Türk Telekom Q1 2023 Financial & Operational Results Conference Call

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Conductors:

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&

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Conference Call Conducted by Chorus Call Hellas

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

Welcome and thank you for joining the Türk Telekom conference call and live webcast to present and discuss the First Quarter 2023 Financial and Operational Results. We are here with the management team and today’s speakers are CEO, Ümit Önal and CFO, Kaan Aktan. Before starting, I kindly remind you to review the disclaimer on the earnings presentation.

Now, I would like to turn the conference over to Mr. Ümit Önal CEO.

Sir, you may now proceed.

ÖNAL Ü: Hello, everyone. Welcome to our 2023 First Quarter Results Conference Call. Thank you for joining us today. Global markets and the business world were unnerved by the banking crises on both sides of the Atlantic in the first quarter. While the inflation, rates and recession debates continued within both the global and domestic context, Türkiye was shattered by a disaster, unseen for nearly a century. The twin quakes centred at south eastern Türkiye affected 11 provinces, where 14 million people lived. Ministry of Treasury and Finance estimated the total cost of the quakes around USD 104 billion, approximately 9% of Türkiye's expected 2023 GDP.

Obviously, an event of such scale required our immediate attention to so many issues all at once. Yet, accurate allocation of resources and efficient coordination of logistics as well as our superior know-how in customer experience, have assured swift and targeted solutions in a super challenging environment.

Customer behaviour was also defined by the quakes with sudden change in urgencies. With too many moving parts in a mixed quarter, the read through for different lines of businesses varied but generally speaking, in both MoM and YoY comparisons, daily average number of activations dropped in February across Türkiye, but more so in the quake region, of course, while cancellations accelerated in fixed services.

Mobile enjoyed historic low churn rate in the quarter in lack of customers' appetite to act at that front. New mobile line sales started gradually picking up in March, but still fell short of January or prior year same period levels in broad sense. Cancellations in March maintained February pace or even accelerated in some segments due to postponed activity in February. Line cancellation or freezing requests were heavy in fixed broadband as we expected, but demand for new connections was also better than we anticipated across all the regions.

We have started the year with some positive surprise in revenue growth, demonstrating the customers' growing need and attachment to our products and services.

Data usage remained on a robust trend with 11% YoY increase in fixed broadband. On the mobile side, data consumption grew by 25% annually to 13.1 GB.

Starting with Slide #3 on our presentation, net subscriber additions. Total number of subscribers declined to 52.5 million, with a net loss of 254K during the quarter, largely due to the impact of the quakes on net addition performance across all segments, but also to the ongoing contraction in the fixed voice customer base. Fixed broadband base remained flat QoQ at 14.8 million, losing 26K subscribers on net basis and recording a contraction first time for more than a decade.

Fibre subscribers rose to 11.8 million with 293K quarterly net additions. The share of fibre subscribers in our fixed broadband base increased to 80%. Mobile portfolio slightly grew to 25.6 million by adding 112K net subscribers in Q1, thanks to a robust performance in the postpaid segment, which gained 294K new customers, while prepaid segment lost 182K subscribers owing both to quake and competition-related dynamics.

The ongoing decline in the number of fixed voice subscribers has deepened by the quake-hit activation and churn activity, reaching 344K on net basis during the quarter.

Slide #4, financial and operational overview. Revenue growth maintained its accelerating pace on quarterly basis. Consolidated revenues increased by 61% YoY, while operational revenues grew 59%.

Consolidated EBITDA rose 16% to TL 4.8 billion with an EBITDA margin of 31%. Ongoing OPEX inflation and several one-offs weighed on the margin. Net income of TL 645 million was 15% higher YoY, but 36% lower QoQ, largely owing to a pressured operating performance by the quakes and continued OPEX increase. CAPEX was TL 3.3 billion in Q1'23, TL 42 million of which was quake-related spending.

Net Debt/EBITDA increased to 1.63x from 1.47x a quarter ago. We expect the impact of the quakes on our subscriber base, revenues and costs to continue over the coming quarters. On the other hand, we expect to take planned pricing actions both in mobile and fixed services in the remainder of the year.

Summer months and tourism season will be important for the mobile business performance, while fixed operations should enjoy some normalisation and a stronger footing in the back-to-school period. Upselling and re-contracting remained resilient despite the disruption caused by the earthquakes; therefore, we expect to see more contribution of those to our revenues in the upcoming period.

Slide #5, fixed broadband performance. In retail fixed internet activations, we observed a better-than-expected activity, owing both to last year's low base and more pricing actions coming from the other ISPs in January. Accordingly, demand for new connections was stronger than we anticipated despite the earthquake impact. Churn rate was higher YoY but still flattish QoQ due to a relatively high base in Q4 triggered by the October price revisions.

With similar dynamics in wholesale business, total number of new activations also improved annually. Churn rate for the quarter came higher YoY but slightly lower QoQ. As a result, fixed internet business finished Q1 with 14.8 million subscribers after recording a quarterly net loss.

We believe the residential dynamics are still fluid in the quake region and will shape in the coming periods. Moreover, even if unused, we don't cancel any lines at this point until our subscribers act at that front. Therefore, we think we will be facing more quake-related line cancellation and freezing requests in the coming quarters and preserve our view that we will incur a slight net subscriber loss over 2023 in our total fixed broadband business.

