

The Q2 2013 results conference call

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Presenters

Ivica Mudrinic

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Operator

Thank you for standing by and welcome to the T-HT H1 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 (operator instructions). I must advise you that today's conference is being recorded today, Friday 26th July 2013. I would now like to hand the conference over to your first speaker for today, Erika Kaspar. Please go ahead.

Erika Kaspar

Thank you. Ladies and gentlemen, good afternoon and welcome from Zagreb. Today our CEO Mr Ivica Mudrinic, who is dialling in remotely, and CFO Mr Dino Dogan, who is here in Zagreb, will talk you through the highlights of our business and financial performance for the six months ended 30th June this year, using the presentation slides which I hope you have in front of you and, 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 Mudrinic and Mr Dogan will also 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 now to introduce you to Mr Ivica Mudrinic, our CEO, who will outline our company's

performance during the first months of this year.

Ivica Mudrinic

Thank you Erika. Ladies and gentlemen, good afternoon and thank you for joining us today. Let me start the presentation on slide 3. On this slide we take a look at the developments in Croatia's business environment and give an update on the Croatian economy and its outlook since we reported our Q1 earnings in April.

As we have reported during previous presentations, the Croatian economy remains depressed and it is now well into our fifth consecutive year of no real GDP growth. In 2012 GDP showed a 2% decline and whilst growth is not yet expected in 2013, current estimates are for the decline to slow to 1% in 2013. Earlier this year, in February, Croatia's credit rating was downgraded by rating agency Moody's, following a similar downgrade by S&P at the end of 2012. These ratings remain in place for the time-being in the absence of any major positive or negative signs that would trigger an update.

Inflation at the end of June was 2%, lower than the 3.7% reported at the end of March of this year, as the impact of the VAT increase in 2012 has worked its way through; nevertheless, disposable income continues to fall in 2013 as a result of the economic recession.

Unemployment is at 18.6%, down from the 21.6% recorded at the end of March, due to seasonal factors, but higher than the 17.3% recorded in June 2012. On a more positive note, the tourist season has started well this year, with tourist arrivals in January to June up 5% at 3.6 million.

In terms of the prospects for our economy, the government has announced plans for privatisation and the monetisation of highways, but we still await a meaningful structural reform that would put our economy back on a strong footing and lay the foundation for future growth. On July 1st Croatia joined the EU and this should bring access to EU funding opportunities and foreign direct investment. On the back of these opportunities Croatia's GDP is expected to show some degree of growth over the medium term, with forecasts for 0.7% growth in 2014.

Moving on to slide 4, a quick overview of the Telecom and ICT market in Croatia, in the Fixed Voice market there are 9 licensed operators acting on the Croatian market, including operators providing fixed line services over VoIP. The ongoing trend in the global telecom sector is that dwindling demand for Voice services continues, with minutes of use down 20.7% in Q1 2013. Croatia's Fixed Line market has been subject to liberalisation since 2005, with current services of wholesale line rental, naked bitstream, carrier preselection and local loop unbundling.

Unfortunately some fixed line competitors face financial difficulties and have entered the pre-bankruptcy settlement process.

As reported in early July 2013, T-HT filed a notification to the Croatian competition agency, AZTN, based on the proposal of financial and operational restructuring of Optima Telecom within its pre-bankruptcy settlement process as one of OT's largest creditors. In mobile operations there are three operators in the market operating under 7 brands and mobile penetration now stands at 118% and that is down 1% year-on-year, mainly as the number of customers with SIM cards continues to fall amid the increased availability of competitive offers.

Mobile usage continues to increase and rose 22.6% in the first three months of this year. Revenue continues to decline, however, amid pricing pressure in an increasingly competitive market. However, we are experiencing growth in demand for mobile broadband which is being bolstered by a further rise in smartphone penetration. The proportion of the Group's customers using smartphones now stands at 27% against 45% penetration overall in Western Europe. We are very hopeful of seeing further growth here.

Growth in the number of mobile broadband users in Croatia has been driven further by the commercial launch of the LTE Mobile Network by the two mobile operators in 2012. T-HT launched its LTE network over a year ago in March 2012 and continues to expand its 4G coverage across the entire country. As we have reported, the 6% fee imposed on revenues for mobile services were finally abolished at the beginning of July 2012. The impact of the 6% tax in H1 2012 was 56 million and just to remind you it was applicable from January 26th 2012 to July 9th 2012.

