TÜRK TELEKOMÜNIKASYON A.S.

Moderator: Gozde Cullas
April 26th, 2018
12:00 p.m. GMT

OPERATOR: This is conference # 6739508

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Turk Telekom 2018 Q1 conference call. At this time, all audio participants are in a listen-only mode. After today's presentation, we will have a question-and-answer session at which time, if you wish to ask a question, you will need to press star one on your telephone keypad. I must advise that this webcast is being recorded today on the 26th of April, 2018. I will now turn the webcast over to your moderator today Gozde Cullas, please go ahead.

Gozde Cullas: Hello, welcome to 2018 first quarter results conference call. Today's speakers are our CEO, Paul Doany; and our CFO, Kaan Aktan. Before we start, I once again remind you kindly to review our earnings presentation. I will now hand over the call to Paul Doany. Paul?

Paul Doany: Thank you. Good afternoon, everybody. I would like to start with an overview of the first quarter. We focused on boosting fixed broadband penetration and growing mobile subscriber base, as well as expanding the home Pay TV subscriptions, which we call our wireless home segment. At same time, we focus on increasing efficiency, driving innovation, and enhancing customer experience. We see that our strategy is paying off as evidenced in our results.

Over to Slide 3. I'll be speaking a bit at length over this slide, really outlining the key initiatives that we have started in this quarter and going forward to the rest of the year. Firstly, we completed rollout of our active sharing pilot project in the city of Zonguldak. The results are very encouraging. We had around 100 mobile sites in this city and our active sharing partner had 120, after site consolidation we now have around 135 combined, post sharing the LTE indoor coverage has tripled, outdoor coverage almost doubled. During the same period data traffic increased by 40 percent. So we're now able to provide our customers cost effectively and enhance our positioning via improved both coverage and network service quality.

We believe that this mobile radio access network sharing model or RAN active sharing model is a win,-win approach, as encouraged by the sector policy from the ministry, which calls for minimizing infrastructure duplication on all rights-of-use infrastructure and which obviously applies to mobile network as well, as well as benefiting from the authorization that we have signed which encouraged this practice.

This leads to increased coverage as well access capacity, a model even expandable to 5G, where avoidance of duplication will be even more critical. We are now moving on to a larger follow-up projects in a couple of larger cities, with our joint success in Zonguldak. Given the complexity of these types of sharing structures, the one thing that we can say is that we now have a working model across the full teams of the operators from the sites, rentals all the way up to the access provisioning and connectivity. So network execution will be much faster going forward. And this we believe is a very important model for CapEx, OpEx control as I indicated for 4.5G as well as 5G into the future.

We will start to implement a similar philosophy over our fixed network very soon. Now, I would like to explain this because this will be important in the rest of the year. Now, the idea here is that we will be allowing higher network utilization on fixed and again minimizing duplication in the same approach. Now, in this approach we are following the sector policy from the Ministry of Transport and this would apply to the fixed line concession, in this case would be our concession, under Turk Telekom.

Now, the ministry has chaired the last meeting, which also was attended by the regulator, the BTK in which the duplication of infrastructure, as opposed to wasting resources, is now a top priority for them, in addition to disruption on roads and the duplications of ducts -- duct banks, and again the benefits here from the rights of way of this company.

Now, you may know that we already have a duct pricing model, which have been approved by the regulator, but frankly this approach is not sufficient going forward. So, we have now shared our proposal with all the operators in what we call an infrastructure facilities leasing or rental model, which allows for a lengthy time commitment by the renting party, equivalent to what they would have had to spend if they were running off their own infrastructure. So this really is a CapEx model.

Our proposals firstly targets to simplify all processes involved in rolling out infrastructure and enhancing certain service level agreements. Secondly, we offer discounts for time commitments, minimum 10 years. Now, this ensures predictability from our side and to the lessee, the leasing party, that also provides for them the equivalent of a volume based discount which we used to do in the past, meaning multiple of lines. In this case, it will be on a single facility, but for an extended period of time.

Now, the incremental capital investments required for this type of engagements will be based on the incremental CapEx but also subject to limitations of our own CapEx budgets. This way we can meter our own budgets with those of other companies and everybody will be able to optimize on what they will be doing.

These will be commercial agreements, this is very important, this means that they're done by agreement, they will not be regulated in the normal wholesale retail model, as we have now with the port transmission model. But even though they're not regulated they, of course, would still have to be non-discriminatory, it means that we give the same conditions to any applying party, we also don't care who the other party is. They can come as a single company, they can come jointly, they can do whichever model suits them. But, it will be the same term in all cases.

