



## 3Q 2018 Results Conference Call

November 8, 2018 at 15:00 CET

Good afternoon everyone. I am Péter Bauer, Head of Investor Relations at Magyar Telekom. I would like to welcome you to our third quarter 2018 results conference call. With me today is Mr. Tibor Rékasi, our CEO and Mr. János Szabó, our CFO, who will take you through the presentation and answer any questions you may have.

Please note that our presentation can be accessed via the link within the conference call invitation, and is also available in the Investor Relations section of our website.

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

I would like to inform you that Magyar Telekom has re-filed its Q3 report to address errors in our Basic earnings per share figures and the year-on-year figure in our indirect costs in the Hungarian segment. Please note that these changes only effect the relevant tables rather than the overall performance analysis for the quarter.

Now, it is my pleasure to hand over to Tibor to open the presentation.

*Tibor Rékasi*

Thank you, Péter. Good afternoon everybody.

I will first provide you with an overview of the financial results and operational achievements recorded at the Group level for the third quarter of 2018 and give an update on where we stand against our public targets. I will then hand over to János to take you through the results for each of the business segments in more detail.



As shown on Slide 3, in the third quarter of 2018, revenues continued to increase in both Hungary and Macedonia, where positive trends were amplified by the weakening of the forint against the denar. The 5% year-on-year increase in Group revenues was primarily attributable to growth in System Integration and IT revenues, supported by strong demand for mobile data in both countries.

The 6% year-on-year decline in Group EBITDA is mainly due to the absence of one-off items that positively impacted results in the third quarter last year, such as the provision reversal in relation to our terminated loyalty program in Hungary and project revenues linked to the FINA World championship. However, the longer-term trend remains positive, supported by continued revenue growth and cost savings measures.

As shown on Slide 4, both revenues and EBITDA for the first nine months recorded year-on-year increases of 7% and 2% respectively. Although Capex spend was at a lower level compared to the first nine months of 2017, this was purely due to different timing of investment activities which will accelerate in the fourth quarter to take us to our target of around 90 billion forints by end 2018. Free cashflow performance for the first nine months was slightly higher compared to last year thanks to higher EBITDA and lower investment levels. In the last quarter of 2018, we expect the combined effect of enhanced working capital, the sale of our headquarters and higher EBITDA to offset increased Capex levels and allow us to reach our full year free cash flow target of around 60 billion forints.

Now turning to Slide 5 I'd like to touch on the progress against our **strategic priorities**. During the quarter, we continued with the rollout of our high-speed internet **network** to provide superior quality to an increasing number of customers. I'm pleased to report that our mobile network has been rated the best Hungarian network for the third time in a row by the independent P3 Communications. We strongly believe that best in class network quality is one of the key



elements for long term success. As such, it is amongst our top priorities to complete the upgrade of our entire network within the next couple of years to be able to offer gigabit internet connectivity across the whole country.

Leveraging our network enhancements, we have renewed our fixed broadband **portfolio** to offer higher bandwidth, and introduced a new TV package offering a wider range of HD channels during the third quarter. The success of these initiatives is reflected in the continued growth of our broadband and TV customer base.

We also continued to play an active role in the IT market growth and once again participated in a high volume of infrastructure projects during the period. Whilst most of these projects have a comparatively lower impact on profitability, we see signs of increasing demand for higher margin services on the market. To enhance our ability to leverage these opportunities by creating tailored solutions for our IT customers, we have completed a resegmentation of our business customers taking into account future potential among various other factors.

In line with our efforts to simplify our service portfolio and promote **convergent packages**, we have renewed both our retail and business Magenta offers. For residential customers we now offer a 30% discount to their subscription along with higher subsidies on smart device purchases once they sign up for at least two fixed and one mobile service contracts with us. These changes have given a new impetus to growth in the number of Magenta households, which now represent one-fifth of our total household base. At the same time, for small and mid sized business customers, we relaunched Magenta Business packages which offer bundled bonus IT services dependent on the overall subscription value. As IT service penetration in this segment is comparatively low, we expect this initiative to increase awareness of the benefits of IT services such as cloud-based products.

We have also continued with our initiatives to increase **operational efficiency**. Besides our efforts to simplify our service portfolio, we have strongly promoted the use of electronic services



both in sales and customer care. To support this growth, we have renewed our so called Telekom app, which is now used by one-third of our mobile subscribers. In parallel, we have made a number of changes in our operational and organizational structure which will allow us to react quicker to market changes. Last but not least, we are also close to completing the relocation of nearly all our employees into our brand new, state-of-the-art headquarters. I strongly believe that this change will make a real difference in redefining our approach towards our customers and in day-to-day operations.

In **Macedonia**, given the competitive landscape, our key focus during the quarter was on fixed-mobile convergent offers. To increase the appeal of our local Magenta offer and mitigate price pressure, we have doubled the mobile data allowance within this package and made exclusive sport content available as an add-on. The benefits of these initiatives have already started to come through, with further increases in our postpaid mobile and fixed TV customer base as well as increased ARPU levels during the quarter.

*I will now hand over to János to provide you with further details on the performance of our business segments.*

Thank you, Tibor. Good afternoon.

Starting with **Hungary** on **Slide 6**, overall **revenue increased by 5% in the third quarter**, primarily due to significant growth in System Integration and IT revenues, alongside higher equipment sales revenues.

