

First quarter 2006 Results Conference Call

May 11, 2006 at 15:00 CET

Conference call operator introduces call

Elek Straub remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's first quarter 2006 results conference call. I am Elek Straub, Magyar Telekom's Chairman and Chief Executive Officer and I am hosting today's call together with Dr. Klaus Hartmann, our CFO and member of the Board.

Before I start with the analysis of the Group performance, I would like to inform you of the delay to Magyar Telekom's **Annual General Meeting** due to the ongoing investigation, as a result of which the approval of Magyar Telekom's financial statements is still pending. As disclosed earlier, the company is still inquiring into certain consultancy contracts, totalling approximately 700 million forints. The company will seek to hold its AGM and have the annual results and the dividend approved as soon as reasonably practicable. However, based on the unaudited Group financial statements, the Board of Directors considers a dividend payment for 2005 in line with last year's level of around 70 forints per share to be reasonable.

Moving on to **Group performance**, I would like to draw your attention to the improvement in the disclosure of the fixed segment revenue breakdown. In order to provide a more detailed account and reflect the growing importance of non-voice activities, such as internet or content-type services, we have introduced some additional lines to the revenue breakdown. In the new structure, all internet-related revenues, including DSL, dial-up and cable internet, are disclosed in the internet line, whereas the data line mainly covers revenues from managed leased lines. The primary source of multimedia revenues is the cable operation, while the major part of the system integration and IT revenues is generated by our subsidiary BCN, an IT and telecommunication network provider company.

Looking at the results, the first quarter was characterized by impressive revenue growth of almost 7% and a close to 5% EBITDA increase year-on-year, resulting in an EBITDA margin of over 40%. The results of Telekom Montenegro have been consolidated since the second quarter of 2005, contributing over 6 billion forints to Group revenues in the first quarter of 2006. However, excluding the contribution of TCG, we also saw a revenue increase of more than 2%, and a slight improvement in EBITDA in forint terms. Although the ongoing intense competition in the Hungarian fixed segment has put real pressure on voice revenues, expansion in internet and cable operations, as well as the strong performance of the mobile segment, offset the negative impacts, resulting in a turnaround in the declining revenue trend of the past six quarters. This improvement also reflects that the measures taken in line with our strategy are starting to pay off, positively impacting our results.

Now I would like to take the opportunity to say a few words on the progress of our most recent **strategic initiatives** and outline their contribution to our results. According to plans, in February we launched our retail operation in Romania, under the name of EUfonica, providing call-by-call services to the residential and business segments for long distance and international directions. Since the beginning of April, preselection is also available to business customers. Although first quarter revenue contribution from this operation was not tangible given the recent launch of the service, we expect couple of billion forints addition to our international segment revenues from this operation in 2006. In addition, we expect a positive revenue impact from the Bulgarian Orbitel, consolidated to our financials from February. Furthermore, the closing of the Dataplex acquisition took place at the beginning of April, following the approval by the Competition Authority, thus we are consolidating the company's results from the second quarter which will also help Group performance and the achievement our public targets.

I am also pleased to inform you that at the end of February, the court registered the **merger of Magyar Telekom and T-Mobile Hungary**, completing the legal part of the merger process. From 1st of March 2006, Magyar Telekom Plc. is the legal successor of T-Mobile Hungary Ltd, while T-Mobile continues to operate under an independent brand and as an independent line of business within the Magyar Telekom Group. Parallel to the registration process, we have already taken some of the steps towards capitalizing on synergies provided by the merger. We are in the process of integrating sales activities, a few shops have already been merged, while some of the others will operate as a common shop and some will be closed, supporting rationalization.

