Q1 2013 Results Conference Call

May 8, 2013 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's first 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 new Chief Financial Officer. Before we take you through our Q1 results, I would like to take this opportunity to once again welcome János to Magyar Telekom's top management team. We have been working together for a long time and I have great respect for him.

Turning back to our Q1 results, we have today reported <u>revenue</u> growth of almost 7% thanks to the healthy performance of our core telecom operations and a rapid expansion in non-core areas such as equipment sale, Systems integration and IT, as well as energy. We are especially pleased with the rise in our market positions coupled with the only mild ARPU erosion compared to previous years' levels. Notably, our mobile market share rose to over 46% in Hungary, a level last seen in 2004. We also managed to maintain the double-digit pace of expansion in mobile internet with an RPC growth of above 30% year-on-year and a double-digit revenue increase. In the fixed line markets, we remain committed to capitalising on our ability to bundle our services and upsell complementary products. Apart from energy, strong sales of TV sets and tablets continued to strengthen customer loyalty, contributing to our retention efforts resulting in a fixed voice churn rate as low as 3%. Driven by the outstanding revenue generation in the first quarter and based on our current expectations regarding the environment, we now expect full year revenues to be approximately flat compared to our previous guidance of flat to a 3% decline.

<u>Reported EBITDA</u> declined by 24% and our EBITDA margin decreased to 25%. This was mainly due to how the utility tax, effective from January 2013, has been accounted for, as the full year tax amount of 7.3 billion forints was booked entirely in the first quarter. Stripping this out, the EBITDA decline is 10% year-on-year, which reflects the continuous shift in the structure of revenues towards lower-margin services and the regulatory changes in the energy market effective from the beginning of the year. We are currently in discussions regarding potential changes affecting our energy business in order to ascertain whether to continue with our operations within the universal service segment of this market. Based on

our current knowledge, we expect these services to generate at least 40 billion forint of revenues in 2013.

Let me now turn to the segment analysis, starting with Telekom Hungary, where revenues grew by 12% in the first quarter as the number of point of deliveries more than doubled and an especially cold and long winter also encouraged greater heating consumption, resulting in a more than two-fold increase in energy revenues compared to the first quarter of 2012. Equipment sales also contributed greatly to improved revenue streams, while TV and mobile internet growth also remained strong. However, EBITDA was down by 24% year-on-year, largely due to the booking of the utility tax. Excluding the impact of this tax, the EBITDA decline would have been significantly less at 5%, which translates into an EBITDA margin of 34%.

In the mobile market, the 25% reduction in mobile termination rates effective from January 2013 had a significant impact on wholesale revenues. However, positive momentum in the retail market was maintained with continued growth in non-voice services and sales of smartphones. Total mobile revenues thus increased by 2% compared to the first quarter of last year.

In the voice market, we managed to acquire customers in an otherwise contracting market, so our market share increased to over 46% by the end of March. On the other hand, mobile ARPU decreased by 3%, as average usage declined further and competition in the high-end segment intensified. The expansion in non-voice sales remained strong with double-digit growth in mobile internet revenues, and with a smartphone penetration of only 34%, we see a lot of scope for the smartphone and mobile internet boom to continue.

Turning to the fixed market, revenues increased by 2% as the underlying trends of multiplay migration and local pricing continued to weigh on ARPU, but the growth in customer base lifted revenue dynamics upwards in our TV business. The sale of TV sets and tablets to fixed customers which started in the fourth quarter of last year has continued into Q1 2013, serving as a retention tool and driving most of the increase in fixed line revenues.

In the fixed voice business, revenues decreased by 6% compared to the first quarter of 2012. This decrease is significantly less than the 10-15% rates of revenue declines we have recorded in previous years and is also supported by the price increase we implemented in October last year along with the success of our retention efforts, particularly the Hoppá package.

Hoppá was introduced two years ago and with over 40% of our customer base now migrated onto this package, the annual voice churn rate has continued to decline and is now at 3% compared to the 9% rate in 2010. Hoppá also helps to support ARPU levels, with the annual erosion rate now slowing to below 5%.

In the fixed internet business, we saw a 1% decrease in broadband revenues compared to the first quarter of 2012, while our market share slightly increased. The number of customers grew by 6%, which managed to counterbalance the effect of the 4% decline in the retail ARPU that stemmed principally from bundling and increased competition focused on local offers. However, this growth was not sufficient to offset the fall in wholesale internet revenues due to the decline of 19% in the number of wholesale lines.

