

The Q3 2015 results conference call

29 October 2015 at 14:00 CET

Presenters

Davor Tomašković

Hrvatski Telekom – President of the Management Board and CEO

Mr. Kai-Ulrich Deissner

Hrvatski Telekom - CFO

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Operator: Ladies and gentlemen, thank you for standing by. And welcome to the HT Third Quarter 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 star and 1.

I must advise you that this conference is being recorded today, Thursday the 29th of October, 2015.

And I would now like to hand the conference over to your first speaker, Mr. 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 who is here in Zagreb; and our CFO, Mr. Kai-Ulrich Deissner, who is speaking from Germany, will talk you through the highlights of our business and financial performance for the ninth month ended 30th of September 2015 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 investors' page.

After the presentation, Mr. Tomašković and Mr. Deissner will be available for your questions.

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

Allow me now to introduce you to Mr. Davor Tomašković, our CEO who will outline our company's performance during the nine months ended 30 September 2015.

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 nine months ended 30th of September 2015.

I'll start the presentation with slide 3, which presents the financial highlights of the period. I am pleased to report further positive revenue and EBITDA development in the nine months to the end of September.

Total revenue, which includes Optima Telekom, rose 0.9 percent in that period. Excluding Optima, revenue was down 2 percent but that marks an improvement on the 3.6 percent decline seen in the same nine month period last year.

In addition, there has been a clear turnaround in the revenue trend during the third quarter period, with revenue up 2 percent even excluding Optima reflecting a strong contribution from our ICT operations.

EBITDA, before exceptional items in the first nine months of 2015, rose 1.5 percent, even after an increase that we have seen in new regulatory-driven costs in the reported period – the effects of which we estimate at more than 130 million kuna. An increase in the spectrum fee and in costs related to the electronic communication infrastructure were key factors driving that increase.

If we exclude Optima Telekom, EBITDA before exceptional items fell 1.3 percent, which is a considerable improvement on the 8.4 percent decline seen in the same period last year. Margins also improved slightly. Our EBITDA margin before exceptional items is currently 40.1 percent in the nine-month period, compared with 39.9 percent last year.

We continue to focus on transformation initiatives, managing running costs and sustaining our long-term market positioning. Horizon, HT's strategic program initiated in the second half of 2014 is delivering tangible results and we have achieved further cost efficiencies.

Our total operating expenses are lower, even after a full nine months of Optima consolidation and the new regulatory-driven costs mentioned previously. In addition, our 2015 outlook remains unchanged.

If you would please turn to slide 4, which illustrates the highlights of the business from an operational perspective, HT has maintained a leading market position across all areas of the business. And our strong focus on customer satisfaction continues.

We have launched several activities designed to stabilize both the fixed and mobile markets. For example, at the beginning of May, we launched our new "Najbolje" tariffs, which can be tailored to suit the needs of each customer and include 4G access and additional services. We also ran a high-profile media campaign to support this tariff launch.

In addition, the regulator has initiated a procedure which may result in an increase in the monthly price HT charges for wholesale local loop unbundling and Naked Bitstream Access, or NBSA. The consultation process on this issue has just closed.

We also continue to invest strongly in our mobile and fixed broadband networks, and they're on track to meet our ambitious end of year targets. At the third quarter, 46 percent of households were able to access fixed broadband at faster than 30 megabytes per second.

HT's end of year target is around 50 percent. We're also fast approaching our indoor 4G coverage target, with 59 percent of the population covered in the third quarter and an end of year target of around 60 percent.

We are proud to have been awarded a Best in Test certificate by an independent benchmarking study, confirming HT has the highest speed mobile Internet and is the best mobile network in Croatia.

Finally, I am pleased to report as we manage to complete all IP transformation by the end of November, a month ahead of schedule, and by the third quarter we had migrated 98 percent of all retail customers.

Please now turn to slide 5, which outlines the telecom and ICT market in which we operate in Croatia. In the mobile market, SIM penetration was 119 percent at the end of the third quarter, up 0.4 percentage points, reflecting growth in summer visitors.

We have seen consistent growth in contract customers in the period as a result of ongoing attractive tariff and handset offers. Mobile data demand continues to accelerate while the growth in mobile minutes of use slowed to just 0.9 percent year-on-year in the second quarter of 2015 compared with 5.9 percent in the second quarter of last year.

