Q2 2012 Results Conference Call

August 9, 2012 at 14:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's second quarter 2012 results conference call. I am Thilo Kusch, Magyar Telekom's Chief Financial Officer and Member of the Board, and I will be hosting today's call.

Second quarter revenues continued to show an increase thanks to the strong revenue growth in the IT services and energy resale revenues, supported by further growth in mobile broadband and interactive TV services as well as strong smartphones sales. These were particularly offset by lower voice retail revenues driven by economic and pricing pressure and by decline in mobile wholesale revenues due to the regulatory impacts. As a result, we reported a 1% growth in revenues in the second quarter compared to the same quarter last year.

Underlying EBITDA, on the other hand, was down by 9% in the second quarter due to the acceleration of declines in our high margin traditional voice businesses which could not be offset by growth in our lower-margin energy and IT services business. The constraints on household finances in Hungary have continued to tighten and have a negative impact on our voice services revenues through pricing and usage pressures and strong internal migration of customers to more favourable packages. The most recent economic forecasts indicate a recession in Hungary for this year, which together with high inflation is expected to cause real household income to decline by around 3% over the year. In addition, unemployment is at a record high level at above 11% and forecasts show no real easing of this trend for the coming years.

Despite these negative trends and a 7% underlying EBITDA decline in the first half, we maintain our target of a 4-6% decline in underlying EBITDA for the full year. We have implemented wide and deep cost cutting measures for the second half of 2012, not only on G&A items, but also on marketing, subsidies and agent fees where we have adjusted spending to the weaker economy. The fixed and mobile price increase to be launched from the autumn will also assist in achieving our EBITDA target.

Let me now turn to the segment analysis, starting with **Telekom Hungary**. Total sales decreased by 1% in the second quarter as our fast growing energy revenues could not offset the decline in the traditional telco revenues. The combination of a continued reduction of high-margin fixed voice revenues, a higher proportion of the overall sales mix made up by the lower margin energy resale business and higher handset subsidies put pressure on profitability such that underlying EBITDA declined by 11%.

For the mobile market, revenues were down by 3%. A slight increase in our customer base coupled with a steady increase in the proportion of postpaid customers could not fully offset the unfavourable impact of lower effective tariff levels. At the same time, we managed to further increase our SIM based market share to close to 46%, up 1.3 percentage points compared to June 2011.

Besides the positive market share development, the increase in mobile internet usage and penetration also continued in the second quarter of 2012. The number of our mobile broadband subscribers exceeded 1.1 million, which represents 23% of our customer base compared to 15% a year ago. The majority buy smartphones and subscribe for bundled packages which contain a certain amount of voice, broadband and SMS services. The broadband attach rate in new postpaid sales reached 80% in the second quarter of 2012 compared to 52% a year ago, which means that more and more smartphone buyers are interested in the mobile internet services. We have also managed to maintain our 48% market share in mobile broadband.

Moving on to the fixed voice business, revenues decreased by 11% compared to the second quarter of 2011. The continued success of our Hoppá packages and our multi-play strategy had a significant impact on retention levels, with fixed voice churn decreasing to below 4% compared to 8% a year earlier. In 2011, we focused on migrating our PSTN customers to the Hoppá package and since the beginning of 2012, we have made this flat-priced package available on all of our platforms, including voice-over-IP and voice-over-cable. As a result, already 34% of our fixed voice customers now subscribe to Hoppá with more than 90% of these on a 2-year loyalty contract. Despite the improvement in churn figures, the average revenue per access declined by 9% driven by intense competition in the fixed line market, where the share of local multi-play offers with greater price discounts is increasing.

Regarding the fixed internet business, our internet revenues were flat as the 8% growth in the subscriber base compensated for the ARPU erosion resulting from local pricing pressures and multi-play migration.

Turning to the TV market, the positive trends continued into the second quarter as revenues increased by 6% resulting mainly from an expansion of our subscriber base. Growing demand is reflected in our IPTV sales numbers and we continue to focus on the interactive TV market. At the end of July, the interactive TV service became available in the entire country in LTO areas as well through our Hybrid TV product. Thanks to our TV focus, our market share has reached 25% in May, a 1.5 percentage point increase over last year. Television watching has become even more entertaining and enjoyable with the interactive TV's digital sound, enhanced image quality and a wide offering of channels in HD quality, along with its increased functionality, including the electronic program guide, recording, stopping, child lock, searching, Video Store and Archived TV.

Within our retail energy business, the level of sales activity has been remarkable. By the end of June, we had approximately 47,000 electricity and 41,000 gas points of delivery and we expect further expansion in this area. Our aim is to reach 24 billion forint of revenues for the retail energy business by the end of 2012.

I would also like to highlight the high degree of seasonality that this business has, driven by fluctuations in the levels of spending on gas. As an illustration, the share of total energy revenues made up by gas spending was approximately two third in the first quarter and one third in the second quarter. While total energy revenues reached 6 billion forint in the first quarter driven by the extremely cold winter months, revenues for the second quarter reached only 3 billion forint in spite of the nationwide coverage available since April 2012 and the increased number of points of delivery.