In minimizing this, of course, the parties will be benefiting from our right of way and we would be the main party approaching municipality for underground duct laying and also all manner of approval procedures and minimizing road traffic disruption et cetera. Now, this being non-discriminatory and treating everybody equally, we have now started with one model project with one of the companies. And in our last meeting, I must say that we have progressed on all the key items. But clearly the best way to do this is similar to Zonguldak actually, it's a start, with one real project, otherwise, we would be spending a lot of time simply negotiating terms.

Now, clearly this is not like Zonguldak, in the sense that sharing on a one-for-one basis, this is something that will have to be done on a pay basis, so it has a bit more complexity. But all the same, we are very confident that we will have this model working very efficiently very, very soon. What's also important is that whatever is built will be part of the asset register of Türk Telekom contained within the concession agreements.

Also I would like to mention on fiber to the site, which means providing connectivity to radio access network points or mobile, like base stations or in future any manner of radio access network points that would be needed. This is something that we're building into this lengthy time model, which is important both for the mobile sharing part that I indicated earlier, but as well as this fixed sharing and going next to the 5G. Because I believe that going into that future, Turk Telekom should be the primary infrastructure provider.

You may know that we have something similar like this over a 10 year contract with the education facilities. So that kind of model may also work for specific customers, meaning, if you're talking about a major health facility or an industrial facility, such type of customers may also be happy to commit over a 10 year period. And again this will be done on a non-discriminatory basis and will be open to other operators. So we believe then we will be the infrastructure provider for 5G for all 3 access network operators in that regards meaning Turkcell, Vodafone, and obviously our own subsidiary Avea.

Now in relation to corporate venture capital, we have successfully now closed our first deal which is DoctorTurkey indicated on the chart. And this is a very important development, we believe, since health is one of our primary verticals, online health platform is one key aspect of that. And I think I can safely say that it took us time obviously for moving in this direction, but now that we've established the corporate venture capital entity in itself it will be easier for us to do further deals going forward, and it has been very a good experience for the board to have gone through the process of approving this particular investment and seeing how it is valued and what the future of it would be.

This is an example, by the way, of a company which we plan to build up and in the future list on the stock market, which is the favored model. That doesn't mean that we are against exits that are cash exits, but the main intention is to invest in this type of company, which is strategic to our own offerings in the markets.

Now, I move on to the penetration, Internet Bizden and this is the entry package, we've also had a very successful quarter in this one, 40 percent of net additions in broadband came from this campaign. So, we are very encouraged by this entry level. And what is also interesting is that a good part of these customers have already upgraded to higher speeds and higher capacities very quickly after subscription. Similarly, we're building on this Wireless Home pillar of our strategy, which is the Home TV, this is an important tool to create value added bundles to increase retention and acquisition and, if you like, as the main telco given that here we are, in a way competing with the satellite providers, which is D-Smart and Digiturk.

Now, clearly here our main target is to serve these homes on the assumption that these would be Wireless Homes what does that mean-- that these -- this means that these are homes that probably will be satisfied with wireless data and will not be requiring fixed broadband of course at any time they move and they wish to do that but we would like to hook up those homes as home customers in this period. So this quarter has been an indication of a step in this regard, 80 percent of our DTH customers have been with a mobile synergy offer and this reinforces our differentiation strategy, which allows us to build up mobile market share profitably, while we are also having the advantage of connecting a home, meaning a home subscriber over Tivibu.

Our digital keyboard Tambu -- one of -- again our strategic initiatives has been very successful. We've now reached 5.6 million downloads, 20 percent monthly active, which is a healthy percentage for this type of service at this stage of its development. Now, we will have new versions of this Tambu as you may know that this is primarily Turkish and it has in it English and German as a natural offering. We are adding Arabic for the Syrian community living in this country and also extending to the market internationally. And also we are adding as a first target going to Azerbaijan, since the affinity language with Turkish, as one of our international expansions on a model of a managed service type model. And we will be adding interesting new features into this Tambu, like keyboard, because keyboard obviously is what you use with every single thing you are using on your phone. So we will be having more to say about this in the future but we are very encouraged by the level of active use in the short time that we have launched it.

Now, clearly we also have Tivibu Go, where we have added some new generation products and features onto it. And again this would be very helpful for the wireless home, this means that a wireless home that had satellite TV for entertainment would wish over Tivibu Go to be able to enjoy the digital features, such as catch up or video on demand and I'll touch upon on this a bit later on.

