# Türk Telekom Q1 2019 Financial & Operational Results Conference Call

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***Conductors:***

***Dr. Paul Doany, CEO***

***Mr. Kaan Aktan, CFO***

***&***

***Ms. Gözde Çullas, Head of Investor Relations***

OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Gelly, your Chorus Call operator.

Welcome and thank you for joining the Turk Telekom conference call for the First Quarter 2019 Financial & Operational Results.

At this time, I would like to turn the conference over to Ms. Gozde Cullas, Head of Investor Relations, Dr. Paul Doany, CEO and Mr. Kaan Aktan, CFO of Türk Telekom.

Madam and Gentlemen, you may now proceed.

ÇULLAS G: Hello. Welcome to 2019 First Quarter Results Conference Call. We are here with the management team, and today's speakers are our CEO, Dr. Paul Doany and our CFO, Kaan Aktan. Before we start, I kindly remind you to review the notice on our earnings presentation. Paul, please.

DOANY P: Thanks, Gözde. Welcome to you all. I'm pleased to announce that we had a very strong start to the year in terms of operational KPIs and financials. Our strategy of focusing on growth efficiency and customer experience is delivering. Our strong performance enables us to invest in improving the lives of our customers with our digital transformation ambitions in addition to our passion to provide accessible communications to all.

During the quarter, we successfully completed our $500 million U.S. bond offering with 6-year maturity. This is the first Turkish corporate transaction since April 2018 and the first Turkish Eurobond to price inside fair value since May 2016, 5 times oversubscribed from 264 investors across 39 countries, a clear sign of appreciation of our strong balance sheet and record growth in subscribers, revenue, operating profitability and high cash generation capacity.

We are well-positioned to deliver value with digital and ICT solutions in addition to our main core telecom services. To leverage on this strength, we are streamlining our efforts in digital with the recent establishment of a new digital product development unit, led by Dr. Ramazan Demir, who worked with me in my first ten years in fact in charge of digital products. Since then, he also led regulatory strategy. Early 2017, he has now taken over this role and he is now appointed as Assistant General Manager.

We launched our new messaging platform, LAFF, developed by our technology development company, Argela our subsidiary. This is an operator free app, many novel features not available in other platforms will soon be seen complementing, of course, our keyboard platform, Tambu.

We are beginning to focus on monetization features over the keyboard, which, of course, will be operating over LAFF and other platforms, such as, WhatsApp and Bip and so on. Without much campaign effort, we have reached 8.7 million downloads as the leading keyboard in the country. We also highlight our online self-service app, Online Islemler best-in-class self-service customer experience, reaching 26.4 million downloads. Apart from these platforms, we continue to use other digital services to drive customer retention.

I can comfortably say that we are prepared to lead Turkish digital future, building on the synergy of Türk Telekom and subsidiaries, including Innova, Argela and Sebit, as well as, our corporate venture capital investments.

Currently, preparations and tests for 5G are underway in the country. From this perspective, Argela plays a pivotal role, especially in enhancing 4.5G technology for improved monetization of smart digital network features over both fixed and mobile networks, as well as, leading the way for deployments in 5G using advanced products and SDN, Software Defined Networks, Network Function Virtualization and RAN slicing technology in cooperation with other Tier 1 operators in the U.S., and Europe.

I will now take you quickly through the presentation to allow more time for questions.

Slide 3, operational highlights show the first quarterly subscriber performance. Mobile segment was the leader in net additions in the first quarter. With our strong performance in mobile, we are advancing well towards our 30% subscriber market share target. The last 12 months, net additions in mobile was 2.2 million, the highest since the IPO. We continue to increase our subscriber base in fixed broadband segment with 131,000 net additions in the first quarter. This was supported by our penetration focused offers and our new unlimited offers.

The number of our total subscribers increased by 9.7% year-on-year to 46.7 million, with 737,000 net additions in the first quarter. Our strategy of growing our customer base through cross-selling, as well as, retention campaigns benefiting from our integrated synergetic structure and penetration growth focused in the fixed broadband. This combination will continue to pave the way for sustainable subscriber growth.

With this strategy, we now have the consent of 74% of our subscribers for sharing their information within the Türk Telekom Group companies. Triple play drives increased multiproduct ownership among the constant universe of customers who consented a year ago to our multiproduct ownership increased from 59% last year to 63% in the first quarter.

Slide 4, financial performance; here I will briefly summarize the key financials. Top line growth, excluding IFRIC12 adjustments 16.7%, supported by all the main business segments. We're very pleased with our EBITDA of 2.7 billion lira, a 35% increase year-on-year, 49% EBITDA margin or 7 percentage points up compared to the first quarter of 2018. EBITDA was positively impacted by IFRS16 accounting. Excluding this impact; the EBITDA margin is still outstanding at 46%. EBITDA performance is supported by strong revenue growth, as well as, continued improvement in OPEX. There are also some seasonal impacts in some OPEX items, such as in commercial and personnel expenses, which Kaan will mention in detail in his part.

