

The Q4 2014 results conference call

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Presenters

Davor Tomašković

Hrvatski Telekom – President of the Management Board and CEO

Mr. Kai-Ulrich Deissner

Hrvatski Telekom - CFO

Elvis Knežević

Hrvatski Telekom – Investor Relations

Operator: Thank you for standing by and welcome to the HT Full Year Results Conference Call. At this time, all participants are in a listen-only mode. There'll 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 1 on your telephone keypad. I must advise you, this conference is being recorded today, on Thursday, the 12th of February 2015.

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

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 of our business and financial performance for the 12 months ended 31st December, 2014, using presentation slides which I hope you have in front of you.

If not, please visit our Web site 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 Tomaškovic, our CEO, who will outline our company's performance during the 12 months ended 31st of December, 2014.

Davor Tomašković: Good afternoon, ladies and gentlemen. Thank you for joining us today. It's my pleasure to once again present the results from Croatian Telecom, for the 12 months ending 31st December, 2014.

I will start the presentation with slide 4, addressing highlights of the year.

We continue to maintain our market-leading position across all areas of the business, despite that the environment remains very challenging.

We have a new fiber proposition that includes Ultra MAX residential broadband packages and it helped us increase our market competitiveness and mobile data usage trends were up strongly.

We are planning significant investment in fixed and mobile broadband in the forthcoming year in order to maintain our premium provider position. This has been facilitated by recent improvements in the regulatory environment.

We will also continue to implement our transformation initiatives throughout 2015 and this we expect to have a further material impact throughout the current financial year and beyond. But we'll provide you on further details somewhat later in the presentation.

On the financial front, we delivered 2014 in line with our outlook. We slowed the revenue decline to 1.9 percent year-on-year. And if you remember the revenue decline in 2013 compared to 2012 was 6.8 percent.

The improvement largely was due to mobile revenues, which have almost stabilized. Mobile revenues fell only 1.2 percent in '14, compared with over 10 percent; 10.4 percent a year earlier.

Also, the group margin, on an EBITDA before exceptional basis, has remained solid at 40.3 percent, in spite of the worsening environment, the extra transformation costs and changes in the Group's revenue structure.

HT dd proposes the following net profit distribution; 83.1 percent to be reinvested in business development, resulting in additional net profit of 188 million kunas in 2014, with the remaining 17.9 percent to be distributed as retained earnings and legal reserves.

We also propose a dividend of 7 kuna per share, to be paid out of 2009 retained earnings. That is an equivalent of 50.7 percent payout of our net profit in 2014. For 2015, we expect the revenue stabilization and the EBITDA margin before exceptional items to remain at around 40 percent.

If you move to slide 5, it shows that we have delivered full-year results in line with our previously guided outlook, so the revenue, as I already mentioned, declined 1.9 percent, however, the outlook stated around 2 percent.

Our EBITDA margin is 40.3 percent and our outlook stated between 39 and 41. Our capital investments are in the amount of 1.1 billion kuna; we stated that we could be over 1 billion. And with regards to regional expansion, we continue to monitor and evaluate potential M&A opportunities.

You can now turn to slide 7. We see the overview of the Croatian Telecoms market for both fixed and mobile services. They both continue to decline. This is reflected both in the revenue generated, which showed a decline of 17 percent for fixed voice and 18 percent for mobile, and also in the number of subscribers; 6 percent decline in fixed and 10 percent in mobile.

This is at the end of the third quarter; the data that is officially published by the regulator in Croatia.

The trend for usage is different, though, with fixed voice minutes of use falling by 14.6 percent between January and September 2014, while mobile minutes of use increased by 1.2 percent in the same period.

SIM penetration is estimated at 113.2 percent. That's down 2.4 percent, year-on-year. And the IT market is expected to have a modest recover in '14, as a result of new investments funded by the European Union.

If we move to slide 8, we will see that the downward trends in voice are partially offset by growth in both fixed and mobile broadband and pay TV. So, fixed and mobile broadband rose 27 percent in terms of revenue. We're stable in terms of subscribers.

In pay TV, we see the increase, both of – in revenue and in number of subscribers; 11 and 6 percent, respectively. Croatia's fixed broadband household penetration stood at 61 percent in third quarter, which makes about 944,000 lines, which is up 3.1 percent, year-on-year.