Muud our digital music platform and E- dergilik which is our digital magazine and that's also growing very nicely, which would be more of a loyalty play, but that's also growing very well.

Finally, on our partnerships with electricity companies, now, we had indicated earlier that it's a very important vertical for us. So, we have concluded partnerships so far with 3 companies which cover 14 cities across the country. And we are talking to the rest of them, now these discussions are very key for us in the sense, not only of selling broadband, which is an important way for us to increase alternative ISPs, to sell our broadband, we also now extended TV and mobile to those who are interested in moving that earlier than the others, but also we are speaking to these potential new partners in the area of their own business, which is the energy vertical in terms of energy management, energy saving, and also grid and metering projects. And in this also regards we are studying distributed solar and also storage alternatives in a micro-grid formation.

We have stated that yesterday in the Istanbul Smart Grids and Cities Congress, where we explained all of these things, we are gonna public, so you're hearing about them on this call, and again this is a very exciting thing for us. And we also announced the power failure detection system EKTS which is coming from our Innova subsidiary having signed its first deal in the market, and this is another important initiative that is also important for the energy ministry. So that is another sector that we are making good progress in, not as fast as we would like because energy sector doesn’t move as fast as us. As we believe with all this new technology that is also going to impact them we see good opportunities.

Now on to Slide 4, I'm sorry this one took a bit of time but I needed to say these things to you. On this next slide we have seen now the strategic initiatives that we have taken on delivering strong subscriber additions and profitable growth. Our subscriber number increased 8.5 percent year-on-year to 42.6 million with 915,000 net adds in the first quarter. The best first quarter performance in the past 10 years. Our last 12 month performance of 3.3 million new subscriber additions is the highest number the company achieved since its IPO. This was driven by our integrated approach and empathy program which materially improved customer experience thanks to us and all our business units and also our city offices throughout the whole country who are an integral part of this program.

In broadband, we have another strong quarter with a balanced performance between entry level penetration focused campaigns and high speed, high value fiber promotions. We added 320,000 broadband subscribers in the quarter, the best first quarter we've had since the IPO. And we increased total mobile subscribers by 332,000 more than double what we had in the first quarter last year. Mobile net additions in the last 12 months was a strong 1.2 million subscribers.

In Home TV we added a further 108,000 subscribers in the quarter, the highest first quarter net add in this segment so far. And our first -- and our fixed voice customer base grew 79,000 in the quarter as fixed voice continued to benefit from our integrated position.

Financial summary on the next Slide 5. We started the year with strong financial results and more profitable growth. First quarter consolidated revenue increased 8.8 percent to TRY 4.7 billion. Excluding IFRIC12 top line increased by a healthy 9.9 percent, in line with our expectations for the first quarter. EBITDA increased 29 percent to TRY 2 billion with an EBITDA margin of 42 percent, which was positively impacted by the IFRS 15 accounting, which Kaan Aktan will mention in detail in his part. However even excluding this accounting impact, EBITDA margin was an outstanding 39 percent, the highest EBITDA margin of the company in the last 5 years.

Growth in operating profit was also an eye catching 35.5 percent year-on-year, as an outcome of increasing efficiencies under our streamlined organizational structure, other cost saving initiatives and strong revenue growth. In bottom line, net income at TRY 56 million was modest compared to our operating performance mainly due to depreciation of the lira. And on CapEx as you know the first quarters are seasonally low but we invested TRY 581 million in the quarter. CapEx adjusted to IFRS 15 is TRY 430 million.

Next Slide 6, moving on to the fixed broadband, where we again delivered impressive results, surpassing 10 million subscriber mark. We added 320,000 new subscribers in the quarter, the highest first quarter net adds since the IPO. We have been extending our broadband tariffs from entry level low speed and capacity offers to the fastest fiber speed and unlimited capacity offers to target customers more effectively and this strategy is paying off. We have now 10.1 million broadband subscribers out of which 3 million is fiber. In the first quarter net additions in fiber were 211,000 and our fiber subscriber base grew 36 percent year-on-year.

On the other hand, around 40 percent of broadband net additions came via Internet Bizden tariffs in the first quarter. We also started seeing an increased demand from other ISPs for this tariff, which we expect to accelerate further in the subsequent quarters. This campaign has a small naturally dilutive impact on ARPU, however considering average fixed broadband data usage per subscriber being around 84 gigabytes, İnternet Bizden subscribers provide a significant up-sell opportunity going forward, and we already started to benefit from this potential.

In fact, around a quarter of the retail base of this 4* 20 gigabyte entry tariff upsold in the quarter which is a faster pace than we initially thought.

