

# Q4 2012 Results Conference Call

February 28, 2013 at 16:00 CET

Good afternoon, everybody, and welcome to Magyar Telekom's fourth quarter 2012 results conference call. I am Chris Mattheisen, Magyar Telekom's Chief Executive Officer and Chairman of the Board, and I will be hosting today's call with Thilo Kusch, our CFO and fellow member of the Board.

Despite a decline in general economic conditions, we managed to strengthen our presence across our key markets and deliver robust results in 2012. At 2%, the increase in top line revenues was ahead of expectations, driven by the significant expansion of TV, mobile internet, System Integration/IT and retail energy services. The Christmas period, in particular, was once again very strong in terms of mobile handset sales and upgrades, while TV subscriptions and television sets also made a significant contribution to the results.

With a decline of 4%, underlying EBITDA was at the more optimistic end of our targeted range of a 4 to 6% decline. This was due to our stringent approach to cost management and the efficiency review of our real estate assets in Macedonia, which ultimately resulted in savings on a number of operating costs. This was further supported by the gain on the sale of our Pro-M subsidiary.

In addition to continuing with our internal efficiency programmes, in 2012 we made significant progress on the mobile base station modernisation project. To further support the expansion of smartphones and mobile internet usage, we became the first operator in Hungary to launch a commercial LTE service, and by the end of 2012 we had full 4G coverage in Budapest and 60 other towns across Hungary. As a result of these initiatives, our Capex, excluding spectrum acquisitions, of 92 billion forint was slightly ahead of our 90 billion forint target for 2012.

Our free cash flow decreased by 30 billion forint to 62 billion forint, primarily due to the payment of the SEC and DOJ settlement charge in January 2012 and higher capital expenditures largely relating to the 11 billion forint spectrum acquisition.

In line with our strong focus on shareholder returns, our Board of directors at its meeting this morning proposed a dividend payment of 50 forint per share for approval at the Annual General Meeting. The

Annual General Meeting is scheduled for April 12, and the record date for dividend payment is planned for the 9<sup>th</sup> of May 2013.

Looking ahead, we expect market conditions to remain challenging. In addition to intense competition, the weak economy continues to have a negative impact on consumer and corporate spending. Although we are no longer required to pay the special tax, we expect the traffic-based telecom tax introduced in July 2012 and the tax on utility and telecom networks levied on operators from 2013 to put pressure on our performance. While we will continue to identify new revenue sources and keep prudent cost management among our key priorities, we expect our overall profit margin to decline in 2013. We estimate that our revenues will decline by up to 3%, and reported EBITDA by 4 to 7% year-on-year. Capex, excluding spectrum acquisitions, is expected to decrease by approximately 5% in 2013, compared to 2012.

Let us now turn to the quarterly segment analysis, starting with **Telekom Hungary**. Total sales for the segment increased by 6% in the fourth quarter as energy revenues almost quadrupled compared to the same period last year. Growth in TV, fixed and mobile equipment and mobile non-voice revenues also remained healthy, while the price increase had a positive effect on our traditional businesses. Thanks to our successful efficiency measures, we were able to limit the decline in our underlying EBITDA caused by the changing revenue structure to just 2%.

In the mobile market, revenues increased by 1% as we successfully expanded our customer base and market share. The price increase introduced in September led to a mitigated ARPU decrease of less than 2% compared to the fourth quarter of 2011.

We were extremely pleased to see continued strong demand for smartphones in the fourth quarter. To capitalise on this opportunity, we were the first to sell iPhone 5, which along with several other LTE-ready handsets proved extremely popular during the Christmas season. Almost 90% of the handsets sold to post-paid customers in the fourth quarter were smartphones, and more than three quarters of smartphone buyers also subscribed to a mobile internet package. We also saw favourable developments in tablet sales as the number of tablets on our network grew by 20% over the three month period. With smartphone penetration at just above 31% and a little more than 22,000 tablets on our network, we expect sales of high-value mobile devices to remain strong in the coming years.

Moreover, we expect our continuing expansion of LTE coverage to support demand from smartphone and tablet buyers for our mobile broadband packages.

Moving on to the fixed voice business, revenues in the fourth quarter of 2012 decreased by 14% compared to the same period of 2011. However, we are encouraged by the positive trend in our churn rate - year-on-year, we have lost less than 4% of our fixed voice customers. This is testament to the success of our retention strategy focused on migrating customers to the flat-price Hoppá package.

In the fixed internet business, revenues grew by 1% as the 3% ARPU erosion due to local pricing pressures and multi-play migration was more than offset by the 5% increase in the subscriber base.

TV market revenues increased by 7% mainly due to a 5% increase in our subscriber base. Although multi-play migration had as negative an effect on our TV ARPU as on Internet and voice ARPU, interactivity upselling secured an increase in ARPU of more than 3% compared to the fourth quarter of 2011.

Our retail energy business achieved revenues of more than 25 billion forint for 2012. To reiterate, the main purpose of our energy retail segment is retention and upsell of our fixed telco services. Preliminary data indicates that telco churn among energy customers is about a quarter of the rest of our customer base whilst energy customers are 70% more likely to accept upsell offers.

