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Speakers

Hassan Abdel-Gelil – CI Capital
Adel Hamed – Telecom Egypt
Mohamed Shamroukh – Telecom Egypt
Sarah Shabayek – Telecom Egypt

Participants

Dalal Darwich – Arqaam Capital
Hassan Abdel-Gelil – CI Capital
Alexander Vengranovich – Renaissance Capital
Talal Noueihed – Lazard Asset Management
Paul Farah – Steyn Capital Management

Presentation

Operator: Ladies and gentlemen, welcome to Telecom Egypt's Third Quarter 2019 results conference call. I will now hand over the call to Hassan Abdel-Gelil. The floor is yours, sir.

H. Abdel-Gelil: Hello, everyone. This is Hassan Abdel-Gelil from CI Capital. I would like to welcome you all to Telecom Egypt's Third Quarter 2019 results conference call. Joining us from Telecom Egypt are Mr. Adel Hamed, Managing Director and CEO, Mr. Mohamed Shamroukh, CFO, and Ms. Sarah Shabayek, Investor Relations Senior Director.

I am now going to hand over the call to Ms. Sarah Shabayek to begin the company's presentation, which will be followed by a Q&A session. Sarah, the floor is yours.

S. Shabayek: Thank you, Hassan, and thanks to CI Capital for hosting this quarter's conference call. Good afternoon and welcome to our Q3 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 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. Adel Hamed.

A. Hamed

Thank you, Sarah. Good morning and good afternoon everyone. Thank you for joining our call today. This quarter is marked by continuing strong underlying growth in our top line and EBITDA, especially in light of the absence of any infrastructure or submarine cable project. As you all know, Q3 of last year included the Bharti deal and the schools' connectivity project.

The market continues to be hungry for data, both in the retail and wholesale segments. Data revenue in retail continues to grow across the board in mobile and fixed data, with a combined 33% growth YoY. This is the result of the continuing growth in ARPU and customers across our services. Similarly, our infrastructure revenue in wholesale, fueled by the data demand of the domestic operators, grew by 35% YoY.

As you also know, in the beginning of this year, we have taken a decision to expedite our copper-to-fiber replacement program. In the nine months of 2019, Telecom Egypt mobilized all its resources and workforce to complete this ambitious project. This has reflected on our 9M 2019 in-service CapEx that reached EGP 6.3bn. This is, by far, TE’s highest investment in a nine-month period and is almost double as much as last year. This investment is quite strategic for the company; we have created a large opportunity and an exceptional positioning for us to monetize such an investment for years to come and we intend to leverage this positioning to capture a larger share of the market's growth. The side effects of this higher investment is a jump in depreciation and finance expenses, which has pressured our bottom line. However, we believe that the long-term gains and the monetization of this investment are already visible in our top line growth and will continue to drive this growth in the future. We are also very well positioned to execute more strategic projects, such as the new capital and the digital transformation projects, which will kick-off in 2020.

On another note, last quarter, I briefly introduced our mobile wallet application and, today, I am very pleased to tell you that we have launched 'WE Pay' commercially, in collaboration with Banque Misr. 'WE Pay' will enable our customers to carry out a wide range of monetary transactions and our customers will be able to deposit and withdraw cash from WE's retail stores and link their Banque Misr debit and credit cards to the wallet.

With that, I have come to the end of my operational brief and 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, Mr. CEO. Hello everybody. This quarter, our consolidated revenue landed at EGP 6.3bn, declining 13% YoY. Excluding the Bharti deal, it recorded a 12% YoY growth, thanks to our strong retail performance, which constituted 58% of our top line. The 30% YoY spike in home revenue offset the 17% YoY decline in enterprise revenue due to base effect of recognizing the schools' connectivity project in Q3 2018. Mobile revenue increased 46% YoY, driven by both the growing customer base and a healthy ARPU trend. Our wholesale revenue, on the other hand, declined 34% YoY due to the base effect of the Bharti deal. However, adjusted revenue exhibited a 10% YoY increase mainly driven by the 28% growth in domestic revenue.

Additionally, this quarter, we have extended our early retirement program (ERP) to an additional 1k employees with a cost of EGP 0.5bn. The extension of the ERP will be financed using the proceeds we received from Vodafone Egypt on the sale of its subsidiary, Vodafone International Services (VIS), to Vodafone Group. The program has a payback period of 2.5 years. Adjusted for the ERP and the Bharti deal, EBITDA came in flat year over year at EGP 1.5bn.

