TE Call Q1 2022 results call transcript

Speakers

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M. Wael: Good afternoon everyone, apologies for the delay and thank you all for joining us today. Welcome to Telecom Egypt's first quarter 2022 results call. From telecom Egypt, we are pleased to be joined by Mr. Mohammed Abo-Taleb Chief Commercial Officer, Mr. Mohamed Shamroukh CFO and Mrs. Sarah Shabayek Investment, Decision Support and IR Senior Director. As usual, we are going to start with a brief about the quarter's financial and operational highlights. This will be followed, as usual, with a Q&A session. If you have any question, please type it in the in the Q&A tab at the bottom of your zoom screen. With no further delays, I will now hand over the call to management, please go ahead.

S. Shabayek: Thank you, Mariam and thanks to Al Ahly Pharos for hosting this quarter's conference call. We are very sorry for the delay, completely unexpected. Good afternoon and welcome to our Q1 2022 earnings' call. We will start the call with a briefing of the operational performance in the quarter presented by Mohamed Abo-Taleb, our Chief Commercial Officer. Unfortunately, our CEO, Adel Hamed, is out today, as he closing some important business deals in Kingdom of Saudi Arabia and we are fortunate to have Mohamed Abo-taleb with us today to fill in. The key financial highlights will be presented by Mohamed Shamroukh, our CFO. We will also be joined in the Q&A session by Tarek Abdel Hamid, our Chief Marketing Officer and Wael Hanafy, Senior Director of Finance. 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 harbour 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 that we continue to hold these views in the future. 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. Mohamed Abo-Taleb to discuss the operational highlights.

M. Abo-Taleb: Thank you, Sarah. I'm Mohamed Abo-Taleb, CEO's Vice President and Chief Commercial Officer. Good morning and good afternoon, everyone. Thank you for joining our call today. I am very pleased to report that during the first quarter of the year and despite of the global economic headwinds, Telecom Egypt was able to report a promising set of organic results supported by healthy operational KPIs. On top-line, Telecom Egypt's revenue grew 12% YoY, thanks to growth in both the retail and wholesale segments, supported by diversified revenue streams and a growing customer base across different business lines. Data continues to grow supported by an increasing mobile and fixed broadband customer base and ARPUs continue to rise steadily, reflecting our efforts to offer our customers enhanced propositions and create value of every interaction. EBITDA grew 11% YoY, reporting a healthy margin of 38%. Such margin was achieved from the organic cyclical revenue streams and not including any above average margins from infrastructure or international cable projects. This pipeline is still quite busy and we are expecting to see more from that into the following quarters of the year. Our organic operating profit and net profit came almost flat YoY, considering the hike in D&A costs in light of the new accounting treatment of FX changes on the assets level and the amortization of the newly acquired spectrum. Telecom Egypt's FCFF, excluding the one-off annual payment for the license, remained in the positive territory with EGP 0.7bn, capitalizing on last year's performance and setting the tone for healthier organic cash flows in the coming quarters. Our focus in the previous years was to drive P&L growth and from there cash flow growth organically and inorganically through our investments. That focus has not changed but has been refined to sustainable cash flow growth. For that reason, our strategy and KPIs have been transformed into one punch-line: "value creating customer experience", value to our customers in every interaction with us and creating value through these interactions to our shareholders. As such, this year we are revamping the way we do a lot of things to refine our value proposition, to bring value and consistency in the way we deliver our sales and after sales service. This approach will create operational efficiencies, boost growth, and enhance our financial KPIs in turn. This is the way forward to keep the strong momentum we have achieved and future-proof the organization from any headwinds.

With that, I have completed my operational brief and I will now hand the call over to Mr. Mohamed Shamroukh, our Chief Financial Officer, to discuss the key financial highlights.

M. Shamrouk: Thank you, Mr. Mohamed. I will start with some highlights of the first quarter in 2022. The year ahead is likely to face some challenges that we have been navigating and thankfully managing to overcome successfully. Supply shortages, the EGP devaluation and inflationary pressures are the obvious challenges we have been preparing ourselves for, since the 4th quarter of last year.

