Türk Telekom Q2 2023 Financial & Operational Results

Conference Call

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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 Jaime your Chorus Call operator.

Welcome and thank you for joining the Türk Telekom conference call and live webcast to present and discuss the Second Quarter 2023 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 2023 second quarter results conference call. Thank you for joining us today. Geopolitical news occupied the headlines from time to time, but the central banks' interest rates and inflation dilemma remained in centre focus over the second quarter globally.

At home, while Türkiye continued feeling the impact of the February earthquakes albeit at a diminishing capacity, politics largely dominated the domestic agenda. Türkiye has left the critical presidential and parliamentary elections behind towards end of May.

Meanwhile, inflation retreated to 38% as of June, revealing the lowest print in 18 months. Yet a 35% jump in FX rates on average within the quarter is expected to call back inflationary pressures. The recent announcement of another 34% increase in minimum wage effective from

July 1 and several tax hikes are also set to negatively affect the CPI data ahead.

Generally speaking, Türkiye made a lacklustre start to the second quarter as the country still transitioned out of earthquake recess, and Ramadan; usually a slow period in activity, took most of April. The finalisation of a two-round election process in late May and the closure of school season around mid-June kicked off the holiday period. The Eid break within the week of June 26 paved the way for a 9-day holiday for most.

In this backdrop, data consumption depicted usual characteristic of seasonality, where we observed a quarterly pick-up in mobile segment, but some decline in fixed segment. In annual comparison, data usage continued its robust advance with 25% and 11% increase in mobile and fixed, respectively. Although the critical elections in Türkiye heavily influenced both the business environment and consumer sentiment, the potency of our targeted actions that we have been implementing, manifested itself in our operational and cash flow performance in the second quarter as inflation has retreated and the earthquake impact has gradually faded.

Starting with slide #3 in our presentation, net subscriber additions. Total number of subscribers declined to 52.4 million with a net loss of 105K during the quarter, largely due to the ongoing contraction in fixed voice customer base but also to tepid total additions in other businesses.

Fixed broadband base touched the 15.0 million mark first time with 144K net additions driven by improved performance both in new sales and churn in the aftermath of the February earthquakes. Net acquisitions in fixed internet scored stronger than anticipated in a balanced pricing environment in the reporting period. Therefore, we now target a positive net add in fixed broadband compared to our earlier expectation of a slight net loss for the full year despite having introduced price revisions both in wholesale and retail portfolios starting from July 1st. Fibre base expanded to 12.2 million subscribers with 426K of quarterly net additions. The share of fibre subscribers in our fixed broadband base increased to 82% from 73.5% a year ago.

All mobile operators launched their new prices in April, but the first quarter's intensified competition extended into Q2 through longer-lasting and aggressive promotional activities. Our sector-beating ARPU growth in Q1 and quarters of unshaken position in the MNP market might have augmented competitors' need to respond differently, but sticking to our long winning mobile strategy, we have continued prioritising ARPU growth on our side.

As such, mobile portfolio stayed flat at 25.6 million. We recorded a total of 9K net subscriber loss in Q2 driven by 244K decline in the prepaid base. On the flip side, postpaid segment secured 235K net adds, aggregating its total gain to more than 1.2 million subscribers over the last 12 months.

Fixed voice base continued its descent with 237K of subscriber loss, along with the strategy focusing on naked-DSL sales.

Slide #4, financial and operational overview. Both operational revenue and EBITDA surpassed our targets in the first half. Consolidated revenues increased more than 67% YoY in Q2, while operational revenues expanded

68%. Core businesses, particularly mobile, contributed significantly but other businesses also fuelled growth.

Consolidated EBITDA growth picked-up QoQ with 37% annual increase to TL 6 billion mark. 33.6% EBITDA margin moved 230 bps ahead of last quarter's level. We recorded TL 600 million of net loss at the bottom-line due to sizeable net financial expenses incurred in the period.

Net Debt/EBITDA stayed almost flat around 1.65x QoQ, thanks to an improved operating performance.

Slide #5, fixed broadband performance. We observed continued improvement in fixed internet subscriber dynamics over Q2. Following prior quarter's better than expected acquisition performance, new sales remained strong with only slight decline QoQ on seasonality, but significant improvement YoY.

Churn rates normalised from last quarter's quake triggered spike, along with moderate competition in the market, which has operated in a balanced pricing environment since early Q1 in lack of new tariff price revisions. ISPs' subscriber activity was mostly centred around differentiation in contract structures and quake-region specific campaigns.

