

The Q2 2010 results conference call
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Presenters

Juergen Czapran

T-Hrvatski Telekom – Chief Financial Officer and Member of the Management Board

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Operator

Thank you for standing by ladies and gentlemen and welcome to the Results of the First Half of 2010 conference call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session at which time if you wish to ask a question you will need to press *1 on your telephone. I must advise you that this conference is being recorded today, Friday 30th July 2010. I would now like to hand the conference over to your first speaker today, Erika Kaspar. Please go ahead.

Erika Kašpar

Thank you Anya. Ladies and gentlemen good afternoon and welcome from Zagreb where our Chief Financial Officer, Mr Juergen Czapran, will talk you through the highlights of our business and financial performance for the first six months of this year, using the presentation slides which I hope you have in front of you. If not, please visit our website; it is www.t.ht.hr.com where you can access the slides from our investors page. Before we begin, allow me draw your attention to the harbour statement on page 2 of our presentation and allow me now to introduce you to Mr Juergen Czapran, our Chief Financial Officer.

Juergen Czapran

Thank you Erika. Good afternoon to everybody. Let me put the first half of the year in context and update you on the economic situation in Croatia. We are still in a recession. GDP fell 2.5% and that compares with the 5.8 fall we saw across the whole of the year 2009. Unemployment was at 16.6% in June this year, which is higher than in the same period last year. According to

recently released World Bank's forecast, Croatia should recover from recession slower than EU10 countries, and Croatian National Bank expects GDP to fall this year 1.5%.

Looking at the market background on slide 4, there has been very little change since we last updated you in April. At that time there was some talk about mandatory registration of prepaid phones, but I am pleased to say nothing has come of it so far, and our position is well known that it is not a good idea, especially with all these recessionary pressures hurting the mobile industry. We are still hoping that we can resolve the issue of bitstream access over our fibre optic network, and that is something that we are discussing with the regulatory agency. Obviously we would like a quick resolution to this issue and hope that we can come to some agreement sooner rather than later, but that really depends on how quickly the regulator can act and get this sorted out.

Turning now to the Group's performance on slide 5, you can see that revenues are continuing to decline because of the recession and special taxes, and we are down 3.9% compared to the last year. Obviously that has been helped by the contribution of Combis, which we consolidated in May; and that contributed 53 million in these two months, which is a good performance and what we expected from them. I am pleased to say we are making good progress integrating Combis and that operations and alignment process is going according to our expectations. Even if we exclude the contribution of Combis, I am pleased to say we have slowed down the rate at which revenue has been falling. If you look back to the first quarter results, we were down 6% year-on-year, but we have slowed that slightly to 5.2% across the whole of the first half when you excluded the 53 million from Combis. To a large extent that has been helped by the mobile business, where the second quarter was better than the first, or at least we didn't see the same fall in revenue as we did in the first quarter. Obviously profits were down because of the slowdown in revenues, but we have kept a tight control on working capital and so we have actually increased net cash from operations by 28%, which is a good achievement in this environment and obviously that keeps our cash balance healthy. Don't forget, we have paid out 2.8 billion in dividends in May, and we are one of only a few companies in Croatia that is paying dividends at the moment.

You can see the capex has fallen quite dramatically, and there are a number of reasons for that. Firstly; we took a decision to suspend investment in the fibre network until we could reach some agreement with the regulator that allows us to benefit straight away from this very significant investment that we want to make. There is an issue on competition and at the moment as it stands now we spent money to build the network, but we can't actually sell products on it until our competitors have had a first go on it and kept us out for several months. Obviously we don't think that is fair, because it is us that is spending money on the network, not our competitors. We are

negotiating this with the regulator and the agency, but unfortunately it is taking much longer than we hoped. If we can reach an agreement, I think it is likely we will get back to making this investment right away. Secondly, we had some difficulties in obtaining local permits, and that has delayed some deployments of things like fixed access and radio access network infrastructure. Finally, we have reorganised our business and as a consequence we have delayed some big projects like IT so we can get the best efficiency right across the Group.

Looking at revenue development on slide 6 you can see how the different business units are performing. The fixed telephony business is falling at a pretty constant rate of about 9% and has been for a while, so it is not so clear that the recession is making anything worse in fixed business. The brunt of the falls are being seen in mobile and that is directly because of the special tax which cost us about 77 million in the first half, and because the recession and unemployment are making people cut back on buying and using mobile phones. On the opposite side, internet revenues are still a growth story and that is helping to compensate for some of the losses we are experiencing elsewhere.

Finally, if you look at miscellaneous revenue, that is where we put Combis for the time being, but I think in future periods we will show it as a revenue line of its own.

As you know, we are still reporting T-Com and T-Mobile this year despite the merger, and once again we can see a similar pattern of revenue development. Fixed Telephony is falling at a fairly constant rate of about 9% and internet is still growing strongly, so now it is nearly 28% of T-Com revenue compared with 22% last year. EBITDA fell 6.8%, and there has been little erosion of the margin at T-Com of about 1 percentage point, because we are still focused on efficiencies and we have had some success in keeping a tight control of costs. As I mentioned before, capex has fallen quite dramatically, but I am hopeful that all the issues I mentioned can be sorted out so we can get investment back up to a normal level in the fixed line business.

