

**DANUBIUS HOTELS
GROUP**

**ANNUAL REPORT
2006**



**DANUBIUS HOTELS
GROUP**

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Statement by the Chairman

A n n u a l R e p o r t

Dear Shareholders,

It is my pleasure to present to you the Annual Report of 2006 about last year's performance as I believe we can look back on a successful year in many respects. The Company's revenues exceeded HUF 47 billion in 2006, while profit after tax approached one and a half billion forint, showing a 65% improvement compared to the previous year. Our operating profit also improved by over 20%, which is perhaps the best measure of our progress.

During the last year management has concentrated on implementing our new strategy announced at the last general meeting. Our main objective is to increase awareness of Danubius and to strengthen its market position both domestically and abroad. We have rebranded our hotels under the brand names of Danubius Health Spa Resorts and Danubius Hotels, and we formed a new category under the name of Member of Danubius Hotels Group. We also established a sub-brand called Classic Collection, covering several of our prestigious heritage properties. We have focused on the improvement of quality – a priority in all fields of operation – and concentrated on standardisation of services within the brand categories. Of course, this is a long term programme and the full results will emerge over time, but our clear goal, as awareness of our brands improves, is for our guests to readily associate the name Danubius with high quality hotels offering a wide variety of services, whether in health spa, city or other hotels.

Looking at our 2006 operations, our business policy was to improve our margin through increasing average rates, even at the expense of a moderate fall in occupancy. Our average rate in Euro increased by almost 12% in our Hungarian hotels. The weakening of the Hungarian Forint at busy periods during the year certainly helped this process, but there is no doubt that our planned price policy was successfully implemented.

Some other trends were apparent in 2006:

- Leisure business in Budapest fell back following a reduction in the number of flights by budget airlines. We are working to compensate this shortfall with new and attractive offers for the business, events and conference segments.
- The setback in German and Austrian demand continued, but was compensated by an increase in domestic guests, particularly for shorter, weekend stays at good rates. In 2007, we are reorganising our representative offices in Germany to provide a new impetus to business development in this key market.

Our wide ranging renovation programme in 2006 included three major projects. The completion of the reconstruction of the historic Hotel Astoria in Budapest, the total renovation of the art nouveau Thermia Palace Hotel in Piestany, together with the unique Irma Spa which adjoins it, and the full refurbishment of Hotel Centralni Lázně in Marienbad. These three buildings all form part of our Classic Collection. The Thermia Palace and Irma complex is the flagship of Piestany and it is, at the same time, the first five-star hotel in Slovakia. Preparations are also in the pipeline for the reconstruction of the most famous hotel in Budapest, Danubius Hotel Gellért. Our programme of improvements is also laying special emphasis on improvement of function rooms and other facilities to support our business, conference and events business. In our health



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spa hotels, we are constantly improving our facilities and our offering (such as the roll out of our Emporium beauty brand) to build on our leading position.

Looking at the performance of our subsidiaries in 2006, the hotels in Piestany achieved an increase in both occupancy and average rates. However there remains unrealised potential in the operation of the Slovakian company. Following the opening of the Thermia Palace, we hope to arrest the decline in the German market and expect that the profit of the company will continue to grow.

The performance of the Marienbad hotels in recent years has been strong, but 2006 presented new challenges, primarily as a result of increased capacity in the resort which outstripped demand. Although average rates went up, the contribution of the Marienbad subsidiary to Group performance fell back.

Our hotels in Sovata, Romania had a good year. The strengthening of the domestic, primarily business, segment, which had been felt in previous years was boosted as a result of Romania joining the European Union at the beginning of 2007. We are optimistic about the future performance of this company and the possibilities for upgrading another hotel are being considered.

Our London based hotel, Danubius Hotel Regent's Park, performed in line with budget and has assisted in increasing international awareness of the Danubius name not only on the British market, which is a major source of guests for Hungary, but more generally given the level of international tourism and business in London. Further progress has now been made in connection with the proposed Danubius' management contracts for health spa hotels in Buxton and Bath in England and it is hoped that construction of the hotels will start before the end of 2007.

When looking at our plans for 2007, much will depend on the movements in exchange rates. In 2006, we experienced a generally favourable trend and, as the yearend exchange rate did not differ substantially from the end of the previous year, we did not have to account for a significant exchange rate difference on our loans. It is extremely difficult to predict the movement of exchange rates in 2007. At present, the strength of the Forint remains an important risk factor for our revenues.

The position of the Forint is also linked to the general economic and political situation in Hungary. Political events over the end of 2006 and beginning of 2007 have perturbed me, not just because a divided country is a weaker country, but also because of the impact on Hungary's image on the world stage. International tourists today have more options than ever. The events of September and October last year dented tourist's confidence about visiting Hungary and this was felt in our bookings and in the whole market through the first quarter of 2007. Tourism is a key industry for Hungary and it is important that the Government and all others with an interest pull together to restore Hungary's image and realise the full potential of Hungary's unique attractions as both a business and a tourist destination.

The new Government programme introduced in September 2006 to address the problems of the Hungarian economy also had an effect on our operations in Hungary

Statement by the Chairman

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and this will continue in 2007. Management has taken steps to compensate these measures where possible but in several areas the cost increases could not be passed on in a highly competitive market. We have to cope with this and hope that the programme is successful in setting Hungary back on the path towards a balanced economy and renewed economic growth.

In addition to being Chairman of Danubius, I am, as most of you will know, also Chairman of CP Holdings. Although we have previously made an announcement, I think I should mention that CP Holdings Group of Companies made a public purchase offer for the shares it did not own in Danubius in August 2006. Few shareholders decided to accept the offer and, as explained in the offer documents, the offer was made largely for technical reasons in accordance with the requirements of the capital market law.

The movement in the share price has been encouraging. At the beginning of 2006 the share price was HUF 5,700 and by the time of the AGM it reached a record of HUF 8,800. I hope shareholders are pleased with this 54% increase over just one year. Against this background, I hope you will also understand that we have decided to continue with our policy of reinvesting last year's earnings instead of paying a dividend. We have an ambitious reconstruction plan for the coming years and we continue to believe that this is the right approach to enhance the Group's value.

To close, let me thank our guests, our business partners and the entire Danubius team for their support in the course of 2006. During the last year, the new brand strategy has been enthusiastically promoted by our management. It is helping to ensure even closer co-operation between the various countries in which we operate, all of which will strengthen the Danubius name and reputation for quality in everything we do. Finally, I would like to thank you as shareholders for your support and I can assure you that, at every level in the business, we are working to improve our performance and to increase the value of the company for the benefit of all shareholders.

April, 2007



Sir Bernard Schreier,
Chairman of the Board

DANUBIUS HOTELS GROUP

Danubius is the largest health spa hotel chain in Central Europe. More than 8600 hotel rooms in Hungary, United Kingdom, Czech Republic, Slovakia & Romania belong to the Group.



We offer much more than the average hotel and restaurant services: traditional spa therapies, where natural healing resources are used as a basis for treatments, as well as fitness and beauty services. Danubius Quality Conference guarantees the same high quality service for every event organised in our hotels.



DANUBIUS HOTELS
GROUP

You are welcome
any time you need accomodation...
and more...




DANUBIUS
HEALTH SPA RESORTS


DANUBIUS
HOTELS


MEMBER OF
DANUBIUS HOTELS GROUP


DANUBIUS
HOTELS
GROUP

You are welcome any time you need facilities for a conference or meeting ... and more...



DANUBIUS HOTELS GROUP

You are welcome any time you
need a place to relax and revitalise...
and more...



DANUBIUS
HealthSpa

The
EMPORIUM
wellness & beauty

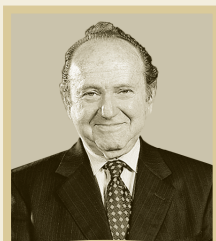
DANUBIUS
PremierFitness



DANUBIUS HOTELS
GROUP

The Board of Directors

A n n u a l R e p o r t



Sir Bernard Schreier

Chairman of the Board;
Chairman of
CP Holdings Limited and subsidiaries;
Vice President of Bank Leumi Plc.



Alexei Schreier

Director of CP Holdings Limited;
Member of the Danubius Board
from 2007 April



Iris Gibbor

Director of CP Holdings Limited



John Smith

Deputy Chairman of Danubius Hotels
Group from 2007; Director of
CP Holdings Limited and subsidiaries



Robert Levy

Chief Executive Officer of CP
Holdings Limited from 2007;
Director of 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

Manager of SAS Scandinavian
Airlines in Budapest until 1998;
honorary docent



Dr. István Fluck

General Vice President of FEMTEC,
Director and Chief Physician of
Budapest Spa Zrt.

The Supervisory Board

A n n u a l R e p o r t



Tibor Antalpéter

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



Dr. Gábor Boér

Deputy Chief Executive Officer of Investor Holding Zrt. since 1990, Chief Executive Officer of Interag Holding Zrt. 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 Gálszécscy

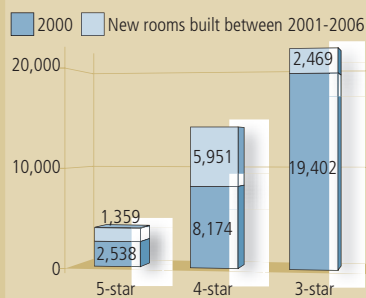
Retired minister



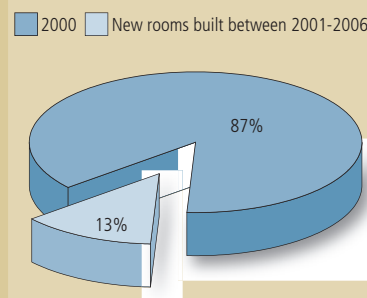
According to Hungarian statistical data the hotel capacity – especially the four- and five star category – continued to increase compared to the previous year. In 2006, however, it was not coupled with the growth of demand. As to demand we experienced a reshuffling: foreign demand fell back while the number of domestic tourists went up.

The hotel capacity extended from year to year, in the past six years it increased by a total of 15%. Significant growth was recorded in the five- and four star category (54 and 73%), as well as on the health-spa and wellness hotel market (approx. 30% more hotel rooms operate in these two categories than two years earlier).

Increase of the number of hotel rooms in the period 2001-2006 by categories

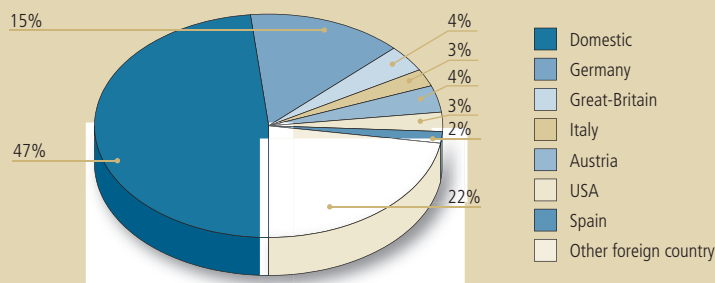


Increase of the number of hotel rooms in the period 2001-2006



The number of hotel guests showed no change against the 2005 figure, however, the period of stay continued to shorten, thus the number of guest nights recorded a negative trend (-1.5%). The decrease in the period of stay can be explained by the modification in the distribution of the guests: last year 42% of the guests were domestic, in 2006 this figure exceeded 45%. And this guest circle takes advantage of the hotel services for the weekends or for a couple of days. Among foreign guests the number of those coming from German and Austrian territories have been decreasing for years, but the number of British, Irish and Spanish guests showing great interest in 2005 also dropped in 2006. This latter was clearly affected by the decrease of the number and frequency of the budget airlines in 2006 that recorded peak performance in 2005.

