The Q4 2015 results conference call

24 February 2016 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: Thank you for standing by, and welcome to the HT Q4 2015 results 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 the star one on your telephone. I must advise you that this conference is being recorded today, Wednesday, the 24th of February, 2016.

I would now like to hand the conference over to your first speaker today Elvis Knežević, IR manager at HT. Please go ahead, sir.

Elvis Knežević: Thank you. Ladies and gentlemen, good afternoon and welcome from Zagreb. Today our CEO, Mr. Davor Tomašković, and our CFO, Mr. Kai-Ulrich Deissner, will talk you through the highlights our business and financial performance for the 12 months ended 31st December 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 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 two of our presentation. Allow me to introduce you to Mr. Davor Tomašković, our CEO, who will outline our company's performance during the term ended 31st December 2015.

Davor Tomašković: Good afternoon, ladies and gentlemen. Thank you for joining us today. It is my pleasure once again to present the results from Hrvatski Telekom for the 12 months ended 31st December 2015. I will start my presentation with slide four.

We have delivered 2015 results in line with our outlook provided, and have provided a highly visible financial turnaround. Revenue in the year rose 0.2 percent to 6.92 billion kunas. This is including the Optima Telekom. If we exclude the Optima Telekom contribution, then the revenue fell two percent. However, it's an improvement on the four percent decline that we have seen in 2014.

EBITDA before exceptional items remained relatively stable, even after new regulatory-driven costs, and was down 0.4 percent, to 2.78 billion kunas. Once again if we exclude Optima. This KPI fell 2.2 percent, but this marked a substantial improvement on the 10.8 percent decline which we reported in 2014. On an EBITDA before exceptional items basis the margin was 40.2 percent.

Net profit was 925 million kunas, down 19.1 percent in the absence of tax deductible profits reported in 2014. Excluding the impact of tax-deductible profits reinvestment, net profit was down three percent.

Looking to the current financial year, we expect further revenue stabilization and similar pre-exceptionally, pre-exceptionally EBITDA margins. A dividend of six kuna per share is proposed to be paid from 2015 net profit, and a minimum dividend of six kuna per share is currently expected to be paid out of 2016 net profit.

Moving now to the operational highlights of the year, please turn to slide five. We have once again maintained our leading market position and we continue to implement the transformation of the business in the face of a challenging market environment. Our strong focus on customer satisfaction continues. We are working to stabilize both the fixed and mobile markets, and have launched several initiatives to enable us to do so. Our strategic program Horizont, underway since 2014, is delivering tangible results and new initiatives have started within this program.

Having invested strongly in mobile and fixed broadband networks, we are pleased to announce that our ambitious end of year 2015 targets were achieved and, in some cases, exceeded. We aimed to cover 50 percent of households with next generation access broadband at speeds greater than 30 megabits per second, and achieved this by the end of 2015, up from 34 percent in 2014.

I'm pleased to announce our second target, to include 60 percent of the population could receive 4G coverage indoors, was, as well, exceeded, and we had 65 percent coverage by the end of 2015, up from 45 percent a year earlier. To further elaborate on the extent of our current coverage, our 65 percent indoor penetration translates into 93 percent in terms of outdoor penetration.

HT is also proud to have been awarded a best in test certificate in July by an independent benchmark study, P3, confirming that HT has the highest speed mobile Internet and is the best mobile network in the Country. We have now migrated all our customers and services onto an IP network, allowing us further efficiencies and participation in Deutsche Telekom's PAN IP European network project, which encourages joint production of services to achieve additional cost synergies and technology excellence.

On slide six you can see that the Group has largely achieved all of its forecasts for the year. In October 2015 we reiterated our projection of revenue stabilization and, in fact, we delivered growth of 0.2 percent. We forecast margin of around 40 percent, and have delivered margin of 40.2 percent. We forecast capex of around 1.35 billion kunas, and in fact invested 1.46 billion kunas last year.

We continue to monitor and evaluate potential M&A opportunities. I will now hand over to our CFO, Kai-Ulrich Deissner, to present the following slides on development in the Croatian market, and our financial results.

Kai-Ulrich Deissner: Thank you very much, Davor. I'll start with a market overview, so if you please turn now to slide eight, which gives an overview of the telco and ICT market in Croatia.

