Q3 2009 Results Conference Call

November 5, 2009 at 15:00 CET

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's third quarter 2009 results conference call. I am Chris Mattheisen, Magyar Telekom's Chairman and Chief Executive Officer and I am hosting today's call together with Thilo Kusch, our CFO and a member of the Board.

In the third quarter, earlier trends resulting from the recessionary economic environment and the government's austerity measures intensified across all segments. Revenues were heavily impacted by the more cost conscious behavior of our clients aimed at rationalizing their telecom spending. Consequently, their usage patterns were characterized by lower overall volumes as well as migration to lower priced packages resulting in severe pressure on not only voice but fixed, internet and to some extent also system integration and IT revenues. As a combined impact of these developments, Group revenues declined by 4% in the third quarter compared to the same period last year.

At the same time, there were many positive developments during the quarter that we would like to highlight. The countermeasures we implemented, partially to tackle the unfavorable operating environment, as well as the intense competition, have now started to bear fruit. Both satellite TV and IPTV sales remained strong, supporting the growth of our 2Play and 3Play customer base. By the end of September this year, one third of our residential customers were subscribed to one of our bundled packages compared to 27% at the year-end 2008. This reflects our efforts aimed at strengthening Magyar Telekom's position as a fully integrated service provider. Concerning our other core markets, despite the difficult environment and intense competition we are faced with in several segments, we managed to maintain our leading market positions.

Turning to the EBITDA performance, thanks to our efforts to enhance the cost efficiency of the Group, third quarter underlying EBITDA margin improved reaching over 44%. Please note that reported EBITDA was somewhat distorted by two provision reversals in the third quarter this year. The first reversed provision of 1 billion forint was in relation to a severance expense booked in 2008 at the Hungarian operations, while the second provision also for 1 billion forint was made in 2007 at Crnogorski Telekom for a litigation case in connection with a voluntary leave program.

We made further progress in increasing headcount productivity and have reached an agreement with the trade unions on the measures to be introduced at the parent company in 2010. Headcount will be reduced by 400 employees, while further reductions will come from - among others - the employment termination of executives and employees retiring. A bonus budget, equivalent to a 1.5% wage development, has been set for 2010, while the size of surplus severance payments will be gradually decreased to a third of the current level in the period of 2011-2014. Total severance expenses related to the headcount reduction will reach around 7 billion forint. As a result of the agreement, Total Workforce Management related costs will be reduced by more than 5% in 2010 compared to the 2008 level.

Looking forward to the rest of the year, we maintain our targets of around 2% revenue decline, up to 5% underlying EBITDA contraction and nominally flat CAPEX. We expect current trends, such as the significant reduction in private consumption and heavily scaled back spend by corporates, to continue to put pressure on our top line. Furthermore, strengthening of the forint may also have an adverse impact on our results by lowering the contribution of our international subsidiaries.

Now let me turn to the business unit analysis, where I will start with the results of our **Consumer Services Business Unit**.

Business trends at CBU that characterized the first half of the year continued into the third quarter. The depressed macroeconomic situation remains the most significant negative driver of our business performance, while competition also remains strong. As a result, CBU revenues declined by 6% compared to the third quarter of 2008. In order to counterbalance the negative external environment, we introduced several cost cutting initiatives in the course of the year that have had positive impacts on third quarter financials. Thanks to this disciplined cost management, third quarter EBITDA margin rose from 57% to over 59% compared to the same period of last year.

In the fixed line market, we are still experiencing significant voice churn as the PSTN voice service continues to lose market share to mobile services and different forms of IP based voice communication. The current recession has accelerated this structural change in the fixed line market. In order to meet this challenge, we are focusing on product bundling, intentionally migrating voice to IP and capitalizing on our TV portfolio, as TV service represents the most attractive offer for our customers.

As I mentioned earlier, the recent initiatives we have taken support the further growth of our TV market share and have resulted in a 20% increase in revenue, quarter on quarter. Our market share exceeded 23% of the pay TV market with nearly 585,000 subscribers. This positive trend is driven mainly by our very attractive satellite TV service, where we have already acquired more than 120,000 subscribers; of them, two thirds also subscribe for at least one more Magyar Telekom fixed line telecommunication service. The success of the satellite TV also boosted our IPTV sales, with more than 50,000 subscribers already connected.

