Türk Telekom Q3 2018 Financial & Operational Results Conference Call

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***Conductors*:**

Dr. Paul Doany, CEO

Mr. Kaan Aktan, CFO

&

Ms. Gozde Cullas, Head of Investor Relations

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

Welcome and thank you for joining the Turk Telekom conference call for Third Quarter 2018 Financial & Operational Results.

At this time, I would like to turn the conference over to Ms. Gozde Cullas, Head of Investor Relations, Dr. Paul Doany, CEO and Mr. Kaan Aktan, CFO of Türk Telekom

Lady and Gentlemen you may now proceed.

CULLAS G: Hello, welcome to 2018 Third Quarter Results Conference Call. We are here with the Management team and today's speakers are our CEO, Dr. Paul Doany and our CFO, Kaan Aktan. Before we start, I kindly remind you to review the notice on our earnings presentation.

I will now handover the call to Paul Doany. Thank you.

DOANY P: Thank you, Gozde. Before starting I would like to welcome our new members of the Board. I believe that the new additions will provide important oversight and contribution to the company with their expertise and strategic planning, financing, entrepreneurship and finance especially in our telecom sector, and this will be in great support of all our stakeholders. With the valuable contribution of our new Board members, we will continue to implement our Business Plan in a more determined manner and support in growing the company in the direction that we have grown so far and also contribute to the economy of the country overall.

On a sad note however yesterday, we lost one of our Board members, Mr. Abdullah Tivnikli who served on several company Boards for the past ten years. We offer condolences to his family, may he rest in peace; he will be missed by all the management team who knew him.

I would like to start with strategic highlights of the quarter on Slide 3. Our strategy is fully on track, as you can see and we continue to deliver on our strategic priorities. Our results demonstrate the strength and resilience of the business together with the benefits of our early actions which support the changing environment that we are now going through. Having said that, Turkey is fundamentally unique in its young, dynamic and tech savvy population with a huge growth potential offering numerous business opportunities, and we remain confident about the future growth and development prospects of the country and businesses in general.

We continue to execute our successful strategy of driving fixed broadband growth through penetration focus campaigns which also prove to be helpful in the current macro environment. 50% of fixed broadband net additions in the third quarter came via penetration campaigns. Importantly, also up-sells from our entry level tariffs also accelerated with more than 35% of our entry level tariffs already up-sold.

There is a significant potential for future growth in fixed broadband with the support of our penetration initiatives. Of course in this environment of inflation pricing incentives, this also supports the initiative of showing that we have low pricing.

We also maintained our focus on best-in-class customer experience with digital solutions. We have significant improvements on our Online Self-Service App, Online İşlemler. Customer satisfaction score has increased substantially to 4.6 stars among IOS users in the third quarter. The number of TT Mobile users of the app more than doubled in the first nine months of the year reaching now 8.8 million corresponding to 54% of our smart phone users.

In the quarter we launched new tools that enable successful performance of the app, as user friendly interface is making ease of the subscribers to interact with us and tools that enable us to run campaigns, provide better value for our subscribers. Our loyalty campaign providing also rewards and free data and free minutes to our customers has been an important contributor for momentum in this channel.

I am encouraged with the current improvements we have, with this, both for its’ contribution for our customer experience journey and also in operational efficiency improvement which is a matter we will be discussing shortly and increasing therefore shareholder value.

Regarding our digital portfolio, we would like to also highlight some new KPIs on Tambu, our digital keyboard. Downloads reached in October 7.2 million and the number of engagements via the Tambu tool bar increased to 14.7 billion since launch. These KPIs form a solid basis for future monetization.

We will be releasing a new version of Tambu very shortly with features such as toolbar integrated food and drink, local search, web search, as well as gamification module. As a very recent development in our digital portfolio, we also launched Eleq, which is our live mobile game, developed by Argela subsidiary. This platform will also have future exciting applications which we will announce in due course.

During the third quarter, we continued our disciplined approach regarding capital efficiency. Following the cooperation protocol which is the leasing of fixed electronic communication infrastructure, this long leasing portfolio we discussed earlier with Turkcell Vodafone, Türksat and Telkoder we announced in the second quarter. Third quarter we signed the first pilot project with Vodafone which of course will be also used by Superonline of Turkcell for fixed infrastructure leasing in Sincan, Ankara. Excavation works have already started in this selected area so this is a very exciting development.

Within the scope of this agreement, Vodafone will have a 15-year lease agreement with us which of course is very efficient for their accounting of this CAPEX contribution. So, for them, they can account for it as a CAPEX, and for us we are getting the money for it as a CAPEX, so it’s a favorable prices to both sides. And this model allows us also to utilize existing infrastructure effectively, for which of course the using party will be paying a leasing charge, while supporting all sector players and a more efficient capital utilization and therefore minimizing duplication.

On the other hand, we continue to evaluate options to spread mobile sharing. As indicated before our Zonguldak is in fact a sharing model, in which there is a one-for-one sharing over facility. We also have package sharing as you know very well and now we are also working on active leasing model, which means, rather than doing a one-for-one, the using party say us go into Turkcell or Vodafone, we would pay a leasing charge to have access to their active facility not only their passive facility, which means basically their base station and therefore using our own spectrum onto their facility.

We hope to be announcing something in that regard relatively shortly. Otherwise, we have what we already have for now which is a good progress on both mobile and fixed to minimize duplicate investments in this important period of FX exposure.

In the third quarter, we also continue to leverage on our strong subscriber base with our attractive multi product offers, while we achieved to accelerate the number of subscriber additions to the record high levels, it is encouraging to see that more and more subscribers opt to have multiple Turk Telekom products. We now have the consent of 72% of our subscribers for sharing their information within Türk Telekom Group companies and among the constant universe of customers, who consented last year, to share their multiple product information. This has increased from 58% in the third quarter 2017 to 63% in the last third quarter this year driven by triple plays.

