

# The Q3 2014 results conference call

## 30 October 2014 at 11:00 CET

### Presenters

**Davor Tomašković**

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

**Kai-Ulrich Deissner**

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Operator: Thank you for standing by and welcome to the T-HT Q3 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 star one on the telephone.

I must advise you that this conference is being recorded today on Thursday the 30th of October, 2014.

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

Elvis Knežević: Thank you. Ladies and gentlemen, good morning and welcome from Zagreb. Today our CEO, Mr. Davor Tomašković, and our CFO, Mr. Kai-Ulrich Deissner will talk you through the highlights of our business and financial performance for the nine months ended 30th September, 2014, using presentation slides, which I hope you have in front of you. If not, please visit our website at [www.t.ht.hr](http://www.t.ht.hr) where you can access the slides from our investor's 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 to introduce you to Mr. Davor Tomašković, our CEO, who will outline our company's performance during the nine months ended 30th September, 2014.

Davor Tomašković: Thank you, Elvis. Good morning, ladies and gentlemen. Thank you for joining us today. I am delighted to be presenting the set of results from Croatian Telecom for the nine months ending 30th of September, 2014. I start the presentation with slide three, highlighting the group's major achievements in this period.

We continue to maintain our leading market position across all areas of business, despite the challenging environment we are facing, particularly in the macroeconomic environment where unemployment and consumer uncertainty weighs heavily on household consumption. In spite of that, we continue with our transformation initiatives and we see the first results impacting third quarter of 2014.

Also, in order to increase our competitiveness in the market and provide innovative approach, we continue to introduce new product and services. We have put new fiber proposition on the market hoping that this will increase definitely our competitiveness in the fixed business area.

In the third quarter for the first time we consolidated Optima Telekom. I will talk more about it in the coming slides. Because of the consolidation, we modified our revenue outlook. Also on the underlying basis 2014 outlook remains unchanged.

We have seen that in spite of the new spectrum fees that the government introduced for all telecom operators, but with the positive uptake coming from the transformation initiatives, we have slowed down the revenue decline to 2.2 percent in the nine months of 2014, compared to the decline of 5.2 percent in the first half of 2014.

Obviously, coming from a very good result in Q3. In Q3 alone, the revenue rose 3.8 percent, and we reported a solid EBITDA before exceptional items margin of 41.5 percent compared to 38.9 percent in the first half of the year.

Now, let's turn to slide four, and our voice market for both fixed and mobile voice services. Demand for voice services in the fixed market continues to decline across the industry. We see the minutes decline by 14.2 percent in Q2 2014.

Let me just stress out once again that what you see here are the market data for the second quarter as they have a time lag.

On the revenue side in the fixed voice, we see a decline of 16 percent and the number of subscribers we see a decline of six percent. In the mobile segment, SIM penetration is estimated at 118 percent, which is almost a three percent contraction year on year, mainly coming from the reduction of ownership of more than one SIM, because there are favorable cross net offers on the market.

Mobile minutes of using increased almost six percent in the second quarter, and we maintain our leading position in mobile offering, enhanced commercial tariff offers, LT coverage and 4G offers.

We see that the EU investments are spurring a modest recovery in the IT market despite this challenging economic environment that we are facing. So we expect the fastest growth in mobile devices, like tablets and Smartphones, and hardware reselling of PCs and services is expected to decline.

So that was it on slide five. There is demonstrated growth on fixed and mobile broadband, and also on PayTV segment. You can see that on the revenue side we witnessed at 34 percent increase of Broadband, both fixed and mobile revenue, and on PayTV 11 percent growth. The number of subscribers have grown for nine percent in TV, while in Broadband four percent.

I now hand over to our CFO, Dr. Kai Deissner and he'll tell you more about our revenue generation in the first nine months of 2014. Kai.

Kai Deissner: Thank you, Davor. And good morning from my side to everyone as well. Let me first say that I'm really pleased to be speaking to you this morning at my first earnings presentation since joining the Company in August of this year.