Regarding internet revenues, we are still seeing the impact of the more competitive pricing that was introduced with last autumn's rebranding. As a result, despite increasing customer numbers, internet revenues dropped by 8% and ARPU by 13% in the third quarter compared to the same period of 2008. Looking forward, we expect broadband prices to remain generally flat, as the market will compete less on price and more on quality differentiation. To reflect this, cable and DSL operators significantly increased the offered bandwidths for residential customers from the beginning of September.

In the residential mobile market, the economic backdrop and regulatory steps are putting sustained pressure on our business performance. Churn rates are still at elevated levels, usage is under pressure and costumer gross additions are also lower than in the same period of last year. We still see that high unemployment, along with more expensive access to credit, is limiting consumer propensity to spend, so resulting in weaker demand for mobile communication services. As a result, CBU mobile revenues decreased by 5% and ARPU by 8% in the third quarter compared to the third quarter of 2008 driven also by lower termination rates. The mobile penetration rate decline continued during the third quarter, coming in at 118% at the end of September: this was mainly as a result of a decreasing number of inactive prepaid SIM cards. Despite the negative external environment, T-Mobile's market share remained broadly unchanged at 44% and customer mix improved further during the quarter.

On the other hand, the mobile broadband market continues to expand. Supporting this trend, we introduced new multimedia mobile packages, offering bundled mobile voice, messaging, internet and mobile TV service, a unique proposal for customers in the Hungarian mobile market. Customer reactions to these offers have been extremely positive: we are seeing that more and more customers use mobile internet and watch TV on their mobile phones. Thanks to these positive trends, T-Mobile maintained its leading position in the mobile broadband market, where we had over 47% market share and over 360,000 subscribers at the end of September.

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.

Let us now turn to the results of our **Business Services Business Unit, or BBU**. Revenues at BBU declined by 8% as, in addition to a decrease in traditional fixed and mobile revenues, system integration and IT revenues also fell in the third quarter compared to the same period in 2008.

As anticipated, the negative impacts of the current macroeconomic environment are affecting the BBU segment even more in the second half of the year. Following the introduction of the governments' austerity measures, business customers became even more focused on cost cutting. Besides lower spending from small- and medium sized businesses and corporate customers, delays and cancellations of new public sector projects also had a negative impact on our system integration and IT revenues. Despite strict cost control at BBU, third quarter EBITDA dropped by 7% while EBITDA margin was flat at 52%.

In the fixed line business, the trends seen in the first half of 2009 continued. The number of fixed voice and internet customers declined, while usage also decreased driven by mobile substitution and IP-based solutions, resulting in lower voice and internet revenues. The tariff levels also continued to fall in the third quarter: mobile voice tariffs remained almost 60% lower than fixed voice tariffs in the corporate segment. Going forward, we expect the economic environment and mobile substitution to put further pressure on our fixed line revenues.

In the mobile business, third quarter revenues declined by 2% compared to the third quarter of 2008 characterized by continued tariff falls partly compensated by increasing non-voice services mainly driven by internet services. Although the total number of mobile customers increased, due to the recession, we are still facing high churn rates and further SIM-card rationalization. Despite higher usage and an increased customer base, effective prices are continuing to fall. Consequently, ARPU dropped by 17% in the first nine months of 2009. On the other hand, we still see high demand for mobile broadband somewhat offsetting declining mobile voice revenues; as a result, non-voice service revenues increased by 12% in the third quarter compared to the third quarter in 2008.

Regarding system integration and IT revenues, we recorded a revenue decline of 11% due to the unfavorable macroeconomic environment. Companies delayed or cancelled many investments; as a result, some projects are falling out of the pipeline this year without being replaced.

Despite all these negative impacts, there are achievements that can give grounds for optimism. We managed to sign some major deals in the third quarter. The main project win was a six-year agreement with the Hungarian Public Television. We will be offering IP-based digital video signaling: this is a contract that is worth 2 million euros of revenue a year with an EBITDA margin of around 15%.

