

Q2 2009 Results Conference Call

August 6, 2009 at 13:30 CET

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's second quarter 2009 results conference call. I am Chris Mattheisen, Magyar Telekom's Chairman and Chief Executive Officer and I am hosting today's call together with Thilo Kusch, our CFO and a member of the Board.

During the **second quarter** of this year we faced further deterioration of the economic environment, the impact of which could be felt throughout all business units of Magyar Telekom. The trends and the impact of the economic downturn were very similar to those experienced in the first quarter of this year: traditional voice revenues, both mobile and fixed line, remained under pressure, churn remained at elevated levels and average tariff levels declined further. Both consumer and business clients remained cautious in their telecom spending as the significant uncertainty surrounding the economic outlook did not improve.

To offset these trends, we are increasingly focusing on initiatives which aim to improve customer retention and increase revenue from new services. We have also taken measures to reduce costs in all business areas by renegotiating supplier contracts and reducing operating costs.

For the second half of 2009, however, we expect competition to remain intense and the external environment to be very challenging. The austerity measures introduced by the government from July 2009, including the increased VAT level and lower subsidies and social contributions, further reduce household purchasing power in Hungary. Thus, we expect more erosion of traditional voice revenues, putting significant pressure on our EBITDA. In addition, EBITDA contribution of our international subsidiaries may be affected by exchange rate trends due to a potential strengthening of the forint in the second half of the year.

Based on the first half results and taking into account the unfavorable economic environment foreseen for the second half of the year, Magyar Telekom now expects a decline in revenue of approximately 2% and a decline in underlying EBITDA of up to 5% for the full year compared to the 2008 level, excluding the second quarter 2008 reversal of the provision related to fixed-to-mobile interconnection fees.

Despite the recession, we are still facing very intense competition, especially in the Hungarian fixed line market, where competitors are rapidly rolling out new and upgrading existing networks. In addition, unfavorable year on year foreign exchange movements and stronger than expected satellite TV equipment sales are also putting pressure on our CAPEX. In order to remain competitive and continue the strong growth of our satellite subscriber base, we decided to maintain our CAPEX guidance, which is flat in nominal terms compared to the 2008 level. This decision implies a 20% cut in fiber network investment for this year.

Let me turn to the analysis of Business Units, where I will start with the results of our **Consumer Services Business Unit**. Total revenues declined by 8% mainly as a result of the reversal of a 3 billion forint provision related to fixed-to-mobile interconnection fees accounted for in the second quarter of last year. Excluding this one-off impact, revenues fell by 4%, as a result of competition and the recession.

The fixed line market was characterized by high fixed voice churn and declining voice and internet revenues, but steadily growing TV revenues, resulting in a decrease of 6% in underlying revenue compared to the second quarter of 2008. Although we are continuously trying to mitigate the decline of the traditional fixed voice segment with retention offers, the PSTN churn remained high in the second quarter. Looking at internet revenues, despite the 10% growth in fixed broadband subscribers, revenues fell by 7%. Following the T-Home rebranding, migration to discounted packages was very popular, which together with the lower tariffs resulted in a 13% decline in broadband ARPU in the second quarter of this year compared to the same period in 2008.

One of our most successful products is the satellite TV service which we launched at the end of November 2008. Within roughly half a year the number of subscribers reached 88,000, of which almost 70% are 2Play or 3Play customers. Another advantage of the satellite TV service is its very small cannibalization impact. Based on our market surveys, only 4% of subscribers came from other T-Home TV services, while 57% were captured from competitors and the rest did not previously have a pay TV subscription at all. With this boost from the TV-focused strategy, the number of IPTV customers almost tripled compared to the June 2008 level.

As announced in May, we decided to further simplify the corporate structure of the Group by merging our cable subsidiary into the parent company. In addition to strengthening Magyar Telekom's market competitiveness, the merger will enable the company to increase cost efficiency by exploiting synergies of joint operation, facilitating cost reductions and optimal usage of financial and human resources. The estimated annual saving will be up to 1 billion forint.

Regarding the fiber roll-out, I already mentioned that we have somewhat reduced our fiber investments for this year. Instead of the originally planned 10 billion forints, we now plan an 8 billion forint investment in 2009. Accordingly, the number of households we intend to cover for this year has been reduced from 200,000 to 160,000, of which 100,000 households have already been covered by fiber by this time.

In the residential mobile business the main drivers are regulatory pressure and continued intense competition, especially in the mobile broadband segment. The recession is also putting pressure on the mobile business, although the situation in the second quarter of 2009 did not worsen compared to the first quarter of this year. We expect tougher times to come in the second half of 2009, when the government's austerity measures will result in decreased consumer activity. Compared to the second quarter of 2008 the higher churn rates, the increase of overdue receivables, fewer gross adds and slightly lower usage are all signs of lower disposable household income and higher cost-sensitivity.

