

The Q3 2019 results conference call

31 October 2019 at 12:00 CET

Presenters

Kostas Nebis

Hrvatski Telekom – President of the Management Board and CEO

Daniel Daub

Hrvatski Telekom - Member of the Management Board and CFO

Elvis Knežević

Hrvatski Telekom – Investor Relations

Operator

Thank you for standing by and welcome to the Hrvatski Telekom Results conference call for the nine months ended 30 September 2019

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 31 October 2019. It is now my pleasure to hand you over to your first speaker today: Mr Elvis Knežević

Mr Elvis Knežević – please go ahead.

Mr Elvis Knežević

Thank you

Ladies and gentlemen, good afternoon and welcome from Zagreb. Today our CEO Mr Kostas Nebis, Mr Daniel Daub, our CFO and Mr Siniša Đuranović, Senior Vice President and General Counsel will talk you through the highlights of our business and financial performance for the nine months ended 30 September 2019, 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, Mr Nebis, Mr Daub and Mr Đuranović 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 nine months ended 30 September 2019.

Mr Kostas Nebis

Thank you Elvis.

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

It is my pleasure to present the results from Hrvatski Telekom Group for the nine months ended 30 September 2019.

I will start the presentation with slide 3, which outlines the business and financial highlights for the period.

We are continuing investments in our mobile and fixed broadband networks so that our customers receive a superior experience and the company maintains its leading position in connectivity.

Overall HT's 4G network reached 99% population coverage outdoors and 87% coverage indoors. In addition, through mobile network modernization program, in Jan-Sep 2019 additional 537 mobile locations have been equipped with "four carrier aggregation" configuration. This has increased our Gigabit capable LTE population coverage from 40% to 53%.

During the 2019 tourist season, mobile data volume in the busiest week of the season in HT network increased by 78% over the previous year. At the same time, the average download speed increased by 40%, from 43 Mbps to 60 Mbps, according OOKLA, the industry body that measures speeds.

We have been able to expand our Fibre to the Home coverage by 40,000 new households during the first nine months of 2019, which is a 2.5-fold increase compared to the same period last year, for a total of 270,000 households with FTTH coverage.

We also added 49,000 new Hybrid access customers in the January to September period, which is 2.2 times more than the same period in 2018. Our customers are now able to benefit from speeds 2 to 3 times higher than before.

We have also maintained our focus on digitally connecting everyone in the country, from consumers to businesses and the public sector.

For example, we have finished an upgrade of our biggest data center in Selska street in Zagreb. The upgrade will enable additional capacity for all users who wish to transfer their infrastructure to a modern and secure space that is compliant with TIER 3 standards.

The new capacity means more space for all users who do not have an adequate space to house their infrastructure and their critical services and wish to considerably lower their current operating costs.

This initiative has also involved the expansion of our data center services portfolio and I'm proud to report that we are the first in Croatia to be implementing the Azure Stack, the most popular public cloud platform.

The advanced tools and services available on the Azure platform enable time- and cost-efficient business operations, whilst the Azure Stack guarantees that customers' data remains stored in Croatia, with certified local support to ensure full business continuity in all situations.

We have also been making strong efforts to reverse the decline in our fixed business, including a focus on retention of existing customers and migrating them to new portfolios and Magenta 1.

I'm delighted to report that these initiatives have reversed the negative trends in operational key performance indicators within our fixed business, and the results have been encouraging, including a rise in broadband customer numbers.

Magenta 1 continues to be a very attractive proposition, with 55% household penetration and 39% business penetration. Meanwhile our One App digital service reached 338,000 monthly active users, a penetration level of 27% over total smartphone base.

Hrvatski Telekom has applied for several EU funded tenders for broadband investments to further accelerate our efforts to provide the fibre infrastructure for a fully connected Croatia.

On the financial side, we continue to deliver a stable financial performance. Our capex to sales ratio is at a high of 19% and our share buyback programme is ongoing. Still, we have revised our revenue outlook for 2019 from "around the 2018 level" to "slightly lower".

