

Q3 2011 Results Conference Call

November 10, 2011 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's third quarter 2011 results conference call. I am Chris Mattheisen, Magyar Telekom's Chief Executive Officer and Chairman of the Board, and I will be hosting today's call with Thilo Kusch, our CFO and a fellow member of the Board.

While the external environment has become even more difficult since our last conference call, our third quarter results still highlight several positive trends in our top line. In the fixed line segment we have clearly slowed the churn rate in the third quarter, which also translated into a decline in voice revenue deterioration. In the residential mobile market we saw a continued sharp increase in the number of mobile broadband subscriptions and the SI/IT segment we were able to reverse some of the negative revenue trends seen in previous quarters thanks to some infrastructure projects at KFKI. Despite the challenging economic climate, we have been able to slow third quarter revenue deterioration for the Group to 1.7% while the average decline for the first 6 months of the year was 3.9%. However, due to the margin dilution impact of the higher SI/IT revenues and the increased level of handset subsidies, underlying EBITDA was down by 7%. Underlying EBITDA margin for the quarter remained at a healthy level of around 42%.

Let me also mention the increased provisions booked in relation to the U.S. investigations. As announced in June, the Board had approved an agreement in principle with the SEC to resolve the SEC's investigation relating to the Company through a settlement. Recently the Board has approved the final settlement with the SEC which remains subject to approval by the SEC and a US district court. The Company continues to engage in discussions with the DOJ regarding the possibility of resolving the DOJ's investigation of the Company through a negotiated settlement. In light of the ongoing negotiations with the DOJ, the Company has increased the amount of the provision recognized in connection with these investigations with 8 billion forints in the third quarter of 2011.

Now let's turn to the segment analysis and start with **Telekom Hungary**, where revenues in the third quarter were down by 3%. The continued reduction of high-margin voice revenues coupled with higher handset subsidies put pressure on profitability and underlying EBITDA declined by 8%. Still, the underlying EBITDA margin reached 42%.

Starting with the fixed line business we see extremely positive results of the Hoppá package, launched at the beginning of the year. A quarter of our fixed customers have subscribed to this package to date, and while the vast majority have come from migration, almost 90% have signed a 2-year loyalty contract. Although this diluted average revenue per access further, I would like to emphasize that the churn figures have significantly improved, and line losses have fallen to almost a third of the amount in the previous year: the total number of voice lines lost was 16,000 in the third quarter of 2011 compared to 46,000 in the third quarter of 2010. At the same time we are migrating an increasing number of customers to IP based solutions and retain our focus on increasing the number of bundled customers under our cross-selling strategy. As a result, by the end of the quarter, the ratio of multi-play subscribers increased to 48% from 40% a year ago.

The broadband market is still characterized by two prevailing but contrasting drivers: continuously falling ARPU due to local price discounts and customer migration to multi-play packages, which could not be fully offset by 10% growth in the subscriber numbers.

Moving to the TV market, our subscriber base grew by 7%, while ARPU also increased by 4% thanks to the growing popularity of the interactive IPTV service which resulted in a 9% increase in TV revenues in the third quarter of 2011 compared to the same quarter in 2010. Not only did the satellite TV subscriber numbers show growth, but migration to IPTV packages is also increasing. Looking forward, we see greater potential to up-sell into this platform, which we expect will support revenues.

In the third quarter of 2011 other fixed line revenues were up by 11% driven by our retail energy business. By end-September 2011 the number of gas and electricity subscribers reached 25,000 and we extended the coverage of this service to all of Budapest and several other large cities.

Thanks to all these positive trends, the decline in fixed line revenues slowed to 4% in the third quarter this year compared to around 6% in the same quarter last year.

Moving on to the mobile market, revenues were down by 2% due to both lower retail and wholesale revenues. A slight increase in the customer base, higher mobile usage and a steady increase in the proportion of post-paid customers could not fully offset the unfavorable impact of lower effective tariff levels resulting in a 2% decline in retail revenues; while the mobile termination rate cut, effective from December 2010, caused some wholesale revenue decline.

In recent quarters the sales focus has completely shifted to smartphones as further dynamic expansion is expected in the coming years. In the third quarter of 2011 the ratio of smartphone sales in the postpaid segment exceeded 70% compared to approximately 30% a year ago. We have also managed to increase the broadband attach rate, and we now attach a mobile broadband subscription to more than every second smartphone sold. As a result of these trends and initiatives, mobile broadband subscriptions increased by 58% in a year, supporting the growth in non-voice revenues. Due to the higher priced smartphones equipment sales, revenues also grew by 11%. At the same time, subsidy costs were also higher in the third quarter compared to the previous quarters and we expect this trend to continue into the fourth quarter. I would like to highlight that we have witnessed a 2 percentage point drop in our mobile broadband market share based on traffic generating subscribers in the August report. This drop is driven by a reporting mistake by Telenor as in the previous monthly reports they only reported the active users of the last 1 month, whereas active users of the previous 3 months would have been eligible. The Regulator is currently in the process of restating the market share figures retrospectively.

