4Q 2017 Results Conference Call

February 22, 2018 at 15:00 CET

Good afternoon everyone. I am Péter Bauer, Head of Investor Relations at Magyar Telekom. I would like to welcome you to our fourth quarter 2017 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 last slide. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties.

With me today is Mr. Christopher Mattheisen, our CEO, and Mr. János Szabó, our CFO, who will take you through the presentation and answer any questions you may have.

Now, it is my pleasure to turn the call to Chris to open the presentation.

Christopher Mattheisen:

Thank you Péter. Good afternoon everybody.

I would like to provide you with an overview of the key financial and operational achievements recorded at the Group level for the fourth quarter and the full year of 2017.

As shown on slide 2, the strong revenue growth recorded by the Group in the first nine months of 2017 continued into the fourth quarter. Group **revenues increased by 6%** year-on-year thanks to the positive trajectory of revenues across all three major services lines in Hungary that more than offset the competition-induced revenue pressure in Macedonia.

Group **EBITDA rose by 1% year-on-year** as gross profit improvement in Hungary, along with the positive impact of cost saving measures, were partly counterbalanced by the severance charge incurred in relation to the Hungarian headcount optimization program and the decline in gross profit recorded in Macedonia.

In terms of **operational achievements**, which can be observed on Slide 3, I believe we have taken some very important steps in 2017 to secure our leading market positions, leaving us well positioned for the year ahead. We have continued with our **fixed network developments**, expanding our high-speed internet coverage by another 270 thousand households during 2017, resulting in an over 80% share from our total base. At the same time, our **mobile network**, which has gained the P3 award as the fifth best network worldwide, was also further improved. We have increased the population based indoor coverage of our 4G network which now reaches over 88%, and we also launched Voice-over-LTE which as of now represents 11% of voice traffic on the network.

In the **mobile segment**, data services continued to play a significant role with both the subscriber base and ARPUs increasing dynamically over the period. Our performance was also supported by the introduction of the new mobile service portfolio structure in March 2017 that provides greater flexibility for customers and proved successful both financially and in terms of increasing customer satisfaction. Over 700 thousand customers signed up to these packages throughout the year with a favourable impact on customer spending levels.

On the **fixed market**, thanks to the rebalancing of our fixed broadband portfolio and implementation of new TV packages, we enhanced our competitiveness and were better placed to exploit our network capabilities by increasing the penetration of our high-speed internet network. By the end of 2017, around 60% of our residential broadband customers opted for a package of over 30 megabits per second. The continued dynamic growth of the TV customer base was compounded by a favourable shift towards higher ARPU packages with 90% of new customers choosing the high-end tariff plan.

One of our main focus areas for 2017 was to further improve our position in the **FMC (fix mobile convergent) segment**, as we strongly believe that the key to long term success is the ability to offer truly integrated packages to our customers. In line with this we have extended our Magenta1 offer according to our customers' requirements, including the option to change from fixed voice to mobile data in the package, and introduced the so called "Telekom discount" to the post-paid portfolio as well. These efforts were clearly effective with an approximate 20% year-on-year increase in the number of households signing up to a bundled fixed-mobile package.

We have faced several **regulatory challenges** throughout 2017, and I am proud to say we successfully adapted to and overcame these. In the obligatory prepaid registration process we managed to secure more than 95% of our prepaid revenues and used this as an opportunity to accelerate subscriber migration to post-paid packages. Furthermore, any negative consequences from the implementation of the EU's Roam Like Home legislation were kept to a potential minimum, reaching the previously forecasted ca. 1 billion forint margin fallout. Finally, on changes to Hungarian legislation regarding loyalty periods and discounts, it is too early to see its full impact at this time, however we strongly believe that our strategic objective of pursuing differentiation through our device offering will support us in increasing customer satisfaction and enable us to mitigate the majority of challenges caused by the legislation.

In Macedonia we faced increased competitive pressures both in the fixed and the mobile segments, putting downward pressure on both revenues and profitability, though the latter was partially offset by cost saving measures.

