

The Q2 2017 results conference call

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Presenters

Davor Tomašković

Hrvatski Telekom – President of the Management Board and CEO

Josef Thürriegl

Hrvatski Telekom - Member of the Management Board and CFO

Elvis Knežević

Hrvatski Telekom – Investor Relations

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by and welcome to the HT Group First Half Results Conference Call.

At this time, all participants are in a listen only mode. There'll 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 star 1 on your telephone keypad. I must advise you, the conference is being recorded today, Thursday the 27th of July, 2017.

And I would now like to hand the conference over to your speaker today, to Elvis Knežević. Please go ahead, sir.

Elvis Knežević: Thank you.

Ladies and gentlemen, good afternoon and welcome from Zagreb. Today, our CEO, Mr. Davor Tomašković and Josef Thürriegl, our CFO will talk you through the highlights of our business and financial performance for the six month ended 30th June, 2017 using presentation slides, which I hope you have in front of you. If not, please visit our website at www.t.ht.hr, where you can access the slides from our investor's page.

After the presentation, Mr. Tomašković and Mr. Thürriegl will be available for your questions. Before we begin, allow me to draw your attention to the harbor statement on page two of our presentation.

Allow me to introduce you to Mr. Davor Tomašković, our CEO, who will outline our company's performance during the six months ended 30th June, 2017.

Davor Tomašković: Good afternoon, ladies and gentlemen, and thank you for joining us today.

It is my pleasure to present the results from Hrvatski Telekom for the six months ended 30th of June, 2017. I will start the presentation with slide three, which outlines the financial highlights of the first half. I'm pleased to report that both HT Group and HT Croatia, excluding Crnogorski Telekom, have enjoyed a robust first half. In Group account, it is reflected in revenue and the EBITDA growth, although net profit was weighed down by depreciation and higher financial expenses.

Revenue across the Group rose 8.5 percent to 3.691 billion kunas, helped by the consolidation of Crnogorski Telekom as of 1st of January, 2017. HT Croatia showed some encouraging trends in mobile, broadband and TV, but the timing of project revenue recognition in our system solution business impacted on sales. HT Croatia's revenue fell .5 percent in the first half of the year.

The Group's EBITDA before exceptional items rose 8.9 percent to 1.458 billion kunas, once again, primarily owing to the consolidation of Crnogorski Telekom.

The EBITDA margin improved 0.2 percent to 39.5 percent, mainly as a result of the continued successful transformation of HT Group and lower merchandise cost in the system solution business.

This was achieved despite lower profitability at Crnogorski Telekom and the increased cost associated with the energy business. The core HT Croatia EBITDA rose 1.1 percent with a margin of 40 percent. Net profit fell 1.7 percent across HT Group, to 410 million kunas in the first half. Excluding Crnogorski Telekom, net profit fell 4.9 percent. This is largely attributable to higher depreciation and higher financial expenses, driven by exchange rate losses and content capitalization at HT Croatia.

Please turn now to slide four, which shows an increase in operating cash flow and continued strong investment in our network. The Group's cash flow from operations

rose 31.7 percent to 1.23 billion kunas, buoyed by the consolidation of Crnogorski Telekom, but also by improved working capital management at HT Croatia.

Excluding Crnogorski Telekom, operating cash flow was still up a very strong 20.1 percent. Capital expenditure was also up, rising 27.7 percent to 824 million kunas, as we invested significantly in our mobile and fixed broadband network, particularly following the release of new estimates, which revealed an increase in the expected number of tourists and call traffic than previously anticipated.

CAPEX was also impacted by the IT transformation underway at HT Croatia. The consolidation of Crnogorski Telekom and an increase in the capitalization of contracts for TV content. Excluding Crnogorski Telekom, CAPEX at HT Croatia rose 17.6 percent.

Since our first quarter results in April, we have updated our outlook to reflect a moderate rise in CAPEX in 2017. Previous guidance was for slightly lower CAPEX in 2017, compared with 2016. The new CAPEX outlook is impacted mainly by further investment to increase capacity in our mobile network, along with high TV content capitalization costs and regulatory costs related to the electronic communications infrastructure.