Net income in the quarter grew year-on-year to 310 million lira, with the improvement in operating performance. Excluding impacts of FX losses and FX hedges, our net income increased to 952 million lira. CAPEX was 637 million lira in the first quarter. We are working on models to minimize duplicate investments by all operators. I'll touch upon that shortly, to support Turkish economy.

On mobile, we are working on scenarios to replicate active sharing model that we have successfully built in Zonguldak which is particularly suitable to low population densities. In terms of passive sharing, we currently have passive sharing at around 5,000 sites, with mostly Vodafone but also Turkcell. We are targeting to extend this model further into a model for high-population density areas and this will operate with both Turkcell and Vodafone.

On the fixed side, an extension of the leasing model, similar to the pilot project we did in Sincan with Vodafone, also contribute to CAPEX efficiency. We are working on a discounted fiber model to base stations in what we term FTTS, fiber to the site. FTTS will be key for enhanced 4.5G through radio slicing, as well, as small-cell technology again over 4.5G, i.e., well before 5G. The same model, of course, can work over 5G provisioning for both Turkcell and

Vodafone. Minimizing fiber network duplication which we have already offered in the commercial protocols in place; as you know, we have signed these protocols with all the operators. This will allow a level playing field in 5G, with the prime fiber connectivity being provided by Türk Telekom to all the players, fair competition, and level playing field.

Slide 5: fixed broadband performance. We recorded 131,000 net additions in the first quarter, and the number of our fixed broadband subscribers exceeded 11 million. Slowdown in subscriber additions is related to our initial marketing for unlimited packages in the fourth quarter 2018 as some of the demand shifted to the fourth quarter, ahead of the launch of the new unlimited offers. We will continue our strategy to drive penetration via affordable entry-level penetration packages and regional campaigns.

In the first quarter, around 70% of these subscribers came via this penetration focused campaign, Internet Bizden. The contribution of partnerships with existing companies will also resume, offering diversification of distribution channels. Starting from 2019, we lifted, of course, our fair usage quota for unlimited tariffs and launched high-capacity offers. We also included 6 megabit per second and 12 megabit per second to our portfolio to provide affordable price points during the transition to unlimited.

Half of the subscriber additions in the first quarter, excluding the entry package, preferred the unlimited package. Additionally, more than half of our existing subscribers preferred unlimited offers during re-contracting. Along with the transition to the unlimited era, we increased our fixed broadband list prices around 25% for new subscribers in January. With up-sells and pricing adjustments carried out earlier, we increased the ARPU by 6% year-on-year.

In terms of fiber, having the most expensive fiber footprints with 285,000 kilometers of fiber, fiber homepass has now increased to 19.1 million in the first quarter. The number of fiber subscribers reached 3.7 million. Speed up-sells will be more crucial in this new unlimited era. Share of our subscribers who prefer 20 megabit per second increased to 37% in the first quarter from 31% a year ago, which shows that we have more up-selling room to drive ARPU.

6th slide, we cover mobile performance. We continue to move towards our target of 30% mobile market share in a cost-effective manner. During the quarter, we added 575,000 mobile subscribers, carrying the last 12 months' net-adds to 2.2 million which is the best net-add performance since 2008. The number of mobile subscribers now increased to 22.1 million. ARPU increased by 7.9% year-on-year despite the negative impact attributable to the suspension regulation and also regulation regarding maximum limit on charges per SMS and voice. The impact of this suspension regulation will be in the base in the second quarter.

Despite the effect of these regulations, we increased service revenue growth by 19%, higher than the leader operator's mobile subscriber revenue growth. Meanwhile, more than 95% of our net additions in the mobile segment came via postpaid subscribers, and postpaid ratio increased to 58%, up from 56% the year before.

Churn rate in the first quarter remained stable at 6.1%, historically lowest level. We aim to maintain our low churn level with our strong value proposition, best-in-class customer experience strategy supported by our customer experience platform, online transactions and our loyalty campaigns via Sil Süpür.

We also aim to use our value-added services more effectively as part of digital packages for retention for our main tariffs, Muud Müzik, Playstore games, e-Dergi the digital publisher, Tivibu Go our television platform including additional features for video-on-demand and catch-up services in high definition quality.

Mobile data on Slide 7; data revenues now represent 59% of the mobile service revenues compared to 55% in the first quarter last year. Our data revenues increased by 19% in the first quarter year-on-year, this is supported by both LTE conversion facilitating high data consumption, as well as, tariff portfolio which started to include more abundant data offerings. LTE population coverage expanded to 92% from 87% a year earlier.

