3Q 2015 Results Conference Call

Nov 5, 2015 at 15:00 CET

Good afternoon everyone and good morning to those of you calling from the Americas. I am Marton Lennert, Magyar Telekom's Head of Investor Relations. On behalf of the Company, I would like to welcome you to our third quarter 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.

Unfortunately, Mr. Christopher Mattheisen, the Chief Executive Officer cannot participate in our call today but we have with us Mr. János Szabó, our CFO, who as is customary will take you through the quarterly results. And now it is my pleasure to turn the call to János to open the presentation.

János Szabó:

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 nine months of 2015. Then, in-line with previous presentations, we will go through the quarterly 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 market shares across the various segments of the Hungarian telco market.

I am pleased to report that we have managed to sustain the positive momentum in our operations. After managing to turn around our revenue, margins and most latterly EBITDA in recent years, we have also managed to return to positive Free Cash Flow generation this quarter which will serve as cornerstone for the resumption of dividend payments after this year's earnings. We believe that we have secured our market positions by being a strong integrated fixed and mobile service provider and continuing the next generation network developments across all segments. We have launched our Quad-Play offer, called MagentaOne in Hungary and in Macedonia to maximize the telecommunication share of the household spending wallet. Whilst at the same time, we have maintained our focus on costs in order to become a leaner and more efficient company. The headcount reduction program has continued in Hungary and our strategic goal has not changed with regard to product and process simplification, including moving more of our customer servicing online.

Let me now give you a summary of our nine month performance in terms of revenue, EBITDA and CAPEX on Slide 4. Our **Group revenues increased by 2.7%** compared to the first nine months of last year, driven by continued improvement in all of our major revenue streams, with the exception of mobile. Our **mobile** revenue is down by half a percent overall due to the sharp MTR cuts in Hungary, offset to a degree by significant growth in mobile data following the Group-wide 4G push. We saw a 1% increase in **fixed line** revenues due to our continued focus on triple play customers and our **System Integration and IT** revenues grew by 13% in line with our strategy. Our **Hungarian energy** revenues were up by 21%, reflecting our conscious decision to place greater focus on the more profitable B2B segment, and this is even after our exit from the residential gas market as of 31st of July 2015. Our original guidance for the full year 2015 anticipated roughly stable revenues compared to 2014 and we maintain this guidance target in spite of exceptionally low mobile termination rates.

Our EBITDA performance improved by 3% year on year for the first nine months of this year. It was achieved not only through increasing the gross margin, mainly as a result of higher revenues and lower level of bad debts, but also through achieving significant recurring savings in employee related expenses. This is even after booking approximately half of the planned one-off Hungarian severance expense of around 8 billion forints in the third quarter; we expect to book the second half of this amount in the fourth quarter of this year.

Looking ahead to the rest of this year, building on our performance year to date and the fact that we do not foresee any major changes in the Hungarian mobile market, we feel comfortable that we will be able to match approximately the EBITDA reported for 2014. This is an improvement on our previous guidance which was for up to a 3% decline.

The **Group Capex** for the first nine months of 2015 was almost 60 billion forints as we accelerated the Hungarian fixed High Speed Internet roll-out program, in conjunction with the continuing PSTN replacement program. However, the vast majority of the planned next generation fixed access investment is still ahead of us, so we expect a significant increase in the fourth quarter. Our Capex guidance for this year remains at 105 billion forints.

<u>On Slide 5</u> you can see the breakdown **of our revenue and EBITDA** performance by sector, with a quarter on quarter comparison. Both Hungarian segments increased their revenues and EBITDA despite the 76% cut in mobile termination rates effective from the 1^{st} of April and the high severance-related expenses booked in the T-Hungary segment. To put this into context, revenues at Telekom Hungary for the third quarter increased slightly, driven by a strong fixed line performance and an increase in energy and IT revenues. The resultant higher gross margins and lower employee related expenses also contributed to a 2% increase in EBITDA in the third quarter this year. Moreover, these very stable results in the residential and SME segments were coupled with a 2% revenue increase at T-Systems Hungary. The System Integration and IT revenues continued to perform well, contributing to a 54% rise in EBITDA in our enterprise segment compared to the same period of last year.