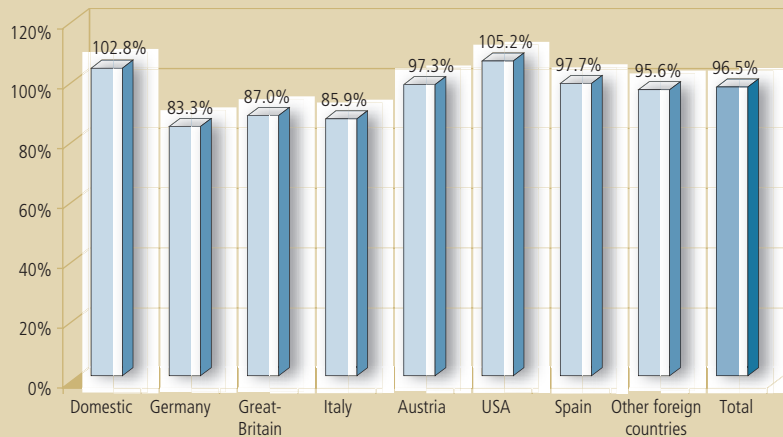
Distribution of guestnights in commercial accommodations in 2006



Tourism in Hungary, in Czech Republic and in Slovakia

Annual Report

Change of guestnights in hotels (2006/2005)

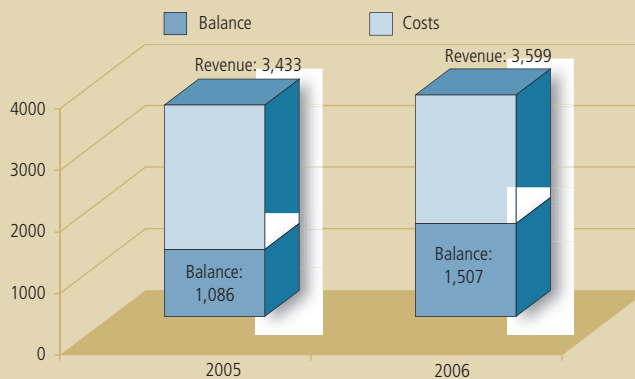


Room occupancy of the hotels was 47.5% in 2006, 0.6 percentage point lower than one year earlier. The highest occupancy was recorded in four- and five star hotels.

Gross room revenues went up by 15% alongside decreasing number of guest nights, this means that average hotel rates were up. The consumer price index for accommodation and F&B services calculated by the Central Statistical Office was 5.3% in 2006, against the yearly 3.9% inflation.

Based on the figures it can be stated that the performance of the tourism industry improved as opposed to last year, it closed each quarter with a balance exceeding 2005. The closing balance was EUR 3599 million revenues and EUR 1507 million balance.

Revenue and balance of tourism – according to the current account balance (EUR million)



Statistics in the Czech Republic show that there are about twice as many hotels there compared to Hungary. Nevertheless, the rate of capacity growth was only 5% during the past five years, which is far lower compared to Hungary. The national average room utilisation was 43% in 2006 against 42.4% recorded a year earlier.

The number of guests in the hotels increased by 3.3%, however, expansion of demand in the higher categories was even greater: 5 and 10% more guests stayed in the four- and five star categories. More than 60% of hotel guests come from abroad. This figure went up by 1.7%. The majority of foreigners – just like in Hungary – arrived from Germany, Great Britain and Italy (proportion: 25%, 8% and 6%). Among domestic guests 6% more stayed in the hotels compared to the previous year.

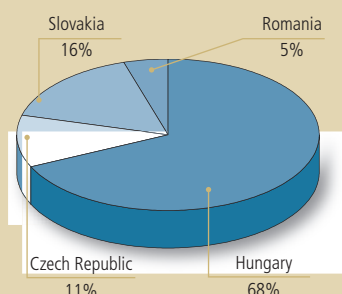
According to data by the Slovakian statistical office revenues from the tourism sector went up by 20% in 2006. The capacity of accommodation has only increased to a small extent (by 2% at national level). The number of guests visiting the commercial accommodation places was up by 4.5%. Both domestic (+3.1%) and foreign (+6.4%) demand showed an increase. In Slovakia the majority (55%) of guests is domestic, unlike in Hungary and the Czech Republic. Those arriving from the neighbouring countries represent the greatest proportion among the foreign guests here (28% from the Czech Republic, 14% from Poland), and these figures showed an increase in the past years. The German demand (12%), occupying third place, is lagging behind in Slovakia (-2%) too.

Source: *Hungarian, Czech and Slovakian Statistical Office, National Bank of Hungary, Hungarian Tourism Zrt.*

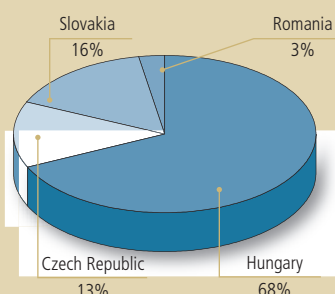
Figures and ratios in hotel business – 2006

A n n u a l R e p o r t

Distribution of the number of rooms



Distribution of revenues



	Hungarian hotels	Czech hotels	Slovakian hotels	Romanian hotels
Number of rooms	5,613	911	1,322	400
Occupancy	65.1%	76.0%	76.8%	54.4%
Average rate (HUF)	13,471	16,064	6,731	6,692
Number of staff	2,881	672	1,319	240
Average number of staff / room	0.51	0.74	0.99	0.60
Profit of rooms department (HUF million)	13,093	3,006	2,045	455
Profit of F&B (HUF million)	2,320	261	388	224
Profit of spa department (HUF million)	944	704	1,840	106
Profit of other minor departments (HUF million)	-91	105	-643	63
Departmental profit (HUF million)	16,266	4,076	3,630	848
<i>Profit margin</i>	<i>55.9%</i>	<i>66.5%</i>	<i>51.1%</i>	<i>66.7%</i>

Hungarian hotels of Danubius Group achieved 65.1% occupancy in 2006, 4% lower than the previous year. The average rate was HUF 13,471, 19% higher compared to last year. The significant weakening of the forint had a positive effect on average rates, however, average rates calculated in EUR also increased a lot (by approx. 12%). Average spending also went up: calculated in HUF by 13%, while in EUR exceeding 5%.

The number of foreign guest nights dropped by 7%. The number of guest nights from the major sending countries – with the exception of the USA – showed a decrease: Germany –19%, Great Britain –17%, Italy –14%. The domestic stays went up by more than 5%.

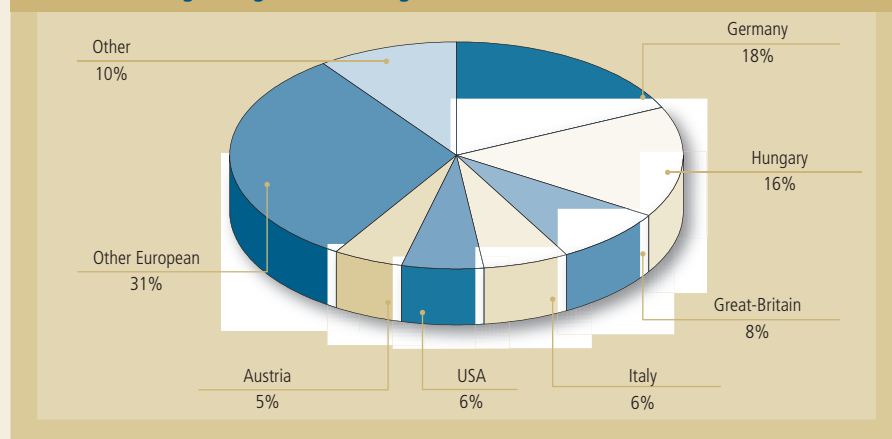
The total revenue of Hungarian hotels was HUF 29.1 billion, showing an increase of 6%. This could be attributed to the significant increase of room revenues, unchanged F&B revenues and a moderate decrease of health spa and other income. Departmental costs went up by 4% while general costs by 7%. The increase of energy costs (+12%, meaning an additional cost of HUF 225 million) can be made responsible for 43% of the increase of general costs.

The gross operating profit (GOP) of Hungarian hotels went up by 8.2% to HUF 8.2 billion as opposed to 2005. This means that 38% of revenue surplus was realized as profit.

The **Budapest hotels** delivered an outstanding performance in 2005 in terms of volumes, however, this could not be repeated in 2006. The number of guest nights decreased by 8%, with Great Britain, Germany, Italy, Spain and Japan, making up almost half of this volume, dropping by 16%. From among the sending countries, demand for Budapest rose only from the USA (by 8%). These produced a 4.4% decrease in the occupancy of the Budapest hotels. The company managed to raise average rates in this market by 18%, which shows an increase exceeding 10% even in EUR. The revenue of the Budapest hotels was up by 6% while GOP indicates 7.3% surplus.

In the country spa hotels the number of German and Austrian traditional spa guests continued to go down, however, domestic demand increased significantly (+16%), but this could unfortunately only compensate half of the traditional health spa turnover. So occupancy went down by 4%, but the company achieved almost 19% average rate increase compared to 2005. Alongside 3.7% increase of revenues, GOP went up by 2%.

Distribution of guestnights in our Hungarian hotels



Czech hotels achieved 76% occupancy in 2006, 4.8% lower compared to the previous year. The decrease was owing to the set back in German and domestic guest nights, which could not be compensated by the increase in Russian and Israeli demand. The average rates calculated in forint were HUF 16,064 in 2006, exceeding last year's by 8.8%. The Czech hotels contributed to the group performance by HUF 6.13 billion revenue and HUF 2.2 billion GOP.

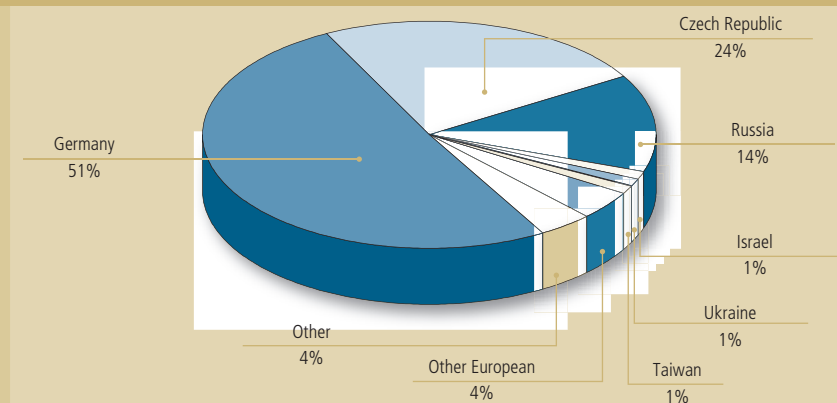
The evaluation of the Czech hotels in forint is largely distorted by changes in the exchange rates: as compared to last year the HUF significantly weakened against the Czech crown (7.1%), the items calculated in forint show a more favourable picture in respect of revenues.

Figures and ratios in hotel business – 2006

A n n u a l R e p o r t

The revenues indicated in CZK – with the exception of F&B – went down by a total 2% compared to 2005, while operating and general costs both went up (by 3% and 6%) making GOP 12% lower than in the previous year.