The final strategic highlight is relating to consumer finance. In the third quarter we launched a new consumer financing model to address mobile handset financing requirements of our customers in co-operation with ING Bank and Hemenal Finansman with the hope of this model, we will facilitate our subscribers, model handset purchases, while we will also be better able to manage our receivables risk. My friend Kaan Aktan will be covering this in his parts. Now to Slide 4.

Our integrated business model with unmatched diversified portfolio, in addition to benefits of our penetration initiatives enabled us to deliver impressive subscriber growth in the third quarter. The number of total Türk Telekom subscribers have now reached 44.7 million, increasing by 10.4% year-on-year; this is the highest pace of the base growth since the IPO.

Subscriber additions in the last twelve months was 4.2 million which is again strongest net add performance since the IPO. The main contributor to total subscriber net added 1.2 million in this quarter is 586,000 net mobile subscriber additions. In the last twelve months we gained more than 1.6 million mobile subscribers. We added 1.2 million net new broadband subscribers in the last twelve months with 288,000 net additions in the third quarter fueled by penetration focused Internet Bizden Campaign.

In the Home TV, we ended the quarter with 1.6 million subscribers reinforcing our #2 player position in the pay TV market. We had 149,000 net additions in the third quarter. Finally, positive trends in a fixed voice subscriber additions continued with 90,000 net additions in the third quarter supported by the momentum we had in penetration campaigns in the broadband segment.

Now on Slide 5 financial performance; during the quarter, we continued to execute financial and pricing disciplines without sacrificing on our strategy of driving penetration and data consumption for sustainable growth. Our revenue growth in the third quarter accelerated to 19% year-on-year, the strongest top line growth the company achieved since the IPO. Excluding IFRIC12, revenue growth was 17% year-on-year, EBITDA performance outpaced revenue performance with an increased 34% year-on-year reflecting strong revenue growth and our strong focus on the efficiency improvements.

EBITDA margin was outstanding at 42%. After hitting bottom in 2016, our EBITDA margin has been expanding thanks to all the initiatives undertaken by the team. On the back of this outstanding performance in EBITDA and revenue, we decided to raise our 2018 guidance and Kaan Aktan will be providing that to you shortly.

On the other hand, negative impact of FX rates increased markedly in this quarter. We had more than 30% appreciation in the Lira against both dollar and euro and this resulted in a 2.8 billion net loss. On the other hand, underlying performance was very strong excluding impacts of FX losses and FX hedges. Excluding these, our net income increased to 1 billion lira in the last quarter from 638 million a year ago by accelerating the top line growth and improved EBITDA margin.

So it is also important to highlight that we generated a significant increase in unlevered free cash flow to 3 billion lira in the first nine months and also Kaan Aktan will be providing more detail on that.

Moving on to Slide 6, on fixed broadband, we maintain our operational momentum in fixed broadband as our focus on penetration led to another quarter of strong subscriber additions.

Our fixed broadband base increased to 10.6 million with 288,000 net new subscribers in the third quarter out of which 50% came from the Internet Bizden. At the same time our fiber subscribers reached 3.4 million, up 229,000 in the third quarter, the highest third quarter fiber net adds we have achieved so far.

Additionally, we also had a seasonality in fixed broadband third quarter thanks to back to school period starting September. Our partnerships with electricity companies continued and their contribution in our net additions is increasing in line with our strategy of driving broadband penetration, using diverse distribution channels. New deals with new electricity companies in other regions are progressing, and we aim to have presence in 32 cities covering almost 70% of households shortly. This will prove in my opinion to be a very important step over the next 12 to 24 months, so it's an essential investment we make at this time.

During the third quarter we implemented some price increases. At the beginning of July, we made our traditional yearly inflation price adjustments at around 9% to 10% for uncommitted subscribers. In addition to this with higher inflation than we anticipated we had another price increase in September at around 12% to 15% to the existing campaign prices for new activations. That increase is incremental to what we budgeted initially.

Overall, those tariff updates, increasing share of premium fiber product and accelerating upsells from internet level packages, for instance, a 35% of the entry package subscribers have upgraded their tariffs so far, allowing us to generate an ARPU growth year-on-year to 44.4 lira. Contrary to the trends in the first half.

Next Slide 7, on upselling dynamics. Our subscribers are getting more value from our broadband products, benefiting from extensive range of our portfolio with different speeds and capacities. Specific to the third quarter, the share of subscribers with above 20 megabit per second speeds in our total fixed broadband base increased to 36% from 30% a year ago. Significant demand for higher capacity continues with the fixed broadband average data usage over 90 gigabytes of data per month.

The share of subscribers using above 100 gigabyte packages doubled to 16% of the total fixed broadband base from 8% a year ago. We have a Fiber Homepass of 17.9 million and we are present at every city in the country, going forward our efforts to up-sell to higher speeds capacities to provide more value to our subscribers will continue.

Next slide is on mobile performance. We delivered an excellent set of third quarter results in mobile. In line with our growth strategy we achieved an outstanding performance by adding 586,000 net new subscribers coupled with robust ARPU growth. Number of total mobile subscribers reached 20.8 million at the end of the third quarter with 1.6 million net adds in the last one year, out of which 1.4 million was a high value postpaid segments.

As shown in the graph on the right hand, in the first nine months of the year we outpaced Turkcell with our strong net addition of 1.2 million, the highest first nine months net additions we've had since 2014. We have been consistently increasing our subscriber market share, and our third quarter subscriber additions give us comfort on continuation of that performance going forward.

We aim to strengthen our position in the mobile market with new partnerships such as we have now with Vestelcell which will be launched soon and this will also provide for further drive of Tivibu over their new television sets which do not require setup box.

