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SPEAKERS:

Mariam Wael – Pharos Holding
Adel Hamed – Telecom Egypt
Mohamed Shamroukh – Telecom Egypt
Sarah Shabayek – Telecom Egypt

PARTICIPANTS:

Alexander Vengranovich – Renaissance Capital
Dalal Darwich – Arqaam Capital
Hassan Abdelgelil – CI Capital
Omar Maher – EFG Hermes

PRESENTATION:

Operator: Good day and welcome to Telecom Egypt's second quarter 2019 results call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mariam Wael, Equity Analyst at Pharos Holding. Please go ahead.

M. Wael: Good afternoon, everyone, this is Mariam Wael. On behalf of Pharos Holding, we are very pleased to be hosting Telecom Egypt's first half 2019 results conference call. Our speakers for today are Mr. Adel Hamed, CEO, Mr. Mohamed Shamroukh, CFO and Mrs. Sarah Shabayek, Investor Relations Senior Director. With no further delay, I'd like to pass on the call to Sarah to begin the presentation.

S.Shabayek: Thank you, Mariam and thanks to Pharos Holding for hosting this quarter's conference call. Good afternoon and welcome to our second quarter 2019 earnings call. We will start the call with a briefing of the operational performance in the quarter presented by our CEO, Adel Hamed followed by the key financial highlights presented by 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'll continue to hold these views. We do not commit to notify you as 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. Adel Hamed.

A.Hamed: Thank you, Sarah. Good morning and good afternoon everyone. Thank you for joining our call today. This quarter's results are a reflection of the successful execution of our strategy to monetize our investments across all business units. Our top line grew 24% YoY, reaching EGP 6.6bn, thanks to the continuously growing demand for our data products followed by the recognition of a new cable project - PEACE. Our customer base is also on an uptrend with an 11% YoY growth in fixed line customers, a 19% YoY increase in fixed broadband customers and a 29% YoY increase in mobile subscribers. It is also very important to highlight that although mobile customers are flat QoQ, mobile revenue increased by 15% QoQ.

I am also very pleased to be able to tell you today about the most recent shift in our fixed broadband offering, which comes in line with our huge project to develop our network capabilities and improve the quality of internet services in Egypt. On the first of July, Telecom Egypt launched WE SPACE, which is our new broadband platform including high speed internet bundles with maximum speeds that start from 30Mbps instead of 5Mbps, allowing our customers to reach the maximum speed availed by the network for their lines. This move is expected to have a positive operational and financial impact and, therefore, allow us to reap the fruits of our strong network investments and to further develop the broadband market in Egypt. We have more projects in the pipeline in light of our strategy to become a total ICT provider and I intend to walk you through our WE Wallet offering as well as our IPTV platform services in the next quarter's call. We have completed the groundwork for both products and regard these launches as crucial on our journey to cross beyond traditional telecom services into new industries.

Our success is not only limited to retail offerings; this quarter, our IC&N revenue has seen a spike on the recognition of USD 20mn from the PEACE cable agreement signed in April, with additional ancillary services revenue to come over the lifetime of the cable. We expect to see more of these projects in the future as they represent the base for the next phase of transforming the country into a digital hub and strengthening our position as a local and international partner of choice.

With that, I have come to the end of my operational brief. I will now hand over the call to Mr. Mohamed Shamroukh, our CFO, to discuss this quarter's key financial trends.

