Türk Telekom 4Q 2022 Financial & Operational Results

Conference Call

Thursday, 23rd February 2023, 15:00 (TR Time)

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&

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Conference Call Conducted by Chorus Call Hellas

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

Welcome and thank you for joining the Türk Telekom conference call and live webcast to present and discuss the Fourth Quarter 2022 Financial and 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 2022 Fourth Quarter and Year-End Results Conference Call. Thank you for joining us today. We are devastated by the quakes that hit Türkiye's south-eastern region recently. We offer our sincere condolences to those who lost their loved ones tragically.

We know that the impact on those who have been through this calamity is unimaginable. We left 2022 behind, but many of its challenges, most importantly geopolitical risks, high inflation, slowing global growth and climate change remain with us. Yet, the sentiment from the World Economic Forum suggested that the 2023 global growth may not be as gloomy as it was seen before.

Besides, finally, we have seen inflation cooling off across the globe. In Türkiye, inflation dropped to 64% by year-end after peaking at 86% in October, thanks to the widely known base effect. Although, it is somewhat relieving to see inflation finally moving in the right direction, it is obvious that it will remain a major problem within the year ahead.

On our side, operators increased their focus on subscriber acquisition both in mobile and fixed internet, in a typical trend that the sector is used to, in the final quarters of the year. Mobile continued enjoying a vigorous demand in warmer than usual winter months, while fixed internet tried to digest the most sizeable price revisions of the year introduced starting from October. Data usage was robust in the final quarter, confirming a resilient demand for telco products despite macroeconomic issues.

Starting with slide #3 on our presentation, net subscriber additions. Total number of Türk Telekom subscribers remained flat QoQ at 52.8 million. Net subscriber additions were 1 million in 2022, including increases of 0.5 million in fixed internet and 1.5 million in mobile. Fixed broadband closed the year with 14.8 million subscribers, amid 64K of moderate quarterly net additions after a robust performance in the third quarter, driven both by the back-to-school period and purchases ahead of the retail price revisions introduced on October 1st.

Fibre subscribers rose to 11.5 million, taking the share of fibre subscribers in our fixed broadband base to 78%, from 67% a year ago. Mobile portfolio expanded to 25.5 million by adding 210K subscribers in Q4. Number of fixed voice subscribers declined by 330K during the quarter, in line with the prior quarters' trend.

Slide #4, financial and operational overview. Revenue growth peaked in the final quarter as expected, with an accumulating impact of price revisions and a piling re-contracted customer base. Consolidated revenues grew by 55% YoY in Q4, while operational revenues recorded a 57% increase. With that, consolidated revenues reached TL 48 billion in 2022, growing by 40% annually.

Operational revenue growth was also 40% ahead of the guidance of 37%. Growing by 17%, consolidated annual EBITDA was TL 19.1 billion, slightly ahead of the guidance. High base, cost inflation and composition of revenue growth were the main reasons driving EBITDA margin to around 40%. Net income was TL 4.1 billion.

The negative impact of the changes in FX and interest rates on the bottom-line was partly offset by the deferred tax gain recorded throughout the year. CAPEX was TL 13.9 billion for the year, very close to the TL 14 billion guidance. Net Debt/EBITDA inched down to 1.47x from 1.54x a quarter ago.

Slide #5, fixed broadband performance. The final quarter of the year was a mixed bag of widespread year-end subscriber acquisition activity, and rebalancing of price parities with the latter extending even into early months of 2023. Demand was slow sector-wise following the strong seasonality and pulled-forward purchases in Q3 ahead of the price adjustments and even slower in our case with widened gap in prices in the market.

We felt the impact on our new sales and churn performance particularly on the retail side; a trend that repeated itself in every round of our price revisions we launched in December, June and October.

Strong appetite for high-speed packages both in new acquisitions and re-contracting helped us pave the way to a smoother transition for the consumer to higher pricing levels. 24 Mbps and above packages made more than 70% of new acquisitions. Pricing and concentration on high-speed packages in new sales combined, has driven Q4 ARPA 42% higher QoQ. Upsell performance was continually robust in another heavy re-contracting period. As a result, annual ARPU growth moved up to 38%, and pushed the fixed broadband revenue increase to its highest level of 43%.