While accelerating the pace of growth in subscriber addition, we also had a visible ARPU uplift in the third quarter. The main drivers of 10% annual growth of our mobile ARPU are increasing data consumption and better tourism activities supporting roaming revenues. Currently, there are signs of easing competition pressures in the overall markets, and we have been making price increases, around 15% to 20% in our mobile acquisition tariffs since the beginning of October.

Mobile data our next slide, Slide 9, share of LTE users continued to make progress in the third quarter reaching 44% of our mobile base, up by 12 percentage points from a year ago, while our LTE population coverage expanded from 80% to 89%. Acceleration of average monthly data usage by 38% year-on-year to 6.5 gigabyte with increasing LTE compatible smartphone penetration to 75% resulted in 23% annual growth in data revenues in the third quarter.

Data revenue share was 56% of our mobile service revenues in the same quarter. Similarly, our leadership in smartphone penetration continued with 82% of our total subscriber base. Going forward, our alternative consumer financing model Kaan will explain a bit more on that part relating to smartphone penetration.

Slide 10, TV performance. On television we also delivered very successful results. As of the end of the third quarter we have 1.6 million Tivibu Home subscribers, an increase of 149,000 in the last quarter. Satellite net additions were particularly strong as we continue to push our wireless home strategy in which we aim to address the mass TV market with affordable pricing.

On the other hand, amid current inflationary environment and following market trends, we increased the prices of our TV portfolio. Still we kept our prices at attractive levels compared to premium players in Pay TV market to address each house especially with our synergy offers like mobile plus Tivibu campaign.

In the third quarter, 96% of the satellite TV sales was with a mobile synergy offer. I think this is a very important metric that indicates how a bundle with the mobile satellite provides for a future up-sell such as future data into these homes because this is the largest home and they will believe in Tivibu Go which will require more mobile data and we have more to say about that in this coming quarter. We have taken many steps in Tivibu business so far rising to the #2 player in the market with 21% market share outstripping both Cable and the D-Smart, while we have only 10% market share a few years ago.

In addition to the importance of content, this performance demonstrates the strength of being an integrated player with diverse segments, large customer base and strong sales network.

We have not only the Turkish Basketball League broadcasting rights exclusively for three years, but we also have 200 TV channels 6,000 plus VOD with differentiating self- install options and user interfaces. We are providing all of these features with attractive prices especially with the Mobile TV bundle since we are positioning TV as an attractive tool within bundle.

Just an extra note on the television market in general is that there are no mass market players with any level of TV local content. Most of the local content is provided in a free form with ads revenue coming from conventional advertising over television. That is actually the reason why catching Pay TV- even though it's a very aggressive price- is in a very easy to access more of this. So I think this is unique in a market like Turkey where people watch a lot of TV but have limited choices of premium contents for Pay TV, meaning the revenue comes from advertising.

Next, slide 11 fixed voice. The performance we delivered in the fixed voice over the last one year is a clear sign of the success of our actions. We positioned fixed voice as a valuable component in our bundles and the Türk Telekom fixed voice subscribers we provide additional benefits in our other services. Latest example of this approach is the Internet Bizden. This is bearing fruits for more than one year delivering subscriber gains, in this traditional voice services despite substitution from mobile voice and/or VOIP.

In the first nine months of this year, we gained 230,000 net fixed voice subscribers. During the first nine months, there is also an increasing trend in the fixed voice ARPU with 22.5 in the third quarter. We implemented 9% price increase for our uncommitted subscribers in our fixed voice tariffs coupled with increases in some one-time of fees. We are also re-contracting at higher prices. We closed relatively aggressive offers. All-in-all third quarter fixed voice revenues posted a positive annual growth of 1.2% after many years of decline.

I handover to Mr. Aktan.

AKTAN K: Thank you, Paul. Hi everyone. We are now on Slide 13 with more details on financials. Quarterly revenues reached to now 5.4 billion lira. This is growing at 19% year-on-year. The main contributors were mobile and fixed broadband, which was clearly at strong double-digit rates of 18% and 14% respectively.

Growth in mobile is particularly strong with service revenue increase of 19%. This is driven by both subscriber and ARPU growth. We had one-off mobile revenue booking in this quarter which mostly offset the impact of lower commission revenues on device sales.

As you remember we have a decline in our device commissions due to our more prudent approach in device sales by putting simply the first focus on collection performance. In order to further support these initiatives, we now started the consumer financing program with partners, financial institutions, ING Bank and Hemenal Finansman which is a subsidiary of QNB in Turkey, are included in this program.

This model will allow us to reduce the bad debt risks, which we have and already achieved to some extent as of today. This will also enable us to design more attractive device campaign and strengthen our competitive position in the market. We started to offer this financing model in more than today 60 Türk Telekom stores and our target is rolling out quickly to reach 90% of our exclusive stores in the last quarter of this year or early next year.

Our international revenues are up by 45% year-on-year. This is driven by higher FX rate in the third quarter. Our fixed voice revenues contributed positively to the consolidated revenue growth after many years of decline. During the quarter, we maintained our pricing discipline; we are adjusting our pricing plans according to new parameters of our macro environment. We have two price adjustments in fixed broadband in the third quarter; increased fixed voice prices in the last quarter and in mobile we have started giving material price changes in October.

All our efforts are for reaching to our long-term market share target of 30% in mobile but while doing so, we will be financially disciplined. EBITDA was boosted in the quarter due to not only record high revenue growth but also thanks to our disciplined cost management effort. We focus on group synergies, organizational streamlining, digitalization and receivable controls. These factors led to 34% growth year-on-year in EBITDA, much higher than revenue growth.

In the third quarter, we had optimize commercial spending Excluding IFRS 15 impact, we have 15% year-over-year decline in commercial costs. There is room for further efficiency on commercial expense side, such as, directing more of our customers to our digital channels for both acquisition and customer service, up-sells, digital invoice and subscription.