Our results have been impacted by the devaluation, obviously accounting-wise we have utilized the new FX standards that have partially neutralized the impact on our P&L with some exceptions related to a slight increase in depreciation and some FX losses and Vodafone Egypt has not utilized the same standards, which led to a huge decline in our investment income. Organically, however, our profitability indicators are growing with an 11% EBITDA growth and bottom line was flat YoY. The devaluation has also led to a minor increase in our net debt to EBITDA ratio to 1.2x from 1.1x, had we used the old exchange rate. Accounting aside, our exposure to the devaluation will have minimal and close to no impact on our cash flows, which in our view is what really matters. In Q1, 19% of our top-line came from foreign currency denominated and received revenue. Since the devaluation took place in the last week of the quarter such revenue has not yet rerated to the new exchange rate, and it is expected to reach 23% out of the total top-line in FY 2022. This would be obvious in the coming quarters and was obvious after the 2016 devaluation. That said, our foreign debt payments of interest and principal are structured to match our net inflows of foreign currency and in that sense we believe, we are hedging our cash flows even against future devaluation moves. On another note, we have been quite fortunate to have mostly completed our investment cycle in 2019 and 2020, as supply shortages of equipment are indeed a burden on many industries around the world, we have been maneuvering around this risk and are able to continue to operate seamlessly. Finally, inflationary pressures have been rising and we have been taking measures in our commercial offerings as well as cost efficiency measures to mitigate this risk. That said, our employees also feel the pain and we have decided to push forward the usual January annual increase, which is scheduled for January 2023 forward to April 2022 in order to ensure that our performing human capital continues to do the great job we've seen over the past few years, this effectively would mean that salaries will increase again in Q2 2022, but remain flat in 2023. Lastly, I would like to reaffirm our guidance for the year, with early double digit revenue, margins in the mid-to-high 30s, CapEx to sales in the low 20s and most importantly a double digit FCF to EBITDA.

Going into some slides, slide# 14 in the presentation provides us with a normalized view about our financing obligations including vendor financing. Our net debt (including vendor finance) to annualized EBITDA stood at 1.2x. Our aim is to maintain this ideally kept at 1x and deleverage gradually over the coming three years. Worth noting that, our interest expense during this quarter declined by 28% YoY and effective interest rate improved further to 4.6% despite of the current higher interest rates in EGP and USD facilities, thanks to the debt restructure backed by stabilized revenue streams in foreign currency generated through our international business units.

Slide# 16 shows our FCF to Firm landing at -1.1bn, adjusted for some governmental payments to be settled in Q2 from its share in 2021's dividends. Excluding the license payment leads to an organic FCF of EGP 0.7bn. Annually this and adding expected dividends from Vodafone leads to annualized FCF/EBITDA of 15% by the end of 2022.

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

M. Wael: Thank you so much. I would like to remind our participants, if you have any questions, please type them in the Q&A box at the bottom of your zoom screen. Our first question is about Telecom Egypt's role in the "Haya Karima" initiative, the revenues and profits expected from this project, and the accounting treatment of the project's figures.

M. Shamroukh: "Haya Karima" or "Decent Life" is a huge initiative launched by the Egyptian government. It aims to develop thousands of villages nation-wide with the 1st phase covering almost 1.5k villages with a total value of EGP 5.8bn. The government will grant Telecom Egypt the total cost of building the infrastructure, which will be used later by TE to provide commercial offerings for its retail customers. There is no impact on our cash flow position and financial obligations as we have received a down-payment with almost 25% out of the total cost of the 1st phase and will collect the remaining amounts upon the completion of certain milestones as we move-forward. The new infrastructure will be based on FTTH technology, which will enable the provision of high speeds and stable services for better customer experience. From an accounting perspective, we will book the collected money as a grant and a deferred revenue, which will be recognized with corresponding D&A costs over a certain period of time to neutralize the impact on P&L and taxes. This is a value accretive project, as the targeted villages are underpenetrated when it comes to data services and there will be no burden on the company's financials while building the infrastructure.

M. Wael: The second question is about the slight contraction in the quarterly gross profit margin. Basically, they're asking if we could see the 40% mark again before the end of the year on the gross profit level.

M. Shamroukh: We guided the market for an EBITDA margin of mid-to-late 30's. By looking at Q1, there were no one-offs due to new cable projects or other revenue streams, thus performance was organic across our business units. We are expecting some projects in the pipeline to be recognized in the coming quarters, and definitely, this will positively add to our margins. Hopefully we can reach the 40% margin, but we are still committed to our earlier communicated guidance.

M. Wael: Okay, thank you. The third question is about Vodafone's current net debt: When do you expect the Vodafone investment income to rebound back? Maybe in the coming quarter?

