

1 2015 Results Conference Call

May 13, 2015 at 15:00 CET

Good afternoon everyone and good morning to those of you calling from overseas. I am Marton Lennert, Magyar Telekom's Head of Investor Relations. On behalf of the Company, I would like to welcome you to our Q1 2015 conference call. If you have not received our presentation by email, please note that this is also available on our Investor Relations website.

Before we get started, I would like to draw your attention to the Disclaimer on the last slide. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties.

Now, let me introduce today's speakers who will take you through the presentation and answer any questions you may have. I am pleased to introduce Mr. Christopher Mattheisen, the Chief Executive Officer of Magyar Telekom; and Mr. János Szabó, the CFO.

And now it is my pleasure to turn the call to Chris to open the presentation.

Christopher Mattheisen:

Thank you, Marton. Good afternoon everybody.

Let's start today's call with a brief summary of what we have achieved financially at group level during this quarter. Then as always, we will go through the results of our four segments – T-Hungary, T-Systems, Macedonia and Montenegro. Slides 2 and 3 provide a summary of our strategic achievements and our operational performance across the various segments of the Hungarian telco market.

I am pleased to report that the positive trends in our operations achieved during 2014 have continued into the first quarter of 2015. On slide 4, you can see that our **group** revenues increased by 3.3% compared to the first quarter of last year driven by strong results from our mobile and energy operations. Thanks to the efforts made last year to invest in 4G networks

across our Hungarian and international footprints, our mobile broadband and equipment revenues significantly increased. We were also able to further enlarge our fixed broadband and TV customer base which partly mitigated the loss in fixed voice. Looking at our guidance for 2015, due to the planned exit from the residential gas market in August this year and the previously announced JV in respect of energy services to the business customers from the second half of this year – meaning that the results of these operations will no longer be consolidated –, we now expect roughly stable revenues in 2015 instead of an increase of up to 3% year-on-year.

The revision to the discount scheme in our energy business has not only helped us grow our revenues during the year but our overall margin as well. We also maintained our focus on cost control into 2015. Due to last year's headcount reduction, savings in employee related expenses, alongside other efficiency measures, have contributed to a 4.8% uplift in our group EBITDA. However, given the planned cut in FTEs this year that will lead to one-off severance expenses mostly in the fourth quarter and the recently announced sharp mobile termination rate cut in Hungary effective from April, our EBITDA performance in the coming quarters is likely to be weaker. Consequently, we maintain our year-end target of an up to 3% decline in EBITDA. Our spending on 3G/LTE was lower than in Q1 2014 but as we are due to start our fixed High Speed Internet access roll-out program in Hungary, we maintain our capex guidance for 2015. At the same time, stripping out the contributions made by our energy services business, we expect roughly stable revenues by 2017 compared to the 2014 level on a like for like basis.

On slide 5 you can see how different **segments** contributed to our revenue and EBITDA performance. The primary growth driver for the whole group is the Telekom Hungary segment driven by strong mobile performance and significant increase in energy revenues. Revenues were up by almost 8 billion forints which is a 7% increase compared to the first quarter last year. The higher gross margins and lower bad debts, coupled with savings in operating expenses, have led to a 12% increase in EBITDA. However, these very good results in the

residential segment were somewhat offset by continuous pressure on our large enterprise customer base where intense mobile competition has led to a lower mobile ARPU. The state-owned operator caused a further increase in our fixed churn. Our SI/IT sales were down due to the change in product mix and intersegment cost allocation. The lower telco margins pulled down the segment's EBITDA despite the lower employee-related expenses and the slightly improved SI/IT margin. János will elaborate on these trends shortly. Turning to our international subsidiaries, we had a very moderate revenue decrease compared to previous quarters as the mobile market continues to show signs of stabilization in Macedonia. The previously witnessed double digit declines in mobile revenue and overall EBITDA have slowed down, with the 25% increase in mobile data revenue – in part reflecting the success of prolonging our Christmas campaign into January – is also promising. However, in Montenegro, besides the decline in messaging and prepaid mobile revenues, the regulatory pressures on fixed voice and broadband continued to weigh, leading to an 8% overall revenue decline.