On the other hand, higher tax rates and increasing electricity prices drove our network expenses higher in the third quarter. We also had an increasing tax expense in relation to strong growth in mobile revenues. All in all, network and technology expenses combined with tax expenses increased 31% year-on-year.

It's also important to point out that personnel expenses increased by 8.8% year-on-year in this quarter. The effects of wage increases of non-unionized personnel will be mostly visible in the second quarter of next year. This is giving us some flexibility until the reflection of inflation to revenues. For this year, we now expect mid to high single digits, closer to mid-level growth in personnel expenses.

EBITDA margin in the third quarter was very sound at 42%. Even if you exclude IFRS 15 impact, EBITDA margin is 39%, indicating 2 percentage point improvement compared to a year ago. Looking at the trends, I'm very pleased to see that the turnaround in EBITDA margin which has started in last year has now reached to a sustainable level which is above 40%. We had 5.1 billion TL net financial expense in the third quarter due to decline in Turkish lira against dollar and Euro.

As a result, we recorded 2.8 billion TL loss in the bottom-line. I would like to emphasize that excluding FX impact, net income is at TL 1 billion level, which is showing close to 60% annual growth on the back of revenue growth and operational efficiencies. We are taking many measures to reduce the impact of future FX headwinds; I will explain them in the next slide.

We had a high tax income of close to 1 billion TL in the first quarter since the losses we recorded during the period were mostly to Turk Telekom's solo financial. This allows us to use carry-forward losses quickly due to strong fundamentals of the standalone entity. CAPEX in this quarter was at 1.2 billion TL. This is in line with our plan. Year-on-year growth is due to base impact and we broadly maintained our CAPEX guidance despite the depreciation of Turkish Lira.

We are now moving to Slide 14. At the end of the third quarter our net debt increased to 18.1 billion TL and we have 2.3 times as net debt to EBITDA. Increase is mainly due to non-cash FX losses while we had a very strong cash flow as we will discuss. We have a covenant limit of 2.5 times in all our loan agreements. Our covenant limit is competitively low considering industry standards and practices. We believe that we can also comfortably increase if it is needed.

We have a strong liquidity of 6.2 billion lira as cash at the end of the quarter. We only have 2.5 billion lira debt repayment during the next two quarters. We also have a committed facility of around USD 100 million. We will continue with our previous approach and we plan to maintain sufficient liquidity.

We have alternative financing instruments, such as, vendor financing, the financing of the existing debt and also TL based financing. We might also consider a euro bond issuance early next year and the decision purely depends on getting the best in market conditions.

Looking at our hedge position, we executed additional participating cross currency swap transactions of USD 200 million plus EUR 108 million during the quarter. We reached now to around USD 1.5 billion equivalent of participating cross currency swap position in total.

On top of that, we have increased FX portion of cash as a tool to hedge our FX based debt. At the end of the quarter, our FX based cash is at 84% of the total cash, which is up from 61% of a year ago. The dollar equivalent of hard currency cash is now USD 837 million.

As we discussed before because of high Turkish Lira deprecation the protection of our existing hedges has declined. In order to address that we increased the protection level of our existing hedges during the third quarter. Including the FX based cash, our hedged portion of the debt increased to 57% in this quarter, which was 44% in the second quarter. And we have plans to go above 60% until year-end.

We are now on Slide 15. Our impressive EBITDA growth, normalized CAPEX and sound working capital management gave us an outstanding cash flow performance. We expect that strong cash flow generation will continue over the next 12 months, since there will be no license fee payments or dividend payment. Our unlevered cash flow in nine months in year-to-date was 3 billion lira, which is compared to around 300 million lira of last year. We also expect a high cash flow in the fourth quarter. It's also encouraging to see that now our mobile subsidiary really is contributing to the creation of operating free cash flow.

Our ability on cash flow generation will enable us to deleverage to our comfort zone and in order to get to 1.5 times in 1 to 3 years' time, and it's clearly seen on the chart on this page our current leverage is well behind the leverage ratio of many EMEA telecom operators.

Finally, on Slide 16, you can see our revised guidance. In the first nine months our top line excluding IFRIC 12 adjustments grew 12% year-over-year and our EBITDA reached 6.2 billion lira with a margin of 41%. On the back of the initiatives we have undertaken and strong performance in this quarter, we are now raising our year-end guidance. We expect the consolidated revenue growth to be around 13%, which was previously 11%, consolidated EBITDA to be at the range of 8 billion to 8.2 billion lira, which is up from 7.6 to 7.8, and consolidated CAPEX to be at 4.2 billion.

Now, we may start the Q&A session.

Q&A

OPERATOR: The first question comes from the line of Tiron Cesar with Bank of America Merrill Lynch. Please go ahead.

TIRON C: Yes, hi everyone. Thanks for the call and the opportunity to ask questions. I have three questions; I hope that's okay. The first one would be on the infrastructure sharing, could you please share any metric which you feel relevant, so we better understand how material these agreements would be with the 2 to 3-year view for example in terms of CAPEX savings.

Second, on the on the mobile side, can you please share with us, what do you think drove the ARPU increase both in postpaid and prepaid besides the price hikes that you've implemented, especially since don't impact postpaid ARPU in one go?

And then the third question would be on OPEX. Looking at your margins, excluding the IFRS changes, they've increased by about 200 basis points compared to last year. Is it fair to assume that some of this is due to the delay in the inflation past through for some of the cost? I mean, obviously we have your revised guidance on EBITDA for 2018. But, is it fair to say that some of those costs might only increase materially in 2019? Thank you so much.

DOANY P: Okay, I'll take the infrastructure sharing quickly. Look, I mean, the basic idea behind, for example, let's say a mobile passive sharing is primarily a one-for-one. So, what that means basically is that a tower for a tower. So, the saving there is that you would be just installing your own active base station onto somebody else's passive. If, however, you are doing active sharing then the entire cost of CAPEX and OPEX is then shared primarily, if it's a sharing model, it is 50-50.