Investment income from Vodafone is on a rise supported by the sale of its subsidiary, the reversal of dispute related provisions, and strong operational growth. The growth of Vodafone's income along with the FX gains recorded in Q3 2019, softened the increase in depreciation and amortization expenses and finance costs caused by the accelerated CapEx program, bringing our net profit to EGP 1.1bn, flat YoY after excluding the Bharti deal.

Our net debt reached EGP 13.7bn because of the higher CapEx spending, bringing our in-service CapEx to 33%. However, our effective interest rate dropped 2% YoY, reaching 8.4% thanks to the restructuring of our debt. By this, I have reached the end of my comments and we are now ready to open the floor for the Q&A session.

Thanks.

Q&A

Operator	*[Operator instructions]*
	The first question comes from Dalal Darwich from Arqaam. Please go ahead.
D. Darwich	Good afternoon and thank you for the presentation. I have a couple of questions, the first being on the increase in Q3 2019's adjusted employee costs by 1% QoQ and 26% YoY and if you may, please explain the loyalty pension fund program and how it impacts your employee costs.
	My second question is on call costs as they also increased around 21% YoY in Q3 and 16% in the past nine months even though top line performance was largely driven by data so I would appreciate it if you could shed some light on that.
M. Shamroukh	Similar to the last two quarters, we distributed one-off incentives to our employees this quarter, which was the main culprit behind the QoQ and YoY increase in employee costs. However, we do not intend to continue distributing such incentives going forward and the growth in employee costs will only be related to the ordinary 10% annual increase in salaries.
	As for the loyalty pension fund program, every year, a portion of every employee's basic salary and a contribution from the company, which increases 10% annually, are added to the fund, however, we decided to cap the company's contribution at EGP 200mn per annum going forward.
A. Hamed	We did not incur such an expense for the loyalty pension fund in 2018.
M. Shamroukh	Exactly. The company did not contribute to the fund in 2018 because in 2017, we accounted for 2018.
	Moving on, the increase in call costs is heavily reliant on the rise in national roaming expenses, which are directly related to mobile revenue growth. Just to reiterate, our long-term strategy is to decrease national roaming costs over time by rolling out more mobile sites and hosting more traffic on our network.
D. Darwich	Okay, great, thank you. If I may, I have one last quick question. How do you expect to monetize the recently launched digital wallet and can you give us a general outlook on the mobile money payment market in Egypt?

S. Shabayek	Tarek Abdelhamid, our Chief Marketing Officer will answer this question.
T. Abdelhamid	Hello. Briefly going over the market landscape, there are around 22 to 24 wallets, primarily operated by banking institutions. Over the last few years, our three competitors have had their own wallets and we have, consequently, seen a lot of traction on digital money. Recently, the Central Bank of Egypt improved the regulatory environment as it gave more freedom for interoperability and international remittances. We see a lot of potential in peer-to-peer transfer digital payments and the unique value proposition that we are trying to hang on to is facilitating payments. To that end, our wallet allows customers to pay for utilities including electricity, water, and gas in addition to other services such as peer-to-peer transfers and QR code purchases. The Central Bank recently announced that around 100k point-of-sale machines will be able to generate QR codes within the next few months.
	I believe this ecosystem will improve a lot especially now that many government services are currently cashless, which will improve the consumption of digital money. At the end of the day, we capitalize on our reach; we have more than 1k outlets in which customers could carry out cash-in and cash-out transactions and purchase devices and we will expand our services to non-exclusive point-of-sale machines such as Fawry machines and so forth, allowing customers to pay via the mobile wallet at any given place.
D. Darwich	Okay, got it. Thank you so much.
Operator	*[Operator instructions]*
H. Abdel-Gelil	Hi, this is Hassan. I have a question regarding the QoQ increase in receivables as well as debtors' and other debit balances that came in simultaneously with a decline in creditors' balances. Please explain the reasons behind this, thank you.
S. Shabayek	Wael Hanafy, our Head of Finance, will answer this question.

