Q1 2023 Results Conference Call

May 11, 2023

Good afternoon, everyone. I am Diana Várkonyi, Head of Investor Relations at Magyar Telekom. It is my pleasure to welcome you to our first quarter 2023 results conference call.

Please note that today's presentation is also available on the Investor Relations section of our website. This event is being recorded, for internal purposes only. By joining the presentation, you give your consent to being recorded.

Throughout the presentation your lines will remain muted and once we have commenced the Q&A session, you will be able to ask a question using the "raise hand" function, after which your microphone will be enabled and you can unmute yourself to ask a question.

Before we start, I would like to draw your attention to the disclaimer on the second page of the presentation. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties.

It is my pleasure to welcome Mr. Tibor Rékasi, our CEO, and Ms. Darja Dodonova, our CFO, who will take you through the presentation and answer any questions you may have.

Now I would like to hand over to Tibor to open the presentation.

Tibor Rékasi

Thank you, Dia. Good afternoon, everybody.

Before going into a detailed analysis of our quarterly operational and financial performance, I would like to give you an overview of the trends in our most important KPIs, which are presented on **Slide 3.** I am pleased to report that our revenues continued to increase year-on-year in the first quarter, reflecting the success of our efforts to deliver superior customer satisfaction by offering gigabit networks and meeting increasing demand for data. At the same time, our profitability deteriorated year-on-year due to heavy cost pressure and some one-off effects versus the same period last year. Our energy costs increased sharply, particularly in Hungary, where we saw a four-fold increase in electricity expenses. Employee related expenses rose in line with the salary increase implemented at the start of the year whilst the persistently high inflation in the Hungarian economy also weighed on other cost items, such as subcontractor costs. The impact of these trends on our profitability was amplified by the supplementary telecommunication tax and the absence of the onetime gain generated from the IT subsidiary sale which positively impacted the base period results. Furthermore, net income and free cashflow trends were also negatively impacted by the high interest rates in Hungary, which affected both our financial costs and lease and other interest-bearing liabilities.

In this turbulent operating environment, we believe our strategic objectives remain as critical as ever, namely providing outstanding customer experience, progressing digitization and ensuring undisruptable operation and business continuity.

Now let's move on to our operational performance, starting on **Slide 4**, with the Hungarian mobile market developments where we were able to maintain the positive momentum in the first quarter as well as to further expand our SIM base by 4.5% year-on-year. Once again, growth was driven by a higher postpaid customer base and even stronger increases in machine-to-machine SIMs. In parallel, the number of customers opting for our mobile data services continued to grow, reaching almost 4 million by the end of the first quarter.

With regards to usage patterns, we continued to witness 27% higher data usage year-on-year, underlying the importance of the RAN modernization process that enables increased network capacities. At the same time, voice usage continued to decline, with lower usage mostly visible among business and prepaid customers.

These, mostly favorable tendencies, coupled with the one-month impact of the inflation-based fee adjustment implemented from March this year, resulted in further ARPU increases in both postpaid and prepaid segments.

The favorable trends in the Hungarian fixed market also continued, as shown on **Slide 5.** The widening reach of our gigabit capable network coupled with the outstanding customer experience we provide allowed us to maintain the pace of customer growth. We recorded further expansion in fixed broadband and TV customer subscriptions, leading to increases in our residential home base. More and more customers opted to enjoy the advantages of the seamless connectivity our gigabit network provides; by the end of the quarter, close to 1.3 million customers were using either our fiber or gigabit speed cable network. This migration not only allows us to provide improved customer experience but makes network operation and maintenance more efficient.

The continuous increase in the ratio of customers connected to the gigabit network, along with the positive contribution from the inflation-based fee adjustment, helped us to maintain positive ARPU trajectories for both broadband and TV services, while despite the continued decline in fixed voice usage, the high ratio of flat packages and the fee adjustment combined resulted in broadly stable fixed-voice ARPU year-on-year.

With that, I'd like to hand over to Darja to take us through the financials results in more detail.

Darja Dodonova

Thank you, Tibor. Good afternoon, everyone.

Let me start with our quarterly revenue performance as shown on **Slide 6**. The strong commercial momentum continued into the first quarter and resulted a 21.8 billion forint increase in revenues compared to the base period. Continued high demand for mobile and fixed data among our growing customer base was one of the key drivers of higher revenue, in addition to the favorable impact of the inflation-based fee adjustment implemented to the Hungarian subscription fees, Tibor mentioned earlier.

Thanks to the sharp rise in average mobile data usage, mobile data revenue rose by 23.1% year-on-year to 41.4 billion forint. The higher retail voice revenue achieved reflects the positive impact of further customer base expansion while the somewhat lower wholesale voice revenue was a result of lower incoming traffic volumes in Hungary. These trends combined resulted in an 8.8 billion forint mobile service revenue increase in the first quarter of 2023.

The customer base expansion and higher ARPU in fixed broadband and Pay TV resulted in fixed service revenue growth throughout the period.

Although revenue from customer sales transactions increased further, driven by higher average handset prices at both countries of operation, it was offset by a strong rise in the present value discount related to installment sales and lower revenue from third party export sales in Hungary. As a result, Equipment revenue remained stable year-on-year.

The growth in SI/IT revenue reflects the slightly different timing of project distribution at our Hungarian operation compared to 2022.

