Q3 2023 Results Conference Call

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Diana Várkonyi

Good afternoon, everyone. I am Diana Várkonyi, Head of Investor Relations at Magyar Telekom. It is my pleasure to welcome you to our third 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 begin, I would like to draw your attention to the disclaimer on the second page of the presentation. Information in this presentation contains forward-looking statements about expected future events and financial results, which are subject to risks and uncertainties.

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

Tibor Rékasi

Thank you, Dia. Good afternoon, everybody.

First, I'd like to provide you with a summary of our progress against the key strategic priorities outlined on **slide 3**. During the third quarter, we continued to invest in our infrastructure to ensure we continue to meet the growing demand for data from our customers. By the end of the quarter, we achieved gigabit speed coverage on 80% of our fixed network in Hungary. This is a crucial driving force behind the growth of our fixed broadband customer base, with a 5.8% increase over the past twelve months, and that the majority of new subscribers opt for gigabit packages. As a result, around 82% of our broadband customers are now connected to our gigabit network, with over half of them subscribing to gigabit speed, leading to dynamic underlying ARPU growth in this segment.

At the same time, we made further progress with the mobile network modernization in Hungary, with upgrades completed at 75% of our sites by the end of September. These investments are key in expanding our 5G network coverage and enhancing the customer experience for the 15% of our postpaid users already benefitting from this technology. Furthermore, they enable us to seamlessly handle the over 33% annual rise in data load on our network, reflecting customers' rising data usage.

To further facilitate these processes and support the digitalization of the Hungarian economy, we recently signed a Memorandum of Understanding with the Hungarian Government. Under this Memorandum, Magyar Telekom has committed to building a gigabit-capable fixed network covering an additional 1 million homes and businesses over the next 4 years and to accelerate the rollout of 5G coverage, resulting in an increase to close to 99% population-based outdoor 5G coverage by 2026. At the same time, according to the Memorandum, the Government of Hungary intends to support fixed line gigabit internet network, 5G coverage developments and ICT investments, among other things, through the review of sector specific tax rules.

Our strategic efforts have also garnered recognition from two rating agencies. Scope Ratings revised the outlook to positive on Magyar Telekom's Triple-B-plus issuer rating based on the Company's improving profitability, while MSCI reiterated its

Triple-A rating, recognizing Magyar Telekom's strong commitment to sustainable operations. These external validations affirm our strategical and operational focuses.

Now, let me say a few words on our progress against our 2023 guidance, as shown **on Slide 4.** As communicated in September, we recently upgraded our guidance for the full year as we expect revenue and EBITDA after leases to grow by 10% to 15%, as a result of recent developments in the Hungarian telecommunications market being more favorable than previously expected.

Our revenue rose by 13.3% year-to-date, in line with the upgraded target of 10 to 15% growth, thanks to a favorable commercial performance, expanding customer base, and strong data demand. This was further supported by the positive effect of the inflation-based fee adjustment to the Hungarian subscription fees.

EBITDA after leases increased by 16.1%, reflecting positive revenue growth that offset increases in indirect costs. Adjusted net income also grew dynamically as higher EBITDA more than offset a deterioration in financial costs.

Finally, with regards to free cashflow, we continue to experience seasonal variances due to the payment schedule of the supplementary telecommunication tax, but these are expected to be eliminated by the year-end, positioning us well to meet our targets for the full year.

Turning now to the operational developments in more detail, as presented on **slide 5**. In the Hungarian mobile market, customer base expansion continues to be driven by a growing postpaid subscriber base, reflecting also sustained pre-to-post migration, and strong growth in M2M SIM card numbers. This growth in M2M SIM cards is driven by the increasing use of such solutions as smart meters used by utility companies and alert watches for the elderly.

In terms of usage, voice traffic continued to decline, particularly among corporate customers. Nevertheless, mobile data usage growth remained strong, with average usage increasing 27% year-on-year, enabled by our network development efforts and the success of our more-for-more pricing strategy. This increase in data usage, coupled with effects of the fee adjustment, led to a 15.6% year-on-year increase in blended mobile ARPU.

To enhance our sales and upsell efforts, we implemented an organizational reshape program, flattening the sales organization to bring sales decisions closer to our customers, ultimately improving customer experience and better execution of the sales process.

Moving to **slide 6,** we see developments in the Hungarian fixed service market. Our household base increased by 3.4% year-on-year, with more customers opting for multiple services from us, leading to a higher increase in the number of subscriptions. As demonstrated by the lower charts, this growth is primarily driven by the uptake of our broadband service, with TV subscribers also steadily expanding. Both of these increases are strongly supported by the progress of the gigabit network rollout as we see improved demand for services on this technology. The strong demand for high-bandwidth broadband packages, and the positive impact of the inflation-based fee adjustment resulted in over 20% year-on-year increase in the fixed broadband ARPU.

In parallel, voice usage and subscriptions continued to moderately decline, a trend we believe is inevitable with the spread of new communication technologies. To mitigate this decline, we will continue to expand our gigabit network coverage to maximize promotion and monetization.

With that, I'd like to hand over to Darja who will provide a more detailed overview of our financials results.

