Türk Telekom 2024 Q1 Financial & Operational Results Conference Call

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Conductors:

Mr. Ümit Önal – Chief Executive Officer

Mr. Kaan Aktan – Chief Financial Officer

Ms. Gülsen Ayaz - Investor Relations Director

Conference Call Conducted by Chorus Call Hellas

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

Welcome and thank you for joining the Türk Telekom conference call and live webcast to present and discuss the 2024 Q1 Financial & Operational Results. We are here with the management team and today's speakers are CEO, Ümit Önal and CFO, Kaan Aktan. Before starting, I kindly remind you to review the disclaimer on the earnings presentation.

Now, I would like to turn the conference over to Mr. Ümit Önal CEO. Sir, you may now proceed.

ÖNAL Ü: Hello everyone. Welcome to our 2024 first quarter results conference call. Thank you for joining us today. Global focus turned more onto economic data as the geopolitical headlines took the back seat. Strong data from the US and sticky inflation both prevailed advocating the view for "higher for longer interest rates" across the board.

At home, markets held up well with broadening conviction around the competence of the current policy set to tackle inflation. The CBRT stayed put in its April and May meetings after moving the policy rate up to 50% in March. S&P's Türkiye rating upgrade to B+ from B with positive outlook in May further improved the sentiment in general.

Annual inflation is considered to have peaked in May to 75% and expected to come off thereafter; hence, June CPI print will likely be one of most critical data points for markets and outlook in general. We successfully managed a challenging period. Firstly, quarterly inflation accelerated to 15% in Q1 from 10% in Q4 last year. This affected our financial performance presented under inflation accounting.

Secondly, first quarter bears some seasonally restrictive features, both for the operational and financial KPIs. While a subdued subscriber activity in winter months, which was further slowed by the Ramadan impact, affected operational performance, a broad-based wage hike took effect from the beginning of the year.

Thirdly, we took several pricing actions during the quarter, but also diligently managed customer sentiment and churn with utmost care in a highly competitive business environment. Data consumption preserved its strength. Usage per LTE subscribers grew by 24% in mobile and stayed flattish in fixed internet YoY. Both mobile and fixed internet data consumption picked up by 4% from the prior quarter.

Starting with financial and operational overview on slide number three. Consolidated revenue climbed to TL 28 billion with 6% annual growth. Excluding the IFRIC 12 accounting impact, revenue growth was 9%, in line with our expectations.

Consolidated EBITDA recorded a whopping 23% growth annually, exceeding TL 10 billion despite Q1 being a low season for most of our businesses. EBITDA margin expanded by 510 basis points YoY to 36.6% beating our forecast for the period.

We generated TL 1 billion net income after recording a TL 2.1 billion tax expense for the period. Investment activity was slow during the quarter with TL 4.6 billion capex spending. Unlevered free cash flow was TL 1.9 billion and net leverage inched down to 1.1x.

Slide number four; net subscriber additions. We closed first quarter with 52.8 million subscribers in total, down 188K from prior quarter end. Excluding the 266K loss in the fixed voice segment, the subscriber portfolios were more or less stable. Fixed broadband base remained flat around 15.2 million with mere 9K net additions in Q1, slightly behind our expectation.

Revising retail tariff prices in early December for new customers and in January for existing customers affected Q1 performance. Seasonality and Ramadan also had a more visible impact on the first quarter performance this year as the number of activations and churn remained below Q1'23 and Q4'23 levels, both in the retail and wholesale segments.

The spike in churn rates observed in Q1'23 amid the south-eastern earthquakes faded over the quarters and Q1'24 rates compared very similar to Q1'22 levels. In quarterly comparison, churn rates also trended slightly downwards with slow activity, rebalancing of price parities and customers getting used to new price levels. Mobile segment lost 16K subscribers on a net basis, closing the quarter with a stable base of 26.2 million in total.

The slower than expected performance was driven by continued weakness in the prepaid segment, while postpaid performance once again surprised to the upside. Postpaid base maintained its healthy growth with 400K net additions and prepaid base its contraction with a similar count of net losses. We achieved our activation target for the quarter with postpaid beating our expectations, but prepared missing it.