Fixed broadband rose with the number of broadband lines rising to 901,000 at the end of March, up 3.6% year-on-year. Fixed line broadband household penetration stands at 49% in Croatia against 73% in Western Europe, providing substantial potential for further growth in the coming months and years.

In Croatia PayTV continues on the growth trend seen for several years. PayTV customers rose again to 643,000 at the end of March 2013, an increase of 5.8% over the previous year. Household penetration of PayTV is now at 42% of households in Croatia, against penetration in Western Europe of 55%, so we can reasonably expect further growth in this market as well. Regulation was extended to the IPTV market in 2012, making Croatia the only country in Europe with a regulated PayTV market.

In the IT market the continuation of tough economic conditions led to a 4.6% decline in Croatia's IT services market which was valued in US\$ terms at 356 million in 2012. The economic downturn continues to exert downward pressure on the market in 2013. On the positive side the Croatian business community continues to embrace the Cloud as a concept that can boost efficiency and we have been actively developing a range of Cloud-based services to suit the needs of our business customers. Croatia now has full EU membership and in the future we expect to maximise our leading position in the ICT services market to ensure we benefit from the expected pipeline of significant IT projects.

Turning now to slide 5, giving you an overview of the Group's highlights, I should like to take you through the Group's performance in H1 2013. As we've explained in our Earnings Report released this morning, the adverse economic climate shows no improvement. At the same time we continued to operate in a highly competitive market and face a range of regulatory and operating challenges. As a result, the Group has posted a fall in revenues for the first half of this year.

Revenues were down 5.9% in the first half of 2013, to HRK 3,435 million and EBITDA before exceptionals was down 14.2% to HRK 1,422 million with the margin at 41.4%, down from the 45.4% in the first half of 2012. Following redundancy costs of 60 million booked in the first half of 2013 versus zero costs booked in H1 2012, EBITDA decreased 17.8% to HRK 1,362 million. The EBITDA margin has also slipped to 39.7%. Fixed revenue and EBITDA performance slightly offset by lower depreciation and amortisation has resulted in a 29.4% fall in net profit to HRK 570 million.

Capex in the first half of 2013 was significantly higher than in the first half of 2012 and Dino will explain this in more detail shortly. That said, the domestic regulatory framework remains a disincentive to meaningful investment in the fiber infrastructure. We strongly believe a robust fiber infrastructure supporting mass market broadband services can and will play a major role in kick-starting the economy of Croatia during these times of prolonged recession.

The Group proposed and approved a dividend of HRK 20.51 per share for a payout ratio equalling 100%. This was paid out to our shareholders on 8th July 2013. Despite the challenging economic environment, we have maintained our market leadership position by putting our customers at the very heart of everything we do. We have continued to promote a range of 4G mobile internet tariffs with our customers; the largest 4G coverage in the country. We also continued to see growth in our PayTV subscriber base, given the attractive programming and subscription packages we offer.

In addition to the innovative TeraStream project which remains on track, we have continued with our transformation initiatives. We have put considerable effort into our IP transformation program. Our aim is to have a simplified, standardised and more efficient network which will facilitate the introduction of new IP oriented and fixed mobile convergence services. At the end of the first half of 2013, 32% of our retail customer base had migrated onto all IP and we also closed the first exchange following the migration of all of its customers to all IP-based voice delivery platforms.

The Group also continues with various efficiency initiatives. Headcount is down 1.9%, at 5,609 employees, reflecting some new hires as part of the business transformation initiatives under way. EU roaming regulation came into effect as of 1 July 2013, on the occasion of Croatia's entry to the EU. At the same time Croatia entered into a strategic partnership with Telekom Slovenija to provide a special offer during the summer months. Under the offer T-HT customers travelling in Slovenija can access the high-quality network of Telekom Slovenija while Telekom Slovenija customers in Croatia can access T-HT's infrastructure at very favourable rates.

On slide 6 you can see the development of the revenue comparison year-on-year and, with the continued recession and challenging regulatory framework in a highly-competitive market, revenues were down 5.9% in the first half of 2013, at HRK 3,435 million. In the fixed line business revenues fell 12.1% during the 6-month period but this decline was at a slower rate than reported in 2012. In addition, T-HT maintained its leading position in the fixed line market, reflecting the Group's continuing dedication to quality services and flexible offers.