M.Shamroukh: Thank you, Adel. Good morning and good afternoon, everyone. I am sure that by now, everyone is familiar with our quarterly investor presentation so I will keep my commentary brief and to the point to leave room for questions. Data continues to drive our revenue growth for both fixed and mobile revenue. This is not only due to a growing customer base, but also a healthy trend of ARPU growth. In order to meet the growing appetite for data services and grasp the opportunity in the market, we have accelerated our investment in infrastructure. This has resulted in increased CAPEX spending in H1 2019 but, overall, within our announced guidance. On the other hand, we are focusing on implementing various cost cutting and optimization initiatives. This quarter, we successfully completed the early retirement program that targeted around 2000 employees and we recorded EGP 1bn as a one-off expense that will be paid to the employees in Q3. We expect to finance around 50% of that amount through an extraordinary dividend that is expected to be paid by Vodafone Egypt in the same quarter. It is important to note here that this distribution is in addition to the EGP 700mn that are to be paid by Vodafone Egypt in June 2020 in line with the agreement that we announced in February this year. Normalizing for the effect of the early retirement program, our EBITDA margin for Q2 2019 would have come in at 26% and for the first half at 29%, which is at the higher end of our guidance. Finally, I would like to point out that our debt restructuring continues to pay off with our effective interest rate declining further to 6.9% in Q2 2019 down from 10.3% last year.

I have reached the end of my comments and we are now ready to open the floor for the Q&A session.

Operator: Thank you, sir. Ladies and gentlemen, if you would like to ask a question, please signal by pressing star 1 on your telephone keypad. If you're using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment.

Again, press star 1 to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

We'll take the first question from the line of Alexander Vengranovich from Renaissance Capital.

A.Vengranovich: Yes, good afternoon. I have a couple of questions, the first being on your mobile subscriber base. If I look at the second quarter's dynamics, there is quite a substantial deceleration in customer base growth QoQ. May you please explain how you expect to boost it in the future? What are the growth drivers for the mobile subscriber base going to be and what sort of measures are you planning to implement to accelerate this growth again?

Secondly, are you planning to offer a fixed-to-mobile converged bundle for the subscribers who are also using your fixed voice and data services and do you have any measures in place that help you avoid the competition in mobile with Vodafone Egypt, which is your associate company?

S.Shabayek: Okay, I'll take the first question. It's important to note that in the second quarter, we've seen a cleanup in the subscriber base. As you know, we've launched a little over a year ago and we had a lot of idle customers over this time so basically, what you see is the impact of the cleanup in Q2. We have hinted in our presentation that although it looks like customers are flat, we've seen a 15% QoQ growth in mobile revenue. This is basically because of the gross additions that came in as well as the very healthy ARPU trends relating to high-value customers.

This leads me to your second question. Our strategy has shifted a little bit over the last year whereas initially, we used to sell our SIM cards and mobile services to the masses regardless of whether the buyers are considered as high-value customers or data customers or not. Now, our vision is more focused and we are trying to push the postpaid converged bundles that include fixed data, not only mobile. As you know, this is a very different dynamic than the usual mobile operators and we believe that it will result in very healthy revenue growth that is more based on long-term commitments with our customers rather than the usual prepaid behavior of the mobile market in Egypt.

Your last question is about how we avoid competition with Vodafone Egypt. We don't necessarily do that in specific but the result of our strategy of focusing on our fixed data customers and the converged product has led us, by default, to avoid competition with Vodafone, which has a very different type of customer. 90% of customers at Vodafone Egypt are prepaid and they're not dual play customers. Vodafone Egypt also tends to have a very loyal customer base as they are offered unique services compared to traditional telecom ones. We still haven't moved into that direction yet, although we want to in the future.

A. Vengranovich: Okay, that's really helpful, thank you.

Operator: We will take the next question from Hassan Abdelgelil from CI Capital.

H. Abdelgelil: Hello, everyone. Thank you for taking my questions. My first question is related to income from Vodafone. I know that you don't share much about Vodafone due to the agreements that you have but can we expect this income to recur because it is decreasing around 19% YoY?

As for my second question, may you disclose the amount of ForEx gain for this quarter? If the Egyptian pound deteriorates, should we expect a ForEx loss?

M. Shamroukh: When it comes to income from Vodafone, their interest expenses have increased because they took out a debt facility to distribute dividends. As per the guidance given from Vodafone's management, they are expecting to close the total amount of debt that they borrowed in Q1 2020.

