Final Transcript

AUERBACH GRAYSON: Telecom Egypt Q1 2018 Results
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SPEAKERS

Ahmed Adel – Beltone Financial
Ahmed El Beheiry – Managing Director and Chief Executive Officer
Mohamed Shamroukh – Chief Financial Officer
Sarah Shabayek – Investor Relations, Senior Director

ANALYSTS

Baha Makarem – Arqaam Capital
Mikhail Arbuzov – Renaissance Capital
Hassan Abdel-Gelil – CI Capital

PRESENTATION

Moderator Welcome to the Telecom Egypt 1st Quarter 2018 Results conference call. This call is recorded and is open to analysts and investors of Telecom Egypt, who will be allowed to ask questions. Members of the media are not allowed to ask questions. All lines have been placed on mute to reduce any background noise. After the speakers' remarks, there will be a Q&A session. [Operator instructions].

I will pass over to the host, Ahmed Adel from Beltone Financial. Thank you.

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 1st Quarter 2018 Results conference call. From Telecom Egypt, we have with us Mr. Ahmed El Beheiry, Managing Director and Chief Executive Officer; Mr. Mohamed Shamroukh, Chief Financial Officer; and Ms. Sarah Shabayek, Investor Relations, Senior Director.

As usual, the conference call will begin with a presentation of the key highlights of the period, followed by a Q&A session.

I will now hand the call to Sarah. Thank you.

S. Shabayek

Thank you, Ahmed, and thanks to Beltone Financial for hosting our conference call. Good afternoon and welcome to our first quarter 2018 earnings call. We will start with a briefing on the operational performance in the quarter presented by our CEO, followed by the key financial trends presented by our CFO.

Kindly note that the presentation is available on our 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. Certain results—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 with 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

Good morning and good afternoon, everyone. Thank you for joining us on today's call. I'm pleased to announce that Telecom Egypt's results for Q1 2018 demonstrates a solid operational performance, paving the way for sustainable growth and the continuation of the transformation we have started in 2017.

Let's move to the key highlights of the quarter. I will be referring and walking you through our Q1 2018 investors' presentation. If you please look at slide 2, you will find the following highlights. Consolidated revenue of Q1 2018 came in at EGP 4.8bn with year-over-year growth of 15%. Our customer base grew across all segments: Fixed Voice, again on the right, reaching 7.3mn, 10% year over year, ADSL totaled 4.4mn, 29%

year over year, and Mobile closed at EGP 2.9mn, 27% quarter over quarter, with above market average mobile data penetration.

EBITDA grew by 9% recording a margin of 31.5%. That is higher than our full year mid-20's to high 20's guidance. We note that Q1 is usually the quarter with the highest margin of the year.

Net profit totaled EGP 688mn with a drop of 48% from Q1 2107, due to decline in investment income from Vodafone Egypt, followed by an increase in depreciation and amortization and interest expense.

Now if you please look at slide 3, you will find a summary of the main events that have taken place in the first quarter of 2018 and subsequent events to the quarter. It is important to highlight that throughout the quarter, we continued with our strategy of transformation and expansion, solidified our "WE retail" brand by launching the postpaid Mobile offering, our new sub-brand "Indigo", followed by a major transformation of the fixed broadband internet in Egypt with the introduction of "WE Internet".

In the quarter our focus was to seal some Wholesale transaction to secure the continuation of our Wholesale segment, as well as launch new retail products for both Mobile and Fixed Broadband segments to reinforce our branding campaign and expand our portfolio. On the Wholesale front, two Wholesale agreements with mobile operators have been completed during the quarter. The first one is a transmission and infrastructure 3-years agreement with Vodafone Egypt, and the second is a a three-year bitstream agreement with Orange Data to provide infrastructure and transmission services.

Also, we have announced and later the BoD has approved the acquisition of MENA Cable. This is a major step towards our expansion strategy, solidifying our presence as a major player in the submarine cable industry. It's a key strategic step towards reinforcing Telecom Egypt's footprint in the submarine cable business.