If it's a leasing model, what we plan to do because the sharing model is a bit more obvious when you do it on a one-for-one basis, even if you end up shutting down station relocating a base station, those costs, of course, will be shared equally, at a certain point your saving is primarily up to say 50% of what you are doing.

If it's a pay model, then what we do there is that we are going to be comparing what's the better price that we can get between Turkcell and Vodafone especially for the urban areas. The urban areas that would be more efficient to do with this way especially in that you'll be paying one rental. So, if you take site rental plus facility running costs, plus of course the CAPEX annualized, it can decline to up to something around half ideally, of course, it approaches half in the ideal world. So, that's basically how it works in the mobile field.

In the fixed line field, the model there is based actually on a CAPEX contribution model. So, the value to the requesting party is that somebody wants to use our infrastructure. The alternative to them is to roll it out themselves. So, the win to them is that they will be doing around half of the funding which presumably would be roughly around what should be their equity if you like for this type of investment and the rest of it would be leased from us.

The advantage of course, to the acquiring parties cheaper than doing it themselves, and you could say that their CAPEX exposure would be around half but it would be…if it's done otherwise. These are the numbers that we have found would work to both sides by the way, because the first model that we tried on the fixed on Istanbul was more like a 75:25. That didn't work, 50-50 worked.

Of course, the advantage to Telekom in this particular case is that we are able to meet demand without us carrying the full CAPEX increment if that suits the acquiring party as well. That's therefore and of course we end owning the assets and we did it in a manner that the acquiring party can also account for it in a manner that works.

But I think what we've learned from the fixed line model, we are now trying to design a mobile that's a pay model. So, what you pay incrementally for the party to carry your infrastructure is a CAPEX contribution in this case from us on a right of use, almost indefinite. We are confident as the CAPEX because would be on like a 15-year lease. We are also confident therefore efficiently and of course, the total cost should end up being ideally around half what it would, if you do it yourself.

DURSUN H: Hello, my name is Hakan, Chief Marketing Officer. For the mobile part actually in the third quarter of 2018, we achieved a service revenue growth of 19.2%, which is a very strong revenue performance and this performance is also above incumbent's service revenue growth.

At the same time, we were able to achieve a strong net adds in the last four quarters. We have significant net adds and we were able to increase our subscriber market share for more than one percentage points. So, given that our strategy on mobile is to get to about one third of the market in share, but not at the cost of profitability. Our execution proves that, we will be able to execute and achieve our strategy on the mobile side, because we were able to achieve a market share increase, as well as, the 10% ARPU increase and in total our mobile services revenue is growing very strongly.

Third quarter in the market was a rational quarter in terms of pricing. The incumbent started increasing the prices in the market, which Vodafone followed and also we followed. And also, going forward we will evaluate every opportunity, we will watch the market closely and if there is any opportunity on rationalizing the prices further, we will definitely take timely action on that. But, we will also continue to gain market share on the subscriber side.

AKTAN K: Well, this is Kaan. So, regarding your question on OPEX and the impact of inflation and actually also the devaluation. Well, it depends on which line item we are referring to. As I mentioned during the call especially on the network and technology side, the impact has been already reflected into our numbers, it came through the increased prices because of FX base spending on especially network & technology. And also by the price increase in electricity and energy costs in the same line item.

The other significant part of the OPEX comes from headcount related costs and it will be fair to say that, the full impact of the inflation adjustment that the next time will do it, they will be mostly visible when we come to the mid-year next year. We are adjusting the salaries in the second quarter for the bulk part of our headcount, and you should have the full impact reflected to the numbers in the third quarter.

For the commercial… commercial spending and also for the doubtful receivables, which is kind of a reflection of the commercial activities, we are very disciplined. And independent of the impact of the inflation, which we might have some next year, we would still be very disciplined in the spending.

TIRON C: Thank you, so much very helpful.

OPERATOR: The next question comes from the line of Davis JP with JP Morgan. Please go ahead.

DAVIDS JP: Hi, thank you and congratulations on the results. I have two questions. This is JP from JP Morgan. And the first one is on your hedging in the quarter. You mentioned that you have added additional cross currency swaps and strengthened existing hedge positions.

Can you give us an indication of what this will do to your effective interest rate going forward, I assume that, these cross currency swaps come with certain cost attached to them?

Separately, it looks like you put through a material revaluation of your plant, property and equipment, can you please talk us through that, and what the impact maybe on the depreciation schedule going forward? Thank you.

AKTAN K: Yes, we have a mixed portfolio of all transactions and new transactions that we executed in the third quarter. So very briefly, the average costs of the hedge portion of that is now around 10% to 11%, and combined with unhedged portion the total cost will be roughly around 6% to 7%. Naturally the new hedges especially, are coming at a higher cost. We may have some further transactions to be executed in the last quarter, but, the size will not be as significant as we did so far.

For the revaluation of the asset, so naturally this is not a new company. So all the assets on the real estate side were recorded at the historic values and very deeply discounted compared to the fair market value and we wanted to bring more visibility to the value of those assets and also to grow or protect our equity. So, this doesn't change our plans or no plans on the real estate, it will be a business as usual with those assets. So, the company will fully depend on it is operating performance and cash flow going forward.

DAVIDS JP: Thank you. Just to confirm, you said that the overall effective interest rate was between 6% and 7%. Is that correct?

AKTAN K: Yes, that's true.

DAVIDS JP: Thank you

OPERATOR: The next question comes from the line of Reznick, Mitch with Hermes. Please go ahead.

REZNICK M: Hi, thanks for taking my questions. Two, debt related; on the covenants, so 2.3 times getting closer to 2.5 you mentioned you can increase the covenant room. Could you specify, you know, some specifics around that. Have you started negotiations? Is that done? Where do you think that needs to go in terms of the covenant? I mean, obviously from an operating point of view, things are moving well and fine, so that, of course, just some color around that?

