Q2 2013 Results Conference Call

August 8, 2013 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's second quarter 2013 results conference call. I am Chris Mattheisen, Magyar Telekom's Chief Executive Officer, and I will be hosting today's call together with János Szabó, our Chief Financial Officer.

We are pleased to report that our revenues for the second quarter grew by almost 8% as the contribution from our non-core businesses increased further while the traditional telecommunication businesses also performed well. As in previous quarters, we have been able to retain or increase our market positions in all our key markets, while ARPU erosion in the traditional voice businesses was limited.

Reported EBITDA showed a slight increase of less than 1% and although the different special tax situation contributed to our overall EBITDA, we believe that this is a commendable result given the challenges we have faced in recent years. In our view, this clearly shows the effectiveness of our retention and customer acquisition strategy based on smart bundling of a diversified service portfolio.

For the full year, we continue to focus on the absolute amount of EBITDA in order to reach our guidance of a 9-12% annual decrease. Concerning the top line, we see two important factors that will shape our revenue development. First, as the bundling of equipment with our core telecommunication services is clearly having a positive effect on customer retention and ARPU levels, we will continue to focus on such propositions. Furthermore, in the System Integration and IT market, we are seeing more demand for the much lower margin application and infrastructure projects than the more complex outsourcing projects. As such, in order to achieve our targeted profitability level, we need to undertake a higher volume of these projects. Consequently, also supported by the favourable evolution of energy and equipment sales, we now expect increasing revenues year-on-year instead of our previously targeted flat performance. With regards to our investments, we still expect CAPEX to be 5 percent less than last year, excluding any spectrum acquisition costs such as the LTE frequency costs in Macedonia.

Let me now turn to the segment analysis, starting with Telekom Hungary, where revenues grew by more than 10% in the second quarter. More than half of this increment was due to energy revenues tripling year-on-year, but our performance in our key markets also showed improvement. At the EBITDA level, there was an increase of 8% as a result of improvement in the direct margin, the lower operating tax burden, and stringent cost cutting efforts focused on consulting and service fee expenses.

In the mobile market, revenues increased by 8% driven by strong equipment sales and solid underlying performance. Smartphones accounted for two-thirds of new handset sales in the second quarter. However, these currently represent only 37% of all handsets on our network, so there is clearly plenty of growth still to come. The rise in tablet sales was also remarkable as we sold five times the amount we sold in the second quarter of last year. Strong device sales support our non-voice business as 84% of post-paid smartphone buyers also subscribe to a mobile broadband package. Our network investments also play an important role in supporting this trend – as of the end of July, our 4G coverage reached 37%, making 4G speeds accessible in 88 towns across the country.

Mobile voice revenues for the quarter fell by 5% year-on-year as the 25% reduction in the regulated mobile termination rates from January 2013 was mitigated by the positive impacts of last autumn's price increases and continuing post-paid migration. Growth in non-voice revenues was limited to 2% this quarter as lower messaging usage offset most of the increase in mobile internet revenues.

Turning to the fixed market, revenues stayed flat as strong TV and equipment sales compensated for declining fixed voice revenues and a slight decrease in Internet sales. As with mobile, the sale of equipment such as TV sets, tablets and laptops helps our retention and acquisition efforts in the Internet and TV businesses.

In fixed voice, recent developments give cause for optimism with annual churn now down to 3% and ARPU loss at its lowest since 2009 at less than 3%. These positive trends, again, validate our retention strategy based on our flat-priced Hoppá package and bundling.

Regarding fixed Internet, revenues fell by 3% compared to the second quarter of 2012. The 6% rise in the number of customers, also reflecting the slight increase in our market share, was offset by the 8% fall in ARPU as local offers and bundled products continued to have a negative impact on prices.

Our TV revenues for the quarter grew by 7% year-on-year as customer acquisition remained strong and ARPU increased by 2% due to continued migration towards more expensive interactive offers. We expect further growth in TV revenues with the addition of several high definition channels to our most popular products and strong TV set sales driving demand.

