Q2 2011 Results Conference Call

Aug 4, 2011 at 15:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's second quarter 2011 results conference call. I am Chris Mattheisen, Magyar Telekom's Chief Executive Officer and Chairman of the Board, and it is my pleasure to host the conference call today.

The second quarter results are a mix of the anaemic economic recovery on the one hand but also encouraging results from our continuing cost efficiency efforts on the other. Despite initially promising trends towards the end of last year and beginning of this year in the Hungarian economy, there is still no clear improvement in household disposable income and consumer spending levels. Hungarian GDP growth continues to be predominantly export-led with unemployment levels still high and consumer confidence still lagging behind. The Government's austerity measures, together with household finances that are still under pressure, have together resulted in a contraction in domestic demand with the consensus forecasting that it will be very slow to pick up. Consequently, spending on telecommunication services remains under pressure and we face, at least in the short term, contracting revenues for the sector. Therefore, despite our achievements to maintain and, in some cases, increase our market share, our revenues still show a declining trend.

Despite these difficult headwinds, our efforts to improve cost efficiency again delivered outstanding results, with an underlying EBITDA margin of 43% in the second quarter. We are, however, cautious on the second half of the year and fear that the current unfavorable economic environment, combined with a potentially stronger Swiss Franc, may limit household disposable income further. Competition is also expected to increase as we approach the year end. Migration of subscribers to our Hoppá package continues to be strong, but, as indicated previously, its positive retention impact will be coupled with dilution in average revenue per access for this year. Furthermore, some of our expense lines are expected to show an increase in the second half, including higher handset subsidies, marketing spend and employee-related expenses, itself a reflection of the government mandated wage increases that are to be implemented from July.

Despite the slight growth in underlying EBITDA for the first half of this year, we maintain our guidance for an underlying EBITDA decline of 4-6% for 2011, although we now expect this decline to be towards the more optimistic end of that range. Our revenue target of a 3-5% decline and CAPEX reduction target of approximately 5% remain unchanged.

Our analysis of the business segments starts with **Telekom Hungary**, which to remind you, incorporates the residential customers and the small and medium-size businesses. Revenues in the second quarter were down by 3% overall due to the continuing decline in our fixed line voice revenues coupled with lower internet revenues, which were only partly offset by increasing television revenues. Mobile revenues also declined slightly. However, thanks to the ongoing cost savings, which can be seen in lower employee-related and other operating expenses, underlying EBITDA was down by only 1% year-on-year, while the underlying EBITDA margin increased by almost 1 percentage point to surpass 42%.

Regarding fixed line revenues, we are facing further declines in traditional PSTN revenues, partly compensated by the increasing new generation IP and cable based fixed voice revenues. Since its introduction at the beginning of this year, our new flat tariff, called Hoppá, significantly contributed to the decrease in fixed voice churn levels, which are now down to 8%. However, as we advised previously, it also lowered the average revenue per access: a decline of 9% in the first half of 2011 compared to the same period in 2010. 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 has proved to be very popular among our customers. More than 300,000 or 18% of our fixed voice customers have migrated to Hoppá to date with the vast majority signing a 2-year loyalty contract. Beyond the positive trend in our churn figures, it has also increased the minutes of use, which we believe will improve our customers' perception of the fixed voice service.

Internet revenues declined due to significant falls in average revenue per user despite an increase in the number of fixed broadband customers and maintenance of our 36% market share of retail broadband customers. This decline was driven by strong competition and discounts to incentivize customers to migrate to multi-play packages resulting in a fall in average price levels.

Moving on to the mobile market, total mobile revenues were down 1% in the second quarter compared to the same period in 2010. The slight decrease in voice retail revenues together with a more substantial one in wholesale, itself driven by the 16% cut in mobile termination rates in December last year, were almost 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 decreased as subsidies in the pre-paid segment and for non-smartphones in the post-paid segment were reduced significantly. Six out of ten handsets sold were smartphones in the last period, and we managed to attach a mobile broadband subscription to every second smartphone sold. Reflecting these ongoing trends, smartphone penetration has reached now almost 15% 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 is further supported by the modernization of our mobile network. As announced earlier this summer, 21 Mbps speed is now available in many parts of Budapest as well as in several rural locations via 300 new HSPA+ base stations. HSPA+ will be available across the entire network by 2013. With the new equipment currently being installed, Magyar Telekom will be ready to launch LTE services once the necessary frequencies become available.