Meanwhile, the share of LTE users continues to grow to reach 49% share among our mobile subscribers, up 10 percentage points from a year ago. 78% of our Smartphone users are now in LTE compatible devices. Average multi-data usage per LTE user is now at 6.2 gigabytes, up from 5.3 first quarter last year.

TV performance, Slide 8; we have achieved our stated target of reaching #2 position in Pay TV. This was an opportunistic strategy given weak subscriber growth from the incumbent market players. We're talking here about the TV incumbent players. So we drove affordable Pay TV to the mass market, aiming to penetrate more homes using satellite television bundled with our mobile postpaid offers which is what we call our wireless home, as well as driving fixed broadband consumption with IPTV to the wired homes.

According to the regulatory authorities' fourth quarter report, we have 24% market share, almost double the level of 2 years ago. Additionally, we continue to drive our OTT platform, Tivibu GO, to support subscriber acquisitions and retention, especially in our mobile segment via building on the strong value proposition of Tivibu GO over multiple screens. The increase of the GO subscribers will also drive growth in mobile data consumption and contribute to mobile service revenues via the wireless home being provided over wireless… meaning our mobile network or fixed broadband for those who opt for a wired connection.

The next chart, fixed voice, on Slide 9 shows our success to retain fixed voice subscribers thanks to our synergy offers, as well as, our entry package, Internet Bizden, and third-party benefits. Fixed voice subscribers increased by 255,000 over the last 12 months. Meanwhile, the number of total fixed lines, including both fixed voice and nDSL, increased to 14.5 million, the highest level over the past 25 quarters.

First quarter fixed voice ARPU increased by 3% year-on-year to 22.7 with support of price increases on the tariffs for uncommitted subscribers and tariff components last year and higher re-contracting prices.

Additionally, we increased prices for uncommitted subscribers by around 10% to 15% in January. With the growth in subscribers and ARPU, fixed voice revenues r increased by 6.5% year-on-year in the first quarter. This is a remarkable turnaround and we target to keep this momentum going thanks to our teams' efforts. Mr. Kaan.

AKTAN K: Paul, thank you. Good afternoon, everyone. We are now on Slide 11 with our financial performance. We had a successful first quarter with strong figures in our key financial metrics. Consolidated revenues, up by 15.3% year-on-year. Excluding construction revenues IFRIC, meaning top line growth is close to 17% which is in line with our guidance. This growth is primarily driven by mobile and broadband businesses, which both grew at 17%. The revenue growth in both businesses came with a healthy combination of subscriber and ARPU growth.

Price increases carried in the fourth quarter last year and higher data consumption are the main drivers for mobile ARPU growth. As we mentioned in the previous quarters, 85% of our subscribers in postpaid are committed. This means that headline price increases immediately impact our new subscriber ARPU, but there will be some time next quarter seeing the impact on committed subscriber base.

On the fixed broadband, we see still fair usage implementation at the beginning of the year. More than half of our existing subscribers preferred unlimited offers during re-contracting. In this segment, we increased prices for uncommitted subscribers by around 25% in mid-January of this year. Upsells and price increases together led to 6% overall ARPU growth in this segment.

On the fixed voice, revenue growth is at 6% year-on-year in the first quarter is well driven by growth both in subscriber and ARPU. Additionally, in fixed voice, we similarly increased tariff prices by 10% to 15% at the beginning of the year. Going forward, we will continue to assess possibilities to adjust prices by monitoring the parameters of the market as well as macro environment.

Our EBITDA performance was substantial in the first quarter. We recorded 2.7 billion lira EBITDA with a margin of 49.1%. Even when we exclude the impact of the new reporting standard, which is IFRS16, accounting of leases, year-on-year margin improvement comes to 4 percentage points. This is the result of strong revenue growth, efficiency measures undertaken in OPEX management, integration synergies, digitalization and prudent receivable management.

The contribution to EBITDA from our mobile business is also improving. Our stand-alone mobile EBITDA margin increased to 32% from just 13%, which was the number 2 years ago. Operating profit of mobile is positive for the past 6 quarters. Positive change in margin came from structural improvement in this business, including increased scale, group synergies, support of new frequencies and optimized commercial spending. This trend is confirming our strategy of growing mobile market share in a profitable manner.

In the first quarter of this year, consolidated operating expenses increased by 1.2% year-on-year. After adjusting for the positive impact of IFRS16, operating expenses increased by 7.7%, which is well below the revenue growth and also the inflation.

