Magyar Telekom Nyrt.
Hungary, Telecommunication Services

SCOPE BBB+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	12.4x	10.3x	12.6x	15.2x
Scope-adjusted debt/EBITDA	2.0x	1.5x	1.2x	0.9x
Scope-adjusted funds from operations/debt	43%	54%	71%	89%
Scope-adjusted free operating cash flow/debt	0%	22%	16%	37%

Rating rationale

Magyar Telekom's business risk profile (BBB+) mainly benefits from the low cyclicality of the telecoms industry and the company's leading position as the incumbent operator in the Hungarian mobile and broadband markets. The company's EBITDA margins have historically been lower than those of its main European peers, primarily due to telecoms and utility taxes in Hungary. However, inflation-linked price increases, cost containment measures and the removal of some special taxes are supporting an improvement. At the same time, future changes in the tax structure cannot be completely ruled out. Magyar Telekom's strong financial risk profile (A) is underpinned by improving leverage and strong EBITDA interest cover. Liquidity remains adequate, supported by credit lines and access to funding support from parent Deutsche Telekom AG. We have made a one-notch negative adjustment to Magyar Telekom's standalone credit assessment, which has improved to A-, under peer group considerations. This reflects our view that the company operates in a market that is more exposed to policy changes than similar rated peers active in more mature, stable and predictable European markets. We have made no adjustment for other supplementary rating drivers. Environmental, social and governance considerations have no impact on the credit rating.

Outlook and rating-change drivers

The Stable Outlook is based on our expectation of a continued healthy business risk profile with a stable market position and a strong financial risk profile, reflected in Scope-adjusted debt/EBITDA of around 1.0x and Scope-adjusted EBITDA interest cover of over 10.0x. The Stable Outlook also reflects our expectation that there will be no positive rating pressure in the near term from the company's major shareholder, Deutsche Telekom AG, nor a rise in Hungary's credit quality due to improvements in the quality and predictability of policymaking.

The upside scenarios for the ratings and Outlook are (collectively): i) broader diversification of operations and/or improved policy visibility in Hungary, reducing regulatory uncertainty; ii) improved rating of the parent company; and iii) maintenance of Scope-adjusted debt/EBITDA below 1.5x. The downside scenarios for the ratings and Outlook are (individually): i) Scope-adjusted debt/EBITDA ratio above 2.5x on a sustained basis; ii) higher regulatory uncertainty as expressed by a deterioration in Hungary's sovereign rating; and iii) a deterioration in the parent company's credit rating.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
23 Sep 2024	Outlook change	BBB+/Stable
26 Sep 2023	Outlook change	BBB+/Positive
27 Sep 2022	Affirmation	BBB+/Stable

Ratings & Outlook

Issuer	BBB+/Stable
Senior unsecured debt	BBB+

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Related Methodology

General Corporate Rating Methodology; October 2023

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong market position with leading market shares across major segments in Hungary as well as North Macedonia • Strong and improving credit metrics, led by improving scale and profitability • Large, diversified customer base	• High dependence on one market, Hungary (rated BBB/Stable), which accounts for over 90% revenues and around 88% of EBITDA • Profitability has historically been lower than that of European peers. Although improvement in the current year has somewhat bridged the gap, it remains vulnerable to taxation changes, which is not the case in some other more mature/stable European markets. • Continued reliance on lower-rated parent Deutsche Telekom AG to meet part of liquidity requirements

Positive rating-change drivers (collectively)	Negative rating-change drivers (individually)
• Broader diversification of operations and/or improved policy visibility in Hungary, reducing regulatory uncertainty • Improved rating of the parent company • Maintenance of Scope-adjusted debt/EBITDA below 1.5x	• Scope-adjusted debt/EBITDA above 2.5x on a sustained basis • Higher regulatory uncertainty as expressed by a deterioration in Hungary's sovereign rating • Deterioration in the parent company's credit rating

Corporate profile

Magyar Telekom Nyrt. is the incumbent telecommunication operator in Hungary and the largest operator in the country, with consolidated revenues of HUF 849bn (EUR 2.2bn) in 2023. It leads the market with 6.4m customers in mobile (including 1.3m machine-to-machine or M2M subscriptions), 1.2m in fixed voice and 1.6m in broadband as of 30 June 2024. Magyar Telekom also functions as a telecom operator in the Republic of North Macedonia and an alternative service provider in Bulgaria and Romania.