Average package speed of our subscriber base exceeded 32 Mbps as of 2022, increasing by 34% over the year. More than 61% of our subscribers are now on 24 Mbps and above packages, compared to 43% a year ago.

Moving on to mobile performance, slide #6. Race for new acquisitions run into the final quarter of the year. Though cooling off seasonally, demand was still solid to help operators stay focused around inflationary pricing. All operators introduced their revised tariffs across the board around late December or early January. MNP market grew remarkably QoQ first time in five quarters as subscribers shopped around for most advantageous packages out of intensified year-end campaigns.

We stayed on top of the market in net ports for the fifth consecutive quarter. Churn rates stayed low in both segments but particularly so in the postpaid base. 374K net adds in postpaid marked the best quarterly performance of the year for the segment. Prepaid segment, on the other hand, contracted about 165K as a result of the adjustment for the inactive subscribers.

While postpaid made 66% of total mobile subscribers, our Prime based stayed flattish QoQ around 5.5 million subscribers. Prime has been a major contributor to ARPU over 2022 and will continue to be so, we believe, this year. 46% and 71% annual growth respectively in postpaid and prepaid ARPU combined into a 53% rise in blended ARPU, up from 40% in the third quarter. A surging 63% growth in mobile revenue was strongly supported by diligent ARPU management and a hefty 1.5 million net additions over the last 12 months.

Now, I would like to give you some information about the impact of the recent earthquakes on our business, on slide #7. We are deeply saddened by the huge earthquakes that struck Türkiye recently, leaving tens of thousands dead and injured. The disaster affected 11 provinces, spreading across an area bigger than 100K square kilometres, where 14 million people, or 16% of Türkiye's population, lived. We had about 5 million subscribers in total in the affected region making almost 10% of our total base. Including the outsourced staff, we had 3.5K employees there.

Finally, the 2.6K mobile sites made 11% of the total we have across the country. This is still work in progress and the numbers are certainly subject to change because of several uncertainties, but based on our early impact analysis, we estimate the revenue loss to be between TL 1.0 - 1.5 billion, one-off CAPEX to be USD 50 - 60 million, and one-off OPEX to be between TL 2.3 - 2.5 billion within 2023.

Moving onto slide #8. As Türk Telekom, our immediate reaction was to put all our resources to work; to ensure uninterrupted communication, care for our employees and their families, and provide every support we can for the rescue and recovery efforts in the region. Our on-site inspections together with our executive and regional teams, starting from the early hours of the disaster, helped us immensely both in understanding the extent of the damage and taking the right actions in the most efficient way.

Our operational scale, widespread presence across Türkiye, and structure as the leading integrated telco operator of the country, has certainly put us ahead of the competition in our agile and adept response in disaster recovery. We took swift action to send about 1,400 employees, including our voluntary rescue team, TTAKE, from all over Türkiye to the region to help recover, disrupted operations and the rescue efforts.

In the early hours of the disaster, the ratio of active mobile sites in the affected region dropped close to 70% on average, with bigger impact in the three most highly affected provinces of Adıyaman, Hatay and Kahramanmaraş. Power outages in addition to the damage itself from the quakes have been a major limitation in serviceability. Still, we were able to make significant progress within days. We installed 224 mobile sites, sent 951 generators and supplied more than 350K litres of fuel to restore our operations.

As you can see on the top right chart, we resumed the active mobile site level above 90% on the fourth day and moved it even above 100% in the following days by adding more mobile sites than we permanently lost. We have also started the optimisation works in the area. Further needs to be done to fully restore our network capabilities, sales activities and operational routines. Obviously, the reconstruction plans and new forms of habitation in the affected provinces will be our roadmap for the medium to long-term strategy.