S. Shabayek: Vodafone has a current net debt of about EGP 3.7bn. Obviously, in Q1, Vodafone Egypt applied a number of special accounting treatments. Based on our expectations and their insights, our share of their organic net income should be around EGP 0.6bn per quarter. So effectively, if you look at Vodafone's revenue and EBITDA, they're growing steadily, and we are expecting that number to grow organically over time, as well as with their cash flow generation, due to lowering interest expenses incurred.

M. Wael: Okay, thank you. Another question is: Can you clarify if the updated FX rates were used for the debt vendor financing and other balance sheet items for the first quarter results?

S. Shabayek: Yes, they have been used. The devaluation happened on 21 March, so all the Q1 balance sheet accounts have been restated to reflect the new exchange rates. We've basically seen a 16% devaluation, which has already been factored in on all the balance sheet accounts. On the P&L, obviously, it was just one week, so all revenue or cost elements booked in the last week of the quarter were also recognized in line with the new exchange rates.

M. Wael: Okay, thank you. Another question from the same participant: Can you explain the significant increase in depreciation & amortization YoY, as well as the decline in investment income?

M.Shamroukh: As mentioned earlier, the significant increase in D&A is related to (i) the amortization of the newly acquired spectrum; (ii) introducing more in-service CapEx based on our investments during the last couple of years; and (iii) the FX treatment on assets, which added EGP 100mn annually to the normal D&A costs. Regarding Vodafone, as explained by Sarah, it didn't treat the effect of the FX change as we did; it recognized the full FX impact on the P&L, which attributed to the decline in our investment income.

M. Wael: Okay, clear thank you. Another question says: Do you expect dividends from Vodafone to be negatively impacted by its low performance so far in Q1 of 2022, and how much do you expect in dividends from Vodafone by the end of this year?

M. Shamroukh: To make it clear, the FX effect has no impact on the cash flow of Telecom Egypt or Vodafone Egypt as all our debt payments are settled from foreign currency insourcing revenue streams. As per the Modified Shareholders' Agreement with Vodafone, our dividend distribution is not related to net profit; it is related to FCF from operations, which will not be negatively impacted. Accordingly, we are expecting the same dividends that we budgeted for based on our performance and Vodafone's guidance to be around EGP 1.3bn.

M. Wael: Okay, thank you. Another question is: Could you please state how much of your COGS is in USD at the moment; should we expect any sort of margin compression or maybe higher costs in USD during the upcoming quarter?

M. Shamroukh: Most of the hard currency COGS are related to international incoming calls, which generate revenues also in USD. In addition, part of these costs are even paid in local currency. Accordingly, we are not expecting our marginality to be negatively impacted as the cost is associated with revenue generation. During Q1, our margins for international incoming calls enhanced from almost 28% to early 30's. However, CapEx spent might be impacted as 80% comes in USD, but we are still committed to our guidance for CapEx as a % of sales to enhance our financials and deleverage the company going forward.

S. Shabayek: I think what's important to note here is that the CapEx to sales ratio is an important KPI for us and for our board. Internally, we are prioritizing higher-value projects and exploring ways to improve CapEx efficiency, in order to remain within the guidance and not adversely affect the company's growth. This is a very important point.

M. Wael: Okay, thank you.

M. Shamroukh: Okay, I have one thing to add related to COGS. The company shifted from the leased model for ADSl routers (CPEs) to a sales model in light of the global headwinds encountered in the supply chain. In Q2 onwards, we expect an increase in this cost element, however this will be coupled with healthy cash flow generation on the back of router sales.

M. Wael: Okay, thank you. The next question is: Can you please comment on the fixed line ARPU and guidance on price increases this year, also on the mobile ARPU?

T. Abdelhamid: This is Tarek T. Abdelhamid, Chief Marketing Officer. We've seen a significant development in the last three years on the fixed line ARPU level QoQ. This is hugely attributed to the new norm brought about by the pandemic. Starting H2 2021, this effect has been normalized to a certain extent, and we now see organic ARPU growth related to the product mix/customer segmentation and some below the line CVM activities. On the mobile side, we've seen a significant growth in the ARPU level YoY. This is a healthy trend driven by a growing base as we continue to attract higher-value customers, and we expect this trend to continue for the rest of the year.