Fixed Telephony; over the page we can see how the fixed telephony business is progressing. As you expect, the metrics are falling as they have done in previous results, so mainlines are down, total traffic is down and ARPA is down 4.3% to HRK132. Of course, we are continuing our efforts to maintain customers with all sorts of new pricing plans and incentives, with more minutes and redesigned business packages.

Over the page you can see all the upward trends in internet products that are driving the 20% growth we have seen in revenue this half year. ADSL mainlines are up 14.5%, and that is because we are successfully acquiring new users with promotion, like offering two months flat fee

or discount on mobile internet if you sign up. Remember that broadband penetration is still relatively low in Croatia at about 40%; there is still plenty of growth left in the market. ARPA rose 4.3% on broadband and that is because a lot of the promotional periods came to an end, so customers went back to a more normal level of billing. In addition, we had a higher promotion of flat traffic subscription packages that had helped average revenue increase. Our IPTV services, MAXtv and Iskon TV continue to grow strongly, and so the total IPTV subscriber base has gone from 171,000 last year to 257,000 this year. When you look at the figures, that is a pretty high proportion of our broadband customers who are taking IPTV as well. As before, we have got attractive sign-up promotions and a good range of content across the service to which we are always adding.

Looking at wholesale and data on the next slide, we are again seeing wholesale revenue falling and that is because there is less international traffic coming in to mobile operators and to the national hubbing services. Also, you will recall there were cuts in the prices of termination, origination and DTI use that were imposed by the regulator a while back.

Just a note on ULL, in the second quarter we have changed the way we report ULL numbers to showing the number of active lines instead of the old way to report the number of realised lines; that is why there is a difference. We think this is a better way to report as it gives a more accurate picture of what is happening in ULL activity. By comparison, under the old methodology, the number of realised lines would have been 138,062 in June this year versus 110,670 in June 2009.

Let's talk about T-Mobile. If you look at slide 11 we can see that mobile revenue fell 9.8% in the first half of 2010, compared with the first half of 2009. That is mostly because of the impact of the recession and especially the taxation measures. Termination rates have also been lower this year and that has also contributed to the decline. The 6% tax itself has cost us 77 million in the first 6 months of the year and at this stage we don't have any clear indication if or when this tax is going to be abolished. If you look at the revenue breakdown, what is clear is that both prepaid and post-paid revenues have been affected. Prepaid revenues are down 14% and that is largely because prepaid users tend to be more sensitive to cost and so they are more likely to reduce the amount of calls they make, or stop using a phone altogether, or even look for another operator because there is competition out there. Prepaid makes up about 30% of T-Mobile revenue. Post-paid revenue makes up nearly 60% of revenue and they have fallen about 9% in the first half for the reasons I have already mentioned. The fall in revenue was the reason EBITDA fell and that is down 14.8% to 764 million. Capex is down by nearly 53% from the same period last year, and reasons I have already mentioned.

If you look at slide 12 you can see we have experienced a slight drop in the number of T-Mobile subscribers to just under 2.8 million, but I think what is noticeable is that also prepaid customers have gone down. We have increased post-paid accounts by 10%, which is important for us, because those are much longer term relationships. We lost prepaid customers because of the recession, but although we have seen some churn of accounts that were started last year when we had promotions, SIM-only is the key word over here. Obviously we are putting a lot of effort into retaining customers and into converting prepaid to post-paid; and as you can see we have been promoting a range of new packages designed to keep customers happy.

Looking in more detail over the next page on the operational data, we can see that ARPU has decreased because of the 6% tax and the rise in VAT, but we have been quite successful in keeping minutes of use up because we have offered some promotions where you have got more minutes for the same cost.

Let's take a look at the Group financials, and I think we have already covered revenue and EBITDA, so I will talk about the net profit first. Net profit was down 24.7% to 822 million and that has fallen quite a bit more than EBITDA, because we have had significantly less financial results this year and that is because interest rates are much much lower. On top of that we had a one-time impact related to our subsidiary in HT Mostar in the amount of HRK32 million. As a consequence, our net margin has fallen quite a bit from 26% to 20%. We have already mentioned capex, but our hope is that if we can resolve all the outstanding issues, we will be able to get capex back on track and maybe even catch up to the level of investment we have already planned. As to headcount, it is up slightly because we took more than 207 people with Combis. On a like-for-like basis the actual number would even be lower than the year before.

Having now a look on the Group 2010 outlook, you will see that we have only modified this slightly. The ongoing recession in Croatia, highest unemployment and the 6% tax on mobile services continues to have an impact on the business. Therefore, and even with the consolidation of Combis, the Group continues to expect a moderate decline in revenues in 2010. The Group expects also some erosion of EBITDA in 2010 but continues to pursue a program of cost control initiatives that should mitigate this erosion to some extent. The Group anticipates lower capital expenditure in 2010, but we will review it at any time and explain during the year according to the prevailing circumstances. Investments we are going to make in the fixed network and focus on optical access network development, aiming to increase broadband coverage and migration to the IP network. Investment in mobile network, we will focus mainly on data capacity. The last one, we already mentioned regional expansion; the Group continues to monitor and evaluate expansion opportunities to increase shareholders value.