Our guidance for revenue growth of around 10 percent in the EBITDA margins before exceptionals maintained at 40 percent remains unchanged. Operationally, the highlights of the first half of the year include introduction of a number of innovative new services. These include VoLTE, which enables voice calls over our super-fast LTE network, and our next TV platform, which allows our customers to consume TV content on any device, anywhere and anytime.

During the period, the Croatian Competition Agency extended a temporary management rights of Optima to Hrvatski Telekom until July, 2021. The agency also conditionally approved a concentration pursuant to the merger agreement of H1 Telekom into Optima.

Finally, we have launched a share buyback program, which commenced on July 3rd, 2017 with a maximum of 2.5 million shares scheduled for acquisition, amounting to 3 percent of the total shares outstanding.

Now, turning to slide five, the revenue performance of HT Croatia, excluding Crnogorski Telekom shows momentum in mobile, broadband and TV, as well as positive developments in fixed wholesale revenue.

However, this was offset by a decline in the system solutions revenue as a result of unfavorable project dynamics compared with H1, 2016, with fewer projects closing in the first half of 2017. Total sales in the first half fell .5 percent to 3.387 billion kunas. And within this total, mobile revenue rose 3.2 percent benefiting from more postpaid customers and more visitors using data while roaming on our network and higher sales of handsets.

Fixed voice revenue fell 10.9 percent to 435 million kunas in the first half of 2017, dragged down by a fall in mainlines as people increasingly substituted mobile for fixed telephony. The consequence of fewer mainlines was lower call traffic and a decline in average revenue per user, as those people who retained their fixed line tend to be low value residential customers.

Broadband and TV revenue was up 1.1 percent to 659 million kunas in the first six months of the year. This reflects broadly flat broadband revenue and slight growth in TV revenue because of a rise in the number of customers for our TV services.

Fixed wholesale revenue rose strongly, up 13.5 percent to 195 million kunas. This was mainly due to network infrastructure revenue driven by an increased number of broadband wholesale customers. In addition, a new regulated price for wholesale customers came into effect on 1st of January 2017.

Other fixed revenue was slightly lower, falling 1.3 percent following a decrease in revenue from Optima Telekom. More substantially though, system solutions revenue fell 16.5 percent to 276 million kunas, reflecting unfavorable project dynamics with fewer projects closing in the first half of this year, compared with the same period in 2016.

And finally, miscellaneous revenue jumped 48.7 percent to 69 million kunas, boosted by the development of energy revenue. This generated 64 million kunas in sales in the first half of 2017, compared with 41 million kunas in the same period last year.

I will now hand over to Josef, who will walk you through our financial performance during this period, in more detail.

Josef Thürriegl: Yes, thank you, Davor.

And good afternoon to everybody.

Please now turn to slide number six, which describes the performance of HT Croatia's mobile business. Mobile data bundles and improved customer experience remain the focus of our mobile business, for which we are proud to offer now a mixed scale speeds of up to 262 megabits per second.

During the first half, we have maintained our leading market position, although market share slipped a little to 46.2 percent at the end of the first half, from 46.9 percent at the end of the same period last year. We estimate that this slight drop may be amongst other results of the fact that total number of sales include also sales which may be used to create a service that traditionally has been considered as fixed land service.

A 7 percent rise in contract customer was just offset by a 7.9 percent fall in prepaid customers and as a result of subscribers numbers fell slightly down by 0.4 percent to 2.237 million at the end of the first half of 2017. Our average revenue per user in prepaid rose 2.6 percent, while postpaid ARPU fell 0.6 percent with blended ARPU being up by 2.2 percent points.

Postpaid ARPU was affected mainly by an increase in machine to machine subscribers, but also by the impact of roaming regulation and the inclusion of free minutes in bundle offers. The average minute of use rose 4.2 percent to 214. The percentage of smartphones, as a proportion of total handset sales, was on that same high level of 81 percent in the postpaid segment in the first half of the year of 2017 as in the year 2016.

Within this, HT grew smartphone penetration to 62 percent. Our 4G network covered 75 percent of the population indoor and 98 percent outdoors, while 45 percent of the population were able to achieve 4G download speeds of 252 megabits per second at the end of the first half, from the starting point of 3 percent beginning of 2017.

