Q4 2014 Results Conference Call

February 26, 2015 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's fourth quarter and full year 2014 results conference call. I am János Szabó, Magyar Telekom's Chief Financial Officer, and I will be hosting today's call.

I am pleased to report that during 2014 we reached some very important milestones: we strengthened our leading position in the mobile market by securing crucial frequencies during the mobile spectrum tender and we became the number one player in the pay TV market making us market leader in all telecommunication and IT markets of Hungary. We were not only able to further expand our subscriber base but managed to increase ARPUs in several of our key market segments. Consequently, we were able to meet our revenue guidance with a 2% annual decline thanks to our successful bundling and rebalancing strategy.

On a full year basis, we were able to slightly exceed our EBITDA guidance with a 1% increase predominantly due to the improved mobile and energy service margins in Hungary coupled with increased employee efficiencies.

Looking ahead to 2015, we aim to further strengthen our positions across all markets. These efforts will be supported by the GTS Hungary acquisition which we expect will improve our positions in the Hungarian business segment. In addition, our agreement with Telenor Hungary on the sharing of mobile frequencies and developing and maintaining a shared 4G network in the 800 megahertz spectrum band in Hungary will allow us to accelerate the 4G mobile broadband coverage rollout in the countryside and offer higher bandwidth to the affected customers.

In terms of revenues, we expect an increase of up to 3 percent as we continue to mitigate pressure stemming from the voice revenue decline by migrating customers to bundled packages while revenues will also be supported by the consolidation impact of GTS.

Although we do anticipate improved efficiency performance at our Hungarian operation and a positive impact from the GTS acquisition, we expect pressure at our international operations and higher severance expenses to result in an overall decline of up to 3 percent in our reported EBITDA for the year.

In terms of investments, after strengthening our technological leadership in the Hungarian mobile market during 2014, we now plan to execute a similar task in the fixed line segment to increase our competitiveness. Therefore, we expect capex of around 105 billion forint for 2015 that will allow us to expand our fixed line high speed internet coverage from the current ca. 1.8 million households to over 2.2 million households.

And finally, I am also pleased to share that, based on the current operating, regulatory and taxation environment and outlook coupled with the anticipated significant improvement in our free cash flow generation, we expect that the Company will be able to pay at least a 15 forint dividend per share on 2015 earnings.

I would also like to take this time to highlight that, based on current market and operational trends, we have updated our 2017 results guidance. While we continue to expect a compounded annual revenue growth rate of around 2 percent compared to 2012 levels, we now expect EBITDA to be higher than earlier forecasted and target a reported EBITDA of at least 185 billion forint for 2017 which will be supported by the current headcount rationalization program. We also expect to be able to leverage the acceleration of fixed network development in terms of improved market positions in Hungary. As a result, while our capex target remains unchanged at 80 billion forint, we increase our free cash flow target to at least 50 billion forint for 2017.

Moving on to the segment analysis, at **Telekom Hungary** revenues slightly increased by half a percent in the fourth quarter compared to the same period in 2013 fueled by record mobile quarterly revenues compensating for the lower fixed voice and energy revenues.

EBITDA for the period also increased by 6%, largely as a result of lower employee-related expenses and higher gross margins.

We finished the year with an extremely strong quarter in the mobile segment. We experienced a 9% increase in revenues quarter-on-quarter thanks to our efficient rebalancing strategy and strong handset sales, supported by the successful Xmas campaign. We were able to increase our customer base by more than 30 thousand during the last three months of the year resulting in a 1.6% growth over the same period last year. Blended ARPU levels also grew as postpaid ARPU was up by more than 4% compared to the fourth quarter of 2013 thanks to the successful tariff upselling activities that were pursued, with customers appreciating the unlimited usage on our flat rate offers. We also expanded our 4G population coverage to 78% by the end of 2014 due to the newly acquired frequencies in the 800 and 1800 MHz band. The number of our 4G users grew by around 140 thousand during the fourth quarter of 2014, boosting our mobile broadband revenues by 8% compared to the fourth quarter of 2013 which overcompensated the 2% loss in mobile retail voice revenues. We further strengthened our position in the high-end segment through the successful launch of the iPhone6. Our increased 4G coverage also boosted other LTE capable handset sales resulting in a 36% increase in our total equipment revenue over the same period last year.

Turning to the fixed line segment, I am pleased to report that, thanks to our successful triple play bundling strategy we further strengthened our fixed broadband and pay TV market shares. We extended our customer base by 70 thousand and almost 40 thousand new subscribers respectively during the year and by the end of 2014 almost half of our TV customers had already an IPTV subscription. Moreover the improved fixed broadband and pay TV performance almost fully compensated the retail voice revenue loss of 9% that was mostly due to the significant discounts given to customers. The overall 7% decline in fixed line revenues in the fourth quarter of 2014 was driven by the weaker TV set sales and the wholesale voice and other fixed line revenue decrease due to the cut in the interconnection rate.

