Q1 2011 Results Conference Call

May 6, 2011 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's first quarter 2011 results conference call. I am Thilo Kusch, Magyar Telekom's Chief Financial Officer and member of the Board, and it is my pleasure to host the conference call today.

Before going onto analyze the first quarter's financial performance, let me first briefly outline the changes in the reporting structure starting from the beginning of this year.

In order to enhance further Magyar Telekom's effectiveness and speed in reacting to the changes in the market place and the wider economy, we changed the management structure as of 1st July 2010. Accordingly, the Group's reporting structure changed as well and the new operating segments are Hungary and T-Systems. Hungary includes the former Consumer Services Business Unit and the small and medium-sized customers of the prior Business Services Business Unit, while T-Systems includes the former BBU without the SMB customers which migrated to Hungary. The two prior units, Headquarters and Technology were split among Hungary and the T-Systems segment. The Macedonia and Montenegro segments remained unchanged.

Although I know that changes in the segment reporting are never popular and make life more difficult, the new structure is simpler and shows a more realistic and comparable profitability for our customer segments in Hungary.

Let me also highlight that we held its Annual General Meeting in the middle of April where shareholders approved the 2010 audited annual financial statements and a dividend payment of 50 forints per share. The dividend payment is due on 12th May 2011 in case of ordinary shares and on 19th of May in case of ADRs.

Let us turn now to the financial performance in the first quarter. On one hand we see some promising signs of the economic recovery with slightly higher consumer spending, increased mobile usage and somewhat lower churn both in the fixed and mobile segment. At the same time however, the intense competition and the limited growth potential in our core markets continue to put pressure on our business performance. Total revenues declined by 3.3% compared to the first quarter of 2010, as fixed voice, internet and mobile voice revenues decreased in Hungary. The decline could not be offset by increases in TV and mobile internet revenues.

EBITDA excluding special influences increased by 3.8% in the first quarter of this year as the lower level of voice related payments, reflecting lower voice usage and the cut in the Hungarian mobile termination rates, the decrease in other operating expenses driven by our cost cutting efforts and the savings in employee-related expenses more than offset the revenue decline. In addition to the cost benefits mentioned, profitability in the first quarter was also helped by real estate gains of 1.4 billion forint. Thanks to all this, underlying EBITDA margin increased to 43.1%.

Although the first quarter 2011 results seem promising, we must not forget, that the figures are compared to an extremely weak first quarter results a year ago when the recession peaked for us in Hungary. This makes the year-on-year comparison look more impressive. Looking ahead, we expect the economic activity to show further improvements, however this recovery is expected to be slow. All in all, despite the promising first quarter results, we stick to our guidance of 3-5% revenue decline and 4-6% underlying EBITDA decline. We intend to cut Capex by approximately 5% compared to last year's spending.

I will now turn to the analysis of the business segments, starting with our **Hungary segment**, which now incorporates the former CBU customers and the small and medium-size businesses. Revenues in the first quarter were down by 3% overall due to the continuous decline in our fixed line voice revenues coupled with lower internet revenues, which were only partly offset by increasing TV revenues. Mobile revenues were flat. Thanks to the ongoing cost savings, which can be seen in lower employee-related and other operating expenses, and the real estate sales gain accounted for in the first quarter, underlying EBITDA was up by 8% year-on-year.

Regarding fixed line revenues, we are facing further declines of the traditional PSTN revenues. Besides still high churn levels, average revenue per access also decreased by 9% year-on-year as customers actively migrated towards more favorable packages. The introduction of our new flat package, called Hoppá, launched at beginning of the year, accelerated this process. The package, which gives unlimited calls to all fixed lines and also to the T-Mobile network for a flat monthly fee, is a unique offering in Hungary and proved to be very popular among our customers. More than 240,000 customers have migrated to Hoppá to date with the vast majority signing a 2-year loyalty contract. While this will have a favorable impact on churn in the long term and the positive usage effects can be already seen, for this year we expect a further deterioration in the fixed voice revenues.

Internet revenues decreased driven by the significant fall in wholesale ADSL lines and decreases in average revenues per retail broadband connection. Although the number of broadband customers, especially fiber and cable broadband connections showed an increase, it could not offset the fall in the average price level driven by strong competition and migration towards multi-play packages. Regarding markets share, however, we maintained our 36% share of retail broadband customers.

Moving on to the mobile market, total mobile revenues were flat in the first quarter of this year compared to the same period in 2010. The slight decrease in voice retail revenues and the more substantial one in wholesale, driven by the 16% cut in MTR rates in December last year, were mostly offset by higher non-voice and equipment sales revenues. Thanks to increased smartphone sales, equipment sales revenues were up, while the total amount of subsidies has not increased as subsidies in the prepaid segment and for non-smartphones in the postpaid segment were reduced significantly. Smartphone sales already amount to 40% of total handset sales and smartphone penetration already exceeds 10% in the residential segment. Accordingly, non-voice revenues are increasing and the ratio of non-voice revenues within ARPU is now approaching 21%.

