Turk Telekom

Moderator: Onur Oz
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8:30 a.m. ET

Operator: Thank you for standing by and welcome to the Turk Telekom Q1 2014 Results Call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session at which time, if you wish to ask a question, you will need to press star 1 on your telephone. I must advise you that this conference is being recorded today on the 2nd of May 2014. I would now like to hand the conference over to your speaker today, Onur Oz, Head of Investor Relations, please go ahead sir.

Onur Oz: Good morning everyone. Our sincere thanks to you who joined our conference call today. Believe me this wasn’t our first choice to hold it today at this time, but circumstances led us to doing it this way. Before we start our presentation I would like to remind you to please go over our notice on the second page of our slide deck. There are important notes on the information you will hear and see in a little while. Today's presenters are Rami Aslan, our CEO, who will walk you through business results followed by Murat Kirkgoz, our CFO who will do the financial section. Without further ado I will hand the call over to Rami to start his presentation.

Rami Aslan: Thank you Onur. Hello. Thank you for joining us today. We're happy to share with you our first quarter results in 2014. I'd like to start by sharing a few words about the recent management changes announced two days ago in our group.

TT embarked on a significant managerial change on Wednesday as a first step towards the integration of our group. On the commercial side and as a first step to drive our revenue growth we have restructured our group to strategically align the consumer and corporate wholesale sides of the business.

This will allow our group to achieve the best topline growth potential across the entire group of companies. On the efficiency side we have restructured our group by aligning and combining several group functions that will ensure we achieve the highest level of efficiencies starting from operation, technology as well as procurement function to combine the best class initiatives supported by the group-wide scale to help achieve these efficiencies.

I'm happy to answer your questions on the subject in the Q&A session, but now let's move on to our presentation.

On the third slide we have the quarter's highlights. But rather than going through the highlights, let me jump right into the details starting from slide 4. On a consolidated-basis we have grown our business by 2% year-on-year in the first quarter. When we exclude the MTR cuts introduced last year in the mobile business the growth becomes 4% year-on-year.

Our EBITDA also grew at 4% year-on-year. The growth here is mainly driven by our overall efficiency initiatives, specifically proceeds from the sale of vacated real estate space. As you know, as we move deeper into next generation network transformation there's a lot of consolidation in terms or real estate and we save by disposing them. The saving here extends into maintenance of the disposed asset as well.

Net income increased 48% quarter-on-quarter; however, we have a 27% decline year-on-year mainly driven by the TL depreciation against euro and the US dollar. The next slide, slide 5, demonstrates very well how we evolved our revenue streams to concentrate on high growth area.

As of Q1 2014 almost 70% of our revenues are driven from high growth businesses such as mobile, broadband and corporate data. Our fixed-voice revenues, which traditionally were our number one revenue source, is now the third largest revenue generator for us.

Moving on to high-speed broadband on slide 6. We're happy to report that the subscriber growth and ARPU growth continue hand-in-hand in the first quarter of 2014. You would remember that we did an average of 5% price increase at the beginning of the year and together with our upselling initiatives the price increase helps us continue to grow our ARPU.

On the subscriber side seasonally Q1 and Q2 are our weaker quarters compared to Q3 and Q4. Adding the price increase effect we think an almost 70% [thousand] net additions in broadband was a great result. Year-on-year we grew our revenues by 8% in the quarter. A careful balancing of price increases, campaigns and subscriber additions while focusing on top quality service and high speed for our customers, we believe we will deliver another good year of revenue growth in our broadband business.

Slide 7 demonstrates the progress of our fiber transformation. As of Q1 we reached 682,000 subscribers in fiber and increased our pickup ratio to 26%. In addition to fiber, we offer our customers VDSL which uses fiber to the curve infrastructure and is capable of providing speeds of 24 megabytes per second or higher.

We have an additional 180,000 customers a year and the number is growing. Our fiber investments will continue in the coming periods; however, for our focus on subscriber growth we also aim to increase the take-up here.

