Q3 2020 Results Conference Call

November 5, 2020

Good afternoon everyone. I am Zoltán Pandi, Head of Investor Relations at Magyar Telekom. I would like to welcome you to our third quarter 2020 results conference call. Please note that our presentation can be accessed via the link within the conference call invitation and is also available in the Investor Relations section of our website.

Before we get started, I would like to draw your attention to the disclaimer on the second page. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties.

As usual, I have senior management with me today: Mr. Tibor Rékasi, our CEO, and Ms. Darja Dodonova, our CFO, who will take you through the presentation and answer any questions you may have.

Now, it is my pleasure to hand over to Tibor to open the presentation.

Tibor Rékasi

Starting with **Slide 3,** I am pleased to report that Magyar Telekom is on track to deliver its updated targets for 2020. Operationally, the third quarter was somewhat less testing than the second; however, we may have a more turbulent period ahead, in light of the deteriorating COVID-19 situation throughout the CEE region. Both our revenue and EBITDA generation improved moderately year-on-year in Q3 2020. EBITDA reached 146 billion forints on an after lease basis, thanks largely to strong B2C results and our efficiency improvement initiatives. As a result, our year-to-date figures are virtually in line with those reported for the same period of 2019.

And now, a few words about investments: as planned, we have fast-tracked our fiber investments and also started the comprehensive modernization of our mobile network. In the first nine months of 2020, CAPEX spend excluding spectrum license fees and leases amounted to 75 billion forints, representing an increase of more than 17 billion forints versus the prior year period. Despite the higher capex spend, however, free cash flow grew to 32.9 billion forints, i.e. up 5 billion forint over the same period.

Looking ahead, we are fully focused on delivering our 2020 targets. Although our EBITDA generation has been flat year-on-year, we are seeing positive momentum, with particularly strong performance in B2C, and we expect this to continue into the fourth quarter. In addition to strong EBITDA generation in Q4, we expect delivery of our targets to be supported by potential smaller real estate sales.

From an operational perspective, we have not seen significant deterioration of the underlying business drivers, despite the rapidly changing COVID-19 situation. Given the circumstances, the health and well-being of our employees remains as a top priority, along with providing our customers with a seamless experience they have benefited from over the past few of months.

Moving to **Slide 4,** and our delivery against strategic targets in the third quarter. Let me start with the social dimension: while over the summer months, we saw a temporary easing of social distancing measures, in response to rising infection rates, from September onwards we have reintroduced remote working wherever possible, allowing the vast majority of our employees to work from home. As far as our customers are concerned, we have introduced tailored solutions for small, medium enterprises and non-profit organizations, allowing for smoother communication and enhanced digital development during this testing period.

From an ESG perspective, I'm pleased to report that Magyar Telekom has been confirmed as a constituent of the FTSE4Good emerging index for the fifth consecutive year. As part of the due diligence, in 2019 FTSE4Good reviewed our performance against more than 100 sustainability related indicators and assigned Magyar Telekom the highest rating of 5, placing the company in the top 1% in the global telecommunication sector.

With respect to network development, we have covered more than 100,000 access points with fiber, which is the highest quarterly increase since the start of the rollout. As a result, we have 2.3 million access points covered by our Gigabit capable network as of the end of September. On the mobile side, the cautious 5G rollout continues and preparations are underway for the upcoming 900 / 1800 MHz spectrum auction, which we will keep you updated on over the coming months. Today we hold frequencies of 10MHz and 15MHz duplexes on the 900 and 1800 bands respectively, which are due to expire in the first half of 2022. Spectrum on both bands has been used frequently for the purposes of providing voice and data services.

From a customer perspective, mobile data usage stabilized at record highs and reached 5.9 GB/month in Q3, representing a 40% rise year-on-year. In response to increasing demand for high bandwidth and growing data consumption, we have rebalanced both our fixed and mobile portfolios applying the more-for-more approach. Thus, we are offering more content, unlimited voice and data plans and greater flexibility to our customers. And we are starting to monetize this surge in data demand, which we will elaborate on shortly.

When it comes to access to financing, we reached an important milestone last week. For the first time in more than 12 years, Magyar Telekom received an investment grade credit rating of BBB+, which we believe reflects the company's resilient business model. This also places Magyar Telekom amongst the highest rated corporates with a Scope Ratings credit review in Hungary. The BBB+ credit rating will be of vital importance for our ability to obtain competitive financing terms when it comes to funding our upcoming investments.

We also remain committed to our efficiency agenda. As you will see later in this presentation, we achieved a substantial decrease in our total indirect costs during the third quarter, which has supported our profitability. The pace of headcount reductions may be lower in the future compared to what we have seen in the past couple of years, simply because the marginal gains are limited following multiple rounds of tightening. That said, we remain committed to delivering further efficiency improvement from other areas of our business.