Magyar Telekom was created in 1989 as a separate division from Hungary's post office and was commonly known as Matav, a shorter version of its former name, Magyar Tavkozlesi Rt. It was privatised in 1993 through a partial sale to a consortium including Deutsche Telekom, which now has a controlling stake of about 66% as of 30 June 2024. Its only significant foreign subsidiary is Macedonian Telekom, the incumbent operator in North Macedonia.

Financial overview

Scope credit ratios	2022	2023	LTM H1 2024	Scope estimates 2024E	2025E	2026E
Scope-adjusted EBITDA/interest cover	12.4x	10.3x	12.4x	12.6x	15.2x	18.5x
Scope-adjusted debt/EBITDA	2.0x	1.5x	1.4x	1.2x	0.9x	0.8x
Scope-adjusted funds from operations/debt	43%	54%	63%	71%	89%	109%
Scope-adjusted free operating cash flow/debt	0%	22%	29%	16%	37%	46%
Scope-adjusted EBITDA in HUF m						
EBITDA	247,946	287,164	334,957	349,432	376,527	391,588
Other items[1]	(3,807)	(124)	222	-	-	-
Scope-adjusted EBITDA	**244,139**	**287,040**	**335,179**	**349,432**	**376,527**	**391,588**
Funds from operations in HUF m						
Scope-adjusted EBITDA	244,139	287,040	335,179	349,432	376,527	391,588
less: (net) cash interest paid	(19,730)	(28,003)	(27,027)	(27,762)	(24,694)	(21,190)
less: cash tax paid per cash flow statement	(18,615)	(17,817)	(20,101)	(33,758)	(40,452)	(44,579)
Funds from operations (FFO)	**205,794**	**241,220**	**288,051**	**287,911**	**311,381**	**325,819**
Free operating cash flow in HUF m						
Funds from operations	205,794	241,220	288,051	287,911	311,381	325,819
Change in working capital	(6,489)	(20,161)	(38,899)	(44,645)	(4,396)	(4,572)
Non-operating cash flow	(2,240)	(825)	(1,223)	(16,216)	(16,216)	(16,216)
less: capital expenditure (net)	(164,376)	(99,545)	(92,684)	(120,890)	(125,749)	(130,801)
less: lease amortisation	(25,909)	(24,731)	(24,404)	(26,940)	(26,940)	(26,940)
Other items[2]	(5,185)	2,279	(893)	(14,987)	(8,645)	(8,645)
Free operating cash flow (FOCF)	**1,595**	**98,237**	**129,948**	**64,232**	**129,435**	**138,644**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	19,730	28,003	27,027	27,762	24,694	21,190
Change in other items	-	-	-	-	-	-
Net cash interest paid	**19,730**	**28,003**	**27,027**	**27,762**	**24,694**	**21,190**
Scope-adjusted debt in HUF m						
Reported gross financial debt	373,895	346,912	359,957	328,182	280,335	245,335
less: cash and cash equivalents	(12,861)	(13,514)	(12,249)	(14,548)	(15,957)	(20,975)
Other items[3]	115,638	110,917	106,346	94,643	83,680	75,035
Scope-adjusted debt (SaD)	**476,672**	**444,315**	**454,054**	**408,278**	**348,058**	**299,395**

[1] Includes associate dividends, gains/ losses on asset disposals
[2] Other non-cash items
[3] Other financial liabilities including frequency fees payable, debtor overpayment etc.

Table of Content

Environmental, social and governance (ESG) profile[4]

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

No significant ESG factors

Environmental, social and governance (ESG) considerations have no effect on the rating.

Past corruption case (settled)

In 2011, Magyar Telekom settled a corruption case with US authorities for USD 95m. The case was related to blocking a third mobile operator from entering Macedonia in 2005. The company has taken remedial measures, including enhanced compliance programmes.

[4] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB+

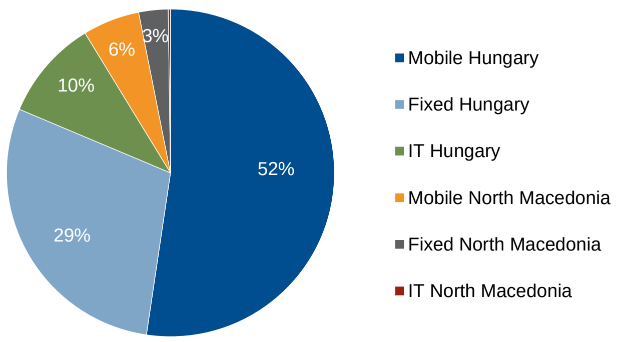
Industry risk profile: A

The industry risk profile for telecommunication services is A, based on low cyclicality (subscriptions for what is now considered a basic service), medium entry barriers (licences, network roll-out), and medium to low substitution risk (over-the-top services).

