

August 11, 2005 at 16:00 CET

Conference call operator introduces call

Elek Straub remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's conference call for the 2005 first half results. 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 analyzing the performance, let me mention the dividend payment of Magyar Telekom and the conclusion of the acquisition of Telekom Montenegro.

Despite the several non-recurring items in our cash flow, such as the severance payment for headcount reduction, the payment of the UMTS license fee and the acquisition cost of Telekom Montenegro, Magyar Telekom was able to pay out the same high level of dividend as last year, thus offering an outstanding dividend yield to investors. The vast majority of the dividend was paid out this June, influencing the net debt to total capital ratio, which reached 39% by the end of the second quarter.

Besides maintaining an impressive dividend yield, we also completed our acquisition in Montenegro, in line with our strategy of achieving growth through value accretive acquisitions. After we reached an agreement with the local government to buy the majority stake and at the same time with some minority shareholders to buy their holdings, Magyar Telekom submitted a public offer for the remaining shares. Following the closure of the offer, Magyar Telekom had a 76.5% stake in Telekom Montenegro for a total purchase price of 140.5 million euros. We are on the way to starting to modernise the company and exploiting the synergies provided by integration within the Group.

Let me continue with the performance of the Group. Revenues increased by 0.7%, EBITDA decreased by 1.6% year-on-year, and EBITDA margin was 41.4%. These figures, however, also contain the contribution of Telekom Montenegro in the second quarter. Looking at the results without TCG, revenues decreased by 1.4%, EBITDA decreased by 2.1% and EBITDA margin was 42% for the first half of the year. Revenues were heavily impacted by strengthening competition at the Hungarian wireline operations, which could only be partially counterbalanced by expanding internet revenues and the slight increase in mobile revenues.

First, I would like to take you through the analysis of the performance of the Hungarian wireline operations. While we witnessed a 7% drop in the segment's revenues, we were able to counterbalance this effect with successful cost control, thus increasing the segment's EBITDA margin compared to the first half of last year. Segment revenues, however, decreased due to declining usage and a lower customer base, as strengthening competition continues to characterize the voice market. Fixed-line erosion further increased in the second quarter, with the number of lines falling by around 70 thousand in the first half of the year. Outgoing traffic revenues decreased by 26%.

The major negative impact is coming from intensifying competition in the highly saturated mobile market. Mobile substitution remains strong as mobile operators are very active in communicating low tariffs and the mobile premium is diminishing. Wireline operations were also hit by the increased competition from alternative and cable operators. Tele2 has been very active in expanding its user base and gaining traffic from Magyar Telekom and other LTOs. The company offers call-by-call carrier selection service in all call directions and in June also launched its Open Internet service in Budapest, which will be available in the entire T-Com area in the next months. Additionally, some cable operators are not just competing on the broadband market, but are also offering voice over cable services, providing free calls within their networks and competitive tariffs in off-net directions. Competition is especially strong in the business segment, where the closed user group offers from mobile competitors cannibalize business traffic.

In order to mitigate the effects of the intensifying competition, T-Com is further customizing its tariff packages with the aim of retaining customers and consolidating revenues. The rebranding campaign, which started in May and is still ongoing, supports the introduction of new offers with increased media presence and with a new, fresh image. In the framework of the rebranding the 'Favorite' tariff packages were introduced in June. Except in the shortened peak period, for an increased monthly fee, customers can make free calls in local directions or even long distance. This new package structure already reflects our strategy in the wireline segment to focus more on access type of revenues in order to retain customers and fend off competition from cable and alternative operators.

Our activities in the area of other local telecom operators increased further. While we already offered both preselection and call-by-call carrier selection for LTO business customers, in June we also made preselection services available to residential customers. Moreover, as part of our triple play strategy, our cable subsidiary introduced voice over cable services in other LTO areas on top of the cable and internet offers. Customers using voice services through our cable network can keep their phone numbers, make free calls within the network, pay a significantly lower monthly fee and have no call set-up charge.

The drop in traffic revenues was partially offset by rapidly growing Internet revenues. Data transmission revenues increased by 34% and already represent 14% of the segment's revenues. In order to reach our new goal of 600 thousand broadband customers by the end of next year, we have again doubled the speed of our ADSL packages at no additional charge. In addition,

August 11, 2005 at 16:00 CET

T-Online introduced a new low-end DSL offer with a lower, 6,500 forint monthly charge. At the end of June, the number of wholesale DSL customers exceeded 250 thousand and the number of total broadband customers, including cable broadband, leased line and wireless LAN customers, reached 270 thousand.