Looking at individual OPEX components, the increase in direct cost is lower than the increase of core revenues. This is clearly contributing to the margin improvement. Provisions for doubtful receivables declined by 32% year-on-year. Our timely decision in last year for implementing more strict credit policy rules and gradually reducing the dependence to device sales is providing solid results, especially when we consider the changes in the macro parameters.

Regarding the commercial expenses in line with our plans, we started the year with lower marketing expense. We had a healthy growth in the mobile segment with strong net additions during the quarter. As such, we prefer to optimize our spending for this quarter. For the fixed broadband during the quarter, we observed that the core customers in our sales channel have been adapting to the transition to unlimited world with no fair usage quota. Similar to mobile, the marketing activity was relatively muted. However, we take up the marketing activities in the second quarter.

Our employee costs increased by 9% year-on-year and this is still reasonable considering the minimum wage increase of 26% this year, which is affecting people-related costs mostly in our call center. Excluding our call center business, our headcount declined by 7% year-on-year, and this supported the increase in the personnel expense to be limited. In the coming quarters, the increase in personnel expense would be higher as we will have the implementation of wage increases for our non-unionized employees. This is in the second quarter. And with this, our focus on operational efficiency has accelerated since the start of integration. This has enabled us to efficiently manage our cost structure.

Network and technology expenses increased by 6.2% year-on-year. Excluding IFRS16 impact, growth was 35%. This is mainly due to increase in the cost of utilities, meaning electricity mainly and FX based technology expenses for services and maintenance.

CAPEX in the first quarter was 637 million lira, which is 10% higher than last year. We recorded 310 million lira net income in the quarter, 1.3 billion lira net financial expense. This had an impact on our net income. We had slightly more than 800 million lira loss due to the FX, a similar level compared to last year.

Interest expense increased year-on-year, mainly due to hedge transaction we carried since the beginning of the second quarter of last year. Post hedges, total cost of financing is now around 9.5% as of March 2019. Net income was also supported by 95 million lira tax income. The main reason behind the tax income is related to deferred tax assets in TT Mobil, as the mobile business is performing well in terms of growing profitability, and we see higher probability to recover certain parts of its previous years' statutory tax losses.

So we move to next page, which is Page 12. I will take you through the debt profile. Our net debt increased by 8% quarter-on-quarter to 17.1 billion lira. The increase is primarily caused by the lease liabilities of 1.1 billion, which is now reported as financial liability after the implementation of IFRS 16. Net debt to EBITDA remained stable at 1.86 multiple compared to previous quarter. And again, excluding IFRS 16 impact, the ratio decreased to 1.78 multiple. Our current leverage level is lower than most of the major global telcos. However, with strong cash flow, we target our leverage to come down to below 1.5 in 1 to 2 years' time.

In February, we successfully completed $500 million bond offering with 6-year maturity. There were 5 times oversubscription for our bond offerings. Looking at the maturity profile, the share of debt with more than 5 years maturity increased to 29% from 19% in this quarter. With the support of the new bond, we have now a strong liquidity of 7.3 billion lira in cash.

We are now on Slide 13. I would like to give you some highlights on our hedge position. We continue to execute additional participating cross-currency swap transactions, both with euro and dollar contracts, and the total dollar equivalent value of those contracts was close to $600 million in the first quarter. With these transactions, we have specifically addressed the debt service of 2019 and 2020. We have now reached to around $2.5 billion equivalent of swap position in total. Both principal and interest payments are covered in these swap contracts, and we hold the right to settle at gross level, meaning we also secure the hard currency liquidity requirement.

As we mentioned before, participating in cross-currency swaps provide protection depending on the barriers of the transaction. Our hedges have the highest protection above dollar-TL rate of 6 TL. Moreover, we continue our strategy to use cash as a tool to manage total FX exposure. FX based cash is is at around $1 billion. We significantly increased our hedge ratio to 84% in the quarter from 67% in the last quarter of last year.

Let me also add that with recent transactions, we have now fully hedged the debt service of 2019 and 2020, which is now giving us maximum clarity in our cash flow of the next 2 years, which will be result of the debt service. Going forward, we target to keep the total hedge ratio at minimum its current level. With improved hedge ratio, as you can also see in our foot notes, the sensitivity of P&L to FX movements continue to decline. The effect of 10% depreciation of lira would have less than 800 million lira impact in our P&L, which is reduced by 42% when we compare it to the previous quarter.

Looking at our cash flow generation, our unlevered free cash flow improved significantly to 1.4 billion lira from a negative 148 million in the same quarter of last year. Our last twelve month unlevered cash flow increased to 5.1 billion lira, which may be a good indication for the full year results of 2019. We have been able to reduce the net financial debt excluding IFRS16, by more than $400 million in the last 12 months by simply using the cash generated from operations without any one-off proceeds. Strong EBITDA generation, together with the disciplined CAPEX will support our cash flow positively in the coming periods. And we believe that this is a very strong differentiation for Türk Telekom.