Limited diversification in terms of segments and geographies

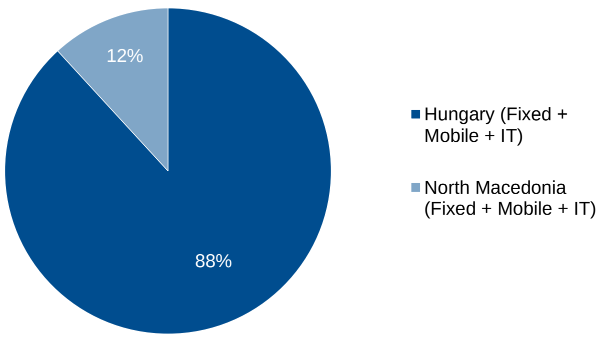
Magyar Telekom's home market of Hungary (9.6m inhabitants) represents around 90% of its revenue and about 88% of its EBITDA after leases (EBITDA AL) (see Figures 1 and 2). The company is mostly focused on telecommunication services in Hungary and, to a much lower extent, in North Macedonia. IT services account for around 10% of revenues, with the majority coming from Hungary. The weight of IT services in group EBITDA is also fairly limited.

Figure 1: Magyar Telekom, revenues in 2023 (HUF 849bn)



Sources: Magyar Telekom, Scope

Figure 2: Magyar Telekom, EBITDA AL in 2023 (HUF 258bn)

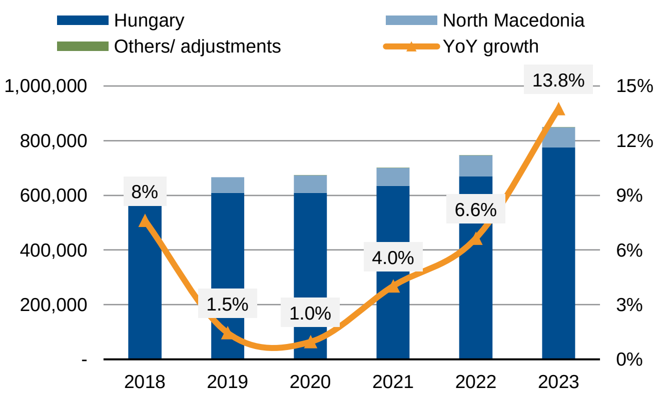


Sources: Magyar Telekom, Scope

Hungarian market growing

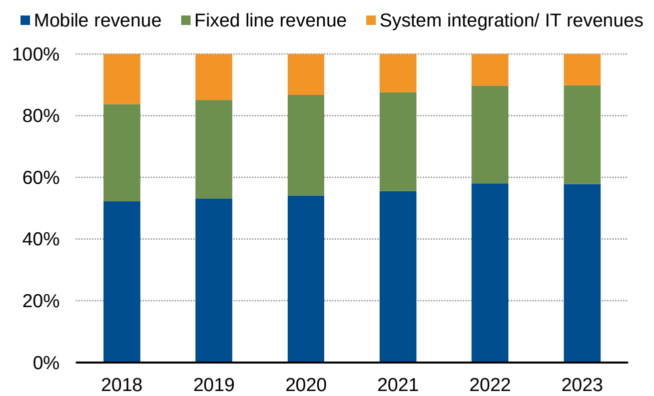
As the incumbent operator, Magyar Telekom is the market leader in Hungary. Its revenues continued to grow during the Covid-19 pandemic: by around 1% in 2020, 4% in 2021, and 7% in 2022, driven by mobile revenues and equipment sales. In September 2022, the company added to its general terms and conditions a fee adjustment clause based on inflation. This was to manage the inflation in energy, personnel and other costs. Consequently, there was a steeper 14% growth in the company's revenues in 2023 (see Figure 3), mainly driven by the inflation-linked price increase implemented for the first time in March 2023.

Figure 3: Revenue trend, 2018-2023 (amounts in HUF m)



Sources: Magyar Telekom, Scope

Figure 4: Segment-wise revenue composition over the years



Sources: Magyar Telekom, Scope

Market leadership position

Magyar Telekom is the clear leader in Hungary, with a market share of around 46% (by subscribers as at 31 December 2023). This level has remained remarkably stable over the last few years (see Figure 5), increasing slightly in 2022 and 2023, far above those of the two main competitors, Vodafone (now acquired by 4iG) and Yettel. The company's market share in terms of revenue is around 48%, which is more than that of most market leaders in Europe.