Upselling and re-contracting performance improved QoQ. 35 Mbps and above packages made 50% of new acquisitions, helping move ARPA 2% higher QoQ. ARPU growth didn't change much from last quarter's levels and stayed around 42% YoY. Following a mixed first half with quakes, Ramadan and elections, we introduced our new prices in both wholesale and retail segments, starting from July 1st.

We raised wholesale tariffs by 70% and retail tariffs by 50% on average over existing prices. This is the first time we revised wholesale tariffs since June and retail ones since October last year in new sales. We have started applying similar pricing actions in our retail portfolio on the re-contracting side since early August.

These moves will shape both subscriber dynamics and ARPU evolution going forward. A sector-wide response to our revisions is yet to be seen, but we expect the sector to align rationally given the ongoing inflationary pressures across the board. Hence, we expect a robust acceleration in ARPU growth in the coming quarters.

Moving on to mobile performance, slide #6. Although mobile operators synchronised their latest pricing actions in April, they started launching rather attractive offers one after the other to lure consumers and revive the MNP market in May. In this backdrop, we preferred to be selective in our offerings and prioritised ARPU growth, which was ahead of the competitors' in the first quarter.

Driven by the above dynamics, MNP market, which had contracted in Q1 on quake slowdown, grew by 13% annually and 9% quarterly. A relatively low base due to the ongoing effects of Covid-19 measures in Q2 last year also played a role in annual expansion. Once again, our top position in net ports remained unchanged for the seventh consecutive quarter, despite fierce competition, thanks to our stronger positioning in the market.

New acquisitions in postpaid performed better than we expected and grew both in quarterly and annual basis. Postpaid churn rate was well contained at similar levels in both comparisons despite the abundance of attractive offers in the market. New acquisitions were also better than last quarter in the prepaid segment after the initial shock of the quakes, but the churn rate was also inevitably higher.

Shaped under these dynamics, postpaid segment made more than 68% of our total mobile base. Well ahead of inflation, 73% ARPU growth stayed on a robust trend with 66% annual rise in postpaid and 88% in prepaid segments, owing to our winner strategy that targets a fine balance of subscriber base and ARPU growth. As usual, subscriber, ARPU and data consumption growth were the main pillars of the 81% YoY surge in mobile revenue.

We have recently taken the liberty to lead the next pricing round and revise both our postpaid and prepaid tariffs in early August. Therefore, we expect strong ARPU evolution to continue in the second half.

Now let's take a look at the full year outlook on slide #7. We have revisited our 2023 guidance after both top-line growth and EBITDA exceeded our expectations in the first half. We now foresee 67-70% operating revenue increase, TL 25 -27 billion EBITDA and TL 19 - 21 billion CAPEX for this year.

While the change in top-line and EBITDA outlook can largely be attributable to expectations of more pricing actions, better operational KPIs and continued high contribution from non-core businesses, the increment to CAPEX reflects the impact of labour cost inflation as well as recent sizeable losses in lira’s value. We maintain a cautious view on cost inflation in general.

We see a diminishing impact of the earthquakes on subscriber dynamics going forward, although our earlier guidance for quake-related revenue, cost and CAPEX items remained unchanged. We expect inflationary pricing to stay in telco operators' focus, although seasonal or periodic promotional activities will likely continue to affect subscriber and ARPU dynamics at times, particularly in the mobile segment.

On the fixed internet side, other ISPs’ response to our recent wholesale and retail pricing actions is yet to be seen. Nevertheless, having been through similar cycles over the last 6-7 quarters, we expect to continue pursuing our dynamic pricing strategy, which closely monitors inflation data.

Aligning our portfolios themed around holidays, tourism and back-to-school to customer needs, will be at the centre of our activities ahead along with indispensable focus on upselling and re-contracting, of course.

Before I give the word to Kaan to discuss our financial performance in detail, allow me to share some worthy remarks. Türkiye has been working relentlessly to overcome the massive disruption caused by the south eastern earthquakes that hit our country early in the year. As Türk Telekom, we have been at the forefront of these efforts. On one hand, we continue to carry out the work on the ground to fully recover the physical damage to our operations and bring connectivity to new habitations such as container and tent sites, and on the other hand, we support the community through subscriber benefits and regional promotional activities as well as social responsibility projects.

Continuous progress in mobile KPIs speak volumes about our competent strategy and growing strength in the market, while the FBB segment is set to enter a momentous path starting from the second half. Therefore, we have confidence in our ability to deliver our revised guidance.

Thank you. Kaan, the floor is yours now.

