



MAKEDONSKI TELEKOM AD - SKOPJE
Kej 13 Noemvri No. 6, 1000 Skopje, R. Makedonija

To: Macedonian Stock Exchange AD Skopje
Orce Nikolov 75, 1000 Skopje

Date: November 2018

Subject: Explanation on the operation of Makedonski Telekom AD - Skopje for the period from 01.01.2018 until 30.09.2018

The following analysis refers to the unaudited financial statements of Makedonski Telekom (MKT) for the period 01.01.2018 - 30.09.2018, prepared in accordance with the International Financial Reporting Standards (IFRSs).

The application of the new standard IFRS 15 Revenue from Contracts with Customers is effective for periods beginning on or after 1 January 2018. IFRS 15 will supersede IAS 11 Construction contracts and IAS 18 Revenue for periods beginning on or after 1 January 2018. The adoption of the new standard will result in significant changes in the financial statements of MKT, primarily in respect of the timing of revenue recognition and in respect of capitalization of costs of obtaining a contract with a customer. In the case of multiple-element arrangements (e.g., mobile contract plus handset) with subsidized products delivered in advance, a larger portion of the total remuneration is attributable to the component delivered in advance (mobile handset), requiring earlier recognition of revenue in future. This leads to the recognition of what is known as a contract asset – a receivable arising from the customer contract that has not yet legally come into existence – in the Balance sheet. At the same time, it results in higher revenue from the sale of goods and merchandise and to lower revenue from the provision of services. Under the new standard, expenses for sales commissions (customer acquisition costs) must be capitalized and recognized over the estimated customer retention period. MKT has been utilized the option for simplified initial application, i.e., contracts that were not completed by 1 January 2018 have been accounted for as if they had been recognized in accordance with IFRS 15 from the very beginning. The cumulative effect arising from the transition has been recognized as an adjustment to the opening balance of equity in the year of initial application.

The effects from operations for the first nine months of 2018 presented below, for the purposes of the comparative analysis with the previous year are given without the influence from the International Financial Reporting Standards 15 Revenue from Contracts with Customers.

I Revenues

The sales revenues in the first nine months of 2018 amounted to MKD 7,768,578 thousand, which represents an increase of 1.7% (excluding IFRS 15 impact) compared to the same period of the previous year.

The implementation of IFRS 15 has negative effect of MKD 19,903 thousands on total revenues.

Voice services



Fixed line voice services

Makedonski Telekom has managed to maintain the **leading position on the fixed voice market with 57.1%** (internal estimation) or 210.3 thousand customers at the end of the first nine months of 2018.

The **voice revenues** in the first nine months of 2018 in the fixed segment services have decreased by 7.3% (excluding IFRS 15 impact) compared to the same period of the previous year due to lower subscription as well as the decreased number of fixed line customers by 0.2% and the decreased outgoing traffic by 10.3%.

The implementation of IFRS 15 has negative effect of MKD 16,684 thousands on fix voice revenues.



Mobile voice services

On the mobile market, the Company has a **market share of 49.0%** (internal estimation). The subscribers' base at the end of the first nine months of 2018 amounts to 1,236 thousand subscribers and it is decreased by 1.4% compared to the same period of the previous year.

At the end of the first nine months of 2018, the **mobile voice revenues** are decreased by 1.7% (excluding IFRS 15 impact) compared to the same period of the previous year. The decrease is due to lower volume in international incoming mobile terminating traffic. The blended ARPU (Average Revenue Per User) has increased by 8.7% compared to the same period of the previous year amounting to MKD 362 mostly driven by the increase of post-paid subscribers' portion in the total subscribers' base.

The implementation of IFRS 15 has negative effect of MKD 177,932 thousands on mobile voice revenues.

Internet, TV and other non-voice services



Fixed Internet and TV

At the end of the first nine months of 2018, the number of total BB accesses is increased by 1.7% and amounts 192.7 thousand compared to 189.5 thousand at the end of the same period of the previous year, while the **broadband Internet market share** at the end of the first nine months of 2018 **amounts to 45.1%** (internal estimation). The investments in the optic network have resulted in an increase by 11% of Households passed with access to the optic network compared to the same period of the previous year. At the end of the first nine months of 2018 the total coverage of the Households with access to the optic network has reached 30%.

