Q3 2012 Results Conference Call

November 8, 2012 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's third quarter 2012 results conference call. I am Thilo Kusch, Magyar Telekom's Chief Financial Officer and Member of the Board, and I will be hosting today's call.

Despite the increasing recessionary pressures we faced in the third quarter, we have made significant progress in our operational activities. Our mobile broadband and TV customer base continued to expand and we have maintained our market positions in all other segments as well. As well as focusing on the retention in our fixed voice business and promoting our interactive TV service through all our platforms, we continued to exploit the opportunities in retail gas and electricity services. Since the nationwide launch of our energy service in April, an encouraging increase in customer numbers reflects the growing market demand for this service. In addition to this, our ongoing focus on the marketing of smartphones resulted in further sales and penetration growth in our customer base. At the end of September, we further expanded our smartphone portfolio and we were the first operator in Hungary to introduce the new iPhone5. Thanks to these combined efforts, we managed to mitigate the pressure of the challenging economic environment and reported only a moderate revenue decline of 1% in the third quarter compared to the same period last year.

Underlying EBITDA increased by 5% in the quarter, with a strong underlying EBITDA margin of 45%. Beside the positive contribution from the sale of our Pro-M subsidiary, we have also begun to realise the benefits of our widespread cost-cutting measures implemented in the second half of 2012. Our real estate transaction in Macedonia also contributed to the EBITDA improvement. We completed an efficiency review of our real estate assets in Macedonia, selling four of our existing buildings and purchasing a single modern one in the third quarter of 2012. This resulted in a gain of close to 4 billion forint. Please note, that although the book CAPEX accounted for the new building is equivalent to 11 billion forint, the trade-in value of the old buildings was 7 billion forint. Furthermore, the cost differential of 4 billion forint is to be paid in six yearly instalments with the first instalment due in the last quarter of this year.

Looking forward, although we expect market conditions to remain challenging, we maintain our revenue target of flat to 2% decline and an underlying EBITDA target of 4-6% decline for this year. However, due to the Macedonian real estate transaction, we have modified our CAPEX guidance and instead of the previous flat target, we are now expecting CAPEX to be approximately 90 billion forint in 2012, excluding spectrum acquisitions.

Let me now turn to the segment analysis, starting with Telekom Hungary. Total sales increased by 2% in the third quarter as growth in our energy revenues compensated for the slight losses in the traditional telco services. Telekom Hungary's underlying EBITDA increased by 3% as significant reductions in total workforce management related expenses and in general and administrative expenses started to yield results in the third quarter and more than offset the continuing shift in the sales composition towards services with lower margin content.

For the mobile market, revenues decreased by 1% as the increase in the customer base could not fully compensate for the unfavourable impact of lower voice usage and decreasing ARPU. At the same time, however, we managed to extend our market leading position for the seventh consecutive quarter, to a SIM-based market share of 46% by the end of September.

The advance in smartphone and mobile internet penetration continued in the third quarter of 2012. Smartphones continue to gain popularity and almost a quarter of all T-Mobile handsets are now smartphones compared to 15% a year ago. We also see a higher demand for mobile internet as post-paid smartphone buyers are 30% more keen to attach a mobile internet package to their new equipment than a year ago. Although temporary campaigns from competitors have slightly reduced our mobile internet market share, we are still the clear market leader with a 46% market share.

Moving on to the fixed voice business, revenues decreased by 11% compared to the third quarter of 2011. Although the rate of migration to our Hoppá package has started to slow down in the past two quarters, it continues to maintain fixed voice churn at record lows of below 4% compared to 6% a year ago, with more than 90% of Hoppá customers on a 2-year loyalty contract. On the other hand, the average revenue per access declined by 9% driven by intense competition and increased fall-out from bundling.

Regarding the fixed internet business, our internet revenues grew by 1% as the 7% increase in the subscriber base compensated for the ARPU erosion resulting from local pricing pressures and multi-play migration.

Turning to the TV market, the positive trends continued into the third quarter as revenues increased by 4% resulting mainly from the 7% expansion of our subscriber base. Interactivity continues to be the focus of our TV strategy, with the number of IPTV customers increasing by 53% compared to last September. Moreover, we see a slow but steady uptake in our reframed Video on Demand, Archive TV, and other complementary services. However, strong price competition and bundling effects have led to an ARPU decline of 2%.

Within our retail energy business, sales activity continues to be remarkable. At the end of the third quarter, we had approximately 74,000 electricity and 52,000 gas points of deliveries that generated more than 5 billion forints of revenues. With the fourth quarter generally the strongest in this highly seasonal business, we are on track to reach our 24 billion forint revenue target for the full year for this business.

Let us now move to the analysis of the quarterly performance of **T-Systems Hungary**. Trends of reduced spending highlighted in previous quarters continued in the Hungarian public and corporate sectors leading to 14% erosion in revenues. However, underlying EBITDA increased by 14% thanks to the positive contribution from the Pro-M sale.

