

Q4 2009 Results Conference Call

February 25, 2010 at 15:00 CET

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's fourth quarter 2009 results conference call. I am Chris Mattheisen, Magyar Telekom's Chairman and Chief Executive Officer and I am hosting today's call together with Thilo Kusch, our CFO and a member of the Board.

We witnessed a very challenging year in 2009, when our already difficult market environment that was characterized by increasingly intense competition deteriorated further as a result of the economic crisis. Driven by the recessionary environment, both in Hungary and at our international subsidiaries in Macedonia and Montenegro, consumer spending came under significant pressure that in turn affected demand for telecommunication services, in both the residential and the corporate segments. Customer efforts to rationalize spending led to lower usage volumes and intensified customer erosion, whilst the competitive pressures drove price levels further down. Rationalization was especially pronounced among small and medium sized businesses where the recession impacted particularly hard. In addition, public sector spending also saw cutbacks, driven by tight public budgetary conditions.

To address these challenges, we remained focused on strengthening our competitive positions in our core markets. Thanks to these initiatives, we have maintained our clear market leadership in the Hungarian mobile segment, both in voice and broadband. In the domestic fixed line segment, we continued with our triple play offerings aimed at strengthening Magyar Telekom's position as the only fully integrated service provider, with demand for these packages exceeding our expectations. At the same time, we were able to increase considerably our share of the TV market in 2009 and are now the second biggest TV provider in Hungary. Owing to our integrated IT-telecommunications products, we further strengthened our ICT leadership, resulting in increased revenues from this segment, despite the difficult market environment.

However, we could not completely offset the adverse impacts of the external environment on our performance; consequently, our revenues, excluding the fixed-to-mobile provision reversal in 2008, declined by 3% in 2009, somewhat greater than what was originally targeted. At the same time, however, thanks to cost control measures which we implemented during 2009, both EBITDA excluding

special influences and one-off items, with a decrease of 4%, and CAPEX of 102 billion forint were slightly better than targeted.

Looking ahead to 2010, we expect continued pressure on consumer spending due to high unemployment and restricted growth in household disposable income. At the same time, unfavorable trends in the corporate segment are likely to continue this year, also putting pressure on our top-line performance. Although some improvements are expected in these trends towards the end of the year, it is still difficult at this time to predict how exactly our performance will be affected, due to the political and economic uncertainties that are still prevalent. In addition, a stronger forint compared to average 2009 exchange rates may have an adverse impact on our results by negatively affecting contributions from our international subsidiaries. Taking all currently known factors into account, we are targeting a revenue and EBITDA decline of 5-7% for 2010, the latter excluding special influences. Whilst in 2010 we are aiming to achieve further efficiency improvements across the Group, the positive impacts on EBITDA might be offset by the accelerated decline of the high margin voice revenues and parallel increase of revenues with lower EBITDA margin content. However, the higher portion of SI/IT revenues in the overall mix should allow us to reduce our CAPEX, with 2010 levels expected to be approximately 5% lower compared to last year's spending.

Before going through the analysis of the fourth quarter results, let me inform you that the Board of Directors of Magyar Telekom is expected to decide on the convocation of the Annual General Meeting and its proposal on the dividend payment after 2009 results tomorrow, on 26th of February. As usual, we will make an announcement on the proposals after the decision has been made.

Turning to the fourth quarter financials, revenues declined by 4% driven by the above mentioned factors, such as the decline in voice retail revenues both in the fixed and mobile segments. These could only be partially compensated by the higher revenue contributions from TV and mobile internet services that reflect the increased customer numbers at both, and the growth in System Integration and IT revenues thanks to the conclusion of some major projects that were postponed earlier in the year.

EBITDA, excluding the special influences, decreased by 8% as lower revenues were coupled by higher employee-related expenses due to the annual wage increase. These could not be fully offset by the lower level of voice related payments, reflecting the lower voice usage and the cut in Hungarian mobile termination rates, and the decrease in other operating expenses driven by the cost cutting initiatives.