Figure 5: Magyar Telekom market share in Hungary, 2015-2023 (% of active SIM cards with voice traffic)

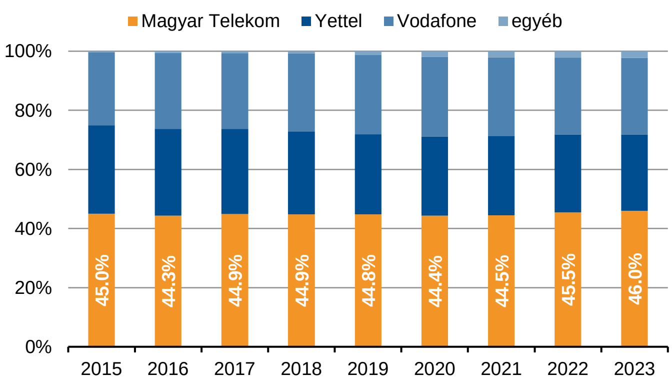
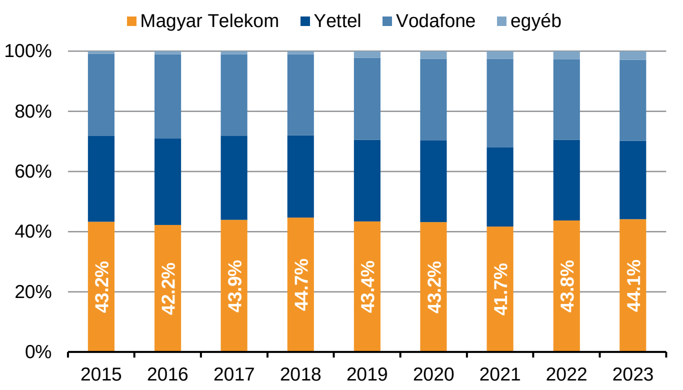


Figure 6: Magyar Telekom market share in Hungary, 2015-2023 (% of active SIM cards with internet traffic)



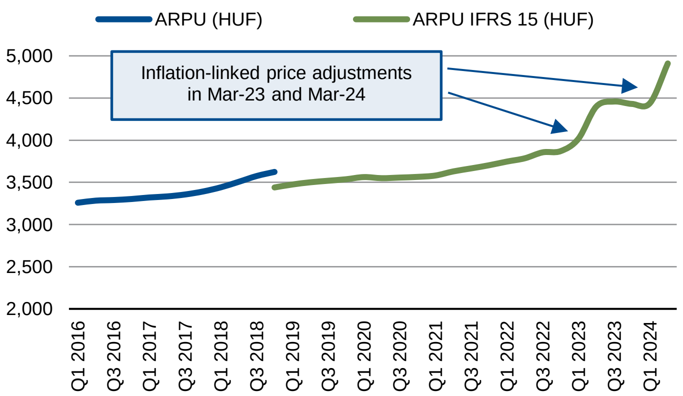
Sources (Figures 5 and 6): National Media and Infocommunications Authority, Hungary (NMHH), Scope

The purchase of Vodafone Hungary by 4iG in 2023, following the acquisition of the Hungarian broadband provider Digi with its marginal mobile activity in 2021, has not materially changed the competitive position of Magyar Telekom in its domestic mobile market. Some incremental market developments are likely, such as the acquisition of a 50%+1 share economic stake by the Middle-Eastern telecom group e& (Etisalat) in PPF Telecom's assets in Bulgaria, Hungary, Serbia, and Slovakia, subject to regulatory approvals. However, we do not expect any material impact on market dynamics in the near to medium term.

Increase in ARPUs following price hikes in 2023 and 2024

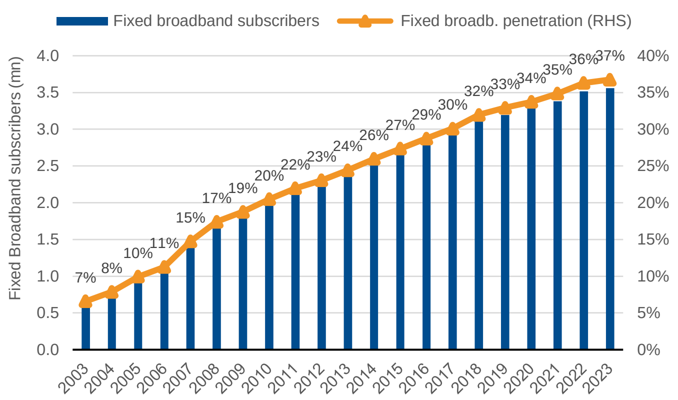
Magyar Telekom's average revenue per user (ARPU) for mobile increased by about 3%-4% per annum over 2021 and 2022, a rare feature in Europe. This was followed by a steep 13% increase in 2023 and a further 11% YoY increase in H1 2024 (see Figure 7), owing to the effect of price indexation. According to the European Commission benchmark, Hungary is among the most expensive markets for mobile services.

