

## 3Q 2016 Results Conference Call

November 10, 2016 at 15:00 CET

Good afternoon everyone and good morning to those of you calling from overseas. I am Linda László, and on behalf of the Company, I would like to welcome you to our third quarter 2016 conference call. Please note that our presentation can be reached if you click on the link within the conference call invitation, and it 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.

And now it is my pleasure to turn the call over to Chris to open the presentation.

Christopher Mattheisen:

Thank you, Linda. Good afternoon everybody.

Let's start today's call with a brief summary of what we have achieved financially at Group level during the third quarter and the first nine months of 2016 and how we see the rest of the year ahead of us. Then, in-line with previous presentations, we will go through the quarterly results of our three segments – MT Hungary, Macedonia and Montenegro.

I am pleased to report a healthy set of financial results for the third quarter of 2016. Although our headline revenue witnessed a 5% decline compared to the third quarter of 2015, as you can see **on Slide 2**, this was primarily due to our earlier decisions with respect to the energy business and a decline in Systems Integration and IT revenues following a temporary slowdown in EU fund inflows. Excluding these two sources of revenue, our core telco

revenues continued to grow by 1% on a like for like basis driven by growth in both mobile equipment and data coupled with an uplift in TV revenue.

Despite this 5% decline in overall revenues accompanied by a somewhat smaller fall in gross profit, Group EBITDA for the quarter increased by 10% year-on-year, driven by lower employee related expenses.

There were some other positive developments during the quarter at our international subsidiaries that I would like to highlight. In Macedonia, the decline in EBITDA that we have experienced for almost two years was reversed with a 2% gain, principally due to stabilization in the mobile market. In the case of Montenegro, although the regulatory and competitive pressures continued, the decline in EBITDA decelerated to only 4% in the third quarter, largely due to our focus on cost efficiency.

**On Slide 3**, you can see our **group financial highlights** for the first nine months of the year. Our **revenues** decreased by 6% compared to the same period last year primarily driven by the decline in energy and System Integration and IT revenues, which was partly mitigated by increasing telco revenues. Thanks to investments in 4G networks across our footprint, our Group mobile broadband and equipment revenues increased significantly whilst voice revenues declined. Following the fixed access network upgrades, we were also able to further grow our fixed broadband and TV customer bases in Hungary, partly compensating for the decline in fixed revenues at the foreign subsidiaries. Group-wide rollout of Magenta 1, our quad-play proposition, has also played a key role in further promoting our brand.

Our **EBITDA** performance improved by 7% in the first nine months of the year compared to the same period of 2015. This improvement was achieved despite broadly unchanged gross margin thanks to significant savings in employee related expenses, lower special taxes, as well as one-off gains in other operational income we realized in the first quarter of the year. Group Capex year-to-date increased by 13% compared to last year due to the Montenegrin frequency acquisition. Excluding this item, Capex was roughly stable at 59 billion forints. I am pleased to report that higher EBITDA and trade creditors, the GTS transaction in 2015, as well

as one-off gains related to the Infopark and Origo sale resulted in a continuously increasing **Free Cash Flow**, which exceeded 29 billion forints by the end of the third quarter. Our leverage also improved and we expect our net debt ratio to reach the targeted 30 to 40% range in the upcoming year.

Looking ahead to the rest of this year, we expect revenue and EBITDA to surpass our initial expectations. Our decision to **raise our guidance** is based on two key developments: the fact that Digi has delayed its market entry initially planned for the second half of this year and the improvement we are witnessing in the household spending power in Hungary. Our presence on the residential electricity market has also played a role in boosting our revenues, and we currently do not expect to exit this market before March 2017. Consequently, we now expect our revenues for the full year to reach around 595 billion forint with EBITDA at around 193 billion forint. In terms of our CAPEX, we reiterate our intention to reduce overall CAPEX levels excluding spectrum acquisitions in 2016 by 10% compared to 2015. At the same time, I confirm our previous guidance for 2017.

**On Slide 4**, you can see how **different segments** contributed to our quarterly revenue and EBITDA performance. The revenue drop was principally driven by the Hungarian segment due to the absence of energy revenues and the slowdown in public System Integration and IT projects. MT-Hungary segment's EBITDA improved despite lower gross profit as a result of lower employee related expenses offsetting the decline in other operational income. I am also very pleased to report that following the revenue turnaround and only a slight decline in EBITDA excluding severance expenses in Macedonia in the first half of the year, EBITDA in the third quarter increased supported by improvement in gross margin and savings on employee related expenses. At the same time, revenues declined by 3% driven by the drop in fixed and ICT revenues, which offset the strong mobile performance. The 8% revenue decline in Montenegro was due to intense competition both in fixed line and mobile, while we continued to face regulatory pressure on fixed voice and broadband pricing. However, Montenegrin EBITDA was down by only 4% driven by sustained pressure on margins and

higher OPEX, which were partly compensated by savings on employee related expenses thanks to our decision to outsource network planning and maintenance.

