the value of fixed assets (primarily land and hotel buildings) recorded for taxation purposes and their value recorded in these financial statements.

48

Léčebné Lázně a.s. records a provision for repairs and maintenance in its Czech statutory accounts related to the future repair expenses of its premises, in accordance with Czech accounting and tax legislation. This provision is reversed in these IFRS financial statements and a deferred tax liability is set up for this timing difference.

The tax value of the losses carried forward at 31 December 2005 will expire as follows, if not previously utilised: HUF 19 million 1 January 2008, HUF 214 million 1 January 2009, HUF 30 million 1 January 2010. HUF 161 million can be carried forward indefinitely.

Current corporate income tax receivables

Corporate income tax receivables include overpayments of HUF 189 million (2004: HUF 391 million) as a result of advance payments required by the tax authorities for certain group companies in 2005, based on the actual income taxes paid for 2004.

21 Earnings per share

The calculation of basic earnings per share is based on the net profit attributable to ordinary shareholders of HUF 817 million in 2005 (2004: HUF 1,590 million) and the weighted average number of ordinary shares outstanding during 2005 of 7,910,914 (2004: 7,910,914).

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

	December 31,	
	2005	2004
Weighted average number of issued ordinary shares	8,285,437	8,285,437
Weighted average number of treasury shares	(374,523)	(374,523)
Weighted average number of qualifying ordinary shares	7,910,914	7,910,914
Net profit for the year in million HUF	817	1,590
Earnings per share (HUF/share)	103	201

There are no dilutive factors to earnings per share disclosed above.

22 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	December 31,	
	2005	2004
Less than one year	115	132
More than one year	–	–
	115	132

The Group leases its head office from a related party under an operating lease which has a twelve month notice period.

During the year ended 31 December 2005 HUF 405 million was recognised as an expense in the income statement in respect of operating leases (2004: HUF 453 million).

Leases as lessor

The group has no significant non-cancellable operating or finance lease rental receivables as at 31 December 2005 and 31 December 2004.

23 Commitments

The Group plans to spend approximately HUF 2.6 billion on hotel refurbishment and construction in 2006.

At the acquisition of Piestany, the Group committed to a SKK 700 million (HUF 4,459 million) reconstruction program on hotel buildings by 2006. The remaining amount of the commitment at 31 December 2005 is SKK 308 million (HUF 2,057 million). In 2004 other non-current assets included restricted cash of HUF 1,031 million in respect of this commitment. In 2005 the restriction was cancelled on the renegotiation of the Company's bank loans.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

LL Partners, the company from which Danubius purchased its 66.67% interest in Lángastronómia Kft., has an option to sell to Danubius the remaining 33.3% shareholding in Lángastronómia Kft. between July 7, 2009 and July 7, 2011. The purchase price is USD 5 million plus compound annual interest of 7%, accumulated from 7 July 2004.

24 **Contingent Liabilities**

The Group did not have any significant contingent liabilities as at 31 December 2005.

25 **Pension Plans**

The Group's employees participate in State pension plans to which employers and employees pay contributions. The pension liability resides with the State in Hungary, Czech Republic, Slovakia and Romania.

50

The Group has a defined contribution pension plan in addition to the State plan, which is available for all Hungarian employees after six months employment. The group pays contributions equal to 5% of the salary of employees who are members of the fund. The contribution expense in 2005 was HUF 239 million (2004: HUF 234 million). The assets of the fund are held in separate trustee administered funds and are not included in these financial statements.

On February 1, 2004 the Group formed a Health Fund, which is available for all Hungarian employees after six months employment. The group pays contributions equal to 1% of the salary plus HUF 4,000 per month for employees who decided to become members of the fund. The total contribution expense in 2005 was HUF 188 million (2004: HUF 166 million).

The assets of the fund are held in separate trustee administered funds and are not included in these financial statements.

There are no pension or health plans for the Czech, Slovak and Romanian subsidiaries.

26 **Acquisition of Lángastronómia Kft.**

In July 2004 Danubius acquired a 49% interest in Lángastronómia Kft., a company owning and operating the Gundel Restaurant and its related businesses (the Bagolyvár Restaurant, wineries in Tokaj and Eger). Subsequently in September 2004, Danubius acquired a further 17.67% interest in Lángastronómia Kft.

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Lángastronómia Kft. has been consolidated since October 1, 2004. In the 3 months to 31 December 2004 Lángastronómia Kft. contributed HUF 13 million to the consolidated net profit for the year.

