1Q 2017 Results Conference Call

May 11, 2017 at 15:00 CET

Good afternoon everyone. I am Linda László, Magyar Telekom's Head of Investor Relations. I would like to welcome you to our first quarter 2017 conference call. 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 last slide. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties.

Today we have Mr. Christopher Mattheisen, our CEO, and Mr. János Szabó, our CFO with us, who will take you through the presentation and answer any questions you may have.

Now, it is my pleasure to turn the call to Chris to open the presentation.

Christopher Mattheisen:

Thank you, Linda. Good afternoon everybody.

Before we cover our performance in detail, **I would like to highlight** that following the disposal of our majority stake in Crnogorski Telekom, the Montenegrin segment has been deconsolidated from the Group's results. Consequently, since the beginning of the year, results of the Montenegrin operations are presented separately as profit and cash flow from discontinued operations, and 2016 figures have been modified accordingly, to allow for proper comparison.

Now, let me briefly summarise our financial achievements at Group level during the first quarter of 2017.

I am pleased to report a strong performance in the first quarter, as can be seen **on Slide 2.** Revenues for the Group increased by approximately 2%, mainly driven by achievements in the Hungarian market. To capitalise on the positive momentum in the mobile market and following extensive investment efforts during the Christmas period, we maintained our focus on customer acquisition and retention. These efforts resulted in accelerated mobile postpaid customer growth, decreased churn and increased sales of smartphones and data packages. The fixed line segment also benefitted from the acquisition and retention focus, with increased net adds in both fixed broadband and TV, as well as higher equipment sales. In the first quarter we managed to increase our market share in both fixed broadband and TV compared to December 2016, reversing last year's declining tendency.

The Group's significant decline in EBITDA was largely due to the absence of last year's one-off profits realized on the sale of Infopark Building G and Origo.

Capex for the first quarter increased by 39% compared to first quarter 2016, despite lower investments in PSTN migration. This additional spending was driven by investment in our 4G+ network which now operates at a speed of 300 Mbps in over 40 Hungarian towns. Increased spending on set top boxes also contributed to the rise in Capex, reflective of higher levels of expansion in the TV subscriber base. For the full year, we still expect to achieve a significant decline in our total investments, with Capex falling to around 85 billion forints.

Free cash flow of continuing operations, i.e. without the Montenegrin results fell to 0.3 billion forints, due to the absence of one-off gains that occurred in the same period last year. Despite this, we believe that we are on track to achieve around 55 billion forint free cash flow by the end of 2017.

Although our **net debt ratio** fell to 37% by the end of March as the proceeds from the disposal of Crnogorski Telekom was booked in the first quarter, we expect a circa 3 percentage point increase in the second quarter driven by the dividend payment starting on the 23rd of May.

Looking ahead to the rest of the year, although reportedly Digi has postponed its entry to the mobile market, competitive pressures remain, both in mobile B2B and prepaid segments as well as for fixed 3Play pricing. Further cuts to EU roaming rates, as well as the looming regulatory deadline for prepaid SIM registration are also set to pose challenges. At the same time, we see some signs that give ground for optimism. The first quarter of 2017 saw return to growth in System Integration and IT revenues, and we expect this growth to continue throughout the year, supported by increased EU funding. In mobile, we launched our new flexible postpaid tariff portfolio at the end of March. The portfolio is unique in the Hungarian mobile market, as it allows postpaid customers to choose and combine four different voice and five different data packages, as per their preferences. It is structured to support an increase in the FMC customer base through discounts, and encourage upgrades to larger mobile data packages through equipment subsidies. Initial reaction to this tariff plan has been very encouraging and we expect to report positive impacts in the coming quarters. All in all, considering the above-mentioned factors, I reiterate our previous revenue and EBITDA guidance for 2017.

Moving on to **Slide 3**, for the results of our Hungarian and Macedonian segments, our Hungarian operations contributed greatly to the aforementioned group wide revenue increase, primarily thanks to growth in both Hungarian mobile and System Integration and IT revenues. Macedonia also saw mobile revenues increase; however, this was offset by a decline in fixed line revenues, mostly fixed wholesale revenues.

As previously mentioned, the significant decline in Group EBITDA is principally due to two major one-off profit items that supported the first quarter of 2016, thus distorting the comparison. Stripping out the impact of those, EBITDA decline was around 6%, mostly driven by higher indirect costs and the lower gross profit level at the Hungarian operations. In Macedonia, the improvement in gross profit, which began mid-last year, continued, thanks to better System Integration and IT margin, as well as lower wholesale fees. However, overall EBITDA in the Macedonian segment declined slightly, due to increased indirect costs.

I will now hand over to János to provide you with further detail on the performance of our business segments.

Let me start with **MT-Hungary** on **Slide 4**. Overall revenues increased by approximately 2% in the first quarter, due to the combined impact of growth in mobile data and System Integration and IT revenues, partly offset by a decline in mobile voice revenues.

Mobile revenues for the first quarter increased by almost 3% due to increased spending on mobile data and higher levels of smartphone sales, resulting from our focus on customer acquisition and retention. Voice revenues decreased, which reflects a moderate decline in the overall customer base and intensification in pricing pressure. Fixed line revenues also declined, as robust growth in TV and equipment revenues could not compensate for lower voice and broadband revenues. Termination of part of our wholesale activity at our Romanian subsidiary and the deconsolidation of Origo also had a negative impact on our fixed line revenues. Revenues from energy services also decreased, due to the expiry of the last gas contracts coupled with the decline in the number of electricity customers. The latter reflects our stated intention to exit the residential electricity business, expected sometime in the third quarter of 2017.