As the growing penetration of smartphones and tablets drives demand for fast and stable mobile broadband services, we continue to invest in modernizing our mobile network. The HSPA+ based mobile internet service with a nominal download speed of 21 Mbps has already become available at 380 locations. Besides this achievement, in October we launched an extended network test of the 4G/LTE technology involving several hundred customers in certain areas of Budapest and the commercial launch is expected on January 1, 2012. Following that, consumer needs will determine the pace of expansion, but by 2012 all Budapest areas will be covered.

Let me now hand over to Thilo who will provide further details on the results of the T-Systems Hungary segment and the international subsidiaries.

Thilo Kusch remarks

Thank you, Chris.

At **T-Systems Hungary** pressure on revenues seems to be easing and we achieved an outstanding revenue growth of 16% compared to the third quarter last year. Although a part of this increase is attributable to the base effect of a price allowance to the Government in the third quarter of 2010, a positive turn in the segment's ability to generate revenues is apparent.

Our SI/IT revenues increased by 32% as a result of several positive developments. As a technical factor, several of our partners postponed their planned SI/IT investment from the second quarter to the third quarter, while revenues from some of our biggest ongoing projects with Mercedes and HungaroControl were realized earlier than expected. Although contracts with utilities and manufacturing companies generate higher revenues, the cost-cutting in the financial sector and public institutions have still mitigated growth. Looking ahead, I believe that the SI/IT segment has considerable growth potential even in the current economic environment, although the growth rate in the third quarter should be considered as exceptional. Government austerity measures and cost-cutting in the banking sector continue to weigh on business prospects as the announcement of several large-scale tenders are cancelled or postponed. Moreover, several multinational partners in Hungary are centralizing SI/IT investment decisions on an international level, limiting our ability to participate in such tenders.

In T-Systems Hungary's telecom business, fixed voice revenues recorded further declines, driven by continued erosion in our customer base, lower usage and decreasing ARPU. The rise in internet revenues was unable to compensate for this loss, so revenues from fixed segment fell by 5% in total. Mobile voice revenues dropped too as the higher customer base could not offset the lower tariff levels resulting from strong competition. Nonetheless, total mobile revenues increased by 14% as a result of a one-off item related to a price allowance for the government on the "other mobile revenues" line which had a negative impact on the third quarter results of 2010.

Along with the favorable top-line developments, we have been able to keep costs under control. Thanks to the focus on total workforce efficiency, we have further decreased employee-related costs and through the collection of some outstanding receivables, we managed to reduce bad debt levels as well. As a result, the underlying EBITDA margin for T-Systems increased by 3 percentage points to 17%.

Regarding our **Macedonian** subsidiary the falling revenue trend continued in the third quarter as well mainly driven by the fierce competition in the mobile market. Mobile revenues declined by 15%, while total revenues were down by 12% compared to the same period in 2010. Although cost cutting measures helped to improve the results, they could not fully compensate the revenue decline, with underlying EBITDA falling by 14%. The results also reflect the negative impact from the forint strengthening against the denar. Despite the negative trends, EBITDA margin was still high at 56% thanks to focus on efficiency.

In the fixed line segment in Macedonia revenues were down by 9%, as the growth in TV revenues could not offset the 15% drop in retail revenues. Makedonski Telekom is losing market share both on the fixed voice and broadband segment driven by intensifying competition especially from cable operators. However, we are still the market leaders with 77% market share in the fixed voice and 57% share in the fixed broadband market. At the same time the growing number of double and triple play packages further support rising TV revenues, the subscriptions to bundled packages increased by 32% compared to September 2010.

Turning to the mobile segment, mobile revenues were down by 15% in the third quarter driven by significantly lower retail voice revenues as intense competition puts continuous pressure on tariff levels. Despite the fierce competition, T-Mobile Macedonia's mobile voice market share stabilized at 50%. At the same time, demand for mobile broadband services is still high. Like T-Mobile Hungary, T-Mobile Macedonia is modernizing its network and upgrading the base stations to HSPA+ capable of offering up to 21Mbps download speed.

Regarding our **Montenegrin** subsidiary, total revenues declined by 5% in Hungarian forint terms, while EBITDA fell by 11% in the third quarter compared to the same period in 2010. Let me note, however, that the strengthening of the Hungarian forint explains 4 percentage points in these rates. Nonetheless, the EBITDA margin decreased by 3 percentage points to 40% as the finalization of the compulsory registration period for pre-paid mobile users generated extra costs in the third quarter. On the other hand, we managed to maintain the momentum of a general cost-cutting initiative started in 2009 as employee-related expenses fell by 12%.

Fixed line revenues decreased by 6.7% as higher broadband and IPTV revenues could not compensate for the losses in voice revenues. The number of PSTN connections remained flat while traffic declined due to strong mobile substitution. We maintained our leading market shares in the fixed voice and fixed broadband markets of 98% and 85%, respectively, and managed to increase our share in the pay-TV market to 39%.

Mobile revenues in Montenegro declined by 3% in Hungarian forint terms. Voice revenues fell due to lower wholesale revenues as a result of lower interconnection fees and declining incoming minutes. In the retail business, however, we increased our market share to 35% and revenues were up slightly relative to the same period in 2010 as we kept our focus on acquiring post-paid costumers. Within the non-voice segment, growth remained high and we managed to maintain our competitive position.

Chris Mattheisen remarks

Thank you, Thilo. That concludes the formal part of Magyar Telekom's conference call. We are 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 would like 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.