On the next slide, slide 8, figures show how big of an appetite our customers have on speed and capacity. This appetite is not at the level where mobile connectivity is capable of meeting. However, on the high-speed fixed broadband side, we're happy to be able to give our customers what they need. Average data usage of our customers reached 40 gigabyte per month and a large portion of this is driven by over usage.

While our customers are enjoying high speed of broadband connectivity they also like to have no limits on capacity. Our unlimited capacity package users reached 82% of our total base, up from 73% last year.

Speaking of fiber and speed it's only natural for us to move on to TV subject. On slide 9 we're showing how our IP-TV product Tivibu performed. We now have more than 300,000 subscribers in Tivibu home and more than 1.5 million subscribers in Tivibu web. Mainly two factors are enabling growth in this product. First the availability of fiber and high speed, second our investment in the product to increase content deals, number of channels and larger content archive. Including Tivibu home, Tivibu web and Tivibu mobile and Tivibu smart TV we have a total of 1.9 million subscribers as of Q1 2014.

Moving on to slide 10. Another bright spot and growth contributor our fixed line business is our corporate data. We achieved 17% year-on-year growth in this business in Q1. Our aim is to continue the double digit growth in corporate data. With its outstanding performance corporate data now covers 12% of our fixed line business.

Onto slide 11. We're all familiar with our efforts to hold onto our revenues and fixed voice business despite the huge challenges. I think we're doing fairly well here. Today total access line fell by about 150,000. One of the lowest declines in recent years and our fixed voice revenues dropped 12%. We will continue to defend our revenues here and we believe our latest initiatives, such as TT E4, our smart home phone will help us retain more and more of our customers.

Onto slide 12. Our mobile business recorded a growth of 4% year-on-year in Q1. When we exclude the MTR cuts, which took effect mid last year, our growth is 14%. On the EBITDA side we kept it flat year-on-year despite the continued competition in the market and while we grew our subscriber numbers phenomenally this quarter.

This takes me to the next slide, slide 13. We recorded 757,000 net additions this quarter. This is the highest net number since 2007. And it is over 70% of our already-impressive full-year 2013 net additions in one quarter alone. Now looking at the quality of these net ads, we're happy to report that over 400,000 of these net ads came from postpaid, which is a 15% growth rate.

We sustained our market leadership in postpaid subscriber ratio at 45%. On the ARPU side you see a decline due to MTR cuts. If we take the MTR cut effect out, our blended ARPU increased 4% year-on-year. We're happy to see organic ARPU growth in a quarter where we added a very high number of subscribers to our base.

Our performance in mobile number portability, which we show on slide 14, was instrumental in our continued net gain success. We recorded almost 700,000 additions in MNP, which proves our valuable position is more attractive to the customers than other operators.

Within mentioning that our investment in our mobile business be it on the network side where we caught up with the competition, on the distribution channel side where we fully revamped our exclusive dealers, or on the branding side where our image campaigns proved to create attraction to our brand have lifted Avea's function and quality at the very high level.

Now with the subscriber numbers increasing at a very high pace we are very happy to achieve customer appreciation in our investment and efforts.

Our final side in mobile, slide 15, is on mobile data. We achieved 65% year-on-year growth in our pure mobile revenues which we don't include SMS or value-added services in. With this our mobile data revenues reached 21% of our total mobile service revenues. Our strong performance in mobile data goes hand-in-hand with our highest in the market smart phone penetration. As of Q1 2014 we have 42% smart phone penetration, launching Avea Intouch 3 our own branded Android-based smart phone code to be highly attractive in raising our penetration. I will now hand over to our group CFO Murat Kirkgoz, for review on the financials.

Murat Kirkgoz: Thank you Rami. Good afternoon and good morning everyone. We are now at page 16 summary income statement. Most important, we grew our revenues by 2% year-over-year excluding the impact of MTR cuts our outs our organic revenue growth would be 4%. Our EBITDA margin reached 38% and our EBITDA increased to TL 1.2 million. EBITDA; representing 4% growth versus 2014 Q1. This is despite the remarkable net adds in our mobile business.

Our EBIT margin remained year-over-year at 23% and EBIT going by 2% TRL723 million. Our financial expenses read as TRL246 million negative in Q1, which is mainly due to the unrealized FX losses and hedge gains of

TRL187 million. In result, our net income increased 48% verses previous quarter reaching TRL384 million in Q1.