Similarly, our recent regional campaign which are regional discounts targeting districts with low broadband penetration, which was approved by the regulator an important approval for us, the subscriber base has been limited for now, but we believe that this will allow targeted offers in these regions to provide further opportunities for either upsell in a step or a straight sell depending on those regions. More on that in the next quarters.

Meanwhile as discussed earlier, our partnerships with electricity companies has been very valuable in this regard, and as you can see that these ISPs, because we need to build alternative ISPs, given that Turkcell, Vodafone obviously are one of those, but the others are obviously smaller. We have D-Smart that is not investing enough in its own growth, it's more kind of like protective but they are beginning to move a bit on this; TurkNet, unfortunately are doing mostly online sales, so they don't have a sales force like they used to and Millenicom has been acquired in any case by an electricity company. And this indicates an opportunity for us to build an alternative that should be sharing around 10 percent of our total market potential, meaning electricity companies building up to that level unless of course the other players in the market fill it up. One way or another it has to be filled up by the others.

Now turning back to the ARPU, apart from the dilutive impact of the Internet Bizden tariffs. High base also impacted our ARPU growth. You'd remember that in the late 2016, we adopted a new wholesale pricing model, which is a port transmission.

With that model year-on-year ARPU growth accelerated to 9 percent in the first quarter of '17, which put us in the high base for the first quarter of this year. However, we switched to new pricing in the second quarter of '17 as that model was not sustainable neither for us nor the ISPs. And the new pricing will be in the base in the base in the middle of second quarter '17.

Next slide on upsell dynamics, we continue to provide more value for our new and existing subscribers with higher speed and capacity broadband offers. In the first quarter of this year, we again increased number of subscribers taking higher speeds and capacities we ended the quarter with 34 percent of our retail subscribers with above 16 megabit per second broadband packages, which was 29 percent a year ago. At the same time, subscribers preferring above 100 gigabytes capacity jumped to 12 percent of total the broadband retail base from just 4 percent a year ago. These upsell offers -- efforts will be designed to counter the dilutive effect of the growth then mentioned earlier.

Slide 8, mobile performance. In mobile, we continued our strong performance in the quarter where we gained 332,000 net subscribers compared to 142,000 a year ago. 95 percent of net adds were postpaid and our postpaid ratio increased to 56 percent in the first quarter this year from 53 percent a year ago.

After quarters with some inflation in the price adjustments, the market became more competitive this quarter. Some headline tariffs the prices were reduced or kept flat with some additional benefits such as gigabyte includes and more data capacity.

Our ARPU growth was 6 percent year-on-year following 7 percent in the fourth quarter of last year. One of the reasons for the deceleration in ARPU growth was the base impact and the share of data revenues and service revenues increased in the first quarter of '17 significantly up from 33 percent in the first quarter '16 to 50 percent in the first quarter '17.

In mobile, we also implemented a device policy with a more segmented approach both for subscribers and devices. This led to higher quality non-service mobile revenue. Profit results of this clearly visible in our bad debt expense trends and Kaan Aktan will explain to you that in his part.

Our focus is getting higher market share, but getting that additional market share cost effectively. We target to leverage more of our integrated structure and continue building on our differentiation strategy such as satellite TV and being less dependent on pure mobile value propositions.

Moreover, mobile active network infrastructure sharing that I've indicated earlier will be a very important dynamic going forward, that allows us to maintain profitable growth as opposed to pricing it all away with just rolling out and duplicating mobile infrastructure.

On the next slide, growth in mobile. Our mobile customers continued to move towards enlarged data packages leading to higher data consumption and LTE penetration. LTE compatible smartphones' share in our total smartphone base continue to grow and expanded 13 percentage points year-on-year to 70 percent, while LTE users reached 39 percent of our total subscriber base rising from 24 percent of the base a year ago.

The share of our data revenue increased from 50 percent from the first quarter -- 17 percent to 55 percent in the first quarter this year. While monthly mobile data usage increased by around 40 percent year-on-year from 3.1 gigabyte to 4.3 gigabyte. While average consumption increased quarter-on-quarter from 4 gigabyte in the fourth quarter, the share of data revenues was unchanged quarter-on-quarter due to the new special communication tax scheme. SCT for data increased from 5 percent to 7.5 percent and there was a reduction in SCT rate of voice leading to a lower share of data assuming all else constant.

Nevertheless, we expect increase in data revenue share to resume next quarter as the customer demand for data remains high.

