# The Q3 2013 results conference call
# 30 October 2013 at 15:00 CET

**Presenters**

**Ivica Mudrinić**
T-Hrvatski Telekom – President of the Management Board and CEO

**Dino Dogan**
T-Hrvatski Telekom – Member of the Management Board and CFO

**Erika Kaspar**
T-Hrvatski Telekom – Corporate Communications and Investor Relations

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**Operator**
Thank you for standing by and welcome to the T-HT Q3 results conference call. 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 would like to ask a question you will need to press *1 on your telephone. I must advise you that this conference is being recorded today on Wednesday 30th October 2013. I would now like to hand the conference over to your first speaker for today, Head of Investor Relations, Erika Kašpar; please go ahead.

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**Erika Kašpar**
Thank you ladies and gentlemen; good afternoon and welcome from Zagreb. Today our CEO, Mr Ivica Mudrinić who is here with us, and our CFO, Mr. Dino Dogan, who is dialling in remotely, will talk you through the highlights of our business and financial performance for the nine months ended on 30 September 2013 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 Mudrinić and Mr Dogan will also be available for your questions. Before we begin allow me to draw attention to the harbour statements on page 2 of our presentation. Allow me now to introduce you to Mr Ivica Mudrinić our CEO, who will outline our company's performance during the nine months ended 30 September this year.

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**Ivica Mudrinić**

Thank you Erika and good afternoon ladies and gentlemen; thank you for joining us today for this call. We will start our presentation on page 3 with the overall environment information on the Croatian economy and the current expectations as we go into the end of the year and also reflecting on the expectations economy wise in 2014.

We have seen now a fifth consecutive year without GDP growth; we have seen a protracted recession period lasting for quite a long time; in Q2 2013 the GDP contracted a further 0.7% with an estimated full year impact of 0.5% decline. What you also saw is the credit rating slip to sub-investment grade set by all three major rating agencies. The registered unemployment rate is at 19.1% versus 18.3 a year ago - so this is the September data. Inflation is at 1.1% in September of this year. The disposable income has continuously declined or fallen. The tourist season has been, however, quite good; we saw an increase in tourist arrivals year-on-year up 5.2% at 11.6 million. This is the January through September 2013 figure.

When we look at the economy, it is often the prospects; what we saw is that the budget deficit continues to be quite present and the Government is looking for ways to close some of the deficit through further privatisation, or what is called often monetisation of the highways with a long term concession to help them deal with some of the deficit. We also are expecting - and I think it is a given - that Croatia is about to enter the excessive deficit procedure part of the EU supervision mechanism. What is in the background, in fact, is the far-reaching structural reforms have not taken place unfortunately and so the improvement in the overall investment environment did not take place as well. The EU membership, on the other side, is bringing structural and other funding to the country. We also do expect foreign direct investment to finally materialise; in part we will also see some uplifting in the economy as a result of the EU funding and the accession process and the anticipation is that we will finally see a positive real GDP growth in 2014. The expectation currently is that it will be up 1% or so, depending on the experts, but in principle there is a general consensus that we will see growth in 2014.

On slide 4 we have a short overview of the telecommunications and ICT market in Croatia; we grouped that by service so Fixed Voice, for example, has nine licensed operators all of the usual naked bitstream and bitstream is available. However, in the Fixed Voice segment what you are seeing is a decrease in the number of minutes of use down 16.5% in Q2 of this year. Fixed broadband, however, is growing; up to 9,000 broadband lines in Q2 2013, which is a 3.8% increase year-on-year. In addition, the fixed broadband penetration is at 49%, which in comparison to the Western Europe standard at 68% means that we still have room to grow. What we are seeing is a variety of bundled offers on the market which is helping to stimulate the market itself.

On the mobile segment we have three operators with seven brands; the mobile penetration is at 121%; it is minus 2 percentage points year-on-year. Basically there is now an elimination of double sims or multiple sims because we have a lot of cross net packages which have removed the need for having different sims and different operators as networks. Also we saw the increase in the usage in minutes in the mobile segment, up by 21.7% in Q2 of this year. However, revenue continues to decline; so what we are seeing is the cost per minute has significantly decreased. We also at the same time, however, see a growth in the mobile broadband and also partly fuelled by the smartphone penetration at 31% versus a comparable 46% in the Western European market.

Pay TV; 662,000 Pay TV users in Q2 of 2013, which is 11.2% year-on-year increase. The Pay TV household penetration is at 43% v the 56% that we see in Western Europe. We are the only regulated IPTV market in Europe. We mention this because it is a rather unique position although it is in part coupled with, as you will see later, a really very strong market position.