On the retail side, we have worked tirelessly during the quarter and delivered, as I said, "Indigo" and "WE Internet" launches. Both products are strategically important as they required a huge revamp in the IT systems, customer experience, and product development in order to transform and reinforce the new brand perception of our customers. With the postpaid "Indigo" we are launching WE's first integrated mobile plus fixed broadband bundle, while also availing a new customer experience to our high value customers.

The second launch, again, is the fixed broadband revamp, WE Internet, which is a major milestone to us. This is, in our view, a major game changer in customer experience and service. It required major transformation and coordination and hard work among all divisions of the company in order to capitalize on our existing fiber infrastructure and upsell higher speed to customers. Now, 52% of homes reached a minimum speed of 5 megabits per second, and this number is expected to increase to 70% by end of year. The maximum advertised speed of 100 megabits per second is now the new committed high speed in Egypt up from 16 megabits per second.

We are offering our customer a new experience through our call centers. Enabled by a huge development in the IT systems, now the customer is advised about the maximum speed that can reach its home in order not to overpromise the customer as well as become more transparent. The media and marketing themes had to also come up with an educational ad campaigns so that the customers now understand the better the speeds they can have by calling the call center to find out more about which bundle they are eligible to.

Now I will hand over to the call to Mr. Shamroukh, our group CFO.

M. Shamroukh Thank you, Mr. CEO. Good morning and good afternoon, everyone, and thank you for joining us today on the conference call.

I'll start by looking at slide 4 to give some highlights. Our topline growth was led by Retail services that has witnessed a year-over-year growth of 35%, driven mainly by the rise of Home & Consumer services which grew by 45%. Our data services have demonstrated an exceptional contribution to revenue growth, growing 46% in the Home segment on a30% growth in ADSL subscribers and a 9% growth in ARPU. This growth was accompanied by an increase of 43% in voice services, led by a 10% increase in customers. Also, Enterprise grew by 13% year-over-year.

On the other side, Wholesale revenue remained flat as a decline in ICA stemming from the global decline in the trend of International voice traffic, which was largely offset by the revenue increase in Domestic Wholesale followed by increase in IC&N.

Now looking at slide 6, call costs as a percentage of revenue declined to 21% in Q1 2018 from 23% in Q1 2017, supported by the increase in topline and despite the increase in mobile services related to call costs.

Salaries have increased by 19% year–over-year as Q1 2017 did not include social allowances for employees and raising the minimum wages, which were applied in May 2017 retroactively, and the hiring of new employees for our mobile operations. Normalizing Q1 2017 for such items leads to a 10% year-over-year increase in salaries, aligned with the annual salary increase.

S&D expenses have risen due to the marketing campaigns we have undertaken. We note that advertising revenue in the quarter amounts to 2.5% a negligible number to revenue the increase, however, is because advertising was close to non-existent [ph] in Q1 2017.

EBITDA came in at EGP 1.5bn growing by 9%, and recording a margin of 31.5%. We note that, as previously mentioned, employee cost adjustments took place starting from Q2 2017 retroactively, applying such charges on Q1 2017 leads to a normalized EBITDA margin of 31.8% and hence indicate a close to flat margin year-over-year.

Depreciation increased by 42% year-over-year as a result of our increased investment in the fiber infrastructure and mobile network. Amortization recorded EGP 151mn as a result of the start of mobile license amortization in Q3 2017. Hence, Q1 2017 did not include mobile license amortization.

Investment income from Vodafone declined by 58% due to tax and legal provisions, and the retroactive application of discounts related to Vodafone International Services.

The company started incurring interest expenses in the third quarter of 2017, prior to that interest was capitalized until the mobile launch. Hence, Q1 2017 did not include such interest expense.

