Q1 2012 Results Conference Call - FINAL

May 10, 2012 at 13:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's first quarter 2012 results conference call. I am Chris Mattheisen, Magyar Telekom's Chief Executive Officer and Chairman of the Board, and I will be hosting today's call.

We have today reported a group level growth in revenues of almost 3% thanks to improving retail trends, price increases implemented at the beginning of the year and rapidly increasing energy resale revenues. We are especially pleased about the rises in both our customer numbers and market share in Hungary. Our fixed line churn rate has halved over the past year, down from 9% in Q1 2011 to 4% this year, thanks to the Hoppá package, bundled offers and, of course, the energy resale services. The number of energy resale delivery points is growing rapidly as more customers benefit from the discounts we offer on energy prices. Growth in fixed broadband and TV customer numbers is also showing a healthy increase, mainly within bundled offers; approximately half of our fixed customers are subscribing to a double- or triple-play package. We have also seen positive trends in the mobile market where our customer base was up by 1% in the residential segment and 5% in the business segment. Our mobile market share increased by 1.5 percentage points year-on-year in a fully penetrated market. Thanks to these positive trends Telekom Hungary revenues increased by 3% in the first quarter. The T-Systems Hungary segment was again helped by increasing system Integration andIT revenues, and the international operations benefitted from a weaker forint.

However, underlying EBITDA declined by 5.5% and our EBITDA margin was down by 4 percentage points at 40%. This was due to real estate gains accounted for in the first quarter last year, and our changing mix of revenues, in particular the dilution impact of the energy resale. Without the energy resale business, underlying EBITDA margin would still be above 41% and we are confident that the retention and perception benefits of our new service, and its indirect impact on the absolute amount of EBITDA, vastly outweigh the negative impact on the margin.

Let me now turn to the segment analysis, starting with **Telekom Hungary**, where total sales increased by 3% in the first quarter; mainly thanks to our dynamically expanding energy revenues and a general price increase at the start of the year. Although our focus on cost-cutting initiatives remained strong, the increased proportion of lower margin businesses, including energy, led to an 8% decline in our underlying EBITDA, translating into a 5 percentage point decline in the underlying EBITDA margin from 44% to 39%.

In the fixed voice business, revenues decreased by 14% compared to the first quarter of 2011. Although the rate of revenue decline matches last years' number, the underlying negative trends seem to be slowing as a result of our Hoppá package. Although Hoppá was only launched at the beginning of 2011, by the end of the first quarter of 2012, the number of subscribers had already surpassed half a million. Moreover 90% of these have a 2-year loyalty contract. As well as being a great retention tool, Hoppá also facilitates our bundling strategy; more than half of our fixed voice customers subscribed to a 2Play or 3Play package by the end of the quarter.

Regarding the fixed internet business, we saw a 4% increase in broadband revenues compared to a 7% decline a year ago. This is mainly due to an 8% increase in the number of subscribers. The upsell to more advanced ED3 and fibre technologies could not compensate, however, the negative effects of multi-play migration as demonstrated by a 2% decrease in ARPU.

Turning to the TV market, the high single-digit growth appears to be sustainable as revenues increased by 8% year-on-year. This growth can be attributed to a 7% take-up in the subscriber base and a 2% growth in ARPU. Our popular IPTV and satellite services have attracted customers from other providers, increasing our market share by half a percentage point during the first quarter of 2012. Furthermore, our premium IPTV services prompted service upgrades by our cable TV customers in particular. We are targeting similar upsell opportunities to our satellite customers by introducing Hybrid TV, which enables interactive services in locations where there is no high speed internet or cable connection available.

Total fixed line revenues have decreased by 3% compared to the first quarter of 2011, as growth in TV and Internet revenues could not compensate for erosion in our fixed voice business.

Moving on to the mobile market, there was a moderate decline of 2% in the first quarter. Voice wholesale revenues declined mostly due to the mobile termination rate cut of 20% from beginning of this year, while retail revenues were flat as the growing customer numbers and higher usage could offset the decline in average tariff levels. Despite the decline in revenues, we have seen several positive developments. We managed to slightly increase our customer base and our SIM based market share grew to 45.3%, up from 43.8% in March 2011.

The increase in mobile internet usage and penetration also continued in the first quarter of 2012 and we now have more than a million mobile internet users, most of whom use the internet via their handsets, rather than dongles. Smartphone penetration among all T-Mobile handsets in circulation has increased from 11% a year ago to 21% currently. This demonstrates both past dynamics and future potential. In the first quarter of 2012, almost 80% of the post-paid handsets sold were smartphones, and more than three quarters of smartphone buyers asked for a mobile internet package to be included. We have also maintained our 48% market share in mobile broadband market.

In order to retain our competitive edge amongst the mobile operators, innovation remains one of our primary focus areas. We were the first to introduce an LTE service at the beginning of the year, and we continue to modernise our network to cover the whole of Budapest with fourth generation technology. In addition to this, we launched a branded reseller agreement with Lidl in February, in order to attract further segments of the prepaid market.