As in the previous quarter, we achieved revenue growth across all our major business lines. Mobile service revenues increased thanks to continued growth in demand for data, and subsequently mobile broadband subscriber numbers. We maintained our focus on pre- to postpaid customer migration which also positively affected our results in the third quarter. Our mobile data revenues continued to benefit from the positive impact of the data plans introduced



earlier in the year, as well as from the ongoing upgrades to higher data packages driven by increasingly data heavy everyday use of mobile devices. The significant rise in SMS revenues in the quarter reflects continued growth in demand for mass messaging services and strong mobile equipment revenues, supported by the rising ratio of high-end handsets in the sales mix.

Fixed service revenue improved moderately, thanks to growth in fixed broadband and TV driven by both positive market trends and our efforts to reach customers through fiber optic connections, giving them a broader range of options when upgrading their packages. The strong growth in equipment sales reflects the regulatory change which came into effect last October.

The System Integration and IT segment witnessed ongoing growth in the third quarter of 2018 mainly thanks to high demand for hardware and software projects. These projects, however, typically have lower profit margins and hence a dilutive effect on the gross margin.

Energy service revenues declined as a consequence of our exit from the residential electricity market in November 2017.

**EBITDA in our Hungarian operations decreased by 7%** year-on-year, due to a decrease in Gross profit and growing employee related expenses, which were partly offset by lower operating expenses. The decline in EBITDA was partially caused by the absence of one-off items which had a positive impact on Q3 2017 results. The increasing weight of SI/IT and equipment sales revenues, which are traditionally lower margin services, also contributed to the year-on-year decline. The increase in employee related expenses reflects the change in trainee employment status, a 5% wage increase for the year and a higher severance expense related to management changes.

**Slide 7** shows the key developments in the **Hungarian mobile market**. First, looking at the overall customer base, the significant upward trend in the post-paid ratio reflects our focus on



increasing the ratio of high value customers, as well as our ongoing efforts in the pre- to postpaid migration of our customers. These positive trends have translated into an 8% year-on-year improvement in our blended ARPU, with increases recorded in both prepaid and postpaid segments.

Mobile broadband subscriber growth continued into the third quarter, with a strong increase in 4G subscribers. As a result, over 70% of our customers now use our 4G network which transmits 90% of all mobile internet traffic. This trend has had a positive effect on overall mobile data usage, which is up by 71% year-on-year. And the gap between the average data usage of 3G and 4G customers continues to grow, with 4G subscribers now using more than three times the data of 3G customers.

**Slide 8** shows the continued growth in Broadband and TV customer numbers within our **fixed segment**, supported by the expansion of our triple play subscriber base. Consequently, despite general pricing pressure visible in the decline in overall fixed ARPUs, fixed blended household ARPU increased year-on-year as we have managed to grow the ratio of Multi-Play customers in our portfolio.

**Slide 9** shows the developments in the **Hungarian System Integration and IT segment**. In the third quarter, we witnessed further growth in revenues, again mostly fueled by hardware and software deliveries, primarily in the public sector. At the same time, with the growing infrastructure base, as mentioned earlier, we are now starting to see the first signs of rising demand for higher margin services in the fields of System Integration and IT implementation. While this is equally true for both public and private enterprise customers, small and medium sized businesses continue to lag behind in terms of IT service penetration. By bundling IT services into Magenta Business packages, we now offer some highly useful services free of



charge to these customers with a view to increasing overall demand for IT services in the SME segment going forward.

Turning to the performance of our **Macedonian operations**, these are shown on Slide 10 in the local currency to better reflect underlying performance. In local currency we recorded an increase in revenues, mostly driven by increases in the fixed and System Integration and IT segments. However, at the EBITDA level, this was offset by increases in direct costs and other operating expenses, resulting in a moderate year-on-year decline in the third quarter of 2018.

In the Macedonian market, a strong general trend toward FMC can be observed, with convergent offers gaining in popularity and both market participants expanding their customer base. With Telekabel looking to enter the mobile market as mobile virtual network operator, FMC competition is intensifying. However, we are optimistic that we will be able to maintain our price premium and continue to win and retain customers with our attractive bundle offers, which feature exclusive TV content and a doubling of mobile data allowances. By the end of the quarter, 35% of our serviced households had signed up for one of our FMC products.

In the **mobile segment**, revenue increased slightly as higher voice retail and data revenues offset the decline in wholesale and visitor revenues. Thanks to our attractive service offerings and the continued migration of customers from prepaid to postpaid offers, our postpaid subscriber base continued to grow by 6% year-on-year. This led to further improvements in churn and mobile ARPU despite intense price pressure in the postpaid market. The increase in data revenues was primarily driven by both an increase in the number of mobile broadband subscriptions and an improvement in mobile broadband ARPU.

In the **fixed segment**, the early recognition of an annual refund for Universal Service Obligation net costs led to one-off increases in voice retail revenues and fixed voice ARPU. Simultaneously, the continued underlying decline in fixed voice revenues was mitigated by an increase in



subscriber numbers in both the TV and fixed broadband segments. While intense competition continued to put pressure on broadband ARPU, positive growth in TV ARPU could be sustained.

**System Integration and IT** revenues continued to grow dynamically after last year's temporary decline. The growth was primarily driven by an increase in customized solution projects, such as integrated infrastructure management in the City of Skopje.

In terms of profitability, **Gross profit** remained broadly stable with the increase in revenues offsetting negative effects from a higher relative weight of lower-margin activities such as System Integration and IT, as well as higher subsidies for mobile equipment due to intense competitive pressures. **EBITDA** however, decreased moderately year-on-year, as after the drop in the second quarter, marketing expenses increased temporarily year-on-year.

*Tibor Rékasi 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)*

*If you have any follow-up questions, please do 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 and for your continued interest in Magyar Telekom.*