

First quarter 2009 Results Conference Call

May 7, 2009 at 16:00 CET

Conference call operator introduces call

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's first quarter 2009 results conference call. I am Thilo Kusch, CFO and member of the Board and I am hosting today's call.

Before starting with the quarterly results, let me give you a short explanation for our new **reporting structure** effective from this quarter. As you probably know, at the beginning of last year we introduced a new management structure, which reflects our integrated approach and our focus on customer segments rather than on technologies. This can also be seen in our simplified brand and product structure, which we launched in September 2008. We decided not to report according to the new structure until Q1 2009 to allow us to provide a clear comparison with the previous year.

The new business units are organized along customer segments, thus we have a Consumer and a Business Services Business Unit, containing all the services we offer our residential or corporate clients. The Group Headquarters now also includes the wholesale business, while the Technology Business Unit is responsible for the operations and development of both the fixed and mobile network as well as IT management. While the management structure also includes the ABCD unit responsible for alternative business and corporate development, due to its relatively small size we do not report it separately. For the international business, we are now reporting on a country basis and disclose group-level results for both subsidiaries. Due to the ongoing fixed-mobile integration process at both subsidiaries, separate fixed and mobile margins are starting to become less relevant there, although we still separate results at the revenue level.

Now let us turn to the **quarterly results** and the challenges that we face. First quarter revenues were down by 2% and underlying EBITDA declined by 5.6% compared to the same period last year. While competition remained fierce, especially in the wireline markets, the deteriorating economic environment could also be felt throughout all business segments of Magyar Telekom.

The major impact of the recession was seen in the traditional voice services, both in the residential and corporate segments, where usage, tariff levels and customer churn numbers all came under pressure resulting in declining revenues. While results from our growth areas of TV, mobile broadband and SI/IT services continued to increase, they were not able to offset the fall in the high-margin traditional services.

Although the economic environment has worsened since we announced our public targets for this year, we still believe that our targets can be achieved thanks to our new initiatives and the cost cutting measures we have introduced. At the same time, however, we do see further risks coming from the austerity package of the new government. As we are still waiting for the details and final decisions on the planned actions, we are not yet able to predict the exact impact on household disposable income and, consequently, on our performance.

In terms of revenues, seasonality and new initiatives, such as our successful TV service offering and the recent launch of the fibre optic packages, support our belief that we are on track to reach our original target of a 1% revenue decline. On the EBITDA level, additional cost cutting measures should help to reach the targeted 1 to 2% decline. We aim to achieve further cost cutting in marketing expenses, consultancy costs, agency and rental fees, material and maintenance fees. In terms of CAPEX, although first quarter spending was significantly above last year's level, it still represents only 19% of the annual target. The higher spending is mainly attributable to higher-than-expected demand for the satellite TV service and the accelerated fibre optic network roll-out.

Now let us turn to the **business unit financials**.

Let me start the analysis with our **Consumer Services Business Unit**. CBU provides voice, broadband and TV services both on wireline and wireless networks for residential customers and SOHO segment in Hungary.

In the fixed line market the main trends remained unchanged. Mobile substitution and cable competition continue to put pressure on our traditional fixed line business. At the same time line churn on the traditional copper technology remained.

We made significant steps in 2008 to respond to these challenges. We introduced the T-Home brand with a clear focus on competitive bundled products including the launch of a nationwide

satellite TV service. The integrated approach regarding our existing technologies resulted in a more transparent and unified service offering and pricing structure, thus enabling us to be recognized as a genuine triple-play service provider in the eyes of our customers.

These steps ensure that, going forward, falling traditional voice revenues are increasingly offset by rising TV and broadband revenues. In the first quarter we have seen growing demand for our double and triple play products, which also gave a boost to our IPTV product. In addition, the take-off of our satellite TV service exceeded our own expectations. In the space of four months we have gained close to 50,000 customers, around half of them part of a triple play, and a quarter part of a double play service scheme. In addition, the high churn in our copper network was mitigated by an increasing migration towards alternative and more favorable voice solutions like VoIP and voice over cable.

