# First quarter 2007 Results Conference Call

May 10, 2007 at 15:00 CET

Conference call operator introduces call

## Chris Mattheisen remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's first quarter 2007 results conference call. I am Chris Mattheisen, Magyar Telekom's Chairman and Chief Executive Officer and I am hosting today's call together with Thilo Kusch, our CFO and member of the Board.

Before I start with the analysis of the Group performance, let me draw your attention to our new segmental reporting structure. As a result of the change in the Group's management structure, and to ensure consistency with information used by management for internal reporting and monitoring purposes, Magyar Telekom is changing the way it reports its segmental results with effect from this first quarter. Under the new system, the segments are divided according to the four business lines: T-Com, T-Mobile, T-Systems, and Headquarter and shared services. T-Com and T-Mobile include international activities, such as Macedonia and Montenegro. In addition, T-Com includes the alternative services and wholesale activities in Bulgaria, Romania and the Ukraine. The company's secondary segmental reporting format is by geography.

We believe that the new segment disclosure provides better visibility of customer segmentation by splitting the former fixed line segment into T-Com, which includes fixed line services for residential customers and small businesses, and T-Systems, which serves our corporate clients with fixed line and IT/System integration services. Prior year's quarterly segmental results have been restated to facilitate comparability with the new disclosure structure and can be found in the investor relations section of our website.

Moving on to **Group results**, the first quarter was characterized by strong revenue growth of over 6%. This was driven by the consolidation of the new subsidiaries in the IT and System integration sector and increasing broadband revenues. The good performance of the mobile segment, boosted by the positive revenues of the TETRA service, also played a part. Despite growing revenues, EBITDA decreased by just under 2% as a result of the investigation costs and provisions for headcount reduction and related legal cases. Excluding these non-operational impacts, which total almost 5 bn forints, EBITDA increased by 6% and EBITDA margin was 42%.

Let me start the segmental analysis with the results of T-Com. Revenue of the segment decreased by over 2% due to voice revenue erosion in Hungary and Macedonia, although Montenegrin revenues were slightly up.

The revenues of **T-Com Hungary** were down by over 2%, with the decrease in voice revenues, mainly offset by the strong performance of the internet business. Also Dataplex, our server hosting subsidiary is consolidated here since April last year. The drivers behind the falling voice revenues are similar to those in previous quarters: the negative impact of mobile substitution remains the key issue, while competition from alternative and cable operators also threatens our access and traffic revenues. This year, however, the austerity package has put further pressure on our revenues. The impact of the package is particularly pronounced in revenues from small business customers, who tend to react earlier to higher taxes and energy prices with increased cost controls. Competition and the austerity package together caused an above 4% churn in customer numbers and negatively influenced the fixed line usage. The churn and decrease in usage is much more significant within the small business customer segment, whereas usage in the residential segment has in fact increased slightly.

The strong focus on broadband expansion helps to offset the falling voice revenues. In the first quarter, the total number of broadband customers increased by 56%, within that the number of our cable broadband customers more than doubled. Although affected by falling prices, broadband revenues still increased at a healthy pace of 29%. At the same time, narrowband revenues fell by 9% and dial-up traffic halved in the first quarter compared to the same quarter of last year.

Broadband penetration in households was around 20% in Hungary at the end of the quarter. Although we expect some slowdown in the growth of broadband customers as a result of the austerity package, we have taken measures to drive further penetration growth. In February we doubled the speed of our current broadband packages and we introduced naked ADSL at the end of March. Our IPTV offer further increases the attraction of our product offering and we are continuously upgrading our network in order to increase availability.

EBITDA of T-Com Hungary was down by 3% with a margin of 41% in the first quarter. Although revenue-related payments, such as cost of equipment sales and voice-related payments decreased, higher employee-related expenses driven by severance payments offset the positive impacts. The decrease in voice-related payments is a result of both the continuous erosion of fixed to mobile traffic and a cut in mobile termination fees from February.

Before continuing with the Macedonian market, let me update you on the performance of our cable operations, which is also accounted for within our T-Com segment. The number of cable customers increased to above 410,000 by end of March giving us a market share of 19%. Cable penetration is currently around 60% in our service area. As we offer triple play services on our cable network, we have 67,000 cable broadband and 31,000 voice over cable customers. Our cable operations generated around 2 bn forints EBITDA and an EBITDA margin of above 40% in the first quarter.