Energy revenue was also down by 14% compared to the same period last year due to lower volumes and a reduced regulated price level in the residential segment.

At **T-Systems Hungary** revenues for the fourth quarter decreased by 11% compared to the same period in 2013. This was mainly driven by a 15% decrease in system integration and IT revenues, resulting primarily from the restructuring of inter-segment processes that caused a lower volume of internal services as well as lower infrastructure revenues.

At the same time, mobile revenues fell only by 1% even though we lost in the previous government tender. Although RPC remained stable the voice revenue decline continued, the significant expansion of our 4G coverage boosted mobile internet usage and also led to increased revenues from equipment sales which compensated for the voice revenue loss.

Fixed line revenues were down by 7% as both voice and data revenues were negatively impacted by the continued decline in the customer base.

EBITDA of T-Systems Hungary increased by 43% reflecting primarily the non-deductible VAT charge recorded during the last quarter of 2013 and improved cost control this year partially mitigated by the higher bad debt levels during the respective 2014 period.

Looking forward, we expect downward pressure on traditional revenues to continue throughout 2015. At the same time, we anticipate that our system integration and IT revenues will stabilize. In terms of profitability, after an annual decline of 16% in 2014, we expect a turnaround in EBITDA performance supported by higher gross margins as well as by improved efficiency levels in the T-Systems Hungary segment.

Turning to our international subsidiaries, in **Macedonia** we are seeing positive signs and are pleased to report a slowdown in revenue decline to 3% in forint terms during the fourth quarter of 2014, compared to 10% a year earlier. Meanwhile, EBITDA rose by 2% in forint terms due to lower headcount reduction related severance expenses compared to the last quarter of 2013. The Hungarian forint weakened by 4% on average against the Macedonian denar, compared to the last quarter of 2013, boosting the results in forint terms. In denar terms, there was a 6% drop in total revenues and a 2% decline in EBITDA.

<u>Mobile revenues</u> in denar terms declined by 9% due to the 31% decline in wholesale voice revenues, driven by a 25% cut in mobile termination rates effective from September 2014. At the same time, the retail voice revenue decline slowed, while non-voice revenues were broadly stable. Consequently, ARPUs in the last quarter of 2014 were 12% lower than a year earlier against the more than 15 percent decline witnessed during the same period last year.

<u>In the fixed line segment,</u> thanks to our continued efforts to migrate customers to bundled packages, the number of broadband and IPTV subscriber figures increased further, resulting in a ratio of double and triple play customers of over 60% of the total fixed voice customer base. Consequently, the increase in Internet and TV revenues coupled with a significant uptake of our ICT services were able to partly offset the continued decline in voice revenues leading to an only 3% decline in fixed line revenues.

<u>Looking ahead</u>, we continue with our strategy of promoting mobile BB usage to secure our positions in the mobile market. This effort will be supported by our growing LTE

coverage from the current around 50% population based coverage to around 70% by the end of 2015.We also plan to continue to migrate our fixed line customers to bundles to slow down retail revenue loss.

At our **Montenegrin** subsidiary, revenues declined by 3% in forint terms during the fourth quarter while EBITDA increased by 16%. It is worth noting that EBITDA during the same period last year was affected by headcount reduction related severance costs. Similarly to Macedonia, results were positively impacted by an average 4% year-on-year weakening of the forint against the euro. In local currency terms, total revenues were down by 7% while EBITDA for the period was up by 11%.

Mobile revenues in euro terms were stable as the decline in voice revenues was offset by the significant increase in mobile handset sales fuelled by year-end promotions. The reduction in voice revenues was driven by a combination of the slight decline in our customer base, the cut in mobile termination rates effective from November 2014 and lower visitor revenues. At the same time, increase in usage trends supported by declining price levels continued, meaning that while MOU was up by 11% against the fourth quarter of 2013, ARPU was down by 2%.

Fixed line revenues were down by 11% resulting from lower voice and other revenues. The decline in voice revenues was predominantly a result of retail price regulation which became effective in April 2014 and lower incoming international traffic. Other fixed line revenues decreased due to the absence of one-off revenues from the long term rental of dark fiber recorded in the fourth quarter of 2013.

Looking ahead to 2015, we expect future revenue growth in mobile BB as the penetration of smartphones increases. Regarding the fixed line segment, we see some signs of consolidation leading to increased competition.

That concludes the formal part of Magyar Telekom's conference call. Now, 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 you have any follow-up questions, please 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.