Mobile revenues fell 6.4% and wholesale revenues fell 12.9%. The Group saw a continued growth in IP revenue, whilst ICT revenue rose notably, up 13.4% on demand for the Group's customised solutions. T-HT's ICT Combis reported revenues of HRK 153 million, up from 151 million in the first half of 2012. Combis has successfully delivered value-add customised ICT solutions and more than 1,300 companies and about 9,000 end users now use T-HT's Cloud services.

Moving on to slide 7, we show you a brief overview of the mobile part of the business. It covers both the residential and business segments as a whole. The Group's market share rose marginally to 46.6% against 46.4% the previous year, with the number of mobile subscribers down just 1.2% at 2.35 million customers. Again, there has been an increase in data customers, however, and this figure rose 17% to 1.248 million year-on-year. Minutes of usage per average subscriber per month rose 24.8% to 171 minutes, but monthly ARPU fell 6.3%; however, blended

non-voice ARPU again rose and was 13.3% higher as a result of growing demand for mobile data services.

Across the Group mobile revenue was down 6.4% during the half year, as outlined in the previous slide. Smartphones such as Apple's iPhone as a proportion of total handsets sold by T-HT accounted for 56% of all handset sales in the postpaid segment in the first half of 2013. Customer demand for smartphones, laptops and tablets remains buoyant and this is driving clearly demand for mobile broadband services. T-HT's smartphone penetration is now at 27%, compared to the overall figure of 45% in Western Europe and, consequently, we expect further increases in demand for data services during the remainder of this year.

We have been bringing innovative and attractive packages to market, to further encourage our customers to subscribe to services such as multimedia packages including Deezer music streaming, MAXtv To Go and content storage, launched during the first half of 2013. Mobile operations were also hit by lower termination rates that came into force at the start of this year and fell further at the beginning of July, as Croatia entered the EU, in order to bring Croatia into line with the remainder of the European Union.

On slide 8 we have an overview of the Fixed Telephony operations for the first half of 2013. In the first 6 months of this year the total number of retail and wholesale mainlines fell 4.5% from the previous year, in line with trends across the global telecom industry, due to the continued shift from fixed line services to mobile and IP. Total traffic was 17.1% lower at 1,053 million minutes in the first half of 2013, with ARPA falling 10.1% to HRK 106. Our win back campaign has yielded good results and we have regained fixed line customers from our competitors, with wholesale line rental numbers falling from 132,000 down to 108,000.

On slide 9 is a brief overview of the IP services. The total number of broadband access lines retail and wholesale rose 1.9% to 665,000. Broadband retail ARPA was 2.3% higher, at HRK 127, as the number of customers with higher traffic packages rose. The Group's PayTV subscriber base is still increasing and rose 8% in the first half of 2013 over the previous year, to 374,000. We're offering a range of special deals and packages and provide much sport content including the Croatia Football League, the Championship League and European League. We'll continue to enhance our offering during the year.

We have also introduced the MaxADSL 'double-speed' offer in the residential segment and in the business segment we have launched Poslovni Ultra packages based on FttH targeting business customers. In the first half of 2013 we made further progress with migrating our customer base

onto the IP network and we have migrated 32% of retail customers on this network by the end of June 2013.

Now I would like to hand over to Dino Dogan, my colleague and CFO of Croatian Telekom, to take you through the performance of the specific business areas in the next few slides.

Dino Dogan

Thank you Ivica. Ladies and gentlemen, good afternoon from my side as well. I will turn to slide 10 which describes the residential segment. The revenue in this segment fell 3.1% in the first half of 2013. This was due primarily to an 8.3% fall in Voice revenue in both the Fixed and Mobile markets, which is a result of the difficult economic conditions and tough competitive environment, and unfortunately further regulatory tightening. However, growth continued during the year in the Fixed IP business, including Broadband and TV, along with Mobile Data revenue and Residential Non-Voice revenue rose 5.1% in the first half of 2013.

Our Terminal Equipment revenue was also higher, which is due to lower mobile handset subsidies and the extension of 2012 promotional activities in the Fixed Line market. The corresponding division's contribution to EBITDA fell 5.9% to 1,325 million. The MAXtv Satellite service recorded almost 83% uplift in subscribers to 31,000 customers. After the first half of 2013 T-HT was delighted to receive recognition of the quality services it provides from T-HT customers; QUDAL Research published in May awarded T-HT with gold medal as the best quality provider in 11 different categories.

