First half 2006 Results Conference Call

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Conference call operator introduces call

Elek Straub remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's first half 2006 results conference call. I am Elek Straub, Magyar Telekom's Chairman and Chief Executive Officer and I am hosting today's call together with Dr. Klaus Hartmann, our CFO and member of the Board.

Before starting with the analysis of the Group performance, I would like to say a few words on the ongoing **investigation** at Magyar Telekom. As announced earlier, the Company is still inquiring into certain contracts and has failed to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results.

The Hungarian Financial Supervisory Authority has fined Magyar Telekom six million forints for the second time and ordered the Company to prepare its annual report and to take all possible and necessary legal measures in order to comply with the statutory obligations. The Company is currently investigating the legal solutions to hold a general meeting and prepare the annual report as soon as possible.

Summarizing the **Group performance**, we have shown an impressive, above 5% revenue growth and a slight, 0.5% EBITDA increase in the first half of this year. Revenue growth was helped by the consolidation effect of Telekom Montenegro. However, even excluding the contribution of TCG, revenues were up by almost 3% year-on-year, mainly driven by the Hungarian mobile operations and the favourable foreign exchange effect at our international operations.

Looking at the **second quarter results**, revenues were up by 4% but EBITDA decreased by more than 3%.The lower quarterly margin was mainly driven by increased IT services and the one-time accounting of the retrospective decision of the National Regulatory Authority on the interconnection fee cut at the Hungarian fixed line operations, as well as the higher customer acquisition at the Hungarian mobile business. In addition, expenses related to the investigation had a negative impact on the second quarter results as 1.5 billion of the 1.8 billion forints of investigation-related expenses incurred in the first half of this year were booked in the second quarter.

Let me start the segmental analysis with the results of the **Hungarian fixed line operations**. On the revenue side, the drop in the voice revenues was fully counterbalanced by the higher IT, broadband and multimedia revenues, resulting in above 2% revenue increase in the second quarter. The drivers behind the continuously deteriorating voice revenues are similar to those mentioned in the previous quarters. Mobile substitution and alternative service providers such as Tele2 and cable operators offering voice over cable played a key role in decreasing the price level at our fixed line segment.

At our small and medium enterprise segment the usage also decreased, as mobile operators were very successful in migrating traffic away from our fixed line segment using the so-called closed-user-group offers. Nevertheless, we have seen further improvement in the residential segment, where with the help of our flat rate Favorite packages, we successfully increased customer usage. As the majority of the additional minutes are bundled within the monthly fee, the revenue from these minutes is shown within the subscription fees.

Moving on to the internet revenues, we continue to show impressive growth both in terms of customer numbers and broadband revenues. The number of total broadband connections is now above 440 thousand, generating revenues of close to 10 billion forint in the second quarter of this year. We are continuously improving our product offers and decreasing the price level in order to maintain our leading position in the broadband market. The current monthly fee for the half megabit per second package with a download limit is around 18 euros. We also offer time-based packages, charging around 12 euros for 10 hours of usage.

A new revenue stream, which is starting to play an increasing role at the fixed line operations, comes from the system integration and IT activities. In the second quarter, revenues from this line increased by almost 4 billion forints compared to the same period of last year. The drivers behind the increase are a government system integration project, the acquisition of **Dataplex**, and IT outsourcing activities for business clients. Magyar Telekom has developed an electronic tax return filing system for the State Tax Authority, for which it accounted 2 billion forints revenues in the second quarter. Dataplex, our earlier acquisition in the IT outsourcing and server hosting field, which has been consolidated since April, contributed a further 400 million forints of revenues in the second quarter. In terms of the IT outsourcing services, the contracts with business clients mentioned in the first quarter, such as the ING Bank and E.ON, are continuously adding to our IT revenues.

While we would like to draw your attention to the fact that revenues within this line will fluctuate significantly going forward due to the project nature of this business, we hope that overall system integration and IT activities will become an important revenue stream for the Group in the future. This will be further helped by our most recent acquisition: in June we signed an agreement to acquire **KFKI**, one of the leading Hungarian IT services providers to further build on our competencies in the IT network and system integration fields. The transaction will be closed and consolidation of the company will start once we have received Competition office approval, which is expected in the fourth quarter of this year. In 2005, KFKI Group delivered revenues of around 17 billion forints and EBITDA of 1.5 billion forints.

