Q3 2022 Results Conference Call

November 9, 2022

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 2022 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.

I am pleased to report that during the third quarter of the year we continued to witness strong demand for our services as we maintained our efforts to provide outstanding customer experience, summarized on **slide 3.** Given the importance of reliable networks and uninterrupted servicing capabilities we progressed our selected network upgrades, namely the gigabit fixed network rollout and the radio access network modernization. Both initiatives reached further milestones during the quarter: three quarters of our Hungarian fixed network is now gigabit capable, whilst over half of the mobile network has gone through the modernization process. These upgrades are vital for allowing for significantly higher throughput and capacity which is key to meeting the accelerated demand for data that is reflected in the growing customer base data usage and ARPU.

To further monetize these investments, we introduced a new fixed and mobile service portfolio in September, both based on our more-for-more pricing and designed to provide additional flexibility, such as the variable add-on options now available in three unlimited mobile data packages. We expect that these measures will help us further improve customer satisfaction and maintain positive momentum in customer and ARPU trends.

In parallel to these positive commercial developments, however, the external headwinds driving cost inflation intensified further, making our efficiency measures vital for protecting our profitability. In this context, we implemented a price increase across certain residential fixed and mobile and business mobile contracts as of 1st of September, whilst the Company's right to inflation-based price correction, to be first implemented in 2023, in now in force across all customer contracts.

We also concluded an agreement with the trade unions including a one-off employee compensation of 3 billion forint, which was accounted for in the third quarter. The agreement also sets out the terms of next year's wage increase for the Parent Company and T-Systems Hungary employees, which will be around 7% on average with a higher rate applied to the lower wage levels to provide additional support for the ones most in need.

To ensure uninterrupted energy supply and mitigate risks associated with energy price volatility, we took further steps to diversify our energy sources by securing both traditional and renewable energy contracts on a short and long term basis.

An additional, significant step taken to increase operational efficiency is related to IT servicing. To further improve integrated ICT capabilities, we decided to both increase cross-functional cooperation further between the Parent Company and T-Systems Hungary and also to rebrand services provided to the corporate and public segment from the current T-Systems to the Telekom brand from next year on. With these, while capitalizing on our existing competitive advantage, we would like to improve our convergent digital business offerings as well as increase the sales efficiency of our standardized IT product portfolio.

And once again, we received external recognition for these efforts: Scope Ratings reaffirmed Magyar Telekom at BBB+ with a stable outlook reflecting their view of our strong and stable positions in the domestic mobile and broadband markets and moderate leverage. We also received further recognition for our efforts in the sustainability sphere - our 'AA' ESG rating was reaffirmed by MSCI while ISS Corporate Solutions ranked the Company among the best performers of the telecom sector globally with respect to its sustainability credentials.

Turning to **slide 4**, let me highlight some of the most important elements of our operational performance in Hungary. In a highly penetrated mobile market we were able to further expand our SIM base thanks to increases in machine-to-machine SIMs as well as further growth in our postpaid customer base, driven by successful pre-to-post migration and acquisition efforts. In parallel, the number of customers opting for mobile data packages continued to grow at pace whilst average monthly mobile data usage is now at almost 10 GB, again a significant increase from previous periods. These developments yielded positive financial contribution, reflected in further ARPU growth, which we aim to further capitalize on with our new portfolio offers featuring unlimited data options.

In Hungary's fixed market, we also continued to witness positive developments, as shown on **slide 5**. With the continued expansion of our gigabit network footprint, we managed to maintain the pace of customer growth both in fixed broadband and TV, leading to further increases in our residential home base, with the share of double-play packages increasing steadily.

In parallel, the favorable trends in broadband and TV ARPUs were also maintained in the third quarter driven by customer migration to higher bandwidth broadband packages, the success of our more-for-more pricing strategy and the targeted price increase measures we introduced over the past year.

To build on these positive trends, in September we launched a new residential fixed service portfolio with simplified discounts and flexible pricing. I'm pleased to report that the initial feedback from customers has been positive which is reflected in growing take up.

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

Darja Dodonova

Thank you, Tibor. Good afternoon, everyone.

Before I get into the detail of our quarterly revenue performance, let me draw your attention to a change in our basis of preparation and highlight an accounting policy change. Based on the Principal versus Agent: Software agenda decision by IFRS Interpretation Committee, the Group had to reassess the control in relevant software reselling and provided streaming services whether it is in agent or principal position. This reassessment was completed in the third quarter of 2022 and concluded that agent accounting should be adopted. This resulted in an accounting policy change and restatement in the presentation of these transactions, with a decrease in Revenue, Direct cost and ARPU, while EBITDA AL, Net income, Statement of Financial Position and Free cash flow remained unchanged. Our presentation includes restated 2021 figures to facilitate like-for-like comparison.

Let me continue with the main drivers of our quarterly revenue performance, as shown on **Slide 6.** The primary contributor to revenue growth in both periods was the strong increase in mobile data revenue, fueled by continued growth in our subscriber base as well as higher usage levels in both Hungary and North Macedonia. This sharp increase offset the moderate decline in mobile voice and messaging revenue, resulting in an overall increase in mobile service revenues.

The increase in fixed service revenue was driven by growth in Broadband and Pay TV services. On the one hand, our fixed broadband revenue increase was driven by the positive impact of continued customer base expansion in both countries of operation and migration to higher bandwidth packages in Hungary. On the other hand, our TV revenue was up thanks to further expansion of the IPTV customer base coupled with the positive impact of the targeted price increase measures in Hungary.

With regards to Equipment revenue, both the general increase in handsets prices and the weakening of the forint resulted in a rise in average smartphone prices.

