Q1 2014 Results Conference Call

May 8, 2014 at 15:00 CET

Good afternoon everybody, and welcome to Magyar Telekom's first quarter 2014 results conference call. I am János Szabó, Magyar Telekom's Chief Financial Officer, and I will be hosting today's call.

Beginning with the analysis of the Group's performance, I am pleased to report that EBITDA increased by 4% compared to the first quarter of last year as an improvement in direct costs and lower operating expenses were able to more than offset the 3% decline in revenues. Based on our first quarter performance, I strongly believe that we are on track to fulfill our public guidance for 2014.

Let me now turn to the segmental analysis, starting with **Telekom Hungary**, where revenues decreased by 3% during the first quarter compared to the same period in 2013. While over half of this decline was due to a decrease in energy revenues, lower voice and equipment revenues also contributed to this trend. These lower revenue streams could not be fully offset by growing TV and mobile internet revenues.

EBITDA for the period increased by 7% as a result of savings in other operating expenses and an improvement in gross margins, especially in relation to energy services. The saving in other operating expenses was largely driven by lower fees and levies following the capitalization of set-top-boxes and annual frequency fees, both of which were carried out in 2013.

In the mobile market, although the number of subscribers increased compared with the same period last year, our subscriber base declined from the fourth quarter of 2013, in line with contraction in the total mobile voice market. At the same time, our quarterly mobile ARPU increased by 3%, and MOU also improved. We consider these increases to be a reflection of our continued efforts to mitigate pressure from rationalization-driven downward migration to flat rate packages through a proactive focus on upward migration. The upselling of additional data allowances and handset insurance also supported these trends.

I am also pleased to report that in April 2014 we commenced testing of LTE Advanced technology. We believe that this innovative development represents the future of mobile broadband and will satisfy the customer data transfer demand that continues to grow globally at an ever-increasing rate. We will continue to test the technology and plan to introduce it in a few years time, once the required amount of frequency assets and handsets capable of handling LTE Advanced are available.

Turning to the fixed line market, although fixed voice churn was below 2%, the underlying trends of multi-play migration and local pricing put pressure on voice ARPU which, in addition to lower traffic, led to a decline in voice revenue of more than 12%. At the same time, TV revenues for the quarter grew by 9% as customer acquisition remained strong whilst ARPU was flat. Although fixed equipment sales declined during the quarter over the same period last year, we continue to expect stable performance for the full year as both tablet and TV set sales are expected to increase throughout 2014. Our latest initiative supporting this trend was the launch of our over-the-top TV service, called TV GO, just yesterday. The new service offers a unique entertainment portal providing, among other things, live TV and video-on-demand services. During the first phase, the OTT Live TV package will provide a multiscreen service to our existing TV subscribers at no additional cost in order to improve customer experience.

In the energy segment, revenues declined by 12%. This was largely driven by an 11% cut in regulated retail prices from November 2013, while an especially mild winter led to lower heating consumption.

Let me now continue with the performance of **T-Systems Hungary.** Revenues for the first quarter decreased by 3%, mainly driven by a 2% decrease in System Integration and IT revenues and an almost 13% decline in traditional fixed data revenues. Nevertheless, the segment’s direct margin increased by 6%, reflecting the shift in focus within System Integration and IT from equipment heavy projects to projects where we can act as a real service or transformation partner. Although there will undoubtedly be a short term hit to our revenues, we strongly believe that this move will support our profitability and lead to improved overall performance in the long run.

EBITDA in the first quarter declined mainly due to higher employee expenses, in line with the higher headcount, and a higher telecommunication tax as a result of the increased tax rate implemented in August 2013.

Mobile revenues increased by almost 5% during the period as a 7% growth in the customer base was checked by the slight decline in ARPU. This development in ARPU is a combination of decreasing voice usage counterbalanced by increasing data usage and a boost stemming from the net 4 forint connection fee introduced in November 2013.

Fixed line revenues were down by almost 13% as trends seen in earlier quarters, namely the termination of voice and data contracts, continued, leading to declines of 9% and 13%, respectively, in related revenues.

Moving on to our international subsidiaries, let me first mention that, on average, the Hungarian Forint weakened by 4% against the Macedonian Denar during the first quarter of 2014, which has had a positive translation effect on the results in Forint terms. Competitive pressures remained intense in **Macedonia** in the first quarter of the year resulting in a total revenue decline of 13% in local currency terms compared to the first quarter of 2013. At the same time, EBITDA declined by 6% in Denar terms, thanks to cost cutting measures such as the headcount reduction that took place during 2013. Consequently, EBITDA margin came in at a healthy 41%.

In local currency terms, mobile revenues declined by 19%, reflecting the aggressive price competition prevalent in the market, which is driving retail prices down. In addition to this, the 60% reduction in mobile termination rates, effective from November 2013, contributed to a 35% decline in wholesale voice revenues. As a result, although MOU increased by 5%, ARPU in local currency terms declined by 21%. We expect competition in this market to remain intense following the launch of flat packages offering unlimited voice, SMS and a couple of GB data usage for just 10 euro per month by both of our competitors.

In the fixed line segment, revenues declined by 6% in Denar terms. Although we continued to witness strong growth in IPTV sales, which drove TV revenue growth of 20%, it was not sufficient to compensate for the 11% decline in voice revenues resulting from the 22% drop in traffic volumes brought about by the lower number of customers and continuing mobile substitution.

At the **Montenegrin subsidiary**, although both revenues and EBITDA **show** a relatively stable picture in Forint terms for the first quarter, as with Macedonia, results were positively impacted by the average 4% year-on-year weakening of the Forint against the Euro. Excluding this, total revenues were down by 2% in local currency terms, while EBITDA for the period decreased by 5%, due to the lower fixed line direct margin and higher severance expenses relating to the voluntary headcount reduction program that was implemented at the end of 2013.

Mobile revenues declined by 4% in Euro terms, partly due to a decline in the prepaid customer base and the 4% lower ARPU. This was due to the combined impact of the competition driven tariff pressure and the lower mobile termination rates which came into effect from March this year.

Turning to the fixed line segment, revenues declined by 1% in local currency terms, as the decline in voice revenues was mostly offset by the growing contribution of TV, internet and equipment revenues. However, the shift in the composition of the fixed line revenues from high margin voice towards lower margin TV services and equipment sales put pressure on our profitability during the period. This pressure is expected to compound further following the introduction of retail price regulation concerning the fixed voice market effective from April this year, and for the fixed broadband market, from September 2014.

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)

I believe we have time for one more question.

(Take final question)

If you have any follow-up questions, please 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.