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Regarding the **TV market**, Makedonski Telekom has a **market share of 29.7%** (internal estimation) of the total TV market. The IPTV (digital television via Internet protocol) service, with its high quality, interactivity and the unique TV experience, is excellently accepted on the market and the Company achieved an increase of the number of IPTV customers (including Magenta1, 3 Play and other TV services) by 8.7% compared to the same period of the previous year, which has resulted in a customer base of 124.1 thousand customers at the end of the first nine months of 2018.

The **revenues from digital television via Internet protocol ("IPTV")** at the end of the first nine months of 2018 have increased by 15.3% (excluding IFRS 15 impact) compared to the same period of the previous year. While positive growth in TV ARPU (Average Revenue Per User) could be sustained, the intense competition continued to put a pressure on broadband ARPU. Therefore the **Revenues from retail Internet** at the end of the first nine months of 2018 have declined by 2.5% (excluding IFRS 15 impact) compared to the same period of the previous year.

The implementation of IFRS 15 has negative effect of MKD 37,380 thousands on Internet and TV revenue.



Mobile non-voice services

The **non-voice revenues** in the first nine months of 2018 have increased by 12.6% (excluding IFRS 15 impact) compared to the same period of the previous year, as a result of the increased mobile internet revenue due to the higher GPRS traffic and increased usage of data tariff plans.

The implementation of IFRS 15 has negative effect of MKD 87,530 thousands on Mobile non-voice services.

Other revenues



Other revenues in the fixed and mobile segment

The **revenues from the sale of equipment** at the end of the first nine months of 2018 have increased by 6.2% (excluding IFRS 15 impact) compared to the same period of the previous year, due to the higher average selling price of handsets as well as the higher number of sold handsets partly offset by the lower sale of TV sets and other IT equipment in the fixed segment.

The implementation of IFRS 15 has positive effect of MKD 298,623 thousands on revenues from sale of equipment.

System integration and IT revenues at the end of the first nine months of 2018 continued to grow dynamically after the last year's temporary decline and the same have increased by 37.9% compared to

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the same period of the previous year. The higher revenues are result of the larger number of customised ICT projects.

II Expenses

Operating expenses

On the cost side, at the end of the first nine months of 2018, the operating expenses are decreased by 1.3% (excluding the effect from implementation of IFRS 15) compared to the same period of the previous year.

The implementation of IFRS 15 has negative effect in amount of MKD 25,976 thousand on the operating expenses.

The employee related expenses have decreased by 3.1% (without the effect from implementation of IFRS 15) at the end of the first nine months of 2018 compared to the same period of the previous year. The implementation of IFRS 15 has positive effect in amount of MKD 7,616 thousand on the employee related expenses.

The cost of trading goods sold have increased by 10.1% at the end of the first nine months of 2018 compared to the same period of the previous year

The cost for depreciation and amortization at the end of the first nine months of 2018 has increased by 1.8% compared to the same period of the previous year.

Capital expenditures

The amount of total Capital expenditures (CAPEX), at the end of the first nine months of 2018 is MKD 1,218,174 thousand.

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III Operating and Net profit

The above-stated movements of the revenues and costs resulted in an increase of the Earnings before interest, taxation, depreciation and amortization (EBITDA) for the first nine months of 2018 by 6.7% (excluding IFRS 15 impact) compared to the same period of the previous year. Implicitly the EBITDA margin for the first nine months of 2018 amounts 42.6% (excluding IFRS 15 impact).

Operating profit (Earnings before interest and taxation - EBIT) for the first nine months of 2018 has increased by 13.3% (excluding IFRS 15 impact) compared to the same period of the previous year.

Net profit for the first nine months of 2018 has increased by 16.8% (excluding IFRS 15 impact) compared to the same period of the previous year, while the net profit in accordance with IFRS 15 has been increased by 13.1% and amounts MKD 1,310,813 thousand. The implementation of IFRS 15 have impacted the net profit and resulted in the negative net effect of MKD 42,850 thousands including the positive effect on deferred tax in amount of MKD 3,029 thousand.

