Magyar Telekom

Fourth quarter 2007 Results Conference Call

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Conference call operator introduces call

Chris Mattheisen remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's fourth 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.

I am glad to announce strong financial performance for 2007, which, despite the difficult competitive and macro environment, not just fulfilled - but in some cases exceeded - public targets announced for last year. Revenues in 2007 were up by 1% whereas we had a flat revenue target. Excluding the TETRA revenues coming from asset sales, revenues were up by 3% thanks to the increasing revenue contribution of our IT and System integration activities. More importantly, we outperformed our flat EBITDA target. EBITDA excluding headcount-reduction- and investigation-related expenses increased by 3% in 2007. The underlying EBITDA margin was 41% for the full year. Regarding our capex spending, capex to sales ratio - excluding the GSM license extension fee - was below 14%, which was in line with our public target.

Despite good financial results in 2007, we have to face increasing demands from customers and heightened competitive pressure in the coming years. To prepare ourselves for the future challenges, we started to reshape the company in line with changes in the telecommunications market last year. It was a complex task to define the new structure and work out the details, but the new corporate structure has been in place since the beginning of this year. We have also started to improve the profitability of the traditional businesses through headcount reductions and we have reached an agreement with the trade unions last year enabling a 15% cut in the group-wide headcount by the end of this year. Around 50% of the announced program was actually achieved by the end of January.

We have also made progress in terms of reducing the number of subsidiaries within the group. Since October last year T-Online and Emitel have been integrated within the parent company, and since beginning of this year the number of subsidiaries within the T-Systems segment has also been significantly reduced.
Looking forward to 2008, we are targeting stable revenues and a slight decline in underlying EBITDA compared to 2007. The main factors that are expected to impact underlying EBITDA are the increased competition in the international mobile markets, the difficult Hungarian macroeconomic environment and regulatory impacts. Regarding gross additions to tangible and intangible assets, we target a capex to sales ratio of around 15%, which reflects our commitment towards increasing the fixed and mobile broadband coverage in our key markets as well as developing new products and services. The increased CAPEX spending also includes the Group-wide consolidation of our IT platforms, which will help drive future cost reductions.

Turning to the fourth quarter financials, **Group** revenues showed a 4% decline compared to the same period of last year due to the lower TETRA revenues. The consolidation impact of the new IT and system integration subsidiaries on our quarterly revenue growth was also mitigated, as KFKI was already consolidated in the fourth quarter of 2006. Reported EBITDA showed a significant decline, driven by the headcount reduction-related expenses of 19 billion forints that were booked in the fourth quarter and also higher investigation-related costs. Fourth quarter EBITDA excluding the above items declined by 5% due to our strong focus on customer acquisition and the underlying EBITDA margin was 36%.

Let me start the segmental analysis with the results of T-Com. Revenue of the segment decreased by 2% in the fourth quarter compared to the same period of 2006 driven by voice revenue erosion, partly offset by higher broadband revenues and increased revenue contribution of Montenegro.

Hungarian T-Com revenues were down by 3% in the fourth quarter compared to the same period of 2006, with the decreasing voice revenues partly offset by higher internet, multimedia and equipment sales revenues. On the EBITDA level, headcount-reduction related expenses distorted the figures. Excluding the 11.5 billion forints of severance expenses that were booked in the fourth quarter, EBITDA margin was 38%.

Voice revenues were down by 11% in the fourth quarter compared to the same period in 2006, driven by a further decline in both traffic and tariff levels. The increasing ratio of free minutes within the network offered through the flat rate packages, and strong mobile substitution put pressure on voice revenues.

Mobile substitution is particularly seen in the small business segment, where usage per customer dropped by 22% mainly as a result of migration towards the closed-user-group offers of mobile operators. Usage in the residential segment, on the other hand, was flat thanks to the discounts and flat rate packages.

In the broadband market we are faced with a slowdown in penetration growth and increasing price pressure due to competition. The average monthly growth rate of our broadband customer base was around 2% throughout 2007 compared to a rate of 4% in 2006. The growth in cable broadband and naked ADSL customers is somewhat counterbalancing the slowdown in ADSL penetration growth. Last year the number of cable broadband customers more than doubled and by the end of December was close to 90,000. Naked DSL customers numbered around 14,000.

While the number of broadband internet access connections increased by 25% in 2007, internet revenues were only up by 12% as a result of declining price levels due to price competition. Average net retail ARPU of a broadband customer was 6,000 forints in 2007, a decrease of around 16% compared to 2006.

Regarding our IPTV product, we are seeing encouraging results following the repositioning of the product. In November we launched the so-called Cocktail package which offers customers the opportunity to select the channels according to their needs. Thanks to the new offer, internet TV customer growth has accelerated, and reached around 9,000 by the end of December.