At the end of the fourth quarter last year SIM penetration was down 0.8 percentage points to 113.2 percent, and that's because fewer people owned double SIMs. However, the market also enjoyed consistent growth in contract customers, reflecting a trend that you all know, seen across the global telco industry, the demand for mobile data accelerated. On the other hand, traditional mobile minutes grew 1.9 percent in January to September that compared with the same period of 2014. And this actually represents a slowdown in growth. The number of SMS sent also fell. That's down 8.7 in the same period.

Here, just to remind you that official market statistics provided by HAKOM, our regulatory body, usually lagged by one quarter, which is why we are quoting numbers from the end of September.

Fixed voice minutes of use continued to fall as customers switched to mobiles, decreasing 13.5 percent in the first nine months of last year. Within the telco market fixed broadband and PayTV on the other hand continued to grow. At the end of the third quarter the total number of fixed broadband lines in Croatia was up three percent, year on year, to 972,000, while the number of PayTV customers also rose three percent, to 750,000 in the same period.

Driving this market were convergent and bundled offers. The Croatian ICT market is expected to have shown growth of around three percent, 2.9 percent in 2015. That's supported by all three main sectors of packaged software, IT services, and hardware.

So if you now turn to slide nine, this describes our revenue performance with growth of 0.2 percent in 2015, supported by the consolidation of Optima Telekom, growth in ICT, and an increasing number of energy customers. The breakdown of those revenues has followed a pretty similar pattern to last year with fixed telephony down and pressure also on mobile revenues.

This last bit came mostly from E.U. roaming regulation, cuts in termination rates, and competitive flat rate tariff offers on this market, all of which was partially offset by growth in mobile data and terminal equipment revenues.

Wholesale revenues fell 13.7 percent to 339 million kunas, mainly because wholesale revenues from Optima of around 30 million per quarter are now considered internal transactions and no longer reported here. Excluding this Optima effect, wholesale revenues would have been slightly up. In addition to this, general wholesale prices and traffic declined, but this was offset by deregulation of certain no EU termination rates from the first of April last year.

IP revenues fell two percent as higher TV ARPU could not fully offset the lower broadband revenues. HT reported a 16.8 rise in ICT revenues generated largely from IP communications and ICT solutions, as well as from Cloud and managed services. Just to remind you, the net revenue impact of the Optima consolidation was 296 million kunas. Excluding Optima contribution, Group revenue fell two percent and this reflects an improvement from the four percent decline seen in 2014. More information on the impact of Optima on the Group financials can be found in Appendix I of the presentation, so that this is very transparent. Revenue from energy sales rose to 47 million kunas in last year. That's up from 12 million in the year before.

Let me point out here that, as a Group, we are planning to make some changes to this revenue reporting structure from Q1 of this year. Basic information on this can be found under Appendix number II, and please contact our IR department if you require any further details and explanations to this.

Turning to slide 10 now, we are turning to a more detailed outline of our financial performance. Last year saw EBITDA stabilizing with a margin of 40.2 percent. EBITDA before exceptional items declined 0.4 percent to 2.78 billion kunas, and that's supported by our strong transformation initiatives and the consolidation of Optima. Excluding Optima impact EBITDA before exceptionals fell 2.2 percent. That compares to an almost 11 percent decline in 2014.

Net profit, as already mentioned, was down 19.1 percent to 925 million kunas reported. This was mainly due to some higher depreciation and higher taxes because in the previous year we benefited from a tax deductible profit reinvestment. At the same time, exceptional items were lower last year. If you deduct this tax benefit of 188 million kunas last year, net profit would have been down only three percent.

Net cash from operations rose 3.1 percent to 2.37 billion kunas, mainly because we saw some positive working capital movement and lower tax advances.

The increase in CAPEX reflects a significant investment in our mobile and fixed broadband networks and our IP transformation, along with a change in accounting policy, which I would like to make transparent. This is explained on slide 11. Last year, as a Group, we voluntarily changed our accounting policy with regards to costs related to the electronic communication infrastructure, ECI. This change means that last year EBITDA before exceptional items increased by 50 million through that change of accounting policy. And net profits after non-controlling interest rose by 22 million kunas, and CAPEX increased by 93 million kunas.