Figure 7: Magyar Telekom mobile ARPU (HUF), 12-month rolling average, 2015-2023



Sources: Magyar Telekom, Scope

Figure 8: Hungary fixed broadband market: subscribers (2003-2023)



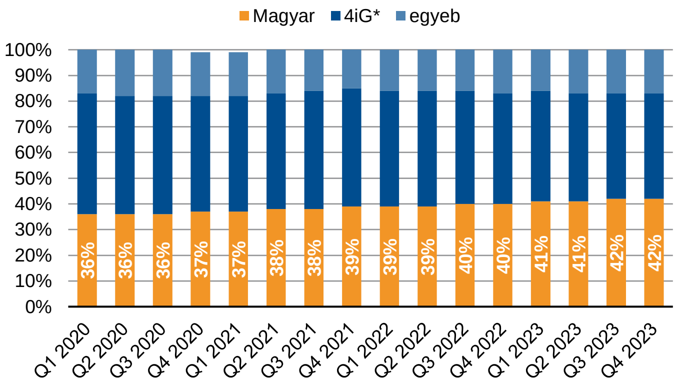
Sources: Hungarian Central Statistical Office, Organisation for Economic Co-operation and Development (OECD), Scope estimates

Leading position in broadband segment as well

Magyar Telekom is also Hungary's leader in the growing market of fixed broadband. Here, subscriber numbers have increased at a compounded annual growth rate of around 3% over the last five years, with penetration rising to 37% in 2023 from 30% in 2017. Cable operators have historically owned much of Hungary's fixed-broadband market, which is not common in Europe. An even more unusual factor is that Magyar Telekom has owned (and sometimes rented) a significant number of broadband access points through cable technology. Nevertheless, fibre broadband connections now represent 54% of the company's total broadband customers (for the quarter ended June 2024) against around 6% a decade ago. In comparison, retail DSL customers' share has gone down to 15% from 60% over the same period, while the share of cable broadband customers has moderated to 31% from 34% of total broadband subscriptions.

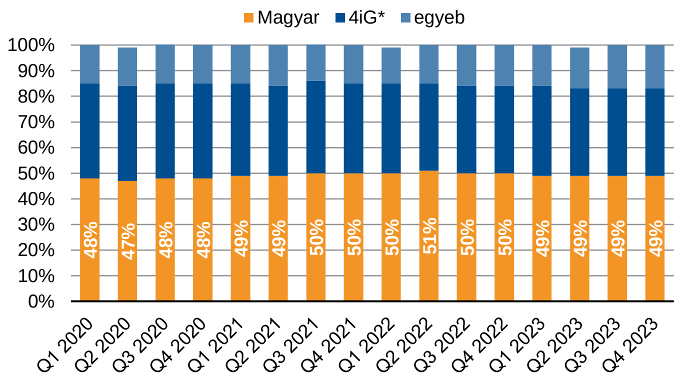
In line with a Memorandum of Understanding signed with the Hungarian government in September 2023, the company intends to spend an overall HUF 123bn on its fixed and mobile network development over the 2024-2027 period. This entails increasing its gigabit-capable fixed network by 1m in four years by year-end 2027 and achieving 99% outdoor population 5G coverage by year-end 2026. The strengthening of Magyar Telekom's fibre network is expected to support its market position further in the segment.

Figure 9: Market share trend in the fixed-line internet market for residential customers in Hungary, 2020-2023



Sources: NMHH, Scope estimates; *Invitel, Invitech, Digi and Vodafone aggregated as 4iG

Figure 10: Market share trend in the fixed-line internet market for non-residential customers in Hungary, 2020-2023



Sources: NMHH, Scope estimates; *Invitel, Invitech, Digi and Vodafone aggregated as 4iG

At present, Magyar Telekom holds over 40% of Hungary's fixed-broadband market. The Hungarian broadband segment has undergone major consolidation in recent years. In 2018, Vodafone became a key player in the Hungarian fixed broadband segment after it acquired cable operator UPC. Around the same time, Digi, a large player in the broadband market, bought the smaller fixed-service operator Invitel and became the second largest player in Hungary. 4iG's purchase of Digi, and more recently of Vodafone Hungary, expanded its market share to about 42%. These acquisitions did not change Magyar Telekom's competitive position substantially, with Magyar Telekom steadily gaining market share in the residential segment, as illustrated in Figure 9. Magyar Telekom's share in the residential broadband market has grown slowly but continually in recent years, mostly through the roll-out of fibre and supported by the acquisition of smaller cable operators. In comparison, there has been a minor dip in its share of the non-residential segment to the 2020-2021 level of around 49% after briefly touching 50% in 2021-2022.

