

First Half 2007 Results Conference Call

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Conference call operator introduces call

Chris Mattheisen remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's first half 2007 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 member of the Board.

As main events in the second quarter, let me start with the decisions of the Annual and Extraordinary General Meetings held in April and June. While the investigation is still ongoing, there was no delay in closing the 2006 books. The Annual General Meeting approved Magyar Telekom Group's 2006 financials and declared a 70 forint per share dividend, which was paid at the end of May.

The Extraordinary General Meeting was called to approve further integration within the Magyar Telekom Group. Following the positive experience gained from the T-Mobile merger, we also decided to integrate the access business line of T-Online Hungary and Emitel with Magyar Telekom. These steps will enable us to improve service quality by simplifying customer service processes and increasing efficiency through joint marketing and communication activities, and by eliminating overlaps within the Group.

While these were the first initiatives to simplify the Group structure and better integrate our services, we are working on further steps to improve our cost efficiency and headcount productivity, and find and develop new revenue sources. We plan to announce a more detailed restructuring plan this autumn.

As a further milestone in the history of the company, the Extraordinary General Meeting amended the Articles of Association of Magyar Telekom by converting the golden share to ordinary shares, thus terminating the priority rights of the government.

Let me also mention the General Meetings held at the two international subsidiaries and their dividend payments, which will affect third quarter financials. In Macedonia, 2005 financials were finally closed at the end of July. The General Meeting approved a record high dividend payment of 30 billion forints. Magyar Telekom, through its holding company Stonebridge, is entitled to a dividend payment of 17 billion forints. In Montenegro, the dividend payment declared for the 2006 financials was 2 billion forints. Of this, Magyar Telekom is entitled to 1.6 bn forints. Please note that the dividends paid to minority shareholders amount almost 14 billion forints, which will decrease the Group cash flow in the third quarter.

Continuing with the second quarter financials, **Group** revenues showed a close to 4% increase compared to the second quarter last year, driven by the consolidation impact of the newly acquired IT and system integration companies, as well as by the TETRA service revenues. The strengthening forint somewhat limited the revenue growth contribution of the international operations.

EBITDA increased by close to 2%, as the high severance expenses in the second quarter of 2007 were offset by last year's one-time accounting impact of the retroactive IC fee cut and investigation-related expenses in the second quarter of 2006 were also higher than in the same period this year. Excluding the 1 billion forint investigation- and the over 3 billion forints headcount reduction-related expenses, EBITDA margin was close to 42% in the second quarter.

Let me start the segmental analysis with the results of **T-Com**. Revenue of the segment decreased by almost 2% due to voice revenue erosion in Hungary and Macedonia, partly offset by the revenue increase in Montenegro.

Hungarian T-Com revenues decreased slightly by 1%, due to the continuously decreasing traffic and tariff levels, partly compensated by growing internet and multimedia revenues. Wholesale revenues also increased in the second quarter; however this was driven by the one-time impact of the retroactive IC fee cut last year. As you may remember, according to the decision of the National Regulatory Authority made last June, the 14% cut to Magyar Telekom's interconnection fees had to be applied retroactively from September 2005, decreasing domestic incoming traffic revenues by 1.2 billion and EBITDA by 1 billion forint in the second quarter of 2006.

The austerity package is negatively influencing our customer number and usage trends. Lower household disposable income has resulted in a slight increase in churn levels and in continuous erosion of domestic outgoing traffic. As a result, retail voice revenues decreased by 12% in the quarter. The sale of bundled and flat rate packages with free minutes has slowed down as more than half of our customers are already using these packages and around 60% of the domestic traffic minutes are bundled or free minutes.

Although the growth rate of our broadband customer base is still strong, at 46% at the end of June, we have started to experience some slowdown in the broadband penetration growth, as a further negative impact of the austerity package. To improve the attractiveness of our broadband offers, we are constantly launching new offers. This month, we have started to offer symmetrical DSL services for small- and medium-size enterprises. Having the same download and upload speed is particularly important for companies that offer content services, operate corporate management systems or mail servers.

On an EBITDA level, the 10% decrease was driven by the 2.7 billion forints headcount reduction related expenses accounted for in the second quarter. These expenses mainly relate to the restructuring of the network division where we have decreased headcount and reduced the layers of management. We have also established a separate technical support area to improve customer services by simplifying processes and reducing the duration of line installations and error corrections. Excluding the restructuring related expenses, EBITDA margin was close to 41%.