A further item affecting Hungarian wireline results was the cut in mobile termination fees last June. In addition to slightly decreasing the segment's revenues, this also contributed to the 22% decrease in the payments to other network operators cost line. All in all, the termination fee cut had a neutral effect on the segment's reported EBITDA.

Before moving on, I would like to highlight the efficiency improvement in our Hungarian wireline operations. The headcount reduction program, announced last year, continues to be executed according to plan, increasing the lines per employee ratio to 433 at the parent company. Accordingly, employee related expenses in the Hungarian wireline operations decreased by more than 8% year-on-year, despite the yearly wage increase of nearly 6% that took place on 1st of April, 2005. Thanks to the headcount reduction and other cost cutting initiatives, the segment's EBITDA margin improved by 1 percentage point compared to the same period last year.

(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!

In the international fixed line segment, due to the consolidation of Telekom Montenegro from the second quarter, we have to split the analysis of this segment to Macedonia and Montenegro.

While the Macedonian macro economy is still weak, there are some slight signs of increasing GDP growth. However, for the time being, top-line growth opportunities at MakTel and MobiMak are still limited. In addition, the strengthening of the forint compared to the Macedonian denar had a negative impact of around 3% year-on-year on the figures in forint terms.

MakTel's revenues decreased by 11% in forint terms year-on-year. Domestic outgoing traffic revenues showed the biggest drop, due to a continuous decrease in usage and the number of revenue producing customers, as mobile substitution is increasing with the growing mobile penetration level. This is partly counterbalanced by the higher per minute tariffs effective as a result of the tariff rebalancing in July 2004. As voice traffic is expected to deteriorate further, the company is focusing on internet services. MakTel continues to have a strong leading position in the dial-up market, and still remains the country's only ADSL service provider. Demand for ADSL is strong; the number of customers more than doubled from the year-end and now exceeds 5,500.

On the cost side, efficient cost control and headcount reduction is still the key focus. Due to our continuous efforts to increase workforce efficiency, average headcount decreased by 24% and in parallel, employee-related expenses fell by 23%. The company managed to further decrease other operating costs, while payments to other network operators also reduced, driven by the lower fixed-to-mobile traffic. Thanks to these steps, MakTel's fixed line EBITDA margin reached an impressive 46% in the first half this year. The company will continue to exploit further cost saving opportunities in the future with further headcount rationalisation and the launch of shared service solutions.

Reflecting the high profitability of our Macedonian operations, the general meeting of MakTel in May decided on a significant dividend payment. The company paid around 24 billion forints in dividends at the beginning of July, of which Stonebridge, the fully owned subsidiary of Magyar Telekom, is entitled to 51% in line with its ownership in MakTel.

As for the regulatory background, the new telecom act came into force on the 5th of March, creating the framework for future competition in the fixed line segment. Voice-over-IP services are already offered by competitors and carrier selection is expected to be launched in the second half of this year. Number portability is not expected in the near future.

Turning to Montenegro, while the company's balance sheet had already been consolidated in our first quarter accounts, the income statement was first consolidated from the second quarter of 2005. The company posted revenues of 4.2 billion forints and a negative EBITDA of 0.4 billion forint for the second quarter. This is due to the launch of the headcount rationalization program at the parent company and the associated 1.3 billion forints accounted for as severance provision in the second quarter. We expect the headcount number and cash flow to be impacted mainly in the third quarter this year. Without this item, the company's EBITDA margin would have been 21% for the quarter.

The fixed line penetration rate in Montenegro is 31%, but is not expected to grow further due to the high mobile penetration level. Although fixed line tariffs are significantly lower than mobile tariffs, mobile substitution is already playing a role. Fixed line revenues have also been negatively affected by the tariff rebalancing introduced in December, which was negatively perceived by the customers.

August 11, 2005 at 16:00 CET

We are now concentrating on customer retention and increasing usage. We are launching several campaigns to boost usage, exploiting the fact that local calls are very cheap in the country. We have also introduced ADSL in the second quarter, but the real impact on customer numbers is not expected until the third quarter as the broadband service on analogue lines has only been available since July.

While no top-line growth can be expected in the wireline market in Montenegro, the management is focusing on efficiency improvement. As part of this, a voluntary headcount reduction program was introduced in the second quarter. This will result in an around 20% reduction in the parent company's headcount by the end of this year. Together with further cost cutting initiatives, we expect to improve the company's margin in the future.

Let me now continue the segmental analysis with our Hungarian mobile operations. While penetration reached almost 89% by the end of June, the market share of T-Mobile Hungary only slightly decreased and the company maintained its leading position with a more than 10 percentage point advantage over the second largest operator.