Before I hand over to Darja, just let me make a quick remark regarding our profitability on **slide 5**. Here you can see that following a hopefully temporary EBITDA after lease dip in Q2 2020, we have returned to growth in the third quarter. A continuation of this positive momentum will be vital for our ability to deliver our annual guidance, which doesn't assume a severe impact to our operations and our financials from social distancing measures and a lockdown being re-introduced in response to the second wave of COVID infections.

Darja, the floor is now yours, please walk us through the Q3 2020 financials in more detail.

Darja Dodonova

Thanks Tibor,

Looking at the details on **Slide 6**, positive developments in group revenue were primarily driven by higher telecommunication service revenues, which were in turn attributable to further improvements recorded in mobile data, fixed broadband and TV services. Equipment sales revenues, in both fixed and mobile, also recovered in the third quarter as transaction figures returned almost to pre-Covid levels. Many of these sales transactions were related to contract extension as customers continued to value the services they receive from us.

Meanwhile, the decline in System integration and IT revenues slowed year-on-year, and showed an absolute increase compared to previous quarters in 2020, as revenues from the corporate segment increased. The contraction in revenue was primarily due to a reduction of projects in the Hungarian public sector, though some recovery in demand has been witnessed from earlier muted levels.

The contraction in other revenues also decelerated, as higher fixed wholesale revenues partly mitigated the significant decline in visitor revenues, which particularly impacted the summer months.

These trends, coupled with the positive foreign exchange impact from the strengthening of the denar against the forint, resulted in an overall 1.8% increase in total revenues for the third quarter. This increase also mitigated the moderate decline in group revenue we recorded in the first half of the year, resulting in stable revenue performance year-on-year in the first nine months of the year.

Slide 7 presents the operational developments in the Hungarian mobile market. I am happy to report that the positive dynamics we experienced earlier this year have continued, both in terms of customer base developments and mobile data usage.

Our total customer base continued to increase moderately, driven by the expansion of our postpaid subscriber base. In parallel, the number of customers opting for mobile data packages has also increased by over 5% compared to a year earlier.

With regard to mobile data usage, our earlier expectations have materialized, and customers are requiring ever increasing monthly volumes. By the third quarter the temporarily free data allowances we provided to customers had ceased, however average monthly data usage increased even further than previous levels. To meet this strong increase in demand, we introduced some seasonal promotional offers during the summer months that provided unlimited data usage for a fixed period of 3, 10 or 30 days. Furthermore, from the beginning of September we reshaped our mobile data portfolio using our more-for-more approach. Reflecting a rise in the average usage level to almost 6 GB per month, we increased the monthly allowance in our entry package to 4GB. At the same time, we made our gigabit capable 5G service available for customers signing up for one of our unlimited data packages. The initial customer reaction to these initiatives are very promising; the uptake of the new portfolio among our subscriber base has been better than expected with around 30% of the customers opting for unlimited data packages.

Looking at average voice usage, it is apparent that the sharp rise witnessed in the lockdown period was a largely temporary occurrence. However, a 10% year-on-year increase was still visible in the quarter, though it had less of a positive impact on ARPUs, due to the high ratio of unlimited voice packages. However, it did trigger further increases in the related telecom tax, as shown later in the presentation.

In terms of ARPU developments, I am happy to report, that after a temporary year-on-year decline in the second quarter, third quarter blended ARPU returned to a positive trajectory. This was achieved despite the lower roaming revenues - which had a negative impact of over 1 percentage point year-on-year - thanks to our successful monetization efforts in mobile data and the favorable trend in pre-to-postpaid migration.

Slide 8 illustrates developments in the fixed market in Hungary. As mentioned earlier, the most important contributor to the favorable fixed performance was the further significant expansion of the broadband and TV subscriber bases that drove a further increase in the ratio of double play residential customers. I am very happy to see that in both service categories we outgrew the market and in the first eight months this year we have already increased our market shares in both markets by around 1 percentage point.

Regarding the developments in ARPU, existing trends were positively supported by the general rebalancing we introduced from the beginning of September. Consequently, the downward trend in average voice revenues, which had been partly mitigated by a temporary rise in fixed voice usage, was further slowed. Additionally, pay TV ARPU increased year-on-year following a decline in previous quarters, while the upward trend in broadband ARPU was further amplified thanks to customer migration towards higher bandwidth packages.