On slide 5 you will see that in the first nine months to September, revenue and profit declined, but margins remained strong. Total revenue across the Group fell 1.3% in the period to HRK 5.71 billion from HRK 5.79 billion last year. This is a result of 6.4% decline in revenue at Crnogorski Telekom to HRK 440 million, compounded by a 0.8% fall in revenue at HT Croatia to HRK 5.27 billion.

The small decline in revenue at HT Croatia mainly reflects our exit from the energy business, the continued decline in fixed voice as more people switch to mobile, and lower visitor revenue. In addition, we saw a slowdown of revenue growth in System Solutions.

Crnogorski Telekom remains under pressure from declining fixed voice revenue and prepaid mobile sales.

EBIDTA AL, which is adjusted for the 'after lease' accounting change, was down 4.8% to HRK 2.24 billion. This fall is attributed to the lower revenue outlined earlier, higher merchandise and roaming costs, and the higher cost of employee benefits, all of which offset a one-off positive impact from the Evotv transaction.

EBITDA AL margins was 1.4 percentage points lower at 39.2%.

The decline in EBITDA AL, along with higher depreciation and exceptional costs, means we have reported a net profit decline of 18.3% to HRK 677 million in the first nine months of the year.

Please now turn to slide 6 which describes our operating cash flow position as well as the continued investment in our network, which are bringing improvements to the experience of our customers.

Net cash flow from operations fell 14.1% to HRK 1.67 billion in the first nine months mainly because of adverse movements in working capital and higher tax paid. Meanwhile capital expenditure was 12.5% lower in the period at HRK 1.09 billion. This decline merely reflects a difference in the yearly distribution of funds and does not impact the significant investment we continue to make in our mobile and fixed broadband networks.

I would now like to hand over to our CFO Daniel Daub who will outline the highlights for both HT Croatia and Crnogorski Telekom performance.

Mr Daniel Daub

Thank you Kostas and good afternoon everyone.

On slide 7 you will see that HT Croatia revenue has decreased 0.8% to HRK 5.27 billion in the nine months to September. This reflects a good performance in mobile and system solutions which was unable to entirely offset the revenue decline after our exit from the energy business and the long-term difficulties in fixed voice.

As the largest revenue stream, mobile revenue rose 1.2% to HRK 2.39 billion in the first nine months of 2019. This increase in mobile revenue came from higher postpaid revenue where both customer numbers and the average amount they spend with us increased, and greater handset sales. This was partly offset, however, by the decrease resulting from the cancellation of the network access fee.

Fixed voice revenue continued its downward trend, with revenue falling 10.7% to HRK 500 million as mainline sales, traffic and average revenue per user all declined because of competitive pressures and fixed to mobile substitution.

Broadband and TV revenue showed modest growth, up 0.8% to HRK 982 million. Within this figure, TV revenue was boosted by more TV customers and higher ARPU as well as the positive impact of seven months of revenue from our Evtv acquisition. This was enough to offset a fall in broadband revenue.

Fixed wholesale revenue rose 2.1% to HRK 235 million mainly due to higher transit traffic.

Other fixed revenue rose 1.4% to HRK 617 million due to higher terminal equipment and a slightly better performance at Optima Telekom.

We saw an improvement in revenue in our system solutions segment, up 10.4% to HRK 538 million reflecting more favourable yearly project dynamics in the first nine months of 2019 compared to the same period last year. As growth slowed we do not expect such a high growth rate for the full year 2019.

Miscellaneous revenue fell to HRK 12 million from HRK 96 million last year because of the sale of the energy business last year, which accounted for HRK 80 million of revenues in the first nine months of 2018.

Slide 8 describes our mobile business in Croatia, where we maintained leadership in the overall market and in mobile technology. In order to maintain our market leadership we are building the foundations for 5G technology, and public consultation on how future 5G spectrum will be allocated has now commenced.