Our actions on the disaster recovery front included sending 124 containers and humanitarian aid to the affected provinces and donating TL 2 billion for the earthquake relief. We have also introduced several initiatives to support our subscribers. On the mobile front, our actions included immediate activation of suspended lines due to their debts, providing one month free communication services, free benefits, discounted additional packages and more. In fixed, we provided free access to all Türk Telekom WiFi spots and public payphones, lifted cancellation fees and extended contract terms for all expiries until March.

Now let's take a look at the 2023 outlook on slide #9. Obviously, an event of such scale will have important economic consequences both at the macro and micro levels. Besides, it seems the challenging trends in macroeconomic indicators, which played an important part on the way we do business and our financial performance will prevail for another while. With that in our central focus, we formulated our 2023 budget after also carefully considering an attainable balance between growth, investment needs and cash flow performance.

Accordingly, we expect our operating revenues to grow by 52 - 55% YoY, our EBITDA to be TL 23 - 25 billion and our CAPEX to be TL 17 - 19 billion. We expect to maintain a dynamic pricing behaviour throughout the year and the scale of our adjustments to be decided according to actual inflation and prevailing consumer sentiment. We foresee robust subscriber evolution along with continued growth in data consumption to support mobile revenue performance.

Fixed internet top-line, on the other hand, should be shaped by speed upselling along with some limited net subscriber loss driven by the earthquake impact. EBITDA will be sensitive to consumer sentiment, growth composition, OPEX evolution and one-off quake related costs.

Finally, targeting a lower intensity ratio YoY, the CAPEX budget considers the 2023 portion of spending for damages from quakes and aims to support our growth plans in select priority areas as well as in fixed broadband and mobile segments.

2022 was a puzzling year. In an environment where we had no control on global and macro issues affecting us, we turned our focus on reinforcing our strengths, which have for decades helped us differentiate ourselves from competition as well as overcome volatile and uncertain times.

We spared meaningful amount of time and energy on perfecting our technological capabilities, customer experience tools and digitalisation agenda. We believe we are well equipped to brace for risks and capitalise on new opportunities in order to keep up with our duties to our stakeholders.

Unfortunately, we started the year with a tragic crisis. We cannot possibly underestimate the instant or lagging multi-dimensional effects of such a catastrophic event, but we have been working round the clock to improve the situation every day and making significant progress to mitigate the impact. We certainly have a lot more work to do. And for that, we are empowered by the unique and most sincere unity that our nation has shown to heal all together.

Now, I will hand over the call to Kaan to discuss our financial performance in detail. Thank you.

AKTAN K: Thank you, good morning and good afternoon everyone. We are now on slide 11, financial performance. Our revenue growth continued its upward trend in the final quarter reaching 55%, which is notably higher than the 45% attained in the third quarter. Fixed internet and mobile ARPUs peaked on the back of multiple price actions throughout the year. Subscriber growth, which was particularly strong in mobile throughout the year, and healthy upsell performances across the board despite macro pressures.

Fixed broadband revenue growth was 43% compared to 35% a quarter ago. Net additions moderated in the aftermath of strong seasonality in the third quarter and the most sizeable price revision we introduced on October 1st. Other ISPs have followed our retail price adjustments, but the process was repeatedly slow, running into even January in some cases. As such, net addition performance once again shifted towards the wholesale segment. That said, we have seen improved activations and churn performance in November and December as other ISPs kicked off their pricing cycle.

Mobile top-line growth surged to 63%, thanks not only to continued strength in the market, but also to our robust strategy achieving a healthy mix of ARPU growth and base expansion at the same time. We saw another solid performance in postpaid additions. Prime continued to be a powerful tool in further increasing the mobile ARPU.

Fixed voice revenue recorded 24% growth, while TV revenues expanded by 26% annually, with a flattish subscriber base QoQ. Growth in corporate data and other revenues also picked up pace with respective 31% and 140% increase. Equipment sales, ICT project and call centre revenues remained as the primary drivers of the latter. Finally, international revenue was 67% higher on traffic growth and currency impact.

