



Final Transcript

BELTONE SECURITIES BROKERAGE: Telecom Egypt Q3 2018 Results

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SPEAKERS

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PRESENTATION

Moderator Ladies and gentlemen, we would like to thank you for standing by. Welcome to the Telecom Egypt Q3 2018 Results Teleconference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session with instructions being given at that time. [Operator instructions]. As a reminder, today's call will be recorded.

I would now like to turn the conference over to our host and facilitator, Mr. Ahmed Adel. Please go ahead.

A. Adel Thank you. Good morning and good afternoon, everyone. This is Ahmed Adel from Beltone Financial. I would like to welcome you all to Telecom Egypt's Q3 2018 Results Conference Call. From Telecom Egypt, we have with us Mr. Ahmed El Beheiry, Managing Director and CEO, Mr. Mohamed Shamroukh, CFO and Mr. Wael Hanafy, Director of Financial Affairs. As usual, we will start the call with the highlights of the year followed by a Q&A session. Thank you. Wael, please start.

W. Hanafy

Thank you, Ahmed and thanks to Beltone Financial for hosting this quarter's conference call. Good afternoon and welcome to our Q3 2018 earnings' call. We will start the call with a briefing of the operational performance in the quarter presented by our CEO, Mr. Ahmed El Beheiry, followed by the key financial performance trends presented by Mr. Mohamed Shamroukh, our CFO. Kindly note that the presentation is available on our IR website under the quarterly results section of the financial information tab on ir.te.eg.

Without further delay, I would like to draw your attention to our safe harbor statement. We may make some forward-looking statements in the course of this conference call. These statements will be based on the information available to us as of today and you should, therefore, not assume in the future that we continue to hold these views. We do not commit to notify you if our views change. We refer to our public filings for some factors that may cause forward-looking statements to differ from actual future events or results.

I will now hand over the call to Mr. Ahmed El Beheiry.

A. El Beheiry

Thank you, Wael. Good morning and good afternoon everyone. Thank you for joining our call today. I am pleased to announce that Telecom Egypt's results of Q3 2018 clearly show our strong growth momentum. The strength of our operational performance is evident in our results and demonstrates our exceptional execution ability. It also displays our strategic planning that pushed us to take advantage of opportunities that well preserve our strong position globally. I would like to highlight that, over the last year, we have strategically evaluated the opportunities that Telecom Egypt has in the market and its strength and we have worked to capitalize on such opportunities across all segments.

We have completed three projects in this quarter that are fundamental to our business: The first is the launch of the one-bill offering under the name 'Indigo Plus' bundling fixed broadband, fixed voice and mobile, becoming the first truly integrated operator in a year from the introduction of "WE" to the market. We have also concluded the deal with Bharti Airtel, which is a manifestation of our planning and execution ability of buying an asset and bundling it with existing assets to create immediate returns. Additionally, we have connected 2,550 schools with fiber and received a material initial revenue related to infrastructure.

Now, let us move to the key highlights of the quarter. I will be referring to and walking you through our Q3 2018 investor's presentation.

Starting with slide 3, summarizing our 9M results:

Consolidated revenues of 9M 2018 landed at EGP 17.4bn, showing a strong growth rate of 32% year-over-year, mainly driven by data services, which continue to lead the overall revenue growth, along with the contribution of mobile. We have also recognized more than EGP 2bn from the aforementioned projects.

Our customer base grew across all segments as follows: fixed voice grew 10% year-over-year, fixed data grew 29% year-over-year and mobile closed at 3.6mn, achieving about 300 thousand net additions in the third quarter, despite the levies imposed on new SIM Cards in July 2018.

EBITDA came in at EGP 5.3bn, growing 36% year-over-year, recording a margin of 31%, beating our guidance thanks to our high margin revenue as well as our cost efficiency that offset the hike in advertising expenses. Operating profits grew 37% year-over-year, outpacing the 49% hike in depreciation and amortization year-over-year. We have also managed to reverse the H1 decline in net profit of 18%, mainly fueled by pressure from Vodafone's investment income and higher interest expense, achieving a stable net profit year-over-year.

Please move on to slide 4, highlighting our Q3 results:

Revenue grew 65% year-over-year to EGP 7.2bn, boosting our P&L with net profit landing at EGP 1.4bn, which is an increase of 50% year-over-year. The main driver that affected our Q3 performance was solid growth in data revenue, driving our strong operational performance. EBITDA increased 78% year-over-year, with a margin of 28% on cost efficiency and the revision of the national roaming agreement, which offset the seasonal increase in advertising expenses.