We are now on Slide 14. We are keeping our guidance unchanged, which was 15% to 16% year-on-year growth for consolidated revenue, excluding IFRIC. EBITDA at 10.0 to 10.2 billion lira, CAPEX will be at 4.6 billion to 4.8 billion lira. CAPEX guidance does not include gross additions to right of use of assets, which is around 900 billion lira. But this is netted off by gross additions to leasing liability arising from IFRS 16.

Regarding the EBITDA's performance in the first quarter, some cost items were lower than what we would expect to see in the rest of the year. We should expect a normalization in the coming quarters. Depending on the cost dynamics and revenue trends, we will assess our EBITDA guidance in the coming period. However, based on the current performance, we are comfortable to deliver the high end of EBITDA guidance. Overall, we expect another strong year in 2019.

Well, thank you very much. I will hand over the call to Gözde now for the Q&A session.

ÇULLAS G: Yes, operator, we can open the Q&A session. Thank you.

Q&A

OPERATOR: The first question is from the line of Kim Ivan with Xtellus Capital. Please go ahead.

KIM I: Yes, good afternoon, 2 questions, please. Firstly, on the cost of debt, so what is the current cost of debt hedged from FX into lira? And what is the average maturity of your hedges, please?

And the second question on the commercial expenses, those went down quite markedly in the first quarter. So I was just wondering whether we can expect the commercial activity and cost to normalize in the remainder of the year.

And for the, let's say, general inflation to impact that cost line as well even though probably to a lesser extent than things like wages. But still, we probably should expect that cost to rise, right? Thank you.

AKTAN K: Well, the total cost of financing, including the hedges is slightly less than 10% right now. It's a combination of hedge portion and un-hedged portion, which is now a smaller percentage of the gross debt. The average cost of the hedged portion is around 12%, 12.5%. But those are the transactions that we accumulated during the last 2 years. So new hedges would come at mid-teens to high teen's level.

Coming to your question on commercial expenses, for the full year, we should definitely expect a nominal increase compared to last year. But the percentage increase should definitely be, again, below inflation and revenue growth, which will mean that we should spend a smaller percentage of revenues for commercial spending.

KIM I: Thank you very much. This is very helpful. But just quickly, what is the average maturity of your hedges right now, if you disclose that? Thank you.

AKTAN K: Well, the average maturities of the hedges… is just replication of the maturity of the debt, so they are symmetrically hedged, with all the interest payments and principal payments.

KIM I: Okay, great. Thank you.

OPERATOR: The next question is from the line of Degtyarev Vyacheslav with Goldman Sachs. Please go ahead.

DEGTYAREV S: Yes, thanks for the call, also the questions. Firstly, how would you describe competitive environment in Turkey during Q1 and also going into Q2?

And secondly, also, how would you describe the corporate solutions opportunity for you? It does seem that Turkcell is getting more focused on that. Basically, do you see high opportunity in corporate segment compared to the consumer segment in Turkey? Thank you.

DOANY P: Could you just repeat that first question, brother?

DEGTYAREV S: Yes. Sure. The first question is basically, how would you describe the competitive environments in Turkey at the beginning of this year?

DOANY P: Okay. Well, look, I mean as you know very well, different operators push where they are strong, are careful where they are less strong. And the market structure is quite clear in the sense that this company has, let me say, a major strength on the fixed side, which is why, for example, on fixed voice, we try. Of course, we are more defensive in that area.

On the fixed broadband, increasing penetration for us is much more key than the market share. We loss of some market share is natural for us, and these dynamics, of course, got boosted by the fair usage quota, which actually interestingly, pushed the demand more towards capacity than bandwidth. So customers are not complaining about bandwidth. Rather, they want more capacity because they want to pay less money, which means, of course, for us, we have a unique upsell future opportunity as we also are able to continue with our penetration packages.

So that's the area where we are strong, and we feed into the market, of course, because we are a wholesaler, and we try to increase that. Türksat which is the cable TV operator, is also of course in the wholesale business right now. And that is also good for us to have a competitor that offers wholesale to Turkcell and Vodafone.

So on the fixed side if you like; I think the dynamics are quite clear. The market still has growth opportunity. And with that growth, of course, market shares will slip into the way they tend to and you can best figure that out.

On the mobile side, of course, we are targeting to increase our mobile market share as we've indicated. The dynamics of this particular segment of the market is that operators are now in the, let's say, third, fourth year of data LTE investments and potential 5G coming. So therefore, most operators... or all 3 operators, for that matter, on mobile are obviously very, very careful on their pricing. Because obviously, giving up on a price on the data addition that one does is... it happens once and you can't fix it.