Turning to the performance of **T-Systems Hungary,** revenues increased by 5% compared to the second quarter of 2011. Although we recorded an outstanding 31% increase in System Integration and IT revenues, this was mitigated by the accelerating decline of fixed line revenues, which fell by 21% overall.

Mobile revenues in the segment declined by 4% reflecting the 20% cut in termination rates at the beginning of the year. Regarding retail voice revenues, the number of customers increased by 6%; however, the adverse economic environment has forced businesses to include mobile expenses amongst their cost-cutting initiatives, resulting in tariff pressure and the rising trend in usage also reversed. On the other hand, businesses continue to value the benefits of mobile internet, thus leading to 28% more subscriptions than a year ago.

The decrease in fixed line revenues is partly attributable to continuing churn and pricing pressures on fixed voice, but is primarily due to a fall in demand for data services, as the insourcing of data services in the public sector accelerated and private sector customers impacted by the economic downturn renegotiated existing contracts. We strive to reduce the decrease in the coming years and to show a brighter picture of fixed line corporate services.

The booming revenues from the System Integration and IT contracts are a result of a number of smaller-scale projects. Please note that there has been a shift in the System Integration and IT revenue structure, meaning that lower-margin equipment sale and installation projects have partly replaced higher-margin complex contracts, leading to a very pronounced dilution in direct margins. However, we expect this dilution to be temporary as business surveys show that demand will rise for more complex projects such as system integration, custom application, and outsourcing services. At the same time, large-scale public projects that have been deferred for a while will hopefully be brought back on-stream in the near future. T-Systems Hungary is in a favourable position to compete for these projects as we extended our market leading position again by 1 percentage point in 2011 to 16% market share, and will aim to maintain EBITDA generation by increasing the market share even further.

The underlying EBITDA of T-Systems Hungary decreased by 1% compared to the second quarter of 2011. The decline in underlying EBITDA margin was limited to 1 percentage point as the fall in System Integration and IT margin was mostly compensated by strict cost control.

Turning to our international subsidiaries, let me draw your attention to the 10% weakening of the forint against both the denar and the euro in the second quarter of 2012 compared to the same period last year.

At our **Macedonian** subsidiary, total revenues declined by 4% and EBITDA was down by 9% in forint terms. However, excluding the positive foreign exchange impact, revenues were down by 13% mainly driven by the decline in voice retail revenues. EBITDA declined by 17% in denar terms in the second quarter compared to the same period last year leading to a margin decline of 2.5 percentage points. Although direct costs and other operating expenses decreased in line with revenues, employee-related expenses were on the same level as last year resulting in margin deterioration. Nevertheless, our EBITDA margin remains at a very healthy level of 51%.

Mobile revenues declined by 15% in the second quarter in denar terms driven by a 4% lower customer base and an 11% decrease in ARPU. Competition in the mobile market remained intense leading to further tariff erosion both on voice and non-voice services. This trend is reflected in the lower ARPU levels which decreased despite the 20% increase in the minutes of use. Nevertheless, thanks to our efforts to reduce overall churn with targeted offers paying special attention to retaining our high value subscribers, we have maintained our leading position in the mobile market. Our overall market share was 50% while our active subscriber market share stood at 57% at the end of the second quarter.

Fixed line segment revenues decreased by 11% in local currency terms primarily driven by falling retail voice revenues that could only partially be compensated by growing TV revenues. To tackle the competitive pressure in the fixed line market, we repositioned our portfolio during the second quarter by focusing heavily on double and triple play offers. The initial results are promising: monthly fixed churn figures have halved compared to thr earlier periods and the IPTV subscriber base expanded by 22% during the second quarter. This led to a 2 percentage point increase in our TV market share which now stands at 13%. Thanks to the introduction of our new offers, by the end of the second quarter, more than one third of our fixed voice customers had subscribed to a double or triple play package and we expect this ratio to improve further.

Now looking at the performance of our **Montenegrin** subsidiary, we see a 6% revenue increase and flat EBITDA in forint terms. In euro terms revenue declined by 4% in the second quarter compared to the same period of last year, while EBITDA declined by 10% driven by several one-off items and accounting corrections.

Mobile revenues declined by 7% in euro terms due to the 10% decline in voice revenues. The decrease in voice retail revenues was primarily the result of competition driven price erosion while wholesale voice revenues fell reflecting the 17% cut in mobile termination rates implemented last November. Non-voice revenues were 10% higher than in the second quarter last year, thanks to higher SMS and mobile broadband usage. The number of mobile internet users increased by 4%, allowing us to become the leading provider in the mobile data market with a 36% market share. At the same time, our mobile voice market share remained broadly stable at 34%, and we further increased our market share in the postpaid segment to 42%.

Fixed line revenues declined by 2% in euro terms, as the growing contribution of internet and TV revenues almost fully offset the decline in voice usage and lower international transit revenues. The number of broadband subscribers rose by 9% compared to the end of June last year which, combined with the 3% decline in ARPU, led to a 6% increase in internet revenues. Our IPTV subscriber base increased by 17% which helped us strengthen our market leading position further. As ARPU for IPTV remained broadly stable compared to the same period last year, our TV revenues also increased by 17% in local currency terms.

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, I 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 would like 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.