

The Q2 2014 results conference call
30 July 2014 at 10:30 CET

Presenters

Davor Tomašković

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

Irena Sekirica

T-Hrvatski Telekom – Controlling Division

Elvis Knežević

T-Hrvatski Telekom – Investor Relations

Operator: Thank you all for standing by and welcome to the T-HT H1 Earning 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 one on your telephone. I must advise you this conference is being recorded today, Wednesday, the 30th of July, 2014.

I'd now like to hand the conference over to your speaker today, Elvis Knežević. Please go ahead, sir.

Elvis Knežević: Thank you. Ladies and gentlemen, good morning and welcome from Zagreb). Today, our CEO, Mr. Davor Tomašković and Ms. Irena Sekirica, Operating Director of the Controlling Division, will talk you through the highlights of the business and financial performance for the six months ended 30th June 2014, using the presentation slide 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 Ms. (Sekirica) will also be available for your questions.

Before we begin, allow me to draw your attention to the harbour statement on page two of our presentation. Allow me now to introduce you to Mr. Davor Tomašković, our CEO, who will outline our company's performance during the six months ending 30th June 2014.

Davor Tomašković: All right. Good morning, ladies and gentlemen. Thank you for joining us today. I'm glad to be presenting another set of results from Croatian Telekom for the six months ended 30th of June 2014.

As stated in the last report for the Q1, we are still facing a very tough economic environment. And I will start the presentation on slide three and give an update on the Croatian economy and its outlook.

As I've said, the economic environment in Croatia remains challenging. So far, in 2014, it's forecast to be the sixth consecutive year with no real GDP growth in the national economy. And consequently, public debt and the budget deficit continued a rising trend seen in previous periods. And as you know, major – all three major rating agencies set the credit ratings of sub-investment grades for Croatia. We – Croatia is also in the excessive deficit procedure, an EU supervision mechanism due to the fiscal imbalance.

If we look at the unemployment rates, we actually see the forecast for 2014 to be rising unemployment to 21 percent. But the outlook for 2015 shows an importance of a very small GDP growth of 1.1 percent and slight decrease in unemployment rates. So this is how we see the challenges in the environment in which we operate.

You can now move to slide four. We look at the overall telecom and IT market in Croatia. Traditional voice services in the fixed market are still shrinking. You see that we have a decline in fixed voice revenue of 17 percent, and number of subscribers of 5 percent. Minutes of use decreased by 14.4 percent.

On the mobile side, we see the market shrinking as well, revenue by 8 percent, and the number of subscribers by a slight 2 percent. When we look at the IT market, there are signs of life. There is a modest recovery that is expected in 2014 as a result of new investments funded by the EU and certain investments by domestic players.

On slide five, I will talk you through the dynamics of fixed and mobile broadband and Pay TV in Croatia which are all recording growth. So the

fixed mobile broadband, we see a growth in revenue of 9 percent, and number of subscribers at 5 percent.

The number of broadband lines have risen to 933,000 at the end of March. And now currently, we're looking at the household penetration rate of about 60 percent, which is still below western European average. So we still expect that this growth is going to capitalize in the coming periods.

At the same time, HT smartphone penetration continues to increase and now stands at 34 percent overall which obviously drives the appetite for mobile growth.

Pay TV market remains stable, with Pay TV penetration of 46 percent of households in Croatia. Revenue rose 13 percent, and number of subscribers 11 percent. It is worthy to note that we are the only regulated market for IPTV in Europe. And we expect all these positive trends to continue in the remaining part of 2014.

I will now hand over to Irena, Operating Director in the Controlling Division who will talk about the group's financial performance.

Irena Sekirica: Thank you, Davor. I'd like to start with slide six where we outline the contribution to first half 2014 revenue from various parts of the group.

In summary, revenue from fixed telephony was 16.1 percent lower as a result of the general usage trends that we see for some years now. At the same time, mobile revenues has particularly come under pressure from EU roaming regulation, the cut in termination rates and from flat tariff offers that we have in the market.

In summary, being for 5.5 percent lower. Now we see the decline slowing to some degree. On a more positive note, mobile data continues to show strong growth.

Looking at the wholesale, there is a lower hubbing traffic coupled with a decline in termination rates, all partially offset by higher infrastructure revenues from ULL, WLR) and BSA segment.

IT revenues rose by 1.9 percent with an increase in TV revenues which are more than offsetting the lower broadband revenues.

As referenced earlier, there has been a strong ICT growth, growth in ICT revenues of 28.4 percent. And this is mainly in IT infrastructure and professional services as well as in the provision of already mentioned ICT solutions for some key accounts.

If we turn to slide seven, we provide you with an overview of key financial details of the group. So looking at the EBITDA before exceptional items, there is a decrease of 10 percent to 1,280 million in the first half of 2014, dominantly as a result of lower revenues.

The margin on EBITDA before exceptionals fell to 38.9 percent from 41 in the prior year. As well as by the decline in revenue, net profit was also impacted by redundancy and business transformation costs as well as lower net financial result. So as a result, the net profit was down 29.5 percent to 401 million, with a net profit margin falling to 12.2 percent in the first half of 2014.