Just a reminder official Q3 market data published by the regulator is still outstanding.

If you look at the fixed voice, then minutes of use decreased by 16.7 percent in the second quarter as consumers continue, already known trend, to switch to mobile.

As fixed line voice declines, so fixed line broadband and pay TV have continued to grow. At the end of the second quarter of 2015, the total number of fixed broadband market lines had risen 3.1 percent year-on-year to 966,000. Similarly, total pay TV customer numbers were up 3.2 percent and reached 747,000.

Growth continues to be driven by convergence and bundled offers. The Croatian ICT market grew by around 4.1 percent in 2014 but this is expected to slow down to 2.9 percent in 2015.

I will now hand over to our CFO, Kai-Ulrich Deissner, to present the financial performance of HT.

Kai-Ulrich Deissner: Thank you very much, Davor. Now we come to the group's financial performance on slide 6.

Revenue in the nine months to September of this year rose 0.9 percent. This was supported by Optima Telekom consolidation and already mentioned strong growth in ICT.

We look to the breakdown. Fixed telephony revenues fell 13.3 percent to 802 million kuna. And that's owing to a fallen main lines, lower traffic and declines in average revenue per user.

Mobile revenue declined much more moderately at minus 2.7 percent. Some positive momentum, which we recorded in earlier periods was offset here by residential customers choosing lower value tariffs and bottom end handsets.

Wholesale revenues fell 21 percent. This is largely because around 33 million of Optima revenue is no longer recognized each quarter, as it is now considered part of our internal transactions. In addition, general prices and traffic declined, although this was offset somewhat by deregulation of some non-EU termination rates earlier this year.

ICT growth, as we said, was very strong in the third quarter, pushing the nine-month growth to 19.6 percent. The majority owing to a catch-up effect whereby some revenues from the first half of the year were deferred into the third quarter, in-line with the very much seasonal nature of the ICT sector.

IP communication and ICT solutions were the main growth contributors of this, alongside with cloud and managed services.

The Optima consolidation has a net revenue impact of 225 million kuna in the nine-month period, which compares to a 77 million impact in the same period of last year which breaks down to 323 million of Optima third-party contributions but it's offset by 98 million of inter-company transactions now being eliminated.

Excluding Optima, group revenue fell 2 percent between January and September of this year. That compares with a 3.6 percent decline in the same period of last year.

We now turn to slide 7, we are pleased to report a rise in EBITDA, EBITDA margins, net profit and cash flow from operations.

Looking at this in greater detail, EBITDA before exceptional items rose 1.5 percent between January and September of this year to almost 2.1 billion. While margins on the same basis lifted slightly to 40.1 percent, that compares with 39.9 percent in the same period last year.

The EBITDA growth was underpinned primarily by strong transformation initiatives and the Optima consolidation. Excluding Optima, EBITDA before exceptional items fell 1.3 percent. However, this is still a vast improvement on the decline of 8.4 percent, which we saw in the same period of last year.

Net profit rose slightly to 730 million from 717 million last year. This reflects the EBITDA growth just discussed, lower redundancy costs and higher net financial income that mainly comes from exchange rate gains. This was offset somewhat by higher depreciation.

Net cash flow from operations rose 7.8 percent to 1.7 billion. And this rise can be attributed to the higher EBITDA and some positive working capital movements.

We've invested significantly in mobile and fixed profit networks and IP transformation in the period, which you can see reflected in the 17.9 percent increase in CapEx in this nine-month period.

If you please turn to slide 8 where I will outline the financial performance of our residential segment. Residential revenues fell 4.2 percent in the nine-month period to the end of September largely as a result of fixed and mobile voice revenue declines and a fall in terminal equipment revenues.

Fixed voice revenues remained on a downward trajectory, as more people has already mentioned switch to mobile while mobile revenues also fell on the impact of EU roaming regulation, a cut in termination rates and more flat rate tariff offers on the market. The combination of these factors, thus, pushed voice revenues down 13.9 percent.

Terminal equipment revenue fell 7.8 percent because of lower handset prices, and a higher proportion of customers who chose lower value tariffs.

Long voice revenues remained largely stable. This is underpinned by data demand. The revenue decline just discussed was slightly offset by the new spectrum fees that were imposed on HT last year and accordingly passed on to customers from July of last year.

