Q2 2010 Results Conference Call

August 5, 2010 at 15:00 CET

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's second quarter 2010 results conference call. I am Thilo Kusch, Magyar Telekom's Chief Financial Officer and member of the Board and it is my pleasure to host today's conference call.

In the second quarter of 2010, the unfavorable operational environment continued to put pressure on our business performance. To offset the negative trends, we are increasingly focusing on initiatives aimed at improving customer retention and increasing revenue from new services. This quarter, we continued to position Magyar Telekom as the leading integrated operator in Hungary. In line with this strategic goal, we introduced our first quadruple-play packages to the residential segment, offering mobile voice and fixed line services bundled into one package. Although it is too early to draw any significant conclusions, the initial reaction from customers has been positive. In addition to launching these products, we were able to considerably increase our share in the TV market, mainly thanks to our successful satellite TV product. This brought us closer to our mid-term target of taking leadership of the pay TV market in Hungary. Furthermore, we increased our clear market leading position on both the mobile voice and mobile broadband markets.

There were some other positive developments during the quarter that I would like to highlight. Based on our expansion strategy, we carried out two acquisitions in Hungary. By acquiring Modultechnika, a cable TV and Internet service provider with an up-to-date cable TV infrastructure, and DK Group, which develops, installs and manages IT applications, we aim to further strengthen our positions in the fixed line and IT services market.

At the same time, as announced earlier, we have changed our management structure effective from the 1st of July. We believe, that these changes will help to enhance co-operation between the marketing, sales and technology areas, and at the same time will ensure the company's transition from a traditional fixed and mobile service provider to a more innovative communications, entertainment and information services company. This step enables us to react more dynamically to the changes in the market and the wider economic environment, thus protect our leading market share positions in all segments.

Based on a government resolution, the new Government plans to deliver 20 billion forint of savings on the chapter of the 2010 budget containing expenditure targets relating to state assets. Such planned savings affect IT and telecommunications services. As a result of the revision and or appropriate rescheduling of effective contracts with the state, we expect a potential negative impact of around 5 to 7 billion forint on both our revenue and EBITDA lines. Although we expect the economic indicators which drive demand for our services to start to show signs of recovery towards the end of the year, the above-mentioned government initiative will cause our full year revenue and EBITDA to decline more than previously forecasted. Consequently, we now project a decline in revenue of 6% to 8% and 7% to 9% in underlying EBITDA for 2010.

In response to these developments and in line with our strong focus on free cash flow generation, we have decided to cut our CAPEX target for this year. Instead of the originally planned 5% decline, we now intend to reduce CAPEX by approximately 10% compared to last year's spending.

Turning to the second quarter financials, total revenues declined by 7% as the strong competition, saturated core markets and the difficult economic environment continued to put pressure on our operational performance. Consequently, lower fixed and mobile voice revenues in all three countries and the declining Hungarian data revenues could not be offset by the growing Hungarian mobile internet and TV revenues. In addition, the appreciation of the Hungarian forint resulted in lower revenue contributions from our international subsidiaries, reflecting the translation impact.

EBITDA excluding special influences decreased by 9% as the lower level of voice related payments, reflecting lower voice usage and the cut in the Hungarian mobile termination rates at the beginning of 2010, and the decrease in other operating expenses driven by our cost cutting efforts could only partly offset the increase in bad debt levels and the decline in the high-margin voice revenues. The main savings were achieved in employee-related expenses and other cost items, such as marketing and consultancy expenses.

Turning to the analysis of the business units, let me start with our **Consumer Services Business Unit or CBU**. Revenues decreased by 3% due to the continued decline of our voice revenues both in the fixed and mobile segments that could not be fully compensated by increasing TV and mobile internet revenues. However, thanks to the strong cost reductions we implemented across all cost categories EBITDA increased by 1% despite the revenue decline.

In the residential fixed line market, we successfully continued with our earlier cross-selling initiatives and increased the ratio of multi-play subscribers to 38%. Although traditional fixed line voice customer churn remained high in the second quarter of 2010, due to mobile substitution and migration to cheaper IP- and cable-based voice services, growth in the number of TV and broadband customers remained strong. The total number of TV customers increased by 30%, driven primarily by the continued dynamic increase in our satellite TV subscriber base but also boosted by the nearly doubling number of IPTV customers. Consequently, while voice revenues suffered a 13% decline in the second quarter compared to the same quarter last year, TV revenues increased by 13%, albeit from a lower base level. The relatively lower revenue growth compared to the pace of customer expansion is driven by the decreasing trend in TV ARPU as our satellite TV product has a lower ARPU level. However, its retention ability is excellent with 70% of our satellite TV customers subscribing for one of our multi-play packages.

Regarding the fiber rollout, we have already completed over 80% of our coverage expansion planned for this year. That means we are now able to reach over 210 thousand households in Hungary with this fiber-to-the-home technology. Subscriber trends improved further in the second quarter, we have reached close to 10% penetration on this network with each subscriber taking, on average, well above two fixed line services. In addition, at certain areas where fiber build-out would not prove the efficient technology, we have been rolling out a VDSL network capable of around 25 megabit-per-second download speed. By the end of June, we had coverage of around 100 thousand households through this technology. Furthermore, we have also finished the upgrade of the cable network to an ED3 ready network to about 550 thousand households, bringing our total high speed internet coverage to around 860 thousand households in Hungary at the end of the second quarter, which is more than 20% of the Hungarian households.

Moving on to the residential mobile market, let me highlight that both the number of active customers and our market share amongst these customers increased by the end of June 2010 compared to the same period last year. Furthermore, customer composition improved as well and usage increased among the CBU customer base. However, driven by the considerable tariff erosion and the 16% cut in mobile termination rates, with effect of January 2010, mobile voice revenues declined by 5% in the second quarter of 2010 compared to the same period last year.