AKTAN K: Thank you very much. Good afternoon, everyone. We are now on slide #9 with the financial performance. Top-line growth continued its strong momentum and moved higher for the fifth consecutive quarter to 67% annually from 61% of last quarter. This is thanks to our dynamic actions designed around the volatile macro and consumer backdrop. Following a sensitively managed earthquake period, we resumed normalcy in our marketing and customer care activities in the second quarter. That, combined with customers also returning to their routines gradually helped activation and churn dynamics to move out of the earthquake impact in general. With similar reasons, re-contracting and upselling also regained strong footing in the second quarter; altogether supporting an improved revenue performance QoQ in our core businesses.

45% fixed broadband revenue growth paused its ascend for the first time in five quarters, but will be reclaiming it back as early as next quarter, thanks to the stronger-than-expected subscriber dynamics extending into the second half as well as the recently implemented sizeable price revisions in the wholesale and retail portfolios.

81% mobile revenue growth once again surprised to the upside, with the support of several strong KPIs confirming the virtue of our strategy that has been reinforcing our positioning in the market. Postpaid net additions and churn were extremely resilient to increased competition.

Net losses in the prepaid segment, on the other hand, was a result of increased preference towards postpaid tariffs of locals and roaming or other alternatives of foreign tourists, we think in addition to competitive pressures.

Although data package sales and top-ups were boosted by the earthquake induced need for communication last quarter, we have seen a similarly strong performance in these categories, thanks not only to seasonality, but also to our targeted and tailored way of addressing customer needs. The number of additional data packages sold grew by 19% YoY, while average top-up amount per prepaid subscribers more than doubled. Corporate data revenue growth was 62% with a similar performance to last quarter. Growth in other revenues on the other hand surged to 134% thanks to robust progress in equipment, ICT project and call centre revenues.
Advanced performance in equipment sales was largely driven by project revenues generated by Türk Telekom and İnnova. Finally, international revenue growth accelerated significantly from last quarter to 88% along with weaker lira.

Now moving on to EBITDA. An accelerated 37% growth moved consolidated EBITDA to TL 6 billion. This is up by 230 bps QoQ, EBITDA margin increased to 33.6%. While revenue increase in excess of opex increase supported to quarterly margin improvement, higher growth in our non-core revenues worked in the opposite direction.

We continued feeling the impact of the quakes on our EBITDA. If adjusted for those items, second quarter EBITDA and EBITDA margin would move up to TL 6.2 billion and 34.3%, respectively. Increase in operating expenses slowed to 88% YoY from 96% of the last quarter. Excluding IFRIC 12 cost, growth in operating expenses was 92%. Annual rise in network and personnel expenses lost steam in quarterly comparison, thanks to some decline in unit energy costs, and the one-off costs recorded last quarter due to the new pension scheme enforced by the government.

As we mentioned in our guidance, we maintain a cautious view on cost inflation, given the reversal of downward trend in inflation with July CPI surging back to 48% from 38% in June. In its latest inflation report, the CBRT increased its year-end inflation forecast to 58%. The salary adjustments we made following government's 34% hike in minimum wage effective from the second half will be reflected on our financials starting from the third quarter.

Coming to the bottom line, USDTRY and EURTRY rates both increased by 35% on average QoQ. Interest rates also went up significantly and remained elevated throughout the quarter amid extreme volatility in financial markets driven by the election uncertainties. As a result, we incurred significantly higher FX losses QoQ on currency weakness. Hedging costs also went up sizeably due to higher FX and interest rates as we continued utilising short-term instruments for hedging purposes.

That said, it would be fair to mention that extreme volatility and change in macro assumptions had caused some of the mark-to-market gains on certain hedging instruments to be incurred in the first quarter, leading to a net FX & hedging loss of merely TL 0.6 billion versus TL 4.2 billion in the second quarter.

On the flip side, TL 1.2 billion of net tax income driven by the revaluation of assets and R&D and investment incentives supported the bottom-line. As a result, we recorded TL 600 million net loss for the period. Again, if adjusted for the quake related items, net loss would be TL 485 million. Finally, CAPEX was at TL 3.7 billion in the second quarter, of which TL 260 million was earthquake related spending.

Moving on to the next slide, slide #10, with debt profile. Thanks to progressive operating performance, Net Debt/EBITDA ratio was contained at around 1.65x in the reporting period despite a massive 35% increase in FX rates QoQ. Cash and cash equivalents add up to TL 9 billion, of which around 38% is FX based. This excludes the USD 320 million equivalent of FX protected time deposit that we book under the financial investments.

