

## **Third quarter 2008 Results Conference Call**

November 6, 2008 at 15:00 CET

*Conference call operator introduces call*

*Chris Mattheisen remarks*

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's third quarter 2008 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.

Magyar Telekom had a very active third quarter. We launched the rebranding campaign, which introduced the T-Home brand coupled with several new offers and bundled packages, and also started the sale of iPhones in Hungary. We have announced our fiber roll-out program, which will determine the development of our fixed line business in the coming years. We also made progress in further improving efficiency as we reached agreement with the trade unions both in Hungary and Montenegro, enabling further headcount reductions. But let us go into more detail.

The first half of 2008 was dedicated to leveraging the profitability improvements of the earlier integration and restructuring steps; the results of this could already be seen in the first half financials. The reserves built up in the first two quarters were necessary to support the intensive marketing campaigns in the second half of the year, which are aimed at stabilizing our leading position in the fixed line voice and broadband markets in Hungary. Accordingly, the third quarter was marked by a very focused advertising campaign launching our T-Home brand in Hungary, coupled with the introduction of several new double and triple play offers in our domestic market. In addition to these offers, the integration of our operations at the beginning of this year has enabled us to exploit our unique position in the Hungarian market and launch fixed-mobile bundles. We also launched the 3G-enabled Apple iPhone with great success in August.

We remain focused on improving our competitiveness in the Hungarian market by repositioning of our voice and internet packages. The third quarter results that we've announced today show that revenues declined by almost 5% compared to the same period of last year, mainly driven by customer and traffic churn in the fixed line segment but also regulatory impacts in the mobile business, coupled by an unfavourable foreign exchange impact at our international subsidiaries. However, we were able to maintain our high profitability with a healthy EBITDA margin of close to 43% on an underlying basis, despite the intensive marketing campaigns.

Although the third quarter results show the difficulties that we do face in all our markets, we maintain our flat revenue target announced for this year and revise our 2008 underlying EBITDA target from a slight decline to flat compared to 2007. Both revenues and underlying EBITDA include the reversal of provisions related to fixed-to-mobile termination rates accounted in the second quarter of this year.

Let me also say a few words on our fiber rollout plans. As announced, we aim to reach around 200,000 households by end-2009 and increase the number of households in Hungary covered by a fiber network to 780,000 by the end-2013. The new network will offer bandwidths with speeds of up to 100Mbit/s, allowing customers to enjoy multiple bandwidth-demanding services such as HDTV, video streaming and high-speed internet access at the same time. In addition, Magyar Telekom will upgrade its hybrid-fiber-coax network in an additional 380,000 households by end-2009 to provide a similarly high bandwidth to our cable customers. These network developments are an important part of our strategy to improve the quality and competitiveness of our fixed line offerings in Hungary. The 2009 investment need will be absorbed by the annual CAPEX spending of the Magyar Telekom Group, therefore the total amount of investments in 2009 will remain at the level planned for 2008.

Before starting with the segmental analysis, let me also touch on the turmoil in the financial markets and its impact on our business. There are signs that the financial crisis is already having a negative impact on the Hungarian macroeconomic environment. The fiscal policy restrictions aimed at reducing Hungary's reliance on external financing have substantially increased the risk of an outright recession; in line with this, analysts have significantly scaled back their GDP growth expectations for 2009.

We therefore expect further pressure on the demand for telecommunication services through lower household disposable income as well as fewer orders from business customers and the public sector. In addition, we will also experience higher financing costs in the future.

On the other hand, our financial position is strong thanks to the company's solid cash flow and strong balance sheet. The majority of our loans have a fixed interest rate and the average maturity of the loans is around 3 years. Although we do not have substantial facility expiring until the fourth quarter of next year, we have access to DT's financial pool which further decreases Magyar Telekom's refinancing risk. This not only reduces Magyar Telekom's exposure to the current financial crisis, but also allows us to exploit the opportunities that may arise from this situation, in particular lower asset prices in respect of potential acquisition targets.

Now let me turn to the segmental analysis, where I will start with the results of the **T-Com** segment. Due to the continuous voice revenue erosion, total revenues decreased by 9% in the third quarter of this year, while internet revenues were broadly flat. EBITDA declined by 13% while the margin reached 41%. However, excluding the severance payments in Montenegro, EBITDA margin remained stable at 42% compared to last year's third quarter.

Third quarter financial figures already show the difficulties that we face in the Hungarian fixed line segment. Revenues at T-Com Hungary dropped by 7%, driven by falling traditional voice revenues. Thanks to our previous efficiency improving measures, EBITDA margin was flat at 42% although, in line with revenues, EBITDA declined by 7% compared to last year's third quarter.

