

1H 2004 Results and Strategic Review Conference Call

August 12, 2004 at 16:00 CET

Final version

Conference call operator introduces call

Elek Straub remarks

Ladies and gentlemen, welcome to Matáv's 2004 first half results conference call. I am Elek Straub, Matáv's Chairman and Chief Executive Officer. Dr. Klaus Hartmann, our CFO and member of the Board and Szabolcs Czente, Head of Investor Relations are also here with me today.

I will begin by providing you a summary of Matáv's performance in the first six months of 2004 and the regulation related issues. Klaus will provide you with more details on our three reporting segments. Then I would like to take you through the strategic announcement we have made today. Following that, we will of course be happy to take your questions.

We announced today our financial results for the first half of 2004. Particular achievements this quarter include being able to stabilise line numbers in the fixed line segment and the growth in ADSL customers. In our mobile segment we are pleased to announce that the mobile rebranding was successful. In addition, T-Mobile Hungary was able to preserve strong profitability despite the intense competition. MakTel, our international subsidiary, was able to sustain high EBITDA margin despite a difficult market environment. Finally, in addition to our quarterly figures we have announced today our mid-term financial targets.

Now, let us go through all these items in detail.

Regarding our regulatory environment, the National Communications Authority has published the final resolutions on both reference interconnection and unbundling offers. The new MARIO fees represent an average 19% decrease in the interconnection traffic fees compared to the former level and came into effect on June 15th 2004. The new interconnection fees are now close to the relevant average Western-European level. The final resolution on the reference unbundling offer published in August 2004 with no change to the fees compared to the draft. The unbundling offer contains the new service of local bitstream access.

As you may already know, fixed line geographic number portability was introduced in January, while mobile number portability has been available from May 1st 2004. The financial effect of the fixed line number portability is already visible at the business segment, while at the residential segment it is negligible. In July this year, Matáv launched a new commercial service to enhance portability opportunities by enabling residential and business customers to retain their old telephone number if they move residence or premises within the same tariff zone.

In the mobile segment, as we already indicated, number portability has not had a significant influence. In the first two months approximately 6 thousand customers used the service in the Hungarian mobile market, which is less than 0.1% of total mobile subscribers. As T-Mobile Hungary both gained and lost some customers, the introduction of the service did not have a tangible impact on its financials.

(Pause)

And now, I would like to hand over to Klaus, who will continue the analysis with our segments.

Dr. Klaus Hartmann remarks

Thank you, Elek.

Good afternoon!

Continuing with the fixed line segment, we announced a 6% decrease in revenues and a 2 percentage points drop in EBITDA margin year-on-year. The main decrease was again in domestic traffic revenues due to several discounts and new packages Matáv offered its customers. However, thanks to these successful offers, the company was able to stabilise line numbers in the fixed line segment.

One of the most successful new offers is the XL package. Subscribers to this tariff package can make local calls off-peak and on weekends without any minute fee or call set up fee, against the payment of a supplementary monthly fee of around 4 euros. Although minute usage as a result of this package increases domestic traffic, the revenue is accounted for in subscription and other charges, thus reducing traffic revenues. The package was introduced last year in December, and by the beginning of July 2004, the number of customers using this supplementary package reached 100 thousand.

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Although offering new packages and discounts is crucial for customer and usage retention, the price decreases do have a negative effect on traffic revenues. While domestic traffic revenues decreased by 12% in the first half of 2004 on a year-on-year basis, traffic reduction only explained 1.3% of this change; the rest came from the above mentioned discounts and other price effects such as interconnection fees and number portability.

From September and October last year, fixed traffic fees to T-Mobile Hungary and Pannon GSM were reduced due to the cut in mobile termination rates. This did not impact EBITDA but did reduce revenues. Number portability also had a slight impact on traffic revenues as some business customers changed operators, which resulted in a switch from traffic revenue to interconnect revenue.

The other significant element of fixed line revenue erosion is the other usage revenues, where the decrease was 57% compared to last year. As more and more local telecom operators sign interconnection agreements directly with the mobile operators, the traffic revenue from LTOs decreases. By now, the LTO-mobile bypass is nearly complete resulting in significantly decreased other usage revenues.

The growth in ADSL connections continues and we are on track to achieve the target of 200 thousand ADSL subscribers by the end of the year. By the end of June the number of ADSL subscribers exceeded 140 thousand. As a result the share of broadband and leased line customers in the total Internet subscriber base increased from 23% to 47% by the end of the first half 2004 on a year-on-year basis. The success of our broadband program is also reflected in our financials: data transmission revenues increased by 46% compared to the same period last year.