As such consolidated revenue increased by 40% annually. Operating revenue grew at a similar pace, surpassing our 37% guidance for the full-year. Mobile helped the outperformance, making almost 37% of Group's annual operating revenue.

Our subsidiaries have also partly driven the better than guided top-line performance in 2022. The contribution to Group revenues has accelerated in the final quarter. Third party revenues generated by our subsidiaries increased by 83% YoY and made more than 11% of our consolidated revenues.

We are now moving onto our operational performance. Consolidated EBITDA was up 30% to TL 5.6 billion with a margin of 37%. Once again last year's high base, inflated OPEX and faster growth in lower margin businesses explained the downward trend in annual comparison. Excluding the IFRIC 12 impact, margin was 40%. As such, we closed 2022 with 40% EBITDA margin for the full year, which was around 42%, excluding the IFRIC 12 accounting.

In the last quarter of the year, operating expenses increased by 74% YoY. Excluding the IFRIC 12 cost, growth in OPEX was 83%. Increase in cost of equipment and technology sales surged to 138% YoY, in parallel to the surge in number of projects acquired both by Türk Telekom and İnnova in the final quarter of the year and inflated equipment and other costs attached to these projects. Other direct costs grew by 75% YoY, owing to higher commissions paid on prepaid loading, shared revenues and value-added services revenues. Higher commissions were driven both by inflation and higher volumes. Trend in network and technology expenses, commercial costs and personnel expenses remained broadly unchanged from prior quarters.

Obviously, an inflated OPEX played a significant part on our 2022 margins. When formulating the 2023 guidance, we believe we applied reasonable caution to our assumptions driving the personnel, network and commercial expenses which constitute the bulk of our operating cost base. Change in personnel costs reflects the impact of the recently announced scheme that removes the age barrier for a certain group of pending pensioners in addition to the usual annual salary adjustments. Network expenses incorporate a significantly higher unit, electricity cost YoY.

Our CAPEX spending was TL 13.9 billion in the year, which is within our budget, which assumed accelerated spending in the final quarter.

It's important to highlight that our insurance covers all our assets against earthquakes at current replacement cost, including operational losses incurred from service disruptions caused by the recent disasters. All labour and installation costs are also under coverage. Based on our earlier experiences and considering both the size of the affected region and the scale of the damage compared to the quakes that took place in the past, we believe we should be able to recover the damage through our insurance in around 18 months at the earliest. Therefore, although, we have reflected some estimated one-time CAPEX and OPEX impact into our 2023 guidance, we assume no insurance recovery will take place within this year.

Coming to the bottom-line. Net income was TL 1 billion, down YoY and QoQ. While higher net financial costs and lower tax income led annual decline, a lower tax income despite a lower net financial expense largely explained the quarterly change. USD and EUR exchange rates increased by 1% and 10% QoQ, respectively, when compared to previous quarter's close. Accordingly, we incurred lower

FX losses in quarterly comparison. Short-term derivative instruments continued to be our main hedging tool. A relatively stable interest rate environment led the flattish net interest expense in quarterly comparison.

Finally, although we once again recorded tax income, it was significantly lower both QoQ and YoY, thanks to a reversal in inflation trend. We recorded TL 4.1 billion net income for the full-year, down by 28% annually, despite 36% average increase in USDTRY and EURTRY rates and higher interest rates YoY. The bottom line was supported by a TL 2.3 billion tax credit.

Our Board of Directors resolved to propose at the 2022 Ordinary General Assembly that Türk Telekom pays no dividend out of 2022 earnings. The decision reflects the need for elevated caution in light of recent events and the consideration of our Company's liquidity and investment requirements along with possible volatility in financial markets on global or domestic macro uncertainties.

We are now moving onto slide 12 with debt profile. Net Debt/EBITDA inched down to 1.47x QoQ as EBITDA growth improved, hard currency debt continued coming down and lira remained on a relatively stable course. Cash and cash equivalents were TL 5.1 billion, of which around 54% is FX-based. This obviously excludes TL 4.9 billion of FX protected time deposit, which is reported under financial investments.