Let me now hand over to Thilo who will provide further details on the results of the T-Systems Hungary segment and the international subsidiaries.

### *Thilo Kusch remarks*

Thank you, Chris.

Now let's turn to **T-Systems Hungary's** results. Revenues decreased by 3% compared to the fourth quarter of 2011. The 10% increase in System Integration and IT revenues was offset by an acceleration in the decline in fixed line revenues, which fell by 24% overall. Mobile revenues also witnessed a decline, principally due to the fallout of Pro-M revenues from September. Underlying EBITDA decreased

by 29% compared to the fourth quarter of 2011 as the fall in revenues together with the contraction in the System integration/IT margin and disposal of the higher margin Pro-M business could not be compensated through cost-cutting initiatives.

Looking at the segment in greater detail, mobile voice revenues declined by 5% as contract renegotiations placed pressure on tariffs and usage levels waned. Competition in this segment is extremely fierce given that price is the primary differentiator. As mentioned earlier, the loss of Pro-M revenues also had a significant negative impact on other mobile revenues.

The decrease in fixed line revenues is partly attributable to continuing churn and price pressures in both the fixed voice and internet segments. However, the majority of the decline was driven by a sharp decrease in data revenues, as the trend to insource data services in the public sector accelerated.

A number of small scale projects contributed to a 10% increase in System Integration and IT revenues. However, our margins were diluted by the continued shift in the System Integration and IT sales mix as lower margin equipment and license sales, and hardware installation projects replaced higher margin complex contracts.

Despite these adverse factors in the fourth quarter, there have been a number of achievements that give grounds for optimism. We signed several major deals during the period, including one with the Budapest Transport Company. We also renewed an important long-term contract with Raiffeisen Bank to continue to provide the full-range of telecom services.

Moving on to our international subsidiaries, performance in **Macedonia** in the fourth quarter remained under pressure from challenging economic conditions and intense competition. Consequently, total revenues in local currency terms declined by 10% compared to the last quarter of 2011. On average, the forint strengthened by 7% against the Macedonian denar during the last quarter of 2012 leading to a decline in forint terms of 17%.

Mobile revenues in local currency were down 13% for the quarter, as voice retail revenues continued to decline. This was primarily due to a 6% decrease in the subscriber base, and severe price pressure induced by competition. In order to retain customers we introduced new, competitive price plans and special promotions, including temporarily halved subscription fees and bundled free minutes. Consequently, although MOU increased by 21% compared to the fourth quarter of 2011,

ARPU decreased by 7% in denar terms. However, we did experience increasing demand for smartphones, which comprised 40% of handset sales in 2012. This trend also supported positive developments in mobile internet usage, which led to a sharp increase in revenues from this source.

In the fixed line segment, revenues were 7% lower in denar terms as trends we experienced in earlier quarters continued. Voice revenue decline can be partially attributed to the lower average subscriber base, though discounts given under our new fixed portfolio, on offer since May, also had a major impact on this trend. However, thanks to our new product portfolio, designed to migrate customers to double and triple play packages, the number of broadband customers grew by 6% and the IPTV subscriber base by 65%, compared to 2011. In addition to this, the ratio of double and triple play customers grew to 54% by year end, from 47% a year earlier.

Underlying EBITDA in Macedonia declined by 26% in forint terms. In denar terms, the decrease was 20% due to lower revenues and increased mobile voice and TV related payments driven by the higher subscriber base. Savings on employee-related and other operating expenses could only partially mitigate these trends. Consequently, underlying EBITDA margin declined to 44%.

Revenues at our **Montenegrin** subsidiary declined by 8% in the fourth quarter compared to the same period last year, while underlying EBITDA decreased by 4%. As with Macedonia, our Montenegrin subsidiary's fourth quarter results were deflated by a 7% year-on-year negative foreign exchange effect. Excluding this, total revenues were down by 1% in local currency. Underlying EBITDA for the period increased by 3% due to significant savings in employee-related expenses linked to an accrual release. As a result of this, we managed to increase the underlying EBITDA margin to 36%.

Mobile revenues declined by 2% in euro terms. Two regulatory events continued to affect our mobile business in Montenegro. Pre-paid user registration and SIM-based tax introduced from 1 July 2012 have led to a decrease in our subscriber base whilst MOU and ARPU increased as pre-paid customers with the lowest usage continued to churn out. However, mobile internet and equipment sales remained robust and we strengthened our market leader position in the post-paid segment with a market share of 43% in December.

Fixed line revenues remained flat in local currency terms, as the growing contribution of TV and equipment revenues offset the decline in voice and data usage. Although competition from cable

operators is getting stronger, we have managed to maintain high market shares in all of our fixed line businesses.

*Chris Mattheisen remarks*

Thank you, Thilo. That concludes the formal part of Magyar Telekom's conference call. We are now happy to open the floor for questions. Operator, when you are ready, we will take the first question.

*(Take questions)*

If you have any follow-up questions, please contact our Investor Relations Department. As usual, the transcript of today's conference call will be available on our website. Thank you again for joining us today, and for your continued interest in Magyar Telekom.