

Second quarter 2008 Results Conference Call

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Conference call operator introduces call

Chris Mattheisen remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's second quarter 2008 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 member of the Board.

We are glad that we could repeat the strong financial performance of the first quarter in the second quarter of 2008. Revenues in the second quarter increased by 4%, while EBITDA grew by 15% compared to the same period last year. Excluding the severance payments and the investigation related costs, and also the one-time accounting impact related to the reversal of the provisions, more on that later, EBITDA was up by 1.2% and margin reached 43%. These results show our commitment to reducing costs and increasing profitability across the Group by building on the new management structure and increased operational efficiency.

The large-scale headcount reduction program announced last year is progressing to plan with end-June Group headcount down 14% on the end-June 2007 figure. This means that we have already accomplished more than 90% of our year-end target of reducing headcount by 15%. In addition, we made significant progress in simplifying the organization by creating a leaner management structure. As a result, managerial positions decreased by 38% at the parent company by the end of June. Accordingly, the positive effects of these cost savings and efficiency improvements are evident in the strong profitability of the second quarter.

Before starting with the segmental analysis, let me talk in a little more detail about the reversal of provisions, which had a significant impact on the quarterly figures. Based on a Ministerial decree, fixed line operators are required to pass on the mobile termination fee reductions to customers with universal service packages. The national regulatory authority carried out a detailed analysis this year about Magyar Telekom's compliance with this obligation.

In its resolution, the NRA determined that following the change of tariff packages, in 2004 and 2005 subscribers were given compensation that exceeded the level required by the decree. Based on this conclusion, Magyar Telekom has revisited its conservative approach to fixed to mobile revenue recognition and has released related provisions accumulated since 2004 in the amount of 8.5 billion forint. This impacted both the Hungarian T-Com and T-Systems segments in the second quarter of 2008. The release is cash neutral and has a positive effect on the profit reported in 2008.

Now let me continue with the segmental analysis, starting with the results of the **T-Com** segment. Revenue here decreased by 3% in the second quarter this year compared to the same quarter last year due to voice revenue erosion, partly offset by higher internet revenues and the one-time impact of the provision reversal. EBITDA improvement was driven by lower severance expenses and higher efficiency.

Excluding the provision release, revenues at T-Com Hungary decreased by 7% in the second quarter, driven mainly by the continued decrease in voice revenues, while internet revenues were flat. The increase of multimedia revenues could, however, somewhat offset the above-mentioned negative trends. On an EBITDA level, excluding the around 2.7 billion forint severance expense accounted in the second quarter last year and the release of provisions of 3.2 billion forint this year, we had a decrease of 3%. At the same time EBITDA margin reached 43% reflecting our efficiency improvements driven by successful headcount rationalization measures.

Excluding the above mentioned one-time effect, voice revenues were down by 12% in the second quarter of 2008, driven by a further decline in traffic and tariff levels, as well as higher churn. The total number of fixed lines decreased by 8% compared to June 2007. Closed-user-group offers of mobile, and double- and triple-play offers from our competitors, primarily cable, are the main causes of the customer churn and traffic decline.

The declining growth in the broadband market and the continuous decrease of the ADSL ARPU has led internet revenues to stagnate in the second quarter. The average revenue per user of ADSL customers was 5,400 forint in the first half of 2008, a decrease of around 13% compared to the same period in 2007. The composition of the broadband market is changing.

While cable broadband customers represent around 38% of the whole broadband market currently, more than 70% of the new broadband subscribers come from cable. Although there is still potential in ADSL, where the number of subscribers increased by 10%, cable broadband technology does seem to become more popular.

Our cable company, T-Kábel is also benefiting from this trend; the number of cable broadband customers increased by 37% throughout last year, reaching 100,000 subscribers at the end of June 2008. The increase in multimedia revenues is also a product of the growing cable market, as it reflects the higher number of cable TV subscribers and also the higher tariffs effective from the beginning of 2008.

The recognition of these changing customer needs led us to the decision to reposition the company and improve our customer experience. In September the T-Home brand will be introduced replacing the T-Com, T-Online and T-Kábel brands. This means that all home-based fixed-line communication and entertainment services will be offered under a single brand.