Turning your attention now to slide number seven, which describes HT Croatia fixed line and IP business, where we have seen a rise in broadband lines and TV customers but a fall in fixed mainlines. The number of fixed mainlines at the end of the first half of 2017 was 970,000, down 6.7 percent on the same period last year.

In contrast, the number of broadband access lines rose 5.0 percent to 766,000, boosted by strong growth in wholesale broadband lines of 15.6%. And in addition, we saw more modest but significant growth of 2.9 percent in retail broadband lines.

The number of TV customers rose 5.2 percent in the period to 411,000 reflecting our commitment to service and program offer improvements through premium and exclusive TV content. While customers numbers were up in some segments, average revenue per user fell in fixed line, broadband and TV in total. So, fixed line ARPU was down 6.5 percent, in line with general market trends, turning away from fixed line telephones.

TV ARPU was down marginal of 0.5 percent to 81 kuna per month. Broadband retail ARPU was down 3.1 percent at the end of June, 2017, compared to the same period last year. This reflects a stronger competition and the aggressive offers in the market. We are continuing to enhance our technology to improve customer experience, so next generation access, more than 30 megabits per second, has now been enabled for 56 percent of Croatian households, while 18 percent of households are enabled with speeds of 100 megabits per second.

Following our acquisition of a majority stake in Crnogorski Telekom, we present now standalone revenues for this business on slide number eight. We have started to consolidate Crnogorski Telekom from the beginning of this year, but we are presenting first half 2016 on a standalone basis, for illustrative purposes to communicate key trends in Crnogorski Telekom's performance.

Let me add also that EUR is the official reporting currency of Crnogorski Telekom. Revenue remains under pressure, impacted by the current regulatory environment and aggressive competition in the telephone market in Montenegro. Total revenue at Crnogorski Telekom was 41.2 million euro, down by 7.5 percent when compared to the first half of last year.

Breaking down this total, mobile revenues fell 1.4 percent to 19.9 million euros, reflecting the decline in prepaid customer numbers against the backdrop of heavy competition as well as regulatory pressure. However Crnogorski Telekom's core postpaid market recorded a 1.1 percent rise in revenue. Fixed line revenue was also under pressure in the first half falling 14.4 percent to EUR 19 million in the period. The decline in fixed voice is an outcome of the fixed to mobile substitution trend and the more competitive situation in this segment in Montenegro.

Broadband and TV revenue also fell impacted by a lower customer base and regulatory framework. We are working to prevent churn by refreshing Crnogorski Telekom's offers in the core retail telecommunications market. Only system solutions showed a rise in revenue, increasing 6.8 percent to 2.2 million euros in the first half of the year.

EBITDA before exceptional items fell 6.3 percent to 40 million in the first half of 2017, in line with revenue, while CAPEX jumped 64.6 percent to 8.8 million euro, as a result of the capitalization of exclusive TV content contract.

To further illustrate the current position of the new business, slide number nine describes Crnogorski Telekom's business performance in the first half of 2017. The key trend was a rise in mobile customers, but a decline in fixed mainline, broadband and TV customers. So, mobile subscribers were up 2.7 percent at the end of June, 2017, compared with the same period last year, as a rise in postpaid subscribers offset the fall in prepaid ones.

In line with market trends elsewhere, fixed retail mainlines fell 8.6 percent in the period to 131,000, while broadband retail access lines also fell 5.3 percent to 71,000. TV customers declined 6.4 percent, by the end of the first half to 58,000.

I will now hand back to Davor who will outline for you, our outlook for the whole year 2017.

Davor Tomašković: Thank you, Josef.

Now, on to our final slide number 10. This shows our updated outlook, which is unchanged except for CAPEX forecast, and reflects the inclusion) of our majority stake in Crnogorski Telekom.

HT Group continues to expect 2017's full year revenue to be around 10 percent higher than in 2016. Similarly after achieving a margin of 40.5 percent in 2016, we continue to expect to report an EBITDA before exceptional items margin of around 40 percent in the current financial year. However, we now expect CAPEX to be moderately higher than the 1.61 billion kunas we spent in 2016.

This has been updated from the slightly lower forecast provided at the first quarter results in April, due to the reasons we mentioned earlier. With regards to regional expansion, HT is monitoring and evaluating potential M&A opportunities.

Thank you for your attention, we are now ready to take any questions you might have.