Leading position in North Macedonia

In North Macedonia (2.1m inhabitants, around 9% of group revenues in 2023), Magyar Telekom's 51% subsidiary is the incumbent operator (still 35% owned by the government), with around 50% of the mobile market and a broadband market share of about 40%.

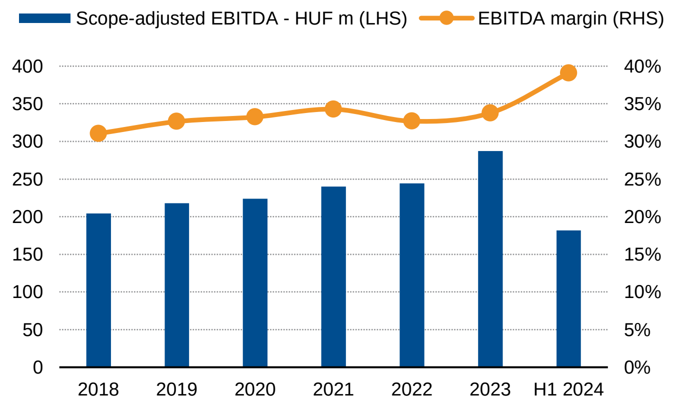
Magyar Telekom is also the leading IT provider in Hungary's very fragmented market (through the T-Systems and T-Business brands), with a market share estimated at about 12%.

Improving profitability

In terms of profitability, Magyar Telekom's EBITDA AL margin averaged about 32% over the 2018-2023 five-year period. This is lower than that of most European incumbents focused domestically, which typically have around 40%. Magyar Telekom's lower profitability in the domestic market is due to a higher level of telecom tax (a trend that increased in 2022 with the introduction of the supplementary telecom tax). While the company's profitability in North Macedonia has remained better and range-bound, profitability in the Hungarian market improved this year, led by significant inflation-linked price increases together with cost mitigation measures and the discontinuation of the utility tax[5]. In H1 2024, the company's EBITDA margin was nearly 600 bps higher than in 2023 (see Figure 11), with roughly 100 bps thanks to the discontinuation of the utility tax. The abolition of supplementary telecom tax from 2025 onwards is likely to further push profit margins in 2025.

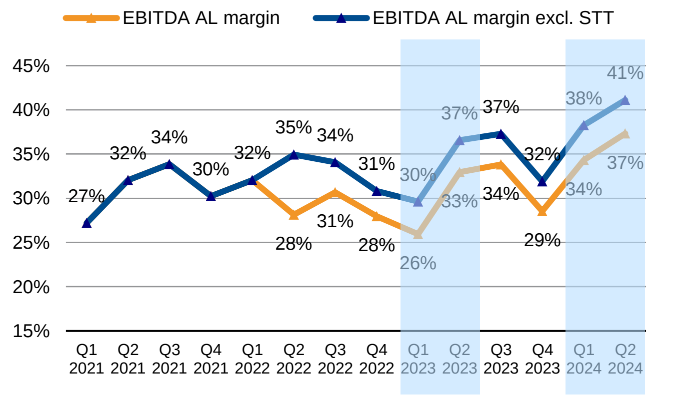
The supplementary telecom tax, equivalent to approx. 3.5% of revenues in 2023 (see Figure 12), is scheduled to be abolished from January 2025. As a result, we expect at least a 500 bps sustainable improvement in the company's EBITDA margins over the medium term, compared to the past five-year average of around 33%. In this respect, the Memorandum of Understanding signed between the Hungarian government and Magyar Telekom in September 2023 provides some comfort on the intended tax structure over the medium term. Nevertheless, future changes in the taxation structure cannot be fully ruled out.

