

The Q1 2013 results conference call

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Presenters

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Operator

Thank you for standing by Ladies and Gentlemen and welcome to the T-HT Results 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 keypad. I must advise you that this conference is being recorded today on Tuesday 30th April 2013. And I would now like to hand the conference over to your first speaker, Miss Erika Kaspar. Please go ahead.

Erika Kaspar

Thank you. Ladies and gentlemen, good afternoon and welcome from Zagreb. Today our CEO, Mr Ivica Mudrinic, and our CFO Mr Dino Dogan will talk you through the highlights of our business and financial performance for the 3 months ending 31st March this year, using the 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 investors' page. After the presentation, Mr Mudrinic and Mr Dogan will also 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 now to introduce you to Mr Ivica Mudrinic, our CEO, who will outline our company's performance during the 3 months ended 31st March 2013.

Ivica Mudrinic

Thank you Erika. Good afternoon ladies and gentlemen and thank you for joining us today. I will start the presentation on slide 3 with an overview of the environment in which we operate, so the first part is actually about the Croatian economy, certain facts related to the GDP development. We continue to have a prolonged recession. It has continued not only during the course of 2012, where we saw a contraction of roughly 2%, but also it continues into 2013 when estimates are indicating that we will see a further contraction of ½ % or so.

We also saw the credit rating downgraded to sub-investment grade with a stable outlook by Standard & Poor's, December 2012 and Moody's following similarly in February 2013. The registered unemployment rate is very high, 21.6%; in March 2012, it was 20%, so it has further increased. So we have increased unemployment. The inflation however has slowed down to a 3.7% and we also see continuously falling disposable income. We do expect the tourism season to be successful; when we look at 2012, it was an increase of 5%, 12.3 million tourists, 88% of which were foreign. Now, the prospects for the economy, we are still waiting and this is the general position by most analysts and economic experts, we are still waiting for far reaching structural reforms and the improvements in the investment climate or the investment environment. We in addition, see the EU accession effective or starting July 1st 2013 when we become a member of the EU, that this will, through structural funding and other funding have a positive impact. And this would be also a signal for foreign direct investment that this is, as a part of the EU, an opportunity for many of them.

In the 2nd half of 2013, we do expect some recovery in the GDP and in 2014 expert opinion is that we will see an inflection and finally an increase or a growth of GDP during the course of next year. In addition to this, we have seen announcements of significant privatisations. The largest insurance company and also the postal bank which is the last significant or relevant bank that has not been privatised.

Moving to slide 4, we have an overview of the telecom and the ICT market in Croatia, starting with the fixed voice. We have 10 licensed and active operators in the market, all of the usual services, wholesale services, are available, carrier pre select and unbundled local loop and wholesale line retail, in addition naked bitstream and bitstream are available as well. We also

saw in the fixed voice segment, minutes of use decrease by 15% in 2012. So there are a number of factors which impacted or influenced this process. Part of it is substitution by mobile; part has to do with some of the let's say bankruptcies in the business sector and in addition, the lack of disposable income has also impacted the use of the phone in fixed voice in this context.

On the fixed broadband side, we have 890,000 broadband lines in December 2012, which is a year on increase of 3.4%. The household penetration is at 49% versus 66% in Western Europe, which means that we still have a significant growth potential that we are actually counting on.

On the mobile side, we have 3 operators in the market with 7 brands. The mobile penetration is running at 116%; it is down 1% year on year, mostly having to do with clean up of the customer base, but in addition, the cross net bundles have actually made double SIMs from different operators unnecessary, so therefore many customers are giving them up. We also saw increased usage but at the same time, revenue continued to decline by 3.9% in 2012. We do see growth in the mobile broadband and in addition we see the smart phone penetration increasing. So at T-HT, our smartphone penetration is at 25%, versus 42% in Western Europe. Again, like in the case of fixed broadband here we also see an opportunity to grow.

On the pay TV market, the total Pay TV customer base is 619,000, which is a 6% increase year on year. The household penetration is 41%, but again versus 56% in Western Europe, which we see again as an opportunity. We also saw a new player launch a Pay TV service in December 2012 and I note we are the only regulated IPTV market in Europe.

On the ICT segment which is increasingly important for our business, we saw the total IT services market decline by 4.6% and at a total of 356 million US dollars. In addition to this trend and on the upside potential, we saw cloud as a concept gradually becoming accepted within the Croatian IT community and the business community as well. And as Croatia approaches the full EU membership, we do expect significant IT projects to be launched. Combis, a member of our Group, has maintained its leading position in the Croatian ICT market.