In the energy segment, the increase in delivery points was more constrained with a net add of 7 thousand as opposed to net add levels of well above 20 thousand in the previous quarters, reflecting our wait-and-see approach until the ongoing negotiations with the relevant authorities have come to a conclusion. Until then, we have been and will continue to focus on the competitive, ie. non-price-regulated segment, as such, two-thirds of the total revenues came from the competitive segment in the second quarter as opposed to approximately 50% in 2012.

Let me now hand over to János who will provide further details on the results of the T-Systems Hungary segment as well as the international subsidiaries.

János Szabó remarks

Thank you, Chris.

Turning to the performance of T-Systems Hungary, revenues increased by 9% in the second quarter of 2013 compared to the same period last year, due to high System Integration and IT sales more than compensating for the absence of the PRO-M contract. The EBITDA of T-Systems Hungary fell by 6% due to the unfavourable impact of the shift in the revenue mix towards System Integration and IT services on margins.

Concerning mobile revenues, the bulk of the 15% year-over-year decline is a result of the sale of our PRO-M subsidiary in August 2012. T-Systems Hungary has withstood strong price competition on tenders well, as the number of voice customers increased by 7% year-on-year and most of the ARPU loss is due to the cut in termination rates in effect from January 2013.

Fixed revenues fell by 6% due to the relatively small voice ARPU loss of 1% coupled with a 3% loss in the number of customers. Although Internet subscribers and their ARPU rose year-on-year, other data services completely offset these positive results due to the loss of some important data contracts over the past year.

In System Integration and IT, revenues increased by 28%, but margin dilution was strong with complex service-heavy projects increasingly replaced by simpler and lower margin equipment-heavy tenders as corporates continued to keep their System Integration and IT spending to a minimum.

Regarding our **Macedonian** subsidiary, we have talked about the deteriorating situation in the mobile market contributing partly to the change in our Group EBITDA target at the end of June. Revenues decreased by 6% in forint terms, and in our efforts to retain our market share in the mobile business, we recorded a 20% decline in EBITDA as cost-cutting efforts could not offset the impact of the adverse market conditions. Nonetheless, we remain committed to keeping our market leader position in the Macedonian mobile market and expect the situation to improve in the near future as mobile termination rates become symmetrical in September 2013. Let me also inform you that a frequency tender took place in Macedonia in July, where all three mobile network operators paid 10.3 million euros for the 20-year license of a paired 10 MHz band on 800 MHz and a paired 15 MHz band on 1800 MHz. We plan to start LTE services by the end of the year.

Mobile revenues declined by 9% in the second quarter due to a 9% fall in ARPU and a 2% decline in the number of customers. Despite the continued negative effect of aggressively priced seasonal offers from competitors on our performance, we have been successful in keeping our market share at above 48%.

In the fixed line segment, the revenue decrease was moderated to 2% in forint terms as the continued boom in IPTV, coupled with higher Internet revenues, could mostly offset the losses in fixed voice.

Turning to our **Montenegrin** subsidiary, total sales remained largely unchanged and EBITDA for the quarter rose by 2% year-on-year in forint terms, despite higher personal income tax and a SIM-based tax introduced from July 2012. Whilst encouraged by these strong results in Montenegro, we remain cautious regarding our outlook given the increase in VAT effective as of July the 1st and the fact that the country is facing severe macroeconomic headwinds.

Mobile revenues in the second quarter fell by 2% year-on-year as the effect of the 43% cut in mobile termination rates weighed on wholesale revenues, but strong non-voice and equipment sales compensated for most of the losses.

Fixed line revenues increased by 2% as the expansion in TV and System Integration and IT segments more than offset the decline in the fixed voice and Internet businesses.

Chris Mattheisen remarks

Thank you very much, János. That concludes the formal part of Magyar Telekom's conference call. Before we start taking your questions, let me personally invite you to our Investor Day that we will hold on the 30th of September here in Budapest, where we will talk about our mid-term strategy, provide further details on all our business segments, and give guidance regarding future performance. If you would like to attend or have any questions regarding the event, please get in touch with our IR team. Now, 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)

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. We look forward to welcoming you at our Investor Day in Budapest.