Moving on to slide 9, we will take a look at the business segment where declines in both voice and non-voice revenue were counterbalanced by strong ICT revenue.

Total business revenue fell 1.8 percent, with the most substantial decline of 16.7 percent in the voice segment. This reflects decline in both mobile and fixed voice revenues primarily.

In addition, non-voice revenues also declined – down 5.3 percent to 751 million kuna between January and September, mainly because of significantly lower wholesale revenue where prices and traffic generally decreased but also including the previously noted absence of revenues from Optima after the consolidation.

ICT, on the other hand, helped lift other revenues in the business segment by 17.4 percent. And there was also growth in terminal equipment, as customers in this segment bought more expensive handsets and in the miscellaneous category. This includes HT's energy products and also increased mobile prices, as explained earlier due to the new spectrum fees.

Thank you for your attention on this financial part. I will now hand it back to our CEO, Davor Tomašković, to talk you through the main developments in our mobile, fixed and IP business and the outlook for this year.

Davor Tomašković: Thank you, Kai. On slide 10, you can see that in mobile we have maintained a truly customer-centric focus which incorporates a range of factors from the competitive mobile data bundles our customers buy from us to the experience of Internet speeds of up to 150 megabytes per second they can enjoy.

In a highly competitive market, HT has maintained its 46.3 percent market share by subscribers at the end of the third quarter.

Total prepaid and postpaid subscribers were down slightly, reflecting fewer prepaid customers. But data subscribers continued to grow strongly – up 6.1 percent by the end of the third quarter compared to the same period last year.

Blended average revenue per user fell 5.3 percent in the January to September period as a result of the competitive market, and attractive customer offers also blended non-voice ARPU rose 5.4 percent on the rising rate of data use.

And the market for competitive offers also helped lift average minutes of use as more minutes were included in flat offers, and customer bundles across the pre- and postpaid segments.

Smartphones as a proportion of handset sales increased to 78 percent in the post-paid segment from 73 percent last year, while HT's total smartphone penetration is at 47 percent.

HT's 4G coverage reached 59 percent in the nine months to the end of September while 3G's available indoors to 77 percent of the population.

Having acquired new spectrum, we are now able to offer 150 megabytes per second mobile Internet speeds to nearly 60 percent of the population.

Turning now to fixed line business on slide 11, we continue to be both proactive and reactive in our efforts to retain and gain customers through a range of marketing initiatives. These include a 1 kuna phone connection offer and attractive fixed line tariffs, double and triple play offers and multi-brand strategy.

Despite these efforts, the number of fixed lines and ARPA continue to decline amid fixed to mobile substitution. The number of main lines fell 6.9 percent at the end of the third quarter 2015, which is similar to the level of declines seen the year earlier period.

ARPA also fell 6.9 percent to 88 kunas in the nine months to September 2015.

Broadband – on slide 12. Broadband continues to show growth. The number of growth and access lines at the end of the third quarter rose 2.3 percent on the back of strong wholesale growth of 44.9 percent, while retail lines experienced a 2.3 percent decline.

Meanwhile, TV customer numbers fell 2.1 percent at the end of the third quarter, amid an increasingly competitive marketplace. Still, TV ARPU was up 1.1 percent in the first nine months of the year, because of program improvements and our exclusive content such as HBO Premium.

HT's marketing activities include the promotion of TV Direct to the home alongside mobile offerings. And we were in the process of addressing the low end TV segment, the only TV segment that is continuing to register meaningful growth in this market.

Growth in retail ARPA was largely stable in the first nine months of the year. And as I noted earlier in this presentation, 46 percent of households are now able to access fixed broadband at faster than 30 megabytes per second. Our end of year target is around 50 percent.

Finally, please turn to slide 13, where I reiterate our outlook for 2015 which remains unchanged from February of this year.

In 2014, revenue was 6.9 billion, and we expect this to remain stable in 2015. In 2014, the group achieved a pre-exceptional EBITDA margin of 40.3 percent, and the outlook for 2015 is for a similar margin of around 40 percent.

HT spent 1.07 billion in CapEx in last year and will increase this investment to around 1.35 billion kuna in 2015, as we have previously outlined.

This year, as in previous year, we continue to monitor and evaluate potential M&A opportunities.

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