The FX exposure included USD equivalent of 2.1 billion of FX debt, 2.3 billion of total hedge position, 150 million of FX based cash. As you can see on the bottom right chart on this page, the hedge amount includes a 250 million USD equivalent of FX protected time deposits, down slightly from 260 million in the third quarter.

Considering the ineffective portion of the hedge portfolio, mainly the existing participating cross currency swap contracts, the FX exposure was USD 460 million short position compared to USD 520 million short position a quarter ago. The share of local currency borrowings within the total debt portfolio inched up to 16%.

We are now on the final slide, slide 13. The dynamics of the FX hedging market remained unchanged from earlier quarters with the long-end being still dysfunctional and theoretically speaking extremely costly. As such, the short-term portion of our hedge portfolio continued its ascend, while net FX exposure contracted as a result of our efforts to narrow down the position.

The FX sensitivity analysis we report regularly in our quarterly financials suggests, assuming all else constant, a 10% increase in FX rates will have around TL 800 million negative impact on our pre-tax income. On the flip side, the sensitivity analysis produces around TL 900 million positive impact in case of similar appreciation in lira. Finally, TL 1.9 billion of unlevered free cash flow in the final quarter placed the annual figure to TL 5.1 billion.

This concludes my presentation and we can now open up the Q&A session.

OPERATOR: The first question is from the line of Zaczkiewicz Daniel with Barclays. Please go ahead.

ZACZKIEWICZ D: Hello and thanks very much for the call and I've just got a few questions if that's okay. Could I firstly ask when you're expecting your EBITDA margins to bottom out and at what sort of levels? Then with regard to your short-term debt maturities, what are your refinancing plans? Also can I ask, when you might look to address your 2024 Eurobond? Then finally, could you just provide any update as to where you stand with regard to an extension of your fixed concession? Thanks very much.

AKTAN K: I think the first part of the question was about the margin performance that we should see this year. Obviously, we had a sizeable adjustment in salaries starting from the beginning of January. And we will also incur a larger part of the additional OPEX due to the earthquakes, in the first quarter and first half. This means that we should see the minimum margin during this timeframe and hopefully expect to see some improvement in the second part of the year.

And the second question was about… Currently, we have around EUR 200 - 220 million committed facilities under two separate ECA agreements. We expect to have another one probably in this quarter around 80 million. If you look at the repayment schedule of our existing debt, we see something less than 300 million in terms of the short-term portion of the long-term debt. And there are also the TL loans to be repaid, but by nature, they are all short-term. And so far, we've been able to renew the existing Turkish lira portfolio either with similar commercial loans or by introducing bonds to the local market.

For next year obviously, there will be the eurobond repayment on top of a few hundred million dollars of debt payment on the long-term hard currency debt contract. Currently, we are holding around TL 10 billion cash. Again, we are pretty much secured for the refinancing of this year. Hopefully, we should see a better environment when we close the year-end. But still, our plans will be around to have the necessary facilities in place, even if we don't have a similar eurobond issue that would refinance 2024. So, we will have our plans around this strategy.

And for the concession part, I'll turn to our CEO.

ÖNAL Ü: Hello again. As you know, we have applied to the relevant regulatory authority for the renewal of our concession, which will expire in 2026.

And again, as you know, our main shareholder, the sovereign wealth fund of Türkiye stated that they also wanted the concession issue to be clarified as soon as possible after the share transfer and that Türk Telekom would pave the way for this issue and that this issue was important in order to be able to make long-term plans for the Company at the highest level.

Even though we know that after the earthquake disaster, this subject has come to the fore for many areas, we believe that it is also very important and very supportive to solve this problem for all parties.

So, this is definitely one of the most important priorities on our agenda and this issue has been also followed by the decision makers and we are also following it accordingly.

ZACZKIEWICZ D: Thank you.

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: Thank you everyone for joining us today. I hope you enjoy your day. Thank you for joining. Bye-bye.