In the **Macedonian** fixed line business, a year-on-year revenue decline of close to 4% was driven by lower retail voice revenues, which could not be fully offset by the higher internet revenues which resulted from the considerable increase in the ADSL subscriber base. We expect both wholesale and retail voice revenues to remain under pressure as not only mobile substitution but also competition from alternative service providers puts pressure on this revenue stream. Our major competitor, OnNet, has already launched call-by-call services for international and national long distance calls in March, and also provides international call termination services at favourable prices.

On the cost side, thanks to the strong focus on cost control measures, both employee-related and other operating expenses declined considerably, resulting in a broadly stable EBITDA level and a strong EBITDA margin of over 50%. Revenues at T-Com Montenegro grew by 3% as the downward pressure on retail voice revenues driven by mobile substitution was more than offset by increasing wholesale and broadband internet revenues, boosted by the significant rise in the number of ADSL customers. Although the mobile operator ProMonte has obtained a license for terminating international voice traffic, it has not yet launched its service. Operating costs were heavily impacted by provisions created for employee severance costs and related pending legal cases. Excluding these items, EBITDA shows positive trends with a margin of around 34%.

(PAUSE)

Let me now hand over to Thilo who will provide you further details on T-Mobile and T-Systems segment results.

## Thilo Kusch remarks

Thank you, Chris.
Good afternoon ladies and gentlemen!

Having gone through the analysis of the fixed line segment, let us now look at the results of the **T-Mobile** segment. This segment showed a close to 8% revenue and 6% EBITDA growth, mainly driven by the Hungarian mobile operations and the consolidation of the TETRA services.

The revenues of the **Hungarian** mobile operations were up by 4% due to the combined impact of a 6% increase in customer base and a 3% decrease in the ARPU level. As a result of continued strong competition in the Hungarian market, the penetration level increased further reaching 100% by the end of March. Although the market share of T-

Mobile Hungary slightly decreased compared to March last year, it was stable towards end of last year by remaining above 44%. The decreasing tariff levels put pressure on the ARPU levels. While in the last quarters the lower tariff levels boosted usage, this year we have experienced lower price elasticity driven by the lower disposable income of customers. In addition, the cut in mobile termination fees negatively influenced wholesale revenues. From February, the termination fee of T-Mobile Hungary decreased by 15% to 23 forints. As a result, while usage was up by 9% year-on-year and value added service revenues increased, they could not outweigh the strong erosion in tariff levels and lower wholesale revenues and ARPU slightly decreased.

Value added services stood at 15% of ARPU in the first quarter, an increase of one percentage point compared to the same period of last year thanks to the continuous rollout of the HSDPA network. Our population-based coverage is around 30% and we plan to reach about 50% by the end of the year. To promote the usage of the new services and also use the capacities of the new network, we increased the subsidies on the 3G and HSDPA enabled handsets and data cards. This, and the continued strong focus on customer migration towards postpaid packages, caused an above 5% increase in the average acquisition cost of new customers. However, the increased acquisition costs were counterbalanced by lower retention costs, which we were able to achieve thanks to stable churn levels.

T-Mobile was the first to introduce HSPDA services in Hungary. Although we expect strong growth in the number of data cards and HSPDA usage, going forward we also expect increasing competition and price pressure in the mobile broadband market.

Now, let me explain how the forthcoming regulation of the roaming tariffs will negatively impact our financials. While the retail price cap on roaming tariffs charged to our customers will negatively influence our revenues, the wholesale price regulation will reduce the related payment obligations, reducing the negative impact on EBITDA. A further potential effect could be for the lower prices to positively impact usage, which may further reduce the negative effect of the roaming regulation. The decline in wholesale revenues from foreign tourists visiting Hungary will also decrease EBITDA and an increase in traffic would only be able to partly offset this trend. The exact impact, however, will remain uncertain until the final regulation and timing are announced.

Turning to the **TETRA services**, in the first quarter we consolidated 1.7 bn forints in revenues and 0.6 bn forints in EBITDA for these services. Although the accounted service revenues will be lower due to the finance lease treatment, according to the contract, we will receive an annual 9 billion forints service fee from the government for the next 9 years.