Our SI/IT revenue decreased year-on-year as a result of the absence of revenues formerly generated by the Hungarian healthcare business unit including Pan-Inform LLC and lower project volumes in North Macedonia. In underlying terms, SI/IT revenues at the Hungarian operation showed positive development thanks to higher project volumes.

Turning to **slide 7** and our profitability. The sustained improvement in gross profit is thanks to positive underlying telecommunication service developments, with strong demand for data among the key drivers of our performance. Despite this positive trend in our gross profit, the EBITDA after leases declined by 2.8% year-over-year in the third quarter because of the recently introduced supplementary telecommunication tax which negatively affected our profitability in the third quarter to the tune of 6.5 billion forint. In addition, our employee related expenses increased by 3.6% year-on-year driven by the 2022 wage increase and one-off compensation to employees which were partly offset by lower severance expenses and headcount reduction. Other operating expenses, excluding the additional supplementary telecommunication tax and employee-related expenses, rose by 16.6%. We witnessed a negative impact of rising cost inflation and the weakening forint. Higher energy costs put extra pressure on us, with respect to both fuel and electricity, with the latter putting particularly strong pressure on results of the North Macedonia operation.

Slide 8 shows the year-on-year changes in net income both on a quarterly and year-to-date basis. As illustrated by the chart, in the third quarter a decline of 4.5% was recorded as lower EBITDA year-on-year was coupled with a deterioration in net financial results. The latter is the combined result of higher interest expenses related to lease liabilities, higher average interest costs and an unfavorable change in other finance expense due to higher losses related to the significant weakening of the forint during the period. These were partly offset by gains on the recognition of derivatives at fair value caused by the upward shift of the relevant yield curves.

Income tax expenses increased in the third quarter, due to an increase in local business tax in line with the higher related tax base which offset the saving related to the year-on-year lower level of the profit before tax. These impacts could only be partially offset by lower D&A expenses driven by lower depreciation expenses at the Hungarian operation thanks to full copper network retirement in some areas of Hungary, lower software related depreciation expenses thanks to the optimization of the IT infrastructure and the proportionally lower amortization of the spectrum licenses that expired in April 2022 and were since reacquired. Looking at the first nine months of the year, I am pleased to report that EBITDA improvement driven by the favorable gross profit and lower D&A could fully offset the higher financial and income tax expenses, leading to a 14.4% year-on-year improvement in net income.

Let me also briefly reflect on our recently introduced KPI, adjusted net income, which amounted to 45.8 billion forint in the first nine months of 2022. Adjustments versus reported net income were minor in the period. The non-realized loss on measuring derivatives at fair value particularly related to booked leased liabilities offset the positive impact from the continued rise in the Hungarian yield curve over the periods.

Turning to **Slide 9,** where we present the development of the Group's capital expenditure and an update on the rollout of our gigabit capable fixed network.

In the first nine months of 2022, capital expenditure after leases, without spectrum licenses, increased by 16.2% year-on-year to 83 billion forints, reflecting different timing of investments and external pressure because of the weakening forint versus last year. In Hungary, increases were primarily driven by further strong progress in radio network modernization, continued expansion of the fiber network and higher spending on CPEs.

In North Macedonia, capital expenditure after leases, excluding the successfully secured spectrum licenses in the second quarter, rose by 2.5-billion-forint year-on-year driven by the nearly completed RAN modernization.

On **Slide 10** we present the year-on year development of our cash flow generation in the first nine months. The underlying improvement in free cashflow is attributable to strong operational performance in both Hungary and North Macedonia, which generated an over 25 billion forint increase in gross profit. The positive change in the working capital was thank to the fact that the payment of the supplementary telecommunication tax which was accounted for in our first nine-month results will be due only in the fourth quarter of the year. The cashflow from the disposal of Pan-Inform positively impacted our performance and fully offset the deterioration related to higher income tax payments, FX losses reflecting of the weakening forint and the cash flow impact of the fiber network acquisition covering 110 thousand access points in Hungary

Overall, free cashflow was also impacted by the payment of the spectrum fees related to the acquisition of 900 and 1800 megahertz spectrum licenses in the amount of 44.3 billion forint in Hungary and 3.1 billion forint in relation to the secured frequencies in North Macedonia.

Finally, let me summarize how we are delivering against our updated targets, shown on **Slide 11**.

In the first nine months of 2022, as detailed in the first part of the presentation, we achieved strong commercial results, reflected in the year-on-year revenue growth of over 9%. This performance allowed us to upgrade our revenue target for the year, from a growth rate of 1 to 3% projected to that of around 5%.

Regarding EBITDA After Leases, while in the first half of the year the strong business performance, coupled with the one-off gain on the disposal of Pan-Inform, could fully mitigate the impact of the additional tax, in the third quarter, the negative impacts of the cost inflation have started to have more of an effect on our results, mitigating these advances. Looking ahead, we expect the inflationary pressure, weakening of the forint and the additional tax to put further pressure on profitability, which is to be partially mitigated by the higher rate of revenue growth.

Regarding Capex After Leases and Free cashflow performance, you can see the seasonality differences that impact our performance against our targets. In terms of capex after leases, the year-on-year increase is attributable to a more even delivery of projects throughout the year which resulted in more balanced spending compared to 2021, with an additional negative effect of the forint weakening.

With regards to free cashflow, the difference in the performance compared to last year is mostly driven by the better business performance and a temporary boost from the shift in the payment of the supplementary telecommunication tax to the last quarter of the 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 shortly be available on our website. If you have any follow up questions, please don’t hesitate to contact us.