The positive trend we've seen in pay TV growth is expected to continue. The household penetration is currently at 47 percent. The revenue's up, as I said, 11 percent and that means that we see subscribers climbing to 730,000 compared to 690,000 a year ago.

So that would complete the overview of the market, and the outlook, I'll hand over to our CFO, Kai-Ulrich Deissner, to present the financial results.

Kai-Ulrich Deissner: Thank you, Davor, and good afternoon from my side as well.

If you turn to page 9, this takes a more detailed look at the breakdown of our revenue in 2014.

The pace of the revenue decline slowed in this last year, revenues falling 1.9 percent to 6.9 billion kunas. That compares to a decline of 6.8 percent in 2013. It was, in particular, mobile growth in the second half of 2014 that helped to stem the rate of decline.

This 1.9 percent decline, just to be marked, includes the results of Optima Telekom, which was consolidated, as you know, as of the 1st of July, 2014. Excluding Optima, the group revenue decline would have been 4 percent.

In this revenue, fixed telephony fell by 15.2 percent, to just over 1.2 billion kunas; continuing the general decline in usage that has been evident for some time and that Davor explained.

Mobile revenue, on the other hand, almost stabilized, down just 1.2 percent in the year and that's due to a strong rise in mobile data and handset revenue, but also

boosted by the price adjustment that we did as of July of last year and that was a response to the increased spectrum fee that the government imposed. Specifically, in the second half of the year, mobile revenue was even up 3.1 percent compared to the second half of 2013.

Wholesale, on the other hand, fell just over 30 percent, impacted by a number of factors, among them lower hubbing traffic and that's due to a change in business model, the negative effect in consolidation of Optima and a regulatory decline in termination rates. This was somehow compensated by higher infrastructure revenues that we saw in the wholesale segment.

In IP, an increase in TV revenues more than compensated the slightly lower broadband revenues. In ICT, we're able to report solid growth, mainly that in specific in ICT solutions for key accounts; cloud and managed service and IT infrastructure and systems solutions. The growth is 13 percent.

Optima, in all of this, contributed 221 million, to other revenues, including the negative consolidation effect on wholesale revenues. The net impact of the Optima consolidation was 149 million.

We now turn to page 10, giving you an overview of the key financial KPIs. We see that we've delivered a very solid, pre-exceptional EBITDA margin of 40.3 percent and that's to be duly noted against the background of a worsening economic environment, the transformation initiatives that we undertook this year, and changes in the revenue structure, which we've just seen.

The decline in EBITDA before exceptionals slowed compared to 2013. It was falling 9.1 percent in 2014, compared to 12.9 percent just a year earlier.

Net profit is down 20.7 percent, to 1.142 billion, was impacted, in particular, by exceptional items, which is mainly redundancy cost due to the transformation, lower net financial results that's mainly due to content capitalization and joint ventures. We saw a positively compensating effect from higher tax benefits.

For net cash flow, we saw improvement in working capital that helped us raise net cash flow by 7.4 percent, to just over 2.2 billion in 2014. And CapEx in that period

was just about a quarter lower in the absence of investments that we made in 2013; in particular, it included Spectrum and one-off real estate investments.

If we now turn to page 11, we look at our mobile results, where we've implemented a very successful, I would say, value strategy with particular focus on data mobile bundles. We've broadly maintained our market shares by subscriber numbers, with data subscriber growth offsetting a decline in prepaid customers.

Prepaid and postpaid subscriber numbers fell 2.2 percent, to 2.252 million at the end of 2014, compared with the year earlier, in part because of strong competition, but also because fewer customers now use dual SIM cards with the rise of flat rates.

Data subscribers, however, grew 8.1 percent in the same period, to just over 1.4 million. Blended ARPU in 2014 fell 4.3 percent, to 79 kunas per month, impacted by a very competitive market, the overall economic situation and E.U. regulations on roaming prices, which continue to impact ARPU. Blended non-voice ARPU, in line with our data strategy, rose 8.8 percent, 33 kuna per month.