High churn numbers, the slowdown in the broadband market and the continuing advance of cable competition are having negative effects on our fixed line business performance. In addition, wholesale revenues declined further due to the consolidation of the international voice wholesale business within Deutsche Telekom since the beginning of this year. On the other hand, this consolidation is having a positive impact on our network and headcount costs leading to further efficiency improvements. Internet revenues were also slightly down in the third quarter – as we followed the pricing of our competitors – although increasing multimedia revenues offset some of these negative trends.

To address the competitive situation we decided to rebrand and reposition our fixed line services. We not only replaced our brands but introduced new, simply structured double and triple play offers, to become the leading triple play company in Hungary. These new packages are very competitive both in terms of pricing and quality. In addition, we announced our new generation access strategy to offer super-fast broadband access complementing our mobile broadband leadership. With the help of these initiatives we are able to offer attractive, high quality services to our customers with a fixed voice service bundled together with broadcasting and broadband services. As an additional benefit, we also expect the high churn rates in the traditional fixed line business to slow down as a result of these new offers.

In spite of the difficulties characterizing our services on traditional copper technology, our cable business again closed a successful quarter and showed a healthy EBITDA margin of 43%. Growth in our cable broadband subscriber base reached 28% compared to last year's number. Despite increasing competition for cable subscribers, T-Kábel was able to stabilize its cable TV customer base and even showed a 4% increase in multimedia revenues. To further increase our cable network we are continuously eyeing potential acquisitions in Hungary. In line with this strategy, we acquired a small cable company in July.

Turning to the fixed line business in Macedonia, revenues declined by 7% mainly due to the unfavorable foreign exchange effect, as revenues in local currency were only down by 2%. Competition further intensified, not only in the wholesale voice market where it was driven by the alternative operators, but also as a result of the mobile competitor, Cosmofon's fixed offers, which put pressure on our retail voice revenues. Cosmofon has grabbed a 2% market share in the fixed line market since its entrance in mid-June, which together with the strong mobile substitution led to a churn rate of above 5% at MakTel.

To offset the strong decline in voice traffic, Maktel is continuously focusing on broadband services. The number of ADSL subscribers more than tripled compared to September-2007 and the company's retail market share is around 50% of the Macedonian broadband market. Besides increasing the download and upload speed, we have also raised the monthly traffic included in all ADSL packages at the beginning of September. As part of the rebranding campaign, several double play offers containing voice and internet services have been introduced, which will be extended to triple play including IPTV by the end of this year.

Despite the pressure on our revenues, we were able to achieve an EBITDA margin of 49% in the third quarter. Profitability was helped by efficiency improvements, namely the lower headcount number as a result of headcount rationalization started in the second quarter of 2008, lower consultancy costs and savings in marketing expenses.

In Montenegro, fixed line revenues are still characterized by the continuous decline, which reached 35% in the third quarter compared to the same period of last year. The main reason for the drop was the significant decline in wholesale revenues, which could not be offset by increasing internet revenues. Due to the intensifying competition and severance-related payments totalling close to 1 billion forint, EBITDA dropped by 81% and EBITDA margin was only 12%. Adjusted for severance payments, EBITDA margin reached 31% in the third quarter of 2008.

The drivers behind the declining retail revenues are still alternative services and strong mobile substitution, while in the wholesale segment we are losing revenues due to Promonte's international traffic rerouting. Although there is a significant drop in wholesale revenues this year, which also has a negative impact on our EBITDA, this is expected to stabilize from next year.

To counterbalance these negative trends, our focus in the fixed line business is on enhancing efficiency and on broadband services. In the third quarter we reached agreements with nearly 100 fixed line employees to leave the company by year-end. Regarding our broadband services, we introduced new flat ADSL packages and a new IPTV package to strengthen our market position and maintain the pace of the growing broadband market. At end of September, our ADSL and IPTV customer base exceeded 30,000, representing a nearly threefold increase in one year.

Looking forward, we expect fixed line competition to strengthen further as regulatory requirements in line with EU regulation gradually come into force during 2009. To offset these negative impacts, we are determined to further increase the efficiency within the company and take advantage of the booming broadband market.

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

*Thilo Kusch remarks*

Thank you, Chris.

Let me start with the third quarter results of our corporate segment. Revenues at **T-Systems** declined by 5% compared to the third quarter last year, mainly due to the continuous fall in the traditional fixed line business revenues. System integration and IT revenues also decreased by 2% in the third quarter as a result of some delays in big SI/IT projects. We expect SI/IT revenues to increase in the seasonally strong fourth quarter and the growth rate for the whole of 2008 to reach around 5% in this revenue category.

Due to a one-time correction of cost classification between T-Systems and T-Com in the amount of half a billion forint, EBITDA was 32% higher compared to last year's figure. Excluding this impact, EBITDA increased by 17% and the margin reached 22% thanks to the increased level of integration across all our operations.

Building upon our strong mobile and fixed business competencies and the successful transformation of our company structure, we intend to further strengthen our presence in the corporate segment. This quarter, we won several important business contracts, among others, the managed LAN service for the FHB mortgage bank, and a managed voice contract for Borsodchem, which is a chemical company.

