24 July 2020

Conference call: HT Group - Results for the six months ended 30 June 2020

Speakers: Kostas Nebis, President of the Management Board and CEO
Daniel Daub, CFO
Sinisa Đuranović, Senior Vice President and General Counsel
Tomislav Bajić, Head of Investor Relations

Presentation Material: Results for the six months ended 30 June 2020

Operator
Thank you for standing by and welcome to the Hrvatski Telekom Results conference call for the six months ended 30 June 2020.

At this time, all participants are in a listen-only mode. Today, there will be a presentation followed by a question and answer session at which time, should you wish to ask a question, you will need to press the <star> 1 on your telephone.

I must advise you that this conference is being recorded today, Thursday 24 July 2020. It is now my pleasure to hand you over to your first speaker today: Mr Tomislav Bajic

Mr Tomislav Bajic — please go ahead.

Mr Tomislav Bajic
Thank you

Ladies and gentlemen, good afternoon and welcome from Zagreb. Today our CEO Mr Kostas Nebis, our CFO Mr Daniel Daub, and our Senior Vice President and General Counsel Mr Siniša Đuranović, will talk you through the highlights of our business and financial performance for the six months ended 30 June 2020, 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, we will be available for your questions.

Before we begin, allow me to draw your attention to the harbour statements on page 2 of our presentation.

Allow me to introduce you to Mr Kostas Nebis, our CEO. He will outline our company’s performance during the first half of 2020.
Thank you Tomislav.

Good afternoon ladies and gentlemen and thank you for joining us today.

It is my pleasure to present the results of the Hrvatski Telekom Group for the six months ended 30 June 2020. I will start the presentation with slide three which describes the business highlights for this period.

When I presented our first quarter results to you in April, the massive disruption caused by the COVID-19 pandemic had been underway for around six weeks, and it required from us not only to adapt to the unprecedented situation, but also to review our outlook. As a way of dealing with corona we at HT Group took a number of actions to ensure the continuity of our operations, as well as to protect the interests of all our stakeholders.

Facing the corona challenge we clearly defined what needed to be done. Our first responsibility was towards our employees and ensuring their safety and wellbeing. Secondly, but equally as important, it was the accountability to our customers and meeting their needs, as well as the high expectations they have of us. And last, but certainly not least it was our dedication to supporting the society and ensuring that everybody in Croatia stays connected. I dare to say we have been very successful in all areas.

We adapted to the new conditions and introduced a new flexible and agile operating model. We maintained our networks strong and stable at all times enabling our customers not only to work professionally, but also to function personally. And we continued to drive the digitalization agenda and remained dedicated to connecting everyone with the opportunities that digitization can provide to the Croatian society.

The foundation for Business development is network quality, and this is something Hrvatski Telekom has put special focus on. Last year we successfully completed the mobile network modernization which has enabled us to considerably improve our performance capabilities in 2020, which was visible in the corona-lockdown period when our networks remained stable, enduring a substantial traffic increase.

Despite the corona situation and the challenging outlook, we remained committed to our investment plans, fiber roll-out and preparation for 5G development, which we consider to be critical for Croatia’s economic recovery.

Our purpose is to bring a world of better opportunities to everyone in Croatia via digitalization. Mobile speeds and coverage are critical enablers in this journey, hence I am really proud Hrvatski Telekom has been recognized by OOKLA, for the second year in a row, as the ‘Fastest Mobile Network’ with the ‘Best Mobile Coverage Network’ in the country. With over 10 million consumer-initiated tests completed per day, and with 30 billion tests to date Ookla Speedtest is the industry standard and the most relevant telco global test as it reflects the first-hand user experience.

At the same time Hrvatski Telekom is the leader in the segment of 5G technology with testing being done to prepare us for the commercial operations once the required radio frequency spectrum is allocated.
We also continued to intensively build the fiber-optic infrastructure and in the first half of the year we have covered almost 20,000 households with FTTH in the access network, covering in total 299 thousand households. The preparation and implementation of fiber-optic infrastructure for an additional 60,000 households and businesses by the end of the year is ongoing. Overall, our fiber-based access network (FTTx) is now available to 455 thousand households. All these numbers are the result of our investments and they are clearly demonstrating our strong commitment to connecting everyone in Croatia.