Net cashflow from operations was down 25.2 percent, mainly due to fall in the volume of trade payables as well as the lower EBITDA.

Looking at the capex, we see a decline of 19.6 percent. Here, there is an absence of one-off real estate investments that were present in 2013, and also as a result of the seasonalization which envisages the IT and network platform investments in 2014 by the second half.

And that concludes our overview of the group financials for the first six months of 2014. And I will now hand you back to our CEO, Davor.

Davor Tomašković: Thank you, Irena. So as you have seen, we're facing a tough changes in the market which cause decline in revenue and which then impacts our EBITDA and net profits decline. So we have undertaken a number of transformation initiatives in the first half of this year to combat the negative impact on the business.

We are mainly focused on adapting our cost base and we have changed or introduced a new organizational structure which reduced the number of

management positions by almost 31 percent. We also have had the voluntary redundancy program in the first half of the year.

We signed the new Collective Agreement which is valid from 1st of July 2014. And as we announced earlier this month, we're starting to outsource the group's construction and maintenance services related to infrastructure to Ericsson.

It should be noted that among the major changes in the operating environment in the first half of the year, the government recently just at the end of June imposed a three-fold increase of radio frequency fees. However, despite this unexpected cost, we maintained our outlook for 2014.

Let us turn to slide nine. And I'll take you to our mobile business in both advanced and business segments. We have been pursuing a successful value strategy in mobile and are seeing an increasing number of customers, customers choosing HT's more advanced services over those offered by our – by our competitors.

We see that the average minutes of use have risen 8.9 percent. And we see that the number of postpaid customers reached 1 million and 90,000 customers. We also mentioned the earlier experience in strong demand for smartphones. They make up 73 percent of total handset sales in the postpaid segment. And this is an increase from 56 percent at the end of 2013.

As we already noted, this annual radio frequency fees that was imposed on us by the government, caused that we have to adjust our mobile services prices at both prepaid and postpaid segment.

We maintained our market share in the first quarter at 46.3 percent. In line with market trends, the number of mobile subscribers slipped slightly by 1.8 percent. However, the mobile data subscribers rose 9.6 percent. Monthly ARPU has also seen a decline from 84 to 79 kuna per month or 6.5 percent. But if you look at the blended non-voice ARPU, it actually rose by almost 11 percent.

On slide 10, I would like to outline the key trends in our fixed telephony operations. There we see that the total number of mainlines decreased by 5.9 percent, and ARPA also decreased by 9.6 percent. We see that as a consequence of the continued shift from fixed line voices to mobile and IP.

The total traffic was 22 percent lower compared to the last year – and compared to the last year, in the first six months of last year.

We also made moves to stabilize the overall telecom market of Croatia by taking over the management of Optima telekom in accordance with the Croatian competition agency. We did this move in order to preserve the market, the customers of Optima telekom and also all the lenders to Optima telekom.

We will consolidate Optima's results in our next reporting period. And therefore, we have more details on its performance at that time.

On slide 11, I will take us also to look at the performance of the group's broadband and TV market. Number of broadband access lines continues to rise by 2.3 percent to 680,000. But ARPA fell by 1.4 percent.

We continue to promote our two-play and three-play offers, and also Ultra Max packages based on our fiber, FTTH technology. We also could use some new and exclusive TV content which includes Formula One rights and HBO premium packages.

We also pursue the IP transformation and by now, successfully migrated almost 60 percent of retail customers to the IP technology.

Let's now turn to slide 12 which is a breakdown of revenue performance in the residential segment. We see an overall revenue decline of 2.5 percent mainly driven by the decrease of voice revenue of almost 14 percent, partly offset by an increase of non-voice revenue. And that's on the back of higher IP mainly from our TV services and mobile data.

It's most important to note that non-voice – non-voice revenue - is now almost at the same level with the revenue we derive from voice services. At the same time, you see a significant increase in terminal equipment revenue by

60 percent. That is thanks to the higher mobile handset revenues. And these are caused by the introduction of split contracts where the entire handset revenue is actually recognized at the moment of handset sale to the customer.

On slide, 13, we'll consider our business segment – our business segment. Revenue here was 8.8 percent lower than last year, again driven by a very significant drop in voice revenue of over 27 percent. Non-voice revenue also decreased by 2.9 percent. And again, here in business, even more emphasized than in residential we will see that the non-voice revenue has been higher than the voice revenue.

On slide 14, I would like to discuss our outlook for 2014. As I highlighted earlier, in spite of the very challenging Croatian economy environment and unemployment and GDP decline, we still remain as our outlook from the beginning of the year.

We continue to expect the 2014 EBITDA margin between 39 and 41 percent. This requires a strategic shift to pull the downward trend in the performance of our business. And in order to reverse this negative trend, we intend to lift capex to more than 1 billion in this year. And we will focus our investments on infrastructure development and improvement of service quality especially now there's broadband, TV and cloud services.

We are also alongside these priorities continuing to monitor and evaluate potential merger and acquisition opportunities.

That would be all from my side. Thank you for your attention.