Turning to **Macedonia**, fixed line revenues were down by over 11% reflecting the negative impact of the strong forint. However, revenues in local currency terms were still down by 5% due to the increasing competition. Traffic revenues suffered from the 6% decrease in line numbers and the continuously eroding traffic minutes. Although the main competition continues to come from mobile operators, an increasing number of alternative operators and cable companies now offer voice and broadband services in Macedonia. Since 1st of June new interconnection and unbundling prices were introduced by the regulator; this cut in interconnection fees has further encouraged competition. As the regulator defined the new rates based on EU benchmarks, the fees are now close to the EU average level.

International traffic was also heavily hit by competition. In international incoming traffic, the market share loss of the Macedonian fixed line business was up to 20% due to the impact of alternative operators and through mobile service providers terminating international calls in their own network. Thus part of the international traffic revenues will shift to our mobile subsidiary, T-Mobile Macedonia.

In order to better position ourselves to deal with increasing competition, we are planning the rebranding of the Macedonian fixed line business in the second half of the year, with a parallel launch of new tariff plans and packages to reduce churn levels and encourage usage. We are also improving our broadband network to increase the number of ADSL customers and developing our IPTV offer to compete with cable operators.

Despite negative trends on the revenue side, EBITDA increased and the margin of close to 49% in the second quarter was outstanding. Cost saving initiatives, improving collection efficiency and lower tax levels on wages helped profitability.

In **Montenegro**, fixed line revenues were up by 16% as eroding voice retail revenues were counterbalanced by strong growth in wholesale revenues. While increasing mobile penetration was an important driver of higher wholesale traffic, the main reason for the 90% increase in international incoming traffic was the reclassification of Serbian traffic from domestic to international following Montenegro's declaration of independence.

Cost saving measures and decreased fixed-to-mobile interconnection fees helped profitability. As a result, EBITDA margin was 36% in the second quarter.

In addition to increasing mobile substitution, we also saw an increase in competition in the fixed line segment. Incoming international traffic will decrease as mobile competitors are expected to use their own licenses for terminating international calls. The recent distribution of cable and wimax licenses may also pose a threat to fixed line traffic. In addition, the government has started to prepare the new, EU-compliant telecommunication law, which may come into force as soon as this year. To strengthen its position amidst increasing competition, Telekom Crne Gore is planning a tariff rebalancing this autumn; the new packages have already been approved by the regulator.

Let me now hand over to Thilo who will provide you further details on T-Systems and T-Mobile segment results.

Thilo Kusch remarks

Thank you, Chris.

Good afternoon ladies and gentlemen!

Having gone through the analysis of the fixed line business, let us now look at the results of our corporate segment. **T-Systems** showed 14% revenue growth thanks to the consolidation of the new IT and system integration companies. On the other hand, fixed line revenues alone decreased by 12% as a combined result of sharply deteriorating voice but stable data revenues.

The recent acquisitions resulted in a high number of subsidiaries and several overlaps in terms of services and back office functions within the segment. In May, we decided to simplify our structure by merging subsidiaries and grouping them into three divisions according to their competencies. The legal procedures relating to these initiatives are expected to be completed by January 2008.

Benefits from integrations within the Group are also starting to come through. As announced earlier, we have unified the customer relationship management for the top 500 companies to enable us to offer integrated packages. Thanks to the joint efforts with T-Mobile, we were able to utilise cross-selling opportunities for some top clients, such as the Hungarian affiliates of UNIQA and KBC Bank.

Continuing with the mobile business, the **T-Mobile** segment showed above 4% growth, driven by the good performance of the international subsidiaries and the contribution from the TETRA services.

Hungarian mobile revenues showed a moderate 1% revenue increase as higher voice retail and value added revenues were partly offset by lower wholesale revenues. The 15% cut in mobile termination fees of T-Mobile Hungary from February this year decreased wholesale revenues. Nevertheless, due to the parallel decrease in asymmetry between the mobile termination fees of the three Hungarian mobile operators, voice-related outpayments also decreased, favourably impacting profitability. EBITDA margin in the second quarter reached 43%.

