

4Q 2015 Results Conference Call

Feb 25, 2016 at 15:00 CET

Good afternoon everyone. I am Marton Lennert, Magyar Telekom's Head of IR. On behalf of the Company, I would like to welcome you to our full year and fourth 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. We are about to follow the presentation slide by slide.

Before we get started, I would like to draw your attention to the disclaimer on the last page. 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 who will talk about the outstanding full year results and also our outlook for 2016 and 2017. Following that, Mr. János Szabó, our CFO will talk about the fourth quarter results in more detail.

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

Christopher Mattheisen:

Thank you, Marton. Good afternoon everybody.

Let me please start with the **outstanding results** we have achieved in 2015. It fills me with great pride to report that we have achieved our best set of financial results in many recent years. Our Group revenue of 656 billion forint is the highest turnover recorded since 2008, and our 2015 EBITDA of 187 billion has continued its upwards trajectory from 2012.

We have been able to sustain these positive trends and 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 status in the full year 2015. This will serve as the

cornerstone for the resumption of dividend payments relating to last year's earnings. Earlier yesterday, the Board of Directors decided to propose at the Annual General Meeting a dividend payment of 15 forint for a share.

On slide 2, we have summarized the most important **strategic highlights** that have helped us to achieve this excellent set of results. It is our strong belief that we have managed to consolidate our leading market positions through providing integrated fixed and mobile services, whilst continuing to develop next generation IP networks across all segments which will strengthen our technology leadership positions further. We launched our Quad-Play offer, called MagentaOne, in both Hungary and Macedonia last year to maximize the telecommunication share of the household spending wallet, with Montenegro following in January of this year. Meanwhile, 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 in Hungary has concluded and our strategic goal has not changed with regard to product and process simplification and digitalization, including moving more of our customer servicing online.

Regarding Hungary, I am pleased to announce that we have reached over 97% 4G population coverage and according to a number of various independent measures, we now have one of the best 4G networks in terms of speed, not only in Europe but also globally. We already serve almost a million customers on our 4G network. Moreover, we have rolled out High Speed Internet access to almost half a million households. Consequently, it was the growth in mobile and fixed line broadband and TV that drove the outstanding revenues in Hungary, along with a significant increase in System integration/IT and energy sales. I am also delighted to announce that after five years of decline, T-Systems has also managed to turn around its EBITDA and return to growth.

In Macedonia, following the merger of our subsidiaries, we successfully launched our integrated Telekom brand and MagentaOne offer there as I have already mentioned. This should help us to better withstand the challenges posed by the merger of our mobile competitors that will create a stronger integrated player, although the mobile market in Macedonia generally is now starting to show signs of stabilization. In Montenegro, we continued to witness intense competition in mobile, with regulatory pressures remaining prevalent in fixed line.

As shown on [Slide 3](#), our **Group revenues** increased by 4.8% to 656.3 billion forints in 2015, significantly ahead of our guidance of roughly stable revenues compared to 2014. Key drivers to this included the later than expected exit from the residential gas business coupled with outstanding B2B energy sales, the GTS contribution to fixed line revenues, as well as Group-wide System Integration/IT outperformance. In mobile, growth in data and equipment revenues counterbalanced the decline in voice wholesale caused by the sharp MTR cut. On the fixed side, higher retail broadband, TV and equipment revenues served to offset the decrease in voice and retail data revenues. At the same time, our strong focus on profitability resulted in higher than expected EBITDA with growth of 3.4% during the year driven by higher gross margins, not only in the energy business and SI/IT but also in the core fixed line and mobile businesses. Capex for 2015 totaled closed to 110 billion forint, slightly exceeding our target of 105 billion due to the intensity of the fixed line network rollout towards the end of the year.

The **segmental breakdown** of our exceptional revenue and EBITDA result for the full year can be seen on [Slide 4](#). Year on year, revenues of both Hungarian segments increased which was in contrast to our two foreign subsidiaries. EBITDA growth at Group level was principally

attributable to the T-Hungary segment, which is the business responsible for residential, and small and medium business customers, and this is even after booking severance costs to this division that were 3 billion forint higher than in 2014.