Continuing with **Macedonia**, revenues slightly increased in the fourth quarter. Although mobile substitution and competition from alternative operators put pressure on voice revenues, increasing internet, data and equipment sales revenues were able to offset that. Despite increasing competition and the strengthening role of alternative operators, the EBITDA margin was 41% in the fourth quarter.

Driven by the entrance of the third mobile operator, mobile substitution accelerated, decreasing outgoing traffic in the fixed line. Wholesale traffic is also under pressure from alternative operators, who take away an increasing portion of international traffic. Their average market share was about 10% of the total international outgoing traffic in 2007. In terms of international termination into the fixed network, alternative operators accounted for half of the traffic, while their market share in international traffic terminated to the mobile networks was around 35% at the end of December last year.

To offset the strong decline in voice traffic, MakTel is focusing on broadband services. Thanks to a marketing push since September last year, ADSL customer growth gained new impetus. The number of broadband customers was close to 50,000 at the end of last year. The company has around 50% retail market share in the Macedonian broadband market with household internet penetration reaching around 16%.

In **Montenegro**, fixed line revenues were up by 6% thanks to the growing wholesale and internet revenues, which offset the erosion of voice retail revenues. The increase in international incoming traffic was driven by the reclassification of Serbian traffic from domestic to international following Montenegro's declaration of independence.

Subscription fees further supported revenue growth thanks to the recent rebalancing step. On the cost side, outpayments increased due to the higher fixed-to-mobile termination rates and EBITDA margin was 35% in the fourth quarter.

The new EU-compliant telecommunications law is expected to come into effect soon. To prepare for the forthcoming increase in competition, Telekom Crne Gore opted for a tariff rebalancing step and introduced new tariffs from the beginning of September last year. Fixed-to-mobile and international call rates were reduced, and access fees, local and long distance tariffs were increased. The new packages introduced within the rebalancing step include bundled minutes within the monthly fee.

Thanks to the strong focus on broadband services, the number of ADSL customers is increasing rapidly and exceeded 14,000 by year-end. To benefit from the still very low cable coverage in Montenegro, we introduced IPTV service in November last year. Our product, which offers 50 channels for a 9 euro monthly fee, has proved to be a great success and is attracting high customer demand.

We have also proceeded with the headcount reduction program in Montenegro and laid off 250 employees in October last year. Provisions for this program were created at the end of 2006 in the amount of 2.5 billion forints. We have also reached improvements in the collection process and significantly reduced bad debt.

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

Thilo Kusch remarks

Thank you, Chris.
Good afternoon ladies and gentlemen!

Let me continue with the results of our corporate segment. **T-Systems** is looking back on a very successful year.

Together with KFKI and T-Systems Hungary, we became the **leading service provider in the IT and system integration market** in Hungary. This is a really great achievement considering that three years ago we did not have any material presence in this market. Revenues from these new services were able to compensate for the eroding voice traffic, thus revenues were flat in the fourth quarter last year compared to the same period in 2006.

Voice revenues again declined by above 20% in the last quarter, reflecting the continuous decline of usage, tariff levels and line numbers driven by mobile substitution and competition from alternative operators. The consolidation impact of the new IT companies, which drove revenues in the first three quarters, was limited in the fourth quarter to the contribution of T-Systems Hungary as KFKI was already consolidated in the fourth quarter of 2006. As a result, growth in IT and system integration revenues was 10% in the fourth quarter.

The segment's EBITDA was hit by one-off items. Headcount reduction-related severance expenses in the amount of 1.5 billion forint are included within the employee-related expenses. In addition, operating costs include a 1.5 billion forint bad debt expense reflecting the likely loss to be incurred as a result of the early termination of a long term IT outsourcing contract by a corporate customer.

Excluding these impacts, EBITDA in the fourth quarter declined by 28% and EBITDA margin was 15%.

As Chris already mentioned, we have reduced the number of subsidiaries at the T-Systems unit. Following the acquisition of KFKI and T-Systems Hungary, we had six separate legal entities within the unit. In line with our announcement in May, through merging some of the subsidiaries we have just two separate legal entities managing two divisions out of the three within the T-Systems.

The operational activities are divided as follows: the traditional service portfolio, including voice services and data wide-area-network solutions, as well as the outsourcing activities, is managed under the **Infocom** division and contributes to around half of the unit's revenues.

The **IT Infrastructure** division, under the subsidiary of KFKI, covers network and system integration, network operation, and IT consultancy services and accounts for around one third of T-System's revenues. And the third division, which is **IT Applications** under the subsidiary IQSYS, is responsible for on-site support and operations as well as for application development and operation. The new, simplified structure enables us to improve efficiency through optimizing the distribution channels as well as a more focused approach to our customers.