Driven partly by the reduced termination rates, average tariff level erosion was above 10% in the first half of the year. Usage growth slowed down to 7% by the end of June meaning that price elasticity remained under pressure, most probably due to the lower household disposable income. Although value added services increased and the postpaid ratio within the customer base improved further, these could not offset the lower tariff levels. Consequently, average revenue per user decreased by over 4%.

Mobile penetration in Hungary reached close to 102% at the end of June and the customer base of T-Mobile Hungary increased by almost 6%. Although its market share based on total number of SIM cards slightly decreased, looking at the active customer base, T-Mobile showed a stable market share with around 45%. The ratio of postpaid customers increased further thanks to our successful efforts to migrate prepaid customers to postpaid packages. Increased acquisition cost of postpaid customers and higher subsidies on 3G and HSDPA enabled handsets and data cards are the main reason for the 9% increase in acquisition cost per gross addition. To compensate for that, we have decreased subsidies for prepaid customers and retention costs were also down thanks to the stable churn levels.

We are continuously improving our HSDPA network by increasing population coverage, network quality and speed. The population coverage currently stands at around 40%, and in May, we started a network upgrade programme to double the download speed from 3.6 to 7.2 Megabits per second. Customers only need a software upgrade for their data cards to use the super-speed mobile broadband services.

We have also launched new offers and discounts for mobile broadband subscriptions with a fixed contract period. Currently, we have above 100 thousand mobile broadband subscriptions, an increase of 50% since the beginning of the year.

As for the roaming regulation, T-Mobile Hungary will launch reduced roaming fees from 29th of August. This will automatically apply to all customers, except those in special roaming packages. Call initiation fees within the EU countries will decrease by over 40% and call receiving fees by over 30%. The full-year EBITDA impact of the reduced fees will reach a few billion forints, however increasing roaming usage will partly compensate for the negative impact.

Turning to **Macedonia**, penetration growth in the mobile market remains strong as the two existing operators focus on customer acquisition ahead of the service launch by a third operator. As a result, penetration level reached 73% at the end of June. Continuing to benefit from improved customer perception following the rebranding, T-Mobile Macedonia maintained its market share at 66% and its customer base exceeded 1 million by the end of the first half of 2007. The quality of the customer base also improved, with the postpaid ratio increasing by 6 percentage points since June 2006.

The strong increase in usage was driven by the new campaigns offering very cheap within-network calls. Revenue per user levels also gained from the higher usage, and were up by 5% in local currency terms.

Revenue and EBITDA growth was correspondingly strong in the second quarter of 2007, with a high EBITDA margin of 56%. As for the second half of the year, we expect increasing competition as the third entrant Mobilkom starts operations, most likely in September. As a further threat, the government plans to tender a fourth license and the new competitor may launch services as soon as next year.

Mobile revenues in **Montenegro** improved significantly by 40% driven by the strong increase in traffic and the higher mobile-to-mobile termination rates. The new rate of 10 euro cents per minute is in line with the European average. The strong increase in the customer base and the extraordinarily high penetration of 141% was driven by the extended availability of prepaid cards and the increasing number of tourists buying SIM cards in Montenegro.

In order to strengthen our market position, we have increased our focus on market share in the postpaid segment. Reflecting our successful efforts, since May T-Mobile Montenegro has been the market leader in the postpaid segment. This, however, also involves increased acquisition and retention costs as well as a higher marketing spend.

Telekom Serbia, the third operator, launched mobile services in July and mainly targets the prepaid segment with lower entry barriers and subsidised handsets. While it offers very favourable tariffs for calls into Serbia, the domestic prices are only slightly below the existing offers of T-Mobile Montenegro and Promonte.

As announced earlier, 3G licenses were auctioned to the three mobile operators. In June, T-Mobile was the first in the country to launch mobile broadband services and offers its customers video call services and several 3G-enabled handsets. Network rollout will be gradual, currently covering the capital.

Chris Mattheisen remarks

Thanks Thilo

That concludes the formal part of Magyar Telekom's conference call. Now we are happy to open the floor for questions. Operator, when you are ready, we will take the first question.

If there are follow-up questions, I encourage you to contact our Investor Relations Department. The telephone number is 36-1-458-0437 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 transcripts of our conference calls will be available on our official website. Thank you again for joining us today, and for your continued interest in Magyar Telekom.