Turning to **Slide 7** and our profitability. We are pleased to report sustained improvement in gross profit thanks to positive underlying telecommunication service developments. Despite this positive trend, EBITDA after leases declined by 8.9% year-on-year in the first quarter. The absence of the 3.3 billion forint subsidiary sale gain booked in the base period and strong pressure on our indirect costs offset the positive result of the sustained commercial momentum. The fact that the supplementary telecommunication tax in relation to first quarter 2022 results was booked in the second quarter of 2022, given the timing of its introduction, led to a 7.2 billion forint EBITDA decline in the first quarter of this year compared to the base period. The supplementary telecommunication tax together with the higher utility tax eliminated almost 60% of the positive impact of the favorable gross profit performance. In line with the trade union agreement, we implemented the planned wage increase in Hungary as of from January 1, 2023 which resulted in higher employee related costs for the period.

Our other operating cost was impacted by different external factors including higher electricity costs, inflationary pressure on other costs and continued weakness of the Hungarian forint compared to the base period. Consequently, our other indirect costs in the first quarter were 5 billion forint higher year-on-year.

Slide 8 shows the trend in our Net Income and adjusted Net Income. As the title of the slide suggests, the supplementary telecommunication tax and the higher interest rate placed extra pressure on our Net Income. The chart on this slide shows a decline of 43% in our reported Net Income driven by the 4.1 billion forint lower EBITDA and a 5.7 billion forint lower net financial result. The latter is a combined result of the higher interest expenses and the unfavorable change in the other finance expense due to different shifts in relevant yield curves which resulted in a year-on-year deterioration in the fair value of derivatives and offset FX gains related to the strengthening of the forint during the period.

Income tax was lower by 10.5% year-on-year at 4 billion forint in the first quarter of 2023, reflecting the year-on-year lower level of profit before tax.

Our efforts to optimize our IT infrastructure which led to lower depreciation expenses and the proportionally lower amortization related to the spectrum licenses that expired in April 2022 and were since reacquired in the Hungarian operation could only partially offset the negative impacts on our profit before tax. In North Macedonia, the lower D&A resulted from the absence of one-off increases related to shortened useful life of equipment and accelerated depreciation in relation to the RAN modernization program in the first quarter of 2022.

Let me also briefly reflect on our adjusted net income, which amounted to 12.1 billion forint in the first quarter, a 22% decline compared to the base period. Adjustments versus reported net income were mostly related to non-realized results related to measuring derivatives at fair value, stemming from changes in the yield curves and the FX rates.

Slide 9 presents the free cash flow generation and the development of the Group's capital expenditure in the first quarter of 2023 against the same period in 2022. The free cash flow performance can be attributed, on the one hand, to the weaker operating performance, namely the 4.1 billion forint decrease in EBITDA, as well as the missing subsidiary sale related cash in-flow booked in the first quarter of 2022.

On the other hand, the 2.7 billion negative change in interest and other financial charges reflects the higher interest payment related to the loan portfolio due to the change in interest rates, higher leased liability related interest and higher bank charges.

All in all, Free Cash Flow decreased by 10.2 billion forint year-on-year.

We do not provide guidance on our capital expenditure but let me provide you with some details regarding our investments during the quarter. Our capex during the period remained broadly stable year-on-year. As the chart on the right-hand side illustrates, the make-up of our investments was a bit different compared to last year. Due to the continuous uptake of gigabit service in Hungary we invested almost 50% more capex to fiber provisioning and CPE while we decreased our investments in North Macedonia following the completion of the RAN modernization program.

Finally, **on Slide 10,** let me say a few words on our guidance for 2023, focusing on the most important developments against the first quarter performance. While revenues should continue to benefit from increases in the customer base and the inflation-based fee adjustment, high inflation and deteriorating economic performance are expected to exert pressure on consumer spending. At the same time, despite the higher growth in SI/IT revenues in the first quarter, we expect full year SI/IT revenues to remain at a similar level to last year.

With regards to profitability, the significant negative year-on-year impact of the supplementary telecommunication tax in the first quarter of 2023 stemming from the fact this was only booked from the second quarter in 2022 will be eliminated going forward. Furthermore, to mitigate cost increases driven by inflationary pressure we have introduced several efficiency measures. Some of these, such as the IT transformation and optimization project launched last year have already started delivering savings. At the same time, we are implementing further initiatives that are expected to contribute to our results going forward. To highlight some of these, I'd mention the rationalization of the headquarters rental to free up unused space which will allow us to generate savings on rental costs. We also introduced several measures to optimize electricity costs: to mitigate energy consumption increases driven by the continuous surge in transmitted data volumes we placed strong focus on network efficiencies, including the elimination of less efficient technologies, such as 3G or copper, and improving energy efficiency of the current networks by the ongoing RAN modernization and the fiber rollouts. At the same time, to diversify our sources of energy, we concluded a PPA agreement to secure renewable energy for a 3 year period.

We foresee that the favorable gross profit trajectory coupled with positive contribution from these measures will outweigh the increases in other indirect costs and enable us to meet our public targets for 2023.

That concludes our presentation, I will now hand back to Dia.

Dia Várkonyi

Thank you very much Darja.

We are now happy to take any questions you may have. Please use the “raise hand” function, following which your microphone will be enabled and you can unmute yourself to ask a question.

(Take questions)

Thank you again for joining us today. Please note that a transcript of this conference call will shortly be available on our website. If you have any follow up questions, please don’t hesitate to contact us.