Similarly, we stayed close to our budget in postpaid churn but slightly deviated away in prepaid churn. As such, last 12 months postpaid net adds remained extremely strong, around 1.7 million. We now have more than 72% of our mobile customers on postpaid packages.

Slide number five, fixed broadband performance. Fixed internet went through a highly competitive period after we introduced retail price hikes in December, which has been followed by other ISPs in a slow fashion, and in some cases in smaller magnitudes similar to earlier instances when we went ahead with retail-only price revisions. Nevertheless, it would be fair to say we have seen several ISPs taking due action by February/March.

Online channel and bundle offerings remained pretty aggressive though. Recontracting and upsell numbers were affected by price revisions, but still strong with performances in line with our expectations. Customers' preference for higher speed packages stayed intact with 50 Mbps and above packages making nearly 54% of new sales in the first quarter. 35 Mbps and above packages made 64% in recontracting, the highest quarterly level attained historically. Raising the entry speed to 50 Mbps in December for new sales and raising the minimum speed to 35 Mbps for existing customers in January significantly helped us achieve these levels. We expect these actions to positively support ARPU evolution in the coming periods as well.

Average package speed of our subscriber base increased by 43% YoY to 50 Mbps as of Q1. 55% of our subscribers are now on 35 Mbps and above packages compared to 51% a quarter ago and 40% a year ago. A 5% ARPU growth and 2.5% expansion in average subscriber base carried the increase in FBB revenue in excess of 7% YoY, in line with our target for the quarter.

Following the retail tariff price revisions for new customers in December, we introduced a similar adjustment to existing subscriber offers in January. More importantly though, the regulator has approved a 70% increase on average in wholesale prices, which will become effective starting from July. We plan to revise our retail prices in June accordingly, and we expect a sector-wide adjustment to retail prices by other ISPs.

We foresee that the upcoming wholesale and retail price adjustments will affect activation and churn dynamics in the coming months, but we also believe that a price hike at the wholesale level in current market conditions should support balanced competition in the fragmented fixed internet market.

Therefore, we expect fixed internet ARPU to find significant support from these price adjustments while absorption of new price levels by customers should improve towards summer months and back to school period. Finally, we plan to further shorten our retail contracts to 15 months through a 3+12 structure in June from 9+9 at the same time we will be launching our revised tariff prices.

Moving onto mobile performance, slide number 6. Mobile delivered a fantastic performance in Q1, showcasing its strength at many fronts. Mounting focus on subscriber acquisition in the final quarter of last year infiltrated into the early months of 2024.

Our subscriber market share gains continued in 2022 and 2023. This might have catalysed intense competition we think. Once again, we took the lead in mobile sector to kick start this year's price revisions in early January. However, other operators have not followed in a short period of time, unlike in several preceding quarters.

In this environment, we supported subscriber dynamics by keeping the old portfolio open until late January/mid-February when competition finally launched their new tariffs; yet this time in smaller increases distorting the price parities in the market.

Promotional activity was rather heavy during the quarter. In this environment we preferred a balancing act between subscriber acquisitions, churn and ARPU growth. The chart on the bottom right unleashes competitors' trade-off between net adds and ARPU. The slide in ARPU multiples in a way confirms narrowing price parties as well as our resilience to augmented competition over the last couple of quarters. The MNP market contracted QoQ owing to seasonality but grew YoY in stiff race for acquisitions.

In this environment, we prioritised ARPU over gains in the MNP market, ending a streak of leadership in this domain for nine quarters in reluctance to proactively take part in a disrupted market. At this point, we maintain our view that the competition will be rational in the coming quarters due to ongoing inflationary pressures, but we will be carefully watching the landscape in the coming periods.

We managed churn extremely well, thanks to our advanced CRM capabilities despite lucrative offerings from competitors as well as meaningful price revisions in our existing customer tariffs in January. A solid upsell performance over and above that was another positive surprise.