If you turn to slide six, you see the contributions to revenue in various parts of our group. Overall revenue declined here, actually, moderate. Consolidated revenues fell 2.2 percent in the nine months of this year, and excluding the consolidation of

Optima, the group revenue would have declined 3.7 percent. As we mentioned earlier already, in the first six months of the year, revenue fell by 5.2 percent, so considerably higher loss.

We got to the separate parts of revenue. Fixed telephony revenue was down 15.5 percent due to general usage trends that we've been seeing for some time. Mobile revenue came under pressure, in particular, from EU roaming rates, cut in termination rates and, of course, competitive flat rate offers. In the nine months of this year, mobile revenue thus fell 2.1 percent. Although, if we consider only the third quarter, this was moderated by a 4.3 percent growth in the third quarter of this year.

In wholesale, we witnessed a negative effect of the Optima consolidation, as we had to deconsolidate revenues from Optima. Secondly, a decline in termination rates and a change in our hubbing business model. On the negative side and on the positive side, higher infrastructure revenues from the various parts of the business.

In IP, revenue was up 1.4 percent, and this is much due to increase in TV revenues that more than compensated for the Broadband revenues. ICT revenue, as already mentioned, continued to show very strong growth up 30.9 percent, mainly in IT infrastructure and professional services for key accounts.

Optima contributed the major part of the increase in what we call Other revenues adding here 113 million kunas through third-party transactions. In total, Optima's net consolidation added 77 million kunas in revenues. This is the positive impact of the 113 already mentioned and a negative impact of 36 million kunas in intercompany transactions, mainly non-voice wholesale revenue. In addition to this, Optima contributed 21 million kunas to the Groups EBITDA.

We now turn to slide seven. We take a closer look at the quarterly revenue performance of this year. The revenue trend clearly improved over the year with Q3 revenues, even adjusted for Optima contribution, almost flat compared with the same period last year. The main contributor to these good results was mobile business, as we've seen, in particular, strong growth in seasonal visitors, mobile data, and the price increase following the new government spectrum fee. Second main contributor was ICT, mainly from project-based contracts, which enjoyed a very strong quarter with revenue on the quarter at 35.5 percent.

On slide eight, you can see that the transformation initiatives we are undertaking have shown some material savings already this year, but, at the same time, impact the group's profitability by increasing costs in some areas this year.

EBITDA before exceptional items declined 7.5 percent, impacted mainly by lower revenues and higher operating expenses. If you take the quarterly numbers on this, then Q1 we saw a decrease of 5.8 percent, in Q2, 13.6 percent and now in Q3 of 2.9 percent. This fallen EBITDA had a negative impact on the profits, which was further made worse by redundancy and other transformation costs. Net profit, thus, fell 25.6 percent to 717 million kuna.

Still cash flow from operations remained largely stable, and CAPEX was lower. That's mainly in the absence of one of real – real estate investments and the shift of some investments in IT and network platform areas throughout the year.

I'll now hand back to Davor who's going to talk you through the transformation initiatives entered during the quarter of this year to ensure that we're in good shape for growth in the coming years. Davor.

Davor Tomašković: Thanks, Kai. On slide nine, we turn to group's transformation initiatives. As you know, these initiatives have been instigated in response to the challenging market conditions in which HT operates for some time now. We expect that these initiatives will result in significant cost savings, and these cost savings are outlined on the slide. And these will be in addition to the savings that we already anticipated in 2014 in our outlook.

So following the signing of contract with Ericsson servisi for the outsourcing of managed services, we're expected to save more than 20 million kuna per year in the period 2015 to 2017. Within the headcount restructuring and the creation of more customer-centric and decision-oriented organization, we're expected to save more than 32 million kuna per year in the same period, 2015 to 2017. The total number of employees reduced in the previous period is 374. By September 30, 224 have already left the company.

On the 1st of July of 2014, we also signed with our social partners the new Collective Agreement, within which we gained more flexibility in organization sizing and aligned the conditions from the Collective Agreement in line with the market. For example,

we reduced severance payments, service bonus and similar payment, and we expect savings in the range of above 8 million kuna per year.