Turning to **Slide 9,** Group EBITDA After Leases also recovered, increasing by 1.5% year-on-year in the third quarter of 2020, leading to stable results for the first nine months of 2020. The improvement seen versus the first half of the year was mostly visible at gross profit level. Pressures stemming from higher telecom taxes, lower roaming volumes and a fall in visitor revenues persisted, and some one-off negative impacts were recorded. However, positive trends in service margin as well as a stabilizing contribution from SI/IT led to more favorable gross profit developments in the third quarter.

The year-on-year improvement in indirect costs reflects our efforts to transform our operation and deliver on our EBITDA target, despite the headwinds presented by the COVID-19 pandemic.

In the first half of the year the majority of savings were driven by a headcount reduction, coupled with a temporary hire freeze at both the Hungarian and North Macedonian operations. But in the third quarter, employee related expenses were at the same level as the previous year, primarily reflecting the different timing of bonus accruals within the year.

Other indirect expenses demonstrated further improvements, most predominantly due to reduced advisory, marketing and network maintenance and repair expenses - which more than offset cost increases associated with implementing protective measures for office and sales employees.

However, at an EBITDA After Lease level, and on a first nine months basis, the absence of income from real-estate sales, which positively impacted results in the first nine months of 2019, offset some of the favourable impacts of the efficiency improvements.

Slide 10 shows some further details of the Group's capital expenditure and the Hungarian fixed network rollout developments.

As already demonstrated by the first half performance, we managed a much more balanced investment schedule for the year, investing 75 billion forints in the first nine months of 2020, representing a year-on-year increase of over 17 billion forints. The majority of this increase is related to the fixed network, primarily the fiber rollout, but also reflects the higher spend on customer premise equipment, in line with increased customer demand for gigabit network connections. In the first nine months of 2020, 30% more broadband customers signed up for a fiber connection, versus the same period in 2019. Consequently, by the end of September, around 60% of our broadband customers were using our gigabit network; while gigabit capable access points account expanded to 54% of our coverage area in Hungary. That success clearly demonstrates the competitive advantage that our upgraded network is providing, and I strongly believe that these ratios will increase further as our network development plans progress.

Some of the increase in Capex is attributable to the developments we made with regard to the mobile network modernization project. This allows for higher capacity on our current 4G networks, as well as facilitating the rollout of 5G services. Recently, a major milestone was reached with gigabit speeds achieved on our 5G network, while we also gradually extended service areas to partially cover 28 towns in Hungary.

Let me now talk you through the below EBITDA lines on **slide 11**.

Depreciation and amortization remains slightly higher than in the base period, as D&A reached HUF 104.4 billion forints YTD in 2020. This shouldn't come as too much of a surprise following the activation of the recently acquired 5G frequency licenses.

Net financial losses amounted to 17.6 billion forints in the first nine months of the year. However, the Q3 net loss amounted to a mere 1.2 billion forints, which requires a bit of explanation. On one hand, the forint weakened somewhat against the Euro. All else being equal that should have a negative effect to the net financials. However, at the same time we booked non-realized gains on cross-currency interest rates swaps, which we have in place to mitigate our exposure on Euro denominated long-term loans. As fair value adjustments are done, we not only have to take into account the relevant FX moves but also changes in the Euro and forint yield environments. Essentially, during Q3 we saw an uplift in the forint yield curve triggering the booking of a HUF 4.5 billion gain. I consider this item fairly technical as it is a non-realized item. And we shouldn't forget that the sum of these gains and losses converge to zero, as we are approaching the expiry of a particular swap arrangement. That said, our reported net financials will be exposed to these yield curve changes through swap revaluation in the future, too; the size of the potential gain or loss will obviously be dependent on direction and the magnitude of the yield curve move.

With somewhat higher depreciation and lower net financial results off-setting each other, year-to-date profit before tax and profit after tax are largely in line with the previous period, amounting to 41.3 billion forints and 27.6 billion forints respectively.

Finally, a few words on cash-flows on **slide 12.**

Free cash-flow generation (excluding spectrum licences) reached 32.9 billion forints in the first nine months of the year which was sufficient to cover both our investments and also a significant part of the 5G spectrum license fees that we paid in Q2. We have seen a working capital build of 6.5 billion forints year-to-date, and an 8.8 billion forints reversal quarter-on-quarter. These changes are very much in line with fluctuations in handset accounts payable.

Free-cash flow including spectrum licenses, remained in negative territory by the end of the third quarter.With this I will hand back to Zoltan to kick off the Q&A session.

Zoltán Pandi remarks

Thank you very much, Darja.

That concludes our presentation. We are now happy to take any questions you may have. Operator, when you are ready, we will take the first question.

(Take questions)

If you have any follow-up questions, please do contact our Investor Relations team. Please also note that the transcript of our conference call will shortly be available on our website. Thank you again for joining us today and your continued interest in Magyar Telekom.