Moving to slide 5, highlights for our Group, the financial, first of all the revenue is down 6.1% to 1.695 billion kunas; tough economic, competitive and regulatory environment continues and this has influenced the revenue trend. The EBITDA before exceptional items is down 14.3% to 6.69 billion at a margin of 39.5%. The net profit is down 34.7% to 238 million at a margin of 14% of sales. CAPEX is up 73% at 220 million, so these are just some of the key figures which we will explain a little bit more during the course of this conference call.

The General Assembly has been convened for 17th June this year. The proposed dividend pay out of 20 kunas and 51 lipa per share with 20.51 kuna per share, which equals 100% pay out ratio.

On the operational side, we have of course maintained leading market position in all of the segments in which we operate. We have continued our 4th generation mobile internet tariffs. We have the largest coverage in the country with 4G. We have piloted and are continuing to develop, the cutting edge TeraStream technology. This is the fixed line optical access concept that we have developed during the course of 2012. In addition, we have decreased our headcount to 5,514 employees. And a note on the operational side, we will have the EU Roaming Regulation applied effective July 1st 2013 as we join the EU.

On slide 6, we give you a breakdown of the revenue development. Again, as I would mention, a 6.1% decline in the total revenue. The distribution of the revenue and the change, you see that the fixed voice contribution is down 51 million and mobile is down 6.2% or 45 million wholesale reduced by 21 million. IP is up by 3, ICT up by 9 and others down by 5, giving you a yield of roughly 1.7 billion kunas.

This is a result of the continued recession and regulatory measures and in addition, of course, intensifying competition, all of which are impacting the revenue. The fixed line revenue down to general usage trends, but at a slower rate mobile revenue decline primarily as a result of competitive pressure and continued recession. Both voice and non-voice wholesale revenues are down as well.

Continued growth in IP revenue; ICT revenue up following an uptake in customised solutions. When we look at the total picture, we can also note that Combis contributed 75 million in this period, Iskon 77 million. Again, we show you the comparison to previous year as well.

Moving to slide 7, a brief overview of the mobile market, here we show you the market share by subscribers and again you see a 46.5% subscriber market share. In addition we show on the upper right side, the total number of subscribers. You see a decline of 1.7%, part of which has to do with some of the cleaning that I mentioned earlier. There is also an interesting split between pre-paid and post-paid, which again shows a very stable position. But also we have shown now the so-called non voice or data revenues, again which are increasing and form a significant part of the period. The customer base of course is equally the same when it comes to the overall impact on our business as well. The average revenue on the bottom left graph, again shows a

decline in the total blended ARPU. However, you see the increase in the non-voice ARPU, 8.9%, again reflecting the increase in the customer base that I mentioned a moment ago.

Moving to slide number 8, fixed telephony, here we see the main line trends or the number of lines that we have; a total decrease is 4.6%. We also show the wholesale and the retail split and you see again a roughly stable retail position. The average revenue however declined by 10.3% as mentioned earlier and is now 107 kunas in January to March in 2013. The number of ULLs has increased by 7.5% so these are lines that are being used by our competitors on a wholesale relationship.

On slide 9, we give you an overview of the IP services. The number of broadband access lines has increased by 1.5%. Again we show you the split between retail and wholesale, indicating that the vast majority are a retail relationship with our customers. The broadband retail average revenue is up by 2.2%, so this is again a healthy indication of our position in the market and the number of TV customers has increased by 7%, totalling 369,000 at the end of March 2013.

What I would like to note here, is that our Max TV offering or our television business, we have actually excluded the content as the key differentiator in the market, including the National Soccer League, Championship League and Europa Leagues.

So at this point in time, I would like to hand the floor to Dino Dogan, our CFO, who will take you through the presentation in the next section.

Dino Dogan

Thank you very much Ivica. Ladies and gentlemen, good afternoon from my side as well. So let me continue with slide number 10 which gives you an overview on the residential segment. The revenues in this segment fell 3.9% in the full year of 2012. This was again due largely to a 8.4% decline in voice revenue in both the fixed and the mobile markets, along with a continuation of a tough economic condition, intense competition, tough economic conditions, intense competition and further regulatory tightening. We will see some impacts on that one later on.

At the same time, the industry wide shift from fixed voice to mobile and IP services continues. However, growth continued during the year in the fixed IP and mobile data revenue and residential non-voice revenue rose 3.5% in the 1st quarter. The terminal equipment also rose due to lower mobile handset subsidies and extended 2012 promotional activities and fixed line market. The division's contribution to EBITDA fell 10.6% to an overall of 640 million kuna. The

residential segment continues its efforts to innovate in terms of its product offerings and services and subscribers to the max TV satellite service. Those rose 87.1% over the previous year to a total of 30,000.

In February we also launched our hotspot phone service. This is part of the largest global-wide WiFi network Fon and provides access to over 7 million phone hotspots in more than 100 countries worldwide for free.