Simultaneously with the introduction of T-Home, Magyar Telekom's "T" brand and the residential and business mobile services T-Mobile brand will also be refreshed. Our aim is to better satisfy customer needs through the simplification of other integrated service offerings and we also expect our business processes to improve as a result of the change.

Besides the new brand structure, we are developing a new product structure with revised pricing. As part of the repositioning we will be focusing on double- and triple-play services launching new attractive offers. A renewed Magyar Telekom will be better able to leverage its competitive advantage of having a uniquely broad range of services in Hungary's telecommunications market.

Continuing with Macedonia, competition further increased in the fixed line market in the second quarter of the year. While the wholesale voice market remains very competitive, recently the mobile competitor Cosmofon entered the fixed voice market with residential offers, and alternative operators started to unbundle MakTel's lines. Increased competition and mobile substitution resulted in declining voice revenues that were partly offset by increasing internet, equipment sales and data revenues.

The broadband subscriber base in Macedonia is continuously increasing thanks to the ADSL campaign launched last year, despite very strong competition from cable operators. The number of customers exceeded 77,000, representing a more than 4-fold increase compared to June-2007. To make our ADSL products more attractive to customers, we have increased download and upload speed in all of our packages.

During the second quarter we successfully introduced the T-Home brand in Macedonia. Later this year we plan to further broaden our T-Home services with the introduction of IPTV and voice-over-IP products, enabling us to focus on double- and triple-play offers in Macedonia as well.

With respect to profitability, EBITDA decreased by 59%, mainly as a result of headcount reduction-related severance payments of 1.7 billion forint accounted in the second quarter of this year. In connection with this voluntary headcount reduction program 340 employees left the company in June. Without this severance payment, EBITDA declined by 24% and EBITDA margin reached 38% in the second quarter of this year, reflecting the strong competition and also provisions created relating to some legal cases.

In Montenegro, fixed line revenues were down by 19% as slightly decreasing voice retail revenues and significantly declining wholesale revenues could not be offset by the increase in internet revenues. Due to the intensifying competition in the fixed segment, EBITDA dropped by 25% and the EBITDA margin was 33%.

Retail voice revenues were down mainly due to the increased competition from alternative and mobile operators. We also see pressure on wholesale revenues driven by Promonte's newly established direct link with Telekom Serbia. Since March the mobile operator has been rerouting its international traffic via Serbia instead of using our transit services. Looking further, due to Promonte's rerouting we expect wholesale revenues to decline by around 40% in 2008. This will also have a measurable impact on EBITDA.

Our focus in Montenegro remains on broadband services. The number of ADSL subscribers almost tripled, exceeding 27,000, and our IPTV service is living up to our expectations; at the end of June the number of IPTV subscribers was more than 11,000. As a result, internet revenues grew by 72% in the second quarter of 2008 compared to the same period in 2007.

Let me now hand over to Thilo who will provide further details on T-Systems and T-Mobile segment results.

Thilo Kusch remarks

Thank you, Chris.

Good afternoon everybody!

I will start with the results of our corporate segment which is T-Systems. Revenues increased by 25% in the second quarter of 2008 compared to the same quarter last year. This strong performance was mainly due to the earlier mentioned one-time effect of the reversal of provisions created for fixed-to-mobile interconnection fees. EBITDA more than doubled and the EBITDA margin reached 40% in the second quarter.

Besides this accounting impact, the segment's EBITDA was further helped by the reversal of a 0.6 billion forint provision of the 1.5 billion forint bad debt expense that was booked in the fourth quarter of 2007 in relation to a long term IT outsourcing contract.

The transformation to the new company structure has been successful, with the benefits of extending the unified customer relationship management from corporate customers to small and medium-sized businesses starting to come through. The simplified internal processes have brought about a more efficient operation and enabled further headcount reductions at KFKI.

Having gone through the analysis of the T-Com and T-Systems segment, let us now look at the results of the mobile operations. The **T-Mobile** segment's revenues grew by 2%, while profitability increased further in the second quarter reaching a very strong EBITDA margin of 47%.