Mobile revenues in the segment declined by 9% driven by lower voice revenues as well as the fallout of Pro-M revenues from September. Although the number of mobile voice customers increased by 8%, the continued tariff pressure coupled with lower usage levels led to a 4% decline in retail voice revenues. The mobile internet subscriber base also continued to increase in the quarter; however, prevailing price pressures in the market limited revenue expansion from this source.

The decrease in fixed line revenues is partly attributable to continuing churn and price pressures in both the fixed voice and internet segments. However, the majority of the decline is driven by the sharp decrease in data revenues, as the insourcing of data services in the public sector accelerated, while private sector customers impacted by the economic downturn continue to renegotiate existing contracts on more favourable terms.

System Integration and IT revenues in the third quarter showed a healthy level in absolute terms. The 14% decline compared to the same quarter last year is the result of outstandingly strong performance of last year when a couple of major infrastructure projects were concluded leading to one-time positive impacts. Furthermore, please note that in two customer segments crucial for us, namely the public and financial sectors, the scope for spending has proved to be very limited with no significant improvement expected in the short term.

Before moving onto the performance analysis of the international segments, let me highlight that our streamlining project at T-Systems Hungary has been completed. Previously several smaller subsidiaries operated as part of the segment; however, to allow for more efficient customer relations and internal operations, we began to streamline these processes last year. While from an operational perspective, this process was completed at the beginning of the year, the legal merger of these subsidiaries into one company, T-Systems Hungary Limited, is effective from the beginning of October.

Now, continuing with our international subsidiaries, in Macedonia total revenues declined by 9% in forint terms compared to the same period last year.

Mobile revenues were down by 9% in the third quarter as voice retail revenues remained under pressure. Despite an increase in usage in excess of 20%, ARPU decreased by 5% reflecting the severe price competition. Mobile operators are trying to expand their customer base with more and more favorable offers, putting strong pressures on revenues and profitability. In addition to bundled minutes and promotional monthly fees, recently we witnessed the introduction of full flat packages to the market as well. Amid this environment, we aim to strike an optimal balance between maintaining our strong leading position and protecting the profitability. We provide targeted, churn reducing offers in both the prepaid and postpaid segments and pay close attention to retaining our high value subscribers. Consequently, though our market share slightly declined, we maintained our clear advantage on the mobile voice market with a 48% share.

Fixed line segment revenues decreased by 10% as the strongly growing TV revenues could not counterbalance the revenue decline of traditional voice and data products. Voice revenue decline was partially driven by the discounts given under our new fixed portfolio offered since May, which is aimed at migrating our customers to double and triple play packages. Thanks to our new product portfolio, the monthly fixed voice churn figures decreased by 40% compared to earlier periods and IPTV gross adds roughly tripled in these months. This led to a 64% increase in our TV subscriber base compared to a year earlier and our market share grew to 15%. Furthermore, by the end of the third quarter, over 40% of our customers had signed up for double or triple play packages.

Underlying EBITDA of the subsidiary increased by 17% in forint terms, thanks to the real estate transaction mentioned earlier. Excluding this positive impact, underlying EBITDA declined by 19% as the decline in revenues was coupled with increased TV outpayments related to the higher subscriber base. Furthermore, higher mobile termination fees of one of our competitors led to increased mobile outpayments. Nevertheless, underlying EBITDA margin, even without the positive real estate impact, remained high at 51%.

Now looking at the performance of our **Montenegrin** subsidiary, in forint terms we see flat revenues in the third quarter compared to the same period last year. EBITDA declined by 4% mainly driven by a one-off increase in VAT relating to mobile equipment subsidies charged by the Tax office retrospectively for the period 2009-2011.

Mobile revenues declined by 6% due principally to the 14% decline in voice revenues. The decrease in voice retail revenues was primarily the result of lower prepaid revenues driven by weaker summer season with fewer tourists using our services compared to the same period last year. At the same time, wholesale voice revenues also declined reflecting the mobile termination rate cut implemented last November and lower incoming minutes. Non-voice revenues were 36% higher than in the third quarter last year, thanks to higher mobile broadband usage. At the same time, our mobile voice market share remained broadly stable at 34%, and thanks to our continued focus on acquiring postpaid customers, we could further increase our postpaid subscriber base by 8% compared to a year earlier.

Fixed line revenues were up by 4%, as the growing contribution of internet and TV revenues fully offset the decline in voice and data usage. We maintained our leading positions in the fixed voice and broadband markets with 98% and 83% market shares respectively, and managed to increase our share in the pay-TV market to 43% thanks to our bundling strategy and high quality IPTV product.

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

(Take questions)

I believe we have time for one more question.

(Take final question)

If there are follow-up questions, I encourage you to contact our Investor Relations Department. The telephone number is 36-1-458-0424 or, if you would like to send an e-mail you can address it to investor.relations@telekom.hu. I would like to also inform you that the transcript of our conference call will be available on our official website. Thank you again for joining us today, and for your continued interest in Magyar Telekom.