Distribution of guestnights in our Czech hotels

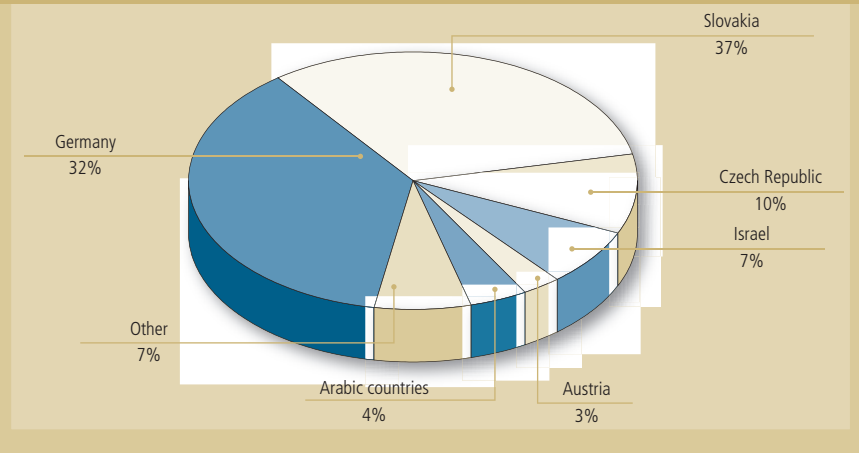


In the **Slovakian hotels** the ongoing decrease in the number of German guest nights continued too (-14% compared to 2005). Upturn in domestic, Czech and Israeli demand could not balance, even together, the set back in the number of German guest nights. The total number of guest nights, however, remained the same. The performance of the Slovakian subsidiary was influenced partly by the fact that the Thermia Palace was closed during the entire year due to reconstruction works, partly because the evaluation in local currency and in forint shows a significant difference here too (the forint weakened against the Slovakian crown by 6.3%).

Occupancy went up by 4.1% to 76.8% and the average rate calculated in forint increased by 11% (to HUF 6,731). The Slovakian hotels contributed to the revenues by HUF 7.1 billion and increased group GOP by HUF 1.6 billion.

Revenues indicated in Slovakian crowns increased the most in the health spa area, revenues from room sales also increased while F&B was lagging behind the previous year. This means – in local currency – a 3% increase in revenues. The costs were lower by 7% – alongside decreasing departmental costs and increasing general costs – compared to 2005, which means that in Slovakian crowns 60% more GOP was produced compared to a year earlier.

Distribution of guestnights in our Slovakian hotels

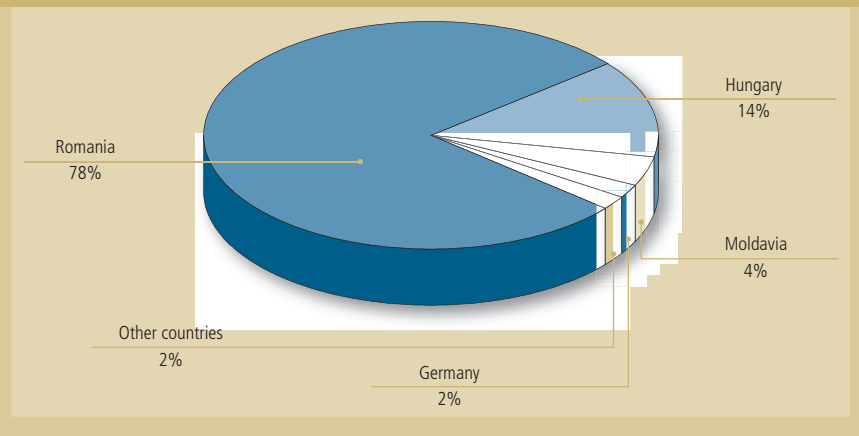


Evaluating the **Romanian hotels**, the difference in the statements made in forint and local currencies have to be taken into consideration here too, since the forint weakened against the Romanian lei by 9.1%.

The changes in demand are indicated by the fact that while the number of German guest nights dropped to its half and those of Hungarian guests went up only moderately, domestic and Moldavian guest nights increased to a large extent (+15% and +40%). The total number of guest nights was up by 11%, producing 54.4% occupancy in 2006, 5.6% more compared to the previous year. This could be achieved by HUF 6,692 average rate (+21%).

The contribution of the Romanian hotels to group revenues was HUF 1.3 billion, and HUF 504 million to the GOP. Revenues shown in local currency went up in all departments – in the health spa department to the greatest extent. Costs were controlled and the Sovata hotels achieved a GOP exceeding that of 2005 by 33%.

Distribution of guestnights in our Romanian hotels



Introduction – improvement in operating profit and profit after tax

The Danubius Group produced HUF 47.3 billion revenue at consolidated level in 2006, exceeding the figure of the previous year by 11%. This was achieved with group level average rates of HUF 12,172 and group level occupancy of 67.7% which indicates that in line with our targets the company has raised the average rates (+16%) accompanied only by a moderate set back in occupancy (-2.2%). The HUF 2.7 billion operating profit shows 18% improvement.

The changes in the exchange rates had a significant impact on the group performance. On the one hand, the weakening of the forint against the euro had a positive effect on our Hungarian revenues – owing to offering rates in Euro –: the monthly average rates fluctuated significantly but showed weakening of the forint all along the year (1–13% against the euro). At the same time in case of the foreign subsidiaries the local currencies strengthened against the Euro. On the other hand, due to the consolidation of the foreign subsidiaries in forint the weakening of the forint compared to the local currencies influenced our profits.

Besides this, the year-end exchange rate applied when revaluating the loans did not deviate significantly from the previous year's, meaning that the accounted exchange rate difference shows HUF 158 million profit in 2006.

The consolidated profit before tax was HUF 1.8 billion in 2006, surpassing the previous year by 58% (+HUF 650 million). This is better than the 2005 result by HUF 113 million (+7.5%) even without the exchange rate differences.

The profit after tax of the Group was HUF 1.5 billion in 2006, 65% higher than a year ago.

Business in the Hungarian subsidiaries representing the majority shares in the group was hit by several unfavourable outside effects in the second half of the year. The news of the Budapest riots at the end of September and in October had a very detrimental effect on the country and hit tourism badly. Moreover, the new government program introduced from September 2006 also adversely affected results. The increase of the VAT from 15% to 20% in prices of room-, food-, and certain health spa services caused 5% loss regarding our offered prices and contracted partners. The solidarity tax and the changes in the taxes on contribution in kind as well as the increase of gas and electricity prices also burdened the company significantly.

Changes within the Danubius Group

There were no changes in the companies consolidated in the Danubius group in the year 2006.

In November 2005 Danubius Group acquired 1.75% shares of Smrdaky Local Government held in Slovenské Liečebné Kúpele Piestany a.s., and with that the share of the group 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 this firm is consolidated from the end of December 2005, the effect of which is highlighted in our report.

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 2006 report already shows the balance of related management fee revenues and financial expenditures.

In the management of the company the following change took place: Sándor Betegh, former CEO retired on 1 March 2006 and was succeeded by Dr. Imre Deák. There was no change in the members of the Board, as the members with mandates expiring in 2006 have all been re-elected by the AGM for another five years.

In a recently announced new strategy the company has listed the hotels of Danubius into new brands as of 1 July 2006. Hotels with a health spa profile belong to Danubius Health Spa Resorts while city hotels of a higher category are listed under the Danubius Hotels brand. Those in special historical buildings are also in a sub-brand called Classic Collection. The Member of Danubius Hotels Group category includes all other hotels belonging to the group and the internationally branded properties.

Balance Sheet (consolidated, audited, according to IFRS)

Assets HUF million	At December 31,		Index
	2005	2006	
Total current assets	6,814	7,608	111.7%
Total non-current assets	72,350	77,472	107.1%
Total assets	79,164	85,080	107.5%
Liabilities and Shareholders' Equity HUF million	At December 31,		Index
	2005	2006	
<i>Total current liabilities</i>	9,300	12,303	132.3%
<i>Total non-current liabilities</i>	20,961	20,968	100.0%
Total liabilities	30,261	33,271	109.9%
<i>Attributable to equity holders of the parent</i>	46,092	48,959	106.2%
<i>Minority interests</i>	2,811	2,850	101.4%
Total shareholders' equity	48,903	51,809	105.9%
Total liabilities and shareholders' equity	79,164	85,080	107.5%

Report of the Board of Directors

A n n u a l R e p o r t

Total consolidated asset value amounted to HUF 85.1 billion as of 31 December 2006, HUF 5.9 billion higher compared to the end of previous period. The asset value of the first consolidated Preventív Security Zrt. and its subsidiaries was HUF 367 million at the end of the period.

Non-current assets reflect the reclassification of certain assets now held for sale. In spite of the upswing of turnover, current assets increased only by HUF 259 million, excluding the effect of reclassification. Accounts receivable increased by 5.9% that is well below the 10.6% increase of total revenue while cash and cash equivalents are 31% higher compared to the end of last year, mainly reflecting the effect of our year-end debt collection programme.

The amount of Property, plant and equipment increased by HUF 5.3 billion during the reported year in line with the sum of capitalised investments less amortisation. The investments in associated companies, amounted to HUF 1,715 million show the historic cost adjusted by share of earnings of the investment in CP Regents Park Two Ltd.

Total liabilities increased by HUF 3 billion, which is caused entirely by the increase of short-term liabilities. The amount of trade creditors went up by HUF 899 million due to an upswing in turnover and the construction in progress, as well as the consolidation of Preventív Group (HUF 121 million). The HUF 974 million increase in other payables and accruals includes HUF 350 million deferred revenue in respect of the sale of Hotel Esztergom, the growth of tax payment obligations (the larger part of which is owing to the increase of the VAT from 15 to 20% related to hotel and spa services as well as food turnover) and the increase of the liabilities of the Czech and Slovakian subsidiaries partly owing to the changes in the exchange rates.

The Group had EUR 80.5 million and GBP 5.1 million long-term loan on 31 December 2006. The GBP loan, borrowed from related parties and shown in a separate line, was spent on the financing of the share purchase in London. The long-term loans decreased by EUR 3.9 million in the last quarter due to the EUR 7.1 million repayments made, of which EUR 6.7 million was provided by the Hungarian entities, and the EUR 3.2 million new borrowings drawn down by the Slovakian company to finance the construction of Thermia Palace. Even though the EUR/HUF exchange rate has fluctuated extremely over the year, the year-end FX rate did not deviate significantly compared with the prior year.

The value of shareholders' equity went up by HUF 2.9 billion as the result of the HUF 1,450 million increase of translation reserve due to the significant exchange rate fluctuations between the Hungarian forint, the Czech and Slovak crown and the Romanian lei and net after tax profit retained to the business. The parent company mitigates its interest exposure by means of hedging instruments the effect of which is included in the fair valuation reserve in accordance with IAS 39.

Statement of Income (consolidated, audited, according to IFRS)

HUF million	2005	2006	Index
Total operating revenue and other income	42,785	47,315	110.6%
Total operating expenses	40,497	44,606	110.1%
Profit from operations	2,288	2,709	118.4%
Financial income / (loss)	-1,165	-882	
Share of profit / (loss) of associates	6	-48	
Profit before tax	1,129	1,779	157.6%
Current tax expense	431	262	60.8%
Deferred tax expense / (benefit)	-183	63	
Profit for the year	881	1,454	165.0%
<i>Attributable to: Equity holders of the parent</i>	<i>817</i>	<i>1,409</i>	<i>172.5%</i>
<i>Minority interest</i>	<i>64</i>	<i>45</i>	<i>70.3%</i>

Starting from 2006 companies not pursuing hotel operation activities represent a larger proportion in the consolidation and for this reason costs are shown in the statement of income in a new structure by cost types. In order to allow for comparison with the previous period, we publish the figures of the Q1-Q4 2005 already in this structure, and show the differences in the chart below:

	January to December 2005	
	By place of cost structure	By type of cost structure
Cost of room sales	4,114	
Cost of food and beverage sales	10,319	
Cost of spa sales	2,254	
Cost of other minor department sales	2,837	
Administrative and general costs	15,328	
Other expenses	1,321	2,106
Depreciation	4,324	4,324
Material expenses and services used		18,088
Personnel expenses		16,066
Change in inventories of finished goods and work in progress		(50)
Work performed by the entity and capitalized		(37)
Total operating expenses	40,497	40,497

Last year other expenses showed exclusively taxes and loss of value of doubtful debts, while the year under review includes other items as well. The majority of the difference is caused by the fact that the Slovakian company has indicated earlier the non-refundable VAT by departmental units, however, the present report shows all the taxes among other expenses.