Finally, net profit declined by 48%, impacted most significantly by: the decline from investment income, mainly Vodafone's decline, followed by an increase in depreciation and amortization, and the increase in interest expense. If we normalized net profit from Vodafone, this would lead to a net profit of EGP 931mn, a decline of only 30% year over year.

And now moving to slide 7, the chart shows the variance between Q1 2017 and the Q1 2018 net profit, displaying the major factors contributing to the decline of net profit from Q1 2017. As you can see, the main decline relates to non-cash charges (depreciation and amortization) and the one-off drop in Vodafone's investment income.

In slide 8, this quarter our in-service capex including mobile license came in at EGP 603mn, representing 12.6% of the total revenue, in line with our spending in Q1 2017 of 12.1%.

If you move to slide 9, our net debt totaled EGP 6.5bn in Q1 2018 down from EGP 6.17bn in Q4 2017, representing a net debt to EBITDA of 1.1x (based on annualized EBITDA) compared to 1.3x in the full year of 2017. We are working hard to manage our cash flows in order limit leveraging the company more in order to reduce the impact of higher interest expenses on our bottom line.

This, however, does not mean that we do not look for facilities to draw on in order to have liquidity. As such, our Board of Directors has approved three decisions related to the financing yesterday, approving the five years $500 million syndicated loan to refinance outstanding short-term US liability and to provide a cushion for working capital needs. The Board of Directors also have approved a four-year vendor financing, including a 24-months grace period. Both of these approvals are quite strategically important, as they allow us to phase out our payments in line with expected cash inflows and avail lower interest expenses financing to the business. We aim to close the year at 80% of our debt in US dollars as we guided before.

And finally, if we move to slide 10, as Ahmed has mentioned at the beginning of the call, our results in terms of revenue growth and EBITDA margins of Q1 have exceeded our guidance and we maintain our guidance for the full year of 2018 across all KPIs.

This concludes my financial highlights and I will now hand back the call to the operator to open the line for questions. Operator, please go ahead.

Moderator — [Operator instructions]. Our first question will come from the line of Baha Makarem. Your line is open.

B. Makarem — Hi, thank you for the presentation. I have two quick questions. First one regarding the mobile subscriber base, it seemed a bit low compared to what I was expecting. Is there any reason for this or is this the new pace of growth? On top of that, can you give us any idea on what kind of impact the postpaid launch has had on subscribers, so what it looks like now? Any kind of unofficial light to shed?

Second question is regarding the Vodafone stake, are there any provisions? You mentioned there were tax and legal provisions, are any of those leaking into Q2? Is there any guidance you can give on where this figure will go moving forwards? Will it remain low for the rest of the year? Thank you.

A. El Beheiry: First, your question about the subscriber base, we launched on the 18th of September, and the end of quarter number is 2.3mn. This is a very high figure, actually, to the industry in general and to the Egyptian market in particular. So, I can assure you that this number is surpassing our highest expectations during the launch. I didn't foresee that we'll end the quarter was actually more than that.

As for your question about the postpaid, in Egypt postpaid is not an engine for increasing subscriber base, we put it in the market first to reinforce our positioning, second to try to capture high end customers. But the postpaid segment in Egypt for all three mobile operators is between 1% and 3% depending on the definition of postpaid. So, the numbers cannot tell anything today. For postpaid, I'm not tracking it by a number, I'm tracking it as enlarging the portfolio of our marketing positioning. Our Indigo market positioning in the start included one very important new card which is the first offer in the era of bundling fixed and mobile. So, we offered the DSL with basic Indigo offering for 5 and 15 megabits per second.

As for your second question, which is the Vodafone one, I will let them comment on that but I don't foresee the decline in the coming quarters, as has per my understanding. It's something more related to Q1 special events on their side. So, I don't see an effect on Q2 and the subsequent quarters at all.

S. Shabayek: So, Baha, just to recap it's a one-off for the quarter.

B. Makarem: Okay, perfect. Thank you.

S. Shabayek: One other thing, to give you a flavor of the market, the entire market declined in Q1 by 1mn customers. So, in fact what we did in terms of net additions is quite impressive in our view.