And then, on the plans for the Eurobond issue, you mentioned early next year, assumes proceeds would be to redeem the existing bonds that matures in 2019. Just some clarification on that?

And then, can you talk through the cash value of the hedges that you have now, the ones that are in the money just…so we can have that number to add back to the liquidity profile of the business? Thank you.

AKTAN K: Yes, end of the third quarter was the time where we had the dollar rate as close to six, our actual was at 2.3. And I would like to remind you that the official measurement is at mid-years and end of the year. Considering the current level of the FX and also the improving the EBITDA performance every quarter, when we approach to the year-end, there will be sizable headroom still left to 2.5.

So, in that sense we are in a much comfortable place as of today. The discussions are very new with the banks, so it will be misleading to give you any reference to the new level of whether it is doable easily or in a short-period of time. So, when we have more details, on the new levels, when we start discussions we will definitely let, you know…

REZNICK M: Okay.

AKTAN K: And what was the second question, I remember the third one…?

REZNICK M: I rattled off too quickly. And the third question was on your comments about plans to issue a Eurobond early in 2019? Just a confirmation proceeds would be for redemption of the existing bond…

AKTAN K: That's true. That's one of the alternative financing. So, we will be obviously very careful in getting the right price if we do it next year.

REZNICK M: Right.

AKTAN K: I'd say next year, because we see a window of opportunity to be. There will be some window of opportunity. That's how we see the market next year, with a better price than what we have today. But that's not the only option. If we get it, obviously we may use the cash for repaying our bonds in mid-year, next year. But there are… we have other alternative as well.

Obviously, the best tool is the cash we generate because the Company is very clearly in a very strong cash flow generation period. That's something we expected to see, but this is also very, very clearly reflected to our numbers. And we expect to have a similar trend to be in place for the next 12 to 18 months.

Other than this, we are still investing and buying and procuring equipment from international suppliers and normally we want them to provide a certain financing together with the procurement through ECAs. We always had the opportunity to tap that market the ECAs, and as said we may even consider our local currency, the borrowings, this will be all about getting the right price, getting the right risk composition.

REZNICK M: Okay. And then, the last question I had was on the cash value of the hedges that are in the money?

AKTAN K: Yes, true, we have a positive mark-to-market in those items, but currently we don't have a plan to unwind, so that we can use the cash in case.

REZNICK M: Okay. And is it , the size of the value of those hedges, is it, can you give a number, I mean or you can jump into the financials?

AKTAN K: I think all details are in our footnotes and financial statements.

REZNICK M: Okay, I will have a look. Great, thank you very much.

OPERATOR: The next question comes from the line of Drouet Hervé with HSBC. Please go ahead.

DROUET H: Yes, good afternoon. Thank you for the taking as well my questions. Couple of questions, the first one is, firstly, about the initiatives, you know, the government initiatives to limit inflation. On your side, how you are involved with those initiatives and what do you believe will be the impact in the coming quarters. And do you believe if those initiatives are going to last?

And looking forward, how potentially that may impact the way you set in the future of tariff and how the regulator might be involved both potentially in terms of wholesale pricing.

The second question is on the cost side. You mentioned obviously the, I mean, on the impact of the inflations especially on energy and network cost, which tends to come relatively quickly, but, back to the employees cost, can you remind us when do you usually renegotiate the, salaries? I mean, is it something more you do more in Q1 and where we may see more of inflation impact on the employee costs more towards the beginning of 2019, and if it is the case, where do you think we might see the expense, employee cost you know, growing? At that time, do you think it can still be below inflation?

And finally, just about the savings, back to the first questions on you may get from sharing of the network. You were mentioning this 50% potential savings you may do on CAPEX by the sharing. Just wanted to mention, does it include when you say that, is it total cost i.e. the CAPEX, plus reducing cost everything being taken into total. So, both of them, so both sides, do you believe you can achieve this 50% savings through those CAPEX sharing exercise? Thank you.

DURSUN H: Let me start with the first part. To manage the revenue side of of our business, basically, I will answer the pricing part first. We had recently done inflationary pricing adjustments to almost all our services. In summary, we increased our mobile prices around 15% to 20% in the last couple of weeks, plus we also applied 12-15% increase to our fixed broadband offers in the market which is also very recent and we will continue to act in a financial disciplined way, of course, to manage our revenues positively.

On the government side, we haven't seen any pressure from the government side yet and we are not expecting actually. The government launched an anti-inflation campaign for voluntary participation so there is nothing mandatory, and we have full support on this program as the main company in this country.

Basically, we are participating to the campaign with a 10% discount for the first three months of a contracted acquisition campaign on selected tariffs in mobile, fixed broadband and TV businesses. This in total is a positive business case for us anyway, and this is also ensuring a smooth transition for our new increased prices at the same time, so we see this as a positive.

For the second question, I will ask Kaan Aktan to answer you.

AKTAN K: Basically, we have two groups of employees, like you can call them white colors and blue colors. The blue color part which is smaller in number of headcounts and also the shares they get from the total headcount cost. They may have a slight adjustment at the beginning of the year but the impact will be limited and the real adjustments, the real impact of the inflation will come with the new agreements we sign with this Group at mid-year.

For the bulk part, which I mean the white color is the inflation adjustment is made in end of April. So, when we finish the second quarter or when we get with third quarter number. All the adjustments will be fully reflected into the numbers. Until then, the first and second quarter, there will be a gradual increase in the headcount related cost. But I am excluding from the discussion, potential moves between in-house and outsourced employees, because from time to time we may have different approaches, because we are also using some outsource services sometimes we take them into the company, as employer we are doing the opposite of this, but if anything happens in that sense, we will give enough details.