Turning to the TV market, revenues grew by 4% year-on-year as the total number of customers increased by 5% compared to March 2012. We are also pleased to see the continued migration towards IPTV in our portfolio. In addition, an increasing share of our customers now use value-added TV services which we have both simplified and added new content to in order to increase their customer appeal. Such positive trends outweighed the negative effects of bundling and local pricing, driving a slight year-on-year increase in TV ARPU.

Energy revenues amounted to more than 15 billion forints in the first quarter, mainly due to the positive effects of an unusually cold winter while the number of points of delivery more than doubled.

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

János Szabó remarks

Thank you Chris, first of all, for the warm welcome. I am delighted to be here today and look forward to meeting you all in person soon.

Turning to the performance of **T-Systems,** revenues increased by 1% in the first quarter of 2013 compared to the same period last year.

There was a notable shift in the revenue mix behind this slight change with 19% growth in System integration and IT revenues offset by significant declines in both mobile and fixed line revenues. The EBITDA of T-Systems Hungary decreased by 30% driven by the significant margin dilution in the telecommunication arm due to intense price competition in the corporate segment and the sale of our PRO-M subsidiary last August. Furthermore, the lower complexity of projects undertaken within Systems Integration and IT also contributed to the decrease in margin, while the booking of the full year utility tax also heavily influenced the results; excluding the impact of this tax, EBITDA decreased by 17%.

The 18% decline in the segment's mobile revenues reflects the intense pressure on our tariffs from strong price competition on tenders, the 25% cut in termination rates at the beginning of the year and the absence of the revenue from the PRO-M contract. Although we recorded a 6% increase in the number of voice customers, this was more than offset by the 13% decline in ARPU reflecting price pressure and slightly lower usage.

Fixed revenues fell by 14% as price discounts were granted to cash-strapped corporate customers while public sector corporations continued to look for in-house solutions. Fixed voice ARPU erosion thus amounted to 6% and we lost 4% of our voice customers in the past year.

In System Integration and IT, revenues increased sharply, but margin dilution was strong as demand for large-scale outsourcing projects continued to decline, substituted by low-margin equipment resale and installation contracts. Looking ahead, we strongly believe that more complex projects are to emerge in the long term, especially in healthcare and transportation. We also expect public tenders to accelerate as deadlines for the allocation of EU funds draw nearer.

Regarding our **Macedonian** subsidiary, total revenues were down 9% in both forint and denar terms as the exchange rate remained practically unchanged year-on-year. At the EBITDA line, a 27% fall was recorded compared to the first quarter of 2012. This reflects not just the lower revenues but also higher severance expenses, an increase in mobile-related payments as part of efforts to retain customers during a period of intense price competition, and an increase in TV related payments driven by the higher subscriber base.

Mobile revenues declined by 7% in the first quarter. Our ARPU declined by 4%, free minutes were bundled while subsidies increased, thereby narrowing the mobile margin significantly. However, our 48% share of the voice market remained unchanged with no decline registered during the quarter for the first time in the last four years; whilst we also experienced increasing demand for smartphones, which comprised 68% of handset sales in the first quarter of 2013 compared to 30% a year ago. This trend also supported positive developments in mobile internet usage, which led to a significant increase in revenues from this source.

In the fixed line segment, revenues decreased by 12% in the first quarter of 2013 as double-digit growth in IPTV could not compensate for the losses in retail voice and internet due to multiplay migration and strong competition from cable companies.

Turning to our **Montenegrin** subsidiary, as in Macedonia, the exchange rate effect was also negligible year-on-year. Total sales declined by 6% and EBITDA fell by 15% year-on-year, but these rates were influenced by some one-off items relating to the recognition of revenues in the first quarter of 2012. Excluding these one-offs, revenues were down by 4% and EBITDA declined by 11%.

Mobile revenues fell by 9% as mobile termination rates were reduced by 43% with effect from January 2013 which weighed on wholesale revenues, while retail dynamics were largely influenced by a special tax of 1 euro per month on every SIM card levied on the customers, with effect from July 2012.

Fixed line revenues fell by 4% as the expansion in the TV market could not compensate for losses 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. Of course, we are now happy to open the floor for questions. 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 speaking to you again soon.