Figure 11: Trend in Magyar Telekom's Scope-adjusted EBITDA margin, 2018-2024



Sources: Magyar Telekom, Scope estimates

Figure 12: Comparison of EBITDA AL margin with and without supplementary telecom tax, 2021-2024



Sources: Magyar Telekom, Scope estimates

[5] On 20 November 2012, the Parliament of Hungary adopted an act imposing tax on utility networks effective from 1 January 2013. The act provided that a tax of HUF 125 per meter would be levied on the owners of ducts providing water supply, wastewater supply and internal rainwater drainage, natural gas, heat and electricity supply and communications services.

Financial risk profile: A

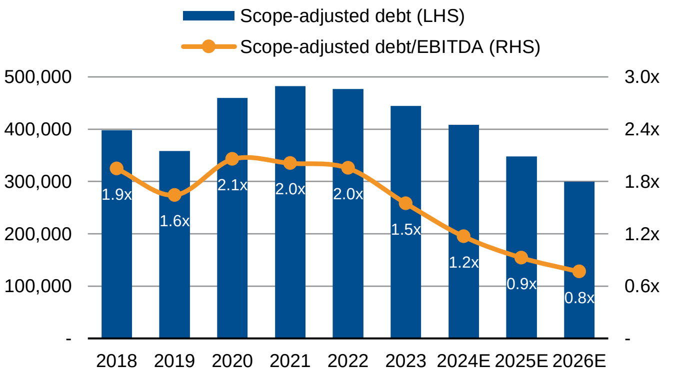
Magyar Telekom's financial risk profile is characterised by strong leverage and debt protection as well as good cash flow cover.

The main driver of the issuer's debt in recent years has been investment in spectrum, with auctions in 2020 and 2021 and some payments in early 2022. Additionally, in the first half of 2022, the Hungarian government announced a temporary supplementary telecoms tax, which put pressure on the company's margins (about 3.5-4pp). In the Memorandum of Understanding signed between Magyar Telekom and the Hungarian government on 15 September 2023, the government indicated its intention to review sector-specific tax rules by abolishing the utility tax by 2024 and the supplementary telecom tax by 2025. The aim is to encourage investments in the country's telecom infrastructure space. In line with this, the utility tax has already been abolished in the current year, while the supplementary tax is to be discontinued from 2025 onwards.

Leverage expected to be around 1.0x over the medium term

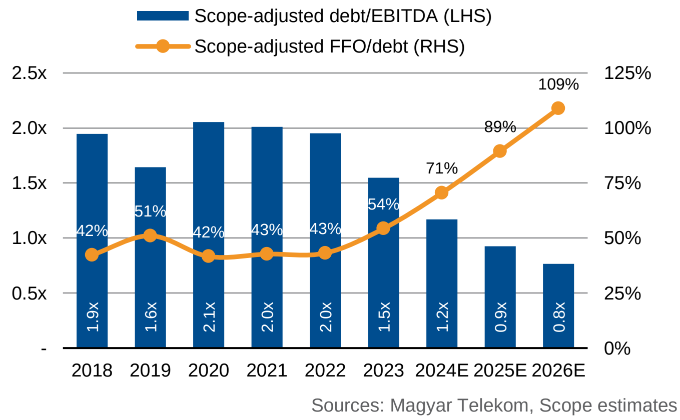
Over the last six years, Magyar Telekom's leverage, as reflected by Scope-adjusted debt/EBITDA, remained in the 1.5x to 2.1x range, averaging about 1.9x. For 2023 (see Figure 13), it stood at 1.5x, declining further to 1.4x for the twelve-month period ending in June 2024 (1.0x in H1 2024) led by an improvement in profitability. We expect Scope-adjusted debt/EBITDA to remain at roughly 1x in 2024 and 2025 on the back of improved scale and profitability, which in turn are likely to be driven by the implementation of inflation-linked price increases, cost mitigation measures as well as the abolition of the utility and supplementary telecom tax. This is also projected to drive a sustained improvement in Scope-adjusted funds from operations (FFO)/debt over the forecasted period (see Figure 14). Further, the company is likely to continue paying out approx. 60%-80% of its net adjusted profits as dividends and share buy-backs, in line with its policy outlined for the 2022-2024 period.

