

3Q 2017 Results Conference Call

November 9, 2017 at 15:00 CET

Good afternoon everyone. I am Linda László, Head of Investor Relations at Magyar Telekom. I would like to welcome you to our third quarter 2017 results 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.

With me today is Mr. Christopher Mattheisen, our CEO, and Mr. János Szabó, our CFO, 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.

Let me start by highlighting key financial and operational achievements at Group level for the third quarter, followed by an update on our targets for the year.

As shown on **slide 2**, both top line and EBITDA grew strongly year-on-year. The 9% increase in Group **revenue** was driven by continued high demand for equipment across all the segments alongside high visitor data revenues and improving ARPU trends for Hungarian fixed services. At the same time however, increasing competitive pressure and postponement of public IT tenders resulted in revenue pressure in Macedonia.

Group **EBITDA** improved by 12% year-on-year, a reflection of a more balanced revenue mix in Hungary and cost structure optimisation measures implemented in both Hungary and Macedonia.

In terms of operational highlights, which can be observed on **Slide 3**, demand for data services in the mobile segment remained strong with average monthly usage increasing by over 40% on our network compared to a year earlier. This growth in mobile data demand is expected to continue driven by initiatives such as our flexible postpaid tariff scheme and the launch of unlimited data packages. Such initiatives are expected to also support the positive trends witnessed in both the customer mix and ARPU.

Introduction of the EU Roam Like Home legislation had a marginal overall positive revenue impact, thanks to increased subscriber and visitor data usage, whilst adverse EBITDA impact was lower than our initial expectations.

In the **fixed line segment**, we restructured our broadband offerings during the quarter to enhance our competitiveness and better exploit our network capabilities; we now offer faster download speed packages ranging from 30 megabits per second to even 2 gigabits per second in some specific cases. Early results from this initiative are promising: over 80 thousand customers have subscribed to new packages, over a quarter of whom are new customers to Magyar Telekom. Amongst these almost half opted for a package with speeds of over 100 megabits per second. This rate compares to an average rate of one-fifth for the subscriber base as a whole.

At the beginning of September, we expanded our flagship **Magenta 1** offering in line with our focus on FMC and evolving customer requirements. This offering used to supply mobile voice, fixed voice, broadband and TV; now, customers can choose between fixed voice or mobile data as the additional element. This initiative further supports the expansion of our active FMC customer base, which now stands at 11% of our total households. Our total FMC household base, i.e. including those where there is no direct linkage between fixed and mobile subscriptions, stands at 23%. As currently the only truly integrated operator in Hungary, we are uniquely positioned to fulfil the communication requirements of Hungarian households and thus maximize the telecommunication share of the household spending wallet.

Looking briefly at the **Macedonian operations**, EBITDA rose by 5% year-on-year, despite an increase in competitor related pricing pressure, thanks to continued expansion of mobile broadband and TV service subscriber bases coupled with significant savings in operating expenses.

Before moving on, I would like to note that following changes to **Hungarian legislation regarding loyalty periods** and discounts, we introduced some changes to our fixed portfolio, effective as of mid-October. Customers who subscribe for a 1-year loyalty period will receive discounts for the first 3 months, whilst those who opt for a 2-year loyalty period receive discounts on a wide range of audio-visual equipment, including mobile handsets. This loyalty system differentiates us from our competitors, as does our highly regarded service value proposition.

Moving to our nine month **2017 financial results and full year targets on Slide 4**, we delivered a 6% increase in nine months revenues due to strong growth in mobile, fixed and IT equipment sales. Whilst this growth may appear strong in relation to our full year revenue target, equipment revenues are subject to large fluctuations based on market demand.

EBITDA in the third quarter was supported by several one-off factors, including real estate sales, provision reversal and strong visitor revenues, which we do not expect to be repeated in the fourth quarter.

The above-mentioned influencers on revenue and EBITDA performance, as well as increasing competitive pressures in both Hungary and Macedonia mean that our full year revenue and EBITDA targets remain unchanged. Our capital investments for the last quarter are largely already scheduled; we are confident of meeting our Capex target and also anticipate meeting our free cash flow target for the full year.

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

Thank you, Chris. Good afternoon.

Let me start with **Hungary** on **Slide 5**. Overall revenue increased by 10% in the third quarter, due to significant growth in System Integration and IT revenues, coupled with growth in mobile data and equipment revenues.

Mobile service revenues increased due to continued growth in mobile data revenues resulting from higher subscriber numbers and usage, which compensated for the competition driven decline in voice revenues. Other mobile revenues also increased thanks to sales growth in smartphones and accessories coupled with the provision reversal relating to cessation of the points-based loyalty program in Hungary. This program allowed subscribers to collect points to be used in exchange for discounts on equipment and accessories and was terminated in the Summer. The Roam Like Home regulation partly supported mobile revenues, through boosting visitor revenues.

