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Q2 2020 Results Conference Call

August 6, 2020

Good afternoon everyone. I am Zoltán Pandi, Head of Investor Relations at Magyar Telekom. I would like to welcome you to our second quarter 2020 results conference call. It's my pleasure to participate on this call for the first time as a member of the Magyar Telekom IR team, I'm looking forward to working with you all in the future. Please note that our presentation can be accessed via the link within the conference call invitation and is also available in the Investor Relations section of our website.

Before we get started, I would like to draw your attention to the disclaimer on the second page. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties.

As usual I have senior management with me today: Mr. Tibor Rékasi, our CEO, and Ms. Darja Dodonova, our CFO, who will take you through the presentation and answer any questions you may have.

Now, it is my pleasure to hand over to Tibor to open the presentation.

Tibor Rékasi

Thank you Zoltán, Good afternoon.

Let me say a few words about the past couple of months before we move to the presentation of the Q2 2020 results. The COVID-19 pandemic has continued to have a profound impact throughout the second quarter, not just on global markets, but on every aspect of our daily lives. The second quarter has been a story of two tales; while April was about managing the COVID-19 crisis on the back of the lockdown, May was a transition month into June when we started to experience a "new normal". During this unprecedented period, the management team of Magyar Telekom focused primarily on two key areas:

- First, against a backdrop of surging voice and data traffic over our network, we remained firmly committed to providing the same high-quality services that our customers rightfully expect from us.
- And second, the health and wellbeing of our colleagues and customers remained a top priority.

I'm very glad to say that we have been successful on both fronts and will provide further details on this as we progress through the presentation.

Turning to **Slide 3** and our results for the second quarter and first half of 2020, while the COVID-19 pandemic has in some respects provided longer-term opportunities for telecoms, in the short-term it has provided headwinds which have affected our performance. We have delivered strong results overall – in the first half of 2020, revenues amounted to 316.5 billion forint, while EBITDA after leases reached 91.0 billion forint. However, these results fell slightly short of both base period results and our original 2020 expectations. That said, we intend to deliver on our earlier 2020 guidance – for both revenues and EBITDA after leases - unless a severe second wave of COVID-19 is experienced later in 2020.

As far as investments are concerned, despite the challenging situation we have all found ourselves in, we have continued to deliver on our "Digital Hungary" strategy. We successfully accelerated our fiber investments and started the modernization of our mobile network. In the first half of 2020, CAPEX spending excluding spectrum license fees and leases amounted to 48.5 billion forint, representing an increase of 14.8 billion forint versus the prior year period. By fast-tracking these investments, we expect our CAPEX to be approximately 10% higher in 2020 than originally anticipated. With regards to free cash flow, our intention is to off-set the bulk part of this CAPEX uplift. In H1 2020, free cash flow generation was stable despite higher year-on-year CAPEX spending, supported mainly by more favorable working capital developments.

Moving to **Slide 4** and our delivery against strategic targets in the second quarter.

First and foremost, we are proud of how we have supported our communities during these challenging times. Over the last couple of months, Magyar Telekom proved that the Company is much more than a telecommunications service provider and we consider ourselves a trusted partner of the society. As the COVID-19 related lockdown measures were implemented, connectivity became more vital than ever. Magyar Telekom acted as a first mover in the Hungarian market, introducing a complimentary 10 + 10 GB mobile data pack to our customers and launched affordably priced new data options. Furthermore, in order to care for the most vulnerable members of society, we launched a new set of initiatives, including free digital education materials, those above 65 years of age received complimentary fixed line calls for a limited period, and GPs were granted 1000 mobile minutes per month.

In order to ensure the safety of our employees, we introduced home office and teleworking wherever possible, allowing around 80% of our employees to work from home during the lockdown period. We also provided protective equipment to our front-line staff. Thanks to these efforts, we have not registered any work-related COVID-19 infections among our staff in Hungary to date.

With regards to network enhancements, the fiber rollout continued and more than 50% of our network is now Gigabit capable, meaning we cover 2.2 million households. Following the commercial launch of 5G services in the second quarter, the service was further extended to new areas in Hungary.

From a customer perspective, mobile data usage continued to surge reaching 5.8 GB/month in Q2, which represents a 60% year-on-year increase. Meanwhile, we continue to pursue the development of digital channels by any means possible. For example, from Q2, we started providing customers with the ability to switch subscription plans in the Telekom mobile app - 10% of our customers used this service in the first month of launch.

Efficiency remains high on our agenda. The Group's total headcount is now 15% lower year-on-year and internal efficiency improvement efforts proved vital during the crisis in preserving the Group's cash-flow generation capability.