Now moving to page 17. Our assets grow TRL505 million thanks to some cash flows from our operations. Other assets have increased mainly as a result of prorated expenses such as rent, usage fees and cyclical fees that are seasonally paid in the first quarter. Our net debt has decreased TRL102 million over the interest bearing liabilities increased due to depreciation of Turkish lira in the first quarter.

And now at page 18 we have generated TRL445 million before financial activity in this quarter and this is TRL460 million above of last year. We are starting to observe the positive effect of the efficiency in our cash flows. Cash at hand had increased by TRL496 Turkish as a result of the strong operational cash flow.

Going to next page they will be presented profile we continue diversification of our funding verses in the first quarter and our leverage has decreased to 1.4 from the 1.5 level of the year end. This is a comfortable level compared to other industry players. While the maturity of our debt increased to TRL2.6 from TRL2.3 of last year while over cost of funding continue to reduce.

I will now hand it back to Rami.

Rami Aslan: Thank you Murat. In closing I'd like to thank you and wrap up the call in stating that our group in embarking into an exciting beginning of a new era of integration initiatives and restructuring. Our group will no doubt become more consumer-focused taking into consideration the consumers' top needs and priorities now and in the future.

We will focus not only on fueling the topline growth, but also efficiencies across the entire group. Preparing and embarking on this initiative will no doubt require full active management that can position the group to achieve those goals successfully and smoothly and in a rapid manner. With that I'd like to pass on to Onur for the Q&A session.

Operator: Absolutely, thank you. As a reminder if you wish to ask a question please press star 1 on your telephone and wait for your name to be announced. That is star 1 to ask a question please. And if you would like to cancel your request, please press the hash key. Your first question comes from Cesar Tiron from Morgan Stanley, please go ahead.

Cesar Tiron: Yes, hi, thank you. I have two questions please. The first one is on the management change. Can you please explain to us why do you think the impact of this management change will be different from what we've seen previously because there has been quite a big [restructure] two years ago, if I recall?

And then the second question would be on the cost side and more important on the personal expenses. So you have an early retirement plan, if I recall last year, and then now you've been awarding these extra bonus to employees in Q1, which makes it very difficult to understand what is the underlying personal expenses and this is quite a substantial amount of your OpEx in the fixed line so I understand you cannot guide on exceptionals, but equally I would like to understand better what to review on personal expenses in the next quarters and how this will evolve versus last year? Thank you so much.

Rami Aslan: Thank you very much. I'll answer your first question and I'll pass it to Murat the CFO on the second question.

Your question regarding why this change is different. You are right we've embarked on different changes before. The difference here is that this change is very focused on integrational functions. To give you an idea, we have three of our group new VPs coming from Avea. That is in the technology side, the human resources side and the procurement side and they will basically take a wider role across the group and those functions so we're basically combining the function not purely just change of people doing the same functions and boxes.

We also have one of the functions taken by the TT team members as well. And so effectively here we're not just changing people, we're actually changing the structure itself and the capacity of the people who cover those functions. So from a strategy on business development, business planning, this is a group wide function, procurement it's a group wide function for the first time, human resources is a group-wide function for the first time. And technology is combining not only group wide, but also the technology and the operations across the entire group. So with that we believe that we will have a lot of group focus initiatives, you know, having all of the functions combined in a group way where people focus not in solo but rather at the best interest of the group.

On the second question the core side of personnel I'll pass it to Murat Kirkgoz the CFO.

Murat Kirkgoz: Thank you Rami. Thank you sir one of expenses of this quarter you are right to observe. The figure is around 92 million of personnel incentives. Our management decided to set a provision for next bonus in Q1 and that is – as we are embarking on a new year with concrete steps toward integration, this seemed to be essential. If this number would be eliminated the underlying EBITDA would read as 1.292 billion and underlying EBITDA margin would be 40.4%. And you would remark that also last year Q1 was an exceptional payment of incentives was done for the employee termination program we don't expect any any material one-offs this year regarding the personal area for the rest of the year.