We turn to slide 12 now. This outlines the financial performance of the residential segment where revenues fell 4.2 percent. Voice revenues here fell in both the fixed line segment, reflecting the industry-wide decline in usage, and in mobile voice revenues because of E.U. roaming regulation, cut in termination rates, and flat rate tariff offers that reflect our competitive environment.

Voice revenues overall fell 14.7 to 1.56 billion kunas. Non-voice revenues, on the other hand, rose 0.3 percent as mobile data sales compensated for slightly lower broadband revenues. Miscellaneous revenue almost doubled to 165 million kunas, reflecting the spectrum fees that were passed on to customers from July 2014, as well as the increased customer base for energy.

We turn to slide 13. This shows the business segment financial performance. This shows strong ICT revenues, slightly compensated by the fall in voice and non-voice revenues. Total revenues was down one percent to 2.72 billion kunas, reflecting a notable improvement to the 10 percent fall in 2014. Voice revenues slipped 12.3 percent, as both fixed and mobile voice registered declines. Non-voice revenues also fell, down 6.3 percent, following significantly lower wholesale revenues, as explained before.

This reflects the general decline in prices and traffic and, in particular, the absence of Optima revenue after consolidation in the third quarter of 2014. Other revenues rose 14.5 percent to 742 million, and this is mainly driven by ICT, while terminal equipment also contributed with an increase of 20.3 percent in miscellaneous revenue from energy, and higher mobile prices jumped 32 percent.

We now turn to slide 14, to take you through the results from our mobile operations this year, where we have focused on data bundles and the customer experience, which has in particular been enhanced by the offer of speeds of up to 225 megabits per second. Our market share by subscribers rose slightly from 46.8 percent to 47 percent in 2015, in a highly-competitive market environment. By the end of

December, total subscribers were down 0.9 percent, but data subscribers rose strongly up 6.2 percent to 1.5 million.

Blended ARPU fell 5.6 percent in the period January to December, as a result of intense competition in the market, although blended non-voice ARPU rose 6.4 percent as customers continued to increase their use of data. Average minutes of use rose 3.8 percent to 195, as customers took out flat offers and mobile bundles with a high number of minutes included. During the year the proportion of total handset sales that were smartphones increased to 79 percent in the postpaid segment from 73 percent last year.

As Davor noted earlier in this presentation, we are pleased to report that HT exceeded its goal of reaching 60 of pop coverage indoors with 4G, and in fact achieved 65 percent by the end of last year. Our 3G coverage achieved 77 percent indoor pop coverage and, in some urban areas, our mobile network enabled to download speeds of up 225 megabits per second. So we continue to focus on providing technology excellence to ensure customer satisfaction and maintain our market leadership.

Turning to slide 15, we continue to implement marketing initiatives in order to try and to staunch the decline in the number and average revenue from fixed lines. Retail and wholesale mainlines fell eight percent in the year, while ARPA fell 6.8 percent. We continue with both proactive and reactive churn prevention efforts with offers such as phone connection for one kuna, attractive fixed line tariffs, and double and triple play packages.

Turning now to slide 16, the declining trend in fixed line continues, but broadband lines are showing growth, as you see on this slide. The number of broadband access lines was up 3.1 percent year on year at the end of the fourth quarter, this was in particular supported by strong wholesale rise by 44.7 percent. Broadband retail ARPA remained flat at 126 kunas, while the number of TV customers fell 1.5 percent to a hundred – 388,000 as a result of aggressive competitive bundled offers on the market.

Our TV offer includes some very attractive exclusive content such as top flight sporting events and blockbuster movies, and we're actively promoting TV direct to home and mobile offerings. We're also repackaging our content to enable us to effectively address the low end of the TV segment.

And this concludes this market overview. I will now hand back to Davor Tomašković to talk you through the outlook and our planned dividend for next year.

Davor Tomašković: Thank you, Kai.

We now move to take a look at our outlook and objectives for the current year and beyond. Slide 18 illustrates how we have delivered on our strategic priorities over the past two years, and the further initiatives already underway in 2016.

In 2014 our priority was to build credibility, which we did by delivering solid results, reorganizing the business, and delivering on our projects. Once these foundations were laid, we undertook to focus on the customer if 2015, transforming the customer experience becoming the driving force in our market, and investing in the network, and injecting renewed energy and focusing to organization.