Going a step further, **slide 5** sets out at a high-level the wide-ranging impacts of COVID-19. Whilst many continue to suffer from the pandemic's negative impact the telecommunications industry has been less severely impacted. COVID-19 potentially offers longer-term opportunities through increased demand for enhanced connectivity and digital cooperation. In the short run though, our ability to create value from these sources has been limited. We have seen an uplift in data and voice traffic and cost savings across some OPEX lines. However, monetization of data and voice traffic uplift was capped by one-off data specials as well as the telecom tax payable per minute of voice usage.

Diminishing visitor revenues and equipment sales exacerbated the negative impact of COVID-19, along with more indirect effect such as muted public sector spending in SI/IT. As a result, the negative impacts unfortunately outweighed the positives. Overall, in the first half of 2020, the COVID-19 related gross margin decline was in the low to mid-single digit territory in billion forint terms.

With that I'd like to hand over to Darja who will walk you through the Q2 2020 financials in more detail.

Darja Dodonova

Thanks Tibor, moving on to **slide 6** you can see the profound impact of COVID-19 on our results interrupting the growing trend recorded in recent quarters in both revenues and EBITDA after leases.

Looking at the details, group's revenue performance in more detail on **Slide 7**, mobile and fixed line services revenue rose year-on-year, yet SI / IT sales came in much lower in Q2 2020 than a year ago. Total revenues reached 157.2 billion forint in the second quarter representing a 3.6 billion forint decline year-on-year. Thanks to efforts taken during recent quarters, growth in telecommunication service revenues was achieved despite the aforementioned headwinds in mobile data usage and roaming. The increase was primarily attributable to the strong performance of fixed broadband and TV services at both operations, amplified by the positive foreign exchange impact stemming from the strengthening of the denar compared to the forint.

Higher equipment sales revenues reflect an increase in third party export sales, while equipment sales in Hungary recorded a moderate decline driven by lower transaction volumes in both the fixed and mobile segments.

Meanwhile, system integration and IT revenues recorded a decline in Hungary, reflecting a general temporary contraction of the market. While lower demand was visible in the corporate and public segment, the revenue decline was mostly driven by a year-on-year decline in the number of public sector implementation projects.

Other revenues also declined driven by a contraction in visitor revenues, lower dunning fees in the mobile segment and a higher level of discounts provided to fixed line customers in relation to online bill payments in Hungary.

Slide 8 shows the operational developments in the Hungarian mobile market. Our postpaid subscriber base continued to expand, at an annual rate of 3% year-on-year, while an increase in the mobile data customer base was also maintained. This result was achieved - despite more than a 50% decline in the number of customer visits at our shops during April - thanks to the smooth transition from physical to digital distribution channels. Our shops have now reverted to standard opening hours and the number of customers visiting shops is gradually returning to pre-COVID-19 levels. Nevertheless, we have taken the decision to review our sales strategy and increase our focus on non-physical channels.

With regards to usage trends, the strong increase in average usage levels is a clear reflection of the unique situation our customers were facing during the second quarter, especially in April. Average voice usage grew by 15% year-on-year, compared to pre-COVID levels of 5% growth. With regards to mobile data usage, following an initial 75% year-on-year increase in average monthly usage levels in April, usage patterns returned to pre-COVID-19 levels.

However, these increases did not directly translate into ARPU improvement as the impact of COVID-19 resulted in lower prepaid usage, an absence of roaming revenues, and an increase in mobile data allowances offered to customers. Separately, an increase in unlimited and semi-flat voice packages coupled with increasing competitive pressures - particularly in the small- and medium-sized business segments - added further pressure to ARPU. Consequently, despite an improvement in customer composition, blended ARPU declined 1.5% year-on-year.

Turning to **Slide 9** which illustrates developments in the fixed market in Hungary, we successfully grew both our customer base and the average number of services each household subscribes for. While the most popular choice is still our three-play offer, more and more customers are opting for the broadband and TV double play package. This is also reflected in the growth of our broadband and TV subscriber bases, along with the continued moderate decline in the number of fixed voice customers.

ARPU trends in the fixed market have remained resilient during the COVID-19 pandemic. The downward trend in average voice revenues has been partly mitigated by a temporary rise in fixed voice usage resulting from the COVID-related lockdown measures. While pay TV ARPU remained broadly stable year-on-year, reflecting the high proportion of customers already subscribed to the high-end packages – 90% of customers to be specific, broadband ARPU increased as customers migrated towards higher bandwidth packages. The number of customers opting for a gigabit speed package also increased by 50% year-on-year.