I will now turn to the analysis of the T-Systems Hungary segment, which includes major corporate clients, including the public sector. Due to a lack of any strong positive catalyst in the economic environment, this segment continued to face revenue pressure. Revenues declined by 10% compared to the second quarter last year, primarily driven by lower system integration and IT revenues. The 16% decline in this area is mainly caused by the lack of any public IT project launch in the last couple of quarters driven by government budget constraints while several projects won earlier are nearing completion. However, as this is an issue for the whole IT market, we believe it does not have any market share implications. Based on the latest IDC analysis, our market share in IT services is 15%. Looking ahead, even if some IT projects are put out to tender and we are successful in winning some or all of them, it would still take at least a couple of months for revenues from these projects to be recognized; as a result, we do not expect any significant uptake in system integration or IT revenues this year.

In the telecom business, fixed voice revenues recorded further declines, driven by continued erosion in our customer base, lower usage and decreasing ARPU. Mobile voice revenues dropped too as the higher customer base could not offset the lower tariff levels resulting from strong competition. In addition, the renegotiation of the governmental contracts in August 2010 had a negative impact on our other mobile revenues as well.

On the other hand, successful cost control measures could fully offset top-line decline. Thanks to the focus on total workforce efficiency, we decreased further employee-related costs and through the collection of some outstanding receivables, we managed to decrease the bad debt levels as well. As a result, the underlying EBITDA margin increased by 3 percentage points to 21%.

Regarding our **Macedonian** subsidiary, the intensifying competitive environment in the mobile market had a major impact on our results. Total revenues declined by 13% in the second quarter of 2011 compared to the same period in 2010. The EBITDA margin fell by 3 percentage points, with cost-cutting lagging behind this decline in revenue.

In the fixed line segment, revenues were down by 8% in the second quarter of 2011 as the strong growth in wholesale voice and TV revenues could not offset the 17% drop in retail voice revenues. Despite intense competition in the fixed voice retail market, fixed voice market share stabilized at 78%. The higher voice wholesale revenues were due to 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 subscriptions.

Mobile revenues declined by 17% in the second quarter as a result of significantly lower retail voice revenues due to intensifying competition that is putting sustained pressure on tariff levels and reducing our customer numbers. The slight increase in the post-paid ratio and higher usage levels could not offset the 8% decline in ARPU and the decrease in revenue producing customers. Price competition is especially fierce in the business and pre-paid segments. Competitors are offering higher subsidies and free minutes, putting pressure on our margins and also causing our market share to decline. Nonetheless, T-Mobile Macedonia managed to maintain its clear market leading position with a 50% market share. At the same time, demand for mobile broadband services is increasingly supported by smartphone sales and T-Mobile Macedonia continues to expand its 3G coverage, which now covers two-thirds of the population.

Regarding our **Montenegrin** subsidiary, total revenues remained flat in Hungarian Forint terms, while EBITDA was up by 15% in the second quarter compared to the same period in 2010. EBITDA margin increased from 37% to 42% thanks to the cost saving measures introduced in Montenegro last year. Let me note however, that there was a one-off effect in the second quarter of 2010 in connection with a fraud case in the mobile segment, which had a negative impact on the revenue and EBITDA lines for that quarter of 0.8 million euros and 1.2 million euros, respectively.

<u>Fixed line revenues</u> decreased by 3.3% as contracting voice revenues were only partially 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.

<u>Mobile revenues</u> were up by 4% in the second quarter compared to the same period last year. The increase is mostly attributable to the aforementioned one-off effect. Voice revenues slipped due to lower wholesale revenues as a result of lower interconnection fees and declining incoming minutes together with a declining number of customers in the retail segment. Within the non-voice segment however, the dynamics remained unchanged and we managed to maintain our competitive position.

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 can 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.