The strong growth in mobile broadband services will be further supported by the modernization of our mobile network. As announced this week, by the summer 21 Mbps speed will be available in many parts of Budapest as well as in several rural locations via 200 new HSPA+ base stations. HSPA+ will be available across the entire network by 2013. The supplier, Ericsson is replacing the current 2G and 3G wireless base stations with multi-standard equipment that will also enable our network for the fourth generation LTE technologies. Magyar Telekom will be able to launch LTE services once the necessary frequencies are available, most probably at the end-of this year.

Now we turn our attention to the **T-Systems segment**, which still felt the pressure of previous negative periods in the first quarter of 2011. Although some macroeconomic indicators started to improve during the second half of last year and budget stability in the medium term now seems to be feasible, growth prospects for the economy are still under pressure from the weak lending market. Therefore our private clients are still very conscious of their spending, while public sector clients are facing budget cuts. As a result, revenues in this segment declined by 4% in the first quarter of this year compared to the same period of 2010, led by the continued decline in fixed line revenues.

Our fixed line customer base eroded further, partly due to technological substitution of fixed voice services to IP based and mobile solutions. Mobile voice revenues declined moderately, from the combined effect of a larger customer base and further decreases in prices. The growing number of mobile broadband customers is supported by increased smartphone sales, which resulted in a slight increase in mobile non-voice revenues. In addition to these, the previous renegotiation of governmental contracts in the third quarter of 2010 has an ongoing negative effect on our other mobile revenues and will impact quarter-on-quarter comparisons in the second quarter.

The system integration and IT revenues were broadly flat, underlying EBITDA margin remained at 17%.

Regarding our **Macedonian** subsidiary, total revenues decreased by 7% in the first quarter of 2011 compared to the same period in 2010. On EBITDA line, significant one-off cost items occurred in the same period of the preceding year distorting the year-on-year comparison. However, underlying EBITDA followed the negative revenue trends and decreased by 7%. Meanwhile, our EBITDA margin remained flat at 54% reflecting the ability of our cost saving measures to offset falling revenues.

In the fixed line segment, revenues were up by 2% in the first quarter of 2011 as the profound growth in wholesale voice and TV revenues exceeded the 15% drop in retail voice revenues. Despite intense competition in the fixed voice retail market, fixed voice churn stabilized at 8% during the first quarter compared to 11% a year before. The higher voice wholesale revenues were due to the combined impact of growing incoming traffic volumes and higher prices charged for international traffic termination. At the same time, the focus on double and triple play packages gave further impetus to rising internet and TV revenues.

Mobile revenues declined by 14% in the first quarter, as increasing wholsale revenues could not compensate for significantly lower retail voice revenues. The main reason for falling retail voice revenues is intensifying competition, which is putting sustained pressure on tariff levels and reduced our customer numbers. The slightly increasing post-paid ratio and higher usage could not offset the 5% decline in the ARPU. T-Mobile Macedonia's continued to maintain its clear market leading position with 50% market share. At the same time, demand for mobile broadband services is increasing supported by smartphone sales and T-Mobile Macedonia continues to expand its 3G coverage, which now reaches 60% of the population.

Regarding our **Montenegrin** subsidiary, total revenues decreased by 1% in forint terms, while EBITDA was up by 3% in the first quarter compared to the same period of 2010. Underlying EBITDA margin increased from 36% to 38% thanks to the cost saving measures introduced in Montenegro last year.

Fixed line revenues were broadly flat as declining voice revenues were offset by higher broadband and IPTV revenues. The number of PSTN connections remained flat while traffic declined due to strong mobile substitution. We maintained our fixed voice and fixed broadband market shares of 98% and 85%, respectively, and also kept our leading position in the pay-TV market with a 38% market share.

Mobile revenues were down by 3% in the first quarter compared to the same period last year. Voice revenues were slightly down due to lower wholesale revenues caused be lower international traffic. Retail revenues were impacted by the lower number of prepaid customers. Looking at last year's figures you might have realized that we have restated customer numbers as we changed to the Montenegrin Agency definition to be consistent with market share and penetration data. As the Agency has stricter churn policies regarding the prepaid customers, our prepaid customer base significantly decreased based on the new definition.

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 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.

Figures prepared in accordance with IFRS, Magyar Telekom also presents non-GAAP financial performance measures, including, among others, EBITDA, EBITDA margin, underlying EBITDA, underlying EBITDA margin and net debt. These non-GAAP measures should be considered in addition to, but not as a substitute for, the information prepared in accordance with IFRS. Non-GAAP financial performance measures are not subject to IFRS or any other generally accepted accounting principles. Other companies may define these terms in different ways. For further information relevant to the interpretation of these terms, please refer to the chapter "Reconciliation of pro forma figures", which is posted on Magyar Telekom's Investor Relations webpage at www.telekom.hu/investor_relations.