The harmonization of the internal structures and operations of the companies has also started. The migration of T-Mobile to SAP has begun and we are also in the process of integrating the different data warehouses of the fixed-line and mobile segments. This will enable us to conduct complex analyses on the usage patterns and offer bundled packages tailored to customer needs. Consequently, there will be some initial costs related for example to the transformation of the shops, the introduction of the shared service center and to the unified customer databases, but these are expected to be counterbalanced by the resulting synergies. According to our estimates, the impact of the merger on our 2006 P&L will be close to neutral, while we foresee tangible positive benefits to arise in the years to come.

Let me start the segmental analysis with the results of the **Hungarian fixed-line**. The decline in EBITDA was caused partly by fierce competition putting pressure on revenues, and partly by higher expenses driven by increased sales and one-off costs related to the introduction of several new offers. The drop in revenues of close to 3% was driven by the decrease in voice revenues, partly offset by the strong performance of the internet business.

The main drivers of the segment results are similar to those of the previous quarters. Competition from alternative and cable operators jeopardizing both subscription and traffic revenues, and the negative impact of mobile substitution on usage remain the key issues. Nevertheless, we can already see some improvement. Based on our estimates, in the fourth quarter of 2005, we were able to stop Tele2's traffic expansion in the residential segment, while in the first three months of this year we succeeded in reversing their expansion. Thanks to our promotions and our flat-rate packages, traffic generated by Tele2 slightly decreased, both in the residential and in the small and medium size enterprises segments, along with a decline in the number of users. In addition, the subscriber base of UPC is growing at a slightly slower pace, partly as a consequence of the different promotions offered to those planning to cancel their PSTN subscription. These offers include, for example, free mobile prepaid cards every quarter for a period of one year, or reduced monthly fee for three months. In the latter case, subscription fees can also be used to make calls and at the end of the three-month period, the customer can choose whether to keep the line with the normal fees or cancel it. However, signing a one year subscription contract with the company is a precondition for any of these offers in order to ensure the necessary pay-back. All in all, thanks to these efforts, the speed of line erosion slowed down somewhat this quarter.

Furthermore, we witnessed a rapid expansion in the flat rate packages. Helped by the introduction of Favorit Non-Stop and Non-Stop Plusz, the 24 hour extensions of the original Favorit packages, flat-rate packages now account for around 25% of all residential lines. The impact of these packages on our results is twofold. On one hand, they have supported the moderate year-on-year increase in subscription revenues and helped promote retention and usage. On the other hand, the majority of the additionally generated minutes are bundled in the monthly fee with a negative effect on traffic revenues. This is the major driver behind the parallel increase in long distance, stable local minutes and a considerable decline in outgoing traffic revenues.

Concerning the recent draft interconnection fees published by the National Regulatory Authority, it would decrease interconnection tariffs by an estimated average 14% compared to previous levels. The resolution is not finalized yet therefore it had no impact at all on our first quarter results.

With regard to our cable operations, I would like to draw your attention to the 14% growth in multimedia revenues driven by a 5% rise in the number of cable subscribers and the price increase introduced at the beginning of the

year. At the same time, voice-over-cable customers increased by more than 5 thousand in the first three months, reaching nearly 19 thousand, however revenue contribution from this source is still limited.

In the internet business, the broadband revenue stream has increased in importance, while the role of the narrowband revenues is in a decline. The number of broadband connections exceeded 400 thousand, also supported by the heavy migration of dial-up users to ADSL, which resulted in an impressive 37% increase in broadband revenues year-on-year. With the aim of reaching our target of 600 thousand broadband customers by year-end, we have introduced a new low-user DSL offer with per-minute pricing and no monthly fee. In addition, since the beginning of April, T-Online has been providing retail ADSL in the area of Monortel, one of the LTOs in Hungary. IPTV network testing has also commenced and we plan a commercial launch of the service around the year-end.

Before moving on, I would like to mention our recent move of gaining control of iWiW, the leading Hungarian online social network, which is the fourth most visited web page in Hungary. It has more than half a million registered member, providing a great opportunity to offer value-added online services to a significant user base and also contributes with an efficient advertising platform.