We recorded an extraordinarily strong 16% blended ARPU growth with respective 20% and 12% increases in the prepaid and postpaid segments. That, combined with a 2.6% average subscriber growth, led to an impressive 21% expansion in mobile revenues annually.

A growing strength in the market, driven by our customers and superior asset quality in addition to quarters of superb performance encourage us to think that mobile has a lot more to deliver. Continued repricing of the subscriber base, solid trends in data usage and strong seasonality ahead will be the prime drivers of future performance.

We have recently achieved a key milestone by sharing our inaugural Sustainable Finance Framework with our stakeholders and issuing our sustainability bond. The framework demonstrates our dedication to our sustainability agenda consistent with Türk Telekom's long-term vision.

This strategic financing framework enables us to provide clear and transparent information regarding our commitment to green and social investments. We believe green, social and sustainable finance instruments are effective tools to channel investments to projects that have demonstrated climate and social benefits and thereby contribute to the achievement of the SDGs.

The framework outlines the classification and eligibility criteria of the projects as well as the environmental and social considerations. It also details the principles and requirements for an effective reporting around sustainable financing instruments.

The framework has been independently reviewed by S&P Global, which has certified it as compliant with widely recognised international principles and guidelines. As the first non-financial corporate in Türkiye to have issued an international Sustainability Bond under our Sustainable Finance Framework, we continue to lead by example. As such, Türk Telekom has aligned its funding strategy with its sustainability roadmap and targets.

We made a fulfilling start to the year with continued momentum in our leading businesses. In comparison to Q1 targets revenue growth came in line with our expectation while EBITDA margin scored higher with more than 500 basis points expansion. Mobile was once again at the helm of top line growth with stunning results. Fixed broadband on the other hand has extended its contribution with ARPU growth ramping up as foreseen and is clearly loaded-up with more of it. We believe we left the most challenging period in inflation management behind and remain confident about our full year guidance.

This concludes my part. Thank you. Kaan, over to you now.

AKTAN K: Thank you very much. Good morning and good afternoon everyone. We are now on slide 10 with financial performance. Our consolidated revenues increased to TL 28 billion from TL 26 billion a year ago. This is a 6% growth. Mobile, fixed internet, ICT solutions and call centre were the main contributors to annual growth. Excluding the IFRIC 12 accounting impact, first quarter revenue was TL 27 billion. This is up 9% YoY with increases of 7% in fixed broadband, 21% in mobile, 5% in TV and 9% in other revenues in addition to contractions of 17% fixed voice and 11% in corporate data and 6% in international revenues. A relatively wider gap between consolidated and operational revenue growth this quarter was largely owing to low capex spending in the period.

Fixed internet and mobile together made almost 73% of operating revenue. The two lines of the business made significant contribution to growth with TL 2.6 billion higher revenues in total YoY. The 7% annual increase in fixed internet revenue was driven by respective 2.5% average subscriber growth and 5% ARPU growth. The 21% increase in mobile revenue can also be decomposed into similar 2.6% average subscriber growth, but higher 16% ARPU growth.

Moving on to EBITDA; our consolidated EBITDA rose 23% annually in excess of TL 10 billion from TL 8 billion in the first quarter with the margin expansion by 510 basis points YoY to 36.6%. Excluding the IFRIC 12 accounting impact, EBITDA margin was 37.3%.

Personnel costs increased 14% YoY as the annual wage hike took effect from the beginning of the year. As such, personnel cost to revenue ratio moved close to 27% from 25% a year ago. Commercial costs also grew by 28% YoY due to the last year's low base on contained spending in the aftermath of the twin earthquakes.

Still opex to sales ratio of 63% compared favorably to 68% thanks mainly to declining network interconnection and other costs YoY. Lower energy cost in the lack of electricity tariff increases together with lower maintenance costs incurred in the period took network expenses substantially down.

Finally, taking a partial reserve for the compensation of earthquake damages which are now covered by our insurance policy has pushed other costs lower YoY. We have collected this amount in the second quarter hence the cash flow impact will be visible in the next set of results. It is important to note that the amount collected so far constitutes relatively smaller portion of the amount we expect to recover and there will likely be bigger P&L and cash flow impact on account of this item in the remainder of the year which is fully incorporated in FY guidance.