DOANY P: Okay. I mean your question on sharing, when I give the 50% as if you like ideal number… if you imagine, for example, a green field mobile, two operators sharing model, each one run their spectrum either on their own build facility or on somebody else's. If they were splitting everything one-for-one, the rough saving will be around 50%, right?

Of course, in reality if you are relocating your base stations to fit on to somebody else's so you are gridding up, there are costs to do that that's why you know, it wouldn't be really 50%. If you have an existing facility and if you get to the active leasing model, it will also depend on the charging margin and what is the cost to the party on which you are going and therefore, it is important to grid to the other party's network and to find which of them is giving you a lower price.

If you were to compare, let's say, for example doing it in a built up area where you need to build 5,000 additional base stations compared to going onto somebody else's, the saving is unlikely to be the absolute full 50% in this case. So, the sharing model would normally work better. If it is a pay model, the idea there is to go with whoever gives us the lowest price.

DROUET H: Understood. Thanks very much. That's very clear.

DOANY P: Thank you.

OPERATOR: Next question comes from the line of Singh, Madhvendra with Morgan Stanley. Please go ahead.

SINGH M: Yes, hi. Just couple of questions. Firstly, on the debt side of things. Given the impact you have seen and volatility you have seen on the currency. Do you think that the strategy of continuing to borrow in hard currency is it still you know, the right strategy to follow or wouldn't you think that maybe you know, reducing the hard currency exposure on debt side somewhat and you know like deleverage fast, especially given that you are not paying the dividend as well?

And then, you know maybe if that means you know, you grew a bit slower that is okay?

And secondly, just related question on that, assuming that, you know, there would be no dividend for this year, given the FX losses and all. What do you think… how do you think 2019 dividend would look like? Thank you.

AKTAN K: For the funding part…the first part of the question. I mean local currency funding is obviously is within our plan. We made the decision to raise local currency exposures in our total funding. I mean the way to do is obviously, the more preferred way is to create a real Turkish lira exposure by borrowing in local currency and that's mostly through the local party. But we didn't have the right market conditions for doing that

So, when we had right price and the right level of liquidity in that market, we definitely like to be part of it through maybe a local bond issuance of different instruments, but as you see in the way we act for dealing the FX risk**,** we will be using the derivative instruments to convert our hard currency exposure to local currency exposure.

Obviously, we already have a large debt portfolio the easiest way to convert to local currency is to use hedging alternatives. We will also continue doing that. As I said in the long term, there should be a real Turkish lira debt instrument within our portfolio.

SINGH M: What about on dividend?

AKTAN K: For the dividend part, obviously, we have a very straight forward, I mean policy for the dividend. It says, if there is net income in a year, this is distributed. When I look to their numbers for that year and where the FX is as of today, it will be very difficult you know… to say that there will be dividend next year based on those factors.

SINGH M: Sorry, I meant about the dividend for 2019 earnings, so the one which will be paid into 2020 not 2019.

AKTAN K: I mean again it is the same principal will be in place. So far, there is no change for that. If you see there is net income next year. There we may consider dividends payment, but again, it totally depending on the shareholder's decision. If they feel that's you know…

SINGH M: Basically, the background of the question is that I have heard that you know in future, you will have a change in legislation which will allow you to remove FX losses from the calculation of net income to pay a dividend. So, I am just wondering you know by when can you actually start doing that?

AKTAN K: We didn't take it from that respective. What we know, it is not impacting the formulation of the dividend payment. It is a formulation for local legislation to compile with the capital adequacy ratios.

If there is net income, but you know, the shareholder wants to keep the money in the company because we have a loss, that's fully dependent on their decision. So I think it will be too early to make a judgment on that one.

SINGH M: Okay. Thank you.

OPERATOR: The next question comes from the line of Özkan Atınç with Wood & Co. Please go ahead.

ATINÇ O: Good afternoon. This is Atınç from Wood & Company. First of all, please accept my condolences for the loss of the Board Member. If I may, I like to ask three questions. The first one is regarding your recent accounting change, and the way you account for your land bank. Is this just a more realistic accounting practice being taken into consideration or a sign of feature disposals; disposals to raise cash? Well, that’s the first question.

The second one is, during the presentation, Kaan Bey mentioned a net debt over EBITDA target in three years but I missed that, was the 1.5 times? If you could clarify that, I would be pleased.

And my third question is regarding your pay TV segment, now that you are in… you have secured number two position. But is there any signal of widening use of Netflix on your network and whether this is a source of concern for you? And any plans you may have to invest in additional premium content. If you could elaborate on those? Thank you.

AKTAN K: Well, the first question on the land and building. Well, as I mentioned I think it was in a prior question, it is purely for bringing visibility and transparency to the balance sheet by putting the right value or the fair value of the asset and strengthening the equity. So, there is no change in our plans for disposing or not disposing the asset. So, we will not be depending on anything, in any funding or cash that we can generate from the sale of the fixed assets. That's not within our plan.

The company is already in a natural way of deleveraging. If you look to the numbers in dollar-based, in mid-year… last year our net debt was around USD 3.6 billion. Now, we are at the level of USD 3.1. And maybe we are doing in a hard way, but we are deleveraging the Company by simply creating cash from the operations and that will continue.

For the leverage part, I mean, we always want to, you know, convert to 1.5 levels, but there is a part that we cannot control in this story, which is the FX rate. So, we still have as you know, un-hedged portion of the debt, so depending on the FX that may be moves up or down in our leverage ratio. But we definitely will like to be below 2 and converge to 1.5 in 2 to 3-years' time.

DURSUN H.: I mean, for the TV part, we are happy to reach to 21% market share up from 10% two years ago. Our pay TV strategy is to offer affordable prices to this market, especially with the satellite TV and as bundled with our other services.