Figure 13: Scope-adjusted debt (HUF m) and debt/EBITDA



Sources: Magyar Telekom, Scope estimates

Figure 14: Scope-adjusted debt/EBITDA and FFO/debt



Sources: Magyar Telekom, Scope estimates

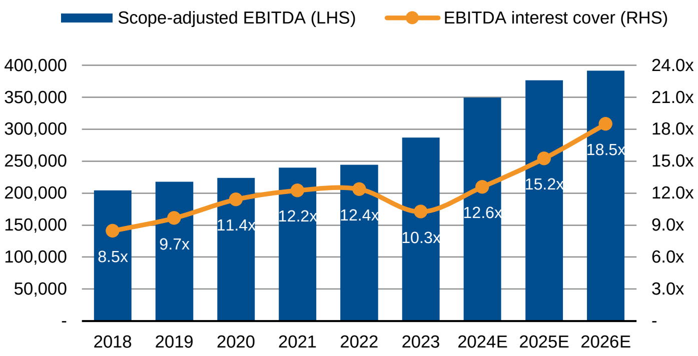
Strong debt protection

Over the last six years, Scope-adjusted EBITDA interest cover averaged 10.7x. We expect the forecasted improvement in profitability to drive a material improvement in interest cover as well. In H1 2024, Magyar Telekom's interest cover was 11.9x compared to 10.3x in 2023 (see Figure 15). Despite improved scale and profits, interest cover moderated in 2023 owing to an increase in interest cost. Overall, we expect debt protection to remain strong at above 10x.

Good cash flow cover

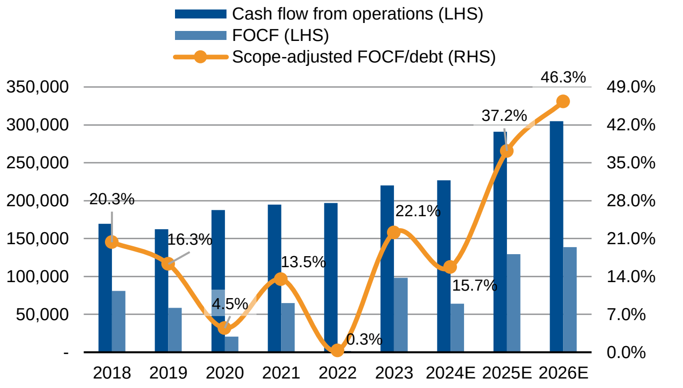
Over the last six years, the Scope-adjusted free operating cash flow/debt ratio averaged 12.8%, with a peak of 22.1% in 2023 (see Figure 16). Excluding exceptional figures in 2020 and 2022, when Magyar Telekom made spectrum payments, the average stood at about 16%. We anticipate that the ratio will remain healthy and improve in 2025/2026, with better margins and no major spectrum payments expected.

Figure 15: Scope-adjusted EBITDA (HUF m) and EBITDA/interest cover



Sources: Magyar Telekom, Scope estimates

Figure 16: Scope-adjusted cash flow estimates (HUF m) and free operating cash flow/debt



Sources: Magyar Telekom, Scope estimates

Adequate liquidity

Over the last five years, the combination of cash, free operating cash flow and undrawn committed lines has averaged around 140% of short-term debt, reaching around 240% in 2023. The issuer's parent company, Deutsche Telekom, which has been providing most current and non-current financial liabilities at Magyar Telekom for many years, also ensures adequate liquidity for its subsidiary.

Balance in HUF m	2024E	2025E	2026E
Unrestricted cash (t-1)	13,514	14,548	15,957
Open committed credit lines (t-1)	44,500	44,500	44,500
Free operating cash flow	64,232	129,435	138,644
Short-term debt (t-1)	93,648	47,847	35,000
Coverage	**131%**	**>200%**	**>200%**

Supplementary rating drivers: -1 notch

We have made a one-notch negative adjustment to Magyar Telekom's standalone credit assessment, which has improved to A-, under peer group considerations. This reflects our view that the company operates in a market that is more exposed to policy changes than similar rated peers active in more mature, stable and predictable European markets. For example, the possible reintroduction of sector-specific special taxes in the event of an adverse economic scenario cannot be completely ruled out. We have made no adjustment for other supplementary rating drivers such as financial policy, parent support, or governance and structure. However, we note that the company remains partially reliant on the lower rated Deutsche Telekom AG for its liquidity needs. Magyar Telekom's integration into the Deutsche Telekom group (cash pooling and financing) is such that, although Deutsche Telekom is more indebted, there is a low risk that its activities would adversely affect Magyar Telekom's ability to meet its own contractual financial debt obligations as a going concern on time and in full. Environmental, social and governance (ESG) considerations also have no impact on the rating.

Long-term debt rating

Senior unsecured debt rating: BBB+

We rate senior unsecured debt issued by Magyar Telekom at BBB+, the same level as the issuer rating. This reflects our view of the company's ability to meet contractual and financial debt obligations as a going concern, on time and in full out of its operating business.

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