In MKD thousands	2017 Sep YTD in accordance with IAS 11 and IAS 18	2018 Sep YTD in accordance with IFRS 15	Change YoY	2018 Sep YTD in accordance with IAS 11 and IAS 18 (excl. IFRS 15 effect)		Change YoY
				IFRS 15 effect	2018 Sep YTD in accordance with IAS 11 and IAS 18 (excl. IFRS 15 effect)	
Total Operating revenues	7.762.362	7.836.943	1,0%	19.903	7.856.846	1,2%
Sales revenues	7.657.115	7.768.578	1,5%		7.788.481	1,7%
Total Operating expenses	6.431.075	6.374.425	-0,9%	25.976	6.348.449	-1,3%
Deapreciation and amortization	1.807.840	1.839.776	1,8%	0	1.839.776	1,8%
Earning before interest, taxation, depreciation and amortization (EBITDA)	3.139.127	3.302.294	5,2%	45.879	3.348.173	6,7%
EBITDA margin in %	40,4%	42,1%			42,6%	
Operating Profit (Earning before interest and taxation - EBIT)	1.331.287	1.462.518	9,9%	45.879	1.508.397	13,3%
Net Profit	1.159.237	1.310.813	13,1%	42.850	1.353.663	16,8%

On 13 February 2006, Magyar Telekom Plc., the controlling owner of the Company, (via Stonebridge Communications AD - Skopje, majority shareholder of the Company), announced that it was investigating certain contracts entered into by another subsidiary of Magyar Telekom Plc. to determine whether the contracts were entered into in violation of Magyar Telekom Plc. policy or applicable law or regulation. Magyar Telekom's Audit Committee retained White & Case, as its independent legal counsel to conduct the internal investigation. Subsequent to this, on 19 February 2007, the Board of Directors of the Company, based on the recommendation of the Audit Committee of the Company and the Audit Committee of Magyar Telekom Plc., adopted a resolution to conduct an independent internal investigation regarding certain contracts in Macedonia.

Based on publicly available information, as well as information obtained from Magyar Telekom and as previously disclosed, Magyar Telekom's Audit Committee conducted an internal investigation regarding certain contracts relating to the activities of Magyar Telekom and/or its affiliates in Montenegro and Macedonia that totalled more than EUR 31 million. In particular, the internal investigation examined whether Magyar Telekom and/or its Montenegrin and Macedonian affiliates had made payments prohibited by U.S. laws or regulations, including the U.S. Foreign Corrupt Practices Act (the "FCPA"). The Company has previously disclosed the results of the internal investigation.



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Magyar Telekom's Audit Committee informed the U.S. Department of Justice (the "DOJ") and the U.S. Securities and Exchange Commission (the "SEC") of the internal investigation. The DOJ and the SEC commenced investigations into the activities that were the subject of the internal investigation. On 29 December 2011, Magyar Telekom announced that it had entered into final settlements with the DOJ and the SEC to resolve the DOJ's and the SEC's investigations relating to Magyar Telekom. The settlements concluded the DOJ's and the SEC's investigations. Magyar Telekom disclosed the key terms of the settlements with the DOJ and the SEC on 29 December 2011. In particular, Magyar Telekom disclosed that it had entered into a two-year deferred prosecution agreement (the "DPA") with the DOJ. The DPA expired on 5 January 2014, and further to the DOJ's request filed in accordance with the DPA, the U.S. District Court for the Eastern District of Virginia dismissed the charges against Magyar Telekom on 5 February 2014.

In relation to the local investigation by the state authorities in Macedonia and further to the previously disclosed information in the Financial Statements of the Company for the preceding years, the criminal procedure at the basic court is on-going.

We have not become aware of any information as a result of a request from any regulators or other external parties, other than the previously disclosed, from which we have concluded that the financial statements may be misstated, including from the effects of a possible illegal act.

Nikola Ljusev
Chief Executive Officer

Slavko Projkoski
Chief Financial Officer

Proofreading by Lingva Ekspert