We have a very strong content that we can operate with affordable prices. This includes a Basketball League exclusive for three years, English Premier League, all documentary channels, kids channel, Video on Demand content, music channels. So, it is a very strong content proposal and it's getting a very good reaction in the market.

Regarding global content players like Netflix, we do not see them as competitors to our Tivibu platform; especially as Turk Telekom we see them as complementary. So, we are evaluating every opportunity to co-operate and add to our existing strong content. So, we do not see them as competitors in this sense. Of course, for such players there is also an opportunity on the corporate Data Live sites and Datacenter Placement sites. So, we are always open to such opportunities and in discussions with such players on a continuous basis.

DOANY P: I think, if you mean, this is Paul Doany, if you mean that on network carriage like video capacity carriage as a burden on the network?

ATINÇ O: Yes, that's exactly, what I meant.

DOANY P: Yes, okay. So the answer to that, basically is that Netflix market share in Turkey, in fact, is very small and we're very happy to carry that traffic because people if you really want to know what's the biggest burden on our video carriage, I mean, Netflix is definitely not one of them, a good part of that would be general, YouTube and some illegal film watchers which actually unfortunately it's illegal, but in fact, you know, they need connectivity for that.

We take the average within our 90 gigabytes average capacity per home, so a very, very small percentage of that is actually normally pay type, which for us is very important in the sense that we actually want people, of course, to need more to upsell more in relation to capacity.

So, any form of paid service, the customer pays for, they pay us and they pay Netflix is very good. If they have access to a live free video, which frankly is the bigger share of what we have to carry, that's actually what we use to upsell.

So as there is more demand, if anything that's also good for us. In relation to ROE, the complementarity parts that what Hakan is mentioning is that, if you watch anything when you want it such as YouTube or Netflix or whatever, because you can watch it as you stream it. The difference between our normal satellite TV is that, that's basically coming through satellite and therefore the catch up version of it is what we can provide over Tivibu Go for example, and that becomes something very important whether you have a fixed broadband connection in the home or the ability for one such as a copper line in there or you can have more data on your mobile.

And again, all of these are ways that we can use to upsell or carry more data. So, we are not actually in that burden syndrome.

ATINÇ O: Okay. That's very useful. Thank you very much.

DOANY P: Thank you.

OPERATOR: The next question comes from the line of Latmiral Ludovico with Kairos Partner. Please go ahead.

LATMIRAL L: Good afternoon. Thank you for the opportunity to my questions. So, I've got two questions. Actually, first, I would like to know whether you think that there might be a capital increase some way in the future?

And then could you please tell us kind of bit more on the interest rates that you pay? I mean, if I got it right from the questioner from JP Morgan, your hedging cost is around 11%, and then you have kind of 6% of effective rate; so this makes something like 17% on your USD based debt, is that right? Thank you so much.

AKTAN K: Okay. For the capital increase, we don't see any such plans for now or in the future and we don't have any proposition or request from the shareholders for having a capital increase in the company.

For the second question, I said that the hedged portion comes with now a cost of 10% to 11%. The un-hedged portion comes with a cost of 3% to 4%. So, the weighted average for the total debt portfolio comes through 6% to 7%. Are those numbers clear and they make sense?

LATMIRAL L: Yes. So, may I ask you, which is the rate in Turkish lira? So, I guess that if it's 4% in US dollar, then…?

AKTAN K: Yes, I mean, obviously 10% to 11% is the rate for the Turkish lira, part of, or the hedged part…

LATMIRAL L: Okay.

AKTAN K: We can't simply you know, offer 6% to 7% over the total value of the debt and you get the net interest charge on a cash basis from that; from the total debt.

LATMIRAL L: Okay. Thank you.

DOANY P: The other question on capital increase?

LATMIRAL L: Yes, no question.

AKTAN K: Okay. We can have the next question?

OPERATOR: The next question comes from the line of Farazi, Dilawer with Loomis Sayles. Please go ahead.

FARAZI D: Hi, there. It is Dilawer Farazi here with Loomis Sayles. Quick question, given the volatility in FX rate have you seen, yes, what's your hedge ratio, I think you relate to anyone you want to be around 60% by the end of the year? How do you actually structure your hedging strategy? Do you look there on a quarter-by-quarter basis, you know, what's the process involved in that? That's the first question.

The second question is around the covenant renegotiation. Can we expect to have news on that by the end of this year or is it an imminent thing or is it an ongoing sort of long drawn out process? Thank you.

AKTAN K: For the Covenant question, obviously it is not a pressing issue for us right now. Looking at the FX rate, but we simply want to have the flexibility in case that there is further volatility in the FX rate.

But again, I mean if the negotiations are not moving in the direction that we like them to be so, we will not participate in any such deal. So… and I cannot tell you that there is an officially started process initiated process around it, which is just right now an idea and this is why we are bringing this up.

So, and let me remind you that again with 6 lira of the currency rate at the end of the quarter we were at 2.3 multiple. And what was the first question, again?

FARAZI D: It was about the strategy on hedge ratio.

AKTAN K: Okay i get this; it is about the hedge ratio. So, it was a part of a long-term plan by the way, so we had a very low ratio last year, so we had a plan to increase gradually the hedge portion of the debt every quarter. So, obviously, with the volatility that we saw in the third quarter we went a little bit higher than what we plan, and we are still wanted to be above 60% not to stay at 60%, it will again depend on the market conditions.

So far… the rate seems to be in a far, better level compared to the end of the quarter, but the other parameters is obviously the level of the interest rate. So, whenever we see that we had the right numbers and you can get an effective protection in return for a meaningful cost. So, we may have higher percentages, let me not give you the level that we want to get at the year end, but we just say that we want to be above 60 for the time.

FARAZI D: Thank you.

CULLAS G: If there are no more questions…

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.

CULLAS G: Okay, we will now thank you for participating. We can close the call. Thank you.

DOANY P: Thank you.

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