Cesar Tiron: And so as a follow up to that then we should see personnel expenses declining on the teen basis on the year-on-year basis in the next couple of quarters? Because in Q3 and Q4 would not have any impact and you had the impact last year. But then you don't incur an incremental cost in 2014, so the personal expense should decline on a year-on-year basis next quarter, right?

Rami Aslan: We wouldn't have a material increase. The drivers are inflation adjustments that are compensated by the decline of the number of employees so you would see in the worst case a flat personnel expense.

Cesar Tiron: Got it, thank you so much.

Operator: Thank you. Your next question comes from Tibor Bokor from [Wood London].

Tibor Bokor: Hi, good afternoon. I have a lot of questions, but the main ones I would say follow up on restructuring. If you could explain to us whether there's any synergies that you already can talk about and specifically does the restructuring mean that you will have to buy out minorities in Avea? And on that if you could also clarify that the dividend to proposal goes down to 70% payout and whether the dividend policy going forward remains at 100% and this is sort of exceptional one off situation. Thank you.

Rami Aslan: Thank you very much. On the first question on the synergies, you are right. That is one of the main purposes, you know, to drive efficiencies we need to use the widest scale of the group. So you know we are trying here with this year of integration is basically on various functions but therefore full integration first of all, but as immediate effect with this structure you are going to see the initiatives that will take into consideration the group scale using the best in class of each of the group entities.

For example on the procurement side we believe that having Avea, which is what we believe is the best in the group in terms of procurement initiatives and procurement standards will lead the function, but having the benefits from the scale will actually add to our efficiencies tremendously.

We've done a few pilot projects in this area and we've secured tremendous savings simply by applying Avea’s standards across the group using the group scale. And that carries on clearly for, you know, most of the functions but, you know, the technology and the management, administration and the operations as well so that will be one of the key drivers.

I wish to answer and that's probably also related to the initial question as well. Here we have on the frontline growth we're also restructuring ourselves in a way that we're a lot more consumer centric. So you will see our team focusing on the consumer side as a total and as one unit rather than as independent units that might be competing against each other. And that will be serving the best interest of the consumer as well and making sure that we answer the consumer from a global group perspective rather than from a solo perspective. That will clearly also fuel the topline and insure that not only we are improving efficiencies but also improving the topline.

On the second question related to the dividends proposal, you are right. I mean I confirm that this is an exceptional change because we're embarking on this integration and what can come with this integration. There are few areas where we are currently looking at how best to integrate the group including every area and that's certainly something that we're assessing on a continuous basis, but that doesn't change our dividend policy whatsoever so we continue to maximize the dividends going forward.

Tibor Bokor: Thank you. Just to follow up on minorities, can you comment does the restructuring trigger buyout of these minorities or that's to your discretion?

Rami Aslan: It is certainly to our discretion. I mean this is something that we continue to assess and if it's to the best interest of the group and if it makes sense at the time, we would like to do that. We will certainly communicate this to the market.

Tibor Bokor: Thank you.

Operator: Thank you. Your next question comes from Atinc Ozkan from Credit Suisse please go ahead.

Atinc Ozkan: Yes, thank you. This is Atinc from Credit Suisse, two questions please. In the general assembly article I saw a specific article regarding authorization of the board for acquisitions up to EUR300 million. Is this something routine that you are doing at every general assembly? I might have missed that in previous years, or related to some specific turn of actions?

Rami Aslan: It is routine actually. It is routine every year. So there's no change.

Atinc Ozkan: OK. And I already heard about your answer minority buyout so can you provide us any update on your past interest about Digiturk given that appears to be for sale and you had an interest, thank you?

Rami Aslan: I mean content clearly it's always on our radar screen and it's something that we value tremendously. We follow the developments and [digit turf] amongst several opportunities in that domain. As in when this comes to the market we will be following it closely and if it makes sense to us at the time, we will look at it and we will pursue it if it makes sense.

Beyond that I mean I don't think that there is much developing at their end, but we are continuously follow that on a close basis.