The revenues and costs of foreign subsidiaries are reported in forint but owing to the already mentioned – in certain cases significant – exchange rate movements this may deviate largely from the evaluation in their own currencies.

The involvement of Preventív Security Zrt. and its subsidiaries into the consolidation resulted in HUF 1,031 million surplus revenue and the total costs and expenses also increased. At profit before tax level it contributed to the performance of the group by a total of HUF 64 million.

Although the favourable trends experienced in the first three quarter stopped mainly due to the strengthening of HUF against EUR and the potential market damages caused by the political situation, the full year revenue exceeded last year's figures by 10.6%. In spite of the 10.1% increase of total operating expenses this revenue increase contributed to a 18.4% operating profit increase.

Danubius Group recognised HUF 47.3 billion revenue in the period between January and December 2006. This exceeds the prior year's figure by 4.5 billion (10.6%). This growth includes the first consolidated Preventív data as well as the net profit from the sale of the Gösser Brasserie in Keszthely (HUF 195 million) shown on the other revenues row. During the whole year the weak forint had a positive effect on the increase of revenues, on the one hand owing to the direct impact on average rates, on the other hand because this region (especially Hungary) became cheaper for foreign travellers.

The HUF consolidated revenues of major departmental units increased. Revenue on room sales went up by 11.8%, which in Forint terms increased, in respect of all geographical markets. F&B revenue at consolidated level was up only by 1.4% compared to last year owing to an increase reported from the Czech and Romanian subsidiaries parallel to Hungarian stagnation and Slovakian fall back. Spa revenues were not favourable in the Hungarian hotels that are still strongly dependent on the German market but went up substantially in Piestany and Sovata. The HUF 322 million increase of other revenues is due to the one off item of the net profit from the already mentioned sale of the Gösser Brasserie and a HUF 163 million reversal of Piestany legal provision.

Total costs and expenses at consolidated level were up by HUF 4.1 billion (10.1%) compared to the similar period last year that is, excluding Preventív Group's first consolidation effect of HUF 964 million, well below the increase of revenue. The value of material type expenditures was above the previous period by approx. HUF 2.1 billion, an increase of 11.6%, of which HUF 432 million was attributed to the increase of energy costs in Forint terms. The average increase of personnel type expenditures was 8.2% at group level, of which only 5.9% increase belongs to the Hungarian operation, while a significant increase was experienced in the Slovakian and Czech companies. Simultaneously, the group average headcount was reduced by 2% to 5,513 employees by the end of 2006. Other expenditures increased by HUF 409 million mainly due to the increase of revenue proportionate – mostly local – taxes. The amount of Depreciation, amortisation and impairment exceeded the previous year figure by 6.1% due to the extensive capital expenditure projects in the Czech and Slovakian subsidiaries.

The group achieved an operating profit of HUF 2.7 billion in the year ended 31 December 2006, 18.4% (HUF 421 million) higher year to date. The Romanian subsidiary reported an outstanding increase (HUF 182 million operative profit against last year's HUF 4 million operative loss), the Hungarian operation also produced above the average increase.

In terms of geographical segment ratios there were no significant changes in HUF revenues compared to the previous year, however the Hungarian and Romanian companies produce a greater proportion of operating profit:

Q1-Q4 2006 data	Revenues	Operating profit
Hungarian companies	68.8%	77.6%
Czech companies	13.2%	17.0%
Slovakian company	15.3%	-1.3%
Romanian company	2.7%	6.7%
Total	100.0%	100.0%

Profit before tax shows a less favourable picture than the operating profit, although the HUF 1.32 billion foreign exchange rate loss (the majority of which was unrealised) recognised in the first three quarter flash report disappeared by the end of December and turned to FX gain of HUF 158 million. The interest expenses increased by HUF 240 million to HUF 1,083 million, mainly due to the higher amount of average outstanding loan and increase of EURIBOR prime rate.

Based on the above the consolidated profit before tax was HUF 1.8 billion in 2006 compared to last year's HUF 1.1 billion.

The profit after tax of the Group was HUF 1.5 billion in 2006, 65% (+HUF 573 million) higher than a year ago.

Reconstruction works, renewals

In 2006 the company spent a total of HUF 2.31 billion on reconstruction works in our **Hungarian hotels**. We continued the already launched room refurbishments and paid special attention to investments aiming at streamlining the use of energy as well as the security technical and fire protection developments observing the changes of the mandatory stipulations. In addition we focused on technical planning works establishing the development concepts of the future.

In **Danubius Hotel Astoria**, the refurbishment of the room levels in the historical wing was completed. The reconstruction of the Café Mirror restaurant and the main kitchen was carried out, and the floodlight illuminating the entire historical wing was also completed. With the lobby and entrance renewal project starting in the near future, the three-year complete reconstruction project of the hotel will come to an end.

In **Hotel Budapest** we have refurbished the rooms and apartments on two hotel levels and installed new fire alarm system in the common areas, simultaneously to which the chimneys have been renewed and a new water softener system installed.

A new restaurant was built in **Best Western Hotel Hungaria** by connecting the former restaurant and brasserie, which – in addition to the newly introduced buffet breakfast choice – assures a more effective serving of breakfast for hotel guests. The partial refurbishment of one room level has already been completed and the fire alarm system has been extended.

In **Hotel Stadion** the reconstruction of the function room level was completed and the guest elevators were renewed. Through the renewal of the five conference rooms and connecting common areas new possibilities were opened up for the hotel in organising events. The swimming pool was fitted with equipment designed to provide currents for swimming and the sauna was replaced.

The overall refurbishment of 45 rooms on the second guest floor was completed in **DHSR Helia** and a water softening equipment servicing the entire building was installed.

The lobby and the Ybl room in **Danubius Grand Hotel Margitsziget** were rearranged and modernised: the front office desk and the marble floor were renewed and the lights were replaced. The main terrace on the first floor was equally redone.

In **DHSR Bük** we continued to renew the health spa department (including the periodic replacement of the thermal pool covers and the thermal water distant pipe) and to partially refurbish 40 rooms and bathrooms on the second floor. We have improved the sound system in the conference rooms and we replaced the furniture and carpets in the lobby.

In **DHSR Sárvár** the rearranging of the spa department and renewing the massage and mud treatment areas were completed and a new state-of-the-art fitness centre was created.

“All inclusive” services were on offer in **Hotel Marina** in Balatonfüred in this year’s main season, which required the transformation and renewal of the F&B units and the installation of electric guest check in and control system.

Refurbishment of 12 guest rooms started on the first floor of **Hotel Palatinus** in Pécs.

The major capital expenditure of the year 2006 in **Marienbad** was carried out in Centralní Lázně: the reconstruction and refurbishment of 107 rooms, the restaurants, kitchen and balneo area together with the renovation of the façade. In Hotel Svoboda 14 new room units were built in addition to the refurbishment of 21 guest rooms. The preparation of the swimming pool project in Hotel Hvezda is in process. The documentations for the refurbishment of Hotel King Edward (presently out of use) and the corridor between the Centralní Lázně and Nové Lázně are ready and were handed in to the authorities for approval. Roof repairs on the main Kolonada and energy saving projects were also carried out and the Arnika area was upgraded into a garden landscape. The company spent a total of CZK 204 million (HUF 1.90 billion) on reconstruction and renewal works in 2006.

In **Piestany and Smrdaky** SKK 543 million (HUF 3.86 billion) was spent on reconstructions and refurbishments in 2006, mainly on works carried out on the Thermia Palace and the Irma Health Spa. The hotel was opened in December under the name Danubius Health Spa Resort Thermia Palace, the third five star hotel in the Danubius group and the very first one in Slovakia. The connected Irma Bath was also completed.

In **Sovata** a fitness room was built in the health spa department in Hotel Sovata. The buffet on the Medve Lake beach was rebuilt and the connecting changing cabins were renewed. We also started changing the roof on the lake spa pavilion. The renewal of the guest elevators in Hotel Bradet was completed.

The increasing performance of the Romanian subsidiary enhances the chance of continuing the reconstruction programme, therefore we started to elaborate the mid-term development plans.

The refurbishment of 94 rooms and bathrooms was launched in the **London based Danubius Hotel Regents Park**.

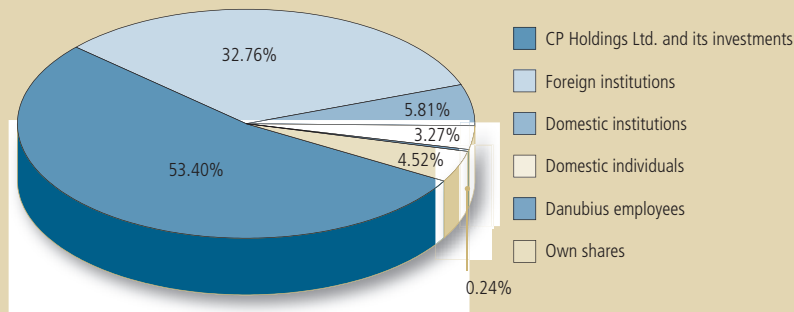
Shareholders' structure

On 31st December 2006, 53.401% 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 Zrt. (29.378%), CP Holdings Ltd. (17.907%) and Israel Tractors (6.116%).

The mandatory joint public offer submitted by CP Holdings Ltd., Israel Tractors and Equipment Co. Ltd. and Interag Holding Zrt. (the „Bidders“) on 8 August 2006 was closed on 4 October 2006. The Bidders have become, in the course of the public purchase offer, owners of 448 pcs of shares representing 0.0054% of the registered capital of Danubius Hotel and Spa Public Limited Company, as a result of which have 53.401% control of the company.

Foreign financial investors own a further 32.76% of the shares of which ownership of the Citibank and Deutsche Bank custodians exceeds 5% (representing 5.57% and 6.70%). The shares of the employees of the company represent 0.24%, and the company continues to own 4.52% own shares. Domestic private persons, institutions and pension funds own 9.08% of the equities.

Shareholders' structure on 31st December 2006



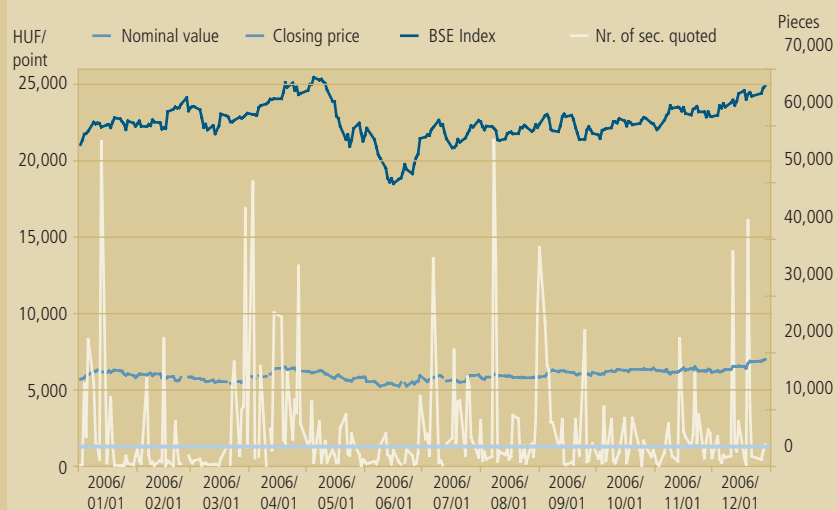
Report of the Board of Directors

A n n u a l R e p o r t

Trading on the Budapest Stock Exchange

	2005	2006
Number of trading days	252	252
Number of deals	2,582	6,325
Number of securities traded	909,710	1,502,821
Value of securities traded (HUF million)	4,891.4	8,986.4
Average price (HUF)	5,377	5,980
Minimum price (HUF)	4,355	5,000
Maximum price (HUF)	6,000	6,990
Closing price (HUF)	5,845	6,950

Trading of Danubius shares on BSE in 2006



Report of Supervisory Board related to the 2006 Balance Sheet of the company and the Report of the Board of Directors

The Supervisory Board of Danubius pursued its activities properly and regularly in the 2006 business year, according to the prevailing Act on Business Associations, the Articles of Association, the Rules of Procedure and the approved work schedule of the Supervisory Board. The Supervisory Board submits its report before the Annual General Meeting 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 established that the take over of the CEO position on 1st March 2006 went smoothly, and the shareholders were informed accordingly from publications and at the Annual General Meeting held in April. The majority of the employees were not affected directly by this change, however, they were able to experience already in the second half of the year the positive signs of the finalisation of the standardisation procedures and especially the measures taken for their observation. The development of internal communication, the importance of accentuated professional activities in recognition got a new swing as well as the efficiency of career development and training programs.