By maintaining our networks strong and stable, by providing a number of benefits to our customers, by simplifying customer interactions, and by raising the level of service Hrvatski Telekom has delivered against increasing customer expectations. This is clearly reflected in the improved customer satisfaction levels on the back of continuously decreasing complaints and technical faults.

The customer satisfaction is directly related to the great progress we have made in building a digital company with highly satisfied and engaged employees, with the recent employee satisfaction survey reaching 82%, which represents the best ever result in the HT’s history, confirming that Hrvatski Telekom is moving to the right direction.

We have also signed a new Collective Agreement which entered into force on 1 July 2020, and is valid for the next two years, and which retained a high level of employee’s material and social rights. By signing a new Collective Agreement, and in addition to all the activities we have been undertaking during the coronavirus period, we have demonstrated that the engagement of our employees is a key prerequisite for becoming the most desired ICT employer in the country.

The Regulatory environment changed at the end of the period, with a 50% reduction in the annual fee for the use of unpaired radiofrequency spectrum. On 30 June 2020, amendments of the Ordinance on payment of fees for the right to use of addresses, numbers and radio frequency spectrum came into force. Following these amendments, the annual fee for the use of unpaired radiofrequency spectrum for the public mobile network was reduced by 50%.

In response to the disruption caused by COVID-19, the regulatory body HAKOM has decided to postpone the allocation of the 700 MHz, 3.6 GHz and 26 GHz frequency bands, which was originally planned for the end of 2020, until the first half of 2021.

In regards to the Financial performance - the global pandemic has had far-reaching social and economic consequences, and these inevitably affect also the HT Group operations. Top line revenue has come under pressure due to COVID-19, which is leading us to a revised outlook for 2020. I will talk you through our revised outlook later in this presentation.

Excluding the one-off EvoTV transaction in 2019, EBITDA after leases decreased by 3.7% in the six months to 30 June, while our capex to sales ratio was 23% of sales.

With regards to Capital allocation, the Management Board in March adopted amendments to the provision of the Share Buyback Program. This removed some limitations regarding everyday trading related to volume and price, which allowed us to more efficiently execute the program. In H1 2020, HT bought back 355,198 shares or 0.4% of total shares outstanding.

General Assembly also confirmed our proposal for dividend of HRK 8.00, representing a pay-out ratio of 90.2%.

The share buyback program and our regular dividend policy provides clear evidence of the Company’s intention to transfer value to its shareholders.
Please turn now to slide four, which provides highlights of the Group financial performance in the first half of the year.

Following the successful turnaround of the underlying business delivered in Q4 2019, we started this year on a positive note, supported by the growth in mobile postpaid, fixed broadband, TV and systems solutions.

Nevertheless, and as outlined in our April call there isn’t a single industry that hasn’t been affected by the corona pandemic, including the Telecoms sector. And, we also felt the effects of this crisis. From service suspensions from temporarily closed businesses, lower prepaid revenues due to restricted customers’ mobility, lower visitors’ revenues as a result of tourism YoY deficit. Accordingly, the positive momentum of the first 3 months was outweighed by the Q2 COVID-19 related revenue pressures.

Total revenue decreased by 5.4% to HRK 3.49 billion, comprising of a 5.3% decrease in revenue at HT Croatia to HRK 3.23 billion, and a 7.4% decline at Crnogorski Telekom to HRK 266 million.

The Crnogorski Telekom revenue decline was driven by lower fixed revenue. This was mostly due to a decrease in residential voice revenue, lower prepaid and visitor mobile revenue, and a decline in wholesale revenues.

EBITDA after leases decreased by 7.8% to HRK 1.29 billion, partly due to the EvoTV transaction in the first quarter of 2019, along with lower net revenue. Excluding this one-off acquisition effect, EBITDA after leases adjustments decreased by a more modest 3.7%. HT Croatia’s share of EBITDA after leases was down 8.1% to HRK 1.20 billion, while Crnogorski Telekom EBITDA after leases declined 3.9% to HRK 97 million.

This decline in EBITDA after leases, along with higher exceptional items, contributed a 28.5% decline in net profit in the first half to HRK 313 million.