Looking forward, we expect 2009 to be a difficult year for the SI/IT industry, however the contribution of SI/IT will further increase in T-Systems' revenues. With the likely economic slowdown, we expect companies and the public sector to cut back their IT spending. On the other hand, the role of outsourcing services as a main tool to cut costs and improve efficiency at our corporate clients will increase, which is a great opportunity for T-Systems to gain new outsourcing projects.

Due to the unusually high uncertainty characterizing the external environment, we cannot at this point forecast the full impacts of the negative economic trends, but we feel that Magyar Telekom's business services are well positioned to face the challenges and even exploit the potential opportunities.

Having gone through the analysis of the T-Com and T-Systems segments, let us now look at the results of the mobile operations. Revenues of the **T-Mobile** segment were down by 3%, driven mainly by regulatory and unfavorable FX impacts at our foreign subsidiaries. Profitability, however, was still high, with EBITDA margin reaching 45%.

The Hungarian mobile market penetration surpassed 117% by the end of September, with further growth coming mostly from data cards. Market shares remained stable in the third quarter, thus T-Mobile Hungary maintained its leading market share at 44%.

Revenues at T-Mobile Hungary were broadly stable, as the higher value added revenues were able to offset the lower wholesale and visitor revenues. Several regulatory effects impacted the segment's results. Besides the 15% reduction of T-Mobile Hungary's mobile termination rates from January this year, the two EU-wide cuts in voice roaming tariffs are negatively impacting our roaming and visitor revenues. In addition, T-Mobile Hungary voluntarily reduced data roaming prices from the 1<sup>st</sup> of July 2008, which put further pressure on revenues. On the cost side, strong promotions in the third quarter increased equipment costs and marketing expenses. As a result, EBITDA decreased by 3% and the margin in the third quarter was 43%.

The cuts in mobile termination rates and roaming tariffs were the main drivers of the further erosion in average tariff levels, which the increasing usage and value added services, as well as the continuously improving customer mix were not able to offset. The increasing number of inactive customers further diluted average revenue per user, consequently, ARPU per SIM card declined by 10% compared to the same period in 2007.

Looking forward, the National Communications Authority has announced two additional 16% reductions of the mobile termination rates, which will apply to all three mobile operators symmetrically. The lower fees will come into effect from January and December 2010, and will put further pressure on our wholesale revenues.

Competition in the mobile broadband market continued, as all three operators maintained their focus on this area. The number of customers at T-Mobile Hungary increased by almost 70% exceeding 211,000 at the end of the third quarter, leading to 15% growth in the value-added revenues. In addition to improving the quality, we are continuously improving the coverage of our 3G network. As a result, our population based coverage has reached 63% and we provide services in more than 230 settlements. To take advantage of Magyar Telekom's unique position in the market, we have launched a package bundling unlimited download DSL and a 3GB download mobile internet for a monthly fee of less than 6,000 forint.

The iPhone 3G has been sold exclusively by T-Mobile in Hungary since August 2008 and T-Mobile also introduced two new tariff packages especially tailored for the iPhone 3G, including minutes of use, SMS messages and Internet usage. With these new packages, the features and capabilities of the iPhone 3G can be fully exploited, and thanks to this, iPhone customers' ARPU is nearly twice that of an average residential SIM card.

Turning to Macedonia, the market penetration here reached 106% as all three operators continued to emphasize customer acquisitions. Although the SIM-card based market share of T-Mobile Macedonia slightly decreased, the company maintained its clear market leadership position, and its active subscriber market share was 69% at the end of September.

Mainly as a result of the unfavorable foreign exchange impact, revenues decreased by 6%. Revenues and EBITDA in local currency were flat compared to the same quarter last year. The growth in the customer base and the improving customer mix were able to offset the decline in ARPU. Despite the strong competition, profitability was strong in the period, and EBITDA margin reached 57%.

Mobile revenues in Montenegro declined by 10% in the third quarter this year. Tariff declines induced by the strong competition and lower mobile usage could not be offset by the higher customer base, resulting in lower retail voice revenues. Due to the somewhat weaker summer season, visitor revenues also dropped this quarter; in addition, the third operator's free SMS offers had a negative impact on our value added service revenues.



Despite the negative revenue trends, we see encouraging signs that competitors are behaving more rationally from a financial perspective than a few quarters ago, with lower handset subsidies and less advertising activity indicating a normalization of the competitive environment. As a result of the improving market conditions, EBITDA margin was 42%, which is a clear improvement compared to margins in the first and second quarters. Nevertheless, competition is still strong in the Montenegrin mobile market and we expect increasing customer acquisition campaigns towards the end of the year.

*Chris Mattheisen remarks*

Thanks 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 want to send an e-mail you can address it to [investor.relations@telekom.hu](mailto: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.