The Supervisory Board obtained from the Board and the management of the company all the support to pursue the tasks. The chairman of the Supervisory Board is invited to all meetings held by the Board of Directors, thus getting directly information about the discussions on major issues and overall decisions related to the entire company. The President and the Senior Vice President of the company participate regularly at the meetings of the Supervisory Board where together with the representative of the auditor of the company and the presidential auditor and the head of internal control as well as members of the supervisory board are informed about actual and forecast figures, events and possible problems.

The Supervisory Board of the company group continues to invite to its meetings the chairman and the members of the supervisory board of Danubius Zrt. where the flash report presenting the quarter year operating activities of the company is discussed jointly.

The composition of the Supervisory Board has not changed during the past year, it has pursued its activities based on the approved work schedule with four members. The Supervisory Board held meetings five times in 2006 and the decisions passed on the items discussed were recorded in the minutes of each meeting.

In addition to reviewing the quarter year flash reports required by the Budapest Stock Exchange the Supervisory Board dealt with the following issues:

- the working plan of the internal control,
- the three-year business strategy of the company,
- the documents of the AGM,
- experience gathered in the field of outsourcing man power,
- the operation of the Danubius Health and Pension fund,

Report of the Supervisory Board

A n n u a l R e p o r t

- the restructuring implemented on 31st July 2006,
- the profitability and efficiency of the purchasing activities with special regard to the service centre,
- the process, results and problems of standardisation, experience about the Mystery Shopping examinations.

Having read the report of the Board of Directors and the Auditor as well as the information obtained at the meetings the Supervisory Board established that:

- Danubius Hotels Nyrt. has pursued its activities by fully observing the prevailing acts and legal provisions,
- the financial obligations were entirely met in line with the plan,
- the capital expenditure and reconstruction projects were implemented according to a proper schedule.

The Supervisory Board agrees with and proposes for approval the report of the Board of Directors on the 2006 business year and supports its concept for the year 2007.

The Supervisory Board discussed the 2006 annual report prepared by Danubius Hotels Nyrt. in line with the Hungarian Accounting Act with HUF 56 910 778 thousand total assets and HUF 1 071 554 thousand profit after tax as well as the annual consolidated report prepared by the Danubius group in line with the International Financial Reporting Standard (IFRS) with HUF 85 080 million total assets and HUF 1 454 million profit after tax and proposes it to the Annual General Meeting for approval.

The Supervisory Board agrees with the proposal of the Board of Directors regarding the allocation of the achieved profit.

Budapest, 18th April 2007



Tibor Antalpéter
Chairman of the Supervisory Board



KPMG Hungária Kft.

Váci út 99.

H-1139 Budapest

Hungary

Telefon: (36-1) 887 7100

Telefon: (36-1) 270 7100

Telefax: (36-1) 887 7101

Telefax: (36-1) 270 7101

e-mail: info@kpmg.hu

internet: www.kpmg.hu

To the shareholders of Danubius Hotel and Spa Nyrt.

We have audited the accompanying 2006 consolidated financial statements of Danubius Hotel and Spa Nyrt (hereinafter referred to as "the Company"), which comprise the consolidated balance sheet as at 31 December 2006, which shows total assets of 85,080 million and a retained profit for the year of 1,454 million, and the consolidated income statement, consolidated statement of changes in equity and cash flow statement for the year then ended, and the consolidated supplementary notes including a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on the audit and to assess whether the consolidated business report is consistent with the consolidated financial statements. We conducted our audit in accordance with the Hungarian National Standards on Auditing and applicable laws and regulations in Hungary. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Our work with respect to

Independent Auditors' Report

A n n u a l R e p o r t

the consolidated business report was limited to the assessment of the consistency of the consolidated business report with the consolidated financial statements, and did not include a review of any information other than that drawn from the audited accounting records of the Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

We have audited the consolidated financial statements of Danubius Hotel and Spa Nyrt., its components and elements and their documentary support in accordance with Hungarian National Standards on Auditing and gained sufficient and appropriate evidence that the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Danubius Hotel and Spa Nyrt. and its consolidated subsidiaries as of 31 December 2006, and of their consolidated financial performance and of the consolidated result of their operations for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU. The consolidated business report is consistent with the disclosures in the consolidated annual financial statements.

Budapest, 24 April 2007

KPMG Hungária Kft.
1139 Budapest, Váci út 99.
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 2006 IFRS Consolidated Annual Report of Danubius Hotel and Spa Nyrt. 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

Annual Report

Danubius Hotel and Spa Nyrt. and Subsidiaries

Consolidated Balance Sheet

(All amounts in million HUF)

	Notes	At December 31,	
		2006	2005
Assets			
Cash and cash equivalents	3	3,087	2,363
Accounts receivable	4	2,000	1,889
Other receivables and prepayments	5	1,142	1,678
Inventory	6	844	884
Assets held for sale	7	535	–
Total current assets		7,608	6,814
Property, plant and equipment	8	72,947	67,687
Intangible assets	9	2,147	2,111
Investments in associates	10	1,715	1,763
Other investments, including derivatives		92	235
Deferred tax assets	21	571	554
Total non-current assets		77,472	72,350
Total assets		85,080	79,164
Liabilities and Shareholders' Equity			
Trade accounts payable		3,226	2,327
Advance payments from guests		518	433
Income tax payable		61	215
Other payables and accruals	12	3,690	2,716
Interest-bearing loans and borrowings	13	3,940	2,769
Provisions	11	868	840
Total current liabilities		12,303	9,300
Interest-bearing loans and borrowings	13	17,471	17,609
Loan from related party	27	1,866	1,828
Deferred tax liabilities	21	1,631	1,524
Total non-current liabilities		20,968	20,961
Total liabilities		33,271	30,261
Shareholders' Equity			
Share capital	15	8,285	8,285
Capital reserve		7,435	7,435
Treasury shares	15	(1,162)	(1,162)
Translation reserve		3,850	2,400
Hedging reserve		8	–
Retained earnings		30,543	29,134
Attributable to equity holders of the parent		48,959	46,092
Minority interests	14	2,850	2,811
Total shareholders' equity		51,809	48,903
Total liabilities and shareholders' equity		85,080	79,164



Consolidated Statement of Income

Annual Report

Danubius Hotel and Spa Nyrt. and Subsidiaries

Consolidated Statement of Income

(All amounts in million HUF)

	Notes	Year ended December 31,	
		2006	2005
Room revenue		22,885	20,462
Food and beverage revenue		14,571	14,371
Spa revenue		5,890	5,242
Other departmental revenue		2,220	2,279
Revenue from wineries		163	175
Revenue from security services		1,008	–
Other income	17	578	256
Total operating revenue and other income		47,315	42,785
Cost of goods purchased for resale		398	335
Raw material costs	18	9,428	8,702
Services used	19	10,354	9,051
Material expenses and services used		20,180	18,088
Wages and salaries		11,880	10,975
Other personnel expenses		1,347	1,232
Taxes and contributions		4,161	3,859
Personnel expenses		17,388	16,066
Depreciation and amortisation		4,587	4,324
Other expenses	20	2,515	2,106
Changes in inventories of finished goods and work in progress		(5)	(50)
Work performed by the entity and capitalised		(59)	(37)
Total operating expenses		44,606	40,497
Profit from operations		2,709	2,288
Interest income		43	57
Interest expense		(1,083)	(843)
Foreign currency (loss) / gain		158	(379)
Financial income / (loss)		(882)	(1,165)
Share of profit / (loss) of associates		(48)	6
Profit before tax		1,779	1,129
Current tax expense	21	262	431
Deferred tax expense / (benefit)	21	63	(183)
Profit for the year		1,454	881
Attributable to:			
Equity holders of the parent		1,409	817
Minority interest	14	45	64
Basic and diluted earnings per share (HUF per share):	22	178	103

Consolidated Statement of Changes in Shareholders' Equity

Annual Report

Danubius Hotel and Spa Nyrt. and Subsidiaries

D Consolidated Statement of Changes in Shareholders' Equity (All amounts in million HUF)

	Attributable to equity holders of the parent							Minority interest	Total equity
	Share Capital	Capital Re-serve	Treasury Shares	Retained Earnings	Trans-lation Reserve	Hedging Reserve	Total		
January 1, 2005	8,285	7,435	(1,162)	28,317	1,296	–	44,171	2,896	47,067
Dividends to minority shareholders	–	–	–	–	–	–	–	(8)	(8)
Acquisition of subsidiary	–	–	–	–	–	–	–	29	29
Acquisition of minority interest	–	–	–	–	–	–	–	(172)	(172)
<i>Subtotal: transactions with equity holders</i>	–	–	–	–	–	–	–	(151)	(151)
Net profit for the year	–	–	–	817	–	–	817	64	881
Translation of foreign subsidiaries	–	–	–	–	1,104	–	1,104	2	1,106
<i>Subtotal: income and expense for the year</i>	–	–	–	817	1,104	–	1,921	66	1,987
December 31, 2005	8,285	7,435	(1,162)	29,134	2,400	–	46,092	2,811	48,903
Dividends to minority shareholders	–	–	–	–	–	–	–	(8)	(8)
<i>Subtotal: transactions with equity holders</i>	–	–	–	–	–	–	–	(8)	(8)
Net profit for the year	–	–	–	1,409	–	–	1,409	45	1,454
Fair valuation of hedging instruments (see Note 29)	–	–	–	–	–	8	8	–	8
Translation of foreign subsidiaries	–	–	–	–	1,450	–	1,450	2	1,452
<i>Subtotal: income and expense for the year</i>	–	–	–	1,409	1,450	8	2,867	47	2,914
December 31, 2006	8,285	7,435	(1,162)	30,543	3,850	8	48,959	2,850	51,809



Consolidated Statement of Cash Flows

A n n u a l R e p o r t

Danubius Hotel and Spa Nyrt. and Subsidiaries

Consolidated Statement of Cash Flows

(All amounts in million HUF)

	Note	Year ended December 31,	
		2006	2005
Cash flows from operating activities:			
Profit for the year		1,454	881
Adjustments for:			
Income tax	21	325	248
Share of profit/(loss) from associates		48	(6)
Interest income		(43)	(57)
Interest expense		1,083	843
Depreciation and amortisation		4,587	4,324
Unrealised foreign exchange (gain) / loss		(265)	341
Gain on sale of fixed assets	17	(268)	(121)
Changes in assets and liabilities:			
Accounts receivable and other receivables		530	81
Inventory		40	(34)
Accounts payable and other current liabilities		1,836	392
<i>Cash generated from operations</i>		9,327	6,892
Interest paid		(1,086)	(817)
Corporate income tax paid		(353)	(531)
Net cash provided by operations		7,888	5,544
Cash flows from investing activities:			
Purchase of property, plant and equipment		(8,403)	(4,972)
Purchase of intangible assets		(216)	(309)
Cash paid on acquisition of shares from minority	14	–	(172)
Acquisition of subsidiary, net of cash acquired	14, 26	–	(82)
Interest received		14	79
Investment in associate	10	–	(1,775)
Proceeds on sale of fixed assets		363	187
Decrease in restricted cash		–	1,031
Other cash inflows		15	12
Net cash used in investing activities		(8,227)	(6,001)
Cash flows from financing activities:			
Receipts of long-term bank loans		2,867	2,887
Repayment of long-term bank loans		(2,703)	(3,943)
Payment of finance lease liabilities		(136)	(125)
Related party loan received	10	–	1,740
Net cash provided by / (used in) financing activities		28	559
Increase / (decrease) in cash and cash equivalents		(311)	102
Cash and cash equivalents at beginning of year		2,326	2,224
Cash and cash equivalents at end of year, net		2,015	2,326

(All amounts in million HUF)

1 The Company and its recent history

Danubius Hotel and Spa Nyrt. ("Danubius" or "the Company") is a company limited by shares which is domiciled in, and 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 2006, 53.4% of the Company's shares were owned by CP Holdings Limited, a UK private company, and companies controlled by CP Holdings Limited. The ultimate controlling party of the Group is the Schreier family.

