



2Q 2019 Results Conference Call

August 8, 2019 at 15:00 CET

Good afternoon everyone and welcome to the Magyar Telekom second quarter 2019 results conference call. I am Péter Bauer, Head of Investor Relations at Magyar Telekom, and with me today is Mr. Tibor Rékasi, our CEO, and Mr. János Szabó, our CFO, who will take you through the presentation and answer any questions you may have.

Please note that the Q2 results presentation can be accessed via the link provided in the conference call invitation, and is also available in the Investor Relations section of our website.

Before we begin, 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.

Now, it is my pleasure to hand over to Tibor who will begin the presentation.

Tibor Rékasi

Thank you, Péter. Good afternoon everybody.

Let me start with an update on the progress we've made against our strategic priorities, as set out on **Slide 3**.

In Hungary, we continued our accelerated fibre rollout programme, adding more than 130 thousand access points to our **fiber network** since the beginning of the year. This initiative is central to increasing our competitiveness, and supports our aim to upgrade an increasing number of customers to higher bandwidth packages. Meanwhile, our efforts to provide leading network quality to our customers were also recognised, with Opensignal ranking Hungarian mobile networks as the 11th best worldwide, with our video experience and latency being the second best in the world. At the same time, we have been awarded by P3 fourth in a row as the best Hungarian mobile network.



In maintaining the competitiveness of our service offerings, we closely monitor market developments and customer needs on an ongoing basis. In April, we revised our post-paid voice portfolio applying the successful more-for-more logic with very promising initial results. By the end of June, we had almost 200 thousand customers signing up to the new packages with customers typically choosing one of the semi-flat packages. With regard to next steps, we have started reviewing the post-paid data schemes to ensure we are meeting demand for rapidly increasing data usage. From August 1st, we doubled the monthly data allowance of our entry level package from 1 to 2 gigabytes, for less than a 20% increase in price, and also introduced a more attractive price for our popular 3 gigabit package, thus attracting a greater number of lower usage customers to this package.

During the second quarter, we also broadened the availability of our convergent Magenta offer by offering the pre-paid Magenta option to customers who have two or more fixed subscriptions and a mobile pre-paid package with us. While the benefits of this option are more limited, compared to the post-paid packages, it has proven popular among the targeted customer segment.

As competition in our core telecommunication market intensifies, we have decided to investigate the possibility of further simplifying our operational structure through the potential sale of T-Systems Magyarország Zrt. The finalization of the contractual conditions including the purchase price and the signing of the binding legal documentation are subject to the due diligence of T-Systems Magyarország Zrt., the final decision of the Board of Directors of Magyar Telekom Nyrt. and receipt of the requisite authority clearance. The financial impact of the transaction cannot yet be reliably estimated. The closing of the transaction is expected this financial year.

Meanwhile, in North Macedonia, favourable trends were sustained with customer numbers rising further, supported by bundled and fixed-mobile convergent service offerings. These positive developments are reflected in our financial performance for the quarter, with both revenues and EBITDA increasing year-on-year.



Turning to the Group's results, as shown on Slide 4, Q2 2019 recorded declining revenues driven by the temporary, but significant, drop in the Hungarian System Intergration and IT revenues. Although we managed to record higher revenues in all other revenue segments – both in Hungary and North Macedonia – these were not enough to offset the fall in SI/IT revenues, leading to a 4% year-on-year revenue decline.

Group EBITDA - excluding the impact of IFRS 16 adoption - however, grew 4% year-on-year as the gross profit decline in Hungary was more than offset by lower indirect costs while, in North Macedonia, improvements were recorded in both gross profit and indirect costs. Furthermore, EBITDA was favourably impacted by the implementation of IFRS 16 to the tune of 4.5 billion forints.

Looking at our **performance against the previously communicated targets** on Slide 5... As forecasted, the revenue growth trend reversed in the second quarter to reach a broadly stable level in the first half of the year compared to a year earlier. Looking ahead, we expect that SI/IT revenues will witness some further decline, though at a much lower rate than recorded in Q2, and, given the changes in our market environment, service revenues are also expected to come under competitive pressures.

With regard to the Group's **EBITDA**, we expect that improved operating efficiency across the Group will mitigate potential revenue and gross margin pressure, as witnessed already in the second quarter. Meanwhile, the higher level of **Capex**, excluding the impact of IFRS 16 adoption, versus last year is driven largely by the more even timing of annual investments compared to 2018.

Our **free cashflow** performance, excluding the 11 billion forint payment for the extension of the 2100 Megahertz frequency license, declined by 7 billion forints versus the prior year. This is attributable to higher outpayments to suppliers, reflecting strong seasonality trends, while mitigated by an improvement in installment and other receivables.



Given the results reported for the first half of the year, we believe we are very well positioned to deliver on our full year target for 2019.

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

Thank you, Tibor. Good afternoon.

Starting with **Hungary** on **Slide 6**, overall **revenue decreased by 5.1% in the second quarter**, primarily due to a significant decline in SI/IT revenues which could not be offset by continued growth in data usage.

As in the previous quarters mobile service revenues have grown, thanks to continuous strong demand for data from the customers coupled with still growing SMS revenues. We expect these trends to carry on into the second half of the year, as we capitalise on our mobile data packages introduced on the 1st August, with higher data limits, which were designed with our more-for-more strategy in mind. The temporary decline in mobile equipment revenues is due to uncertainty surrounding Huawei which has resulted in a significant reduction in sales of their handsets during the quarter, with customers opting for a 'wait and see' approach rather than buying handsets on offer from other brands. On a more positive note, our mobile service revenues continued to benefit from our focus on pre- to postpaid customer migration which also positively affected our results in the second quarter.