Fixed line revenues increased due to growth in fixed broadband, TV, data and equipment revenues, which more than offset the continued structural decline in voice retail revenues. TV revenues grew due to subscriber base expansion and higher ARPU levels, which was coupled with growth in data revenues driven by FINA World Championships related projects and increased fixed equipment sales on account of higher sales volumes of TV sets and laptops.

The significant increase in System Integration and IT revenues observed in the first half of the year was sustained, underpinned by EU fund inflows, albeit at a slightly slower pace than in the second quarter.

Hungarian EBITDA increased by 13% year-on-year, driven by an increase in gross profit and higher other operating income. Gross profit increased due to a more balanced revenue composition and the provision reversal related to cessation of the loyalty program. Higher telecom tax, driven by increased mobile voice traffic due to growing popularity of flat rate packages, was offset by lower mobile handset subsidies. Employee-related expenses slightly

increased due to higher employee numbers, while other operating income improved due to real estate sales as part of our optimization program, and higher brand fee income from the E2 energy joint venture.

Slide 6 shows developments in the Hungarian **mobile market** where there has been a variance in trends between different segments. Whilst competition driven price decrease continued to impact profitability in the SMB and Enterprise segments, in the residential market, favorable trends in the customer mix were sustained. Furthermore, the customizable postpaid tariff system launched at the end of March was well received by the market. This, along with higher demand for larger data packages and data boosters and expansion of the Magenta1 offer to include unlimited data packages contributed to a year-on-year increase of almost 3% in blended ARPU for the third quarter.

We also increased our total mobile customer base by 2% in the quarter. The third quarters' prepaid customer figures are yet to show the impact of compulsory prepaid registration, as the final cut-off date was extended until the end of September 2017; the impact on customer figures will be felt in the fourth quarter. All in all, following the registration process, we have retained 86% of SIM cards and more than 95% of prepaid revenues, which we consider a great achievement.

Moving to mobile broadband usage, 83% of our total mobile data is now provided via our 4G network which covers 99% of Hungary's population. The increasing proportion of data provided as 4G runs parallel to the rise in average data usage per month, which currently stands at 1.5 Gigabits per month.

In terms of our fixed line segment, as you can see on **Slide 7, broadband and TV** customer base expansion continued in the third quarter. Despite an increasingly competitive environment, fixed broadband revenues increased thanks to a restructuring of our broadband offerings. Expansion of the customer base as a result of this initiative offset the 2% decline in fixed broadband ARPU and we expect further growth in subscriber numbers. TV revenues increased too, underpinned by improved ARPU levels, reflecting the price increases that

relate to the content fee introduced in July 2016 and the launch of our new TV package around twelve months ago. Briefly on our energy business, it should come as no surprise that revenues declined by 8% in the third quarter; the fourth quarter will be the last in which we generate energy revenues, following our exit from the residential segment of the electricity market as of November 1, 2017.

Our focus on FMC continues, demonstrated by the increased proportion of 3Play customers, which now represent 43% of our total households, an absolute 5 percentage point growth year-on-year. This positive trend was coupled with an increase in multiplay ARPU levels.

Slide 8 shows the year-on-year development of the **Hungarian System Integration and IT segment for the quarter**. The 10% increase in System Integration and IT revenue was a key contributor to overall growth in Hungarian revenues and is attributable to increased EU fund inflows. EU funded projects are typically public sector hardware and software deliveries, and so despite their positive impact on revenue, they're relatively low margin. These projects do however, serve as a starting point for the development of long term customer relationships and so have the potential to translate into future IT service contracts.

Moving onto our **Macedonian operations** on **Slide 9**, I am pleased to report that the turnaround in EBITDA witnessed in the second quarter has continued into the third quarter. Total revenues declined by 3%, whilst mobile revenues remained stable for the quarter, helping to offset a decline in revenues in the fixed segment. System Integration and IT revenues continued to be negatively impacted by delayed government projects resulting from market uncertainty.

In the **mobile segment**, data and equipment sales revenues continued to increase, however, the majority of this growth was offset by the 30% cut in mobile termination rates, which took effect in December 2016. Blended ARPU for the segment slightly improved, despite increased competition and slight contraction of the subscriber base, as a result of ongoing migration of customers from prepaid to postpaid and increasing data revenues. Prepaid ARPU increased

by approximately 8% in the third quarter thanks to seasonally high visitor numbers and an approximate 30% increase in entry level prepaid package pricing.

In the **fixed line segment**, revenues declined due to lower voice retail, broadband and wholesale revenues. Voice retail revenues declined due to lower subscriber numbers and a general decrease in usage, whilst the decline in broadband retail revenues was driven by lower pricing resulting from 3Play competition. These negative impacts were partially offset by strong TV revenue growth supported by both increased IPTV customer numbers and continued growth in ARPU levels.

System integration and IT revenues significantly declined in the quarter due to the postponement of several major government projects.

Macedonian **EBITDA** increased by 5% this quarter due to significant cost savings. These savings were the result of cost optimisation measures as well as a deferral in marketing expenditure. Despite the challenges that ongoing competitive pressures, we believe that the turnaround in EBITDA is sustainable.

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.