The consolidated financial statements of the Company as at and for the year ended 31 December 2006 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in associates.

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 88.85% shareholding 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 .

In August 2005, Danubius acquired a 25% interest in CP Regents Park Two Limited, a company 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 10).

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 Preventív-Security Zrt, a company, which provides security services, resulting in a 78.6% shareholding at December 31, 2005 (see Note 26).

(All amounts in million HUF)

2 Significant accounting policies

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Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by EU.

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 except for derivative financial instruments, which are measured at fair value (see Note 28).

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

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

The financial statements were authorised for issue by the Board of Directors on April 24, 2007.

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 30.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

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 consolidated 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 subsidiaries after elimination of all inter-company transactions and balances, including any unrealised gains and losses.

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. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Investments

Investments in which the Group has less than 20% ownership are classified as available for sale financial assets and carried at cost, less provision for impairment, where such investments are unquoted and fair value cannot be reasonably estimated. Otherwise they are measured at fair value using the quoted bid price of the investment.

The Company's principal subsidiary companies are as follows:

Name	Principal Activity	Country of Incorporation	Group interest held at December 31, 2006	Group interest held at December 31, 2005
Danubius Szálloda-üzemeltető és Szolgáltató Zrt.	Hotel operator	Hungary	100.00%	100.00%
Lángastronómia Kft.	Restaurant operator	Hungary	66.67%	66.67%
Preventív-Security Zrt.	Security	Hungary	78.60%	78.60%
Léčebné Lázně a.s.	Hotel operator	Czech Republic	95.36%	95.36%
Gama 45 s.r.o	Hotel owner	Czech Republic	100.00%	100.00%
Slovenské Léčebné Kúpele Piestany a.s.	Hotel operator	Slovakia	88.85%	88.85%
Salina Invest SA	Holding company	Romania	56.43%	56.43%
SC Balneoclimaterica SA	Hotel operator	Romania	53.03%	53.03%

(All amounts in million HUF)

Financial statements of foreign operations

The presentation and functional currencies of the Group's foreign operations differ from that of the parent company. 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 prior to 1 January 2005, the effective date of revised IAS 21, 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 functional 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.

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 directly attributable to bringing the asset to a working condition for its intended use.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

Depreciation

Depreciation is provided using the straight-line method over the estimated useful lives of each part of an item of property, plant and equipment. 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. Leased assets are depreciated over the shorter of the lease term and their useful lives.

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

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. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

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 Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Goodwill 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. In respect of equity accounted investees, the carrying amount of goodwill is included in the carrying amount of the investment.

Negative goodwill

The excess of the net fair value of identifiable assets, liabilities and contingent liabilities acquired over the cost is recognised immediately in the income statement.

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.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

Acquisitions of minority interests

Goodwill arising on the acquisition of a minority interest in a subsidiary represents the excess of the cost of the additional investment over the carrying amount of the net assets acquired at the date of exchange.

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

Non-derivative financial instruments

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Debt securities are classified as held to maturity if the Group has the positive intent and ability to hold them to maturity, and are measured at amortised cost less any impairment losses. 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.

(All amounts in million HUF)

Trade and other receivables

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

Impairment

Financial assets

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date. An impairment loss is recognised if carrying amount of an asset or its cash-generating exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a *pro rata* basis.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Non-current assets held for sale

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale (current, if sale is expected within a year). Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter generally the asset (or disposal group) are measured at the lower of carrying amount and fair value less costs to sell. Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on a *pro rata* basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

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. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Trade and other payables

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

(All amounts in million HUF)

Interest-bearing loans

Interest bearing loans are recognised initially at fair value of the proceeds received, less attributable transaction costs. In subsequent periods, they are measured at amortised cost using the effective interest method. Any difference between proceeds received (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings on an effective interest basis.

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, winery, security 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)

Financial Income

Financial income comprises interest income on funds invested, dividend income, gains on the disposal of available-for-sale financial assets, changes in the fair value of financial assets at fair value through profit or loss, foreign currency gains and gains on hedging instruments that are recognised in profit or loss. Interest income is recognised as it accrues, using the effective interest method.

Borrowing costs

The Group recognises all borrowing costs immediately when incurred to profit and loss and does not capitalise any borrowing cost to qualifying assets.

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. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. 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.

(All amounts in million HUF)

Employee benefits

Defined contribution 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.

Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

Derivative financial instruments

The Group holds derivative financial instruments to hedge its interest rate risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss. If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

Segment reporting

Group operations are presented in respect of geographical areas identified by location of assets and business segments that are separately evaluated for management reporting purposes. Management considers that it operates primarily in hotel and hospitality segment. In Hungary the Group also has a security segment through its Preventív Security Zrt subsidiary.

(All amounts in million HUF)

New accounting pronouncements not yet adopted

New standards, amendments to Standards and Interpretations not yet effective as at 31 December 2006 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.

IFRS 7 *Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures* require extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1, which become mandatory for the Group's 2007 financial statements, will require additional disclosures with respect to financial instruments and share capital.

IFRS 8 *Segment Reporting* describes how an entity reports segment activities in its annual financial statements and relates to selected details regarding segments in interim statements. Also the standard relates to disclosure requirements regarding products and services, geographical areas and major customers. The standard leaves the key to division of the segments to the entity such that the segment reporting is based on elements which are under supervision of management for purpose of operating decision making. The standard will become mandatory for the Group's 2009 financial statements. Early adoption is permitted and comparative figures are required to be restated.

IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies* addresses the application of IAS 29 when an economy first becomes hyperinflationary and in particular the accounting for deferred tax. IFRIC 7 becomes mandatory for the Group's 2007 financial statements.

IFRIC 9 *Reassessment of Embedded Derivatives* requires that a reassessment of whether embedded derivative should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC 9 becomes mandatory for the Group's 2007 financial statements.

IFRIC 10 *Interim Financial Reporting and Impairment* prohibits the reversal of an impairment loss recognized in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC 10 will become mandatory for the Group's 2007 financial statements, and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Group first applied the measurement criteria of IAS 36 and IAS 39 respectively.

IFRIC 11 *Group and Treasury Share Transactions* addresses how to apply IFRS 2 Share-based Payment to share-based payment arrangements involving an entity's own equity instruments or equity instruments of another entity in the same group (e.g. equity instruments of its Parent). IFRIC 11 is effective for annual periods beginning on or after 1 March 2007. Earlier application is permitted.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

IFRIC 12 *Service Concession Arrangements* addresses the accounting by private sector operators involved in the provision of public sector infrastructure assets and services to private sector operators.

3 Cash and cash equivalents

	December 31,	
	2006	2005
Cash and cash equivalents	3,087	2,363
Overdraft (see Note 13)	(1,072)	(37)
Cash and cash equivalents, net (per cash flow statement)	2,015	2,326

4 Accounts receivable

	December 31,	
	2006	2005
Trade receivables	2,411	2,280
Allowance for doubtful receivables	(411)	(391)
	2,000	1,889

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

5 Other receivables and prepayments

	December 31,	
	2006	2005
Receivables from employees	40	29
Prepaid and recoverable taxes and duties	167	187
Advance payments to suppliers	96	126
Other prepayments and accruals	549	521
Other receivables	290	815
	1,142	1,678

6 Inventory

	December 31,	
	2006	2005
Food and beverages	275	372
Wine in barrels	311	232
Materials	157	205
Goods for resale	101	75
	844	884

7 Assets held for sale

Assets held for sale comprises the net carrying value, less cost to sell, of certain hotel and hospitality properties and an investment the Group expects to sell within the next twelve months.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

8 Property, plant and equipment

	Land	Buildings and improvements	Furniture, fittings and equipment	Constructions in progress	Total
At 1 January 2005					
Gross book value	9,491	72,965	18,006	1,788	102,250
Accumulated depreciation and impairment	–	22,711	13,966	–	36,677
Net book value	9,491	50,254	4,040	1,788	65,573
For year ended 31 December 2005					
– Additions and capitalisations	4	3,664	1,094	210	4,972
– Acquisitions through business combinations	–	5	44	–	49
– Effect of movements in exchange rates	233	963	81	92	1,369
– Depreciation charge for the year	–	(2,503)	(1,707)	–	(4,210)
– Disposal	(16)	–	(48)	(2)	(66)
Closing net book value	9,712	52,383	3,504	2,088	67,687
At 31 December 2005					
Gross book value	9,712	78,116	18,926	2,093	108,847
Accumulated depreciation and impairment	–	25,733	15,422	5	41,160
Net book value	9,712	52,383	3,504	2,088	67,687
For year ended 31 December 2006					
– Additions and capitalisations	19	3,420	1,436	3,528	8,403
– Effect of movements in exchange rates	398	1,167	187	(78)	1,674
– Depreciation charge for the year	(9)	(2,696)	(1,674)	–	(4,379)
– Disposal	–	(39)	(17)	–	(56)
– Transfers	(60)	(275)	–	–	(335)
– Other	(21)	(17)	(3)	(6)	(47)
Closing net book value	10,039	53,943	3,433	5,532	72,947
At 31 December 2006					
Gross book value	10,048	75,825	20,382	5,532	111,787
Accumulated depreciation and impairment	9	21,882	16,949	–	38,840
Net book value	10,039	53,943	3,433	5,532	72,947

The net book value of property, plant and equipment pledged as loan security was HUF 30,879 million as of 31 December 2006 and HUF 25,177 million as of 31 December 2005.

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 2006 and 31 December 2005 the net carrying amount of the leased equipment was HUF 317 million and HUF 393 million, respectively. This equipment is included in "Furniture, fittings and equipment". The leased equipment secures lease obligations (see Note 13).