Our fixed service revenues increased this quarter thanks to continued expansion of our broadband and TV revenues. In both product lines we managed to grow our customer numbers and thereby offset the structural decline in voice usage and customers. We are very pleased to once again report strong growth in equipment sales and believe this validates the approach we



introduced at the end of last year, which allows customers to combine equipment discounts provided in relation to separate services.

The System Integration and IT revenues witnessed a slowdown due to two key factors - a one-off high-volume deal which inflated our Q2 2018 revenues and a change in the seasonality of public sector projects versus last year.

Despite the revenue decline in the second quarter, our EBITDA increased by 1.2%, keeping us on track to reach our EBITDA target for the year. The decline in our gross profit, attributable to the lower SI/IT performance, was offset by the strong contribution from fixed and mobile services. Our EBITDA figure was further boosted by one-off items which positively affected our other operating expense and income line.

Slide 7 shows the key developments within our **Hungarian mobile operations**. The continuous trend towards postpaid subscribers within our customer base is a direct result of our focus on increasing the ratio of high value customers and our ongoing efforts aimed at encouraging pre-to postpaid migration. The growing attractiveness of postpaid data packages, which I touched upon earlier, has played a key role in driving this trend, which is also supported by the requirement for annual registration of prepaid SIM cards.

Thanks to the positive developments I described earlier, we realised a 3.1% increase in our blended mobile ARPU. The aforementioned pre-to postpaid migration helped to offset the slight decline in our postpaid ARPU along with prepaid group ARPU.

We saw steady growth in our mobile broadband subscriber base in the second quarter with a strong increase in our 4G subscribers. Our sustained focus on growing equipment sales, and providing customers with the latest and 4G ready handsets, has no doubt contributed to the attractiveness of our offers. Thanks to these efforts, we see more and more customers opting for packages with the fastest possible speeds enabled by our state-of-the-art network, which has just recently won the P3 award for the fourth time, for providing the best data service in the Hungarian market. As a result of this, our mobile data is transmitted primarily via our 4G



network, which now handles 96% of our total mobile traffic. This is in line with industry trends which show that data services are currently one of the most important growth drivers in the current telecommunication sector. Consequently, overall mobile data usage is up by 68% year-on-year. The gap between the mobile usage of our 4G and non 4G customers continues to widen, with 4G customers using over 6 times as much data as non-4G customers.

Slide 8 illustrates the continued growth in Broadband and TV customer numbers within our **fixed segment**, supported by the expansion of our triple play subscriber base. In addition to the structural decline in voice ARPU, we have experienced a decrease in TV ARPU due to higher customer discounts, while the fixed broadband ARPU has continued to grow in the second quarter. Our continued focus on our FMC offering is reflected in the growing number of double- and tripleplay customers in our portfolio.

On Slide 9 we have outlined the developments in the **Hungarian System Integration and IT segment**. In the second quarter we experienced a significant revenue decline, which resulted in a lower gross profit for the period. We believe this is only a temporary setback, driven by one-off effects, and remain committed to increasing our gross margin, as per our strategy. We have reached a 25% gross margin in the quarter keeping it on the same level as our Q2 performance in previous years.

Moving on to the performance of our **North Macedonian operations**, this is shown on Slide 10 in local currency to better reflect underlying performance. With three providers now offering integrated services, competition in the telecommunications market remains intense. However, our revenues showed further year-on-year improvement in the second quarter of 2019, thanks to our attractive service offerings.

In the **mobile segment**, revenue growth was primarily driven by higher data revenues. This reflects the continued expansion of our mobile broadband customer base, along with a significant increase in the average level of usage, which was up almost 30% compared to a



year earlier. Both of these trends are strongly supported by our focus on attractive smartphone offerings, which accounted for 90% of our total handset sales in the period. Our total customer base continued to grow, driven by a 6% increase in the number of postpaid subscribers, which was only partially offset by a parallel decline in prepaid subscribers. Despite price levels remaining under pressure, increasing mobile data penetration, coupled with further improvements in our customer mix, led to broadly stable year-on-year blended ARPU performance. As a result of our initiatives, we successfully maintained our market leadership in the mobile segment.

Fixed line revenues also continued to display a positive trend, thanks to higher TV and retail broadband revenues that fully offset lower wholesale and equipment revenues. While competitive pressures are also present in this segment, as shown by the decline in ARPU, the success of our bundling strategy and the associated growth in our subscriber base, counterbalanced their impact.

These positive developments were further supported by the increasing attractiveness of our **FMC Magenta** offer that was redesigned to expand its availability. Since May, customers with an existing mobile and a fixed broadband package have been able to sign up to a Magenta package, with extra benefits accruing to those who take up multiple mobile subscriptions. Thanks to this offering, the number of customers who signed up to an integrated fixed-mobile Magenta plan grew by 30% versus the prior year period.

System integration and IT revenues increased significantly, primarily driven by the strong uptake of public sector projects. Significant contributors to this growth included an equipment delivery project for the Public Transport Enterprise in Skopje, and an IT project delivered for the Meteorological Institute.

EBITDA for the segment improved considerably, even excluding the impact of IFRS 16 implementation, as a combined result of higher gross profits and lower indirect costs. These savings are most visible in the employee related expenses line, which reflects a 6% decline in average headcount and lower severance expenses compared to the prior year.



Looking forward, we believe, that despite the intense competitive pressures, with our attractive Magenta 1 FMC offering, our strong performance in the SI/IT segment and our efforts to drive further efficiencies in the cost base, we are well positioned to maintain the positive performance recorded in the first half of the year.

Tibor Rékasi 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.