Atinc Ozkan: And one final one on the segmental margins if I may. There is a TRY 35 negative item on your consolidated EBITDA, could you clarify what was your adjusted segmental margins in mobile and wireline first quarter without these two items? Thank you.

Rami Aslan: Can you clarify the question, I'm sorry, I'm not sure I got that question?

Atinc Ozkan: You had a net 35 million negative EBITDA impact at consolidated EBITDA line I think due to one off items the gain on real estate sale and the 92 million on this payment –-

Rami Aslan: Right.

Atinc Ozkan: Can you provide some clarity on the impact on your divisional margins.

Rami Aslan: Sure Murat would you like to take that?

Murat Kirkgoz: Sure thank you. Actually it’s 12 million negative to mobile and the rest goes to the fixed line, so if you will just, you can split like 12 million negative to the mobile and the rest is going to the fixed line.

Atinc Ozkan: So I just saw your mobile margin was well above 12% there?

Murat Kirkgoz: Correct.

Atinc Ozkan: Thank you.

Operator: Thank you. Once again if you would like to ask a question, please press star 1 on your telephone. Your next question comes from Ranjan Sharma from JP Morgan. Please go ahead.

Ranjan Sharma: Hi it's Ranjan Sharma from JP Morgan. One question from my side on your EBITDA on the mobile site what is your plan to increase EBITDA margins? I mean you are seeing tremendous growth coming through that really make EBITDA is in negative growth, hasn't really followed your revenue growth so if you can share your plan to increase EBITDA margins here. Thank you.

Rami Aslan: Sure I'll pass it to Kadir Boysan [Chief Business Developer Officer] and he will answer the question.

Kadir Boysan: Good afternoon to you hi Ranjan. OK. I just want to step back from your question for a second and say that we actually delivered an outstanding performance in this quarter. Just to wrap up historical records high on net additions and strong actual revenue growth despite MTR cuts so in the meantime we maintain our absolute EBITDA level in the nominal term, then if you take out the one off effect actually the margin was stable if not up. So given that performance we are quite satisfied as it is today.

And going forward obviously we started to reap the benefits of our investment so far. Actually Rami alluded to it, we've been investing into our network in last three years, especially on 3G and we will continue to do so. That's the significant part.

The second part is we actually transformed our channels from wholesaler to the retail unit from location all the way to the display to the display and most critical, the level of service. We revamped our branch. Not only the logo, but Avea's campaigns and supported that with our to brand, Woops, for the youth and the Prime for the actually high ARPU customers. And we actually supplemented that push with our partnerships, which are targeting segments and bringing significant net addition.
So if you combine all of what you see there is actually a strong momentum on the mobile side, the margin is relatively stable and the growth is tremendous. So we will continue to pursue the strategy to insure that the momentum is

intact, but we will also watch out our possible to make sure they are right balance in that one. So going forward as we build up slowly our scale and continue to grow, the margin will improve gradually as well.

Ranjan Sharma: All right thank you so much.

Operator: Thank you. Your next question comes from Tibor Bokor from Wood London. Please go ahead.

Tibor Bokor: Hi, a few follow-up questions. I mean it's clear that in the first quarter tremendous success in terms of the mobile subscriber additions and probably it cost you quite a lot in terms of the margins, but nevertheless I look at the EBITDA for the mobile and it’s identical year-over-year while the revenues are some 40 million higher and when I look at the commercial costs of consolidated these are only 16 million higher, so I would just like to understand how much of the subscriber uptake did we already see in the first quarter or did you get these clients towards the end of the quarter and we didn’t see the full -- we have seen just the full impact of the cost and not the revenues?

And secondly, how many commercial costs did you spend to acquire these clients and what is the [offer] going forward? I mean if we look at last three quarters the subscriber uptake is accelerating and should we expect that to continue or should we expect on contrary and maybe losing some of the clients in the second quarter? So a little bit on that, thank you.

Rami Aslan: OK thanks Tibor. Firstly I mean the optic has started actually last year around September-October time, starting with Q4 significant net additions and that actually accelerated further in quarter one. And you will see the commercial impact of that, yes you're right, there's an increase on the commercial side obviously. Subscriber acquisition cost is coming on the OPEX side.