What is, I think, very helpful for us this year, all of us in the market, is that the tax regime got neutralized. We don't have these differences in tax between voice and data for example. So now it's a flat rate and so on. So that also provides clarity on price and what people are giving into the market. We are able to increase our mobile market share in most cases last year because we were providing certain bundle where we are also able to, if you like, compete where we can lower the pay TV price for example, that got us some customers.

In the course of this year, we cut back on that pay TV.

So therefore, on the pay TV, because of FX effects on the boxes, we are now more keen ,as we have enough homes to actually build up that average price. And again, there we are competing with TV players who actually are landlocked and are not able to grow into a very large free-to-air and our content is much better than the free-to-air content.

So that's an interesting opportunity for the company, allowing for the mobile market share to grow while Turkcell, of course, are focused on price increases to their top-end customers. Now there lies an interesting opportunity for Turkcell because in that segment, if they're able to monetize mobile bandwidth, it means that their top, let's say, 15%, 20% ARPU customers can be paying a higher price for better bandwidth access as one does with fixed. That is a very important opportunity I think for them.

We would lag behind Vodafone in that regard because they tend to be stronger in the corporate segment. So we tactically go for the average in that area so we can continue to build up our market share.

So in the end, the bottom line for us is we are focused on revenue, margin and the CAPEX level that we are doing. Turkcell have a similar focus. Vodafone are also now more keen on their profitability as opposed to build up market share. So the dynamics of the sector currently are moving us toward a potential new investment cycle, and that's why operators by definition, have to be more cautious. That's how I see the market.

For the ICT solutions for the corporates, we have under us, as you know, we own 3 subsidiaries. Argela is focused on telecom technology. They have in particular, developed solutions around SDN and virtualization. And in particular, what we find most exciting of what they are doing is that they are working on a sliced bandwidth solution for mobile network, which would be ideally suited for, for example, Turkcell in the market. Then second could be Vodafone. We would lag third in that because we have the advantage of fixed.

And the other one is a set up product, which is something that goes over fixed, and that is now something that they are working with AT&T, Verizon and also Telefónica. So we see an interesting opportunity there, which is more like telecom technology.

On the ICT services, Innova is better placed, and they have of course, certain products but they are more of an ICT service player rather than product. That's the sort of market situation in Turkey. We would say that digital transformation of customers is going to be a cycle perhaps not this year. But from next year most companies are going to need to go through another investment cycle with their so-called ICT or IT. Innova will get a good share of that segment. Of course, we are facing some competition from Turkcell.

We faced that in the health recently, but that will be, of course, healthy competition. And then we have Sebit where we are the strongest one in the education field.

So we try to be focused by vertical, if you like. So the health vertical is of interest to us, that's why we invested in Doctor Turkey, for example. We see a very interesting opportunity for us in that through that company. And on the education part, because we have a strong platform and we have a strong content company Sebit, we also have a... we see you know a good opportunity in that, especially for private tutoring, the areas where we would drive these companies and the acquisitions that we, of course, are making, mostly if you say, health and education.

A third possibility will be in the energy area. We are looking at a company right now in which we may participate. That also would be an interesting dynamic for us since we are also cooperating with electricity companies. Innova also have a couple of interesting products that we are now selling to electricity companies. And I would say that will be a third vertical.

DEGTYAREV S: Okay, thank you very much for very detailed explanation.

DOANY P: Thank you.

OPERATOR: The next question is from the line of Drouet Herve with HSBC. Please go ahead.

DROUET H: Yes, good afternoon, thank you for the presentation. A couple of questions. First one is, if you can come back on the cost side and especially on the employee cost. As with marketing, should we expect the growth... potential growth in employee cost less than inflation? Is it something you think which is feasible? And when do you think we will have more visibility on the agreement with the unions?

The second question is regarding the launch. Your competitors, one of your competitors, has launched a kind of fixed wireless superbox. I was wondering how you see that being potentially impacting your business, if it does at all. And what do you think on your side you could propose as well in that respect?

And maybe the third question is maybe on the accounting side. Obviously, with IFRS 16, you have these lease liabilities. I think you mentioned 1.1 billion Turkish lira. I was wondering what is the assumption on the length of the contract to calculate this lease liability. Thank you.

AKTAN K: Yes. The first question, employee cost. So starting from second quarter, we should expect a higher percentage of growth quarter-over-quarter or year-over-year. And it should convert to mid-teens if not at the level of the expected inflation, but we think should be the minimum that you should see, especially the full impact should be more visible in the third quarter. We will do most of the salary adjustments completed within this second quarter. But normal… a full 3-month impact should be more visible in the third quarter.