Flat offers on the market and bundles with high volumes of minutes helped us push up minutes of usage, average customer, by 8.2 percent in 2014. During that year, the proportion of total handset sales that were smart phones, thus supporting data also increased to 73 percent in the postpaid segment, up from 60 percent last year.

To be duly noted, we've previously highlighted that the government of Croatia imposed a threefold increase in radio frequency spectrum fees in May and we thus adjusted the mobile service prices accordingly.

On page 12, we look to the fixed line business, which showed a continuing decline, but we've taken steps to stabilize this market, in particular through assuming control over Optima. The total number of fixed line access mainlines at the end of 2014 was 6.9 percent lower than the same time in the previous year, reflecting the continued shift of customers from fixed services to mobile services in our market and to IP. Fixed line ARPA decreased 8.9 percent as a result of these general market trends.

As we have first reported in Q3, we increased our stakes in Optima Telekom, to just under 20 percent. The objectives of this overall transaction were to prevent

disruptive moves on this market for fixed telecoms, as well as to safeguard our receivables, which we had with Optima.

If we now turn to slide 13, we can see that while fixed telephony continued to decline, the numbers for broadband and for TV were rising and HT is leading the way in conversion offers and in content. The number of broadband access lines grew 2.6 percent by the end of the year, compared to the year earlier, while TV customers also increased 0.7 percent, to 393,000 in that same period.

As Davor Tomašković said, we've introduced a new MAXtv package, called Pickbox. It contains more than 70 hit series and 300 movies to complement premium content, exclusive TV content, which may have an offer and which helped drive ARPU up for TV by 6.6 percent.

At the same time, still broadband ARPA fell 0.7 percent, to 126 kunas. This was, in particular, due to residential customers who migrated to flat packages and to bundles. To mitigate this decline, we've been promoting our MAX2 and MAX3 packages, attractive tablet offers as an incentive.

It should be noted that we're leading the way in IP transformation, with just over three-quarters of our retail customers now migrated to IP-based services by the end of last year.

If we go to slide 14 now, we can see a breakdown of our revenues in the residential segment. Residential revenues declined 1.3 percent, to just under 4 billion kunas, so virtually stable, mainly as a result of lower voice revenues, which fell just under 12 percent in both fixed and mobile.

The trends previously discussed, including E.U. roaming, a cut in termination rates and flat-rate tariff offers were driving this. This decline in voice revenues was partially offset by a 3.3 percent increase in non-voice revenues, largely boosted by TV and mobile data.

Terminal equipment increased just over 50 percent. This can be mainly explained by the introduction of split contracts, where the entire handset revenue is recognized at the moment of sale. Miscellaneous revenues rose 107.8 percent, largely as the

result of this spectrum fee, which we are reporting here and which we've passed on to customers.

Finally, on slide 15, we are moving on to the business segment, where you see an overall 10 percent decline, which is largely due to the wholesale revenues, which fell 30.7 percent in the last year. Voice revenues in all of this fell 26.4 percent in both fixed and mobile and in both retail and wholesale.

Non-voice revenues also fell, by 6.7 percent. This reflects lower fixed revenue, mobile revenue, in particular from a decline in SMS usage and wholesale revenues. This latter can be explained by regulated prices, the already quoted change in the business model for hubbing, and the consolidation effect of Optima from the third quarter onwards.

Non-voice revenues exceeded revenues in 2014 and we saw strong growth in ICT in this segment.

I will now hand back to Davor Tomašković to talk you through our outlook.

Davor Tomašković: Thanks, Kai. Please turn to slide number 17 to consider HT's outlook for the forthcoming year.

We have a clear strategy to maintain strong profitability and our focus in 2015 will be on our customers and on the investments in our network. Over the midterm, our strategic direction includes enhancing value from the market, leveraging our substantial infrastructure and further strict cost management.

To this end, we have built a solid foundation in the year just passed; delivering on our 2014 outlook, initiating a transformation and setting clear strategic priorities for the coming years.

In 2015, we will focus on customers and the network by delivering a superior customer experience, enhancing value to further transformation, and exploiting specific pocket and opportunities for growth, besides investing in our network.

On slide 18, you see opportunities and threats that arose from our environment. We plan to leverage the key opportunities; also the environment remains pretty challenging. The opportunities include an increasing demand for bundled offers and

the development of fixed mobile converged services, which are available across platforms and devices.