Moving on to slide 5, which gives more flavor on the Bharti deal and the schools' connectivity project:

These projects were part of our long-term strategy, we have started talking about the MENA Cable transaction in March and I am sure you are all familiar now with the details. The schools' project, on the other hand, is also part of our ongoing business of expanding our fiber network, similar to many other projects we have recognized before in the new urban communities. We do not regard this as a one-off given that it was

mentioned in earlier conference calls as our normal course of business. The recognition of the projects, however, is what makes its revenue volatile from a quarter to another. What these two projects have in common is that, while we recognize a chunk at completion, we also continue to benefit from recurring revenues. For Bharti, this is maintenance revenue and for the schools' project, it is broadband subscriptions revenue.

I will now hand over the call to Mr. Mohamed Shamroukh, our CFO, to walk you through the main financial highlights of the quarter.

M. Shamroukh

Thank you, Mr. CEO. Good morning and good afternoon, everyone. I will now focus on our key financial highlights.

Starting with slide 8, revenue by business unit in the 9M of 2018: Retail revenue in 9M 2018 grew 43% year-over-year, making up 59% of total revenue growth. The growth in Home & Consumer revenue amounted to 46% year-over-year, owing to the rise in data services revenue, which contributed almost one-third of the growth.

Mobile revenue continues to grow, contributing a low single digit to the total revenue and a high single digit to the retail revenue. On the wholesale side, revenue grew thanks to the rise in IC&N revenue resulting from the deal with Bharti Airtel, which contributed EGP1.6bn. Excluding the aforementioned would record a total segment growth of 2% year-over-year as the increase in domestic wholesale revenue neutralizes the decrease in ICA revenue.

Now, moving to slide number 10 and highlighting the main P&L indicators for Q3:

Starting with the costs, we continue to monitor and control our major costs. Call costs remain stable in the quarter even though our mobile revenue increased, which clearly indicates the favorable revision of the national roaming agreement with Etisalat. Employee costs control continues with the costs representing 22% of normalized revenue. EBITDA in the quarter reached EGP 2bn growing 78% year-over-year, dialing a margin of 28% with high margin revenue and efficient cost control, offsetting the seasonally higher advertising cost.

Mobile license amortization and higher Capex investments led to a 46% increase year-over-year in depreciation & amortization cost. This,

however, was fully absorbed as our operating profit grew 119% year-over-year.

Vodafone investment income contributed positively to TE's bottom line with a 13% YoY growth. As for the net interest expense, it grew year-over-year as interest expense related to the borrowing obtained to pay the mobile license was capitalized prior to September 2017. On a quarter-over-quarter basis, interest expense declined due to the efficient conversion of debt to USD with the effective interest rate almost halved reaching 7% down from 13%, its peak being in Q4 2017.

Net profit stood at EGP 1.4bn, growing 50% year-over-year, driven by strong operational growth, offsetting the increase in interest and financing expenses.

Slide 11, Shows the YoY variance & analysis for 9M 2018 operating profit, and same for Slide12 which shows the main drivers behind the 119% YoY growth in Q3 2018 operating profit.

Slide 13, demonstrates our cash flow performance:

I would like here to highlight our operating cash flow performance, which would have stood at EGP 2.7bn if it were not for the one-off settlement fee we paid to Etisalat at the beginning of the year and the settlement of the long-term liabilities on MENA Cable, which were part of the USD 90mn purchase price. Normalizing both net cash from operating activities would have reached EGP 2,665mn as of 9M 2018 instead of EGP 961mn.

Slide 14 shows our net debt position:

Net debt grew to EGP 12.5bn by the end of 9M 2018, representing a net debt to EBITDA of 1.8x (based on an annualized EBITDA). We note, again, that our effective interest rate has declined to 8.3% in the 9 months, which is a great achievement considering the Egyptian lending rate. We have carried out a debt restructure by taking out a USD 500mn medium-term loan to support our capital and operational expenditure and refinance existing short-term facilities; this has not been reflected in Q3 yet. The increase in our debt level in this quarter was still financed through short-term facilities.

It is also important to note that we have received the cash from the Bharti deal in the first week of October and as such, our net debt has fallen to EGP 10.8bn and our net debt/ EBITDA to 1.6x compared to 1.8x at the end of Q3.

Finally, slide 15 recaps the results versus our guidance:

We have beaten our guidance across all KPIs so far and we are likely to continue to beat it in the full year given our 9M performance. It is important to note, however, that Q4 profitability is traditionally lower.