And what we see is, I mean, it’s stable the nominal term is there but if you take out the one off cost items then the EBITDA comes to an actual stable position so we haven't actually diluted our EBITDA underlying operational level. It's important to note that. And if you ask what's happening going forward, I mean we obviously want to keep up the momentum, but we also watch for about overall profitability and ensure that remains in line and we don't compromise on our EBITDA margin going forward. Therefore we expect the momentum to continue, but it depends on the overall competitive environment so we want to make sure that the momentum remains as it is. But we want to find the right balance in our profitable targets as well as our growth.

Tibor Bokor: Well I think the market will be comparing the margins in the first quarter more towards the margin in the fourth quarter, which was 18% and it was a huge success. And also taking into account turkcell results seeing that they have been losing some of the market share and do you see any signs of turkcell let's say in the end of the quarter or maybe in recent day's stepping up [i.e.] the competitive profile changing recently? Thank you.

Kadir Boysan: Hi there it’s Kadir again. Let me tackle the first part of the question. Actually in our market there is a seasonality effect. If you look at the actual quarter four, which is around 18% margin, it also -- and if you look at last year at Q1 you will see they actually change as well. So this is not effecting our business, which effects our profitability.

Now the latter part in relation to our competitive environmental it's difficult to predict how it's going to develop going forward, but I can explicitly state it's been very intense in the last six months and we expect that to remain intense. And it's important to underline both of our competition have taken action actually towards actually especially on the [MNP] to balance things out, but we have not seen a major actual impact on our trend going forward. So we remain comfortable and confident going forward.

Tibor Bokor: Thank you.

Operator: Thank you. Your next question comes from Vera Sutedja from Erste Bank. Please go ahead.

Vera Sutedja: Good afternoon. My question is related to the integration project again. Do you actually – could you quantify how much expectation in term of cost savings or in terms of revenue generation or incremental that could come up from this project, and how long is this project going to last and when -- so when should we see feasibility or the result of this project?

Rami Aslan: Thank you. It's not an easy question. The first question it's unfortunately I cannot given you a number, but I can tell you that it is an extremely significant impact on the group in terms of efficiencies. Again it's not only on the cost side, but also on the topline growth as well. We ensure there is minimal cannibalization amongst our product lines. Our portfolio is really geared towards the customer needs and priorities and that should fuel the growth more than it is today.

Now on the cost efficiencies, we should see this, you know, as a concrete step that will start the impact, but, you know, we have done for example a pilot of 13 stores that were launched last week. That's a concrete step that we should see an impact of and if, you know, once we fine tune that we should do this across the country. We will see those results and build on them.

So it's going to be a continuous effort and a continuous impact. I do expect to see in certain areas very quick impact and then slow improvement going forward and in some areas we should see the impact maybe in a quarter or slightly later. And again that will continue to improve going forward. But the message here is very clear. Is that we are not working solo, we're working as a group. We are using our scale. We are structuring ourselves as such and that should carry a tremendous value enhancement to our proposition.

Vera Sutedja: And can I say basically the guidance for this year full year 2014 already includes some of the benefits of this project, or just most of the benefits should come only from next year onwards or the year after?

Rami Aslan: Sorry I missed the word [pilot] so they were just explaining to me that you were referring to the pilot. So, I mean, this is clearly not a very large pilot but, you know, that will carry the impact immediately based on what we're offering. But that will be carried and built on very, very quickly. So you will start to see the impact of that quickly and we're not talking about 2015, we will see the impact in Q3 and certainly in Q4, and that will have the full impact in 2015.

Vera Sutedja: OK thank you.

Rami Aslan: Pleasure.

Operator: Thank you. We have no further questions from the phone lines. Please continue. There are no further questions would you like to make a closing statement?

Rami Aslan: OK we thank everyone to join us today, which we know that it's one day after a holiday, May 1. Again apologize for the not so good timing and we thank everybody to join us today. If you have any further questions, please get in touch with our team and we will be available for you to answer any of your questions. Thank you very much again and have a good day.

Operator: Thank you. That does conclude our conference for today. Thank you all for participating. You may disconnect.

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