Q3 2010 Results Conference Call

November 4, 2010 at 15:00 CET

Good afternoon ladies and gentlemen and welcome to Magyar Telekom's third quarter 2010 results conference call. I am Chris Mattheisen, Magyar Telekom's Chairman and Chief Executive Officer and I will be hosting today's call with Thilo Kusch, our CFO and a member of the Board.

During the third quarter, the economic environment started to show some signs of recovery; this is reflected in our financial performance. However, it is too early to tell whether this is the beginning of a sustainable improvement or a short-lived one. Our results were also supported by technological trends and our consistent and focused strategy aimed at exploiting opportunities arising from these. Our strong efforts to invest in state of the art fixed and mobile networks started to bear fruit; demand for IP based services is gathering momentum as the product portfolio offered via IP based platforms become more and more attractive given the wide variety of bundled products in the residential segment. This now also includes quadruple play packages. In addition to this, thanks to our best in class 3G network, mobile internet is becoming the growth engine of our mobile performance. Furthermore, also as a result of these strategic initiatives, we have managed to maintain market leadership in our key markets and are now closer to our goal of becoming market leader in the pay TV market, having narrowed the gap between us and the current market leader.

Looking ahead, the special tax imposed on the telecommunications sector among others will have a considerable impact on our results. The estimated total special tax amount payable by the Company in 2010 will be around 27 billion forint, which is expected to impact EBITDA. We are in the process of reviewing how the special tax will affect our plans beyond 2010. The Government saving measures which we previously expected to have an impact of 5 to 7 billion forint on both our revenue and EBITDA lines will have a more moderate effect on this year's results, however it will also affect the results of the following years. Consequently, we expect the declines in revenue and underlying EBITDA, excluding the impact of the special tax, in 2010 that were previously guided to be down 6 to 8% and 7 to 9% respectively, to be closer to 6% in the 6 to 8% range and 7% in the 7 to 9% range. In terms of our CAPEX, we reiterate our intention to reduce overall CAPEX levels in 2010 by 10% compared to 2009.

Let us turn now to the financial performance in the third quarter. Revenues declined by 3% compared to the same period in 2009, as retail fixed voice revenues decreased in all markets, reflecting the unfavourable economic environment and intense competition. Retail mobile revenues declined further in Hungary, driven by rationalization efforts by our business customers. At the same time, the 16% cut in Hungarian mobile termination rates at the beginning of 2010 negatively impacted wholesale mobile revenue performance. These trends could not be fully offset by the significant improvement in TV and mobile broadband revenues.

EBITDA excluding special influences declined by 3% in the third quarter of this year as cost cutting initiatives aimed at reducing marketing, material and maintenance and consultancy expenses could not wholly offset lower revenues. Nevertheless, these cost cutting measures did ensure that the underlying EBITDA margin was over 44% in the third quarter.

I will turn now to the analysis of the business units, starting with our **Consumer Services Business Unit or CBU**. Revenues in the third quarter were down by 1% overall due to the continuous decline in our fixed line voice revenues which was mitigated by increasing TV and mobile internet revenues. In spite of this revenue decline, EBITDA increased by 3% due to strong cost reductions implemented across all cost categories.

In the residential fixed line market the technological change is gathering momentum. While copper based services - mainly traditional PSTN voice service - are continuously losing their revenue producing ability, IP based solutions are starting to generate higher subscriber numbers and more revenue streams. As a result of this trend, the decline in revenue for the fixed line business slowed to 6%. Within the revenue mix, traditional voice revenues fell by 13% while internet revenues remained flat, and TV revenues increased by 19%. The improvement in financial performance was also facilitated by our cross-selling strategy which focused on increasing the number of bundled customers. As a result of this, by the end of the quarter the ratio of our multiplay subscribers increased further to 41%. In addition, we have seen increased demand for our recently launched quadruple play packages where we offer fixed line TV, broadband internet and voice services bundled with our mobile voice service.

The broadband internet market is still characterized by two prevailing but contrasting drivers: continuously falling ARPUs as a result of customers migrating to lower priced packages offset by rapidly growing subscriber numbers on all of our platforms. The increase in our customer base is driven not only by our favorable multiplay packages, but also by our attractive high speed internet offerings on fiber, EuroDocsis 3.0 and VDSL networks that are now available in more than 900,000 Hungarian households.