I would also like to highlight the key developments in our retail energy business. Energy revenues amounted to almost 6 billion forints in the first quarter, mainly due to the significant rise in the number of delivery points from 35 thousand at the end of December to 62 thousand at the end of March and the positive effects of an unusually cold winter. Although the low profitability of the energy business does dilute our group level margins, it serves as a great retention tool and improves the churn rates of higher-margin telco services.

Turning to the performance of **T-Systems Hungary,** revenues were broadly flat in the first quarter of 2012 compared to the same period last year. Although we recorded an increase of 7% in System integration and IT revenues, this was offset by a continuous decline of fixed line revenues, which fell by 13% overall. We are still seeing a high churn level among fixed voice customers and a strong price pressure in the corporate sector. Contract conditions with the Government have also changed unfavourably. These factors have had a negative impact on both voice and data revenues. Going forward, we expect that the majority of voice and data traffic in the public segment, which is currently transmitted via our network, will be migrated to networks operated by state owned companies.

The 1% decline in the segment's mobile revenues reflects a 20% cut in termination rates at the beginning of the year and strong pressure on our tariffs from intense competition and the adverse economic environment. These can be largely offset by the 5% increase in our customer base and higher usage. Although the number of mobile broadband subscriptions has increased significantly, revenues from mobile internet increased more moderately, reflecting the prevailing price pressure.

In the System Integration and IT markets we have seen some improvement in public sector spending, but a number of major projects remain on hold. The increase in System Integration and IT revenues was largely driven by one off revenues relating to equipment sales and installation. It was also supported by the consolidation of Daten-Kontor Group, which has been on-going since March last year. We have also managed to extend some major contracts, though in most cases they necessitated some price allowances.

However, the underlying EBITDA performance of T-Systems rose by 24% and underlying EBITDA margin improved by 4 percentage points to 22% thanks to strict cost control and lower mobile termination rates.

Regarding our **Macedonian** subsidiary, total revenues were down 5% reflecting a 9% weakening of the forint against the denar. Excluding the positive FX impact, revenues declined by 12% mainly driven by the decline in voice retail revenues.

On the EBITDA line, a one-off provision reversal, which occurred in the first quarter of 2011 and relates to a legal case, distorts the year-on-year comparison. However, underlying EBITDA, excluding this item, also followed negative revenue trends and decreased by 21% in denar terms. Meanwhile, we did maintain a healthy EBITDA margin of 47%.

Fixed line segment revenues in local currency decreased by 10% in the first quarter of 2012. Competition in the fixed market is becoming more intense and aggressively priced and communicated triple play offers are dominating the market. Growth in fixed broadband and TV subscribers, the roll-out of fiber to the home platform and combined fixed-mobile products can only partially offset the decline in fixed voice revenues.

Mobile revenues declined by 14% in the first quarter in denar terms. We have already highlighted the fact that competition in the mobile market has intensified in the last few quarters and the competitive environment remains tough. Both we and our competitors are continually increasing the number of bundled minutes and widening closed-user-group offers. The increase in usage was largely driven by this trend and as such, could not offset the ARPU decline or the decrease in revenue producing customers. The fiercest is still the prepaid segment, where ARPU is down by 21% in local currency. Non-voice revenues have also decreased as higher mobile internet sales could not compensate for a decline in messaging revenues. Despite this, we have maintained the leading position in both fixed and mobile voice markets in Macedonia with approximately 75% and 50% shares, respectively.

Turning to our Montenegrin subsidiary, first quarter results were positively impacted by the 8% year-on-year foreign exchange effect. In local currency, total revenues declined by a moderate 1% while EBITDA rose by 57% compared to the same period last year. However, the majority of this increase was due to the severance expense of 3 million euros which was accounted for in the first quarter of 2011. Underlying EBITDA also improved by 6%, driven by a decline in employee related expenses as a result of the lower headcount. Overall, the underlying EBITDA margin rose to 41% from 38% a year earlier.

Fixed line revenues were flat thanks to a significant increase in our broadband and IPTV subscriber base which may counterbalance the decline in voice usage. In the IPTV market we managed to strengthen our market-leading position with a 19% increase in our customer base. Our market share was 42% at the end of March this year, an increase of 4 percentage points compared to a year earlier. Our broadband subscriber base rose by 11%, and our market share was 84% at the end of the first quarter.

Mobile revenues declined by 4% in Euro terms. Voice revenues decreased by 6% due to a 29% cut in mobile termination rates – executed in two steps, in April and November last year – which put significant pressure on our wholesale voice revenues. Non-voice revenues were up by a healthy 9%, reflecting higher SMS and mobile broadband usage. Our overall mobile voice market share has been stable during the quarter, at 35%, and we could further increase our postpaid subscriber base by 11% compared to a year earlier, thus strengthened our leading position in that segment.

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 would like 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.