Now, I would like to inform you about the discussions we have had in relation to special communication tax and the lack of clarity generally on the tax regime or what we pay to the government, which includes treasury share with regards to disputes we've had on that, leading up to last year. And just by way of explanation, you may realize that we believe, for example, that the treasury share claims that have been levered against all other operators have been unfairly done in the sense that this is discounted revenue, for example, so this is not revenue that you are making and yet we were asked to pay 15 percent of that.

Now, all operators of course had a case on this that we finally settled that in good faith in order to have more clarity going forward. And one part of that relates to the special communication tax. And special communication tax had the anomaly of having a treatment for voice and a treatment for data and no clarity on whether it's not voice or data.

And this is something that we now hope that the (25 and 5) and uncertainty of what is zero has now become 7.5 percent. Accordingly, we would like to inform you that the Ministry of Finance had just concluded a review of all the mobile operators and we have just concluded ours with them, where they have looked at the allocation of revenue in relation to a bundled price that includes voice and includes data and includes other services. So, how is that revenue allocation done? Right now we know that 7.5 percent at least will be one number that is applied to what is known as voice and data and what will be applying on the other. So special communication tax would be zero for the other and also what will be VAT treatments.

We have -- we believe that there will be no material impacts on our 2015, 2016 and obviously 2017 in that regard. So, we are very happy that going forward we should not be subject to uncertainty of tax claims or payment claims. I mean treasury share is not a tax but I think that's a dispute that probably we have seen the end of that one. So, we are hoping that the future will be a lot more predicable going forward and we have been very transparent in our revenue allocation.

Now on Slide 10, turning to our TV business. Tivibu has maintained its uptake momentum in the first quarter. We have one of the strongest TV platforms in terms of content and technology features with extensive dual platforms and IPTV, DTH, direct-to-home and catchup TV, video-on-demand with also self-installation options for the set-top boxes, which create some differentiation. And obviously people who want installation pay the extra, this way we are able to maintain a very, very low price for that, which is the only area that we are being very, very disruptive. So, to be clear on TV, we are playing very disruptive.

For instance our Tivibu mobile discount campaign offers mobile subscribes satellite TV with very advantageous prices. And for new mobile subscribers over the reference of a telephone mobile customer Tivibu Super package with more than 200 TV channels, 4,000 plus video-on-demand, UEFA Europe and the Champions League, kids, music, documentary channels et cetera are offered for new acquisitions. 80 percent of our DTH net adds came from this campaign in the first quarter.

Actually we had a slight slow January because the set boxes were being sold ahead of our stock and that is now addressed and we topped that up. So we see a very good year coming forward in this very, very important segment for us where we called the wireless home segment. This is a strategy where we are trying to grab in the TV segment, which we believe in a country that watches a lot of TV, the level of Pay TV has been way, way underpenetrated.

Given especially that the incumbent in this market Digiturk is way overpriced with obviously top premium content. And then we have now a challenged D-Smart that has average content but has a limited budget to be able to gain new acquisitions because obviously the cost of acquisition requires investment. So therefore, we see an opportunity for us to play our mobile bundle in that space.

Addressing that we accept the strategy going forward and it's beginning to bear fruit and that's also one of the reasons why wireless homes are critical for our future, which also requires us to improve our mobile data coverage costs effectively. The market data for the first quarter is not available but according to our estimates we -- after becoming the #2 player in the total Pay TV market with our strong Q1 performance, we believe that we now beat the conventional cable TV and also D-Smart in that segment so we become #2 after Digiturk.

And also Digiturk are clearly losing some customers in the base that are not paying for the full premium content but not happy to pay their lower price either because the difference between the low end content and what we offer is very, very minimal.

Our strategy not only improves our position but also accelerated the growth in the market. In 2017, Pay TV market growth accelerated to 10 percent from just 2 percent in 2015. So our offerings have been attractive to grow the market and we are pleased with this progress and we will be happy to report more in the next quarter.

Finally on fixed voice, Slide 11. Fixed voice is one of the key beneficiaries of our synergy and penetration campaigns. After delivering positive subscriber net additions for the 2 quarters in a row, we again expanded our fixed voice base with 79,000 net additions in the quarter. The number of fixed voice subscribers reached 9.7 million at the end of the first quarter combined with positive trend in naked DSL line, total fixed access reached 13.9 million.

We had a slight decline in fixed voice ARPU in the first quarter, partly due to mix impacts. As of the end of April we will carry inflationary price adjustments and increase fixed voice pricing by around 9 percent for the uncommitted subscribers. We expect this to support our fixed voice ARPU in the next quarters. Our strategy is to ensure a decelerated pace of decline in fixed voice revenues and our results affirm this strategy is working.