**Macedonian** mobile penetration reached 70% by the end of March 2007 as both mobile operators strengthened their focus on customer acquisition prior to the entrance of the third operator, Mobilkom, in the second half of the year. T-Mobile Macedonia successfully managed to slow down its market share erosion, which by the end of the first quarter stood at 66%. Despite a continued decrease in tariff levels, the significantly higher MOU and positive shift in the customer mix toward postpaid clients resulted in a year-to-date ARPU increase of 5%.

Revenues in the segment grew by 13%. The 9% increase in the customer base, as well as higher voice and data usage counterbalanced the negative impacts that intensifying competition had on tariff levels. While the higher usage resulted in a rise in related outpayments, and increased postpaid gross additions drove equipment costs up, general cost cutting initiatives were able to offset these impacts, resulting in a 14% EBITDA increase and an EBITDA margin of 54%.

As for the **Montenegrin** mobile market, penetration stood at 135% at the end of the first quarter, reflecting the extended availability of the SIM cards since last October. Thanks to our continued focus on postpaid customers, we increased postpaid market share to 48% whilst maintaining a relatively stable market position overall. This effort also serves our longer term interest, as a third operator is expected to launch operations at some point during this summer. Let me say a few words on the results of the recent mobile license tenders. A consortium lead by Telekom Serbia won the third mobile license for 16 million euros, while T-Mobile Montenegro and ProMonte were awarded 3G licenses for around 2 million and 4 million euros, respectively. We plan to launch commercial 3G services at the end of the year.

Turning to the performance of the segment, revenue increase of 23% was supported by a higher customer base and significant growth in usage. Employee severance costs affected segment profitability. Excluding these expenses, EBITDA margin was around 37%.

Continuing with the **T-Systems** segment, the very strong growth in revenues is testament to the successful execution of our new strategy, focused on increasing our presence in the Hungarian IT and system integrations market. Thanks to our new competencies, we are able to provide a significantly broader product portfolio to our corporate clients, which is an important growth driver to our business. In terms of market share, we gained around 20% in the info-communication outsourcing market, around 10% in the IT services market, broadly the same in the application development market, and a somewhat lower market share in the infrastructure services market. Looking at the two new subsidiaries, we have been consolidating KFKI since mid-September and T-Systems Hungary since January 2007. In the first quarter this year, the new companies contributed 5.3 bn forints revenues and 0.7 bn forints EBITDA to the segment results.

We also strengthened our position in the info-communication outsourcing market through major business client wins, such as the Central Office for Administrative and Electronic Public Services for a 5-year contract period. Other governmental projects have further added to our revenues, such as the development of the Electronic Tax filing system for the State Tax Authority.

Turning to the traditional voice revenues, we face tough competition and tariff erosion, driven by the increasing traffic migration from the fixed line to the mobile network. Due to the high mobile termination fees, mobile operators can offer more competitive packages to clients. This results in continuous erosion of fixed line traffic, especially fixed to mobile calls. Domestic outgoing traffic of the segment decreased by 25% in the first quarter of 2007 compared to the same quarter of last year. Together with the lower average tariff level, this resulted in a 22% erosion in voice revenues.

To protect our customer base, we are offering bundled fixed-mobile packages to our corporate clients. As part of the fixed-mobile merger, we have integrated customer relationship management for the top corporate clients and are targeting these clients with integrated packages. Besides contributing to improved customer retention, this also offers cross-sell opportunities for the Group.

As for the profitability of the segment, EBITDA slightly increased and EBITDA margin was 23% in the first quarter, reflecting the consolidation of the new subsidiaries which have a lower EBITDA margin.

## Chris Mattheisen remarks

That concludes the formal part of Magyar Telekom's conference call. Now we are happy to open the floor for questions. Operator, when you are ready, we will take the first question.

(Take questions)

I believe we have time for one more question.

(Take final question)

This is all the time we have. If there are follow-up questions, I encourage you to contact our Investor Relations Department. The telephone number is 36-1-458-0437 or if you want to send an e-mail you can address it to investor.relations@telekom.hu. I would like to inform you that the transcripts of our conference calls will be available on our official website. Thank you again for joining us today, and for your continued interest in Magyar Telekom.