At the end of the third quarter 2019, HT maintained its leading market position with a share of 44.8%, down slightly from the 45.3% reported in the third quarter of 2018. mainly due to competitors' active promotion of their FMS offers where they count their broadband customers as mobile subscribers.

Despite this slight decline, we increased the number of subscribers across HT Croatia by 1.2%, largely driven by a 5.1% increase in postpaid customers to 1.37 million. This offset a 3.7% decline in prepaid customers to 988,000 at the end of the third quarter.

Average revenue per user rose 2.2% to HRK 45 in the prepaid segment in the nine months to September but was flat at HRK 87 in the postpaid customer segment.

HT Croatia's smartphone proportion of total handset sales is 91% in the postpaid segment, which is flat on the first nine months of 2018. Smartphone customers now account for 68% of HT Croatia's overall subscriber base.

HT Croatia's programme of modernisation continues, with 85% of the mobile network already upgraded. We are developing our 5G capabilities and the regulator has recently published its proposals on the future of 5G spectrum allocation. Public consultations on future 5G assignment have now commenced and we look forward to further updates on this key infrastructure.

Meanwhile as data traffic continues to grow, we remain focussed on expanding capacity on 4G network sites.

Please now turn to slide 9 for details of HT Croatia's fixed line and IP business. Here the acquisition of Evtv boosted the number of TV customers, and retail broadband lines have turned to growth.

Fixed mainlines, which have been in decline for many years due to fixed to mobile substitution, regulation and enforced competition, declined 5.6% to 839,000 at the end of the third quarter.

Retail fixed mainlines were down 5.1% to 792,000 and wholesale fixed mainlines fell 14.3% to 47,000. We continue our endeavours to mitigate these declines through the introduction of a range of tailor-made propositions and customer base management activities.

Fixed voice ARPU was down 5.1% to HRK 69.

In addition, broadband access lines declined 1.1% to 740,000 at the end of the third quarter. We were very pleased to see a 0.4% rise in retail lines to 622,000. However, wholesale broadband access lines fell 8.4% to 118,000.

The reversal of broadband retail customer declines is a result of a concerted effort to retain customers and encouraging loyalty with strong offers like Magenta1. Still, strong competition and aggressively priced offers in the market meant that broadband retail ARPU was 7.3% down at HRK 104 in the third quarter.

TV customers rose strongly, up 18.7% to 490,000 by the end of the third quarter. This boost mainly came from the acquisition of Evotv which uses DVBT – or Terrestrial Digital Video Broadcasting - technology. TV ARPU was also up 3% to HRK 86.

As a result of investments into the fixed infrastructure, Next Generation Access coverage for speeds above 30 Mbps reached the level of 60% whilst coverage for speeds above 100 Mbps reached 23% of Croatia's total 1.5 million households.

Turning now to slide 10, we describe the standalone performance of Crnogorski Telekom, which has reported a decline in both revenue and profitability.

Revenue fell by 5.9% in the first nine months of 2019. This was largely the result of negative trends in the fixed voice and mobile prepaid segments, which was only partly offset by an increase in system solutions revenue. However, we have maintained our market leadership in the postpaid market.

Broadband and TV revenue have remained broadly stable.

However, we have seen a decline in EBITDA of 7.2%, adjusted for the 'after lease' accounting change, to HRK 164 million. This was mainly the result of the revenue development just discussed and the absence of some positive one-off impacts reported in the nine months to September 2018, including the sale of real estate and a change in accounting standards.

Finally, please turn to slide 10 for our Group outlook for 2019. We have decided to amend our revenue forecasts down a little and now expect revenue to be slightly lower than the HRK 7.78 billion reported last year, rather than around the same level as previously forecast.

The margin for EBITDA AL before exceptionals continues to be forecast at around 38% in 2019, against the 38.6% achieved in 2018.

Capex AL is also expected to remain around the 2018 level of HRK 1,826 million.

In 2019, we will again continue to monitor and evaluate M&A opportunities following the completion of our acquisition of Evotv in the first quarter.

We are now ready to take any questions.