Let me now continue to Slide 5, and you will see that we returned to **Free Cash Flow** positive status in 2015. Our capex decreased by 40% to 110 billion forint for the full year, although it should be recalled that 98 billion forint was spent in the fourth quarter of 2014 on acquiring the Hungarian frequency licenses. Stripping out this and the additional capex of 20.5 billion that was spent in 2015 on developing the Hungarian fixed line network, on a like for like basis, capex increased by only around 2.5 billion forints compared to the previous year.

Looking to 2016 on Slide 6, we remain focused on the continued **execution of our turnaround** strategy which involves growing our profitability in line with our targets. The ongoing shift in our revenue mix, achieved by migrating customers to bundled packages across Magyar Telekom's operations, is expected to mitigate the decline in voice revenue. MagentaOne, the integrated fixed and mobile bundle that is our flagship product will be key to achieving this. Following our exit from the residential gas business and a move away from full consolidation of the B2B energy business with effect from January 1st of this year, we expect revenues of 580 to 590 billion forints in 2016, and have upgraded our 2017 revenue guidance to a range of between 585 and 595 billion forints.

Critical to improving our operational efficiency in the mid-term include the 2014 and 2015 headcount reduction programs in Hungary that have already been successfully completed and the continued replacement of legacy networks. Migration to All-IP and the replacement of our CRM and billing system will continue, along with building up our online capabilities that will help to reduce our costs radically in the long run. Although we expect our foreign

subsidiaries to continue, at least in the short term, to face operating headwinds, we believe that the rates of decline will continue to decelerate and our goal is to achieve turnaround in the upcoming years.

Overall, our reported EBITDA is expected to range between 187 and 191 billion forint in 2016, while our updated EBITDA guidance for 2017 is for between 189 and 193 billion forint. The growing contribution from System integration and IT activities across our geographies will play a key role in achieving our target of growing Group EBITDA from one year to the next. In terms of capex, despite continued network development, we expect an annual decline of approximately 10% in both 2016 and 2017.

I will now hand over to János who will talk in more detail about our fourth quarter performance.

János Szabó remarks

Thank you, Chris.

A summary of our **revenue and EBITDA performance** can be seen on [Slide 7](#) in terms of full year and quarter on quarter results. Both of the Hungarian segments helped Group financials grow despite a decline in both of our foreign subsidiaries.

The following page shows the breakdown of our revenue and EBITDA performance by sector in absolute terms, with a quarter on quarter comparison. The revenue growth was driven by T-Systems' SI/IT sales while the T-Hungary business fueled EBITDA growth for the Group.

Let me now turn to the segmental analysis [on Slide 9](#), starting with **Telekom Hungary**, where revenues increased by 2.5% during the fourth quarter compared to the same period in 2014. Mobile data continued to grow but was not able to offset the decline in mobile wholesale revenues of approximately 4 billion forints, a direct consequence of the sharp MTR cuts which was beyond our control. However, we managed to achieve significant revenue growth from

both fixed broadband and TV, a combination of enlarged customer bases and higher ARPUs in each of these two areas. Higher fixed wholesale, data and SI/IT revenues were largely a reflection of GTS acquisition whilst energy revenues benefited from our greater focus on the higher margin B2B segment.

Our segment EBITDA increased by 10% year on year primarily due to significant improvement in the gross margin. Employee-related expenses were higher due to provision recognized for severance payments being higher by 1.7 billion forints partly offset by recurring savings deriving from the headcount reduction program.

On Slide 10 you can see that we were able to increase our postpaid **mobile** customer base by 66 thousand in the fourth quarter of 2015 compared to last year. The 3% increase in our contracted mobile RPC was driven by strong demand for mobile data. Year on year, average minutes of use is 7% higher which is consistent with the growth in our flat rate subscriber base that is centered on the high end segments of our residential, and small and medium business customers. We are pleased to report that more than 730 thousand of our customers now actively use our 4G network within the T-Hungary segment.

