

Fourth quarter 2008 Results Conference Call

February 24, 2009 at 16:00 CET

Conference call operator introduces call

Chris Mattheisen remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's fourth 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.

2008 marked an important milestone in the continuing development of the new Magyar Telekom. We made further significant steps towards becoming an integrated company, with a leaner organization, simplified brand structure and powerful and competitive product offerings from T-Home, T-Mobile and T-Systems.

In 2008 we created a new management structure and, in parallel, redesigned our branding structure. After the September launch, within just a few months our new T-Home brand had reached over 40% brand awareness among customers, an excellent result compared to the brand awareness of our competitors.

We also launched several important initiatives to improve our competitiveness and support the new T-Home brand. The introduction of the fibre optic program and our satellite TV service, in particular will ensure Magyar Telekom is well placed to face future challenges. We can report very positive customer reactions to our satellite TV launch. In the short time since the launch, the order volume is already well above expectations. We believe that by gaining a foothold in the TV market we can protect and even grow our voice and broadband market shares, in line with our strategic goal to strengthen Magyar Telekom's triple-play position.

As well as seeing through the transformation of the Group last year, I am glad to announce strong financial performance for 2008. Despite the strong competitive and challenging macroeconomic environment, the Group **fulfilled the public targets** announced for last year. We delivered broadly stable revenues, while reaching a slight increase in underlying EBITDA compared to our flat target. As a result, our underlying EBITDA margin was close to 42% in 2008, compared to 41% for the year before, reflecting our efforts to improve efficiency.

In terms of CAPEX, excluding the unexpected items such as the 3G license in Macedonia and other non-cash items, we reported a CAPEX to Sales ratio of around 15%, again in line with the announced targets.

Looking ahead, the general economic outlook and its potential impact on our business is still difficult to predict. Despite the very challenging environment and uncertain outlook that we face, not just in Hungary but in our international markets as well, we are targeting for 2009 a revenue decline of 1% and an EBITDA decline of 1 to 2% compared to the 2008 results, excluding both special influences and the one-off item related to the fixed-to-mobile provision reversal. In terms of CAPEX, as announced earlier, we aim to maintain the absolute amount at 2008 levels, despite the weakening Hungarian currency. This includes the previously announced investments in the fibre roll-out program. We are continuously monitoring the economic environment and its impact on our business and will communicate if and when our assessment of our outlook changes.

Today we have also announced, that the Board of Directors proposed a dividend payment of 74 forint per share to the approval of the Annual General Meeting. The proposed dividend payment reflects Magyar Telekom's strong cash

generation, but also takes into account the difficult economic and financial environment we currently face. The Annual General Meeting will be held on the 2nd of April, earlier than in previous years, and accordingly the record and dividend payment dates will be brought forward.

Now let us turn to the **fourth quarter financials**. Both Group revenues and underlying EBITDA decreased by almost 2% in the fourth quarter of 2008 compared to the same period of 2007. Underlying EBITDA margin was close to 36% in the last quarter of 2008. The slight decrease in revenues reflects the impact of lower prices in our fixed line segment, and, in particular, special broadband internet offers in connection with the rebranding campaign. On the other hand, T-Systems closed a strong quarter and our mobile business grew thanks to the improved performance at our international subsidiaries. The difficult financial and economic environment did not have a meaningful impact on our operations in the fourth quarter.

Let me start the segmental analysis with the **T-Home** segment. Due to voice revenue erosion in all three countries and declining internet revenues in Hungary, total revenues decreased by 7% in the fourth quarter of 2008 compared to the same quarter in the previous year. EBITDA improvement was driven by lower severance expenses.

Revenues at **T-Home Hungary** were down by 7%, driven by a continued decrease in voice revenues and declining internet revenues. High levels of mobile substitution, intensifying migration to Voice-over-IP and competition from Voice-over-Cable providers resulted in a 10% decline in the total number of fixed lines and 15% lower outgoing traffic compared to 2007. On an EBITDA level, excluding severance expenses of 11.5 billion forint accounted in the fourth quarter of 2007 and around 2 billion forint in 2008, EBITDA declined by 8% and EBITDA margin was flat at 38%.

Internet revenues declined by 9% in the fourth quarter of 2008, driven by the continuous pressure on broadband tariffs. Although the number of our retail ADSL customers increased by 8%, this was not enough to offset the lower prices. As a result of the price cuts carried out as part of our rebranding campaign, average revenue per ADSL customer was 5,300 forint in 2008, a decrease of around 11%. However, our cable company, T-Kábel has a stable market position and was able to increase the number of cable broadband subscribers by 20%, reaching 108,000 at the end of December.

In response to the difficulties facing our fixed line business, following the rebranding, Magyar Telekom has started to reposition itself as the leading triple play company in Hungary. The most important steps towards achieving this goal were the improvement in our fixed line network through fiber optic development and placing greater focus on broadcasting services.