Now let me turn to the business unit analysis, where I will start with the results of our **Consumer Services Business Unit**. Total revenues declined here by 4%, driven by the continuing intense competition and the recession putting pressure on both fixed line and mobile revenues. Nevertheless, thanks to our efforts to enhance the cost efficiency at CBU, fourth quarter underlying EBITDA margin of 53% was a slight increase compared to the same period in 2008.

In the fixed line market, the recession, mobile substitution and cable competition continued to put pressure on our traditional voice business and PSTN churn remained high in the fourth quarter of 2009. However, the efforts to strengthen Magyar Telekom's position as an integrated operator with TV as one of the core products in the offering have borne fruit, with the number of 3Play customers doubling during 2009. Despite this, 55% of total CBU customers still only have voice subscription, and we aim to retain these customers by selling them at least one further service to lessen the chance that they will be lost: this should help mitigate the revenue and profit loss on our traditional voice business.

Decreasing fixed voice revenues were coupled with some decline in internet revenues. Although the number of broadband customers continued to increase, exceeding 595,000, and we were able to maintain our market leading position in the retail broadband market, internet revenues decreased by almost 7%, reflecting the declining prices and the increasing migration towards lower priced packages.

Thanks to our TV-focused strategy in the fourth quarter of 2009, television revenues increased by 33% compared to the same period of 2008, parallel to the 38% growth in the subscriber base, which exceeded 630,000 by the end of 2009. In addition to the strong demand for our satellite TV offering, the number of IPTV subscribers more than doubled over the year.

Regarding the fiber rollout, we will continue to increase the number of covered households this year, and plan to cover an additional 50,000 households by the end of 2010. The upgrade of the cable network with the Euro Docsis 3.0 technology that provides superfast broadband is also set to continue with an additional 220,000 households. Besides increasing the coverage, we plan to widen our product portfolio by offering IPTV via cable. Accordingly we now plan an investment of around 5 billion forint in 2010, while the total Capex plan of 40 billion forint for the 5-year project is maintained.

In the residential mobile voice market, the recession and the regulatory steps were the main drivers of the business trends. Due to the crisis, churn rates did increase significantly and the customer base is

lower than in the same period of 2008. As a result, CBU mobile revenues came under pressure in the fourth quarter resulting in a 5% decrease in total mobile revenues compared to the fourth quarter of 2008 and an annual 7% decrease in ARPU, which was also impacted by the mobile termination rate cut effective since January 2009. Please bear in mind, that in January 2010, the regulator cut the mobile termination rates by a further 16%. The number of inactive prepaid SIM cards declined in the fourth quarter as all operators continued to clean-up their SIM portfolio and customers cancelled their multiple SIM cards. In this environment, T-Mobile managed to remain the clear market leader with a 44% market share among active customers.

Despite the difficult economic environment, the mobile broadband market continues to expand. Driven also by our high quality 3G network, the number of T-Mobile Hungary's mobile internet subscribers increased by more than 60% in 2009, reaching close to 430,000 by the year-end. Non-voice mobile revenues remained broadly flat in the fourth quarter of 2009 compared to the same period of 2008, as the increase in internet revenues was offset by the decreasing data revenues driven by the lower number of SMS and MMS. We see that customers are reacting very positively to our multimedia mobile packages, which offer bundled mobile voice, messaging, internet and mobile TV service. Due to the high demand for mobile internet solutions, we expect that the mobile broadband market will continue to grow further in 2010.

Let me hand over now to Thilo who will provide further details on the results of the Business Services and the international subsidiaries.

Thilo Kusch remarks

Thank you, Chris.

Let us now continue with the results of the **Business Services Business Unit, or BBU**. The depressed macroeconomic environment continues to put significant pressure on our business performance in this unit, mainly impacting voice services. Despite the scale of the slowdown in economic activity and the competitive landscape we operate in, BBU financials were relatively solid.