Down at the operating profit level, operating profit was TL 1.1 billion in the first quarter compared to TL 1.7 billion operating loss in the same quarter of last year. There has been a change in the calculation of depreciation starting from 2024 as we make concrete progress on the potential extension of the fixed line concession agreement.

Accordingly, we will be amortising the related fixed line tangible assets either throughout their remaining useful life or throughout the extended period of concession agreement whichever is shorter. This compares favorably to earlier methodology that used to amortise these assets until 2026. In other words, till the current expiry of the concession agreement.

Coming to the bottom line; net financial expense increased by 87% YoY to TL 5.6 billion from TL 3 billion a year ago due to extraordinarily low base in the same period last year. USDTRY and EURTRY rates increased by respective 69% and 67% YoY; 10% and 7%QoQ. Similarly, market interest rates in the first quarter this year were significantly higher compared to a year ago and kept climbing QoQ as the Central Bank further hiked its policy rate by 500 basis points in March. The widely known shift in monetary policy is the obvious reason behind the sizable variance in net financial expense YoY. It would be reasonable to expect a normalised delta in the next quarter.

Finally, we recorded TL 2.1 billion of tax expense. The deviation of effective tax rate from the usual corporate tax rate was largely driven by the indexation of last year's tax assets to Q1'24 as per the inflation accounting principles. The related amount which doesn't have any impact on cash flow and net profit is offset at the monetary gain loss line again as per inflation accounting methodology. As a result, we generated TL 1 billion of net income for the period.

We are now moving onto Slide 11. Investment activity was slow during the quarter due to seasonality and Ramadan with the TL 4.6 billion capex spending comparing 22% lower YoY. With consolidated revenue growing by 6% on the other hand quarterly intensity ratio declined to as low as 16% level.

Moving on to slide 12 with debt profile. Though relatively contained the quarterly increase in FX rates limited the improvement in Net Debt/EBITDA which has inched down to 1.1x from 1.2x a quarter ago. Cash and cash equivalents add up to TL 14 billion, of which 45% is FX based. This excludes the 270 million USD equivalent of FX protected time deposit that we book under financial investments. The share of local currency borrowings within the total debt portfolio was 15%. The FX exposure included USD equivalents of 2 billion of FX denominated debt, 2.5 billion of total hedge position and 200 million of hard currency cash. The hedge amount included a 270 million USD equivalent of FX protected time deposit, which stayed flat QoQ.

As you can see on the top right chart, almost 70% of our debt had less than 1-year to maturity as of the first quarter, a picture driven largely by our Eurobonds due in June'24 and February'25. However, we worked out a proforma debt maturity profile in order to present an approximation of how the picture should look like in the next reporting period taking into account the obvious post-Q1 developments.

First and foremost, we issued a 5-year USD 500 million Sustainability Bond with 2029 maturity through an extremely successful transaction in May. At the same time, we tendered USD 300 million of February'25 notes for which the process has also been completed. That means the outstanding 2025 Notes is now USD 200 million. Finally, we took into account the expiry of the 2024 Notes as well as the newly secured long-term ECA facilities for respective USD 120 million from Citibank and EUR 80 million from Exim Bank of China, as you might have followed from our disclosures in April and May. As such, we will be attaining a balanced maturity profile with about 37% of total debt falling into short-term maturity as of the second quarter.

We are now on slide 13. Our long FX position was USD 430 million by the end of the quarter. Excluding the ineffective portion of the hedge portfolio, namely Participating Cross Currency Swap contracts foreign currency exposure was USD 340 million short FX position. We should mention that a large part of the existing PCCS portfolio will expire together with the June'24 Notes because these contracts were purchased at the time to hedge this particular debt.

The FX sensitivity analysis we report regularly in our quarterly financials suggests, assuming all else constant, a 10% increase or decrease in the FX rates will have around TL 1.1 billion impact on our pre-tax income in the opposite direction.