9 Intangible assets

	Goodwill	Land usage rights	Software and other intangibles	Total
At 1 January 2005				
Gross book value	1,146	537	1,377	3,060
Accumulated depreciation and impairment	168	102	996	1,266
Net book value	978	435	381	1,794
Year ended 31 December 2005				
– Additions and capitalisations	–	58	251	309
– Acquisitions through business combinations	117	–	1	118
– Effect of movements in exchange rates	–	–	4	4
– Depreciation charge for the year	–	(11)	(103)	(114)
Closing net book value	1,095	482	534	2,111
At 31 December 2005				
Gross book value	1,095	595	1,631	3,321
Accumulated depreciation and impairment	–	113	1,097	1,210
Net book value	1,095	482	534	2,111
Year ended 31 December 2006				
– Additions and capitalisations	–	–	216	216
– Effect of movements in exchange rates	–	–	17	17
– Depreciation charge for the year	–	(19)	(189)	(208)
– Other	–	–	11	11
Closing net book value	1,095	463	589	2,147
At 31 December 2006				
Gross book value	1,095	595	1,512	3,202
Accumulated depreciation and impairment	–	132	923	1,055
Net book value	1,095	463	589	2,147

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

At 31 December 2006 intangible assets include HUF 456 million, net of amortisation (2005: HUF 462 million) for land usage rights relating to two hotels on Margaret Island held under licenses given by the Municipality of Budapest.

Goodwill relates to the following acquisitions:

	December 31,	
	2006	2005
Léčebné Lázně a.s.	565	565
Lángastronómia Kft.	413	413
Preventiv-Security Zrt. (see Note 26)	117	117
Total positive goodwill	1,095	1,095

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

10 Investments in associates

10

As of 31 December 2005 and 2006 the only investment in an associate company was a 25% shareholding in CP Regents Park Two Limited, a United Kingdom company.

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 2006 and 2005 was HUF 48 million and HUF 6 million, respectively. Included in other revenue is a management support fee of HUF 147 million and HUF 54 million from this Associate for 2006 and 2005, respectively. The interest expense was HUF 120 million and HUF 43 million in 2006 and 2005, respectively on the loan received from CP Holdings Limited and a loan arrangement and handling fee of HUF 20 million and HUF 36 million was paid to CP Holdings Limited in 2006 and 2005, respectively.

Summary financial information on associate – 100 percent:

In thousand GBP	Assets	Liabilities	Equity	Revenues	Net result
CP Regents Park Two Limited					
2006	58,632	39,174	19,458	10,004	(770)
2005	59,352	39,124	20,228	4,799	(178)

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

11 Provisions

11

	Acquisition of Piestany	Retirement and Redundancy	Other	Total
Balance at 31 December 2004	610	54	45	709
Provision made during the year	–	200	–	200
Provision used during the year	–	(95)	–	(95)
Effect of movements in exchange rates	26	–	–	26
Balance at 31 December 2005	636	159	45	840
Provision made during the year	–	181	27	208
Provision released	(163)	–	–	(163)
Provision used during the year	–	(105)	–	(105)
Effect of movements in exchange rates	57	5	–	62
Increase/(decrease) due to acquisition or disposal	–	–	26	26
Balance at 31 December 2006	530	240	98	868

In 2002 a provision for legal cases of HUF 621 million was recognised at the acquisition of Piestany from which HUF 11 million was utilized in 2003 as a result of a lost legal case. At the end of 2006 HUF 163 million of the provision was released as it is not probable that an outflow of resources embodying economic benefits will be required to settle these obligations.

Provision for retirement and redundancy comprises provisions for Hungarian termination and Slovakian long service benefits. The amounts used represents the amounts paid for termination and long-service benefits. As of 31 December 2006 and 2005 the other provision of HUF 98 million and HUF 45 million, respectively related to various legal cases.

12 Other payables and accruals

12

	December 31,	
	2006	2005
Wages and salaries	749	643
Social security	454	439
Taxes payable	697	467
Accrued expenses	724	606
Advance payment received	350	–
Other	716	561
	3690	2716

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

13 Interest-bearing loans and borrowings

13

Non-current liabilities	December 31,	
	2006	2005
Secured bank loans	17,465	17,430
Finance lease liabilities	6	179
	17,471	17,609

Current liabilities	December 31,	
	2006	2005
Current portion of secured bank loans	2,689	2,596
Bank overdrafts	1,072	37
	3,761	2,633
Current portion of finance lease liabilities	179	136
	3,940	2,769

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

	December 31, 2006			December 31, 2005		
	Minimum Lease Payments	Interest	Principal	Minimum Lease Payments	Interest	Principal
Within 1 year	191	12	179	160	24	136
1 to 2 years	–	–	–	191	12	179
2 to 5 years	6	–	6	–	–	–
over 5 years	–	–	–	–	–	–
Total debt	197	12	185	351	36	315

As of 31 December 2006 the Group's secured bank loans are denominated in EUR, total to EUR 80.5 million and fall due for repayment, as follows:

	December 31,	
	2006	2005
Within 1 year	3,761	2,633
1 to 2 years	3,023	3,358
2 to 5 years	11,760	9,209
over 5 years	2,682	4,863
Total debt	21,226	20,063
Total current debt	(3,761)	(2,633)
Total non-current debt	17,465	17,430

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

The interest rates for all borrowings are floating and determined by 3 months EURIBOR + margin between 0.95% to 4.5% depending on the relevant country.

The net book value of property, plant and equipment pledged as security for bank loans was HUF 30,879 million as of 31 December 2006 and HUF 25,177 million as of 31 December 2005.

14 Minority Interests



	December 31,	
	2006	2005
Lángastrónia Kft.	522	504
Preventív-Security Zrt.	36	29
Léčebné Lázně a.s.	461	447
Slovenské Liečebné Kúpele Piestany a.s.	1,123	1,133
Salina Invest SA és SC Balneoclimaterica SA	708	698
Total	2,850	2,811

	December 31,	
	2006	2005
Opening balance at 1 January	2,811	2,896
Income attributable to minority shareholders	45	64
Translation of foreign subsidiaries	2	2
Acquisition of minority interest	–	(172)
Acquisition of subsidiary	–	29
Dividends to minority shareholders	(8)	(8)
Closing balance at 31 December	2,850	2,811

In 2005 Preventív-Security Zrt. was consolidated as the Group's interest in that company increased from 32.75% to 78.6% (see Note 26).

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

15 Share Capital



The registered share capital at December 31, 2006 and 2005 consists of 8,285,437 authorised, issued and fully paid ordinary shares, each of par value HUF 1,000. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at general meetings of the Company.

(All amounts in million HUF)

At December 31, 2006 and 2005, the Company owned 374,523 treasury shares, which cost HUF 1,162 million.

16 Reserves

1e

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, 2006 is HUF 20,603 million (2005: HUF 20,932 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).

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

Reserve for treasury shares

The reserve for the Company's own shares comprises the cost of the Company's shares held by the Group. As 31 December 2006 and 2005 the Group held 374,523 of the Company's shares.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Capital reserve

Capital reserve reflects the equity split made in 1991 when the privatization of the Company and the transformation to Public Limited Company was taking place.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

17 Other income

17

	2006	2005
Gain on sale of fixed assets	268	121
Release of legal provision (Piestany, see Note 11)	163	–
Other	147	135
	578	256

18 Material cost

18

	2006	2005
Raw materials used in servicing	3,761	3,598
Utility costs (gas, electricity, fuel and water consumption)	3,495	3,047
Other materials used	2,172	2,057
	9,428	8,702

19 Services used

19

	2006	2005
Maintenance cost	1,742	1,591
Washing, cleaning services	1,616	1,367
Safety services	932	290
Professional and membership fees	855	726
Hospitality Services	813	835
Marketing, PR services	662	557
Rental	579	459
Commission	529	472
Bank and insurance charges	477	467
Manpower hired	431	511
Telecommunication services	315	320
Software, IT support	239	211
Delivery and transport fees	218	229
Other	946	1,016
	10,354	9,051

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

20 Other expenses

50

	2006	2005
Taxes and contributions	1,931	1,505
Provisions made	208	105
Damages	78	16
Donations, sponsorship	78	87
Other	220	393
	2,515	2,106

21 Income tax

51

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

	2006	2005
Current tax	262	431
Deferred tax	63	(183)
	325	248

The deferred tax charge / (benefit) comprises:

	2006	2005
Origination and reversal of temporary differences	35	(169)
Tax losses (recognized)/utilised	28	(14)
	63	(183)

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

	2006		2005	
Profit before tax		1,779		1,129
Income tax using the Hungarian corporation tax rate	16%	285	16%	181
Effect of different tax rates in foreign jurisdictions		53		88
Non-deductible expenses		219		52
Tax exempt revenues		(78)		(12)
Tax incentives		(111)		(61)
Effect of tax losses utilised / (deferred)		(28)		13
Effect of tax rate changes (decreases) in foreign jurisdictions		-		(31)
Others		(15)		18
		325		248

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 2006 and 31 December 2005 are attributable to the following:

	Assets		Liabilities	
	2006	2005	2006	2005
Property, plant and equipment	71	78	1,546	1,428
Repairs and maintenance provision	–	–	185	255
Legal provisions	101	121	–	–
Provision for doubtful debts	52	51	–	–
Other provisions	19	17	–	–
Tax loss carry forwards	396	424	–	–
Other	32	22	–	–
	671	713	1,731	1,683
Offset of assets and liabilities within individual legal entities	(100)	(159)	(100)	(159)
	571	554	1,631	1,524

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.

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.

SC Balneoclimaterica SA has tax losses brought forward from previous periods but no deferred tax asset has been recognised due to uncertainty about the future utilization of these.

22 Earnings per share

The calculation of basic earnings per share is based on the net profit attributable to ordinary shareholders of HUF 1,409 million in 2006 (2005: HUF 817 million) and the weighted average number of ordinary shares outstanding during 2005 and 2006 of 7,910,914.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

	December 31,	
	2006	2005
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	1,409	817
Basic earnings per share (HUF/share)	178	103

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

23 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	December 31,	
	2006	2005
Less than one year	120	115
More than one year	60	–
Total	180	115

The Group leases its head office from a related party under an operating lease with an expiry date of 30 June 2008.

During the year ended 31 December 2006 HUF 262 million was recognised as an expense in the income statement in respect of operating leases (2005: HUF 242 million).

24 Commitments and contingent liabilities

During 2006 the Group fulfilled the SKK 700 million obligation reconstruction undertaken in the privatisation contract signed at the time of the acquisition of SLKP by 31 December 2006. The process of submitting the necessary documentation to the Slovakian Privatisation and Asset Management Agency has started and the guarantee registered at the time of undertaking the above obligation is expected to be cancelled in 2007.

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.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

The company has an obligation to purchase the 43.5% shareholding in SC Salina Invest SA currently owned by Corvinus International Investment Zrt. before 1 July 2007. The purchase price is estimated to be approximately HUF 1.6 billion.

As of 31 December 2006 there is no material contractual commitments for the acquisition of property, plant and equipment.

The Group did not have any significant contingent liabilities as at 31 December 2006.

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.

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 2006 was HUF 248 million while in 2005 it was HUF 239 million. The assets of the fund are held in separate trustee administered funds and are not included in these financial statements.

In 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 was HUF 198 million in 2006 while it was HUF 188 million in 2005. 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 Preventív-Security Zrt.

On 29 December 2005, the Group acquired a further 45.85% share in Preventív-Security Zrt. addition to the 32.75% shareholding. 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 was paid in 2006. Preventív-Security Zrt. has been consolidated as of December 31, 2005 and HUF 18 million income from associate was recorded to the consolidated net profit for 2005. 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. In 2006 Preventív Group was fully consolidated (see Note 29 – Segment Reporting).

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

27 Related Party Transactions

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Transactions with related parties are summarised as follows:

	2006	2005
Management fee to CP Holdings	371	315
Interest to CP Holdings	120	43
Loan arrangement fee to CP Holdings	20	36
Management support fee from CP Regents Park Two Ltd.	(147)	(54)
Rental fee to Interag Zrt.	159	134
Services provided by Interag Zrt.	5	5
Service provided to Interag Zrt.	21	–
Service provided by Investor Zrt.	15	13
Service provided to Investor Zrt.	4	–

Related party receivables and payables are not significant as at December 31, 2006, with the exception of the loan amounting to HUF 1,866 million (GBP 5.1 million less loan arrangement fee of GBP 0.1 million to CP Holdings) from CP Holdings (see Note 9). The repayment of the loan starts from 2010 and the interest rate is floating and linked to LIBOR.