Meanwhile, the mobile internet market continued to expand dynamically and we witnessed a strong increase in both our subscriber base and revenues. The number of T-Mobile's internet subscribers increased by 63% compared to the same period last year to over 500 thousand. At the same time, we increased our leading market position in mobile broadband to 51% among traffic generating subscribers.

Let me now turn to the analysis of the results of the **Business Services Business Unit, or BBU**. Due to a lack of any strong positive catalysts in the economic environment, the unit faced continued revenue and profit pressure in the second quarter. Revenues declined by 5% compared to the same period last year, primarily driven by lower fixed voice revenues and to a smaller extent by the decreasing fixed data and mobile voice revenues. On the other hand, System Integration and IT revenues showed a 2% increase thanks to the consolidation impact of ISH and some one-off asset sales under the IT infrastructure contracts. At the same time, thanks to cost reduction measures in place, EBITDA margin for this segment was kept stable at 47%.

Looking at our operational performance, we continued to see that our business partners are facing increased external pressure to renegotiate their contracts, resulting in a decline in revenues at BBU. The most severely impacted item by these renegotiations is fixed voice revenue; however, mobile voice and IT are also affected. Declining ARPUs in this segment reflect these trends - both fixed voice and mobile ARPUs declined by 9% in the first half of 2010 compared to the same period last year.

In addition, as financial institutions, which represent a significant portion of our customer base, became even more severely affected by the recession in the second quarter, their IT and telecommunications spending came under serious pressure. At the same time, the situation in the public sector remains unchanged with continued delays to major public tenders and limited visibility regarding expected tender launches during the second half of the year.

Moving onto the analysis of the performance of our international subsidiaries. Both the Macedonian Denar and the Euro weakened by 5% compared to the forint in the second quarter of 2010 compared to the same period in 2009. To reflect better the underlying business performance in these countries, we are presenting the analysis in local currency terms.

Total revenues **in Macedonia** declined by 4% in the second quarter of 2010 compared to the same period last year, while EBITDA declined by 5% in local currency terms reflecting the intense competition in both the fixed line and mobile segments and impacting our margins, that fell slightly from 58% to 57%.

In the fixed line segment, the competition driven retail voice revenue decline was mitigated by higher wholesale voice, internet and TV revenues, resulting in a 1% revenue decline in the second quarter. The increase in voice wholesale revenues was due to the combined impact of growing incoming traffic volumes and higher prices charged for international traffic termination. At the same time, the intense growth in broadband and IPTV subscriber base gave further impetus to rising internet and TV revenues. However, it should be noted, that these two revenue items represent only around 20% of the fixed line revenue base.

Mobile revenues declined by 6% in the second quarter, primarily due to lower retail voice and non-voice revenues. Although our customer mix improved and usage continued to increase, these could not counterbalance the 15% decline in average tariff level which reflects the sustained competitive pressures. The non-voice revenue decline was driven by the increasing ratio of free SMS included in packages.

Turning to the analysis of the **Montenegrin operation,** in local currency terms, total revenues declined by 6% in the second quarter compared to the same period last year. At the same time, thanks to the strict cost reduction measures undertaken by the subsidiary, especially in relation to receivables provisions, marketing expenses and technological support costs EBITDA grew by 2%, And consequently, EBITDA margin increased from 34% to 37% year-on-year.

Let me also inform you, that in the second quarter of 2010 it was determined that a number of prepaid mobile fill-up vouchers had been misappropriated at Crnogorski Telekom. Accordingly, we reversed previously recognized revenues of 0.8 million euro and recognized a provision of 0.4 million euro in relation to VAT and other costs associated with the misappropriated vouchers, resulting in a negative EBITDA impact of totaling 1.2 million euro.

Fixed line revenues declined by 2% as the strong increase in internet and IPTV revenues could only partially counterbalance the decreasing voice revenues. The wholesale revenue decline was driven by the significant fallout of international traffic towards Serbia, where a considerable portion of that traffic is now transited by our competitors. Retail voice revenues continued to suffer from intense mobile substitution, however thanks to our efforts to promote multi-play packages 38% of our voice subscribers now use at least one additional service from the company. At the same time, our broadband subscriber base grew by 38% with an even higher growth rate of 50% among our IPTV customers. Thanks to that dynamic progress, based on official statistics, we are now the market leader in the pay TV market in Montenegro.

In the Montenegrin mobile market, Promonte, the market leader, rebranded its operation as Telenor and its rebranding was accompanied by a widespread marketing campaign. Consequently, it registered an increase in its market share in the period, while T-Mobile Montenegro's market share declined to 34%. Nevertheless, we maintained our leadership in the post-paid segment with a 44% market share and where we also recorded 5% customer growth compared to last year. Despite the continuous improvement in our customer mix and the 18% higher usage, these could not offset the significant decline in average tariff levels and lower volume of handset sales, resulting in 10% lower overall mobile revenues. However, excluding the one-off revenue reversal of 800 thousand Euros, that I mentioned earlier, the mobile revenue decline in Montenegro would have been 5%.

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.

Figures prepared in accordance with IFRS, Magyar Telekom also presents non-GAAP financial performance measures, including, among others, EBITDA, EBITDA margin, underlying EBITDA, underlying EBITDA margin and net debt. These non-GAAP measures should be considered in addition to, but not as a substitute for, the information prepared in accordance with IFRS. Non-GAAP financial performance measures are not subject to IFRS or any other generally accepted accounting principles. Other companies may define these terms in different ways. For further information relevant to the interpretation of these terms, please refer to the chapter “Reconciliation of pro forma figures”, which is posted on Magyar Telekom’s Investor Relations webpage at www.telekom.hu/investor_relations.