Unlevered free cash flow was TL 1.9 billion compared to negative TL 3.6 billion in the first quarter of last year, underlining the strong operational performance and relatively lower capex spending in the period. It's also worth remembering that earthquakes and macro volatility had put some pressure on the last year's numbers.

Well, this will conclude my presentation, and we can now open up to Q&A session.

OPERATOR: The first question comes from the line of Campos Gustavo with Jefferies. Please go ahead.

GUSTAVO C: Hello, thank you for taking my question and congratulations on the presentation. I have a few questions, if I may. First one, in the case of the concession renewal you were expecting, are you expecting to incur any additional investments or changes in the royalty structure or is it going to be very similar to what we've seen before? That's my first question.

AKTAN K: So, we were discussing, is it about the expected terms of it or particularly the investment requirements that will come as part of it?

GUSTAVO C: My question was on both, if you could touch on that. Thank you.

AKTAN K: Well, to be honest, all such factors may be part of the end results because we've been discussing every particular subject during the information exchanges. I think some one-off payments combined with a revenue share and also some level of investment requirement may all be part of the overall terms. But again, it's really early to flag any specific level in any of those underlying obligations. But what is more important for us is that there is a healthy process that we exchange information and views and also expect to have some solid results during the year.

GUSTAVO C: Sounds good. Thank you very much. It's good color. I was also wondering you have a PCCS contract that's expiring for your 2024 bond. Are you planning to also hedge this new bond and the sign the ECA facilities with similar new PCCS contracts to hedge the FX exposure? That's my second question. Thank you.

AKTAN K: Well, thank you very much. Obviously, we are looking at the level of the total exposure, and we are trying to manage the total exposure and keep it as close as possible to a neutral position and for the last many quarters, we've been around USD 200-300 million FX short position. The same rules will apply since we are adding new exposures, we are following the same principle.

And obviously, the tools that we are using are a bit different. We are mainly depending on short-term locally procured hedging contracts, but we also follow the news around getting ability to access to international markets with long-term swap contracts. If those become available and there is liquidity and terms are in favour, we may also start adding such contracts. But again, it's a bit early. We should expect to see some relaxations on the regulation front.

GUSTAVO C: All right. Understood. Thanks for the information. That's helpful. Lastly, you have USD 700 million in proforma short-term debt. Majority of it, I understand, is in hard currency. How are you planning to address these maturities and are you expecting the FX breakdown of your total gross debt to change over the next 12 months as these maturities come up? That's the last thing from me. Thank you.

AKTAN K: I wouldn't expect a major change in it. I mean, the way we will finance the next 12 months payments. Obviously, the balance sheet at the end of the first quarter includes close to USD 700 million of cash and cash equivalents and also FX protected time deposits, which are recorded as financial investment, but they are also part of our funding plan. And on top, we issued a new USD 500 million Eurobond, as I mentioned in my speech. We bought back USD 300 million of 2025 maturity Eurobond. And there is also upcoming payment in June for the USD 500 million Eurobond. So, this is also part of this number that you mentioned for short-term debt. And on that specific transaction, there is full coverage of PCCSs with the current FX rates which should provide close to USD 90 million of mark-to-market value at the date of expiry.

So, all combined together, I think we have a very sound, reliable plan for funding the payment requirements on the financial debt. And other than that, if there are other needs that don't exist right now. So, we have plenty of other means to finance the requirements because we will be at the beginning of next year once we make the payment of 2025 Eurobond, there will be only one tranche left, which is the one that we just issued. So, there is always room for another issue. These are all depending on the future plans, not the existing capex requirements of financial requirements.

OPERATOR: The next question comes from the line of Demirtas, Cemal with Ata Invest. Please go ahead.

DEMIRTAS C: Thank you for the presentation. My first question is about the accounting change related to fixed line tangible assets. In your earnings release and in your presentation, you mentioned that it's favourable but what was the impact in numbers in first quarter depreciation expense? That's my first question. And the second one is about the concession agreement. Is it closer? I know it's difficult to make timing, but I'd like to understand, is it going to be soon or is it going to be happening in this year, in 2024? Thank you.