Thank you very much I will transfer now to my friend, Kaan Aktan.

Kaan Aktan: Thank you Paul, good afternoon everyone. We are now on Slide 13. We made a good start for the year with 9 percent year-on-year revenue growth. Excluding the IFRIC revenues, the construction revenue, growth was %10 which is in line with our target for the quarter. Both mobile and broadband performed well by growing 10 percent and 12 percent, respectively. In broadband revenue growth was underlined by strong net additions, which was 320,000 in the first quarter, the best first quarter net addition since the IPO.

We had flat out performance in this segment, this is mainly due to the base impact of the same quarter of last year, which was the last period before the change in wholesale pricing, this impact is in the following quarters.

Additionally, our penetration focused offers had some impact on our ARPU growth, the dilutive impact on ARPU in absolute term was around TRY 0.7 for the quarter. However, we feel very comfortable about this since we see that these are incremental, no additional investment is required and upsell potential based on the amount of data consumed by new customers is very prominent.

In mobile, total revenues grew by 10 percent year-on-year. This is driven both by subscriber and ARPU growth; we had 6 percent year-on-year ARPU growth amid a competitive market environment. Our mobile service revenue growth which is excluding commissions on device sales and other similar non-operating items was 12 percent year-on-year. This is 2 percentage points stronger than the total mobile revenues growth.

As Paul mentioned we adopted a more segmented approach in our device business. We are now providing devices to our subscribers based on their ability to pay and their credit scores, as a result last year's mobile revenue was lower compared to previous quarters, but the quality is highly improved. The combined effect was a reduction in bad debt expense.

Our corporate data revenue growth was strong again, at 15 percent. This is driven by our best in class corporate data solutions and growth in specific large scale projects.

On top of that decline rate in fixed voice revenue is slowing down quarter-by-quarter .Year-on-year decline rate is now at 4.6 percent, this is coming down from 6 percent last quarter and 8 percent in the first quarter of last year.

Our EBITDA performance was even stronger than revenue performance this quarter as a result of cost efficiencies we have put into practice under our streamlined organization. The number of employees, excluding employees of our call center operation was down by 8 percent year-on-year and personnel expenses declined by 3 percent year-on-year.

Adjusted for the one-off impacts voluntary exit and retirement programs that we had in both first quarters, personnel expense will be broadly similar or flat versus last year. For the rest of the year, we plan to transfer a portion of outsourced field service employees in fixed line to in house. This is for enhancing customer experience and service effectiveness.

It will also lead to a shift from other expense lines to personnel expenses with a net OpEx reduction as the combined impact at the end of the year. Incorporating all these impacts we expect a growth in personnel expenses to normalize at high single to low double-digit rate in the full year of 2018.

Our net debt expense declined 24 percent year-on-year as a result of enhanced receivable management process in device sales and elimination of one-off bookings in the first quarter of last year. Going forward, the new formulation for setting the bad debt reserve will have some implication on the P&L as well. The bad debt expense is now directly proportionate to the level of the new business created in this specific period. In other words the base for calculation is not what is charged to the customer now, but whether it is based on the total exposure acquired with each new contract.

I also want to inform you about the new device financing initiatives that we will launch in the second quarter. Two financial institutions will start providing financing to our customers who will come to our stores and buy a device. The process will be fully integrated to our sales and collection systems. The installments will be collected through our bills and paid to the banks on our customers' behalf. There is a clear strategy in this domain.

We believe that financing of devices should be performed by the financial institutions. But we also prefer partnering with third parties in an exclusive model. We want to give the best service and terms to our customers in this domain but we don't want to carry the credit risk and balance sheet exposure that comes with it. We also prefer to initiate the project simultaneously with 2 different institutions so that we can create competition for the delivery of added value and better customer experience.

Going back to other OpEx items, you would see 9 percent year-on-year decline in network and technology expenses and 32 percent increase in tax expenses, this was due to the shift of frequency piece from network expense line to the tax line. These 2 expenses, when combined together should increase 8 percent year-on-year.

Finally, we had 22 percent year-on-year decline in commercial expenses where the impact of the new IFRS accounting is most visible. As you already know we adopted new standards IFRS 9 and 15 as of 2018, this change lead to TRY 10 million lower revenue and TRY 140 million higher EBITDA. As a result of these changes, our EBITDA margin increased to 42 percent.