The effect of the acquisition on the consolidated financial statements was:

Balance sheet at acquisition	
Property, Plant and Equipment	757
Fair value adjustment to Property, Plant and Equipment	976
Deferred tax liability on fair value adjustment	(156)
Cash and cash equivalents	218
Inventories and Receivables	540
Loans	(688)
Other short term liabilities	(261)
Net identifiable assets and liabilities	1,386
Danubius Group share of net assets (66.67%)	924
Goodwill on acquisition (see note 8)	413
<i>Net purchase consideration</i>	<i>1,337</i>
Add: Waiver of intercompany loans	688
<i>Total purchase consideration, paid in cash</i>	<i>2,025</i>
Less: Cash acquired	(218)
Net cash outflow	1,807

Other than the property, plant and equipment as disclosed above, the carrying amounts of the assets and liabilities of Lángastronómia Kft. immediately prior to the acquisition corresponded to their fair values.

The goodwill arising on the acquisition of Lángastronómia Kft. is attributable mainly to the expected future earnings of the Gundel restaurant business which does not meet the criteria for recognition as an intangible asset at the date of acquisition.

At 31 December 2004 and 2005, Danubius determined that there is no impairment of the investment in Lángastronómia Kft. The recoverable amount of the investment is determined on the basis of value in use which is higher than the net book value.

27 Acquisition of Preventív-Security Zrt.

At December 31, 2004 the Company owned a 32.75% share in Preventív-Security Zrt. (included in investments in associates). On December 29, 2005 a further 45.85% share was acquired. The total purchase price for the 45.85% share was HUF 108 million of which HUF 94 million was paid in 2005 and HUF 14 million is payable in 2006. Preventív-Security Zrt. has been consolidated as of December 31, 2005 and HUF 18 million income

The notes set out on pages 29 to 57 are an integral part of the consolidated financial statements.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

from associate was recorded to the consolidated net profit for the year. If the acquisition had occurred on January 1, 2005 the Group revenues would have been higher by HUF 1,304 million and net profit would have been higher by HUF 26 million.

The effect of the acquisition on the consolidated financial statements was:

Consolidated Balance sheet at acquisition	
Property, Plant and Equipment	49
Goodwill	71
Intangible assets	1
Cash and cash equivalents	12
Inventories and Receivables	198
Loans	(46)
Other short term liabilities	(150)
Net identifiable assets and liabilities	135
Danubius Group share of net assets acquired (45.85%)	62
Goodwill on acquisition	46
<i>Total purchase consideration</i>	<i>108</i>
Less: consideration payable in 2006	14
<i>Purchase consideration paid in 2005</i>	<i>94</i>
Less: Cash acquired	(12)
Net cash outflow	82

The carrying amounts of the assets and liabilities of Preventív-Security Zrt. and its subsidiaries immediately prior to the acquisition corresponded to their fair values.

Goodwill has arisen on the acquisition of Preventív-Security Zrt. because its security services contracts are short term contracts and do not meet the criteria for recognition as an intangible asset at the date of acquisition.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

28 Related Party Transactions

Transactions with related parties are summarised as follows:

	2005	2004
Management fee to CP Holdings	315	310
Interest to CP Holdings	43	–
Loan arrangement fee to CP Holdings	36	–
Management support fee from CP Regents Park Two Ltd.	(54)	–
Rental fee to Interag Rt.	134	149
Services provided by Interag Rt.	5	5
Service provided to Interag Rt.	–	(1)
Service provided by Investor Rt.	13	13
Service provided to Investor Rt.	–	(2)
Service provided by Preventiv-Security ZRt.	260	250

Related party receivables and payables are not significant as at December 31, 2005, with the exception of the loan amounting to HUF 1,828 million (GBP 5.1 million less loan arrangement fee of GBP 0.1 million to CP Holdings Ltd.) from CP Holdings Ltd. (see note 9).

Interag Rt., Investor Rt., CP Regents Park Two Ltd. are each subsidiary companies of CP Holdings Ltd.

The Group considers the pricing of all transactions with related parties to be at arm's length.

Transactions with key management personnel

Total remuneration is included in personal expenses:

	2005	2004
Directors	142	181
Executive officers	95	91
Total	237	272



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

29 Financial instruments

The Group has financial assets, which include cash and cash equivalents, investments in state treasury bills and accounts receivable. The Group has financial liabilities which include, inter alia, bank loans and accounts payable. The fair values of these financial instruments are not materially different from their stated value.

Currency risk

The Group's sales prices are primarily quoted in Euro or US dollars and income is received in foreign currency or local currency. The Group's hotel properties are located principally in Hungary, the Czech Republic and Slovakia, the governments of which countries are committed as part of their EU accession to adopt the Euro at dates in the future which are not yet fixed. The Group also owns hotel properties in Romania and has an affiliate in the UK.

