1Q 2016 Results Conference Call

May 4, 2016 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 2016 conference call. With me today are Mr. Christopher Mattheisen, the Chief Executive Officer of Magyar Telekom, and Mr. János Szabó, our CFO.

Before they take you through our presentation, 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. If you have not received our presentation by email, please note that this is also available on our Investor Relations website.

I would also like to highlight that we have introduced a **new reporting structure** as of this quarter, to reflect the further streamlining of our operations. The Group's new operating segments are Hungary, Macedonia and Montenegro. MT Hungary includes the former T-Hungary segment, which serves residential and SMB customers, and the former T-Systems segment, which serves enterprise customers. The Macedonia and Montenegro segments remain unchanged.

In addition to this change, we have implemented further improvements in our **Quarterly Financial Report**, which was published yesterday. We hope that the new and simplified structure makes the report easier to follow and provides greater insights into our operational and financial performance.

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 the first quarter of 2016.

I am pleased to report that the positive trends in our operations achieved during 2015 have continued into the first quarter of this year, boosted further by one-off gains. Although our headline revenue witnessed a decline compared to the first quarter of 2015, as you can see **on Slide 2**, this was primarily due to our decision to exit from the residential gas market and the deconsolidation of our B2B energy business. Excluding contributions from energy, our revenues continued to grow by 1.8% with the Hungarian segment maintaining its positive momentum, and growth in mobile and SI/IT revenues driving a revenue turnaround in Macedonia following 5 years of decline. Growth in Group EBITDA for the quarter accelerated to 13.6% year-on-year due to a combination of this underlying revenue growth, a sustained strategic focus on cost rationalization and one-off gains. We successfully sold one of our main office buildings and our media company, Origo, which resulted in one-off gains of 5.1 billion Hungarian forints for the quarter. Mirroring this growth in Group EBITDA and assisted further by an improvement in working capital levels, Group Free Cash Flow also increased by 11.2 billion forints, despite the incremental severance payout, loan repayment and a higher settlement of capex creditors. The net debt to total capital ratio improved further to 41.8%, and we are approaching our target range of 30-40%. During the first months of the year, we sustained our strategic focus on reducing costs through headcount reduction, product and process simplification and digitalization, including more online customer servicing.

On Slide 3, you can see our **group financials**. Current performance is in-line with expectations and we are pleased to reiterate our guidance targets; for the avoidance of doubt, the one-off gains in this quarter were as expected and already incorporated into our outlook.

On Slide 4, you can see how **different segments** contributed to our revenue and EBITDA performance. The revenue drop was principally driven by the Hungary segment due to the absence of energy revenues. On the other hand, I am very pleased to see a revenue turnaround in Macedonia following 5 years of decline, driven by growth in mobile and SI/IT revenues.

Thanks to the efforts made last year to invest in 4G networks across our footprints, our Group mobile broadband and equipment revenues increased significantly albeit they were partly offset by reduced voice wholesale revenues resulting from the sharp decrease in mobile termination rates in Hungary. Following the fixed access network upgrades, we were also able to grow further our fixed broadband and TV customer bases at higher ARPUs in Hungary, which contributed to overall growth of 2.3% in Group fixed line revenues. Group-wide rollout of our quad-play Magenta1 proposition based on the integrated Telekom brand has helped too in promoting our brand and services. We were also able to continue to grow our System Integration and IT revenues, an area of the market which we consider to offer significant development potential what we intend to target.

Let me now turn to the segmental analysis **on Slide 5**, starting with **MT Hungary**, where revenues declined by just under 9% during the first quarter compared to the same period in 2015 due in the main to the drop in energy revenues that I mentioned earlier. We are proud of the fact that our mobile revenues suffered only a slight decline despite the sharp MTR cut; or another way to look at it, is that if we ignore the MTR impact, underlying growth trends were positive. We were also able to increase both fixed broadband and TV revenues thanks to a growing customer base and ARPUs, and we continued to grow in System Integration and IT.

EBITDA in the MT Hungary segment increased by more than 17%. Besides one-off-gains, the underlying growth was driven by an increase in the gross profit matched with a fall in operating expenditure. Employee-related expenses improved due to the headcount reduction program implemented in 2014 and 2015 resulting in a reduction amounting to circa 2.0

billion forints, partly offset by a smaller proportion of project related employee related expenses which were capitalized in the quarter. The Utility tax expense is also lower due to the five-year utility tax credit following the network investments and upgrades that were implemented last year.

On Slide 6 you can see a 3% increase in our postpaid customer base driven by prepaid to postpaid migration thanks to strong demand for data. Our postpaid ratio is at 58% in Hungary and continues to grow. We are pleased to report that our **mobile** ARPU increased by 3.5%, excluding the MTR cut effect. Thanks to our attractive device portfolio, smartphone sales represented over 90% of postpaid handsets with total smartphone penetration now at almost 60%. Retail mobile market remained relatively stable due to the muted impact of UPC as the only MVNO and we do not expect Digi to enter the market before the fourth quarter of this year. However, we do see very strong price competition in the business mobile market encouraged no doubt by the higher than average market shares which we have in both the SMB and enterprise segments.

We continued to increase our **fixed** broadband and TV customer base as can be seen on **Slide 7**. We are proud to announce that we already have more than a million broadband subscribers in Hungary with an increasing share of high bandwidth tariff plans which have driven our ARPU up by 2%. We have continued to push IPTV sales to offer greater value to our customers in return for a higher blended TV ARPU as well. On the other hand, competition in the business sub-segment remained intense coupled with continued market share loss to the state-owned operator in the enterprise segment.