In the mobile segment both the healthy EBITDA margin and the market share were maintained, even though all three mobile operators were very active on the market. The rebranding of T-Mobile Hungary had a major role in reaching these results.

While penetration exceeded 81%, T-Mobile Hungary was able to stabilise its market share with almost 48% share. The high market share was maintained despite the fact that our mobile company has the highest entry barriers in the market. The decrease in the subsidy on prepaid handsets improved profitability of the segment and decreased the risk of prepaid acquisition. The positive news is that competitors followed suit thus increasing the profitability of the whole market.

Although market share figures were also helped by the extension of the refill vouchers' availability period, the rebranding campaign had a definite positive effect on sales and customer retention. Therefore we feel that the rebranding campaign was successful despite the fact the new brand was introduced over a very short time period. The process was completed within one and a half months, which was the fastest rebranding within the T-Mobile family, but brand awareness had already reached a high level in the first month.

To support the campaign, T-Mobile Hungary introduced several new offers and handsets to its customers. The Relax package, which was launched in parallel with the rebranding, is already available in other T-Mobile networks. The package was so successful, that both competitors introduced the same tariff structure with decreased per-minute tariffs. Under this competitive pressure T-Mobile Hungary was also forced to decrease its Relax prices at the end of June.

All three mobile operators are also competing fiercely for the business segment. In the first half of the year all competitors launched zero forint per minute tariffs for within company calls targeting the small and medium enterprises. Roaming discounts have also been offered to customers by all operators in the summer months. For the subscribers of T-Mobile Hungary the incoming roaming calls are free in any T-Mobile Network around the globe.

Thanks to the rebranding campaign and the several new offers, the share of post-paid customers increased further to 27% of the total customer base. While usage mainly increased due to seasonality effects compared to the first quarter, the new offers also boosted minutes of usage due to the high price-elasticity of T-Mobile Hungary customers.

As we announced earlier, the National Communications Authority published its resolution regarding its fixed to mobile termination fees in May. T-Mobile Hungary's termination fees have been reduced by 8.8%, while the fees of Pannon GSM have gone down by 9.2%. As the decrease was applied from June 15th 2004, its financial impact will primarily be felt from the third quarter of 2004.

Regarding the UMTS tender, we still do not have detailed information on the licensing guidelines. According to government officials, the tender will be announced by the end of August.

Continuing with MakTel, the 4% revenue increase at our international subsidiary was primarily driven by foreign exchange rate movements, as the forint weakened against the Macedonian Denar by 3.5% in the first half of 2004.

Although the EBITDA margin of MakTel was still considerable at almost 52% in the first half this year, as you can see from our quarterly figures, MakTel's profitability has deteriorated over the last three quarters. In the 4th quarter of 2003 it was above 57%, while in the first quarter this year above 52% and in the second quarter below 51%. While some of the decreases can be explained by seasonality, the main drivers behind this trend were the appearance of the second mobile operator, the increasing number of disconnected customers due to non-payment, the increased expenses related to IT developments and severance payments due to the headcount reduction.

Despite these negative effects, the management's aim is to keep the profitability of MakTel at the current level through major restructuring of the company. In addition to this, the company will be even more focused on attracting residential fixed line customers with improved offers and will exploit the opportunities provided by the still growing mobile market.

Before moving on, I would like to mention that our stake in MakTel has increased. As we announced in May, SEEF, a subsidiary of Soros Investment Capital decided to exercise its put option with respect to its remaining shareholding in Stonebridge, which is the majority owner of MakTel. The transaction was completed in July; as a result Matáv's share in Stonebridge increased by 3 percentage points to 92.6%. The other shareholder of Stonebridge is CosmoTelco with a 7.4% stake.

On a Group level, net interest and other charges decreased 14% compared to the same period of last year mainly due to the lower average net debt level and the elimination of the foreign exchange loss due to the decrease in the forex loan balance. As you may know, practically all of Matáv's debt has been forint-denominated since the end of 2003.

On a quarter-on-quarter basis, the net interest charges increased by 1.4 billion forints. The main reasons behind this rise were the increased debt level due to higher dividend payment in June and the movement of the forint against the euro. In the first quarter the forint strengthened resulting in a foreign exchange gain on working capital items, while in the second quarter due to the opposite movement of the forint, a foreign exchange loss was incurred.

Matáv paid a record dividend in June at 70 forint per share and a total of 73 billion forint. The dividend payment was partially financed by a Hungarian forint-denominated loan from Deutsche Telekom Group in the amount of 60 billion forint. As a result the company's net debt ratio increased to close to 35% at the end of June from 30.4% at the end of the first quarter. Matáv thus proved its determination to implement its dividend policy and maintain its net debt ratio within the targeted range.