The share of local currency borrowings within the total debt portfolio declined to 22% from 27% a quarter ago. The FX exposure included USD equivalent of 2 billion of FX denominated debt, 2.6 billion of total hedge position and 130 million of hard currency cash. The hedged amount included a USD 320 million equivalent of FX protected time deposit which is unchanged from the first quarter.

We are now on slide #11. Our long FX position was USD 690 million by the end of the quarter. Excluding the ineffective portion of the hedge portfolio, namely the PCCS contracts, foreign currency exposure was USD 140 million short FX position compared to 370 million short position a quarter ago.

Similar to previous quarters, in continued lack of long-term derivative transaction in the FX hedging market, we kept utilising short-term instruments, while the net FX exposure contracted continuously over the last six quarters as a result of ongoing effort 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 would have around TL 370 million negative impact on our pre-tax income. On the flip side, the sensitivity analysis produces around TL 270 million positive impact in case of a similar appreciation in TL.

Leaving behind the low seasonality and the earthquake pressures, unlevered free cash flow turned to a positive TL 2.3 billion from a negative TL 2 billion a quarter ago, along with an improved EBITDA performance. It also compares favourably to TL 1.5 billion generated in the same quarter of last year.
This will conclude my presentation. We can now open the Q&A session.

OPERATOR: The first question today comes from Evgeny Annenkov from Bank of America. Please go ahead with your question.

ANNENKOV E: Thank you. Hi, good evening. Thank you for the presentation and congratulations with a solid quarter operationally. I have two questions please, the first one on competition in fixed broadband segment. I understand the price response by ISPs is yet to be seen. But if we talk about maturities, do you see any major changes in contract structure in the market? In particular no commitment or 3+9 months contracts, do they gain more traction or do customers still prefer to go for longer contracts in the high-inflation environment?

And second, on cash generation. You have delivered a solid TL 2.3 billion free cash flow in the quarter. I see this partly was helped by major inflow from payables. Can you please give more colour on working capital and which tools you have to mitigate cost pressure and protect cash flow?

ÖNAL Ü: Thank you very much for your question. Just like you have said, we have made our price revisions. As of now, we haven't seen a full participation from all other ISPs, but we expect them to follow suit. We will be planning our price increases in line with the balancing of the parities, for customers to get used to the new price levels and the course of inflation. Of course, with that, we have a forecast that we will have a strong back-to-school period after the post-earthquake subscriber dynamics developed better than our expectations and the consumers get used to the new price levels. We think that the subscriber movement, which we previously expected to be slightly negative, will be positive in the fixed broadband business line.

In terms of the contract structure, you know we have our 12+12 contract structure that we have started implementing. But from time to time, we see that our competitors are implementing 3+9 or 6+6 kind of contract structures, but they are not so widespread. We know that non-contracted customer base is also not so widespread, they're just a periodical based on need kind of implementation.

By the way, I would like to highlight that point as well. After a long period, we have increased our wholesale and retail prices. We have this inflationary environment, and it is important for us to increase wholesale prices. But independent of the regulatory authorities' approval for limited increases or not at all, we believe that we will be able to turn this scheme into an automated one within this inflationary environment which will put the price increases of all ISPs into a more predictable and healthy manner.

AKTAN K: Yes, for the second part of the question, which was around the cash flow performance. Well, when you look at the cash flow, it's very obvious that it is being impacted by the seasonality in the way we spend money for CAPEX. Because the CAPEX of a quarter mostly falls into the accounts payable as a result of the payment terms. When you look at the second quarter, we see a higher CAPEX. There is also earthquake-related spending that also improved; coming from the first quarter - end of first quarter - that has also impacted the accounts payable. But I should also remind one factor here. This is something we started, especially last year, we delivered went down on the payment term, days payable for hard currency for CAPEX items, which were priced in hard currency.

This was the result of our effort to minimise the FX exposure. It gives us a bit burden on the cash flow. We know that. We saw the impact last year as well, but it's also saving us from a higher FX exposure, meaning we have to now hedge less to overcome the FX risk. I think that strategy will stay a bit longer until when we have more visibility on the FX rate trends and continue putting a bit of pressure on the cash flow performance.

And the other factor, the payables is also impacted by everything that comes as a result of the inflation. All types of payable items are also inflated by the pricing impact. This is something also giving a bit positive results for cash flow.

ANNENKOV E: Thank you for the very detailed answers. That's very helpful. Thank you.

OPERATOR: And our next question comes from Ulle Adamson from T. Rowe Price. Please go ahead with your question.