In the last two quarters mobile penetration continuously declined due to double and triple SIM card rationalization and mobile operators cleaning up their customer portfolios. Penetration stood at 119% at the end of June 2009, while T-Mobile remained the clear market leader both in the mobile voice market with a 44% market share and in the mobile broadband market with a market share of close to 50%. Despite the difficult economic environment and strong competition, the number of our mobile broadband subscribers is growing steadily. Our non-voice revenues increased by 10% in the second quarter of 2009 compared to the same period last year. However, growing mobile broadband revenues could not counterbalance the drop in retail and wholesale voice revenues, so residential mobile revenues did decline by 3% in the second quarter this year.

As emphasized earlier, the recession accelerated the change in the revenue mix. We face continuous pressure on our EBITDA margin, as traditional voice revenues are eroding and new services with lower margin contributions are increasing. Although marketing and other costs were significantly cut at CBU compared to the second quarter of 2008, cost-cutting measures could not counterbalance higher employee related costs driven by the Group-wide wage increase from April and higher content- and TV-related payments mainly due to the broadcast and royalty fee paid for the satellite service. On an EBITDA level, excluding the 3 billion forint fixed-to-mobile interconnection provision reversal accounted for last year, EBITDA declined by 9% and the EBITDA margin was 57% in the second quarter of 2009.

As most of you probably know, VAT increased in Hungary by 5 percentage points from 20% to 25% from the 1st of July 2009, which will put pressure on household purchasing power in the second half of the year. In the telecom sector companies passed on most of the VAT increase to customers, so on average the prices of our residential products increased by around 4%.

Let me hand over now to Thilo who will provide further details on the results of the Business Services and the international subsidiaries.

Thilo Kusch remarks

Thank you, Chris.

Let us continue with the results of the **Business Services Business Unit, or BBU**. Total revenues decreased by 11% driven by the 5 billion forint reversal of the provision related to the fixed-to-mobile interconnection fees accounted for in the second quarter of last year. After this adjustment, 2009 second quarter BBU revenues were flat compared to the same period of last year.

The very unfavorable macroeconomic environment is of course having a negative impact, especially on our mobile voice services, as our corporate customers continuously rationalize their voice services spending. On the other hand, in the SI/IT segment we are still performing very well - in the second quarter our SI/IT revenues showed strong growth of 21%, thereby counterbalancing the falling voice revenues.

Regarding fixed line business performance, we do not see any meaningful change in the trends: churn rates are at high levels, tariffs are falling further, thus voice revenues dropped by 9% compared to the second quarter of last year, after adjusting for last year's provisioning reversal as referred to earlier. This negative trend is somewhat offset by continuing strong demand for our fixed line data products where we see minor revenue losses compared to last year.

In the mobile business second quarter revenues declined by 6% compared to the second quarter of 2008 as a combined result of further eroding voice revenues and increasing value added services mainly driven by data services. Due to the recession, corporate customers are focusing more on costs, rationalizing spending by returning unused SIM cards, limiting private mobile usage and continuously renegotiating tariff plans. As a consequence, mobile subscriber churn is significantly above its long term average and per minute charges are rapidly falling - this quarter effective prices were 19% lower than in the same period of 2008. In addition, further cuts in mobile termination rates also put pressure on our mobile voice revenues, which declined by 9% compared to the same quarter of 2008. On the other hand, due to growing mobile data revenues non-voice service revenues increased by 9%, somewhat offsetting the decline in mobile voice revenues.

Beside mobile data, SI/IT revenues are the main source of growth at BBU. After the strong first quarter we again closed a very good quarter in the SI/IT business. The second quarter SI/IT revenues were up by 21% compared to the second quarter of 2008, driven by both increased intergroup and external service demand. After consolidation, revenues were up 7%, still a very impressive result in the current very challenging market environment. At the end of the second quarter we launched our new virtual service portfolio enabling customers to use IT services, such as hosted mail, voice conference, desktop sharing or a remote server for a monthly rental fee without needing to make any investment.

On the other hand, we also face pressure on our SI/IT business margins as customers continuously drive down prices and foreign exchange rate trends move against us.

Turning to the cost side, the second quarter was characterized by strict operating cost control at BBU, however this was counterbalanced by the general wage increase from April and higher SI/IT related subcontractor payments in line with higher outsourcing revenues. After adjusting for last year's reversal of provision, EBITDA declined by 9% and the margin was down from 52% to 47% compared to the second quarter of 2008.