DOANY P: Okay. In relation to the fixed wireless, actually you know that the way we see this next wave of connectivity before the...what you connect to it, this fiber to the site has 2 legs to it: One is to the facility of the network to the other operator, where we will provide this to Turkcell and Vodafone, which is going to be very important, which means fiber to the most economic point within their network.

And the second one, which is the point you are asking, is connectivity at the customer premises. Now for customer premises, they are going to be needing in the future small-cell technology, 4.5G, which is probably going to be one of the most important differentiators that people will be able to provide, other than to provide from the network itself, meaning a macro station. This will be far more impactful than having fixed wireless connectivity to the home because those, in the end, would have to be fibered.

So the dynamic that we have here is a wholesale opportunity from Türk Telekom to grow our competitors' network, mean allow them to provide fiber, either to their customer or fiber to the most economic point of their network, you see. And there is no other player in the market that can actually do it and that's the level playing field that I was discussing. So that actually is an opportunity for us as a wholesaler. And in the end it is going to lead to increased competition in a segment where we are at least competing here on bandwidth and quality, you see which is in fact what Turkcell are also asking for.

AKTAN K: And finally, the average term of leases is around 3 years.

DROUET H: Thank you, that's very useful. Thank you again for your answers.

DOANY P: Thank you.

OPERATOR: The next question is from Cabejšek Ondrej with UBS. Please go ahead.

CABEJŠEK O: Hi, thanks for taking my questions. I have 2, please. In terms of your FX exposure, obviously, you've made a big step in... throughout the first quarter in hedging your debt. But I'm wondering why do you keep sort of an 8% equivalent of lira cash that you could be converting into hard currency and then hedging the uncovered debt still. That would increase your hedging ratio from about 84% to about 92%. Just curious, why you are doing this because your... well, your listed competitor isn't, for example, so just curious?

And second question is Internet Bizden. So if I'm not mistaken, in April, the first contracts of the original Bizden subscribers from April 2017 are expiring. Just curious what behavior you are seeing from these customers, i.e., are they up-selling, are they leaving, what sort of ARPU increases are we looking at, et cetera? Thank you.

AKTAN K: Well, the part of the cash that we keep in lira, in local currency, is just the result of operational necessities our strategy is the same as before, which is to keep the maximum amount of cash in hard currency. Some of the quarter end, you have a settlement date that follows the end of the quarter, meaning sizable cash out to the suppliers, and we don't want to take the risk for that short period on which we prefer to keep the cash in local currency or partially keep the cash in local currency. Yes, can you repeat your second question?

CABEJŠEK O: Sure. So the second question is around Bizden, because you launched this product in April 2017, if I'm not mistaken. So I'm just curious what sort of behavior are you seeing with the customers whose 2 year contracts are expiring now. And are they being up-sold to regular tariffs at what ARPU's, et cetera, if you could just give us some guidance on this?

AKTAN K: Well, as you said, the expiry of the contracts, we had limited examples to...in order…so that we can give you an exact figure on where we are. But our history with those subscribers under the low-cost, low quota contract offers that we will be introduced in 2017, they were up-selling to higher quotapackages even sooner than we were expecting and we saw a much higher consumption in average, when we look at the overall consumption patterns of those subscribers. I think the churn rate and the up-sell rate is in line with the plans. But when we have a larger example…set of example, we can share the data.

CABEJŠEK O: Alright, thank you very much.

OPERATOR: The next question is from Ahmed Rishad with GoldenTree Asset Management. Please go ahead.

AHMED R: Hi, there. And congrats on a good set of results. Wanted to just... I know you've spoken about it previously, but just delve a little deeper into, I think, some of these costs, because obviously there has been substantial improvement in margin this quarter. If you look at commercial cost, that's 4% of revenues versus 7% in Q1 '18. And if you look at other costs, that's 23% of revenues versus 26%. So between those 2, there is a 6% margin improvement. Could you kind of just go into the specifics of what you guys have done to achieve that margin improvement?

AKTAN K: Well, in the commercial costs, as I mentioned in my speaker notes, so we had a very, I mean, low spending in the first quarter. We already had a very strong momentum in our mobile business. And it was a transition period for fixed broadband since we introduced the unlimited…the true unlimited packages with no fair usage quota. It was an adaptation period for the whole market, so we deliberately prefer to be silent because it would have a minimum impact on the commercial performance. And we were already satisfied with what we were having during the quarter.

As I mentioned again in one of the previous questions, you should expect an increase in nominal term compared to last year when we come to the end of the year in terms of the total commercial spending. But ideally, it should be a single-digit number, meaning again that we should be spending a smaller percentage of revenues compared to the full year of 2018. That's really one of the key enablers of margin improvement. It's not only in the commercial expenses, but we are now enjoying a cost optimization, a cost benefit that comes from our integration project, which we started like 4 years ago.