Slide 11 gives you an outline of the performance of the business segment. Revenue in this segment was 9.3% lower, at 1,469 million in the first half of 2013. Voice revenue in the first half of 2013 fell 20.2% to a total of 623 million. Non-voice revenue fell 0.4% to 543 million in the second half of 2013, with lower fixed traditional data and wholesale revenues almost offset by revenue growth in mobile data and in visitor revenue.

Other services revenue was up 2.9% with a 13.4% rise in our ICT revenues, offset by lower postpaid subscription revenues after changes to mobile tariff structures. The entire business segment contribution to EBITDA was down 18.3% to 822 million. We are continuing to develop and evolve our Cloud-based services to assist our customers, especially our business customers as demand grows, for products that assist in achieving greater efficiencies and we have launched a new mobile tariff portfolio.

I will conclude by outlining our financial highlights on slide 12 for the first half of 2013, ended June 30th. Group revenue was down 5.9% as the lengthy recession we are still experiencing has continued again into 2013, amid a difficult regulatory framework and intense competition in our market. Against this backdrop, EBITDA before exceptional items fell 14.2% to 1,422 million, and EBITDA margin slipped to 41.4% from 45.4% in the previous year. Following redundancy costs of 60 million booked in the first half of 2013 versus zero cost booked in the first half year of 2012, our EBITDA fell 17.8% to 1,362 million, while the margin was also lower at 39.7% from 45.4% in the first half of 2013.

Net profit for the first half of 2013 was down 29.4% at 570 million and the net profit margin was 16.6%. Our Capex rose 64.9% to 612 million. Capex in the first half of 2013 was significantly higher than in the first half of 2012 and this was primarily as a result of the capitalisation of content provider costs, along with higher investments in IT; the refurbishment of a building for call centre reallocation and the refurbishment of the building to house the new data centre. Rising Capex was also due to ongoing strategic projects; the PSTN migration and mobile broadband development that had been rescheduled in the first half of 2012. Our net cash flow from operations was 7.9% lower at 1,073 million, owing to the fall in the net profit.

That concludes our overview of the Group's results for the first half of 2013. The challenging conditions in which we have been operating for some years still persist, but we have nevertheless managed to deliver a stable set of numbers, whilst maintaining our market leadership. We will definitely continue to focus on developing new products and innovative services as our strategy of transformation progresses. We continue to remain in the vanguard of technological development, to enable us to offer unparalleled service to our customers and maintain our leading market share across all areas of business.

I will now hand you back to our CEO, Ivica Mudrinic, who will talk you through our outlook for the remainder of 2013.

Ivica Mudrinic

Thank you, Dino. While we'll carefully monitor the Group's performance in our important Q3, we have maintained our outlook for the year 2013 despite earlier explained very challenging environment. On the revenue front last year brought no recovery in the national economy. The recession persisted with the GDP change of minus 2% in 2012 and minus 1, or a contraction of 1% forecast for 2013. Unemployment and business payment arrears remained at high levels.

Public debt increased and industrial production declined further. Telecommunications pending in the residential and corporate sector have also tightened.

Competitive pressure and a stringent regulatory regime continued to exert pressure on the Group's business, whilst Croatia's entry into the EU on 1st July 2013 is expected to have an additional negative impact on revenue. In light of this tough economic environment, the Group's revenue will decline further in 2013. However, we expect our efforts to capitalise in certain areas of growth will help to slow down the decline in Group revenues seen last year's EBITDA before exceptional items. The economic environment and revenue trends outlined above will impact EBITDA accordingly; however, the EBITDA margin for 2013 is anticipated to remain robust at between 43 and 45%, supported by continuing cost management initiatives.

On the Capex issue, T-HT will focus its investment in 2013 on new service concepts; IP transformation and the development of mobile broadband, whilst the regulatory framework for planned fiber investments remains unfavourable. Excluding investment in the spectrum licence in 2012, Capex in 2013 is expected to be higher than the previous year. We also, on the regional expansion side, continue to monitor and evaluate expansion opportunities to increase shareholder value.

This concludes the presentation and now I'll hand it to Erika and the moderator to help us with Q&A.