We also report higher exceptional items, which were mainly related to personnel restructuring costs, which were incurred in March 2020, whereas last year these costs were incurred in July.

We can now turn to slide five which describes cash flow and capex, which in turn reflects our strong investments in our mobile and fixed broadband networks. Hrvatski Telekom is the leader in Croatia, but this by no way means we can allow ourselves to become complacent. We constantly strive to be better, more efficient, to provide the best customer experience, and to create even more value for our shareholders. This is impossible to do without investments, which will prove especially important in the upcoming period and during the next year when economy will start getting back to growth trajectory.

Net cash flow from operations decreased 3.7% to HRK1.03 billion, mainly due to lower net profit and unfavourable movements in working capital.

Capital expenditure after leases rose 10.3% overall to HRK 804 million, reflecting a 12.4% rise in HT Croatia, but a 12.3% decline in capex at Crnogorski Telekom. The increase in Hrvatski Telekom’s capex
after leases was mainly due to the seasonality of content capitalization. The decline of Crnogorski Telekom is largely because of a slowdown in fixed access investments and LTE.

With this, I would now like to hand over to our CFO, Daniel Daub, who will outline the highlights of both HT Croatia and Crnogorski Telekom’s performance.

**Mr Daniel Daub**

**SLIDE 6**

Thank you, Kostas, and good afternoon everyone. On slide six, we will look at revenue at HT Croatia in a little more detail.

As mentioned earlier, we are pleased to report a good performance in our broadband, TV and system solutions business, although mobile revenue has come under pressure from lower handset sales and fewer visitors.

Total revenue at HT Croatia fell 5.3% in the first half to HRK 3.23 billion. This decline was impacted by a 6.5% slide in mobile revenue to HRK 1.40 billion, mainly driven by lower handset and visitor sales which were only partly compensated by postpaid revenue.

Fixed voice revenue in the first half fell 13.7% to HRK 290 million due to a fall in main lines, traffic and ARPU. Broadband and TV revenue rose 4.7% in the period to HRK 680 million. TV revenue was supported by the acquisition of EvoTV, which started to be consolidated in March 2019. Excluding EvoTV, revenue and ARPU were higher but the TV customer base was lower. Meanwhile, we increased our broadband customer base and average revenue per user, which lifted broadband revenue overall.

Fixed wholesale revenue was down 15% to HRK 133 million as a result of lower regulated wholesale prices resulting from a change in the weighted average cost of capital, as well as lower transit traffic in Iskon.

Meanwhile, other fixed revenue also fell 14.6% to HRK 351 million, driven down largely by a lower contribution from Optima after the cancellation of the bilateral relationship with Telekom Slovenia. Despite the revenue decline, the change in the telco relationship is mostly EBITDA neutral.

We saw system solutions revenue increase by 6.5% in the first half of 2020 to HRK 378 million underpinned by growth in customized ICT solutions and the standard solution ICT portfolio.

Miscellaneous revenue fell 93% because the 2019 first half included a contribution from travel agency E-tours, which was sold in November 2019 and subsequently did not contribute to miscellaneous revenue in the first half of 2020.

**SLIDE 7**

On slide seven, we look in more detail at our mobile business and I’m pleased to report that we have maintained our market and technology leadership in the first half of 2020 and continue to grow postpaid average revenue per user alongside our postpaid customer base.

We remained the leading mobile provider by subscribers with a 44.3% of the market at the end of the second quarter 2020. This reflects our stable customer base and share of mobile SIMs.
Our total subscribers fell slightly to 2.23 million at the end of the second quarter 2020 from 2.29 million in the year-ago period. This was because a 2.6% rise in postpaid customers did not entirely offset a 7.9% decline in prepaid customers. The higher number of postpaid customers reflects the success of our attractive offers, tariffs and handsets, and the marketing campaign for our Bonbon branded services, which allows users to choose a package of calls and texts that suit their own particular needs.

The prepaid decline is largely due to an overall decline in that market as well as lower visitors’ revenue.

Average revenue per user fell by HRK 1 to HRK 38 in the prepaid segment but increased by HRK 2 to HRK 97 for postpaid customers. Postpaid ARPU increased as a result of successful pre- to post- migration and “more for more” customer base development activities, driving upsell, with the introduction of new attractive tariffs lifting both our customer base and the amount our customers spend.