I will now hand the call back to the operator to open the floor for questions. Operator, please go ahead.

Moderator Ladies and gentlemen, we will now begin the question and answer session of today's conference call. [Operator instructions]. One moment, please.

A. Adel I have a question from my side here, if I may. This is Ahmed Adel from Beltone. I would like to ask the management about their plan for distributing dividends because, last year, the dividends were cut because of the acquisition of MENA Cable. However, this year, there are significant returns so what is the plan or what is the policy for dividends in 2018?

I would also like to get an update on the rollout plan for the fiber optics cables. What is the percentage of completion and the expected time to conclude this project? Thank you.

A. El Beheiry The strategy of our dividends will be discussed in the coming period but we do intend to distribute dividends this year keeping our long-standing dividend policy. The scale of distribution is still undetermined but I think, in the next quarter's conference call, we will definitely have more details to share with you.

The second part of the question was about the schools' project, but I did not hear the question. May you repeat it, please?

A. Adel Yes, I just wanted to get an update on the plan for rolling out the fiber optics cables. What is the percentage of completion and the expected time to conclude the project?

M. Shamroukh I will take care of this question. Ahmed, we actually upgraded 67% of our legacy network, which was made of copper, and replaced it with fiber. If you remember correctly, we put a 10-year plan that ends in 2024. We

might speed up this project and finalize it in 2 years but for now, we are still committed to our initial plan.

A. Adel Thank you very much.

Moderator [Operator instructions]. There are no questions from the phone lines at this time. My apologies. We just had a line queue up from Omar Maher of EFG. Please go ahead.

O. Maher Thank you. Good afternoon, gentlemen. I just have a question about the Vodafone stake. I think that the material you provided effectively covered your Q3 results, but I was hoping you could clarify the trends on what is happening—

A. El Beheiry I'm sorry—may you repeat the question? The line is extremely bad. We cannot hear you well.

O. Maher My question is about the Vodafone stake. I was saying that the explanation of the material that you provided covered everything within the results and is quite clear. Thank you for that. However, on Vodafone, I was hoping you could elaborate on what is currently taking place, like the trends in the market, maybe. Also judging by what's happening on the domestic wholesale side, obviously a big part of that business is coming from the mobile operators as well. I know that, from previous calls, you said that you cannot really comment on this but it would be helpful if you could provide any information.

M. Shamroukh If I understood your question correctly, Omar, you are referring to the decline in profit from Vodafone, am I correct?

O. Maher I am actually seeing an increase in profit from Vodafone, if I am not mistaken.

M. Shamroukh Yes, however, the overall decline was larger than what we had anticipated in our guidance.

O. Maher I think, from Vodafone, you received almost EGP 680mn this quarter, which is approximately 14% or 15% higher than last year and last quarter at the same time.

M. Shamroukh Yes.

- O. Maher I was hoping you could help us understand if there is a significant growth in that business. We do not have a lot of visibility on the Egyptian operation specifically, so if you could provide some information and help us understand it, that would be great.
- M. Shamroukh I am not entitled to give guidance about Vodafone's performance in general but again, they are doing well in terms of retail revenues, they are growing every year. They are leading the market from a mobile perspective and most of the revenue is coming from data.
- O. Maher I mean if I could put that into context or compare it to the domestic wholesale business, we are seeing a decline in revenue from domestic wholesale. As far as I understand, a big part of that is coming from the mobile operators.
- A. El Beheiry The domestic wholesale business is a seasonal business. It is not related to the quarterly results at all. Wholesale revenue increases depending on contract durations and the timing of signing contracts so it is very seasonal. For example, if the mobile industry is doing well, that does not necessarily mean that you will see results in the immediate quarter especially because our wholesale business does not only rely on other mobile operators.
- M. Shamroukh I would like to add that there were some IRU's that were recognized from mobile operators in Q2 so there is a quarter-over-quarter decline in domestic wholesale, however, if you normalize the IRUs, you will see a growth of at least 13% year-over-year.
- O. Maher That's very clear, thank you. My second question, if I may, is actually on the guidance. Last quarter, you said that you would not change the guidance. Obviously, it hasn't changed this quarter either, so should we expect a significant decline in the margin in the fourth quarter that would offset the high margin that we saw in the nine months of this year?
- M. Shamroukh We maintain our guidance of high 20's EBITDA and we are not anticipating lower profitability during Q4 2018 as we are working to and hope to conclude certain projects by then.
- O. Maher Alright, thank you.
- Moderator The next question will come from the line of Hassan Abdel-Gelil of CI Capital. Please go ahead.