Let me now turn to the segmental analysis on slide 7, starting with **Telekom Hungary**, where revenues increased by more than 3% during the first quarter compared to the same period in 2014. We are proud of the fact that we were able to increase further our mobile customer base by 2% and ARPU by 4% among the Hungarian residential and small-medium size business subscribers. Our mobile data revenues grew by almost 16% which was driven by a very attractive device portfolio, which includes the iPhone6, and a strong 4G push that was supported by the network sharing agreement with Telenor in the countryside of Hungary. We witnessed an acceleration in prepaid to postpaid migration and an increase in the mobile broadband attach rate, which in combination with a larger flat rate customer base with a higher ARPU helped us to increase our gross mobile margin. We maintained our leadership positions in the Hungarian fixed line markets and, driven by the successful upgrade campaigns, we were able to achieve both higher TV and broadband ARPUs compared to the

first quarter of last year that also resulted in a better fixed line gross margin. A more streamlined business model in residential gas and electricity and further savings in employee related and other operating expenses have led to a 3.4 billion forint uplift in EBITDA.

On slide 8 you can see a 5% increase in our postpaid customer base driven by lower churn and higher prepaid to postpaid migration. Our postpaid ratio has now surpassed 50% and continues to grow at an increasing pace. There has also been an acceleration in minutes of usage due to the growing flat rate customer base but average tariff is slowly eroding. It is very encouraging to see that our significant efforts to increase the level of outdoor 4G coverage have paid off with 80% of the population now covered. Our LTE footprint significantly increased after the frequency tender in the fourth quarter of 2014 resulting in a three times higher 4G user base than last year. We are pleased to report that more than 540 thousand of our customers, equivalent to around 26% of the total mobile broadband customer base, now use our 4G network, enjoying the unique customer experience it provides. Our postpaid ARPU has increased by 2% despite the dilutive tariff effect of prepaid to postpaid migration. Thanks to our attractive device portfolio, smartphone sales represented over 90% of postpaid handsets sold in the first quarter of 2015.

We continued the restructuring of our customer base and revenue mix in our fixed line operations within this residential and SME segment. As shown on slide 9, we had 74 thousand broadband and almost 50 thousand TV net adds compared to the the first quarter of 2014 which helped us maintain our market leadership positions. The growth in the broadband market is driven by cable and VDSL as offering high bandwidth grows in importance for our customers. The increasing ratio of higher bandwidth packages due to upselling activities was driven by last year's network upgrades. We continued to focus on IPTV to offer more value to our customers. Almost half of our TV subscriber base already enjoys the benefits of the interactive television service for a higher monthly fee. Our migration activity and the price increase implemented last year helped us reach higher ARPU levels of 5% for TV and 1% for broadband compared to the first quarter of 2014.

We are proud to report on slide 10 that it would seem that we have finally turned the corner when it comes to loss of residential households. Fixed line customer erosion has been lowered to 1% this quarter thanks to the smart bundling strategy coupled with strong IP based migration. The number of homes with at least one fixed line service provided by Magyar Telekom has increased for the second quarter in a row after many years of decline and the average revenue generated per household is also increasing. However, fixed line voice ARPU is down by 4% driven by 5% lower minutes of usage.

The main reason behind the 26% growth in energy revenues is the revenue increase from the business sub-segment. Within the residential sub-segment, a narrowing of the discounts offered to residential customers compared to the regulated universal service prices and increased average gas consumption due to the colder winter in Hungary this year helped to mitigate the effects of a flat customer base and the unfavorable developments in the regulatory environment.

I will now hand over to János who will talk in more detail about the performance of T-Systems Hungary as well as our international subsidiaries.

János Szabó remarks

Thank you, Chris.

Let me please continue on slide 11 with the performance of **T-Systems Hungary** where revenues decreased by 14% in the first quarter, compared to the same period last year, mainly driven by a 19% decrease in System Integration and IT revenues and lower mobile voice and traditional fixed data revenues. The decline in the gross profit of the segment was somewhat more muted, falling by 8%, helped by the recognition of a major debtor that we had previously provided for. Despite the improvement in employee related expenses however, EBITDA in the first quarter declined by 17%.