W. Hanafy	The QoQ rise in debtor's balances and receivables came as a result of a number of projects that are still in the process of collection, namely NUCA projects, the Port Said connectivity project revenue that we recognized earlier in Q1 2019, and some cable projects that we will collect in Q4 2019. As for the creditors' balances, yes, there is a decrease of around EGP 1bn because we closed some of our due balances and we increased our overdraft facility to better manage our cash.
H. Abdel-Gelil	Should we expect the same payables trend in Q4 2019?
W. Hanafy	We are trying to stretch our payment terms with our vendors for the next quarter and the beginning of next year and after that, we will rebound to our normal trends.
H. Abdel-Gelil	In other words, is there a cap or a maximum limit for the overdraft that Telecom Egypt wishes not to exceed?
S. Shabayek	So far, we have a mandate from the BoD to cap our long-term debts at EGP 13bn and we now have an overdraft of around EGP 3bn on top of the aforementioned limit. This will be revised in the budget. At the end of the year, we will provide a new guidance for our debt position and for FY 2020.
H. Abdel-Gelil	You said the mandate is not to exceed EGP 14bn?
S. Shabayek	EGP 13bn, because that was before expediting our CapEx program. We are going back to our board with a new budget for FY 2020, as we do every year, and a new business plan and we will announce our guidance for the full year once the board approves the budget
H. Abdel-Gelil	Perfect, thanks.
Operator	*[Operator instructions]* The next question comes from Alex Vengranovich from Renaissance Capital. Please go ahead.
A. Vengranovich	Good afternoon, thanks for taking my question. I am just wondering why you have such a solid increase in the mobile customer base in the third quarter. In fact, you have re-accelerated the growth of customers so I just wanted to understand the reasons behind this and how sustainable this growth could be in the coming quarters.
T. Abdelhamid	The reason why we have seen an improvement in our net additions in Q3 is primarily because we revamped our main prepaid offer, which is a hybrid monthly bundle, and we have seen a lot of interest in the market. That was also coupled with

	on-ground activations that took place in sporting clubs and all the popular summer destinations in addition to evolving our distribution channels. All this together, coming with ATL campaigns, increased our net additions.
	We also contained most of the effects of the churn that took place in 2017 and we launched our BTL and ATL campaigns to engage and retain our customers. To sum up, the increase in mobile customers that you see is the dual effect of improving our gross additions and decreasing our churn rate.
A. Vengranovich	Okay, so will you continue this campaign in Q4 and in the future?
T. Abdelhamid	Yes, so far, we are seeing the same level of acquisition and more or less the same churn rate.
Operator	*[Operator instructions]*
	The next question comes from Talal Noueihed from Lazard Asset Management.
T. Noueihed	Hello, everyone. Would you mind stating your CapEx guidance for 2020 and the coming two years and telling us when you expect your CapEx to reach normal levels?
S. Shabayek	Hi, Talal. We should be, again, reviewing our guidance; however, it looks to be in line with what we said before, which is that next year will be the peak of our CapEx and we will decrease our spending after 2020 because by then, our accelerated CapEx program will be complete. We are expecting 2020 CapEx to be similar to this year in absolute terms. It could be a little higher because we are wrapping up many projects but then, definitely, we will normalize our CapEx starting 2021.
M. Shamroukh	The expected CapEx for 2020 will be very high compared to our sales because almost 50% of CapEx will represent services and materials that we are yet to receive from vendors based on previously signed agreements related to the company's accelerated program.
	Consequently, our in-service CapEx ratio for 2020, excluding the aforementioned 50%, will be between 15-20%, back from the high-30s that we have been seeing in the last two years. Going forward, this will help us maintain our depreciation expense at its current level and control our cash position.
Operator	The next question comes from Paul Farah from Steyn Capital Management. Please go ahead.

P. Farah	Hi, thank you very much for the call. My question is very similar to Talal's. As per my understanding, you are saying that normalized CapEx will represent 15-20% of sales. However, if I am looking at your cash flow from operations, it is quite less than that so when do you expect to generate free cash flow? Thank you.
S. Shabayek	Our operating cash flow is pressured by the payables as a result of the expedited program so a balanced working capital will hopefully lead to free cash flow by 2021.

Conclusion

S. Shabayek	Thank you everyone for dialing in and as usual, if you have any further questions, please contact the IR team.