Moving on to the full year **2017 financial results and targets,** I am pleased to report a very strong set of financial results that exceeded our public targets in all key indicators. As you can see on slide 4, revenues reached 610 billion forints, an annual increase of 6%. This reflects the success of the initiatives implemented to increase customer satisfaction which led to us strengthening our position in the market in several key areas including system integration and

IT, post-paid mobile, TV and fixed broadband. Moreover, despite the absence of the considerable one-off profits recorded in 2016, we still managed to maintain EBTDA near 2016 levels, largely attributable to the improvement in gross profit and the group-wide cost optimization.

Though Capex totalled 86 billion forints, marginally exceeding our original target, Free Cash Flow increased by 2% to 58 billion forints which enables us to propose a 25 forint dividend per share on 2017 earnings for approval to the Annual General Meeting.

I will now hand over to János to provide you with further detail on the performance of our business segments and our 2018 financial outlook

Thank you, Chris. Good afternoon.

Let me start with **Hungary** on **Slide 5**. Overall **revenue increased by 7% in the fourth quarter**, due primarily to significant growth in System Integration and IT revenues, alongside higher mobile data and equipment revenues.

Mobile service revenues increased due to continued growth in mobile data revenues resulting from higher subscriber numbers and usage, compensating for the competition driven decline in voice revenues. Other mobile revenues also increased thanks to sales growth in smartphones and accessories as well as higher visitor data revenues following the change in EU regulation.

Fixed line revenues increased in-line with growth in fixed broadband, TV, and equipment revenues, which more than offset the continued structural decline in voice retail revenues. The strong growth in equipment sales reflects our decision to pursue differentiation through our device offering and eliminate the barriers between fixed and mobile service, and the related equipment.

The significant increase in System Integration and IT revenues observed in the first nine months of the year was sustained, while energy service revenues declined as a consequence of our exit from the last remaining segment, the residential electricity market, as of November 1, 2017.

Despite the severance expense booked in the fourth quarter**, Hungarian EBITDA increased moderately** year-on-year, thanks to higher gross profit and operating expense improvements. The gross profit increase was supported by reduced bad debt expense, reflecting the lower rates of impairment applied to the Hungarian mobile operations as per the improved rates of collection. Telecom tax meanwhile increased, driven by higher mobile voice traffic due to the growing popularity of flat rate packages.

Slide 6 shows developments in the **Hungarian mobile market**. First, looking at the overall customer base development, the loss of customers who did not register their prepaid SIM cards by the extended deadline of September 30, 2017 is behind the negative trend. Excluding that, we saw continued increase in the overall subscriber base driven by the strong growth in the number of post-paid customers, resulting in an over 5 percentage point increase in the post-paid ratio year-on-year. This can primarily be attributed to the very favourable market perception of the customizable post-paid tariff system launched at the end of March, and was also supported by the acceleration of the pre-to-postpaid migration that Chris mentioned earlier. This tendency also supported mobile data usage trends. Year-on-year, we recorded a 13% rise in the number of mobile data customers, with a much higher increase in total usage. We saw strong demand for larger data packages and now more than a third of our customer base subscribe to packages including at least 4 gigabytes per month in data allowance. The combined impact of the above developments, led to a year-on-year increase of 4% in the blended ARPU level.

In terms of our **fixed segment**, as you can see on Slide 7, broadband and TV subscriber numbers were both up by more than 5% year-on-year and had a positive impact on the further expansion of our triple play subscriber base. As mentioned earlier, these trends received further impetus from the network improvements we have been continuously undertaking and the restructuring of our broadband offering. This, along with the introduction of our new brand, Flip which offers one very attractively priced 3Play package, reflects our enduring commitment to meet increasing customer needs. Although competitive pricing, primarily of triple play offers, continued to put downward pressure on ARPU levels, the higher customer base and migration to triple play packages led to an overall 3% increase in the average fixed revenue per household, demonstrating the effectiveness of our efforts to increase the popularity of our bundled packages.