M. Wael: Okay, thank you. Another question related to the mobile ARPU: How did the 4.7mn social solidarity and school student subscribers negatively impact the blended mobile ARPU?

T. Abdelhamid: Well, the ARPU is a byproduct of the subscriber mix and as I mentioned, we continue to attract higher-value customers at large to maintain the organic growth while continuing to serve the student segment and the solidarity project – the impact of which has already been quite obvious in 2021. Going forward, the base mix and the healthy ARPU development on the normal segments will contribute to the ARPU growth, so I don't think we will see further influence of the 4.7mn subscribers you mentioned on the ARPU level.

M. Wael: Okay, thank you. Another question is, have you seen any change in the behavior of consumers due to high inflation, like, for example, moving to smaller bundles?

T. Abdelhamid: To date, we haven't seen any contraction in customers' consumption. As you see in the presentation, the traffic is still growing – reflecting a healthy trend, which means that the consumptions of different products are still the same or even growing better, and this corresponds with our strategy to evolve the product portfolio and continue to attract higher-value customers. We are now focusing more on the fixed mobile conversions value propositions to attract higher-value customers.

M. Wael: Okay, thank you. The next question is: With the potential change in Vodafone Egypt's ownership from Vodafone Group to Vodacom, do we expect to see any change in the strategy or in Vodafone operations?

M. Shamroukh: We are not entitled to comment on this. However, we don't expect any change in Vodafone's strategy for the local market, but we do see an upside, mainly in the financial services market. As you know, Vodacom is a leader in providing financial services and given Vodafone Egypt's position as the local market leader in this sector, through its VF cash platform, we do expect they will introduce new products and further enhance this area while maintaining the same strategy.

M. Wael: Okay, thank you, I would like to remind our participants that if you have any questions, please type them now. Another question is regarding the government's interest in attracting private investments, and in the meantime is there any progress with the tower sales?

M. Shamroukh: The government can comment on its interest in attracting private investments. Regarding the second point, mobile towers sales is one of the main pillars that we are working on. We've already hired financial and technical consultants to work with us on the tower sale transaction and we are doing our best to close a deal by year end with an estimated return of USD 250mn. Additionally, there is the build-to-suit model that will positively impact our financials by saving 50% of the CapEx needed to roll out mobile sites, besides the rent model. A lot of options and details are on the table, but we are rationally studying all the alternatives to make sure the quality of service is maintained so as not to affect our commercial position now or in the near future.

M. Wael: Okay, thank you. The next question is: Could you please repeat the impact of the accounting treatment for the "Decent Life" initiative?

M. Shamroukh: In a simple format, the first phase of "Haya Karima" will cost us about EGP5.8 bn. The cash received will be recognized as an asset that will amortize over a certain period of time. Corresponding to this amortization, an equal amount of revenue will be recognized annually to neutralize the impact on the P&L and avoid tax implications.

M. Wael: Okay, thank you. A CapEx related question: Could you please state your guidance for CapEx/sales for this year and next year?

S. Shabayek: Our guidance for 2022 is early 20's, and for 2023 it's about 20%. The long term guidance is 18%; this is where we see maintenance plus expansion CapEx going forward.

M. Wael: Okay, thank you. Another question asks about the willingness of Egyptian corporates to spend on telecom services.

T. Abdelhamid: In the enterprise segment in specific, we've seen high demand related to digital transformation programs—as a cost-saving kind of approach. We are expanding our product portfolio, particularly for managed services and digital transformation; and our data centers have enough capacity to serve our local market as well. Recently, we secured a couple of interesting deals, so the demand is still there and we forecast that it will continue.

M. Wael: Okay, thank you. Another question is related to the announcement or the agreement with Mobily to build a submarine cable: Could you please provide more details on that topic?

M. Shamroukh: This is business as usual and more commercial details will be disclosed at the appropriate time.

M. Wael: Thank you so much, this was our final question. I would like to ask our participants, if they have a final question, to please type it now. We will wait for one minute to see if there are any questions.

It seems we have no more questions. I would like to thank you all for joining and will hand over to management for any closing remarks.

S. Shabayek: Thank you very much Mariam for hosting the call today. Thank you everyone for attending. The IR team is at your disposal if you have any further questions. Again, sorry for the delay, and the technical issues here and there and looking forward to seeing you all in the next quarterly call. Thank you very much.

M. Wael: Thank you so much Sarah. Thank you all for joining. Have a great day everyone.