The Group had loans of EUR 80 million (2004: EUR 82.3 million), GBP 5.1 million (2004: nil GBP), ROL nil million (2004: ROL 92,641 million), CZK nil million (2004: CZK 7.1 million), nil USD (2003: nil USD) and SKK 4 million (2004: nil SKK) outstanding at 31 December 2005 (see note 13).

Management periodically reviews the merits of entering into foreign currency hedging contracts or other derivative products, but has not entered into any such contracts.

Interest rate risk

Interest rates on loans are listed in note 13.

Management has not entered into any interest rate hedging contract as management believes the contracted interest rates are favourable for the Company.

Credit risk

Financial assets which may be subject to credit risk consist of short term investments, cash at bank and trade receivables. Short term investments are government securities, cash is held at reputable banks and the allowance for doubtful receivables reflects credit risk on trade receivables. The Company has no significant concentrations of credit risk.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

30 Segment reporting

Geographical segments

December 31, 2005

	Operations in Hungary	Operations in Czech Republic	Operations in Slovakia	Operations in Romania	Elimination	Consolidated
Revenue	29,977	5,570	6,317	978	–	42,842
Inter-segment revenue	407	126	–	–	(533)	–
Total revenue	30,384	5,696	6,317	978	(533)	42,842
Profit/(loss) per segment	474	710	(206)	(108)	(53)	817
Cost to acquire fixed assets	2,732	1,153	1,353	44	–	5,282
Depreciation and amortisation	2,309	739	1,077	199	–	4,324
Current assets	4,208	1,636	647	278	45	6,814
Non-current assets	65,318	11,975	15,642	1,262	(21,847)	72,350
Current liabilities	6,510	980	1,534	231	45	9,300
Non-current liabilities	14,425	4,413	2,347	494	(718)	20,961
Minority interest	533	447	1,133	698	–	2,811
Net assets	48,058	7,771	11,275	117	(21,129)	46,092

December 31, 2004

	Operations in Hungary	Operations in Czech Republic	Operations in Slovakia	Operations in Romania	Elimination	Consolidated
Revenue	27,013	5,131	6,119	840	–	39,103
Inter-segment revenue	311	126	–	–	(437)	–
Total revenue	27,324	5,257	6,119	840	(437)	39,103
Profit/(loss) per segment	1,250	386	(18)	(24)	(4)	1,590
Cost to acquire fixed assets	3,097	1,102	1,779	70	–	6,048
Depreciation and amortisation	2,614	535	836	194	–	4,179
Current assets	4,466	1,421	1,016	215	(357)	6,761
Non-current assets	60,711	10,812	14,892	1,393	(22,377)	65,431
Current liabilities	6,870	1,310	2,121	223	(357)	10,167
Non-current liabilities	13,553	3,889	1,359	526	(718)	18,609
Minority interest	469	417	1,321	689	–	2,896
Net assets	44,285	6,617	11,107	170	(21,659)	40,520

Eliminations principally comprise the equity consolidation and inter group loans. Inter-segment pricing is determined on an arm's length basis.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Business segments

Management considers hotel and hospitality operations as the only business segment, therefore all amounts included in the financial statements are part of that segment. (The security business became a subsidiary only on 31 December 2005 and its assets are not material in the context of the Group.)

31 Key sources of estimation uncertainty

The Group makes estimates and assumptions concerning the future. The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are described below.

Deferred tax assets

The Group recognizes deferred tax assets in its balance sheet relating to tax loss carry forwards. The recognition of such deferred tax assets is subject to the utilization of tax loss carry forwards. The utilization of certain amounts of such tax loss carry forwards is subject to statutory limitations and is dependent on the amount of future taxable income.

The Group recognizes deferred tax assets relating to tax loss carry forwards based on estimated future taxable income. If the future taxable income is significantly less than the amount estimated, the difference may impact the amount of the deferred tax asset.

Impairment of property, plant and equipment and intangible assets

The carrying amounts of the Group's property, plant and equipment and intangible assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.

The Group considers that the accounting estimate related to asset impairment is significant due to the need to make assumptions regarding the above factors and the material impact that recognising impairment could have on the results of the Group.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

All amounts in million HUF

Depreciation

Property, plant and equipment and intangible assets are recorded at cost and are depreciated or amortized on a straight-line basis over their estimated useful lives. The determination of the useful lives of assets is based on historical experience with similar assets. The appropriateness of the estimated useful lives is reviewed annually. Due to the significant weight of property, plant and equipment in the asset base of the Group, the impact of any changes in these assumptions could be material to the results of operations.