Turning to **Slide 10** Group EBITDA After Leases declined by 2.5% year-on-year in the second quarter of 2020 and by 0.9% for the first half of 2020. Although savings in indirect costs were able to compensate for the lower gross profit, they were not able to offset the unfavorable impacts of lower operating income and higher IFRS 16 depreciation and amortization charges in relation to a higher right of use asset base.

The 1% year-on-year decline in gross profit is the combined result of lower revenues and unfavorable foreign exchange impacts, partly mitigated by lower SI/IT related costs and some decline recorded in bad debt expenses - mostly thanks to the favorable aging of mobile receivables at the Hungarian operation.

The 2.7 billion year-on-year improvement in indirect costs reflects our strong commitment to transforming our operation and delivering on our EBITDA target, despite the significant challenges presented by the COVID-19 pandemic. The majority of the savings stem from a headcount reduction coupled with a temporary hire freeze at both the Hungarian and North Macedonian operations. Meanwhile, further savings were achieved in other indirect expense items - such as advisory, marketing and travel expenses - which more than offset cost increases associated with implementing protective measures for office and sales employees.

However, the absence of income from real-estate sales, which positively impacted results in the second quarter of 2019, led to a year-on-year decline in other operating income for both the second quarter and first half of 2020, resulting in an overall year-on-year decline in EBITDA After Leases.

Going on to **Slide 11** and the Group's capital expenditure... As Tibor highlighted earlier, despite a temporary slowdown during the months of lockdown in Hungary, we managed a much more balanced investment schedule for the year, investing 48.5 billion forint in the first half of 2020, up 14.8 billion forint year-on-year, driven primarily by the fiber roll-out program in Hungary. This was the result of not just higher network related investments but also increased connection costs driven by accelerated growth in fiber customers; we have added more than 20% more broadband customers to our fiber network in the first six months of 2020 than in the same period of 2019. ARPU uplift has been significant as customers opted for higher bandwidth packages - 40% of fiber subscribers now use gigabit packages.

This positive result, together with our strong commitment to Hungary's digitalization efforts, underpin our decision to accelerate our fiber roll-out program further, as we aim to maintain the pace of fiber roll-out and reaching around 25% more access points than in 2019.

Furthermore, we have decided to bring forward the start of our mobile network modernization project which will allow for higher capacity on our current 4G networks, as well as facilitate the future roll-out of 5G services, accelerating digitalization.

These initiatives will require higher capex than originally forecasted, resulting in a change in our capex guidance from broadly stable to 10% annual growth in 2020. However, we strongly believe that thanks to our state-of-the-art networks we will continue to be the partner of choice for connectivity and digitalization for both Hungarian households and businesses in the future.

Let me now talk you through the below EBITDA lines on **slide 12**. Depreciation and amortization was slightly higher than most of you expected and reached 69.0 billion forint in H1 2020. The increase was attributable to the newly acquired frequency licenses, as well as the shortened useful life of copper network elements driven by preparations to retire this network in Hungary. In North Macedonia, the increase in depreciation and amortization expenses was driven by higher amortization expenses in relation to content rights, software and licenses. Looking ahead, the second quarter's 35.3 billion forint D&A level should provide a more accurate estimate for future quarters.

Net financial losses amounted to 16.5 billion forint in the first half of the year, of which approximately two thirds are attributable to the first quarter. Compared to Q1, the forint did not weaken against the Euro any further based on end-of-period forex rates, and therefore Q2's net financial losses were back to "normal" levels. Despite a 33% year-on-year decline in profit before tax, income taxes decreased by just 8% to 6.4 billion forint. The main reason behind the disproportionate fall in income tax is that local business tax payable in Hungary, which we record on the income tax line, is payable on gross margin rather than profits. Profit after tax amounted to 9.0 billion forint in the first half of the year, which is equivalent to 8.7 forint/share on an EPS level.

Finally a few words on cash-flows on **slide 13,** free cash-flow generation (excluding spectrum licences) reached 3.4 billion forint in the first half of the year which was sufficient to cover both our investments excluding the spectrum payments and the seasonally higher working capital needs of our business. The 54.2 billion spectrum license payment related to the 5G auction, together with dividend outpayments and the completion of the share buyback transaction during the second quarter, drove net debt to 471.6 billion forint by the end of the period. Looking ahead, we expect free cash-flow generation to be supported by stronger EBITDA in the second half of the year as well as a decrease in working capital in line with usual seasonality.

Zoltán Pandi remarks

Thank you very much, Darja.

That concludes our presentation. We are now happy to take any questions you may have. Operator, when you are ready, we will take the first question.

(Take questions)

If you have any follow-up questions, please do contact our Investor Relations team. Please also note that the transcript of our conference call will shortly be *available on our website. Thank you again for joining us today and your continued interest in Magyar Telekom.*