Continuing with the mobile business, the **T-Mobile** segment showed 7% revenue decline due to the lower TETRA revenues. In the fourth quarter 2006 we accounted 8 billion forints of revenues for the sale of TETRA network assets to the government, whereas in the fourth quarter last year revenues from network asset sales and service revenues were only 2 billion forints.

Revenues at **T-Mobile Hungary** showed a moderate decline in the fourth quarter mainly due to regulatory effects and lower equipment sales. Wholesale revenues decreased as a result of the 15% cut in mobile termination fees of T-Mobile Hungary from February last year. In addition, new EU roaming tariffs have been in effect since September and had a full impact on fourth quarter revenues and also on EBITDA. The higher number of handsets sold was offset by the significant decrease in the average price of handsets driven by higher ratio of low-end equipment in the Christmas sales.

On the cost side, strong promotions in the fourth quarter significantly increased equipment costs and marketing expenses. Savings from interconnection fees coming from the decrease in asymmetry among the mobile termination fees of the three Hungarian mobile operators offset the higher acquisition costs. As a result, EBITDA margin in the fourth quarter was 40%.

Strong promotions in the fourth quarter pushed penetration to 110% in Hungary by the end of last year. T-Mobile Hungary maintained its market share at 44%. The average tariff level continued to decline partly due to the cut in mobile termination rates since February 2007. The increasing usage and value added services, as well as the continuously improving customer mix were not able to completely offset these negative impacts. Consequently, the average revenue per user declined by 5% by the end of December.

Please note that according to the decree issued last year, mobile termination rates of the three mobile operators again declined from 1st of January 2008 by the same rate as in February 2007. This will continue the pressure on our mobile revenues and ARPU.

Mobile broadband remains an important area of growth. Further discounts were launched by the three operators in the fourth quarter, offering a zero monthly fee for new broadband subscriptions in the first months and instalment payments for laptops and handsets. In a new offer within our loyalty program, T-Mobile Hungary is offering 2 gigabyte downloadable monthly traffic for a 12 euro monthly fee. The number of mobile internet customers exceeded 140,000 by the end of last year, including around 33,000 laptop data cards sold last year.

The population based coverage of our HSDPA network reached 53% by the end of December and we aim to further improve coverage in the next years. This is also in line with the obligation included in the GSM license extension agreement, according to which we will spend 20 billion forints on increasing mobile broadband coverage over the next two years. A focus on internet revenues is essential to offset the negative impacts of the continuing cuts in mobile termination rates and roaming regulation.

Turning to **Macedonia**, the entrance of the third mobile operator had a significant impact on the mobile market development. Revenues in the fourth quarter were up by 10% thanks to the expanding mobile market, although

EBITDA declined by 14% due to the increasing pricing pressure and strong marketing campaigns. However, EBITDA margin was still at 43% in the last quarter of 2007.

After the entrance of the third mobile operator owned by Telekom Austria in September, penetration growth accelerated and exceeded 93% by the end of December. Market share of T-Mobile Macedonia based on SIM cards decreased to 62% while the new entrant took 8% of this market thanks to cheaper prepaid and postpaid offers.

Although the competition driven decline in price cuts put pressure on ARPU, voice revenues increased thanks to the strong increase in the customer base and improving customer mix. Growing wholesale and value added service revenues also contributed to the revenue growth.

In terms of regulation, both T-Mobile and Cosmofon were designated as having significant market power on the Macedonian mobile market, thus both operators have to submit cost-base interconnection offers to the national regulator and termination rates are expected to decrease.

Moving on to **Montenegro**, mobile revenues were up by 7% thanks to the growing customer base and increased mobile termination rates. EBITDA on the other hand significantly decreased due to our strong focus on customer acquisition after the entrance of the third player.

The penetration level in Montenegro was 169% at the end of December according to the data reported by the Montenegrin telecommunications agency. Since the entrance of the third mobile operator, tariff competition has significantly increased with competitors offering bundled minutes and closed-user-group offers. The third entrant is mainly targeting prepaid customers and tourists with lower entry barriers and more favourable Serbian calling tariffs. At the end of 2007 it showed a 25% market share based on SIM cards, the majority of which was taken from our other competitor, ProMonte.

The stiff competition also forced us to increase acquisition cost and offer discounts for new customers. Higher handset subsidies and extended closed-user-group offers are the main drivers of the lower EBITDA margin in the fourth quarter. Due to the high traffic towards other networks, increased mobile termination rates put further pressure on margins. However, the strong focus on the postpaid segment bears fruit: while our overall market share decreased to 34%, we are still the market leader in the postpaid market with above 46% market share.

Chris Mattheisen remarks

Thanks Thilo.

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

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.