- H. Abdel-Gelil Hello, and thanks for taking my question. Congratulations on this quarter's results. I did not really hear what was discussed on the dividends. I also did not hear what you just said on the expectations for the profitability in Q4 2018. Sorry, but can you just repeat these two answers?
- M. Shamroukh As the CEO previously said, we will maintain our long-term policy that we announced before. We will distribute dividends unless new opportunities, similar to the Bharti Airtel deal that took place before, arise and cause us to delay the distribution.
- As for Q4, we do not expect lower profitability as we are working to hopefully close certain projects during the quarter. We maintain our guidance of high 20's EBITDA, instead of mid to high, and high margins towards the full year.
- H. Abdel-Gelil By projects, do you mean that there is a possibility for other enterprise projects or do you mean projects that will be recorded under other revenue streams similar to the one with the Ministry of Education?
- M. Shamroukh No, it is not related to the schools' project and we prefer to keep our guidance on the conservative side: high 20's EBITDA.
- H. Abdel-Gelil You said a project in what?
- M. Shamroukh It is a submarine cable signing.
- H. Abdel-Gelil Oh, okay. Thank you. I have no further questions.
- M. Shamroukh Thank you.
- Moderator We have a follow up question from the line of Omar Maher of EFG. Please go ahead.
- O. Maher Thank you. Last quarter I remember there were some discussions in the call regarding a potential expansion of TE's brand outside of Egypt. There was also another discussion regarding going into mobile money services to help monetize the mobile investments. I was wondering if you have any updates on those strategies and whether it is something that we should expect in 2019 or later on?

A. El Beheiry There are definitely two things that we are checking regularly: expanding our brand abroad and heavily penetrating the data center business & cloud computing. We expect to have updates about the aforementioned in the coming year but, as I mentioned earlier, we will only expand our brand abroad if we find a solid opportunity that is beneficial for us. We are not in a hurry. We are prioritizing moving forward in data centers and cloud computing and we expect to have news about that in 2019.

What was the second part of the question?

O. Maher The second one was on what you discussed last quarter regarding financial inclusion and potentially going into mobile money services.

A. El Beheiry Our mobile wallet is currently being developed and it will be in the market soon. We will start taking it slowly from there but, again, payment is one of our major focuses in the coming year, definitely. You will hear a lot about it from our side in 2019. I hope I answered your question.

O. Maher You did, definitely. I would like to follow up on that, if I may. So is this something that is being developed internally, or are you collaborating with someone in the financial services industry? What I am trying to understand is whether there will be a lot of capex invested.

A. El Beheiry No, we are not talking about building infrastructure for financial inclusion. I am saying that we are initiating mobile payments by introducing the first payment service, which is the WE Mobile Wallet. This is not a capex-intensive project at all.

O. Maher Understood. Thank you.

A. El Beheiry Thank you.

Moderator There are no further questions in queue at this time.

A. Adel If I may, I have a follow up question from my side. I would like the management to shed more light on the deferred tax during the third quarter and the second quarter. I also wanted to make sure about whether or not you are expecting to see recurring revenue in the fourth quarter from the schools' project. Thank you.

M. Shamroukh Regarding the deferred tax, the difference comes from the treatment applied internally and that applied by the tax authority with regards to our

Capex, based on depreciation periods, contributed to the noticeably high deferred tax figures in our financials.

When it comes to the schools' project, what we were working on is just the first phase and we are open to discussions with the Ministry of Education to pursue upcoming phases. We will be benefitting from recurring revenue coming from increased broadband subscriptions. Any other potential infrastructure projects related to schools will depend on whether the government is planning to connect more schools or not.

You can expect more revenues coming from new urban communities in Q4 this year because the level we recognized in 9M 2018 was lower due to the implementation of the schools' project. We are expecting the same level of revenues as the end of 2017.

A. Adel Alright. Thank you.

M. Shamroukh Thank you.

Moderator There are no further questions from the phone lines at this time.

M. Shamroukh No more questions?

Moderator No further questions from the phone lines at this time.

A. Adel Okay, Thank you.

[Telecom Egypt signs off]

Moderator Ladies and gentlemen, that does conclude our conference call for today. We would like to thank you for your participation in today's Telecom Egypt Q3 2018 Results TeleConference call and thank you for using our service. Have a wonderful day. You may now disconnect.