On the ICT segment, which has become part of our near core business, we are seeing the impact by continued negative economic development. This is especially important since it is in fact the Government or the public sector that is one of the key buyers of some of these services. The businesses tend to downsize in this kind of economic environment as well. Overall, ICT has remained flat in 2013. We do expect a modest recovery in 2014 as a result of new investments and certain modernisation. In addition, we could mention the Combis member of our Group, a wholly-owned subsidiary, has maintained a leading position in the Croatian IT Services market in 2012.

On page 5 we give you a short overview of the Group highlights. The revenue is down 8% in these tough economic competitive and regulatory environmental conditions. The revenue decline is a result of the economic downturn, the competitive landscape and also the regulatory impact since we are seeing the full alignment throughout the year, fully aligned effective July 1st but the impact has been with us since the beginning of the year in some parts.

EBITDA, before exceptional items, is down 17%; the margin is at 42.5%. Net profit is down 30.6% margin at 18.5%; Capex is up 39.8% and we paid out a dividend of HRK20.51; this was paid out in July 2013.

On the operational side we maintained the leading market position across all areas of business that we are involved in; continued promotion of fourth generation LTE mobile internet tariffs; we also have the largest coverage in the country.  Continued growth in TV customers; we have internally in parallel numerous transformation initiatives in order to prepare the company to ensure that we have integrity in the core business going forward.

Head count is decreased to 5626 employees in the Group; also we are involved in a restructuring or pre-bankruptcy proceeding with the first alternative operator called Optima Telekom; and as I mentioned the EU roaming revelation is fully applied effective July 1st of this year.  We have, we should mention at the end of this overview, applied for additional digital dividend radio spectrum that the regulator has put on auction or invitation.

On slide number 6 we do give some details about the revenue development; what you can see here is that the Fixed Voice is declining significantly, which is usual in most of the market.  The mobile is also down 11.6%, and you have also wholesale reduced by 13.1%.  IP on the other side is growing; you have an increase of 2%; ICT is growing by 14% and other income category is down 11.6%.  What we are seeing, of course, is the effect of the continued recession, the regulatory measures and the intensifying competition, all of this impacting the revenue.

The fixed revenue is down to the general user trends; this is so-called fixed mobile substitution, but it is slowed down in comparison to the 2012 figures.  From July 2013, mobile and wholesale additionally are impacted by the EU accession or the EU regulatory framework; we are seeing continued growth in IP revenue also ICT revenue, as I mentioned, is up 14.1%.  Combis, the wholly-owned subsidiary, has contributed HRK237 million in this period, January through September, and Iskon, the other wholly-owned subsidiary is HRK250 million.

Turning to slide 7, we have an overview of the mobile development.  What you are seeing in the upper left diagram is a stable market share; 30 September 46.2% market share by subscribers. We also break down the subscriber base - you can see the full numbers year-on-year comparison - a 2.1% decrease in the total number of subscribers, but as you can see this is across the board across the market, but this decline is mostly driven by the elimination of the need for multiple sims that the customers originally in the earlier period thought was important.  You can also see the post paid to prepaid split, which is rather stable and quite strong in both segments.  What is also notable is the growth in the data customers growth - 4.7%.  The average revenue per user is 8.5% down in the blended ARPU; however we see a 13.2% increase in the non-voice average revenue per user.  These are the key indicators; one thing that we should probably mention our two smartphone proportion of the total handset sales is at 58% in the post paid segment, meaning that we are seeing a change in the composition of the handsets that our customers are using. The second thing that we wanted to mention here is that the national mobile termination rate is 19.3 Lipa per minute; this is valid from July 1st of this year and we are seeing a further decrease on 1st January 2014 to 12.8 Lipa up per minute; and on 1st January 2015 6.3 Lipa per minute. On Friday we have an overview of the fixed telephony part of our business; the number of main lines is 4.1% down; we have a split between the retail and the wholesale and again you can see that we have a very strong retail position from this presentation. In addition, the average revenue per customer is 10.1% down, mostly driven by usage and the ULL lines number has increased by 3.8%; these are the number of lines that our competitors are using or buying from us on a wholesale basis.

On slide 9 we have an overview of the IP services - IPTV is always close to our heart as we have a lot of effort and initiative in this area - so the number of broadband access lines has increased by 2.4%. In addition, the broadband retail ARPA is also up 1.8% up to HRK128, which is also a very strong performance; the number of TV customers in total is up by 9.7%. We have seen some promotions that have helped to fuel these growth figures, for example doubling the speed promotion that we launched in May in the residential segment, and this approach has yielded the increase in ARPU and also the uptake by the customers.

I would like to now pass the microphone over to our CFO, Mr Dino Dogan. I think Dino is online and will take you through the next part of the presentation.