Looking forward, our new initiatives will further strengthen our fixed line business. We are continuously rolling out our fiber network and have finalized the upgrade of our cable network. The commercial service for the 40,000 homes already on the fibre network and the 350,000 homes on the upgraded Eurodocsis 3.0 cable network were launched at the end of April. These upgraded and newly built networks enable us to provide superfast broadband internet with a download speed up to 50 Mbit/second, complemented with interactive TV service, offering several HDTV channels.

The residential mobile business is also seeing the first signs of the recession. Both prepaid and postpaid customer churn rates have increased, the growing usage trend has slowed, and customers are postponing handset upgrades. We are also experiencing rationalization among customers with double or triple SIM cards. In addition, mobile operators are cleaning up their customer portfolio by not refilling inactive pre-paid cards and not distributing free SIM cards. As a result of these processes, penetration on the Hungarian market declined to 121% by the end of the first quarter. However, even within this difficult environment T-Mobile Hungary was able to slightly increase its market share to 44%. On the other hand, mobile broadband is rapidly growing; the number of customers exceeded 540,000 by the end of the first quarter, and T-Mobile remained clear market leader in this area with a market share of 52%.

In addition to the economic recession, strong competition and the stiff regulatory environment are having a negative impact on the CBU mobile business. Revenues dropped by 5%, mostly driven

by the continuous fall in wholesale revenues as a result of further cuts in mobile termination rates. The growing subscriber base was not able to offset the lower usage and eroding tariff level. As a result, retail voice revenues were down by 3% compared to the same period of last year. However, thanks to the rapidly growing mobile internet business, non-voice revenues increased by 5%, mitigating somewhat the fall in voice revenues.

The first quarter at CBU was characterized by strict cost control. Marketing costs, in particular, showed significant savings. As a result, despite a 5% decline in revenues, first quarter EBITDA only dropped by 2% compared to the same period of 2008, and EBITDA margin for CBU increased from 57% to 59%.

Let us now turn to the results of our **Business Services Business Unit, or BBU**. This segment offers not only wireline services including fixed voice, data, system integration and IT, but also mobile services for corporate customers, small and medium-sized businesses, as well as for the public sector.

BBU offers its integrated services to almost 3,000 large corporates and 46,000 small- and medium-sized enterprises. Besides KFKI and IQSYS, Dataplex and the TETRA service company, Pro-M is also part of this business unit in our new reporting structure.

Revenues of BBU increased by 4%, mainly driven by higher SI/IT revenues. This is thanks to our strategy of offsetting the declining fixed voice revenues with new revenue sources to address the challenges of contracting traditional voice revenues. As a result of market trends, however, the revenue mix is changing faster than we anticipated. The role of the SI/IT services is dynamically increasing, and the ratio of these revenues already reached one-third of total business unit revenues in the first quarter of 2009. The changing market and the increasing demand for ICT solutions confirms that we have chosen the right strategy and should now continue focusing on our strong SI/IT market positions in order to strengthen our up- and cross-selling capabilities. Nevertheless, the new revenue sources have a lower EBITDA margin, putting pressure on profitability, thus at the same time, we also have to focus on improving our efficiency in the near term through cost cutting, especially in light of the current economic environment.

There are several areas where we plan to cut costs in the BBU, including expenses related to training, consultancy contracts and marketing communication, as well as travel costs.

In the fixed voice market we are experiencing higher churn, lower usage and continuously declining tariffs as a result of strong mobile substitution, while the recession is also affecting our operations. The mobility premium further declined in the corporate segment; mobile voice tariffs are currently more than 50% lower than fixed voice tariffs due to the relatively high fixed line subscription fees, thus mobile substitution is putting significant pressure on our fixed line business. However, in contrast with the residential segment, the demand for internet and data services is still increasing, somewhat offsetting the significant voice revenue decline.