A. El Beheiry: And again, if your question is on our performance in the first 50 or 60 days of our launch, we had never expected to keep on the same slope. Definitely, there will be stabilization in the market happening and what you are seeing as a million additions per month is something that we have expected to have for a month, but we had it continue for two months in a row and was also subject to certain promotions that we had at that time. Again, as I have said since my first day of appointment I'm not going to have a strategy of huge market share penetration, while declining in value. I think that's where we make it up. Thank you.

Moderator Our next question will come from the line of Mikhail Arbuzov. Your line is open.

M. Arbuzov Hi, thank you for the presentation. I have a couple questions, the first one is on your cost side. Would you see marketing expenses as the new norm or was there any seasonal related to mobile launch? And also, I would like to ask are you going to hedge the forex debt exposure? Thank you.

M. Shamroukh Thank you. Actually, regarding marketing expenses, if you are comparing Q1 2018 to Q1 2017, in the first two quarters of the last year we did not spend a lot on marketing because we were waiting for the launch of mobile and we allocated most of the budget in the third and the fourth quarters.

If you normalize it, the total expenses we budgeted for the same amount of money that we spent in 2017 in 2018. But again, as I explained, during the first quarter of last year we did not spend a lot. We were preparing the money for the mobile launch.

Regarding hedging FX, up until this moment we treat it financially we don't need to hedge it as we have to take the cost of hedging. Actually, we have a natural hedging as a lot of our revenue is in hard currency, and we see that the proceedings we are getting in hard currency are sufficient to have the liability.

To give some highlights, we announced the $500 million that we don't have the intention currently to throw all of this amount all of a sudden. We will close our short term liability, which accounts for only $260 million, and we see that we will not exceed this amount getting the cash flow. As we have explained before, we are very consciously rolling out our mobile networks based on site profitability model, where we try to locate sites in area where we can have capture traffic and minimize the impact of national roaming. As a matter of fact, we are very consciously rolling out until the adaption of 4G handsets happens.

Accordingly, we don't see that hedging is important to do today. We might consider if we see that our FX exposure will exceed our proceeding in US dollars. Thanks.

Moderator At this time, there are no further questions coming from the phone lines.

S. Shabayek Operator, can we wait like a minute? If there's no other question, then we'll end the call.

Moderator — Sure. [Operator instructions]. We do have a follow-up question from the line of Mikhail Arbuzov. Your line is open.

M. Arbuzov — I'd like to ask two more questions. Could you indicate where, in which revenue segment, you account your mobile revenue? And second question regarding your cable view, you get only 50% in the company and I wanted to know who are the 50% owners. And am I to understand correctly that EGP 90mn is not all paid by Telecom Egypt, but only in proportion of its ownership? Thank you.

M. Shamroukh — Mobile revenue is recorded under two business units. As I said, we segmented the customers five years ago as we started a customer-centric approach. So mobile is a service that is recorded under customer segment. In the first quarter, all of mobile revenue was recorded under Home, because we did not introduce mobile enterprise services or products yet. Going forward it will be recognized under Home and Enterprise segments in the retail part.

Regarding the submarine cable, the 50% that we have announced will be owned by a local strategic partner. Total financing would be from Telecom Egypt, and the BoD delegated the management to decide whether to go with the strategic partner to acquire the cable or have this asset from Telecom Egypt alone. We see this as a good opportunity in the short-term to manifest the results of the investment, and to have a long-term strategic reach for some of the markets that we see very important for Telecom Egypt, like Saudi Arabia and Oman.

However, the financing in both cases would be totally financed by Telecom Egypt, whether as a total equity or part of equity and shareholders of the new company, which is a domestic strategic partner. Thanks.

M. Arbuzov — Thank you.

Moderator — Thank you. And our next question will come from the line of Hassan Abdel-Gelil.