Revenues at BBU in the fourth quarter of 2009 declined by 2% compared to the fourth quarter of 2008, driven by declining fixed line and mobile voice revenues that were partly offset by higher SI/IT revenues.

Thanks to disciplined cost management, underlying EBITDA increased by 3% and underlying EBITDA margin rose from 43% to 45% in the last quarter of 2009.

Business trends at BBU do not show any considerable improvement. Customers are still rationalizing their IT and telecommunication spending, resulting in significant downward pressure on prices. Rationalization is especially pronounced among small and medium sized businesses where the effects of recession have been particularly felt. The hardest hit segment has been the traditional fixed line voice service business, followed by mobile voice services. Nevertheless, the unfavorable impacts were somewhat offset by a steady increase in the mobile internet and strong fourth quarter system integration/IT service revenues. The latter was driven by some important public sector projects and traffic management services for coach transport companies.

In order to preserve margins, BBU initiated several efficiency improving measures; for example, BBU is continuing to simplify its operations that will help to support the convergence process between system integration/IT and traditional telecommunication services. As a result, from the beginning of 2010, a unified sales team has been delivering traditional telecommunication, as well as ICT and IT Infrastructure equipment services.

Moving on to the analysis of our international subsidiaries, total revenues in **Macedonia** declined by 4% in the fourth quarter of 2009 compared to 2008. This result also reflects the positive impact from the forint weakening against the denar. Although cost cutting measures were implemented and helped to improve the results, they could not fully compensate the revenue decline, with underlying EBITDA falling by 7%.

Despite several churn reduction measures, fixed line revenues declined further due to the intensifying competition coming from alternative operators and mobile substitution. Furthermore, the unfavorable economic environment also put pressure on the Macedonian business, resulting in lower outgoing traffic volumes and high customer erosion.

To counterbalance these unfavorable trends, we strengthened our emphasis on broadband services, and thanks to these efforts the number of ADSL and IPTV customers continued to grow steadily, and our 2Play and 3Play offers prove to be successful. All these helped to ease somewhat the decline in voice revenues.

Turning to the Macedonian mobile business, mobile revenues were kept stable. The close to flat RPC base and the higher usage coupled with an improved customer mix offset the pressures from the continued competition-driven tariff decreases. Although T-Mobile Macedonia's market share decreased slightly to 56%, the company continued to maintain its clear market leadership position. As we are facing increasing demand for mobile broadband services and iPhone, T-Mobile Macedonia continued to expand its 3G coverage, reaching 53% of the population by the year-end.

Let us continue with Montenegro. Despite the negative economic environment, fourth quarter 2009 revenues were broadly flat, helped also somewhat by the forint weakening against the euro. However, underlying EBITDA increased by 17% due to strong cost control, in particular over marketing expenses and underlying EBITDA margin improved from 34% to 40% in the last quarter of 2009 compared to the last quarter of 2008.

In the fixed line business, growing broadband internet and TV revenues partly offset the revenue decline that characterizes the traditional voice business. The ADSL and IPTV market grew dramatically: total connections increased by more than 40% year-on-year. During the quarter, we have also launched bundled triple play products in order to strengthen further the loyalty among standalone fixed line voice subscribers. The first sales results are very encouraging, with demand for our bundled products exceeding our expectations.

The Montenegrin mobile market remained extremely competitive resulting in further decreases in tariff levels. One of our competitors is very active in the post-paid and business segment, while the other, the third entrant, continues to be very aggressive in the pre-paid segment. In this environment, T-Mobile was able to maintain its market leading position in the post-paid market segment, and even increased its overall market share by the end of 2009. The pressure on revenues driven by lower tariffs was somewhat counterbalanced by a higher subscriber base and slight increase in usage. As a consequence, mobile revenues declined by 3% in the fourth quarter compared to same period in 2008.

Chris Mattheisen remarks

Thanks Thilo.

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 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 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.