ÖNAL Ü: Thank you very much for your question related to concession, allow me to answer. You know that the Ministry of Transport and Infrastructure already made statements saying that probably the expansion will be for 25 years for the concession, and it will happen in a not so far future. And even before his statement, we know that, the process has already started, and this is just a public statement related to the process.

You know that in the beginning of 2023, we have made our application for the process. And since then, there have been many meetings made between the delegations. And since the beginning of this year, 2024, now the participatory composition of the meetings has come to the highest level of representation. We know that the meeting traffic intensity has increased. And now the subject matters of these meeting are mainly focusing on more concrete features.

Now the main topics that we are discussing are focusing on the price, the payment method, the calendar of it and they become more concrete and plain. Our full motivation is to conclude this concession subject as soon as possible within this year.

OPERATOR: Mr. Demirtas, have you finished with your questions?

DEMIRTAS C: And there was a second part of my question related to amortisation and depreciation of fixed line tangible assets, what was the accounting change impact at the depreciation expense level?

AKTAN K: Well, as you can imagine it's becoming more complicated especially since we started using the inflation accounting. But when you look at the numbers, the amortisation and depreciation, the total number for the quarter is slightly lower compared to last year's number. And I think that should give you a certain direction because we are now also stopped having a second set of amortisation scheduled under a different accounting principle. From the beginning of the year we've started using the new rules that came with the changing the expectations related to the concession agreement extension. I think going forward, it will be more meaningful to follow the first quarter numbers in order to make some judgment about the full year impact.

OPERATOR: Mr. Demirtas, have you finished with your questions, sir?

DEMIRTAS C: Yes.

OPERATOR: The next question comes from the line of Bystrova, Evgeniya with Barclays. Please go ahead.

BYSTROVA E: Hi, hello thank you very much for the presentation and congrats on results. I have just one question. So obviously, you mentioned insurance proceeds coming up in the next quarters. Could you please also provide some color on what are other seasonality impact on the cash flows that we can expect or see during the rest of the year? Thank you.

AKTAN K: First, I should mention that, that will directly fall into EBITDA. I'm telling this because we are not guiding in terms of cash flow, I will come to that briefly, but we are only guiding for EBITDA and the insurance income that the money that we will be collecting from the insurance will fully be booked under EBITDA and also falling into the cash flow.

And it already included the expected amount because we didn't have the final agreements with the insurers. We just collected a certain prepayment from them, but we're also working on getting into the final resolution with them. And it should definitely be coming in the next few quarters hopefully, and it would have direct impact on EBITDA and cash flow at the same period.

The prepayment that we collected was in the second quarter. Since it came before the release of the financials, we've been able to book this in our P&L for the first quarter. But the cash flow impact you'll see in the second quarter for the prepayment for the rest of it, most probably before the start of the fourth quarter, hopefully.

When we guided for EBITDA, we did not guided cash flow, but at least directionally, we said we should expect a better cash flow generation in 2024 compared to last year. Looking at where we are at the end of the quarter, we are still mentioning the same thing. We say, it should be a good cash flow generation for the FY. Since we are using now inflation accounting, the numbers will also be indexed when it comes to the end of the year, but we should see a real growth in the cash flow.

OPERATOR: The next question comes from the line of Misra Pradyumna with HSBC.

PRADYUMNA M: Hi. Thank for taking my question. It's just a query that is it possible to get the restated rest of the 2023 quarter numbers? That's it.

AKTAN K: Would you kindly repeat the question?

PRADYUMNA M: Yes. I was just curious if we can get the restated rest of the quarters of 2023 numbers?

AKTAN K: Yes. The reporting rules says that in every new quarter when we release the numbers, the prior quarters will be indexed, which means every quarter you will see a different set of prior numbers, which will be indexed with the inflation of the reporting quarter.

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.

AYAZ G: Well, thank you, everyone for joining us today. We hope to have you at our second quarter results. Thank you. Bye-bye.