We also see opportunities in the increasing demand for cloud services, especially from business customers, as well as the increasing portfolio of services offered by telecom operators, such as mobile or e-payments and mobile help. Also we believe that enhanced telecom infrastructure across Croatia will create opportunities for us.

However, there are certain risks that are inherent in the market, not least that the economy is still in a recession and it is believed GDP growth is expected in 2014 to be at negative 0.7 and the registered unemployment rate remains at yearly average of almost 21 percent.

Regulation, both at national and the E.U. level remains a potential threat to growth, as there is the potential for further value distortion in the market. Obviously, at the same time, we see the increasing trend for over-the-top services, but also the competitive threat from rival services may pose a risk.

Please turn now to slide 19. The changing landscape of the telecommunications industry has prompted several years of top-line decline. But HT aims to change that trend by maintaining about average margins. As you can see, growth rates for last couple of years varied in the range of roughly between minus-3 and minus-7 percent, while in 2014, we reported a recent record low of minus-1.9 percent.

The outlook for revenue in 2015 is stable, halting, therefore, five years of declines, through both positive development in core telecom and growth areas, as well as Optima consolidation for a full-year effect. EBITDA margins are also expected to remain stable, thanks mainly to the transformation initiatives at a Group level.

On slide 20, you can see our three major areas of focus this year and beyond. First is to enhance value through further transformation. All the activities we initiated in early '14 showed tangible impact that same year and the full impact we will see in this year.

At the same time, our midterm transformation called Horizont has been launched and includes additional measures to protect profitability.

Secondly, we see growth in five major growth areas that should help us stabilize top line and maintain overall market share. Those are mobile data, fixed broadband, TV, online consumer services and ICT.

Finally, we intend to exploit our infrastructure advantage, to do this we will adopt a network strategy that accelerates the rollout of both fixed and mobile broadband in 2015, by increasing CapEx by 26 percent in 2015.

If you now turn to slide 21, you'll see the impact of our transformation efforts in 2015 and beyond. The initiative that have already completed in 2014 that include outsourcing, headcount restructuring, collective agreement are expected to impact annual EBITDA in the period 15 to 17, by more than 60 million kunas.

These breaks down as over 20 million from outsourcing, 32 million from headcount restructuring, and about 8 million from the collective agreement renegotiation.

Our indirect OpEx continues in '15 and is expected to impact EBITDA by over 25 in the OpEx initiative. It is expected to impact EBITDA by over 25 million in the period of '15 to '17.

As just mentioned earlier, we launched a new group-wide Operational Excellence program called Horizont in the fourth quarter of 2014. And this aims to create significant savings in indirect operating expense.

We also expect to complete IP migration initiative by the end of this year. And we believe that other initiatives that are now on the way will start to deliver results from the second quarter of 2015.

Slide 22 explains how investments in fixed and mobile broadband will enhance the long-term position of HT and enable us to maintain our high market shares. We plan, as I mentioned, to significantly increase CapEx by 26 percent, to 1.35 billion kuna. The bulk of this investment will be dedicated to fixed and mobile broadband. That would also help Croatia fulfill its Europe 2020 Digital Agenda and help Croatian Telecom to maintain its position in the market.

By the end of 2015, we plan to achieve household coverage by next generation access, where fixed broadband speeds are about 30 megabits per second, up around 50 percent and 4G coverage, indoors, of around 60 percent of the population.

This 4G coverage will enable user-dialing speeds of up to a maximum 150 megabits per second. This is twice as much as we have currently where we have 75 megabits per second. And therefore, our current overall strong market position in all segments is expected to remain stable.

Finally, on slide 23, I would like to reiterate our 2015 outlook. In 2014, our revenue of 6.9 billion kuna is expected to remain stable in 2015. We achieved in '14 pre-exceptional EBITDA margins of 40.3 percent and the outlook for 2015 is a similar margin of around 40 percent. We spent 1.073 billion kuna in CapEx in 2014 and will increase significantly this investment to about 1.35 billion in this year.

As in previous years, we are monitoring and evaluating potential M&A opportunities and, depending on those opportunities, we may decide to act.

That will be all from us. Thank you for your attention. And we're now ready to take any questions you might have.