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**Dino Dogan**

Thank you very much and to the ladies and gentlemen good afternoon from my side too. Please allow me to turn to slide 10 which describes the performance in our residential segment. The revenues in this segment fell 3.6% in the first nine months of 2013; this was due primarily to a 10.1% fall in the voice revenue in both the fixed and the mobile market, resulting from the general decline in trend in fixed telephone revenue, further economic deterioration and regulatory pressures in a highly competitive market environment. The non-voice revenue increased 6.3%; however driven higher by revenue growth in fixed IP including broadband and TV and increased mobile data revenue. Our terminal equipment revenue was higher, due to lower mobile handset subsidies and the extension of our 2012 promotional activities in the fixed plan market. The corresponding division contribution to the EBITDA fell 4.8% to HRK 2,039 million. The MAXtv satellite service reported an 83.8% increase in subscribers to a total 38,000 customers.

Let us move on to slide 11 and outline the performance of the business segment. The revenue in this segment was 30.3% lower at HRK 2,232 million in the first nine months of 2013, as a result of factors discussed earlier and due to the new EU regulations which we applied from July 1st 2013 and also outlined above. The voice revenue during the nine months fell 26% to HRK 932 million in fixed and mobile in both retail and wholesale. Our non-voice revenue fell 2.2% to HRK 837 million in the first nine months of this year, with lower fixed traditional data and wholesale revenue offset to a certain degree by revenue growth in mobile data. Other services revenue was up 3.6% with a 14.1% rise in the ICT revenues, offset by lower post-paid subscription revenues after changes to mobile service structures. Overall, the business segment contribution to the EBITDA was 22.2% lower at HRK 1,266 million. We are further developing and expanding our cloud-based services to meet the requirements of our business customers amid rising demand for product that promotes greater efficiency and now has more than 1,450 companies as customers. We have also launched a new mobile tariff portfolio.

Let me move to slide 12 and I will conclude by outlining our financial highlights for the first nine months of 2013 to the end of September. The Group revenue was down 8.0% as we head towards the end of the fifth consecutive year of recession in Croatia, with a further impact on our business of the tightening regulatory framework and tough competition in our domestic telecoms market. As a result the EBITDA before exceptional items fell 17.0% to HRK 2,214 million for the nine-month period and the EBITDA margin fell to 42.5% from 47.1% in the previous year. Just to remind you, exceptional items in the period January to September 2013, referred to the redundancy provision totalling HRK 66 million, whereas there were no exceptional items in January to September 2012. The EBITDA fell 19.5% to HRK 2,148 million and the EBITDA margin was 41.8% at the end of September 2013, coming from 47.1% on 30 September 2012.

The net profit recorded for the first nine months of 2013 was 30.6% lower at HRK 964 million, with a net profit margin of 18.5%, also lower than the 24.5% recorded in the first nine months of 2012. Capex rose 39.8% to HRK 857 million in the nine-month period. This increase was primarily a result of the capitalisation of content provider costs, along with a high investment in IT and refurbishing projects undertaken on the building re-allocated for the use as a call centre, along with the ongoing strategic project of mobile broadband development. Our net cash flow from operations was 26.5% lower at HRK1,427 million in the nine-month period of January to September 2013, largely on the back of net profit decline.

Ladies and gentlemen, that concludes our overview of the results for the period of January to September 2013. We will continue to operate in an unfortunately difficult market position, but we have delivered a solid set of results as we have maintained our market leadership across all areas of our business.

I will now hand you back to our CEO, Ivica Mudrinić, who will talk you through our outlook for 2013.

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**Ivica Mudrinić**

Thank you Dino; what we would like to do, on slide 13, we have an outlook for 2013. At the end of the Third Quarter we have slightly re-adjusted our outlook for EBITDA before exceptional items for the full year 2013, in light of the highly challenging environment we have outlined today.
On the revenue side what we want to point out is that last year brought no recovery in the national economy; the recession persisted with a GDP change of minus 2% in 2012, and minus 0.5% forecast in 2013. Unemployment and business payment arrears remained at high levels; public debt increased and industrial production declined further. Telecommunications spending, as a result in the residential and corporate sector, has also tightened. Competitive pressure and the stringent regulatory regime continue 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 tough 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 down the decline in Group revenues seen last year.

On the EBITDA before exceptional items, the current tough economic and competitive environment, coupled with the introduction of EU regulation, has had a greater impact on the Group's Q3 performance than previously anticipated; consequently we expect the EBITDA margin for the full year to be between 42% and 43%.

Capex: THT will focus its investments in 2013 on a new service concept, IP transformation and the development of mobile broadband, while the regulatory framework for planned fibre investments remains unfavourable. Excluding investment in spectrum licensing in 2012, Capex in 2013 is expected to be higher than the previous year. On the regional expansion, we continue to monitor and evaluate expansion opportunities in order to create shareholder value. Thank you for your attention.

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**Erika Kašpar**

Thank you Ivica; operator we are now ready to take questions.