As announced last September, we have started to roll-out the fiber network as part of our 5-year plan. By April we plan to cover 15,000 households with fiber-to-the-home and launch commercial packages offering bandwidths of up to 50Mbps. Thanks to significantly higher bandwidths, customers will be able to watch various high-definition channels on IPTV whilst simultaneously using extra high-speed internet.

Another important initiative was the introduction of our satellite TV service in November. With this step we expanded the geographic reach of our bundled products and became the only telecommunication company in Hungary capable of offering voice, internet and TV service nationwide. This technology offers premium picture and voice quality, several high-definition channels and electronic program listings. By the end of 2008, we already had more than 5,000 subscribers and an additional 13,000 orders, exceeding our highest expectations.

As a result of the repositioning to a triple play service provider and the greater focus on entertainment services, our IPTV product also strengthened, and the number of customers more than tripled compared to end-2007, to exceed 28,000.

Continuing with the fixed line business in **Macedonia**, revenues decreased by 7% in the fourth quarter of 2008 due to a decline in both wholesale and retail voice revenues. EBITDA was down by 26% due to the high amount of penalties and provisions created in relation to legal cases as some alternative operators filed lawsuits against Makedonski Telekom related to unbundling and leased line services.

Besides the strong competition on the wholesale market coming from alternative operators terminating a significant part of the international incoming traffic, we face increasing pressure from one of our mobile competitors, who has been offering fixed voice services since June 2008. In the fourth quarter, its aggressive marketing communication and promotions continued, which together with the strong mobile substitution resulted in a churn rate of 7% at Makedonski Telekom. In response to the retail market competition, we are exploiting our position and focusing on double and triple play packages. We have successfully launched our first triple play package in November 2008 following the launch of our IPTV product in Macedonia.

On the broadband market we are witnessing continued growth. The number of customers has doubled compared to the end of 2007 to almost 100,000 thanks to our initiatives to increase speed and monthly traffic earlier in 2008. Although 2008 was a very successful year when it comes to our ADSL product, as a result of decreased purchasing power we do expect the unfavorable economic environment to have some negative impact on broadband sales and the take-up of double and triple play packages.

In the fourth quarter of 2008 Makedonski Telekom started investing in a new generation fiber optic network with the aim of offering super-fast broadband access to its customers. By the end-2011, the company plans to cover approximately 57,000 households with its fiber-to-the-home network. The total Capex for this will be around 33 million euros for the three years.

Turning to **Montenegro**, the fixed line market is characterized by increasing competition and mobile substitution. In the last quarter of 2008, the drop in wholesale revenues was offset by the booming internet and slightly increasing retail voice revenues. In terms of profitability, a decrease in the high margin wholesale revenues put pressure on our EBITDA margin. In the last quarter of 2008 we reached a 2% revenue increase, while EBITDA decreased by 16%, resulting in a 29% EBITDA margin compared to a margin of 35% in the last quarter of 2007.

In the second half of 2008 we made important progress towards enhancing efficiency and slowing down fixed line revenue erosion. We agreed a headcount reduction of 100 employees with the trade unions and completed this program by the end-October. Thanks to our new flat voice packages, fixed line churn was stable in the last quarter of 2008, while our new broadband products made a significant contribution to increasing our top line revenues.

In 2009 we plan to continue with our focus on broadband. We believe that, with household broadband penetration at around 14%, there is still room for further growth in this market. However, the difficult economic environment in 2009 is likely to slow this process down. Moreover, this year we plan to introduce bundled fixed line products to the market to further strengthen our position and defend voice revenues. All in all, we think that our favorable market position and quality services will enable us to weather the difficult times ahead.

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

Thilo Kusch remarks

Thank you, Chris.

Let me continue with the fourth quarter results of our mobile segment.

Revenues of the **T-Mobile** segment increased by 2% on the back of good performance at our Macedonian and Montenegrin subsidiaries. However, regulatory influences and strong competition put pressure on our profitability, resulting in an EBITDA margin of 36% in the last quarter of 2008.

The **Hungarian** mobile market is still characterized by a strict regulatory environment and stiff competition. Average tariff levels at T-Mobile Hungary dropped by more than 14% in the last quarter of 2008 compared to the last quarter of 2007 and were not fully compensated by the 11% increase in the subscriber base. In addition, due to the continuous cuts in mobile termination rates, wholesale revenues are also decreasing. On the other hand, declining voice revenues were offset by increasing value-added service revenues thanks to our strong mobile broadband market position. As a result, revenues decreased by 2% in the last quarter of 2008. We are also experiencing pressure regarding profitability. Due to the lower revenues and higher handset subsidies, EBITDA declined by 11% in the last quarter of 2008 compared to the same period in 2007. At the same time, EBITDA margin declined from 40% to 36%.

