LIFE IS FOR SHARING.

Q3 2014 Results Conference Call

November 6, 2014 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's third quarter 2014 results conference call. I am Chris Mattheisen, Magyar Telekom's Chief Executive Officer, and I will be hosting today's call with János Szabó, our CFO.

Before summarizing our third quarter results, I would like to give you a quick overview of recent developments.

Following the frequency auction, we received our licences in mid-October allowing us to start using the acquired frequency blocks. Within one day, we expanded our mobile network by connecting 450 additional 4G base stations. As a result, our population-based nationwide outdoor 4G coverage increased overnight, from 54% to 73%. At the same time, our nominal download speed of 4G mobile internet increased up to 150 Mbit/s, currently the highest possible level. We believe that this is a very important milestone in the implementation of Digital Hungary, and we plan to continue further network developments to reach 93% population-based coverage by the end of 2015. We are also pleased to note that the Hungarian government has retracted its initial proposal for an internet tax.

I am also happy to report that we have recently closed several cable company acquisitions. With a combined household coverage of 30,000, these cable companies are capable of providing TV, fixed broadband and voice services via their networks. As such, these acquisitions serve to further strengthen our high speed internet coverage and market position, in line with our strategy.

We are also very pleased to have reached a further milestone in the development of our new state-of-the-art CRM system by migrating the majority of our fixed customers onto the new platform. This will support our efforts to provide a unique customer experience by both facilitating and accelerating improvements in the quality of product development and customer service.

Moving on to third quarter performance, Group revenues declined by half a percent compared to the same period in 2013, as lower voice, system integration and IT revenues were almost fully offset by a continued healthy increase in mobile internet and TV revenues.

Our gross margin declined by 1% as improvement in the mobile margin was offset, primarily by the higher bad debt expense. At the same time, EBITDA was down by 5% driven by higher severance expenses related to Parent Company headcount reduction.

Looking ahead to the remainder of the year, we maintain our revenue and EBITDA guidance of no more than a 3% decline compared to 2013 levels, and our Capex target, excluding spectrum acquisitions and annual frequency fee capitalizations of 87 billion forint.

Moving on to the segment analysis let me start with the Telekom Hungary segment. Revenues increased by 3% during the third quarter compared to the same period in 2013. This was driven by increasing TV and fixed and mobile broadband services and higher revenues from increased mobile equipment sales, which resulted from the higher number of retained subscribers and increased average smartphone selling prices.

EBITDA for the period decreased by 2%, largely as a result of the higher bad debt expense related to receivables from equipment sales and increased severance expenses relating to the headcount reduction program announced a couple of months ago.

In the mobile market, we recorded a further increase in total subscribers. 4G customers, in particular, saw a steady increase to more than 310,000 as at end-September which had a positive effect on mobile internet usage. This trend, coupled with stable termination rates led to a 4% increase in mobile ARPU in the third quarter over the same period last year.

Turning to the fixed line market, revenues declined by only 1% as growth in TV and internet revenues almost fully compensated for lower voice revenues. We consider three consecutive quarters of increasing internet revenues a great achievement. At the same time, growth in TV revenues was driven by a combination of stable ARPU and an increasing customer base.

In the energy segment, revenues increased by 1% as the increase in gas service revenues driven by higher consumption more than offset the decrease in electricity revenues and the slight decline in points-of-delivery. Regarding the outlook for our energy business, we maintain our 'wait and see approach', which assumes no proactive sales activity.

I will now hand over to János who will talk in more detail about the performance of the T-Systems Hungary segment as well as our international subsidiaries.

János Szabó remarks

Thank you, Chris.

Let me continue with the performance of T-Systems Hungary where revenues decreased by 17% in the third quarter, compared to the same period last year, and EBITDA fell by 57% due to a combination of lower revenues and higher bad debt, primarily due to the waiver of 0.9 billion forint of receivables due from a major customer and increase in some operating costs.

Mobile revenues increased by 1% compared to the same period last year as the mobile connection fee introduced in November 2013 fully offset the impact of lower usage by our stable customer base.

Fixed revenue decline moderated to 4%, thanks to stabilization in data revenues. At the same time, voice revenues continued to decline by 7% driven by the erosion of the customer base and declining usage.

System integration and IT revenues fell by 27% which was partly driven by the reshuffling of internal processes resulting in lower volume of internal services, as well as by a significantly lower number of infrastructure and equipment projects. At the same time, we continued to focus on more complex and higher margin opportunities. In this context, we successfully concluded a 4-year agreement with one of Hungary's major electricity providers to operate the company's complete IT infrastructure; manage server, network and desktop operation, and perform related support tasks.

Turning now to the international subsidiaries, in **Macedonia** third quarter revenues in forint terms declined by 8% year-on-year. At the same time, EBITDA rose by 12%, reflecting the slight improvement in gross margins and the distorting effect of the 1.3 billion forint severance cost booked in the third quarter of last year. These results were positively affected by currency trends as the forint weakened by 4% compared to the denar. The revenue decline in local currency terms was 12% while EBITDA grew by 9% year-on-year.

Mobile revenues in denar terms declined by 15%, driven by a 10% drop in retail voice revenues coupled with a 38% decline in wholesale voice revenues reflecting the cuts in mobile termination rates. Non-voice revenues also declined by 12%, as mobile internet usage could not fully compensate for the fallout in SMS revenues. This further affected third quarter APRU which was 17% lower year-on-year.

In the fixed line segment, revenues declined by 7% as voice revenues continued to decline further and could not be fully counterbalanced by the increase in TV revenues.

Going forward, we are closely monitoring developments around the potential merger of our two competitors, VIP – the local arm of Telekom Austria – and ONE – the fully-owned subsidiary of Telekom Slovenije. The closing of the transaction remains subject to confirmatory due diligence of ONE and approval by the Macedonian authorities. If approved, we expect this transaction to reshape the competitive environment in the Macedonian telecommunication market.

At our **Montenegrin subsidiary**, revenues declined by 2% in the third quarter in forint terms while EBITDA was down 1%. However, in local currency terms revenue decline was 6%, while EBITDA decreased by 4% as efficiency improvements resulting in lower operating and employee related expenses could not fully offset the decline in gross margin stemming from the change in our revenue mix.

Mobile revenues were down 11% in euro terms as higher equipment revenues driven by improving smartphone sales could only partly mitigate the decline in voice revenues. The decrease in voice revenues was partly driven by lower ARPU in the postpaid segment reflecting tariff pressure and the weak tourist season, which negatively impacted both prepaid customer numbers and visitor revenues.

Fixed line revenues in local currency terms decreased by 2%, as growing internet, IPTV, IT and equipment revenues could not fully offset the decline in voice and data revenues. The pressure on voice revenues was mostly a result of retail price regulation effective from April 2014, coupled with lower incoming international traffic due to the lower number of tourists visiting the country.

Chris Mattheisen remarks

Thank you very much, János.

That concludes the formal part of Magyar Telekom's conference call. 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.