Slide number 11 gives an outline on the performance of our business segment. The revenues in our business segment was 8.9% lower, to 722 million kuna in the 1st quarter of 2013. The voice revenue in Q1 2013 fell 19.7% to an overall of 301 million kuna, due to lower mobile voice revenues in both retail and wholesale. The non voice revenue fell 3.8% to 262 million kuna in Q1 2013 due to lower fixed IP revenues and lower wholesale revenues, resulting from a fall in revenues from infrastructure services and global internet access.

Other service revenues was down 2.9% as a result of changes to mobile tariff structures. However, ICT revenues rose 10.4% as the group successfully marketed a range of customised ICT solutions. The business segment contribution to EBITDA was down 18.7% at 397 million kuna.

We are continuing to develop and evolve our cloud based services, to assist our business customers amid strong demand for products that facilitate increased operational efficiencies and we have also launched a new mobile tariff for our business customers.

Now let's come to the financial highlights for the 1st quarter 2013 ending March 31st. So, the Group revenues was down 6.1% as the prolonged recession we have experienced for some years and this has continued again into 2013. Whilst the regulatory framework remains challenging and here just to give you a hint, the mobile termination rate dropped from January 1st 2012 to January 1st 2013 by 35%. On top of this, the competition in our market continues to intensify. As a result, we have focused on marketing and promoting our services to maintain our leading market position and in doing so, we have significantly increased our merchandise cost.

Against this backdrop, EBITDA before exceptional items fell 14.3% to 669 million kuna and the EBITDA margin slipped from 39.5% from 43.2% in the previous year. Following redundancy costs of 60 million kuna, which we booked in the 1st quarter of 2013, versus 0 cost booked in the 1st quarter of 2012, the EBITDA fell 22% to 609 million kuna, while the margin was also lower to 35.9% from 43.2% in the corresponding quarter of 2012.

The net profit for Q1 2013 was 238 million kuna, which is a fall of 34.7%, whilst the net profit margin was 14%, mainly as a result of decreased earnings before interest and tax, the so-called EBIT, combined with lower taxation, as well as a lower financial income.

Our CAPEX increased 73.8% to 220 million kuna. This increase was mostly the result of on going strategic projects, such as the PSTN migration and our mobile broadband deployment, which in the 1st quarter of 2012 has been rescheduled and postponed, as well as activities as a building refurbishment project for reallocating a call centre and higher investments in business related IT projects.

Our net cash flow from operations slipped 19.1% to 461 million kuna, mainly as a result of lower net profit. That concludes our overview ladies and gentlemen of the Group's results for the 1st quarter of 2013. All in all, it was again a challenging period economically, but we have made strong efforts to maintain our market leadership. We are maintaining our momentum in the delivery of new products and innovative services, as our strategy of transformation progresses. Our objective is to remain in the vanguard of technological development, as a means of providing unrivalled levels of service to all our customers and maintain our leading market share across all segments.

I will now hand you back to our CEO, Ivica Mudrinic, who will talk you through our outlook for the remaining of 2013.

Ivica Mudrinic

Thank you Dino. So in the face of the adverse economic situation and other market pressures that we have mentioned today, we are nevertheless maintaining our outlook for the full year 2013 as follows. Last year brought no recovery in the national economy; the recession persisted with GDP forecasts for 2012 as minus 1.8% and for 2013 at 0.2%. The unemployment and business payment arrears remained at high levels. Public debt increased and industrial production declined further. Telecommunication spending in the residential and corporate sector has also tightened. Competitor pressure and a stringent regulatory regime continued to exert pressure on the Group's business, whilst Croatia's entry to the European Union on July 1st is expected to have an additional negative impact on revenue.

In light of this economic environment, the Group's revenue will decline further in 2013. However, we expect our efforts to capitalise on certain areas of growth will help to slow the decline in Group

revenue seen last year. In EBITDA, before exceptional items, the economic environment and revenue trend outlined above will impact EBITDA accordingly. However, the EBITDA margin for 2013 is anticipated to remain robust at between 43 and 45%, supported by continuing cost management initiatives.

CAPEX, T-HT will focus its investments in 2013 on a new service concept, IP transformation and development of mobile broadband. Whilst the regulatory framework for planned fibre investments remains unfavourable. Excluding investments in the spectrum licence in 2012, CAPEX in 2013 is expected to be higher than the previous year.

On the regional expansion issue, the Group continues to monitor and evaluate expansion opportunities to increase shareholders' value.

Thank you very much for your attention and I will turn the microphone back to Erika and to the Speaker for any questions that you may have.

Erika Kaspar

Thank you Ivica. Hello Operator, we are now ready to take questions.