In the first quarter we talked about a slowdown in market expansion, flat tariffs and high migration of customers towards more favourable packages. This trend further strengthened in the second quarter: while competitors have not reduced nominal tariffs, customer migration remained very strong thus the average tariff level decreased further.

Although we witnessed an over 10% decrease in the average tariff level, revenue per user remained broadly flat on a year-on-year comparison. This is thanks to the increasing role of price elasticity and mobile substitution. Customers are recognizing the savings they can achieve by choosing the most suitable package according to their usage patterns, and as a result are increasing their usage. As the mobile premium over the fixed line practically disappears with conscious package selection, customers, especially business clients, are increasingly migrating their traffic to mobile. T-Minutes, our latest offer, further improved the price perception of T-Mobile Hungary boosting usage. The package offers a high amount of minutes within the network and in the wireline direction for a fixed monthly fee, available to both postpaid and prepaid customers.

All these trends have contributed to a significant increase in usage: monthly usage per customer increased by 8% while the customer base also increased by 4% year-on-year. Although the increasing usage could stabilize traffic revenues, it had a negative effect on the cost side as outgoing traffic also increased. As a result, payments to other network operators increased by 15% year-on-year, decreasing the service margin of the mobile segment.

All three mobile operators have reduced their acquisition cost as a result of the falling service margin. At T-Mobile Hungary, acquisition cost of new customers decreased by 30% on a year-on-year basis, mainly driven by the lower handset subsidy. The decrease was higher in the prepaid segment, at over 40%.

Besides decreasing acquisition costs, we are trying to reduce other cost items, especially other operating expenses, to counterbalance the negative trend in the service margin. We expect to realize significant savings in marketing expenses and on agent fees. Besides reaching more favourable fees by renegotiating agent contracts, we are promoting the electronic refill of vouchers. We are also profiting more and more from the purchasing power of the T-Mobile Group, and were successful in decreasing procurement costs by using electronic auctions.

Looking ahead, T-Mobile Hungary will continue its balanced focus on maintaining both profitability and its leading market share. We expect the trends seen in the first half of the year to dominate the second half as well, thus the service margin is likely to remain under pressure. Nevertheless, falling acquisition costs and general cost cutting measures are expected to support profitability.

In terms of 3G, we are working on the rollout of the service. The test network now covers the inner city of Budapest and we plan to start commercial service by the beginning of the fourth quarter.

Moving to the international mobile operations, here we also have to split the figures between our Macedonian and Montenegrin subsidiaries.

The Macedonian mobile market is still characterized by strong competition. The rapidly growing penetration rate reached 54% at the end of the second quarter. Revenues in forint terms grew slightly by 1%, while the increase in local currency terms was almost 5%, showing the negative foreign exchange impact. Although the customer base of Mobimak increased by 28% year-on-year, the prepaid portion in the net sales was almost 90% in the first six months, thus customer growth did not result in a similar incremental revenue growth. In addition, competition-led price erosion has put pressure on revenues.

Reflecting the high profitability and cost efficiency of our Macedonian mobile operations, EBITDA margin almost reached 54% in the first half of 2005. Looking ahead, MobiMak will implement further initiatives in order to maintain high margins and preserve its strong leadership position.

I would also like to say a few words on the Montenegrin mobile market and give you some general information.

Two mobile operators are present in the Montenegrin market: ProMonte, which belongs to the Telenor Group, and Monet, the Telekom Montenegro subsidiary. Monet, which started service four years later than ProMonte, is the second operator with around 43% market share.

First half 2005 Results Conference Call

August 11, 2005 at 16:00 CET

I would like to highlight that the seasonality in mobile usage is especially high in the Montenegrin mobile market. This is due to the tourist season in the summer months, when a high number of visitors travel to the seaside. These tourists usually buy a prepaid card rather than using roaming services. This results in high customer growth in the prepaid segment and an increase in usage in the second and especially in the third quarter; and a significantly higher churn rate and usage drop in the fourth and first quarters.

Although the tariff level of Monet is somewhat lower than that of ProMonte, we first want to compete and increase our market share by introducing new quality services. The vast majority of value added revenues currently come from SMS services, although the network is able to provide both GPRS and EDGE related services, where we see good potential for the future.

As the penetration level at the end of June stood at 76%, we also have to concentrate on customer retention. Therefore we have introduced a loyalty program for postpaid customers in the second quarter, and are also rewarding timely payment to improve collection.

Looking ahead, our aim is to improve the company's profitability by exploiting the opportunities available to us as a result of being part of an international group and through synergies arising from TCG's integration into the Group. The EBITDA margin of Monet was above 41% in the second quarter.

(PAUSE)

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)

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 also 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.