Let me now turn to the segmental analysis on Slide 5, starting with **MT Hungary**. Overall revenues declined by 5% during the third quarter compared to the same period in 2015, due to first a significant reduction in the contribution from energy, and secondly, but to a far lesser extent, a fall in System Integration and IT revenues in line with a temporary slowdown in EU funds into Hungary that we expect to reverse.

Mobile revenues in the quarter improved by 5%, mainly driven by significantly higher equipment sales resulting from sales growth in smartphones, boosted further by the new iPhone 7 launch and the increase in third party export sales. Although fixed voice revenues as a whole showed a slight decline, TV revenues increased due to growth in the subscriber base accompanied by higher ARPU, and almost offset the decline in voice retail and fixed equipment revenues.

EBITDA in the MT Hungary segment increased by almost 13%, mainly driven by a significant decline in employee related expenses due to a drop in severance expenses year on year and underlying efficiency savings resulting from the headcount reduction program carried out over the past couple of years.

On Slide 6 you can see the developments in the Hungarian **mobile market**. The retail mobile market remained relatively stable in the third quarter, while the business mobile market continued to face very strong price competition. Our postpaid share of the overall customer base increased by 3 percentage points to 59%, driven by strong demand for data and we see further room for growth. Although average revenue per user on both a prepaid and a postpaid basis declined slightly, the improvement in the customer mix in favour of the more valuable postpaid customers resulted in a 1% increase in blended ARPU. The popularity of the flat rate plans, offering unlimited voice and messaging, remained high and we continued to enlarge our Magenta 1 quad-play subscriber base that has helped to improve our performance in the

high-end segment. More than one third of our postpaid customer base now subscribes to flat rate plans, which has resulted in a 5% increase in minutes of usage.

Looking ahead, apart from Digi's entry into the mobile market which we now expect in the first quarter next year, mandatory prepaid registration will most probably become effective within a couple of months, which will adversely impact the whole prepaid mobile market.

We continued to increase our **fixed broadband and TV** customer base in the third quarter as can be seen on Slide 7. We maintained our market leader positions in both market segments and increased the share of high bandwidth tariff plans, with over a third of our customers now subscribing to high speed internet capable of at least 30 megabit per secundum speed. Despite growing the subscriber base, broadband retail revenues remained flat as the intense local competition resulted in slightly lower ARPUs. Notwithstanding this, I continue to believe that our high speed network investment strategy has been the right one and will win through over the coming years with further penetration increase. I am happy to announce that just a couple of days ago we made 1000 megabit per secundum fixed line internet access available to our customers for the first time where fiber optic networks have already been installed. This 1000 megabit per secundum level of access will offer the flexibility for household members to enjoy the best digital experiences simultaneously. With regards to our TV service, we maintained our focus on IPTV sales to offer greater value to our customers in return for a higher blended TV ARPU.

Turning to Slide 8, you can see that 90% of our customer base is already on an IP based network, and we are on schedule to conclude the PSTN migration and shut down this legacy platform by the end of this year. The **fixed voice** ARPU declined by 8% due to competitive pressures from the cable operators. We continue to focus on our high-end residential fixed voice customer base that sign-up to our flat rate packages, called Hoppá, that are also a part of our quad-play Magenta 1 proposition. This strategy appears to be working because following a period of several years where the size of the flat fixed voice subscriber base has

basically stagnated, the number of flat rate voice subscribers is now increasing thanks to our quad-play offer.

Briefly on our **energy business**, it comes as no real surprise that our revenues have declined compared to the same period last year following the transfer of most of our B2B clients into the joint venture in January 2016, as well as the exit from the residential gas market last summer.

Turning to **Slide 9**, let me draw your attention to the results of our efforts in **bundling our services**, which is a cornerstone of our strategy. As an integrated service provider, with an integrated IP network and highly valued brand, we are in a very advantageous position to maximise the telecommunication share of household wallet spend through achieving further growth in the number of both triple-play subscribers and quad-play Magenta 1 customers. By the end of September this year, we had reached almost 100 thousand Magenta 1 subscribers in Hungary alone, with an increase of 3% in our blended household fixed line ARPU, principally due to successful cross-selling activities.