EBITDA in the MT-Hungary segment fell by 20%, but again, the 2016 comparison figure is unusually high due to the two major one-off sales, as Chris has mentioned earlier. Stripping out the impact of these one-offs, EBITDA decreased by around 8%, due to lower gross profit and higher other operating expenses. The gross profit decline is due in part to temporary impacts, such as the TV content fee introduced in July 2016, and increased mobile equipment subsidies that supported smartphone sales in the quarter. Other operating expenses increased, driven by higher rental fees related to the sale and subsequent leaseback of Infopark and the rental of local state-of-the-art cable networks. Maintenance, repairs, and remedial work expenses also increased.

Before moving on to the next slide, I would like to draw your attention to the reclassification of **telecom tax** from Other operating expenses to Direct costs. Again, the 2016 income statement has been modified accordingly.

Slide 5 shows developments in the Hungarian **mobile market,** where fierce competition continued. To mitigate these competitive pressures, we continued to focus on our customer acquisition and retention efforts in the first quarter of this year. This yielded significant growth in our postpaid share of customer mix and mobile data subscriber base as well as a strong increase in smartphone sales. Consequently, by the end of the first quarter, almost half of our customers signed up for mobile data packages, and the postpaid ratio in the overall customer base has risen to over 60%. These improvements collectively positively impacted our overall blended ARPU, which increased by over 2% year-on-year, despite severe competitive price pressure. ARPU was also supported by continued growth in the Magenta 1 subscriber base, as well as an increased number of subscribers for flat and semi-flat packages.

As can be seen on **Slide 6**, our **fixed broadband and TV** customer base continued to increase in the first quarter of 2017. Despite an increased number of subscribers, broadband retail revenues remained roughly unchanged, as intense competition negatively affected tariff levels. TV revenues materially increased, underpinned by improving ARPU, due to price increases which reflect the content fee introduced in July 2016, as well as the new TV portfolio. We maintain our focus on further expanding the number of IPTV subscribers, which is approaching 60% of the total subscriber base. Fixed voice revenues declined further due to tariff levels that continue to fall; however, churn remained at a manageable level of 2% thanks to our effective bundling strategy. Although the fixed voice market is fully saturated and the inactivity ratio is increasing, we remain focused on our high-end residential fixed voice customer base with our flat rate package offers. We maintained our position as market leader, increased our market share in both the TV and fixed broadband segments, and continued to increase the share of high bandwidth tariff plans. 40% of our customers subscribe to high speed internet capable of a speed of at least 30 megabits per second. This, as well as high demand for our 1,000 megabits per second fixed network offer, supports the intensive fixed network rollout conducted over the last two years. We currently cover 2.9 million households with high speed internet, and plan to cover at least a further 250 thousand households by the end of the year, with the support of EU funds. We aim to further penetrate the 3Play market despite fierce competition from our two largest competitors, Digi and UPC.

Turning to **Slide 7,** let me draw your attention to the results of our efforts in service **bundling**, reflected in our 3Play customer base, which continues to grow, as well as improving fixed multiplay ARPU. The popularity of Magenta 1, our flagship product, continued to grow. More than 136,000 subscribers had chosen this high-value 4Play package by the end of the first quarter of 2017, compared with just 50,000 at the end of Q1 2016 and the overall FMC customer base reached almost 270,000 by the end of March this year. FMC bundles' share of residential service revenues already exceeds 20% and this segment remains the cornerstone of our growth strategy. Our newly launched mobile postpaid tariff plan is also aimed at further increasing the number of FMC customers, as it offers a 20% to 25% monthly fee discount for fixed-mobile convergence bundles. As the only integrated operator, we believe we are well positioned to maximize the telecommunication share of the household spending wallet.

If we turn to **Slide 8**, you can see the predicted market growth for Hungarian system integration services and application development over the next couple of years, which indicates great potential for growth. System Integration and IT revenues for the first quarter of this year were boosted by two major public procurement project wins, resulting in an almost 12% revenue increase and significant improvement in gross profit. Looking ahead, we believe that the Hungarian System Integration and IT market will grow materially in 2017, underpinned by higher EU fund inflows, following the temporary slow-down of EU fund inflows into Hungary in 2016. Our aim is to also improve the gross profit by undertaking a diversified mix of higher added value System Integration and IT projects and lower margin IT assignments.

Moving onto Macedonia on **Slide 9**, I am pleased to report that despite political and competitive headwinds, as well as the mobile termination rate cut in December 2016, revenue came in almost flat in local currency terms with EBITDA only marginally down, by 1%, compared to a year earlier.

In the **mobile segment**, thanks to the 4G push, significant growth in mobile broadband and equipment revenues more than offset the negative revenue impact resulting from the 33% cut in mobile termination rates. The total mobile revenue increase was further supported by an increase in the customer base and higher mobile ARPU; we managed to maintain our price premium despite aggressive pricing strategies from our main competitor, VIP.

In the **fixed line segment**, revenue decline was mainly driven by a decline in wholesale revenues due to lower incoming international traffic volume and prices. In addition, broadband revenues decreased due to lower pricing resulting from 3Play competition, and voice revenues declined reflecting a shrinking customer base and traffic levels. These negative impacts could not be offset by growth in TV revenues, supported by a growth in both ARPU and subscriber base.

System Integration and IT revenues were slightly down, due to different monthly dynamic. With regards to System Integration and IT projects, I must highlight that risks stemming from current political uncertainty in Macedonia could negatively impact this year's System Integration and IT revenue outlook.

EBITDA for the quarter slightly declined, mainly driven by higher consultancy and marketing costs, while gross profit continued to increase.

Despite political risk and intensifying competition, we believe that a stabilization in revenues, as well as cost efficiency improvements, will result in a return to sustainable growth in EBITDA in Macedonia.

Chris Mattheisen remarks

Thank you very much, János.

That concludes the formal part of Magyar Telekom's conference call. Now, 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 Department. 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.