Moving to the TV market, we further increased our TV market share to over 28%, thanks to our rapidly growing subscriber base which itself grew by 24% during the past year. Extrapolating similar trends going forward, Magyar Telekom is expected to become the market leader in the Hungarian pay TV market in the near future. In addition to this rapid subscriber growth, we continue to also use special offers to encourage customers to move from analogue cable TV platforms to cable platform based IPTV, which we see as offering greater up-selling potential in the future. As a result of this, IPTV subscriber numbers continue to increase rapidly, while cable TV subscriber numbers have started to decline.

We continue to experience growing demand, albeit at a slower rate, for our satellite platform. Our underlying intention is to retain our customers with TV service which aim is justified by the fact that more than 70% of our satellite customers subscribe to at least one other Magyar Telekom fixed line service.

In the residential mobile market, I would like to highlight that besides strong mobile internet revenue increase, mobile retail revenues also stabilized on the back of growing mobile usage and favorable subscriber number trends. As a result of this, total mobile revenues in the third quarter increased by 2% compared to the same period last year.

Negatively, competition and rationalization of consumer spending are putting significant pressures on our effective voice tariff rates. However, churn levels have not deteriorated further and we have successfully managed to increase the ratio of our postpaid consumers. T-Mobile's market share is stable, with close to 45% market share among traffic generating subscribers.

The mobile internet market continues to be characterized by rapid growth both in terms of revenues and subscriber numbers and T-Mobile Hungary remains the clear market leader. Based on a successful start for iPhone 4, we expect smartphones to become the principal driver of growth in the mobile data market. At T-Mobile Hungary, around 20% of handset sales are smartphones and among handsets in use, this ratio is currently around 10%. This trend is also supported by our high quality 3G network which covers more than 75% of the Hungarian population and provides, on average, download speed of more than 2Mbit/sec for our customers.

Overall, we have seen slightly improving trends in the mobile market which makes us cautiously optimistic about the future as we have the best position both in voice and data markets.

Let me hand over now to Thilo who will provide further details on the results of the Business Services and the international subsidiaries.

Thilo Kusch remarks

Thank you, Chris.

I will now turn to the analysis of the Business Services Business Unit, or BBU. The trends at BBU which characterized the first half of the year continued into the third quarter. The difficult macroeconomic situation remained the most significant negative driver of the unit's business performance. Competition also remained strong, resulting in revenue and profit pressure. Revenues declined by 4% compared to the same period last year; this was primarily driven by lower other mobile revenues coupled with decreasing fixed and mobile voice revenues.

Looking at the underlying trends in this segment, we see that fixed line revenue decline accelerated further; primarily due to voice customer erosion. Mobile voice revenues continued to be under pressure as intense competition is still driving tariffs down. This could not be compensated by higher levels of usage and the slight increase in our customer base. The 16% mobile termination rate cut at the beginning of 2010 also negatively impacted wholesale revenues. In addition, other mobile revenues significantly decreased in the third quarter, mainly due to the price allowance given to the Government as a result of the announced budgetary saving measures.

On the other hand, System Integration and IT revenues showed a 23% increase as a result of the consolidation impact of ISH and some new private sector investments. Although overall investment levels are still far from pre-crisis levels, some IT developments could not be postponed any longer, resulting in a revenue increase.

The EBITDA margin of BBU declined to 46%, as cost control measures could not fully offset the decline in high margin voice revenues. The overall mix of BBU revenues changed with the lower margin System Integration and IT revenues increasing to 32% compared to 25% in the third quarter of 2009. It should be highlighted, however, that the Capex requirement of System Integration and IT services is also lower.

I would like to mention an important development at this business unit. Recently we have decided to carry out some organizational changes relating to BBU which will take effect from January, 2011. Around 28,000 small and medium size business customers will be transferred from BBU to Magyar Telekom's mass market business. As most of these customers require products that are found in our residential portfolio, this step will enable us to serve them more efficiently and also enables BBU to focus more of its attention on the crucial corporate, multinational and government accounts which truly require those complex telecommunications and IT solutions: something which differentiates us from the rest of the market. This will also allow us to join forces more effectively with T-Systems International and utilize their skills, capabilities and resources to our advantage and as a result, better serve our customers.