I will now hand over to János who will talk in more detail about the System Integration and IT performance as well as our foreign subsidiaries.

If we turn to **Slide 10**, you can see the great opportunities in application development and integration services driven by overall market growth. We are by far the market leader with a 14% share of a highly fragmented market.

In the third quarter of 2016, our **System Integration and IT revenues** at the Group level declined by 6% driven by a temporary slowdown of EU fund inflows, and the absence of exceptional ICT projects executed in both Macedonia and Montenegro during the same period last year. The timing of our future System Integration and IT projects is very much dependant on the receipt of further EU funds by Hungary, and we see downside risk in this respect for the rest of the year. As a reminder, our fourth quarter revenues in 2015 were

heavily boosted by public projects connected to the end of the recent EU funding cycle. At the same time, both our System Integration and IT margins as well as gross profit improved in the third quarter thanks to major project wins in the financial and utility sectors. Looking ahead, we remain confident that System Integration and IT will be among our key growth drivers and expect 2017 to be a stronger year in this sense.

Moving on to our foreign subsidiaries, starting with Macedonia on Slide 11, I am very pleased to report that we were able to deliver improvement in EBITDA, despite a slight revenue decline. Mobile revenues grew for the third consecutive quarter supported by significant growth in mobile broadband and equipment revenues thanks to our 4G push. At the same time, our market share exceeded 49% by the end of September and successful summer promotions kept our ARPUs stable. Despite increased competition from VIP, which offers integrated fixed-mobile bundles, the popularity of our Magenta 1 offer continued to increase, contributing to further growth in our mobile subscriber base.

In the **fixed line segment**, revenues fell by 8% compared to the same period last year due to lower voice revenues coupled with lower sales of equipment, such as TV sets and laptops, while wholesale revenues declined due to lower incoming international traffic volume and prices. At the same time, fixed broadband revenues improved driven by higher ARPU and an unchanged customer base. **System Integration and IT** revenues were significantly down, due to exceptionally high revenues in the third quarter of 2015 stemming from a public transportation project.

The 2% increase in **EBITDA** in the third quarter was driven by a higher gross margin, savings in employee related expenses, as well as an increase in other operating income. This is the first time in almost two years that we have seen an increase in EBITDA in Macedonia. Bad debt and other direct costs improved thanks to a recent collection campaign and lower fixed equipment sales, respectively. Savings on employee related costs were driven by the outsourcing of lower network planning and maintenance to Ericsson as of 1<sup>st</sup> of July, 2016.

Looking forward, we believe that stabilization in revenues and cost efficiency improvements shall lead to a sustainable turnaround in EBITDA.

At our **Montenegrin subsidiary**, **total revenues** declined by 8% compared to the third quarter of 2015 due to competitive and regulatory pressures that continued to be felt across all major revenue lines as shown on Slide 12. **Mobile** revenues further decreased primarily due to declining SMS revenues, the OTT push and lower Balkan roaming rates driven lower voice wholesale revenues. At the same time, Magenta 1 continued to have a positive impact on mobile ARPUs and subscriber growth, resulting in a 17% increase in our postpaid customer base. **Fixed line** revenues declined by 13% as fixed voice and broadband revenues were heavily affected by the regulatory price caps and more aggressive competition from cable companies offering triple-play packages; while our fixed wholesale revenues suffered from a decline in domestic and international traffic volume. Our **System Integration and IT** revenues in 2015 were boosted by a large mandate related to the Porto Montenegro project. This explains the 19% year-on-year drop in Q3 2016. Despite the double digit EBITDA decline we have witnessed in the first half of the year, in the third quarter Montenegrin **EBITDA** dropped only by 4% thanks to our focus on cost efficiency. With the savings we realised on employee related expenses as a result of the outsourcing project, we were able to somewhat offset the decline in our gross profit. **Capex** increased by 10 billion forints by the end of the third quarter due to the mobile frequency renewal, the one-off license fee for the new spectrum licenses, as well as fixed network investments. Looking ahead, we believe that, with our 4Play proposition, we are well positioned to meet the challenges stemming from more intense competition and stricter regulation. In addition, thanks to the successful license extension and acquisition of new frequency blocks, we will be able to build out a nationwide full-speed 4G network ahead of our competitors leading to further growth of our mobile subscriber base.

### *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.