What we are more interested is that EBITDA margin before those accounting changes, excluding the IFRS impact, EBITDA margin would be 39 percent and it is the highest quarterly margin over the past 22 quarters. This is also close to our mid-term ambition of around 40 percent EBITDA margin. And I would also remind you that these numbers didn't include any enhancement through changes in accounting standards.

Adjusted for such changes, we should certainly aim for higher margins. IFRS 15 impacts on operating profit was limited, at TRY 25 million but we still delivered 35 percent increase in operating profit. This is a very healthy growth. It shows that our financial delivery is improving and increasing and it's doing so more than the cost of the investments we have made in recent years.

And CapEx, in the first quarter we had TRY 581 million CapEx, TRY 150 million was attributable to IFRS 15, which is the accounting of subscriber acquisition and retention costs.

Bottom line, net income is at TRY 66 million. Our excellent operating profitability now in this quarter enabled us to compensate for the impacts of the depreciation in lira. In order to reduce FX risk in the quarter, we carried new hedging transactions and I will mention those in the next slide.

Now we are now on Slide 14. We have at the end of the quarter TRY 13.5 billion net debt and our net debt to EBITDA ratio is around 1.8 multiple. Our TL based net debt increased quarter-on-quarter due to the TL depreciation and the slight negative cash flow from operations.

In order to reduce FX risk, we carried out new hedge transactions during the first quarter. First, we increased hedges via new participation swap contracts. In this scope, we converted additional EUR 100 million loan to Turkish lira in the first quarter. Second, we improved the level of protection in existing contracts, which was related to 350 million dollar of the existing part. Third, we also continue to use cash as a tool to manage total FX exposure. The share of FX based cash increased to 67 percent now and we target to increase it further. As a result, our hedge ratio increased to 41 percent. This was only 30 percent a year ago, We plan to increase the ratio now up to 50 percent before the end of the year. And we also continue increasing protection level of the existing contract.

Our cash balance is at TRY 4 billion, our short-term funding requirement is TRY 2.7 billion. We are now mainly focused on securing the next year's-2019' funding needs. We expect improved cash flow generation in the full year compared to again full year of 2017. This will be based on higher EBITDA and no license fee payments in 2018. This will enable deleveraging from current levels obviously. Last year Turk Telekom delivered TRY 1.7 billion as operating cash flow, this was a significant improvement from previous years. Our first quarter performance was impacted by one-offs and seasonality in CapEx payments as we always did in the past.

Meanwhile, we expect to improve over 2017 results in the full year. Capacity to generate healthy cash flow from operations is a critical objective for us. We see it as the main enabler for cost effective debt management and at the same time maintaining high dividend yields in the long term.

Right now we are on the final slide, which is about the guidance. As of this year we adjusted our financial reporting to new IFRS 15 and IFRS 9 accounting standards. According to adoption of these standards we will have around TRY 600 million incremental impact on EBITDA and CapEx, while no material impact on revenues. So adjusted for this impact, our revised consolidated EBITDA guidance is now at TRY 7.6 billion to TRY 7.8 billion level and consolidated CapEx guidance is around TRY 4.1 billion.

As we are at the start of the year, we are not revising our underlying guidance but we believe we can deliver closer to the high end of our EBITDA guidance. For the full year and for this year, there won't be any IFRS 16 impact since we will implement this new standard in the 1st of January of next year and according to our first estimation IFRS 16 will have around 2 to 2.5 percentage points incremental increase on the EBITDA margin.

I thank you. Now I hand you -- I hand the call to the operator.

Gozde Cullas: We can take questions right now.

Operator: Our question comes from the line of Maddy Singh.

(Maddy Singh): Just a couple of questions. Firstly, I am just wondering given the high inflation rates in Turkey do you have plans to raise the subscription fees at some stage in this year as well? And secondly, any update on the dividend policy for the year, should we expect a dividend payment this year or that is still being -- not finalized or something?

Hakan Dursun: I am Hakan Dursun, Chief Marketing. For the price increases, we are regularly increasing our prices on an annual basis as you described, parallel to inflation rates. For fixed voice services as Paul explained, we will be increasing our prices close to inflation rates. Also during summer time, we will be increasing the prices of our fixed broadband packages accordingly. Also on mobile site, as of second quarter, we started increasing our headline tariffs on the postpaid side and we are looking for every opportunity also to be price disciplined in any segment that we are doing business on. The only disruptive business segment that we are creating synergies is TV business because we see TV business as a differentiator today in mobile subscribers, without decreasing the mobile headline tariffs so that strategy we will continue to implement.