Turning to the cost side of the Hungarian fixed line operations, the decreased EBITDA is a result of the higher equipment cost and other operating expenses, partly offset by lower payments to other network operators.

The higher equipment costs and other operating expenses were mainly due to the stronger ADSL campaigns and increased IT service revenues. Given that IT services usually have a lower margin, the higher revenues in this line also meant higher equipment costs and subcontractor fees. Other operating expenses also include the earlier mentioned costs related to the investigation, which is accounted for at the Hungarian fixed line operations within Headquarter costs.

Another factor affecting our performance was the 1.2 billion forint revenue reduction in June as a result of the final resolution of the National Regulatory Authority, according to which the 14% cut to Magyar Telekom's interconnection fees should be applied retrospectively from September last year. While the cut had a positive impact on the cost side, EBITDA decreased by around 1 billion forints as result of this decision.

(PAUSE)

Let me now hand over to Klaus who will continue with the analysis of the international fixed-line operations and the mobile segment.

Klaus Hartmann remarks

Thank you, Elek.
Good afternoon ladies and gentlemen!

Continuing with the financial performance of the international fixed line operations, the main drivers behind the 12% revenue increase in the second quarter were the favourable foreign exchange movements, the increased traffic volume in Montenegro and the contribution from our operations in Romania and Bulgaria. The revenue from the wholesale point of presence and alternative retail operations in Romania and Bulgaria added 1.2 billion forints to segment revenues in the second quarter of 2006. The EBITDA improvement at the international fixed line operations was further helped by the severance provision created in the second quarter last year in Montenegro.

Starting with the Macedonian operations, the 5% revenue increase was a result of the weakening forint against the local currency, while revenues in Macedonian denar terms were slightly down. Although the rebalancing step last August helped subscription revenues, the introduction of bundled minutes and the continuously decreasing traffic driven by mobile substitution reduced domestic and international traffic revenues. The higher internet revenues driven by the rapidly growing broadband customer numbers could only partly counterbalance the decreasing traffic revenues.

Turning to the cost side, we can see significant savings in the employee-related expenses driven by a year-on-year headcount reduction of almost 25% at the Macedonian parent company. However, this could not counterbalance the increase of some cost elements in the other operating expenses. Due to the liberalization started this year, marketing expenses increased and the introduction of the 15% withholding tax on qualifying foreign transaction raised the other taxes line. Another one-time effect related to the change in the calculation method for handling and posting fixed line telephone bill charges increased second quarter expenses. As a result, EBITDA margin of the Macedonian fixed line operations decreased to 42% in the second quarter.

Before moving on, let me mention that we captured the opportunity to further increase our influence in MakTel in a value-accretive way. During the Macedonian Government auction in June, MakTel bought 10% of the company's shares for 61 million euros, while 0.3% of the shares was sold to minority investors. As a result, a 10% of the shares is held by MakTel as treasury shares, increasing Magyar Telekom's voting rights in the company to almost 57%.

Turning to the Montenegrin operations, let me start by commenting on the significant change in the political situation of the country. At the referendum held in May, Montenegro voted for independence from Serbia, with which it had been in a federation since 2003. In July the independent Montenegro was formally inaugurated creating Europe's newest state. The independence is expected to give further momentum to the economic growth of the country resulting in an accelerated convergence process for the EU accession.

Continuing with the performance of the fixed line operations, we can see revenue growth of more than 15% in the second quarter, compared to the same period last year. Although favourable foreign exchange movement also contributed to the revenue increase, as forint weakened by more than 6% against the euro, revenues in local currency terms were still up by more than 7%. The higher traffic was mainly due to the above mentioned referendum, which significantly increased communication within the country and with citizens based abroad. The activity of international observers and journalists also contributed to the increased traffic. Usage is also recovering from last year's negative effects of the rebalancing and was also helped by stronger seasonality due to the tourist season.

Turning to the cost side, the voluntary headcount reduction program announced last year was the key driver behind the improvement. In the second quarter last year, the management booked a 1.3 billion severance provision. As a result, parent company headcount decreased by 20% over the last year. Altogether, the Montenegrin fixed line operations contributed close to 5 billion forints in revenues and 1.5 billion of EBITDA to the Group performance in the second quarter. The margin exceeded 31%.