**SLIDE 8**

Please now turn to slide eight, which shows the growth in our broadband and TV businesses and a slowing of the rate of contraction in fixed line telephony.

The number of fixed voice services decreased 4.8% to 807,000 at the end of the second quarter. Fixed-to-mobile substitution, regulation and unforced competition remain the key drivers of this decline, but it is contracting at a slower pace compared to previous quarters. Retail fixed voice services decreased 4% to 766,000 while wholesale fixed voice services fell 17.4% to 41,000.

Broadband services declined 1.2% to 732,000 at the end of the second quarter. This in fact reflects a 0.4% rise in retail broadband services to 622,000, but there was a 9.5% fall in wholesale lines to 111,000.

The wholesale base losses are a result of migration to competitive infrastructure including fixed to mobile substitution. Meanwhile the retail broadband base increase was positively compounded by higher retail broadband ARPU due to a reduced focus on aggressively priced offers.

By the end of the second quarter 2020 our TV customer base had grown 0.4% to 492,000, although TV ARPU was down 1.6% in the period.

**SLIDE 9**

We can now turn to slide nine, which describes the standalone performance of Crnogorski Telekom in the first half. During the period, revenue was lower, but profitability increased, with the EBITDA margin rising by 150 basis points to 36.1%.

Total revenue at Crnogorski Telekom fell 7.9% in the first half to HRK 269 million due to lower fixed voice revenue, which outweighed a slight revenue rise in broadband and TV. Mobile revenue declines reflect a combination of lower prepaid revenue and fewer visitors, which weighed on stable postpaid revenue.
EBITDA after leases fell 3.9% to HRK 97 million, dragged down by lower revenues which were only partly offset by lower operating expenses. And as I have mentioned, the EBITDA after leases margin increased by 150 basis points to 36.1%.

Net profit at Crnogorski Telekom fell 42.9% in the first half to HRK 6 million. The positive effect from the net financial result was not sufficient to compensate for the decrease in net profit, which was driven by lower EBITDA.

I will now hand back to Kostas who will conclude this presentation with our outlook for the current year.

Mr Kostas Nebis

SLIDE 10

Thank you Daniel.

In conclusion, we outline our revised outlook on slide 10. Due to high levels of uncertainty and volatility in March and April we put our 2020 outlook under review. Although the environment is still uncertain, we have decided now to issue a revised 2020 outlook.

The changes to our outlook reflect lower revenue expectations, but an improvement in our margin. We had previously estimated that 2020 revenue would be at the same level or slightly lower than the 2019 level of HRK 7.7 billion. We now expect a mid-to-high single digit decrease in 2020 revenue compared to the previous year.

However, our forecasts for the EBITDA after leases margin was previously 38% for the current year, and we now anticipate a margin of 39%. This compares to the 2019 full year EBITDA AL margin of 37.7%.

We have not changed our capex expectations and continue to expect to spend around HRK 1.7 billion in 2020, compared with HRK 1.9 billion in 2019.

To wrap-up, the COVID-19 pandemic has impacted every industry, with Telecoms sector being no exception. But then again, the present situation has made it clear how vital the ICT industry and digitalization are for the whole country, as without them much of our lives would have come to a complete halt.

In the recent months we have seen many examples of businesses adapting and finding new ways of running their operations. Restaurants with take aways, family farms utilizing the power of social media, companies introducing digital collaborative tools which enabled 70% of Croatia citizens during the past months to work from home, official documentation finally handled digitally, schools launching e-programs, universities conducting tests via Teams. While all these possibilities existed before, they have never been as relevant as they are today. And never before have people been using them so extensively.

Taking this into consideration, and with the economy and society looking for ways to get back on track, we are presented with a great opportunity to strengthen our role as an enabler and a trustworthy partner to the Croatian society.
And by doing this, by focusing on our vision of connecting everyone to the opportunities of digitization I’m confident we will come out of this crisis even stronger, delivering sustainable and profitable growth. This is what we, in Hrvatski Telekom stand for and what our shareholders can expect from us.

We are now ready to take any questions.