Slide 8 shows the year-on-year developments of the **Hungarian System Integration and IT segment.** In the fourth quarter we once again recorded a strong increase in System Integration and IT revenues, primarily attributable to strong market demand for hardware and software deliveries. These projects, however, have typically lower profit margins hence a dilutive effect on the gross margin. Nevertheless, these contracts create a very important base for further higher margin opportunities in the fields of system integration and application development, and contributed to an increase in our overall revenue based IT services market share to around 16%.

Let us now move on to the performance of our **Macedonian operations,** shown on **Slide 9** in local currency to better reflect underlying performance. Although both revenues and EBITDA showed some decline in the fourth quarter of 2017 compared to 2016, we witnessed several positive trends in the quarter that give us cause for optimism.

In the **mobile segment**, we managed to maintain stable revenues in the fourth quarter, despite the circa 30% cut in the regulated mobile termination rate which itself negatively impacted total revenues by 3%. Nevertheless, driven by our continued focus on the post-paid segment that generate growth of 8% in the post-paid subscriber base and a 47% boost in the post-paid ratio, we managed to keep the overall blended mobile APRU level stable. This we achieved in an increasingly competitive environment thanks to our strong value proposition that included very favourable equipment offers in the holiday season. The latter led to a dynamic increase in equipment revenues in the last quarter of 2017 that mitigated the negative impact on revenues that stemmed from general pricing pressures and the decline in our prepaid customer base.

In the **fixed segment**, revenue decline was consistent with what we experienced in earlier quarters. Both the voice retail and broadband revenue decrease was driven primarily by the lower pricing that derived from fierce 3Play competition, whereas the decline in wholesale revenues reflects the lower volume of incoming traffic. These negative impacts were partially mitigated by strong TV revenue growth as a consequence of the continued expansion of IPTV customer numbers and further improvement in the ARPU level. In parallel, we also increased our double and triple play subscriber numbers which now stand at almost 75% of our overall fixed customer base.

System integration and IT revenues remained at a modest level, reflecting the postponement of several major government projects, a situation that was already prevalent in the last quarter of 2016 and one that left a relatively low comparable base.

In terms of **profitability**, we saw a drop in gross profit that was mainly due to two temporary factors; on the one hand, to secure our strong market positions in the highly profitable postpaid mobile segment we have invested more intensely in equipment subsidies in the last months of 2017. At the same time, bad debt increased considerably compared to the fourth quarter of 2016 which saw unusual decline in impairment rates.

Consequently, **EBITDA** declined by 4% year-on-year in the fourth quarter of 2017 as the successful implementation of the ongoing cost-saving measures could only partially mitigate the gross profit decline.

Finally, on slide 10, you can see our **public targets for 2018**. In terms of **revenues,** we expect a slight year-on-year decline to approximately 600 billion forints for 2018 on account of the exit of our energy business and somewhat lower equipment sales revenues. At the same time, we would like to further exploit the unique position we have in the Hungarian FMC market by increasing the number of customers who choose one of our bundled fixed-mobile packages, thus supporting us in improving our market positions and maintaining overall service revenues despite pricing pressure. Regarding Macedonia, we are anticipating an acceleration in IT projects to compensate for the fallout in traditional telecommunication revenues, reflecting the strongly competitive environment.

EBITDA in 2018 is anticipated to increase to approximately 190 billion forints thanks to the favourable impacts of the ongoing cost optimization program in both Hungary and Macedonia. **CAPEX** is expected to slightly rise to around 90 billion forints as we progress with the upgrade and expansion of our fixed networks. Our **Free Cash Flow** will receive a slight boost in 2018 from upcoming real-estate sales ahead of our move into the new headquarters, and should total around 60 billion forints.

Based on the current operating and regulatory environment and outlook, we expect the Company to pay 25 forint dividend per share in relation to 2018 earnings.

Chris Mattheisen remarks

Thank you very much, János.

That concludes the formal part of Magyar Telekom's conference call. Now, 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 Department. 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.