In the info-communication outsourcing market, we also strengthened our position through major business client wins, such as the ING Bank or E.ON for 5-7 year contract periods. Info-communication outsourcing includes the operation of both internal and external networks and the transformation of these networks into IP-based technology. Additional services can also include integrated IP-based voice services. Further key business customers were also attracted through other targeted services. For example, we signed a longer-term contract with MOL to provide flat-rate voice services in domestic fixed directions, while with Budapest Bank we contracted for an integrated service package. A pilot of a bundled fixed-mobile flat-rate package was also launched to strengthen customer retention and capitalize on cross-selling opportunities.

As for the profitability of the segment, savings in employee-related costs reflecting the headcount reduction program and the decrease in payments to other network operators of over 18% could not counterbalance the declining revenue and the increase in other operating costs. The highly competitive environment requires more emphasis on sales and marketing activities supporting the launch of the new services, which hit EBITDA and eroded the margin.

Finally, I would like to highlight that the lines per employee ratio at parent-company level reached the year-end target of 500 as early as end-February. We have, therefore, decided not to publish this figure going forward, not only because the announced target has been reached but also due to the difficulties in calculating this figure following the merger of T-Mobile and the parent company. As many central functions of the fixed and mobile businesses will be integrated, no appropriate separation of these employees can be made. Nevertheless, we will remain focused on improving the efficiency of the Hungarian fixed segment.

(PAUSE)

Let me now hand over to Klaus who will continue with the analysis of the international fixed-line operations and the mobile segment.

Klaus Hartmann remarks

Thank you, Elek.

Good afternoon ladies and gentlemen!

Let me begin the analysis of the **international fixed line segment** performance with our Macedonian operator, MakTel.

Macedonian operations are still constrained by the poor macroeconomic environment limiting disposable income. Nevertheless, we managed to increase fixed-line revenues by over 5%, driven primarily by higher international

incoming revenues, but also strongly supported by favourable foreign exchange movements. Measures introduced to stop illegal international incoming traffic termination of our competitors proved very successful, positively impacting wholesale revenues, whereas due to tariff rebalancing in last August, subscription revenues also improved despite the around 4% drop in the number of revenue-producing customers. Furthermore, the number of ADSL customers more than doubled compared to the same period last year, reaching close to 10 thousand and leading to an expansion in internet revenues.

On the down side, however, traffic revenue erosion continued, as a consequence of both the lower customer base and the reduced average usage. Outgoing international traffic was also hit by the presence of alternative operators offering very favourable pricing, while the rising mobile substitution triggered by the higher penetration put pressure on domestic traffic.

On the cost side, we can see some further improvement, for example, in payments to other operators and in the other operating expense line, which also contributed to the impressive increase in year-on-year EBITDA of over 18% and a margin of close to 50%.

Before moving on, I would like to inform you, that the decision to rebrand both the fixed and the mobile operations in Macedonia has been approved. We plan a similar rebranding schedule to that of the Hungarian operations, proceeding first with the mobile arm around this summer, followed by the fixed-line at the beginning of next year. The rebranding process will be accompanied by boosted media presence and introduction of new, innovative products, similarly to that in Hungary, which we anticipate will have a positive impact on our business. All costs related to the rebranding will be financed by Deutsche Telekom.

Let me continue with the **Montenegrin fixed operations**, which showed signs of remarkable improvement reflecting our efforts to increase profitability. Revenue contribution of the fixed segment was over 4 billion forints in the first quarter with an EBITDA margin of over 33%. The increased usage and positive results of the internet segment counterbalanced the impacts of the slight line erosion we witnessed. The major component of internet revenues is still dial-up traffic, however, the expansion of ADSL has also started.

On the cost side, the effects of the efficiency improving efforts from last year started paying off in the quarter, also supporting the good performance. Nevertheless, we are planning further efficiency measures, mainly headcount rationalization, which we expect will hit profitability throughout the remainder of the year.