We are pleased to announce **on Slide 8** that the churn rate in our fixed voice customer base has remained at under 2%. We are working intensively on PSTN migration as we plan to shut down this legacy platform by the end of this year. The ARPU declined by 6% due to the competitive pressures coming from the cable operators. We continue to focus on our high-end residential fixed voice customer base enjoying the flat rate packages, called Hoppá, which is also a part of our quad-play Magenta1 proposition. The number of flat rate voice subscribers has now started to increase again thanks to Magenta1.

Turning to our energy business, we are happy to inform you that the joint venture that provides energy services for business customers started operating as of January 1, 2016. We transferred most of our B2B client into the JV but the universal business customers in the public sector still remain with us. Also, as you know, we exited from the residential gas market with effect from July 31, 2015 and we keenly await the expected forthcoming changes in the residential electricity market.

On Slide 9, let me highlight to you the results of our efforts made in bundling our services which is a key cornerstone to our strategy. On the upper two charts we break down our fixed line residential customers according to how many fixed line services they take from us on an individual household basis. We are pleased to say that we have continued the restructuring of our customer base and revenue mix in our fixed line operations and increased the share of the 3Play customers while the number of households with at least one Telekom fixed line service has remained stable. We witness lower churn among our double- and triple-play customers and our blended household fixed line ARPU increased by 3% mostly due to successful cross-selling activities.

With an integrated IP network and integrated T brand as the focus of our strategy, we continued to market our Quad-play offer, the MagentaOne proposition, achieving over an incremental 50 thousand sales which represents our most valuable, high-end customer segment.

I will now hand over to János who will talk in more detail about the System Integration and IT performance as well as our foreign subsidiaries.

János Szabó remarks

Thank you, Chris.

If we turn to **Slide 10**, you can see an independent estimate of the expected growth in the **System Integration and IT** services market for the next few years, driven by the significant potential opportunities in application development and integration. According to IDC's research, we are by far and away the market leader and we have continued to increase our market share, with the good trends reported last year having extended into 2016. In the first quarter of this year, our SI/IT revenues increased by 25% compared to the same period last year as a result of projects undertaken for financial institutions, utilities and public sector companies. Gross profit also improved, although admittedly at the expense of margin due to a calculated shift within the sales mix.

Despite this, I feel it is important to stress that the timing of future projects will be largely driven by receipt of EU funds into Hungary, which sometimes can be difficult to predict on account of their lumpy profile; as such, we do see some downside risk in the second half of this year due to the slowdown of fund inflows from the EU. We have previously discussed the significant one-off increase in SI/IT fees received in December of last year and how this was driven by the completion of large government IT infrastructure projects that was linked to the conclusion of the previous EU fund cycle - this should flag how it might not always be accurate to extrapolate historic trends.

Moving on to our foreign subsidiaries **on Slide 11**, we are proud to report the revenue turnaround achieved in **Macedonia** in the first quarter following 5 years of decline driven by growth in mobile and SI/IT revenues. Although the merger of One and VIP has created a strong integrated competitor on the market, we continue to witness market stabilization. Our successful rebranding campaign to integrated "Telekom", as well as the Magenta1 quad-play sales helped to increase our mobile market share in the first quarter. Besides increasing our customer base and the limited 2% decline in mobile voice ARPU, our mobile 4G broadband push contributed to the outstanding, 4% growth in mobile revenues. Fixed line revenues continued to fall by 4% compared to the same period of 2015, mainly driven by lower voice-retail and fixed equipment revenues. The decline in voice-retail revenue reflects lower traffic and customer base, partly offset by higher fixed line broadband revenues. At the same time, the TV customer base increased further and System Integration and IT revenues grew by 25%. Compared to the double digit declines of previous years in EBITDA, it was highly encouraging that the decline this quarter was significantly narrowed to a little over 3%, which is a combination of this turnaround in revenue together with a lower level of employee-related expenses. Looking forward, despite the risks stemming from the political environment in Macedonia, we believe in the sustainability of this current revenue turnaround which is expected to lead to higher margins, and ultimately, EBITDA growth.

At our **Montenegrin** subsidiary, total revenues declined by 3.5% compared to the first quarter of 2015 due to the competitive and regulatory pressures that continued to be felt across all major revenue lines. Mobile revenues declined by 2.6% reflecting a lower voice ARPU and a decline in both outgoing and incoming SMSs due to greater penetration by OTT services. However, this decline was partly kept in check by continued double digit mobile broadband subscriber growth, which led to an increase in mobile data revenues and mobile equipment sales. Following the successful launch of the Magenta1 quad-play offer in January 2016, the decline in mobile market share has reversed along with subscriber growth. Fixed line revenues declined by 2.7% driven by lower fixed voice and broadband ARPUs due to sustained regulatory pressures. The competitive environment has become more intense due to a stronger push of cable companies offering 3Play bundle offers; however, in spite of this, our TV revenues recorded a solid 6.6% rise. SI/IT revenues declined 21%, reflecting a different dynamic in the execution of ICT deals. Employee related expenses witnessed a 20.3% reduction following the successful outsourcing of our fixed line network plan and maintenance plans to Ericsson and helped to contribute to an overall 3.9% decline in operating expenses. However, this was not enough to offset the decline in revenues, the principal factor behind an overall 5.8% decline in EBITDA compared to the same period of 2015. Looking ahead, we believe that with fixed and mobile services continuing to converge, the launch of our quad-play offer Magenta1 will make us more resilient to these competitive and regulatory headwinds, through being better positioned to defend the strong market share that we have in fixed line voice and to grow our mobile subscriber base.

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 can 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 Márton or Gerda at 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 your continuous interest in our company and joining us today.