Also, the migration of PSTN lines to full IP remains on track. We have already achieved more than 90 percent of our end of year target, which, actually, reflects the 67 percent of all retail customers being migrated to IP. The overall savings should reach 15 million kunas per year in the coming period.

We now turn to slide 10. I'll take you through the results all of our mobile operations. We broadened and maintained our market share at the level of 46.3 percent. Average minutes of use we see rising, 8.4 percent in this nine months, particularly due to the introduction of flat offers and bundles with higher amount of minutes on both pre and post paid tariffs.

However, the competition has driven down the prices. And, therefore, average blended ARPU is down 5.2 percent. It is also impacted by both economic situation and EU regulated roaming prices, which are introduced in July last year. What we see is the rise in the proportion of Smartphones sold within the postpaid segment increased to 73 percent, compared with 58 percent in the prior year period.

I also would like to note again that the government of Croatia in June this year introduced a threefold increase in radio frequency spectrum fees. And, as a result of that, T-HT has adjusted its mobile service prices.

On the following slide, number 11, we looked at fixed telephony, which shows a continued decline. We see the number of mainlines declining by 6.5 percent compared to the same period last year. We are, obviously, trying to reduce the churn and have been undertaking a number of proactive and reactive prevention offers. We also see the ARPA price declining by 9.2 percent as a result of the general market trends.

During the third quarter we increased our stake in Optima, as we reported earlier, which is now at 19.11 percent of equity that we hold. This takeover and consolidation is based on the agreement we have with Zagrebacka banka. The reasons why we have undertaken this transaction are in line with trying to stabilize the overall telecommunications market in Croatia and prevent any disruptive moves

which could further reduce the market value. And, also, to safeguard our existing receivables and improve the likelihood of their collection.

We will now move to slide 12, where we look in greater detail at our IP services. The total number of Broadband access lines increased by 2.4 percent. We are now at 683,000 lines. Broadband retail ARPA fell by almost one percent.

And, in addition to our promotion of MAX2 and MAX3 packages, we also, as earlier mentioned, introduced super fast internet based on fiber optics and we can, by now, say that this offer has been well received in the market. We also enhanced our exclusive TV content to include now Formula One and HBO premium, helping to lift our TV customer base by 2.6 percent compared to prior year.

If we turn to slide 13, we see a breakdown of revenue in residential market. I'm glad to report that the revenue has remained almost stable. We see a small decline of 1.7 percent, slightly – going slightly below 3 billion kunas in the period of nine months of 2014. The whole decline is mainly influenced by the voice revenue, which has seen a strong decline of 13.1 percent, both fixed and mobile, and, as we earlier discussed, they include EU roaming regulation, cut in termination rates and flat rate tariff offers.

We see an increase of non-voice revenue due to higher fixed IP revenue, largely TV, and as well as higher mobile data revenue. So we also see that now that voice and non-voice revenue are almost at par. Terminal equipment rounding to 60 percent, and this can be mainly attributed to the introduction of split contracts where we recognize the entire handset revenue at the point of sale.

If you look at page 14, we see the performance of business segment in which the revenue decline is still significant, 7.8 percent, but we need to look separately in two segments, in retail and wholesale. The retail revenue is almost stable, but the whole decrease comes from the wholesale revenue. Voice revenue fell sharply, 25.5 percent, both fixed and mobile, and both retail and wholesale. Non-voice revenue fell 4.8 percent. There is a decline in SMS use and lower wholesale revenue.

Also, we see the consolidation of Optima from third quarter, which resulted in the cancelation by the group of revenues received or booked from Optima in the same period last year. Strong growth in ICT revenue helped to soften the impact of the fall in both voice and non-voice revenue.

And on the final slide, 15, I'll discuss our outlook for 2014 in spite of the changes, particularly the government threefold increase in radio frequency spectrum fee and continued macroeconomic situation. We keep our outlook for 2014. There is one modification only – in order to reflect the Optima consolidation, and that is that the revenue decline we estimate at around two percent.

So that means that our EBITDA margin, before exception items, will remain between 39 and 41 percent, and that our CAPEX commitment remains above 1 billion kuna.

Thank you for attention. We are now ready to take any questions.