In Hungary amid strong competition and a stiff regulatory environment T-Mobile closed another very successful quarter. Revenue increase was mainly fuelled by the growing value added services, more than counterbalancing the negative regulatory developments on wholesale and visitor revenues. With the increasing popularity of mobile internet data cards, sales are growing rapidly, helping to offset the unfavourable EU roaming and mobile termination rates regulation on revenues.

Profitability increased further in the second quarter as the overall operation was characterized by strict cost control and T-Mobile acquired customers with lower handset subsidies than in the previous quarters. As a result, EBITDA increased by more than 7% and EBITDA margin exceeded 45% in the second quarter.

Penetration in the Hungarian mobile market continued to expand reaching 115% by the end of June-2008. A significant part of the increase in the penetration rate is due to the operators' distribution of free SIM cards and artificial refill campaigns. As a result, the inactive ratio has been rising continuously, reaching 11% of the total market. T-Mobile maintained its market leader position with a market share of around 44%, which still represents a close to 10 percentage-point lead over the second mobile operator.

In the second quarter average revenue per user continued to decline. Usage increase and improving customer mix were not able to offset the negative impacts stemming from continuous cuts in mobile termination fees, lower roaming tariffs and the general tariff decline in the Hungarian mobile market. In addition, the increasing number of inactive customers is also contributing to the ARPU erosion. T-Mobile Hungary had an inactive ratio of 9% at the end-June 2008.

Turning to mobile internet, we have seen very rapid growth in customer numbers as well as data traffic. The number of mobile internet customers increased by more than 70% in a year, reaching 184,000 at end-June. With the newest package launched on 1st of August, we are offering 3GB download for a monthly fee of 4,000 forints. On average, datacards have a similar ARPU to a voice SIM card.

We are continuously improving our 3G network quality, coverage and service portfolio to maintain growth in the mobile broadband market. We currently cover 59% of the population and provide 3G services in more than 170 towns of Hungary. An official mobile broadband definition has not been created yet, although we estimate our mobile internet market share to be similar to our retail voice market share. Due to the rapid growth in the customer base, mobile internet is playing an increasingly important role in our value-added service revenues.

Turning to Macedonia, mobile market trends seen after the entrance of the third mobile operator last autumn continued in the second quarter this year as well. Operators continue to focus on customer acquisition, thus penetration slightly exceeded 100% by end-June. At the same time, increasing competition is driving prices further down. In this challenging environment, T-Mobile Macedonia successfully maintained its clear market leadership with a market share of 60%.

Although tariff decline is putting pressure on ARPU, the 25% increase in the customer base, higher usage and the improving customer mix were able to offset the negative impacts of the lower tariff levels. As a result, revenues of T-Mobile Macedonia increased by 10% in the second quarter.

Profitability was very strong in the period. Thanks to a lower equipment sales ratio and lower handset subsidies, operating expenses were stable. Favorable cost developments coupled with the strong growth in revenues resulted in an EBITDA increase of 16% and an EBITDA margin of 59% in the second quarter this year. As a result of the regulator's decision to cut mobile termination rates by nearly 40%, a move which will most probably come into effect in September 2008, we expect some slowdown in the EBITDA growth rate in the second half of the year.

Mobile revenues in Montenegro declined by 5% in the second quarter compared to the same quarter last year. Although the customer base increased significantly, declining tariff levels and usage resulted in lower retail voice revenues. Visitor revenues also decreased as both competitors are able to benefit from significant synergies with their Serbian sister and parent companies in the field of roaming calls. We expect some further decline in visitor revenues this year due to the discounts offered by competitors. The strong growth within wholesale revenues was driven by SMS and MMS termination rates introduced recently to prevent the new entrant offering free text messages to customers, which caused value added services to decline.

Although aggressive competition is perhaps still the main characteristic of the Montenegrin mobile market, we are seeing some encouraging signs. Competitors cut back the scale of subsidies on handsets compared to the previous quarters, which also had a positive impact on our profitability. Although EBITDA decreased by 16% and EBITDA margin was 32% in the second quarter, compared to the first quarter of 2008 the trend is positive.

Chris Mattheisen remarks

Thanks Thilo.

That concludes the formal part of Magyar Telekom's conference call. We are 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.