Finally, I would like to say a few words on the results we achieved on the sale of some of our real estate assets. In parallel with the headcount reductions and overall efficiency improvement we started to rationalise our real estate portfolio, and sell the unused office space.

Last year we sold offices in the value of 1.5 billion forints and our revenue in the first half of 2004 reached 1.5 billion forint. This year's revenue was mainly achieved on the back of the sale of a Matáv-owned building which had previously been the headquarters of our Internet subsidiary, Axelero. Rental agreements are also renegotiated continuously. As a result, rental fees are expected to decrease in the coming years. Our aim is to continue the rationalisation of our real estate portfolio parallel with the planned headcount reductions in order to further increase the efficiency in this field.

(Pause)

And now, I would like to hand back to Elek to update you on our mid-term strategic plan.

Elek Straub remarks

Thank you, Klaus.

I am pleased that we have also announced our mid-term strategic plan and targets today. Matáv has a good track record in providing shareholders with short-term guidance figures, but to increase transparency and visibility, we are now announcing mid-term targets as well. Over the past few months, the management has carried out a strategic review to ensure that the company is able to produce solid results despite the strengthening competitive and regulatory pressure across the Group. With today's announcement, we aim to reassure all our stakeholders of this as well.

Our strategy will be implemented by means of a Value Creation Program based on three pillars, which are improved organic performance, exploitation of Group synergies and capitalising on acquisition-driven growth opportunities. Rather than repeat the announcement itself, I would like to draw your attention to some key elements to help you assess the financial impact of the strategy.

In line with our former strategy, we will remain focused on fixed-line access preservation, broadband extension and improving mobile profitability. A new target set in our plan is the cost efficiency improvement through a major headcount rationalisation at both parent company and the subsidiaries. Let me emphasise that as a result of these measures, our fixed line per employee ratio is targeted to reach 500 by end-2006 with proportionately more management positions being reduced thus further improving internal efficiency. In addition, the headcount of the existing subsidiaries will also be reduced by an average of around 17%, with the MakTel headcount being reduced by an above average rate.

Please bear in mind that as the negotiations with the trade unions are still underway and confidential, we cannot provide you with the exact numbers or the breakdown of the rationalisation into headcount reduction and outsourcing at this point in time. As soon as the negotiations are concluded, we will announce the detailed figures.

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In the meantime though, at almost 23 billion forints, the planned provision and related expenses is solid evidence of our commitment to implement a real, tangible headcount reduction with strong influence on efficiency. The per capita expenses of the reduction are expected to be only somewhat higher than those of our 2002 headcount rationalisation. Additional cost savings opportunities will be exploited by the implementation of a Shared Financial Service Center throughout the Group. As a result we expect to eliminate 19.5 billion forints from our cost structure by 2006.

The cumulative impact of these steps will improve the financial performance of the Matáv Group. The program will result in a positive trend in revenue with a targeted low single digit growth in 2005 and 2006. The two main sources of revenue growth are Internet revenues, primarily driven by broadband, and mobile revenues, where growth will mainly result from enhanced data service revenues. Additional revenue increase is expected from the sale of integrated solutions by the newly established joint venture, T-Systems Hungary. At MakTel, we do not foresee major revenue increase in the next 3 years but plan to stabilise the margins despite the unfavourable macroeconomic environment, which limits topline growth.

The financial impact can also be measured in EBITDA terms: Group EBITDA margin target is around 40% in 2004 and exceeding 40% in both 2005 and 2006, all figures are before the restructuring related charges.

Regarding future growth opportunities, implementing further value-accretive acquisitions remains our top priority. To repeat the successful MakTel story in other countries, we have specified a set of criteria concerning the possible acquisition targets and as a first step, we will participate in the privatisation process of Montenegro Telecom.

The company is the incumbent fixed line operator in Montenegro and provides fixed, mobile and Internet services. Its revenues amounted to almost 100 million euro in 2003 with an EBITDA margin of 37%. On the fixed line segment the penetration is 29%, on the mobile 57% with a 44% market share. The 51% stake owned by the Government will be offered for sale, but the sale price is not yet disclosed. We will of course inform you in due course if any new information on the privatisation process becomes available.

Within the frame of this forum, I would like to emphasise again that Matáv will only pursue acquisitions that increase shareholder value. In case targets with attractive value-creation opportunities do not emerge, the company will further increase its dividend payment while maintaining the targeted net debt ratio, remaining fully committed to our dividend policy.

That concludes the formal part of Matáv's conference call. I would like to inform you, that the transcripts of our conference calls will be available on our official website.

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@ln.matav.hu.

Thank you again for joining us today, and for your continued interest in Matáv.