Kaan Aktan: Well for the dividend part as you know as the management we offered to the board the idea of not having a dividend distribution and the board supported the idea and also offered this to the General Assembly. So it will be voted in the General Assembly, this is where we are right now but going forward obviously we are a high dividend yield company based on our past performance and the normal -- going forward, the normal for the company should be still be paying dividends on a regular basis.

Paul Doany: Yes I mean basically the target is to build up the equity value of the company and its cash position in the course of this year so that's the basis of this recommendation so I am sure we will be passing as the board adopted it unanimously and then back to business as of next year leading the dividend of this year payable as of next year and then the strategy will be from that point onwards at a high full value that we believe we can build up to that which is the real value of the company, back to full dividend distribution as of that point.

(Maddy Singh): Just a couple of follow ups on both the points, starting on the dividend one first, given the such high level of FX losses you guys have to suffer every quarter don't you think it's actually probably is a good idea to delever to much lower level where you don't worry -- have to worry about FX losses as such? And then on the pricing front, just wondering you know whether you stand alone in the market in terms of price increases and there is a risk that you are at disadvantage compared to competitors if that is the case? Yes.

Hakan Dursun: Sorry can you repeat the second question for the price impact?

(Maddy Singh): Yes, so I mean just wondering how is the market behavior generally like how do your competitors behave in terms of price increases and are you the only one raising prices for example in mobile?

Hakan Dursun: OK.

Kaan Aktan: Yes let me start with the first one, yes this is actually what we are trying to do, we are increasing the hedge portion of our gross debt on a regular basis. Could it have been more I mean done faster. There is always risk of hedging as well as a similar risk to non hedging the loans, because the cost of hedging is very high. So we are being very careful not to destroy value in the long term but looking at the size of our leverage and the volatility in the market place and the cost of hedging is the best way to cope with the problem will be to deleverage. Actually as Paul mentioned, the dividend decision was part of this strategy. And as I said in my part we will definitely increase the level of hedges and currently we are targeting for 50 percent.

(Maddy Singh): Actually -- sorry to interrupt, my question was more about why prefer hedging over deleveraging, I mean I would rather have much faster deleveraging than hedging because as I said hedging actually costs a lot?

Kaan Aktan: Yes, true but we are using all the means available for the moment we are being very careful in managing our cash flows so we are trying to get a stronger operating cash flow and the dividend is the other measure that we have been taking and that's all we can do for deleveraging the company for the moment.

For the second part of your question, obviously, we are comfortable and we are very disciplined in fixed voice and fixed broadband market in terms of pricing quality. On mobile market we are obviously not the price setter in the market, our focus as Türk Telekom on mobile business is getting higher market share but not at the cost of profitability because we are an integrated operator and we have the flexibility to shift our focus between different business segments. The first quarter this year after a couple of quarters of some inflationary price adjustments, this quarter market was relatively competitive. Especially players reduced their headline tariff prices significantly and also included free additional benefits to their tariffs at unchanged prices. So, we were very successful in implementing our strategy and gained significant number of subscribers in the last 3 quarters but if we look the second half of this year you can also see a strong mobile revenue growth so we are disciplined while we are trying to grow our market share. We will be disciplined also to make sure that we are growing our mobile revenues.

Operator: Your next question comes from the line of Tarun Mittal. Please ask a question.

John Kim: John Kim from Deutsche Bank, two questions please. One if you could paint a picture for us over the next 3 to 5 years about what you think your target market share in Turkish mobile should be, and I guess perhaps the intensity of competition that you are seeing in the market on the contracted and prepaid side. Second question, on your operating costs can you help us quantify any one offs or one time charges you'd like to highlight?

Hakan Dursun: Our 3 to 5 year strategy in the mobile business is to have a 1/3 market share. While we get to this market share, we want to make sure that we fully leverage our market based strategies so we don't compromise on financial discipline when we are building this market share, so we are looking at the synergies that we have with other business like the bundles that Paul mentioned at the beginning of the call, also we have an integrated database with the consent of our customers so this we -- we offer our mobile tariffs to our existing TV, broadband or fixed voice customers where you have a consent so by doing all these things we would like to increase our market share to 1/3 position in the market in the next 3 to 5 years without compromising on profitably.

Kaan Aktan: OK for the first quarter, there are small items negative and positive that may be considered as one offs but they mostly offset each other so we didn't try to flag anything on -- and this we should accept it as business as usual for the quarter. Except for that change in the IFRS, which was explained in our presentation.

Operator: Thank you there are no further questions at this time, please continue.

Gozde Cullas: Thank you, Operator. If there are no further questions we can close the call for today, thank you for participating in this call.

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

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