Darja Dodonova

Thank you, Tibor. Good afternoon, everybody.

Turning to our financial performance on **Slide 7.** As previously highlighted, mobile and fixed service revenues in the third quarter reflect the positive impact of strong commercial momentum and the implementation of an inflation-based fee adjustment. The continued growth in mobile data usage, coupled with the further expansion of our fixed broadband and TV customer base, resulted in a 21 billion Forint increase in total service revenue during the third quarter, compared to the previous year.

In addition to the growth in service revenues, our system integration and IT revenue increased by 3.8% in the same period, reflecting a more favorable project distribution and revenues from high-value projects. The slight decline in equipment revenue is a result of a combination of factors. The positive impact from the higher average handset and device prices was offset by the lower revenue from third-party export sales and higher reductions in relation to the present value discount of equipment installment sales. This, in turn, had an impact on our other revenues, illustrating an increased interest revenue component linked to equipment installment sales. As a result, the total revenue of the Magyar Telekom Group increased by 13.3 % year-on-year in the third quarter, and by the same percentage in the first nine months compare to the base period.

Despite cost pressures, our EBITDA showed improvement, as presented on **Slide 8**. I am pleased to report a 24.8% year-on-year growth in EBITDA after leases in the third quarter of this year. The 19% higher gross profit was driven by the positive developments in our underlying telecommunication services, including the impact of an inflation-based fee adjustment, alongside a higher but, in this case, negative impact from bad debt amounting to 1.3 billion Forint compared to the base period. This increase was attributed to a higher revenue base and the less favorable aging structure of the customer receivables in the current period, versus the favorable aging impact supporting the results in Q3 2022, in our Hungarian operation.

Before turning to our indirect costs, I would like to address the supplementary telecommunication tax, which grew by 16% year-on-year, reflecting the expected revenue increase. Throughout third quarter, we continued to face external macroeconomic challenges which placed additional pressure on our indirect costs. The rise in other indirect costs was primarily driven by higher energy costs in our Hungarian operation, particularly electricity. Furthermore, the inflation-driven cost increase put pressure on our vendor costs. Negative external impacts were partly mitigated by cost efficiency measures and favorable year-on-year developments in North Macedonian energy costs.

Meanwhile, our employee-related expenses grew by 1.0% year-on-year in the third quarter, due to higher expenses in our North Macedonian operation, following the insourcing of certain maintenance functions, as well as wage increases implemented in our Hungarian operation. These factors were mostly offset by the absence of one-off compensation to employees in Hungary, which unfavorably impacted Q3 2022 expenses.

In comparing the first nine months, it's important to note the one-time effect in the base period, namely, the 3.3 billion Forint subsidiary sale gain booked in 2022.

Slide 9 shows the trends in our Net Income and adjusted Net Income. In the third quarter of this year, our reported Net Income grew by 5.9 billion forints, a 34.5% increase primarily due to the higher EBITDA. The 2.5% higher depreciation and amortization expense reflects an increase in IFRS 16 lease liability-related depreciation expenses. The positive impact from profitability was offset by 7.2 billion Forint higher financial expenses, attributed to higher interest related to lease liabilities, installment sales, and higher average interest costs, resulting in total higher interest expenses compared to the base period. Furthermore, the unfavorable change in other finance expense primarily reflects less favorable results related to derivatives, influenced by shifts in the relevant yield curves, while the weakening of the forint against the euro resulted in FX losses in both periods. Income tax increased by 22.1% year-on-year, reflecting higher profit levels.

Adjusted Net Income amounted to 30.0 billion forints in the third quarter of the current year, representing a 49% increase compared to the base period. Over the first nine months, this represents a year-on-year increase of 48%. The 12.1 billion Forint adjustments are primarily attributable to unrealized losses related to measurement of derivatives at fair value.

Turning to **slide 10** and Group's free cash flow generation and capital expenditure developments. Free cash flow generation, excluding spectrum-related payments, was lower compared to the base period by 4.3 billion forints. This was primarily due to the positive contribution from the strong operational performance, offset by a deterioration in working capital resulting from the different timing of the supplementary telecommunication tax outpayment. Interest and other financial charges increased by 7.4 billion Forint, mainly due to increased interest payments on loans, higher bank charges and an increased leasing interest component. The 5.2 billion Forint reduction in other charges reflects more favorable year-on-year FX movements.

Regarding our investments during the first nine months of this year, capex after leases excluding spectrum licenses was down 12.2% year-on-year, amounting to 72.8 billion forints in 2023. As the chart on the right-hand side illustrates, the composition of our investments was somewhat different compared to last year. Due to the continued uptake of gigabit services in Hungary, we invested almost 10% more capex to fiber provisioning and CPE. We also continued our mobile network modernization in Hungary, as Tibor mentioned at the beginning of our presentation. Overall, our network investments were slightly more than a quarter less in both countries. In Hungary, 80%

of our fixed network is already gigabit-capable, and the mobile network modernization in North Macedonia was completed last year.

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 be available on our website shortly. If you have any follow-up questions, please don't hesitate to contact us.