Having gone through the analysis of the fixed segment, let us now look at the results of the **Hungarian mobile operations**. Penetration in Hungary was over 93% at the end of March. T-Mobile tried to capitalize on the relatively calm competitive environment in the first quarter to maintain its leading position and stabilize its market share at a level of around 45%. On the other hand, due to the high migration of customers towards customized packages with more favourable pricing, the average tariff level at T-Mobile decreased by close to 15% over same period last year. However, thanks to improving price elasticity, monthly usage per user increased by 14%, offsetting the negative impact of tariff erosion. Looking at average revenue per user levels, we have recorded a slight improvement year-on-year, mainly driven by the significant increase in enhanced service revenues, now representing almost 16% of total ARPU.

Apart from maintaining our dominant market position, we were also able to improve the profitability of the mobile operations. EBITDA level increased by 8% and the margin reached nearly 40%, reflecting the strong revenue increase and our continuous focus on cost control. Revenue growth of over 4% is attributable to two major factors. Firstly, we witnessed growth in the number of customers of more than 4%, primary driven by the expansion of the postpaid segment. This had a very positive impact on our customer mix, the ratio of postpaid customers exceeded 32%. The other significant factor contributing to revenue improvement was the rising demand for value-added services. Customers are not only using the SMS service but there is also demand for MMS and data access, reflected, for example, in the increasing usage of GPRS.

To capitalize on this demand, we are planning to gradually launch HSDPA from the second half of the year. HSDPA, which stands for High-Speed Downlink Packet Access, is an extended version of the UMTS networks. It increases the available data bandwidth to a level similar to the current fixed-line broadband download speed.

On the cost side, the drop in the cost of equipment sales and employee-related expenses partially offset the negative impact of increasing other operating costs. The lower equipment prices and reduced subsidies on equipment sales resulted in an around 22% drop in new subscriber acquisition costs. However, the over 12% higher gross additions caused a more moderate decrease in the total acquisition cost, and also boosted agency fees and marketing expenses.

Before moving on to the **international mobile** segment, let me give you an update on the developments in the EDR, Tetra project. At the beginning of April, we started Budapest-wide operations of the system, which involves 34 base stations and over 14 thousand handsets. The capex needs of the network were 4 billion forint in the first quarter, while the total investment needed for this year will not exceed 22 billion forint.

Now moving on to the international mobile segment, I would first like to summarize the situation in the Macedonian business environment.

The mobile market in Macedonia is still characterized by fierce competition. Penetration growth slowed down slightly in the first quarter, having reached 62% by the end of March, while Mobimak kept its leading position with a market share of over 68%. Despite the 14% year-on-year decrease in average tariff levels driven by Cosmofon's aggressive pricing, mobile revenues grew by 8% in forint terms. The strong increase is partly attributable to the strengthening of the Macedonian denar of over 4% compared to the forint. In addition, the significant increase in the customer base fuelled by the over 20% growth in postpaid subscribers had a positive impact on subscription revenues, whereas the improvement in traffic revenues was supported by the usage increase. With regards to the profitability of the segment, EBITDA margin strengthened further compared to the same period last year, reaching close to 54% reflecting strict cost control and the improving efficiency of our Macedonian mobile operations.

I would also like to say a few words on the **Montenegrin mobile market**. Penetration reached 79% with Monet's market share at 41%. The slight market share erosion is due to the very favourably priced packages introduced by our competitor, Promonte, at the end of 2005. Although this resulted in significant churn in the prepaid segment, mainly low-user customers were lost, positively impacting usage-per-customer figures and profitability. Revenues of the segment increased compared to the previous quarter, adding more than 2 billion forints to the Group performance. EBITDA contribution also improved significantly, and margin was over 46%.

Elek Straub remarks

(PAUSE)

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.

(Take questions)

I believe we have time for one more question.

(Take final question)

This is all the time we have. 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.