This quarter's ForEx gain amounts to around EGP 450mn. Part of our liabilities are still in hard currency so if the Egyptian pound depreciates, we may incur some ForEx losses but we do not expect this to happen. However, if we calculate interest expense even with the ForEx losses that we might incur with the current effective interest rate, it is still much lower than the interest expense that we would have incurred if we borrowed in EGP. The breakeven point at which we would incur a higher interest expense when borrowing in hard currency is at an exchange rate of EGP/USD 22, which is very far from the current position.

S. Shabayek: Hassan, it's also very important to note here that if the EGP depreciates, this will lead to higher revenues in the international wholesale segment.

H. Abdelgelil: Okay. Will you please repeat the part about the breakeven point?

S. Shabayek: The breakeven point for Telecom Egypt is at an exchange rate of EGP/USD 22 if you compare the interest rate differential with ForEx exposure.

H. Abdelgelil: Okay, so more than EGP 22 would be negative for Telecom Egypt, right? Is this what you mean?

S. Shabayek: Yes.

M. Shamroukh: Yes.

H. Abdelgelil: Okay. If I may add just one more question, my expectation for the cable projects revenue was around USD 20mn but it came in at USD 36mn. Were the extra USD 16mn related to the first project or just another project that was not previously disclosed? May you please explain this in detail?

M. Shamroukh: First, I would like to differentiate between the types of projects that were recognized. During this quarter, we recognized the PEACE cable crossing, which means we sold the rights to use Egypt's domestic infrastructure, allowing the submarine cable to cross between the East and West. This project channeled USD 20mn and came in at a very high margin.

In the meantime, we sold the rights of use on a fiber pair at the West of our TE North cable system and its margin is the same as that of capacity sales. Yes, it has been recognized under cable projects revenue but it's different in nature.

H. Abdelgelil: Okay, thank you.

Operator: We will take the next question from the line of Omar Maher from EFG Hermes. Please go ahead.

O. Maher: Thank you, good afternoon. Thanks for the call. I have two questions please, the first being on the WE SPACE bundles that you recently launched. I know that this is post quarter but I was hoping you could give us a sense of how the update has been or how the demand has met the new bundles. The structures are obviously simplified; you've raised the minimum speed to 30Mbps, I believe, but at the same time, you still have some infrastructure challenges on the last mile in certain areas, which, I guess, would hamper the ability to fully monetize the upgrades of the packages. Could you give us a sense of how you've dealt with this and how the demand has been given that this quarter, specifically in Q2 2019, we saw a bit of a slowdown in the growth of the Home & Consumer business unit QoQ?

The second question is about the IPTV product that you were planning to offer this quarter. You've talked about this for quite some time now and I believe we started hearing about it earlier this year. I'm guessing that the initial plan was to launch a little bit earlier but it seems like it's been delayed so are you facing any challenges on that front and why is it taking so much time for it to be launched? Even though it may be too early to speak about this launch's potential, may you shed some light on where you expect this to go in a year's time? If you end up launching in Q4, where do you expect it to be by Q4 of the following year?

M. Shamroukh: Thank you, Omar. We are currently facing a challenge because the last mile of some cables is made of copper, which slows down internet speeds. However, allow me to explain how we are monetizing the WE SPACE product launch. Prior to the introduction of WE SPACE, the average quota per customer was around 100GB per month, after which, the internet speed was downgraded to 1Mbps. The number of people who topped up their internet after being downgraded to minimum speed was little. Currently, more people top up although we increased the quota in the entry internet bundle from 100GB to 140GB, because the speed was increased to a maximum of 30Mbps up from 5Mbps and the throttling speed was decreased to 256kbps. To access the internet after using up their GBs, customers will either want to top up their bundles or prefer to subscribe to a higher bundle, which is usually WE SPACE Super 2 that's priced at EGP 175 for 250GB compared to EGP 150 for the old bundle. We consider this to be the black horse of our WE SPACE offerings given that it is a value for money product.

On the other hand, we recently began selling new, unsubsidized VDSL routers that rely on new technology and provide higher speed internet access and halted the sale of subsidized ADSL routers. This has led to a slowdown in our net additions in Q2 2019, however it was remedied by allowing customers to pay a small monthly fee for using new routers a month after the launch of WE SPACE.