After the successful approval of the merger of T-Mobile Macedonia and Makedonski Telekom, we are proud to announce that we introduced Telekom as our integrated brand on the market. The mobile market continues to show signs of stabilization but the merger of our mobile competitors created a strong integrated player. Overall, revenues fell by less than 2% at our Macedonian subsidiary thanks to the low drop in mobile revenues and significant growth in SI/IT revenues. On the other hand, EBITDA declined by 17% due to high direct costs and other operating expenses. In Montenegro, the increase in System Integration and IT revenues could not offset the decline in messaging and prepaid mobile revenues. The regulatory pressures within fixed voice and broadband continued to compress our margins.

Let me now turn to the segmental analysis <u>on Slide 7</u>, starting with **Telekom Hungary**, where revenues increased slightly during the third quarter compared to the same period in 2014. Due to the sharp MTR cuts, the decline in mobile wholesale revenue of approximately 4 billion forints could not be compensated for by the growth in mobile data. On the other hand, we managed to achieve significant growth in both fixed broadband and TV revenues thanks to the ever larger customer bases and higher ARPUs in each of these two areas. Higher fixed wholesale, data and SI/IT revenues were largely a reflection of the GTS acquisition whilst energy revenues benefited from our greater focus on the higher margin B2B sub-segment.

Our segment EBITDA increased by 2% year on year mostly with significant improvement in the gross margin. Despite the larger severance charge that was booked in the third quarter this year compared to the same period last year, we still managed to achieve overall savings in employee-related expenses following the FTE cuts.

<u>On Slide 8</u> you can see that we were able to keep our **mobile** customer base in the second quarter of 2015 compared to last year and the postpaid ratio has now grown above 51%, thanks to 77 thousand postpaid net adds. The 3% increase in our contracted mobile RPC was driven by strong demand for mobile data. Year on year, average minutes of use is 8% higher which is consistent with the growth in our flat rate subscriber base that is centered on the high end segments of our residential, small and medium business customers. Magyar Telekom's

4G outdoor population coverage in Hungary has now surpassed 95% penetration which puts us ahead of many of our European peers. We are pleased to report that more than 730 thousand of our customers now actively use our 4G network within the Telekom-Hungary segment, enjoying the unique experience it provides. This is more than one third of the total mobile broadband customer base which is increasing every month. An average 4G user now has 1.5 gigabyte monthly traffic on our robust LTE network which is almost three times more than what an average 3G user consumes a month.

We have continued the restructuring of our customer base and revenue mix within our **fixed line** operations in the residential and SME segment. As shown on Slide 9, we had 86 thousand **broadband** and 39 thousand **TV** net adds compared to the third quarter of 2014 which helped us to maintain our market leadership positions. Our focus has remained to offer quality home services on superior networks as we continue our extensive High Speed Internet network roll-out program. The increasing ratio of higher bandwidth packages due to upselling activities was driven by the network upgrades. We have continued to push IPTV sales to offer greater value to our customers in return for a higher monthly fee and reached 49 thousand net adds in a year. We are proud to report that our successful migration activity and the price increase implemented last year helped us to achieve ARPU growth for both TV and for broadband.

We are pleased to announce on Slide 10 that the erosion rate in our **fixed voice** customer base has remained at only 1% this quarter thanks to the smart bundling strategy we have executed. We are working intensively on PSTN migration as we plan to shut down this legacy platform at the end of next year. More than two-thirds of our customers already enjoy IP based telephony service and our fixed voice ARPU decline was limited to only 4%.

Having both an integrated IP network and integrated T brand as the focus of our strategy, we introduced a new quad-play offer, called MagentaOne, in line with many other Deutsche

Telekom subsidiaries. Our goal is to offer the best selection of our services and by focusing on cross-selling these services, we aim to cover the entire spectrum of household communication needs. With the offered discounts, we plan to lock in the customer base and maximize the share of the household spending wallet. Furthermore, we have witnessed much lower churn levels among customers subscribing to package bundles. Our ever growing MagentaOne subscriber base is definitely our most valuable, high-end customer segment.

Turning to our energy revenues you can still see an increase despite the fact that we exited from the residential segment of the gas market with effect from July 31, 2015. The main reason behind the 8% growth in **energy** sales is the revenue increase from the business sub-segment ahead of preparing to set up a joint venture.