During the current year and beyond, we are committed to focusing on growing the top line. To do this we intend to stabilize core and non-core growth, both organically and through M&A. We will remain flexible and make business model adjustments to enable us to meet top line growth projections, also bringing in further efficiency measures and customer experience improvements.

Slide 19 shows how HT is well placed to leverage its know-how, technology, and customer base to achieve this year's priorities. We actually have identified three largest core and non-core organic growth areas for the whole Group. The first is ICT, where HT has been outperforming the market for many years, as we outlined in greater detail at our Capital Markets Day in November 2015.

Recently we unveiled Croatia's largest Smart City project in Dubrovnik, which will become a testing ground for innovation, development, and importantly for top line growth. Services included in this initiative include real-time parking space vacancy information, multi-sensor video surveillance of the traffic, high-speed Wi-Fi free of charge, remote controlled public city lighting management, and many other features.

The second growth area is mobile data, where we have seen solid revenue growth and our portfolio is set to capture future traffic increases. The last and third growth driver will be energy, where our focused approach has already delivered strong growth and where we, with our strong sales force and sales channels have a competitive advantage. Energy is a good strategic fit for our business, as we are already well-established as a provider of key services to the household and beyond.

In order to further stabilize our core areas of operation, HT intends to bring new propositions to the market. We will leverage our leading market share in terms of household spending and offer a selection of services that have simplicity and premium customer care at their heart, in order to strengthen customer loyalty. In addition, we intend to use our easily-recognizable brand and reputation for superior quality to target all market segments.

In order to strengthen HT's market position, we are undertaking two key business model amendments, which are detailed on slide 20. The first is a change in wholesale prices.

In December 2015 the Croatian telecoms regulator approved higher monthly local-loop unbundling fees which may also be lead to increased wholesale fees for naked bit stream. These will not be applied before January 2017. Being able to charge higher wholesale fees would enable us to protect our investment in infrastructure and the network by possibly increasing other fees as well, thereby boosting the value of the total telecoms market. However, but it is still too early to elaborate on this opportunity in more detail.

The second business model changes are participation in Deutsche Telekom's Pan-European IP network project called PAN-NET, which is designed to increase the competitiveness and efficiency of all companies within the DT Group. Through collaboration and joint production of services, HT can benefit from synergies in development and technological leadership. Advantages include a fast time to market for new product, a best in class service portfolio, radically simplified customer experience, and the opportunity to form partnerships in a timely and agile way, for example to partner with over the top players.

Please turn to slide 21. Our final key top line growth strategy encompasses efficiency efforts and continued intensive investment in our network in order to deliver an improved customer experience. To ensure the top line growth isn't eroded by high costs, we continue to make efficiency savings through workforce rationalization. A program to reduce the workforce by approximately 220 employees is currently underway, as we announced earlier this month. HT is always vigilant about costs, and we have demonstrated tangible results following a range of cost discipline initiatives already.

In 2016 the Horizon umbrella project has been expanded with several new initiatives. HT's network investment for 2016 will improve both mobile and fixed broadband in order to offer customers an even better experience. Continuous mobile broadband deployment will add to our coverage areas and increase speeds. HT has successfully tested voice over LT in a lab environment. For fixed broadband, HT intends to include next generation access coverage by smartly rolling out fiber, but also enhancing existing copper performance. Our key investment conditions in fibre deployment have been agreed with the telecom regulator.

The penultimate slide, number 22, sets out the outlook for 2016. We expect revenue to be in a range of flat to two percent below last year. EBITDA margins before exceptional items should remain around 40 percent. We expect to spend slightly less CAPEX in 2016, compared to the 1.46 billion kunas spent last year, but still above the Group's long term average of 1.1 billion kuna. With regards to regional expansion, we are monitoring and evaluating potential M&A opportunities.

And, finally, on slide 23, our dividend policy is laid out. In its prospectus, when the group listed in 2007, HT pledged that the dividend payout would range from 50 to 100 percent of the Company's distributable profits, depending on its overall financial position and working capital. At our Capital Markets Day in November last year, we committed to announcing a minimum target dividend for each year at the start of that particular year, within the range as set out in our dividend policy.

To comply with that commitment, we announced today that HT currently expects to pay out a minimum dividend of six kuna per share in 2016.

Thank you for attention. We're now willing to take any questions you might have.