Open Letter to the Board of Directors of Magyar Telekom

Members of the Board

Magyar Telekom Nyrt.

Subject: Recommendation to improve the company's ESG profile by publishing a reasonable midterm dividend policy which takes into account real financial leverage of Magyar Telekom and a low real interest rate environment

Dear Members of the Board,

HOLD Asset Management as a committed long term value investor is one of the largest minority shareholders of Magyar Telekom (MTEL), currently holding approximately 14,6 million or 3.8% of the publicly traded shares in its mutual funds and significant number of additional shares in accounts it manages for domestic and foreign institutional investors.

In the past, we were patient investors regarding the company's dividend policy, recognizing the fact, that the upcoming 5G frequency auction meant uncertainty and increasing leverage. However, this uncertainty has been concluded in early 2021 and since then the company is on a quick deleveraging path. We think that MTEL's financial strength is already solid, and its mid-term guidance shows strong and stable cash generation. Therefore, we think it is the right time for the company to come up with a new dividend strategy that recognizes its new situation.

Our proposal is for the Board to publish a new midterm dividend policy for MTEL, which links the total shareholder payout (dividend and buyback) to the midterm expected cash generation of the company and to its actual leverage compared to its target leverage level.

Our detailed considerations on the target leverage level are the following:

- **MTEL should state its target leverage** (i.e. a comfort level), similar to how its parent company Deutsche Telekom (DT) does, where it sees maximum value creation for all shareholders.
- Due to the higher Hungarian country risk, it is justifiable to target lower leverage, than DT's 2.25x-2.75x own target. **We recommend 1.75x-2.25x target net debt to EBITDA for MTEL**.
- At the end of 2021, assuming the usual seasonality of cash generation, we expect that MTEL will be within this range, of around 2.0x net debt to EBITDA.
- It is important to differentiate, that out of the 2.0x leverage at yearend, only roughly 1.2x is real financial debt and 0.8x is a pure IFRS accounting measure, the capitalization of future lease liabilities and frequency payables.
- **Targeting a leverage significantly below our recommended 1.75x-2.25x range would practically mean that the company targets close to zero real financial debt**. In the pre-IFRS16 world, the company had on average 2x net debt to EBITDA between 2016 and 2018 without any future liability capitalizations and was still paying a dividend similar to the current one. Therefore we think, **working on eliminating real financial debt would be quite value destructive** for MTEL shareholders in today's negative global real rate environment and we would strongly disagree with.
- MTEL is asset heavy, hence can monetize its tower assets or its fiber network, should a need for quick deleveraging arise, so it is in a strong financial position.
- Central-Eastern-European sector peers, adjusted for asset deals, have a leverage in the 1.7x-2.7x range, while Western European major telcos are mostly in the 2.5x-3.0x range.

Given the low cyclicality and mature state of the telecom sector without significant growth opportunities, we think MTEL should pay out (in the form of dividend or buyback – total shareholder remuneration) <u>majority</u> of its midterm cash generation as long as it is within its target leverage range and should pay out almost all in the case of leverage going below its optimal level.

Our detailed recommendation for total shareholder remuneration are as follows:

- **at least 80% payout of midterm cash generation, if leverage is below 1.75x**
- **60-80% payout if leverage is in the target range (of 1.75x-2.25x)**
- **40-60% payout if leverage is above target, but below 2.75x**
- **lower payout if leverage is above 2.75x**

MTEL in its latest midterm outlook stated that total shareholder remuneration should grow in line with free cashflow (FCF) and net income. If the intention was to indicate that the company is planning to keep the current low payout ratio stable, we think it is a mistake since it would lead to a quick deleveraging, below optimal level.

We have been hearing growing discontent in the investment community about MTEL's dividend policy for the past two years. The market fears that it is highly influenced by DT's financial situation. DT's current leverage is at 3,0x, above its targeted leverage of 2.25x-2.75x net debt to EBITDA. However, DT still pays out around 40% of cash-flow generation as dividend to its shareholders. DT's intention is to get back to its target leverage in the next few years and dividend payment of MTEL works against it by increasing DT's consolidated leverage (albeit insignificantly).

If MTEL is forced to deleverage quickly below optimal level, while DT runs above target leverage, it destructs value for MTEL shareholders **while transferring this positive value of negative real rates to DT shareholders**. Happened to be this the case, we think it would be deeply unethical and would mean very poor governance both in the case of MTEL and DT. We see that **this concern of the investing community leads to significant undervaluation of MTEL shares on the market** and sell side analysts are also referring to this situation as a justification or discount factor for lower valuation of MTEL.

We sincerely hope that these concerns are unfunded as in a world of growing ESG importance (majority of recent fund flows are going into ESG funds), such poor governance could lead to further negative consequence for both companies in the future. **Fortunately, these concerns can easily be addressed by MTEL** by implementing a new dividend policy along the lines we suggest. It would refute market misconceptions and more importantly, would lead to an optimal capital structure of the company, maximizing value for its shareholders, which should be the aim of the Board.

We wrote this letter driven by the hope that we are able to convince decision-makers of MTEL regarding the benefits of a clear midterm dividend policy. Our fiduciary duty is to represent the common interest of our clients and all minority shareholders by nudging the companies we invest in to improve their visibility, governance (ESG profile) in order to enhance value creation.

Budapest, 13th of January, 2022.

Best Regards,

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