Let me please continue on Slide 11 with the performance of **T-Systems Hungary.** I am delighted to announce that after several quarters of decline, in the third quarter of 2015, both **revenue** and EBITDA for this segment increased by 2% and 54% respectively, providing a solid foundation to achieve the turnaround in EBITDA targeted for full year 2015. The growth was driven by the material increase of 12% in SI/IT revenues compared to the same period of last year, albeit offset to a degree by lower mobile and fixed voice revenues, as well as a decline in fixed broadband and data revenues.

The gross margin of the segment improved by 9%, primarily due to a 3% decrease in the total direct costs driven by lower interconnection costs owing to the MTR cuts and an improvement in the level of bad debts, although there was a rise in SI/IT related and other direct costs. The lower level of bad debts is mainly due to the one-off write-off in the third quarter of 2014 of 0.9 billion forints of receivables due from a major T-Systems customer that was not repeated in this period. Savings in employee related expenses also helped to contribute to the 54% rise in EBITDA for the third quarter.

Mobile revenues declined by 5%, since the fall in mobile retail and wholesale voice revenues could be only partially offset by the improvement in mobile data and mass messaging revenues. Mobile voice and broadband revenues continued to erode due to competition remaining intense; however, we successfully were able to increase our mobile voice and broadband customer base by more than 7% and 13%, respectively. **Fixed line revenues** deteriorated by 17%, due to the significantly lower voice, broadband and data retail revenues. Similar to what we witnessed in the first half of the year, the presence of the state-owned operator among government related fixed data and broadband customers is the main reason for the significant churn of our fixed broadband customers when compared to the same period of last year. The material decline of 23% in fixed data revenues was a significant contributory factor to the decline in fixed line revenues of approximately 900 million forints for the quarter. At the same time however, blended fixed broadband ARPU improved by more than 3%.

Moving on to our foreign operations, starting with **Macedonia** on Slide 12, we were very pleased to launch the Quad-play MagentaOne proposition in the third quarter, following the Maktel – T-Mobile Macedonia merger in July and the integrated "Telekom" rebranding. The VIP and One merger in the country has created a strong integrated competitor, although they are still currently marketed as separate brands. The market stabilization experienced in the first half of the year continued and is reflected by the slowdown in overall revenue decline to under 2% compared to the 7% and 5% decreases witnessed in the first and second quarters. **Mobile** revenues declined only by 6%. The main proponents of this decline were the falls in voice retail and wholesale revenues, as well as the drops in SMS revenues, offset to a degree by the 17% growth in data revenues and 7% increase in equipment sales. In the **fixed line** segment, revenues fell by 7% compared to the same period last year. The decrease is due to lower retail voice and wholesale revenues, as well as shrinking equipment sales; however, what is encouraging is that TV revenues increased by 10% driven by a larger IPTV customer base and higher ARPU. Furthermore, we are proud to report that the outstanding SI/IT performance we witnessed in the first half of the year has been sustained.

Gross margin fell by 10% driven by increased direct costs due to higher interconnection costs and SI/IT service related costs, contributing to EBITDA being 17% lower. Higher marketing expenses in relation to the launch of the rebranding campaign and the MagentaOne Quad-Play offer were also contributing factors to this decline.

As shown on Slide 13, at our **Montenegrin** subsidiary, revenues decreased by 5% in the third quarter of 2015, while EBITDA declined by 23%. **Mobile** revenues decreased by 9%, mostly driven by lower voice revenues due to shrinking RPC and traffic compared to the same period of the previous year. We recorded an increase in mobile ARPU this quarter as we continued to lose lower ARPU prepaid customers, thereby improving the customer mix. SMS revenues continued to decline on account of the OTT push, while our data and equipment revenues increased. Similar to the first half of the year, regulatory price caps materially affected the **fixed** voice and broadband ARPUs. Data revenues decreased mainly due to the transition of regular data customers to ICT, where data services are bundled with managed services. The drop in fixed revenues was offset to a degree by a marginal increase in the TV customer base and ARPU. **SI/IT** revenues increased by 32% driven by an increased number of ICT projects compared to the third quarter of last year. At the same time, SI/IT related costs also rose, similarly with interconnection costs and bad debt expenses, which led to a 10% fall in the gross margin. Other operating expenses increased due to the outsourcing of our network plan and maintenance activities to Ericsson.

That concludes the formal part of Magyar Telekom's conference call. Now, operator, when you are ready, I am ready to take the first question.

(Take questions)

(Take questions)

I believe we have time for one more question.

(Take final question)

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 your continues interest in Magyar Telekom.