To further enhance internet speeds, we have chosen 2mn housing units in Egypt to connect with FTTH as the next phase of our expansion plans in parallel to our current copper-to-fiber replacement program that we expect to complete in 2020. The units are in high-end locations such as Masr el Gedida, Nasr City, Maadi, Dokki and Mohandessin. Customers in the aforementioned locations are data-hungry and will continue to demand more data, coinciding with our monetization strategy.

In the meantime, we have completed the first phase of the national project to connect governmental service buildings across Egypt with fiber in less than 2 months, starting with Port Said, which is an achievement that we have been commended for by the government in Q1 2019. As a result, we recognized EGP 86mn and we will continue connecting other governorates with fiber soon as per the government's plan to complete this project within a 2-year timeframe. This will generate good income for Telecom Egypt and allow us to speed up our fiber expansions.

Now, to answer your second question, our plan was to launch IPTV services in early Q2 2019. Now the plan is to launch towards the end of Q3. Our IPTV platform is currently ready from the technical and user experience perspectives and the equipment and set-up boxes have also been delivered to Telecom Egypt's warehouses. We have several agreements with content providers. However, we are still awaiting regulatory approvals and security checks and we are expecting this process to be completed within 1 month, after which, we will be ready to commercially launch IPTV services.

O. Maher: Thank you. What sort of specific regulatory approvals are you waiting for? You already have the IPTV license so is it something that has to do with the content provider?

M. Shamroukh: We have acquired the license but there are still some pending regulatory/security requirements. We have completed most of them and we will be ready for the commercial launch soon.

O. Maher: Alright, thank you very much.

Operator: The next question comes from Dalal Darwich from Arqaam Capital.

D. Darwich: Hi, thank you for the presentation. I just have two quick questions, please. The first one is how much in cost savings are you expecting from the ERP program per year?

The second question is related to Vodafone's dividend policy. Are there any plans to consolidate or dispose of the business anytime soon?

M. Shamroukh: To answer your first question, we are expecting annual cost savings of EGP 350mn - EGP 400mn per year with a payback period of 2.5 years.

As for the second question, I mentioned earlier that the current situation with Vodafone will not be sustained for long. I think we previously announced that we would meet Vodafone Group during our visit to London and when we did, we agreed on the EGP 450mn extraordinary dividend distribution. We currently have 2 stages to work on, the first stage is related to disclosures, dividend policy and related party transactions. We are currently discussing different proposals for dividend distributions and we may agree to make the distributions from Vodafone's side an obligation based on free cash flow but we're still brainstorming with the group about that. What we have settled on is that we must reach an agreement on disclosures, dividend policy and related party transactions.

As for the second stage, our options are to sell, buy or merge and they are all open for discussion, however, we agreed to settle the smaller issues first before moving on to the larger decisions. We may consider collaborating in different, innovative ways.

D. Darwich: Okay, thank you very much.

Operator: As a reminder, star 1 to ask a question. We'll now take a follow-up question from Alexander Vengranovich from Renaissance Capital.

A.Vengranovich: Hi, yes, thanks again. My question relates to your free cash flow generation. Based on your numbers, I've seen that in the second quarter, you've had negative free cash flow to firm. May you broadly explain the dynamics of the free cash flow volatility between the quarters of the year and the sort of free cash flow generation that we should expect in the third and fourth quarters of the year?

My second question relates to your target leverage over the medium term. Do you have any target in mind where you would probably be satisfied with the existing leverage and distribute all the excess cash as dividends to the shareholders?

M. Shamroukh: I will start with the second question. We previously set our target leverage to be 1.5x of EBITDA but we exceeded this during the current year and we will continue exceeding it during the next year. As we mentioned before, we sped up our infrastructure rollout plan to catch up to market standards before the introduction of 5G to the market and to maintain revenue growth in fixed broadband. Our fixed broadband footprint is continuing to grow given our strong market propositions. After 2 years of operations, we are expecting to fall back to 1.5x of EBITDA. The good news is that despite the debt recorded on our balance sheet, the company’s financial performance is still strong. We are also managing our liquidity using short-term facilities.