We have continued the restructuring of our customer base and revenue mix within our **fixed line** operations. As shown on Slide 11, we had 63 thousand broadband and 35 thousand TV net adds compared to the fourth quarter of 2014 which helped us strengthen our market leadership positions. Our focus has remained to offer quality home services on superior networks as we extended our High Speed Internet network with more than 464 thousand homes passed. The increasing ratio of higher bandwidth packages within our sales mix is due to upselling activities driven by network upgrades. We have continued to push IPTV sales to offer greater value to our customers in return for a higher monthly fee and achieved 53 thousand net adds over the year.

We are pleased to announce on Slide 12 that the churn rate in our **fixed voice** customer base has remained at only 1%. We are working intensively on PSTN migration as we plan to shut down this legacy platform by the end of 2016. Our strategic goal for this year was to have one million IP costumers which we have now achieved. The fixed voice ARPU decline was limited to only 3%. 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 30 thousand sales which represents 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 this 6% growth is the revenue increase from the business sub-segment ahead of preparing to set up joint venture.

Let me please continue onto Slide 13 with the performance of **T-Systems Hungary**. I am really delighted to announce that the positive trends have continued and we managed to reach the targeted full year EBITDA turnaround in 2015. Compared to the same period last year, the total revenues increased by 57% boosted by an outstanding IT performance. SI/IT revenues effectively doubled in the fourth quarter of 2015 compared to the same quarter in 2014, driven by the completion of large government IT infrastructure projects in December that was linked to the conclusion of the previous EU fund cycle. Gross profit of the segment improved by 10%, albeit with a decline in the gross margin percentage due to a higher ratio of lower margin IT infrastructure projects. Competition in the mobile market remained intense resulting in a slight decline in both ARPU and mobile revenues, while the fixed line date revenues deteriorated further, mostly due to the presence of the state-owned operator.

Regarding the outlook for the next few years, we are committed to building upon the turnaround that we have already achieved, continuing to grow EBITDA and free cash flow generation. Within SI/IT, there will be a shift in focus towards higher margin system integration projects and integrated solutions. Whilst we expect a certain drop in revenues for SI/IT in 2016 compared to 2015 due to a pause between two EU fund cycles, we believe that the competencies built up in the banking, transportation and utility sectors, as well as the smart city project and international opportunities similar to the cooperation with OTE on the Coca Cola Hellenic Bottling Company deal, will provide solid foundations for future growth.

Moving to **Macedonia** on Slide 14, we are very pleased to be able to say that the successful rebranding integrated “T” campaign and MagentaOne proposition has helped to increase our mobile market share in the fourth quarter. Together with the mobile market showing signs of further stabilization, this contributed to a significant deceleration in the rate of mobile revenue decline, 3% for this quarter versus the double digit fall we witnessed in 2014. Fixed line revenue still continued its decline in the face of further voice churn, as expected; but the SI/IT business has managed to sustain the excellent performance that we last reported on at our third quarter set of results which we are very pleased about and fills us with cautious optimism. However, there was sharp drop in the gross margin which led to EBITDA falling by 15%. Concerning our future expectations we believe that the consolidation and stabilization that we are witnessing within the market will continue, and this should be able to provide the background for Maktel to execute a revenue, and later an EBITDA turnaround in the upcoming few years.

As shown on Slide 15, at our **Montenegrin** subsidiary, revenues decreased by 9% in the fourth quarter of 2015, while EBITDA declined by 15% due to a fall in margin. Mobile revenues decreased primarily due to lower mobile prepaid RPC, as well as declining SMS revenues in the face of OTT providers growing their market share. Similar to the first nine

months of the year, regulatory pressures materially affected both the fixed voice and broadband revenues. Regarding the outlook, we anticipate a stabilization in revenues, as well as an improvement on the cost side driven by the efficiency improvement projects such as network outsourcing to Ericsson and the recently introduced one billing system. Furthermore, we harbor cautious optimism about the futures sales success of MagentaOne following its recent launch.

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 today will shortly be available on our website. Thank you again for joining us today and your continued interest in Magyar Telekom.