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

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:

	2006	2005
Short-term employee benefits	345	230
Post employment benefits	6	7
Termination benefits	107	–
Total	458	237

The number of key management personnel (directors and executive officers) was 7 in 2006 and 6 in 2005.

(All amounts in million HUF)

28 Financial instruments

S8

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 carrying 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 80.5 million and GBP 5.1 million outstanding as of 31 December 2006 while it was EUR 80 million, GBP 5.1 million and SKK 4 million as of 31 December 2005 (see Note 13).

Management periodically reviews the merits of entering into foreign currency hedging contracts or other derivative products.

Interest rate risk

Interest rates on loans are listed in Note 13.

Since June 2006 the Company uses interest rate swaps to manage the relative level of its exposure to cash flow interest rate risk associated with floating interest-bearing borrowings. The amount and interest payment period of these hedging instruments accord with that of the underlying debt and therefore IAS 39 hedge accounting treatment applies.

As of 31 December 2006 the Company had one interest rate swap (Collar) agreement in effect, with a notional amount of EUR 62.2 million. The fair value of this Collar agreement was an asset of HUF 8 million as of 31 December 2006.

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)

29 Segment reporting

2006	Hungarian operations		Czech operations	Slovakian operations	Romanian operations	Elimination	Total
	H&H segment	Security segment					
Results							
Total operating revenue	31,886	1,334	6,226	7,257	1,287	(675)	47,315
Total operating expenses	29,850	1,267	5,766	7,293	1,105	(675)	44,606
Operating profit	2,036	67	460	(36)	182	–	2,709
Financial results	(864)	(3)	(2)	177	(32)	(158)	(882)
Income from associates	(48)	–	–	–	–	–	(48)
Profit before tax	1,124	64	458	141	150	(158)	1,779
Income tax charge	135	5	119	36	30	–	325
Net profit after tax	989	59	339	105	120	(158)	1,454
Assets and liabilities							
Property, plant and equipment	38,048	54	13,232	19,297	2,316	–	72,947
Investment in associates	1,715	–	–	–	–	–	1,715
Cash and cash equivalents	1,295	22	1,139	235	396	–	3,087
Accounts receivables	1,329	174	201	306	26	(36)	2,000
Inventory	580	4	70	172	18	–	844
Other current and non-current assets	23,441	113	2,558	331	(1,071)	(20,885)	4,487
Total assets	66,408	367	17,200	20,341	1,685	(20,921)	85,080
Trade accounts payable	1,540	121	379	1,116	106	(36)	3,226
Advance payments from guests	337	–	76	105	–	–	518
Interest bearing loans and borrowings	16,581	35	3,833	4,328	516	(2,016)	23,277
Provisions	146	26	–	629	67	–	868
Other current and non-current liabilities	3,833	33	756	682	77	1	5,382
Total liabilities	22,437	215	5,044	6,860	766	(2,051)	33,271
Minority interest	522	36	461	1,123	708	–	2,850
Net assets	43,449	116	11,695	12,358	211	(18,870)	48,959

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

2005	Hungarian operations		Czech operations	Slovakian operations	Romanian operations	Elimination	Total
	H&H segment	Security segment					
Results							
Total operating revenue	30,159	–	5,689	6,316	973	(352)	42,785
Total operating expenses	28,142	–	4,796	6,582	977	–	40,497
Operating profit	2,017	–	893	(266)	(4)	(352)	2,288
Financial results	(924)	–	(3)	(45)	(139)	(54)	(1,165)
Income from associates	6	–	–	–	–	–	6
Profit before tax	1,099	–	890	(311)	(143)	(406)	1,129
Income tax charge/ (benefit)	128	–	204	(40)	(44)	–	248
Net profit after tax	971	–	686	(271)	(99)	(406)	881
Assets and liabilities							
Property, plant and equipment	38,140	49	11,878	15,305	2,315	–	67,687
Investment in associates	1,763	–	–	–	–	–	1,763
Cash and cash equivalents	884	12	1,056	208	203	–	2,363
Accounts receivables	1,271	148	214	233	23	–	1,889
Inventories	627	6	74	163	14	–	884
Other current and non-current assets	24,316	116	2,584	380	(1,015)	(21,803)	4,578
Total assets	67,001	331	15,806	16,289	1,540	(21,803)	79,164
Trade accounts payable	1,579	111	247	329	61	–	2,327
Advance payments from guests	307	–	68	58	–	–	433
Interest bearing loans and borrowings	18,312	46	3,259	2,375	560	(2,346)	22,206
Provisions	105	–	–	694	41	–	840
Other current and non-current liabilities	3,044	39	822	425	62	63	4,455
Total liabilities	23,347	196	4,396	3,881	724	(2,283)	30,261
Minority interest	504	29	447	1,133	698	–	2,811
Net assets	43,150	106	10,963	11,275	118	(19,520)	46,092

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

(All amounts in million HUF)

30 Key sources of estimation uncertainty

30

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 future 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 deferred tax asset may need to be written off.

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.

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 significance 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.

Notes to the Consolidated Financial Statements

(All amounts in million HUF)

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.

31 Subsequent events

On 2 January 2007 the Company sold Hotel Esztergom to a third party.

Business Targets 2007

A n n u a l R e p o r t

The 2007 plans are based on the assumption that in all countries where Danubius operates hotels, over and above the changes already known at the time of the planning, the business environment remains stable. At the same time we did not reckon with any significant changes in the market trends. These assumptions are especially important given the tense political situation in Hungary in recent months.

The new strategy introduced last year focuses on the improvement of quality, which continues to be a priority in all fields of operation. Strong emphasis is put on the development of guest relations in 2007. The Internet allows us to reach our guests directly without agents, therefore it is our intention to make some changes to our web page and introduce certain new features in the course of the year facilitating direct connections and sales. We will continue building out the central reservation system and applying our loyalty program re-named Danubius EuroPoints in our foreign hotels as well.

The exchange rate of the Forint has been fluctuating in Hungary strongly during 2006, which had a positive effect on our - especially main season - profits and this contributed to the remarkable growth of our average rates in 2006. However, in 2007 we are likely to face adverse exchange rate changes. The VAT rate was raised from 15% to 20% in the new government program introduced in September 2006. Our company is applying the new market prices as of 1st April, prior to which in several business deals with previously fixed rates we had no opportunity to compensate the effect of the VAT increase in our rates. When determining the rate increase we had to bear in mind that – even keeping our net prices unchanged – owing to the increase in VAT our guests have to pay more for our services. For the above reasons our plan is to keep average rates at the 2006 level.

In terms of volume, however, growth seems reasonable: we are forecasting 67% occupancy in our hotels in Hungary, around 2% higher compared to the prior year.

This year we will implement a special programme for our spa hotels – the Danubius Health Spa Resort brand – that suffered from increased competition in recent years. We are aiming at putting a stop to the continuous decreasing of the number of German guest nights via product development, active promotion and by reaching the guests directly. On the domestic market we are reckoning with the strengthening of demand partly owing to the long weekends connected to national holidays. In addition to this we are striving to utilise the possibilities offered by the Russian and Israeli markets. According to our plans we will be able to increase average rates this year by a couple of percent in our spa hotels, alongside a moderate increase of occupancy.

On the Budapest market we plan to achieve a growth in volumes in the business segment by intensive, pro-active sales. Due to the aftermath of the September-October turbulences last year, some conferences and events were cancelled in the first months but there are signs of a significant recovery on this market from the second quarter. The drop in the number of flight connections has a negative impact on the number of leisure guests; this shortfall can be especially felt on the British market. At the same time by raising prices in the group leisure segment we are aiming to decrease the ratio of this segment.

Business Targets 2007

A n n u a l R e p o r t

In the Czech hotels we have to take into account the lessening of the number of German guests and domestic guests financed from the health insurance system for 2007 too. To compensate this set back the Czech hotels focus primarily on marketing activities in the Central-Eastern European countries, concentrating especially on the acquisition of business via the Internet. Consequently, we expect a decrease in occupancy but we are targeting to maintain the level of revenue per available room. Calculating in Czech crowns we are expecting a stagnation of revenues and the increase of operating profit, despite the increasing pressure on the cost of labour power.

Slovakian hotels equally forecasted a downturn in the number of guests financed by the health insurance system, but we are expecting the stabilisation of the German and Austrian markets. Forecasts show a moderate demand from the Arab countries and Israel, while the new Russian interest promises significant growth.

We have opened the first five-star spa hotel in Slovakia in December, the Thermia Palace. The services of the hotel are in line with expectations of quality-focused guests of more spending power, due to which the prices of the new hotel are much higher compared to the company average, substantially improving the performance of the Slovakian subsidiary.

Romania joined the European Union, which, added to the general political and economic advantages inherent, will have a positive impact on the performance of our hotels. The domestic market is expected to continue its upturn and the strengthening of the business segment will help moderate the strong seasonality characteristic in Sovata. Owing to product developments carried out in the wellness-fitness area, we are expecting a growth of demand in this field too. The 2006 performance was outstanding and revenues are expected to continue increasing in 2007 too.

The required volume will be achieved in the case of the London hotel in 2007 too, due to the market conditions, the key task here is revenue management. We would like to increase the ratio of individual, direct bookings in this hotel too, simultaneously we aim to keep the existing major partners and raising the ratio of events connected to room sales.

In the course of our investment program in Hungary, reconstructions will be continued in a low-key manner to maintain the quality level of the hotels. The capital reconstruction programs involving Danubius Hotel Gellért and Hotel Nádor in Pécs will enjoy priority. In both cases preparations for a final decision as well as the planning procedures and examination of the return of different financing possibilities are in the pipeline. In Marienbad in the Czech Republic, the building of a new swimming pool in Hotel Hvezda and a corridor connecting Hotel Centralni Lázně with Nové Lázně will be the two major projects. Looking at the Piestany subsidiary, Danubius has met its reconstruction obligations undertaken in the privatisation agreement but refurbishment works aiming at the maintenance of the hotels will be ongoing in the coming years too. In Romania in order to meet the requirements set by business guests, we are envisaging to build meeting and function rooms. The wellness capacity will be increased and since the appearance of a value minded guest circle is to be expected, we started to work out

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plans for the complete reconstruction and increasing of quality of Hotel Bradet. In the London based hotel, room refurbishments are in process.

The changes of the EUR rate have a substantial effect on the operations of the Danubius Group. At the time of planning we were reckoning with the moderate strengthening of the Czech and Slovakian crowns and the Romanian lei and we applied 258 forint/euro rate, which, in the light of the current exchange rate, could be an optimistic assumption for the main season. Under these terms we forecasted consolidated revenues to exceed last year's by 5% and a 15-20% increase of operating profit is expected alongside strict control of operating costs.

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Contact persons:

Dr. Imre Deák President & CEO

Phone: (+36-1) 889 4001 Fax: (+36-1) 889 4005

János Tóbiás Vice President for Finance

Phone: (+36-1) 889 4004 Fax: (+36-1) 889 4005

Eszter Deák Head of Investors' Relations

Phone: (+36-1) 889 4007 Fax: (+36-1) 889 4005

E-mail: investor.relations@danubiushotels.com



Artamira Galéria Kft.



DANUBIUS HOTELS
GROUP

DANUBIUS HOTELS NYRT.

danubiushotels.com

1051 Budapest, Szent István tér 11. Telefon: (+36-1) 889-4000 Fax: (+36-1) 889-4005