S. Shabayek: I’ll take the free cash flow question. Basically, free cash flow is a function of CapEx and payables for Telecom Egypt. Our revenue is very steady and, typically, so is our EBITDA unless we have special projects that usually contribute positively to EBITDA or revenue. However, on a base case scenario, you’ll find that free cash flow is more closely related to our CapEx spending.

In the past few years, we incurred a lot of CapEx. As the CFO mentioned, this will continue for the next two years but we’ve also received the Vodafone dividends of EGP 4.8bn as a one-off payment in Q1 2019, that’s why you see a huge variation between Q1 and Q2.

However, I would like to point out that in the past, our CapEx would ramp up during the second half of the year, specifically by Q4. This year is very different than the usual trend and you can see that on slide 14 of our presentation. In H1 this year, CapEx increased because, as the CFO just mentioned, we are accelerating the copper-to-fiber replacement program, which explains the deterioration of the free cash flow to firm that you see in H1. If you look at the working capital, we’ve settled a lot of payables as well to keep progressing on the investment side.

A.Vengranovich: Okay, Thank you.

Operator: We’ll now take a follow-up question from Omar Maher from EFG Hermes.

O. Maher: Thank you. I have a follow-up question about spectrum. I was wondering if you heard back from the regulator about the new spectrum allocations because, last quarter, you said that Telecom Egypt, along with competing operators, submitted requests and are waiting to hear back from the regulator.

May you please explain the type of frequencies or frequency bands you’re looking for, is it something that has to do with 5G? I imagine that whatever frequency was allocated when the 4G license was awarded was probably sufficient to cover your needs up until today and probably for the next few years as well.

M. Shamroukh: Yes, we have submitted our request for spectrum to the regulator but we haven't heard back from them yet. Given that we are currently carrying 30% of our data traffic on our network, applying for spectrum was our chance to expand because we are essentially a data player. We, however, did not receive any official reply from the regulator's side.

We currently have 5MHz in the 1800MHz of spectrum and we need an additional 10MHz to sustain the quality of our service during the coming years. Yes, our current spectrum is enough to serve 5, 7 or even 8mn mobile customers but we do not want our service quality to degrade over time. Most of our customers are from greater Cairo and we now have full coverage on our own network, not Etisalat Misr's.

In a nutshell, I do not see this happening on the short run but we hope to receive spectrum by 2022 as, by then, most of our debt will be closed, most of our infrastructure investments will be completed, there will be increased demand for data and we will have higher quality customers.

O. Maher: Sorry, if I may ask, you mentioned 1800MHz. This is not what you have in terms of megahertz, it's the band on which you have the current spectrum, but how much of the quantity itself?

S. Shabayek: We have 5MHz in the 1800MHz and 10MHz in the 700MHz.

O. Maher: Okay. So, 5MHz in the 1800 MHz and 10 MHz in the 700 MHz, and then you're asking for an additional 10 MHz in the 700 MHz and an extra 10 MHz in the 2500 MHz, right?

M. Shamroukh: We asked for 30MHz: 10 MHz in the 1800 MHz, 10 MHz in the 700 MHz and 10 MHz in the 2500 MHz.

S. Shabayek: Omar, to be very frank, we have to exaggerate our demands when it comes to spectrum because the allocation itself is much lower. It's like a placement, you have to work your options.

O. Maher: Understood, thank you.

Operator: It appears there are no further questions at this time. I'd like to turn the call back to our host for any additional or closing remarks.

M. Wael: Okay. We would like to thank the management at Telecom Egypt and all participants for joining us. Thank you.

S. Shabayek: Thank you very much, Mariam. Thank you, operator.

Operator: Ladies and gentlemen, this concludes today's call. Thank you for your participation. You may now disconnect.