H. Abdel-Gelil — Hello, thank you for the presentation. I just have two quick questions. The first is related to the margins. I remember that Mr. Ahmed said at the beginning of the call that the margins in Q1 were the best. I wanted to know why is that. Also, I'm very sorry but I didn't listen to what Mr. Shamroukh was saying about the recognition of the mobile revenues, and which segment is it. Thank you.

S. Shabayek — Hassan, I'm sorry, the line was breaking. Can you repeat your question?

H. Abdel-Gelil Sure. What I was saying is that at the beginning of call Mr. Ahmed said that EBITDA margins in Q1 are the highest in the year. Can I know the reason for this? Also, the other question is I didn't get Mr. Shamroukh's answer on the mobile revenues being recognized under Home or under Enterprise.

S. Shabayek Mobile revenues are being recognized under Home because we didn't launch an Enterprise product yet. Once we do, it will start being recognized under Enterprise.

As for Q1 being the highest margin in the quarter, it's a seasonality factors. Usually at the beginning of the quarter you don't get the full impact of the marketing expenses and the salaries that are increasing, and we tend to give more of that during the third and fourth quarters. So, traditionally, if you look at our historical performance, you'll find that Q1 is the highest, usually.

H. Abdel-Gelil Thank you.

Moderator Thank you. Our next question we have a follow-up from Baha Makarem. Your line is open.

B. Makarem Thanks again. So, you're mentioning that once you start rolling out Enterprise mobile services that that's going to be reported within Enterprise. Are we now going to get a separate mobile segment now that postpaid has been launched?

S. Shabayek I don't think for the first year we'll be disclosing mobile on a separate line. Eventually I think we'll be able to give you more guidance in terms of a percentage. But, as the CFO said before, we are disclosing business lines based on the customer-centricity approach rather than which service it is. I think in a year from now we'll probably give you more guidance. However, for now it's more of a competitive intelligence perspective we'd rather not.

B. Makarem Okay, there's no rule, regulatory requirement to disclose these figures for, as you said, competitive reasons?

S. Shabayek It has to be a significant contribution to the topline. So, so far it's not.

B. Makarem Okay, thank you very much.

S. Shabayek You're welcome.

Moderator	Thank you. And at this time, there are no further questions coming from the phone lines.
S. Shabayek	Thank you, operator. Do you have one more?
Moderator	Hassan has a follow-up. Your line is open.
H. Abdel-Gelil	I remember in the last earnings call we had a discussion about the credit balances. It seems to be rising quarter on quarter since quarter two. The answer at that time was that you are extending the payment cycle. Is that still the case? Is it because of just normal delay of the payments?
S. Shabayek	Yes, basically as you can see, we've only spent EGP 1bn in the first quarter in terms of cash capex. Usually the first quarter is very low when it comes to actual capex deployment, so the payments are coming in the coming quarters. But again, something like vendor financing that we've just struck a deal with in terms of the Huawei vendor financing we've just announced, that is going to be recorded under payables, not necessarily under debt; because it's lower interest and it's the payment terms that we're getting for a very low interest. So, you'll see payables increasing as we increase the vendor financing part.
H. Abdel-Gelil	Then what's the stable level? Would it be this quarter's days on hand?
S. Shabayek	Sorry? This quarter is what?
H. Adbel-Gelil	Days on hand. Is this a sustainable level or will it go up again?
S. Shabayek	No, I think you'll see a rise in trend in payables in general, but not far away from where we are at this point in time.
M. Shamroukh	For net debt, we excluded the transactions for MENA Cable, I think we will maintain the same level of not exceeding EGP7bn
H. Adbel-Gelil	Thank you.
Moderator	At this time there are no further questions.
S. Shabayek	Thank you, operator. Thanks everyone for joining our call today. If you have any further questions, please contact Investor Relations.
Moderator	This concludes today's conference call. Thank you.