Considering our Macedonian and Montenegrin subsidiaries, total revenues in **Macedonia** increased by 13% in the second quarter of 2009 compared to 2008. Nevertheless, excluding the foreign exchange effect, revenues dropped by 4% and EBITDA increased by 24%, due to severance payments of 1.7 billion forint related to headcount reduction accounted for in the second quarter of 2008. This was also the driver behind the growth in the EBITDA margin from 45% to 58%.

Fixed line revenues, excluding the impact of the significant weakening of the forint, declined by 11% driven by increasing competition coming from alternative operators, including one mobile operator offering fixed voice service. Although liberalization started several years ago in Macedonia, fixed competition has continuously intensified in the last few quarters. As a result of fierce competition, Makedonski Telekom's market share in international incoming traffic decreased further.

Besides strong competition, the unfavorable economic environment also put pressure on the Macedonian business resulting in lower outgoing traffic and a high churn rate. At the same time, the number of ADSL and IPTV customers is steadily growing and somewhat easing the voice revenue decline, while the 2Play and 3Play packages are also showing signs of success.

Turning to the Macedonian mobile business, revenues in local currency increased by 4%. The higher RPC base and usage coupled with better customer mix offset the decline in ARPU resulting from continuous tariff decreases. T-Mobile Macedonia launched its 3G service in June 2009 and aims to cover 50% of the population by the end of this year. The 3G technology together with our exclusive iPhone offers will also contribute to the increasing non-voice revenues. Although the SIM card-based market share of T-Mobile Macedonia decreased to 59%, the company continued to maintain its clear market leadership position.

Moving on to **Montenegro**, total revenues increased by 9% in the second quarter of 2009 compared to the same period last year. However, excluding the foreign exchange impact, revenues dropped by 6% mainly as a result of a slight decrease in fixed line revenues and falling mobile retail and visitor revenues.

In the fixed line market, a high level of mobile substitution and lower traffic are driving the downward trend in our voice services. As a result, fixed line voice revenues in local currencies were down by 9% in the second quarter of 2009.

In contrast with the deteriorating traditional fixed voice business we still see healthy demand for our broadband internet and IPTV products. Nevertheless, due to the current unfavorable economic environment and increasing broadband penetration, broadband growth has slowed down recently. In response, we are offering restructured ADSL and new low-end IPTV packages to make our product more attractive for potential new customers.

Turning to mobile services, the stagnating economic environment and very intense competition are having a negative impact on the whole market. Although T-Mobile's subscriber base increased by more than 30% year-on-year, the significant drop in usage and tariff levels counterbalanced this very strong subscriber growth. In addition, the weak tourist season is putting pressure on our visitor revenues. As a result, excluding the foreign exchange effect, mobile revenues in Montenegro decreased by 10% in the second quarter compared to the same period last year.

Let me also highlight two important events that happened in Montenegro during the second quarter. First, the Annual General Meeting in April decided on the legal merger of our fixed line and mobile companies that will bring further efficiency and tax advantages for the merged company. Second, thanks to strong cash generation in recent years, the Extraordinary General Meeting in June decided to pay a 50 million euro extraordinary dividend from retained earnings.

Before opening the floor for questions, I would like to say a few words about a recent change in Magyar Telekom's **financing** arrangements with our parent company Deutsche Telekom. Until now Deutsche Telekom financed Magyar Telekom via forint denominated loans, and so the ratio of FX loans within Magyar Telekom's loan portfolio was minor. From June this year, Magyar Telekom receives euro denominated loans from DT and hedges the related FX exposure through corresponding euro-forint swaps.

Although the foreign exchange exposure of Magyar Telekom will not change at all, the ratio of FX loans may reach 40% in the loan portfolio by the year-end and will further increase in the next years. The loans will be initially recognized at fair value and subsequently measured at amortized cost and the swaps will be measured and recognized at fair value in Magyar Telekom's books. Therefore, fluctuations of the forint/euro foreign exchange rate and yields may impact the profit and loss statements going forward. However, these effects will offset each other according to the maturity of the loan and the corresponding foreign exchange swap.

Chris Mattheisen remarks

Thanks Thilo.

That concludes the formal part of Magyar Telekom's conference call. I am now happy to open the floor for questions. 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 there are follow-up questions, I encourage you to contact our Investor Relations Department. The telephone number is 36-1-458-0424 or if you want to send an e-mail you can address it to investor.relations@telekom.hu. I would like to inform you that the transcript of our conference call will be available on our official website. Thank you again for joining us today, and for your continued interest in Magyar Telekom.