In the mobile market both retail and wholesale revenues dropped as a result of the economic recession and mobile termination rate cuts. The main driver behind decreasing retail revenues is the continuous tariff decline, as average revenue per minute decreased by 18% compared to the first quarter of 2008. This decline could not be offset by the higher usage and increased customer base. Although the total number of mobile customers increased, the economic environment also caused the churn rate to accelerate. Both corporate customers and small- and medium-sized businesses became more cost-conscious and started rationalizing their SIM portfolio. In addition, parallel to the increasing lay-offs, companies are giving back the SIM cards of former employees. However, demand for mobile broadband is still increasing; non-voice revenues already represent 20% of total BBU mobile revenues compared to 17% in the first quarter of 2008.

As I already mentioned, system integration and IT revenues were the main driver of increasing revenues within this business unit. SI/IT revenues increased by 29% in the first quarter of 2009 compared to the same period last year, mainly driven by higher outsourcing service revenues at IQSYS and infrastructure revenues at KFKI. Our experience to date is that the small and medium-sized businesses already started cutting costs last year, large corporate customers with longer decision-making processes reacted more moderately and started delaying projects around the end of the first quarter, while governmental projects are only now starting to be impacted. Thus, despite the good performance in the first quarter, we do expect the recession to have negative effects on SI/IT revenues throughout the rest of the year.

On the other hand, there are still opportunities in the outsourcing market, however, these projects have a much longer preparation phase and therefore are not expected to make a significant contribution this year.

Continuing with our Macedonian and Montenegrin subsidiaries, total revenues in **Macedonia** increased by 13% in the first quarter of 2009 compared to the first quarter of 2008, which can be fully explained by the 13% weakening of the forint against the Macedonian Denar. In local currency terms revenues were flat, while EBITDA dropped by 11% due to the 1.3 billion forint one-off gain from real estate sales accounted in the first quarter of 2008. This was also the driver behind the drop in the EBITDA margin from 62% to 55%.

In the fixed line business, further increasing alternative competition and the introduction of wholesale line rental is continuously putting pressure on our fixed line voice revenues. The strong competitive situation coupled with an unfavorable economic environment resulted in an annual line loss of 11% and a decrease in outgoing traffic of 25% compared to the same period of last year. On the other hand, the broadband market in Macedonia is growing. The number of ADSL subscribers increased further, reaching 106,000 at the end of March. As a response to increased fixed voice market competition, Makedonski Telekom introduced double and triple play products after the commercial launch of IPTV last November.

The slowing economy is also having a negative impact on the growth dynamics in the mobile market. Usage and subscriber growth slowed in the first quarter and penetration remained at 110% during the first quarter. Still, the subscriber base increased by 11%, which together with a more favorable customer mix resulted in an 8% increase of first quarter revenues in local currency compared to the same period of 2008.

Turning to **Montenegro**, total revenues increased by 5% in the first quarter of 2009 compared to the same period last year. Nevertheless, excluding the foreign exchange impact, revenues dropped by 7% driven by falling fixed line and flat mobile revenues. EBITDA increased by 4% in local currency terms and EBITDA margin was 34%.

Fixed line revenues, excluding the impact of the significant forint weakening, were down by 9% in the first quarter due to the competitive environment and significant mobile substitution in the voice market. We also face a decline in wholesale revenues due to Promonte's international traffic rerouting.

However, as the rerouting has been taking place since March 2008, we expect less of a negative impact for the remainder of 2009. On the broadband market we are witnessing continued growth.

The number of ADSL customers grew by 70% compared to the end of April last year thanks to the increased speed and more competitive pricing introduced in 2008.

Turning to the mobile services, excluding the foreign exchange impact, revenues were down by 5%, as the increase in wholesale revenues could not offset the retail revenue decline driven by lower usage and significant tariff decrease after the entry of the third mobile operator. Since May 2008, SMS and MMS termination rates were introduced at Promonte and T-Mobile, increasing wholesale revenues. From the beginning of May 2009, message termination rates also came into effect for the third operator. Besides further increasing our wholesale revenues in 2009, this step supports the competitive situation, as it will prevent the third operator from offering free SMS in all directions.

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 transcripts of our conference calls will be available on our official website. Thank you again for joining us today, and for your continued interest in Magyar Telekom.