Moving on to our **Macedonian** subsidiary, total revenues decreased by 1% in the third quarter of 2010 compared to the same period in 2009, whilst EBITDA increased by 4%. However, excluding the FX impact, as the Hungarian forint weakened on average by 5% compared to the Macedonian Denar in the third quarter, revenues were down 6% and EBITDA declined 1%. Nevertheless, the EBITDA margin improved from 55% in the corresponding period of last year to 57% in this third quarter, reflecting the cost saving measures, improved collection efficiency and increased provisions in the third quarter of 2009.

<u>Fixed line revenues</u>, excluding the impact of the weaker forint, declined by 2% in the third quarter. This was driven by intense competition from alternative and mobile providers which resulted in a 7% decline in outgoing traffic volumes and an annual churn level of 9%. However, this trend was largely offset by higher wholesale voice revenues, driven by growing incoming and transited traffic volumes coupled with increasing demand for double and triple play packages: this in turn resulted in higher internet and TV revenues. Internet revenues were up by 13% in local currency terms, tracking the

22% increase in the customer base, whilst TV revenues more than doubled as a result of the strong demand for our IPTV product.

Mobile revenues declined by 8% in local currency terms as a result of intensifying competition which put severe pressure on tariff levels. Nevertheless, our efforts to improve the customer mix proved successful; not only did the post-paid ratio increase to 32% by end-September 2010 compared to 29% in the same period last year but the absolute number of post-paid subscribers rose too. The higher proportion of post-paid subscribers, coupled with more widely used closed-user-group offers resulted in higher MOU and higher ARPU levels in the third quarter. In addition, mobile internet usage increased further, supported by the continuous expansion of our 3G coverage, now at 61% of population.

Continuing with the analysis of our **Montenegrin subsidiary**, total revenues in local currency terms declined by 5% and reported EBITDA by 19% in the third quarter compared to the same period of last year. However, this EBITDA comparison is distorted by the reversal of the 1 billion forint provision in the third quarter of 2009, relating to the 2007 voluntary leave program litigation. Adjusted for this impact, thanks to strong cost controls in marketing, technology and consultancy, underlying EBITDA was actually up by 3% year-on-year.

Fixed line revenues declined by 3%, despite increasing TV and internet revenues, due principally to a fall in voice revenues. Retail voice continued to be under pressure as a result of heavy mobile substitution whilst wholesale voice revenue was similarly affected due to the significant fallout of international traffic towards Serbia as considerable part of that traffic is now transited by our competitors. The fixed line market is characterized by an increased focus on bundled offers, complementing the rapidly growing TV and broadband internet subscriber numbers. Our IPTV service remained the market leader of pay TV services in Montenegro. Our subscriber base reached 35,000 by the end of the third quarter; this represents growth of 43% compared to the same period of last year. At the same time, broadband access numbers grew by 25% to 62,000 by end September 2010.

Moving onto the mobile market in Montenegro, we experienced greater rationality amongst the market participants. However, the macroeconomic environment continues to negatively affect our financial performance. Despite slightly increased usage and stable effective per minute prices, mobile revenues declined by 7% due to significantly lower prepaid customer numbers. Within our revenue structure, decreasing visitor revenues drove the mobile revenue decline. Although visitor minutes, or visitor usage, were stable in the third quarter, higher discounts resulted in lower visitor revenues. Despite declining revenue performance, T-Mobile managed to maintain its voice postpaid market leadership and even improved its SMS market share during the quarter.

Chris Mattheisen remarks

Thanks Thilo.

That concludes the formal part of Magyar Telekom's conference call. I am 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 there are follow-up questions, I encourage you to contact our Investor Relations Department. The telephone number is 36-1-458-0424 or, if you would like to send an e-mail you can address it to investor.relations@telekom.hu. I would like to inform you that the transcript of our conference call will be available on our official website. Thank you again for joining us today, and for your continued interest in Magyar Telekom.