We can now optimally allocate the commercial expenses between different business lines according to the needs of the overall performance that we want to lead, and we are using the same brand, Türk Telekom brand for all our service offerings and the same channel is serving for again, for all the business lines.

AHMED R: And in terms of the other costs?

AKTAN K: Sorry, can you repeat that?

AHMED R: In terms of other costs?

AKTAN K: For other costs, you should consider the impact that came from the IFRS16, which is again the lease accounting. So it's taking off some of the rental costs which is mainly sitting in other costs. These are the rentals of towers and buildings and other rentals, like car rentals which are mainly impacting the other line.

So part of the... most of the change when you compare the change to the percentage revenue comes from the IFRS 16. Normally, we will also expect a good progress in other line because the people related cost is a major item that impact the other line. And we had, for the last 3 years almost in all the years we had a good performance in managing our people related cost.

It's again, partially related to the integration effort that we had, and it will be similarly low number but not maybe as low as last year, because of the inflation adjustment we should be…higher percentage increase this year.

AHMED R: Okay, that's great. Thank you. Thank you very much.

OPERATOR: The next question is from Ignebekcili Murat with HSBC. Please go ahead.

IGNEBEKCILI M: Hello, thank you for taking the questions. This may have been asked before, but I just joined recently. When do you expect the company to return to paying dividends? Would you say 2020 is reasonable?

And secondly, what can you say about upcoming 5G investment cycles? Do you think it will pose a risk to operators' cash flow in the next 5-year period? Thank you.

DOANY P: I'll take the second part of your question. Look, I think that the reality on 5G, especially now that you've seen the tax implications and also allowing people to finance devices you know, the prospect of 5G devices being, let me say, cost effective in this market is not... definitely not immediate.

So starting from that point, the direction that we are... let me say, in the last meeting we had actually with the regulator and all the operators were there, we were looking at what we can offer from our side and we very much pushed for what we call slicing over 4.5G which you can do from a macro base station, and you can complement that with small-cell technology within the customer premises.

These would all be fibered up, and this will be near 5G experience. You can have very high data rates running through that into your LTE devices. WiFi 6 also, by the way should not be underestimated as being able to provide cost effective coverage within customer premises.

So if you say within a 5-year time frame, I would estimate that half of that period, we will be using things we already have, it means 4.5G technology and maybe WiFi 6, perhaps towards years 4 and 5 we will begin to see, let me say, "real 5G" coming to the market. That's our expectation of it.

And we think that the market dynamics in Turkey will support this approach. Now within that period, there will be some special requirements that we discussed with the regulator and with the ministry, all operators, where they would like to have some spotty 5G. And frankly, anything that is spotty is affordable. As soon as you start saying 5G coverage obligation, that becomes the complication.

So we are also looking at providing, for example, 5G spotty in, for example, let's say the new international airport. The operators, we discuss also hospitals, for example… certain hospitals as being areas where the operators could focus on.

So that's the way it's going. So it's actually very, very positive in relation to costs.

AKTAN K: Yes. In terms of the dividend expectations, actually, there are 2 factors, one is the policy. So there is currently no change to the policy which was paying full dividend which is comparable to the net income of that year. The other thing is the level of the net income that we should expect.

Obviously, we have a far more resilient balance sheet right now. IWe should also consider that this came at a higher financing cost, but we can see that net income, positive net income is very much probably expected even if we have higher FX rates compared to where we are right now.

So in that sense, a dividend payout next year is still very much possible with the… again, the level of FX, so I assume a natural probable increase compared to where we are right now, within the limit of such increase, it's very much possible for next year.

IGNEBEKCILI M: Is there a particular net debt to EBITDA level you want to reach before paying out dividends, I mean, this is a question to be asked to shareholders perhaps, but could you comment on that?

AKTAN K: Well, I cannot refer to a direct relationship in that sense, but there are few things. First is, we always said we will feel comfortable when we see we are back to 1.5 and it looks like it's very much possible, if not at the end of this year, but definitely somewhere in next year, before mid-next year even. And net income, if it's also justified with the level of the FX at the end of the year, and we have a net income, I think both objectives will be fulfilled.

So indirectly, I can tell you that we will reach to our goals in terms of where we want to be financially and what level of... what type of dividend payout we should have.

IGNEBEKCILI M: Okay, thank you very much.

OPERATOR: Ladies and gentlemen, there are no further questions at this time. I will now turn the conference over to Türk Telekom management for any closing comments. Thank you.

DOANY P: Well, thank you very much. And we'll talk to you soon 3 months. Bye-bye. Cheers.

ÇULLAS G: Thank you. Bye.

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