ADAMSON U: Yes, hi. Thank you very much. Just wondering how you're thinking about refinancing your 2024 and 2025 upcoming bonds? Thank you very much.

AKTAN K: Thank you. If you look at not only the refinancing of 2024, when you look the overall refinancing of the debt portfolio because that bond only is 20% of the debt that will have a maturity in the next 12 months. Obviously, we are now using sizeable financing from local markets. These are lira commercial loans, more than 20% of the debt portfolio was in lira loans.

By market conditions, gives us maturities less than a year. So, everything that you see as lira borrowings falls below 12 months. There is a remaining roughly 12% of the debt portfolio, which consists not only bonds but other hard currency long-term loans that will expire within the next 12 months. In return, we currently have around EUR 220 million committed ECA facilities.

Again, the plan for the lira side is to roll over the debt once the maturities come. For the other long-term loans repayment, we secured almost a similar committed ECA line. At the same time, we carry around USD 700 million equivalent of cash in total. This consists of USD 320 million of currency protected deposits, another close to USD 350 million of cash kept both in lira and dollar and euros.

So, we have a sizeable cash in hand. There is one thing which seems to be a bit hidden within our numbers. We also have around USD 350 million equivalent mark-to-market coming from the whole huge derivative portfolio. Obviously, these are mostly linked to the repayment of the financial debt, and that would give us a certain benefit when the maturity comes. So all-in-all, we have a sizeable cash or potential reduction from the debt in the form of mark-to-market of the derivatives.

We try to base our worst case scenario, this is really the extreme case, as not having a major refinancing of 2024. But still, we are now looking at all sorts of opportunities in the market as we are kind of seeing that there is a better market for bond issues and the sovereign is, in a way, opening the way. We saw strong demand in the recent issues. So, we are also trying to analyse what will be the outcome from a potential bond issue until we have the payment of the 2024. Again, this wasn't our base case scenario, but I think the market conditions are now changing.

OPERATOR: Our next question comes from Cemal Demirtas from Ata Invest. Please go ahead with your question.

DEMIRTAS C: Thank you for the presentation. My question is about earthquake donations amounting at around TL 2 billion.

Should we expect a full of that amount cash outflow in the second half of the year?

And the other one is rather a strategic question about the licensing of Türk Telekom going forward. In the past, we were just discussing 5G issues and the other regulatory issues. How do you see that process will be going on as the election is already completed? In the future, in the next 6 - 12 months, should we expect some changes in the sector or some clarification about licensing or 5G issues? Thank you.

ÖNAL Ü: Thank you very much for your question. As you know, this donation decision had to be approved by the General Assembly. Recently, we have completed our General Assembly and fulfilled this requirement.

Of course, since the donation decision, we have made many spending and expenditures that can be considered as donations under AFAD, Disaster and Emergency Management Coordination, considering the earthquake priorities and regional needs.

So, I can tell you that considering all the expenditures so far and depending on the size of the remaining amount, we prefer to pay it in periods rather than all at once.

I believe we will be able to share more clear information related to how much of the benefits and expenses will be deducted from the donation around Q3 financials.

Related to your second question, as you know, we recently had our General Assembly, and we have appointed our new Board of Directors. You know I'm CEO, but also I'm also a member of the Board. Just after the General

Assembly, we have made our first Board of Directors meeting. The first item on the agenda was the renewal of the concession which will clear the uncertainty ahead of our company.

You have asked also what to expect in the coming 6 – 12 month period. Personally, as a CEO and a Board member of this company, my will is to solve this concession issue as soon as possible. I see that this is the will of the new Board of Directors as well. This is our primary agenda item. So I believe it's not going to take it so long. I'm more motivated to clear this issue not even up to one year, but this is not a binding comment of course.

Related to 5G, there is nothing much that I can add before what we have shared previously. There's nothing to speed it up so far. The Ministry of Transport and Infrastructure shared some of his views related to 5G transition before. Then we have the earthquake and the economic conditions in our country. For that reason, we don't expect a 5G auction in the short period. But with that, all our investments are compatible with 5G. We are the most ready operator to 5G with all the investments that we have made in the infrastructure and network. We have all the use cases, and the scenarios are going on as well. But again, we don’t expect a 5G auction in the short period.

DEMIRTAS C: Thank you very much, Önal Bey.

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

AYAZ G: Well, thank you, everyone, for joining us today. We really appreciate your participation, and we look forward to meeting you next time. Thank you. Enjoy your day. Bye-bye.