Provisions

The Group establishes provisions where management considers that it is probable that an outflow of economic benefits will be required to settle obligations arising from past events. The estimated amounts of provisions are reviewed on an ongoing basis. Changes in estimates are recognised in the income statement and such changes could be material to the net results reported in a particular year.



Danubius Hotels Rt. reckons with a stable international market environment in 2006 and that incentive to travel remains strong therefore plans to increase its group level revenues as well as its profits.

The company worked out a new middle-term strategy, the goal of which is to increase awareness of Danubius and strengthen its market position both on the domestic and international markets. In order to achieve this, we reposition our hotels and group hotels of similar profile to two new brands in the future. With this step, we intend to ensure a better identification of the hotels and the standardisation of the services offered.

Traditional spa hotels represent our major strength by offering complete health spa services as integrated part of the hotel, at the same time, quality wellness facilities. With the brand name "Danubius Health Spa Resort" we intend to draw more attention to both the domestic and international spa hotels of the group. Our top quality city hotels will be branded "Danubius Hotels". With this brand we aim primarily at individual business and leisure guests looking for quality services and we especially focus on the organisation of conferences and events. We find it increasingly important to emphasise that the hotels not included in the above brands also belong to the group under the name "Member of Danubius Hotels Group". In addition to the high quality standard Danubius services, the unique character and special values of certain hotels are also pointed out. This is marked by the "Classic Collection" sub-brand, which will be used for certain hotels of Danubius Health Spa Resort or Danubius Hotels brands located in historical buildings recalling the atmosphere of the last centuries. Alongside establishing the brands, we will modify the organisational structure too: the current focus on geographical structure will be turned to the operation of a service centred organisation.

The introduction of the brand names and the strengthening of the market position are expected to have a positive impact on our business figures in the middle-term but we expect to see improvement from the 2006 price strategy and marketing activities too.

We are planning revenues of our hotels in Hungary to go up by 5%. The competition among four and five star hotels still remains to be keen in Budapest but the occupancy of Danubius hotels in the last couple of years was outstanding. For 2006 we already targeted the increase of average rates. In order to achieve this, we concentrate our marketing activities principally on segments realising higher average spending, conference, individual business and leisure guests. In case of spa hotels the years of occupancy decrease came to a stop in 2005 and in 2006 there is a chance of a moderate increase of average rates. It remains to be our special task to replace the lessening German guest turnover. We apply ads on our domestic market directly for the guests, we optimise our system of discounts and intensify our business acquisitions to utilise the potential of the Russian market. We strive to keep the volume of guests in our Balaton hotels: we modified the offer in Hotel Marina, for a trial period we offer all inclusive services to our guests staying in the hotel in the main season.

Our sales strategy lays stress upon contacting domestic guests directly, while abroad we continue to strengthen our presence through representations. Internet bookings represent a growing ratio in reservations but there is still great potential in this channel.



BUSINESS OVERVIEW 2006

We endeavour to direct all Internet bookings to the homepage of Danubius to be able to offer the guests a wide variety of possibilities.

We continue to carry out reconstruction works in the future too by monitoring on the maintenance of the buildings and improving quality, mainly completing room and bathroom refurbishments. The overall reconstruction of Hotel Astoria will be completed in 2006 and plans are in the pipeline for preparations for the capital expenditure project on Hotel Gellért.

In the Czech Republic and Slovakia the number of domestic guests financed by the health insurance is likely to decrease further. The lacking turnover can be compensated on the one hand by guests arriving from the EU also financed by the health insurance, on the other hand with the lately increasing number of Russian guests as well as short stay, mostly week-end visitors, the number of whom has recently been going up.

All this makes an average rate increase possible in the Czech Republic, so we are expecting a revenue increase of 4.8% in Czech crowns. We continue to up-grade the hotels in Marienbad by carrying out reconstructions, developing the health-spa departments and complementing these with wellness and swimming pool areas.

In Slovakia the revenue shortage due to closing down of the Thermia Palace owing to an overall reconstruction project and the keen competition does not allow much increase of average rates, therefore revenues (in Slovakian crowns) are planned at the similar level to 2005.

In case of the Romanian hotels, we forecast more than 10% growth in revenues (in Romanian LEI) and as compared to last year's moderate occupancy we are expecting to reach the level of 2004 again while also planning an increase of average rates. We intend to achieve this alongside intense marketing activities by widening the selection of offers and by focusing on increasing the ratio of meeting and conference segments.

The London based Danubius Hotel Regents Park contributes significantly to strengthening awareness of the name Danubius on the international market. In 2006 by refurbishing the common areas we are planning continued increase of quality.



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