In order to utilize the strength provided by a global brand portfolio and following the positive response to the rebranding steps in Hungary, we plan to introduce the T brand in Montenegro both for the fixed and mobile operations, in the second half of the year.

Let me now continue with the analysis of the Hungarian mobile operations. While penetration growth slowed down significantly reaching close to 94% at the end of June, T-Mobile increased its customer base by almost 5% year-on-year and maintained its clear market leadership with an above 45% market share. In terms of revenue per customer, we can see the same trends as in the previous quarters: the continuously decreasing tariff level was almost fully counterbalanced by the increasing usage and value added service revenues. As a result, ARPU remained stable on a year-on-year comparison basis.

A further driver behind mobile revenues is the unified digital radio communication system network we are developing for public safety and security services. In line with the contract deadline, service in Budapest has started in April, based on which we have recorded revenues of 700 million forints for the EDR service in the second quarter at the Hungarian mobile operations. We expect additional revenues in the second half of the year as the service roll-out continues. We have spent 6.5 billion forints of CAPEX on the network roll-out in the first half of the year.

The decrease in the second quarter EBITDA margin at T-Mobile Hungary was mainly driven by higher sales, especially in the postpaid segment, which caused an increase in the marketing expenses and agency fees. An additional driver behind the cost increase was a reversal related to the Universal Telecommunications Support Fund. Based on the latest decision of the Supreme Court, T-Mobile is obliged to pay the contribution already relieved in September last year. As a result, we have accounted for 1.1 billion forints at the Hungarian mobile operations within other operating expenses. The decision also affected the Hungarian fixed line operations, with a positive impact of 0.8 billion forints booked as a reimbursement. As a result, the overall impact on Group level is relatively limited, at around 0.3 billion forint.

Before continuing with the international mobile operations, let me mention that the National Regulatory Authority has published its draft resolution regarding the Hungarian mobile voice termination fees at the end of June. The draft resolution aims to eliminate the asymmetry in the termination fees of the three mobile operators and targets a 17 forint, equalling around 6 eurocent per minute average termination fee from 2009. Consequently, the proposed reduction to Pannon's and Vodafone's average mobile termination fee is higher than the cut in T-Mobile's fees. The next reduction to the termination fees is expected early next year.

Now moving on to the international mobile operations, let me start with the Macedonian mobile market.

In the Macedonian two-player market, MobiMak, our mobile subsidiary, maintained its leading position with a market share of close to 68%. While customer growth remains strong with an above 11% increase due to the continuously decreasing tariff levels, second-quarter revenues of the company grew by 4% in local currency terms. The company was successful in increasing the postpaid share in the customer base, which together with the increasing usage and the favorable foreign exchange effect helped to increase the revenue per user levels in the second quarter. Thanks to the strict cost control, EBITDA margin of the company was outstanding reaching 56% in the second quarter.

Beside the rebranding steps in Montenegro, we also plan to rebrand the Macedonian mobile operations to T-Mobile in September, a step which we expect will further improve the market position of the company.

Continuing with the Montenegrin mobile operations, we can see that the referendum and the increasing number of tourists travelling to the Montenegrin seaside significantly boosted usage and improved the performance of the mobile operations. Even excluding the foreign exchange effect, revenues were up by more than 22% and EBITDA increased by 26% in the second quarter.

Part of the significant increase in the penetration level is a result of tourists buying Montenegrin prepaid cards. Strong market growth is reflected in Monet's customer base, which recorded an increase of above 14%. While the competition drove mobile tariffs down, the increasing usage stabilized the revenue per user levels in euros. For the second half of the year we aim to strengthen our market position by launching new offers and increasing marketing presence thanks to the rebranding campaign.

(PAUSE)

Elek Straub remarks

That concludes the formal part of Magyar Telekom's conference call. Now we are 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)

This is all the time we have. If there are follow-up questions, I encourage you to contact our Investor Relations Department. The telephone number is 36-1-458-0437 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 transcripts of our conference calls will be available on our official website.

Thank you again for joining us today, and for your continued interest in Magyar Telekom.