Mobile revenues decreased by 6% due to mobile ARPU erosion driven by intense competition. However, we successfully maintained our customer base despite this pressure. Our mobile equipment revenue also declined significantly which was partly mitigated by the increased mass messaging and mobile broadband revenues.

Total fixed line revenues declined by 8%. On the voice side, we witnessed continued churn coupled with ARPU erosion. On the broadband side, the state-owned operator has caused significant churn among government related fixed data and broadband customers, and we lost 30% of our fixed broadband customers compared to the first quarter of 2014. Fixed data revenues fell by 14%, contributing to two-thirds of the overall fixed line revenue decline. We lost some major government related SI/IT deals and there was a change in the intersegment cost allocation; however, our gross margin level slightly increased due to a change in product mix.

Moving on to our international subsidiaries on slide 12, we are seeing stabilization in the rate of revenue decline which stood at 7% in **Macedonia** in the first quarter of 2015 compared to the same period in 2014. This is mainly due to lower mobile and fixed voice as well as wholesale revenues which were only partially counterbalanced by higher mobile data and TV

revenues. EBITDA also fell by 7% due to the lower gross margin partly offset by lower employee related expenses. However, our EBITDA margin remained at a healthy level of 40%. FX conversion between the Hungarian Forint and Macedonian Denar remained stable, compared to the first quarter of 2014.

Mobile revenues in Macedonia declined by only 6%, which is a great improvement compared to the previous quarters and we believe that the market is finally showing signs of stabilizing. We had a very strong Christmas campaign that was prolonged until mid-February, supported by an attractive device portfolio and our expanding 4G network. Equipment sales improved by 16% and mobile data revenues grew by 25% helping to offset the decline in voice. The decline in blended mobile ARPU decelerated sharply, slowing down to an 8% decline compared to the 21% drop we witnessed a year earlier.

In the fixed line segment we managed to keep our market shares despite the increasing competition from cable operators. In the meantime, fixed line revenues fell by 9% compared to same period last year mostly due to the lower retail and wholesale voice revenues. However, thanks to our interactive package bundling, the ratio of double and triple play customers remained at around 60% of the total fixed line base. We kept our price premium on the TV market while increasing our ARPU and we were able to increase our subscriber base by 10% leading to a 26% uplift in TV revenue.

Looking forward, we await new developments from the Macedonian authorities on the potential merger of our two competitors, VIP and ONE, to be announced soon. If approved, it is expected to significantly reshape the current competitive environment. In the meantime, we maintain our focus on increasing our LTE coverage and serving our customers on an All-IP fixed line network. FMC bundles also feature strongly in our marketing activity as the whole market in Macedonia becomes increasingly integrated.

At our **Montenegrin** subsidiary, in forint terms, revenues declined by 8% and EBITDA by 11%. Results were negatively impacted by the 0.3% strengthening of the forint against the euro. Excluding this FX impact, revenues were down by 7%, while EBITDA for the period decreased by 9%.

Mobile revenues in Euro terms declined by 6%, driven by the drop in SMS and voice revenues, caused by the lower mobile termination rates and lower traffic volume especially in the prepaid segment. This decline was only partially offset by the significant increase in visitor voice traffic and higher mobile equipment sales. Lower usage trends were reflected in minutes of usage and ARPU, which were down by 5% and 3%, respectively.

Fixed line revenues were down by 11% resulting from the lower voice, internet and equipment revenues despite the higher TV subscription numbers and revenues. The decline in voice and broadband revenues was mostly a result of retail price regulation effective from April 2014 coupled with lower laptop and TV sale volumes.

Looking ahead to 2015, we will focus on accelerating IP migration to ensure this process is complete by 2016, whilst delivering on our cash flow targets.

Chris Mattheisen remarks

Thank you very much, János.

That concludes the formal part of Magyar Telekom's conference call. Now, 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 you have any follow-up questions, please contact our Investor Relations Department. Please also note that the transcript of our conference call will shortly be available on our website. Thank you again for joining us today.