Moving onto our Macedonian and Montenegrin subsidiaries, total revenues in Macedonia increased by 12% in the third quarter of 2009 compared to the same period of 2008. Nevertheless, in local currency terms, revenues dropped by 2% as the falling fixed line revenues more than offset the increase in mobile revenues. Due to higher cost of equipment driven by retention offers, EBITDA declined by 8% in the third quarter 2009 compared to the third quarter of last year, whilst the EBITDA margin was still at 55%.

Fixed line revenues, in local currency declined by 11% driven by increasing competition coming from alternative and mobile operators. This very competitive market place coupled with the unfavorable economic environment resulted in an annual line loss of 14% and a decrease in outgoing traffic of 24% compared to the same period of last year.

On the other hand, we are reassured to see continued strong demand for our broadband products in Macedonia. Internet revenues were up by 9% in local currency terms, while the number of ADSL connections increased by 40% compared to the third quarter of last year. The number of IPTV customers is also steadily growing, and the success of 2Play and 3Play packages are offsetting somewhat the declines in voice revenue.

Turning to the Macedonian mobile market, the penetration rate reached 115% and T-Mobile Macedonia maintained its clear market leader position with 57% market share. Although strong competition is behind sustained decreases in tariffs, this was offset by the higher customer base coupled with higher usage and a more favourable customer mix resulting in a 6% revenue increase in local currency terms. Besides focusing on customer retention by offering higher subsidized handsets, T-Mobile Macedonia continued to increase 3G coverage and will reach 50% of the population by the year-end, in accordance with the licence requirements. In line with the 3G network roll-out, several new mobile internet packages were introduced, which have showed great success.

Let us continue with **Montenegro**. Although total revenues increased by 2%, revenues in local currency declined by 11% in the third quarter of 2009 compared to the third quarter of 2008. This was made up of 2% decline in fixed line and 18% decrease in mobile revenues. Due to the 1 billion forint provision reversal in relation to the litigation regarding the 2007 voluntary leave program, EBITDA increased by 45% in local currency terms. Excluding the reversal of this and the severance related provision created in the third quarter of last year, underlying EBITDA in local currency decreased by 13%.

In the Montenegrin fixed line telecommunication market, high level of mobile substitution and lower international traffic volume continue to put pressure on revenues. Without the foreign exchange impact, fixed line voice revenues were 7% lower in this quarter compared to the same period of 2008. In order to retain voice customers, we started to bundle fixed line broadband internet and IPTV with fixed line voice services from September 2009.

We still see strong demand for our ADSL and IPTV products which also help drive our internet and TV revenues, which in local currency terms increased by 25% in the third quarter this year compared to the same period of last year.

Turning to the mobile market, despite the challenging economic environment, penetration increased further, reaching 226% at the end of September. The market remains extremely competitive, with operators very much focusing on customer acquisition thereby fuelling SIM card growth and driving down effective mobile prices. In addition, the weaker summer tourist season put pressure on our visitor revenues. As a result, mobile revenues in local currency terms decreased by 18% in the third quarter of 2009 compared to the third quarter of 2008.

In response to the challenging market environment, T-Mobile introduced a new prepaid package targeting young customers with attractive closed user group offers. Looking ahead, we expect competition to remain intense, but probably less fierce in terms of pricing as competitors gradually shift their focus more to profitability.

Before opening the floor for questions, I would like to talk about the drivers behind the increase in the third quarter in our effective tax rate and financial expenses. The 5 percentage point increase of the effective tax rate to 23% compared to the first half of this year was solely due to the announced change in the Hungarian tax law, namely the abolition of the solidarity tax and the parallel increase in the corporate tax rate from 16% to 19% from 2010. Although the changes will be in effect only from next year, around a 2 billion forint deferred tax liability has already been created, based on the anticipated impacts on our deferred tax amounts.

Increase in net financial expenses is primarily driven by the higher interest rates due to the elevated inter-bank rates and the over 7% increase in our loan portfolio. These were also coupled with unrealized losses related to derivative valuations in contrast with some unrealized gains in the third quarter last year.

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 want 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.