While mobile penetration increased to above 120%, T-Mobile remained the clear market leader with a 44% market share. However, increasing penetration with a higher number of inactive voice customers and falling mobile termination rates are having a dilutive impact on our ARPU, which declined by 10% in 2008 compared to 2007. To offset the negative ARPU trend we are continuously migrating customers to postpaid packages resulting in a postpaid ratio of 39%.

Competition in the mobile broadband market further intensified. In the last quarter of 2008 T-Mobile introduced mobile internet packages with unlimited traffic, while Pannon doubled the traffic limits in the high-end packages. By the end of last year we had close to 240 000 mobile broadband subscribers, which represents an annual growth rate of almost 60% and also resulted in a significant increase in mobile internet revenues. Based on independent surveys, T-Mobile Hungary has currently the fastest mobile broadband network and the highest 3G coverage with 67% of the population.

Our strong market position is also supported by our exclusive iPhone offerings, which is positively impacting on both our image and financial results. iPhone customers use mobile internet on their handsets extensively and have above average voice traffic usage, and therefore a much higher average ARPU.

Continuing with **Macedonia**, the penetration rate slightly exceeded 110% by the end of last year. Although Telekom Austria-owned VIP, the third entrant, had until now been continuously increasing its market share, in the fourth quarter its market share actually declined as many of the SIM cards distributed free of charge following its entrance in the market churned out during the last quarter of 2008. T-Mobile Macedonia was the only operator which was able to increase its market share compared to the September-2008 position, exceeding 59% at the end of the year.

Revenues at T-Mobile Macedonia slightly increased despite the decline in average revenue per user. The 15% drop in ARPU was mainly a result of significant tariff reductions driven by tough competition. However, the 14% increase in the customer base and the favorable customer mix offset the negative impacts of the lower ARPU and the lower

wholesale revenues. The latter was driven by the 40% cut in termination rates in August 2008. Regarding profitability, EBITDA was flat with an EBITDA margin of 42%.

Let me also mention that in December T-Mobile Macedonia was granted a 3G license at a cost of 10 million euros. As part of the agreement, T-Mobile Macedonia is obliged to cover 50% of the population by the end of 2009 and increase the coverage to 80% by the end of 2011. Commercial launch of the 3G network is planned before June-2009 in Skopje.

In **Montenegro**, competition in the mobile market intensified significantly in 2007 with the entrance of the third operator. However, we see promising signs of a more rational competitive environment. As a result, revenues increased by 39%, EBITDA almost tripled and EBITDA margin more than doubled to 27%. In the fourth quarter of 2008 T-Mobile Montenegro further increased its market share to 36% and retained its market leader position in the postpaid segment.

Looking forward we expect the competition to remain strong. In addition, the gloomy economic outlook will also put pressure on our operations. Although in the last quarter of 2008 we did not feel any impact from the unfavorable economic environment, for this year we expect a weaker tourist season to have a negative impact on our roaming revenues; bad debt expense is likely to increase and more customers may delay their handset upgrades.

Having gone through the analysis of the T-Home and T-Mobile segments, let us now look at the results of the corporate operations. Revenues at **T-Systems** increased by 7% on the back of very strong SI/IT revenue growth and improving voice revenue trends. Supported by the stronger seasonality impact in the fourth quarter, SI/IT revenues increased by 14%, while the drop in fixed line revenues slowed to 3% in the last quarter compared to the same period of 2007. It should also be noted that the strong growth in SI/IT revenues was driven by higher intra-Group revenues. Therefore, these service revenues do not show up in the consolidated results, but do have a positive impact on the Group cash-flow. Regarding profitability, in the fourth quarter of 2008 underlying EBITDA margin was 23%, while underlying EBITDA increased significantly.

The EBITDA increase was due to higher revenues and lower underlying employee-related expenses, reflecting a more efficient operation, driven by the successful integration within the T-Systems segment. EBITDA also increased due to the reversal of part of the bad debt impairment created in the fourth quarter of 2007. We believe that these revenue trends confirm the justification of our strategy to build strong market positions in SI/IT in order to strengthen our up- and cross-selling capabilities.

The very difficult economic environment has not yet had a meaningful impact on our business operation. However, looking forward, there is an increased risk that some of our projects will be cancelled. On the other hand, we see a lot of opportunities in this environment in the outsourcing service market. That is why we intend to focus more and more on cost-effective bundled products to further strengthen cross-selling in 2009. We aim to develop new, unified communication products both for large corporates and the SME segment. For our top 50 customers we intend to supplement our service portfolio with virtualized products such as video communication, hosting and application service provisions.

In the current challenging market environment we believe that these developments will not only help us to retain our current customers, but also foster the acquisition of important new key customers in the business telecommunication market. Looking further ahead we are also aiming to obtain significant contracts related to EU-subsidized IT projects,

which will be a very important driver of growth. This will be especially true if the use of EU funds is accelerated due to the current economic environment.

Chris Mattheisen remarks

Thank you 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.