That said, we believe our fixed internet subscriber base will resume its growth in the medium term, thanks to further room for penetration increase and ongoing digitalisation trends. Although we paused our proactive marketing activities across Türkiye following the quakes, re-contracting and upsell performance remained pretty strong under conditions. 35 Mbps and above packages made 32% of new acquisitions. Continued focus on high-speed packages in new sales led ARPA 6% higher QoQ. Annual ARPU growth moved up to 41% from 38% in Q4.

Average package speed of our subscriber base continued rising despite disruption by the quakes on activations, re-contracting and upsells, exceeding 35 Mbps as of Q1 with 35% increase YoY. Nearly 40% of our subscribers are now on 35 Mbps and above packages. Obviously, the free benefits we provided to our subscribers in the quake region, either to comply with regulator's guidance or through our own initiatives, had, and will continue to have an impact on our ARPU and revenue growth.

Moving on to mobile performance, Slide #6. All operators revised their prepaid and postpaid tariff prices in December and January. As usual, we have seen promotional activities in January in efforts to support activations in transition to new price levels.

However, in the aftermath of February 6 earthquakes, promotions intensified across the board, but more so in the prepaid segment with prolonged durations. Therefore, it would be fair to say that the December-January tariff revisions were less in effect over the quarter compared to prior rounds of pricing in the mobile segment. Still, all operators remain loyal to inflationary pricing and try to maintain a rational mobile market as proven by another renewal of prepaid and postpaid tariffs in April.

Also hit by the quakes, the MNP market, which had recorded its first QoQ growth in five quarters in Q4'22, made it back to contraction territory in Q1'23. We preserved our top position in net ports for six consecutive quarters despite a stiffer competitive environment. Postpaid managed to record strong 294K net adds, following the strongest quarterly performance of 2022 in the final quarter.

Although new sales were visibly disrupted in the quake region, they were fairly strong elsewhere. Yet the real helper in postpaid performance was the historic low churn. Accordingly, the ratio of postpaid subscribers in our total mobile base peaked above 67%. We believe the increase in activation taxes at the beginning of the year at a rate of 122% might have triggered postpaidisation to some extent. Though churn rate declined in the prepaid segment QoQ, lower than expected tourist acquisitions and intensified promotions in the market limited new sales performance; hence, leading to a net loss.

The postpaidisation trend also played a role, we think. We maintained our ARPU growth and controlled base management focus in Prime. Early in the year, we pushed Prime entry level to 25+5 GB packages in new sales. We have also started optimising our existing Prime base to condense it to users of higher content packages. As such, Prime base contracted to 5.1 million. Accordingly, we expect Prime's contribution to ARPU growth to remain strong in the coming periods. Respective 56% and 92% increases in postpaid and prepaid ARPU led 66% rise in blended ARPU.

While several free benefits we provided to our subscribers in the quake region adversely affected revenues, additional data package sales, overbundle fees and significant pickup in top-ups provided robust support. The former is an effect to continue in the coming quarters, but the latter is partly related to boosted social media usage and temporary increase in need for communication for a few weeks after the earthquakes. The number of additional data packages sold grew by 28% YoY, while average top-up amount per prepaid subscriber surged 118%.

We are proud to have proven once again our resilience to extreme shocks, thanks to our distinguished execution capabilities. With still above 50% inflation by the end of the first quarter, the ongoing pressure from the macro environment on our financials has been amplified by the impact of the massive quakes, yet our first quarter performance stayed on track in this most difficult period. We believe our 2023 guidance remains attainable at this point.

Finally, I am delighted to share with you that in line with Türk Telekom Group's strategic investment plans and sustainability agenda, we plan to accelerate solar power plant investments in the near future in order to reduce our carbon footprint, contribute to climate risk management and create financial value. As part of this agenda, Turkish Electricity Transmission Corporation has approved our applications for a total installation capacity of 318 MWe electricity. The allocated capacity corresponds to nearly 50% of our current total electricity consumption.

In our view, this development represents a turning point that enhances our company's potential in areas such as contributing to environmental protection, creating energy efficiency and increasing the use of renewable energy. We believe we will make significant progress towards achieving Türk Telekom Group's sustainability goals with the initiatives that we will implement in the coming period.

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

Thank you.

AKTAN K: Thank you very much. We are now on Slide 8 with financial performance. The positive momentum in consolidated revenue moved into 2023, placing the first quarter growth rate at 61% vs 55% last quarter. Fixed internet and mobile ARPUs continued their climb despite the dilutive impact caused by several free benefits granted to subscribers affected by the quakes; a trend to remain in the coming quarters. Moreover, we paused all our proactive marketing activities across Türkiye immediately after the quakes and resumed normalcy only gradually.

On the positive front, upsell and re-contracting strongly supported ARPU growth, both in fixed internet and postpaid. Data package sales and top-ups were boosted by increased need for communication in the aftermath of the quakes. Finally, the ongoing repricing of existing subscriber bases with our dynamic strategy remained a key driver.

Mobile revenue growth reached 74% YoY with continued expansion of the subscriber base, low churn and January price revisions. 46% fixed broadband revenue growth on the other hand lagged with muted pricing actions by the quakes and slower re-pricing of the base due to longer-term contract periods. All core businesses fell short of realising their full potential in revenue generation due to slowed activation, re-contracting, and upselling activity but faster churn in some segments in the aftermath of the quakes.

Our fixed internet base lost 26K net subscribers by recording a negative number first time for more than a decade, while mobile managed to add 112K subscribers QoQ driven by a strong postpaid performance.

With robust 50% ARPU increase, fixed voice revenue expanded 34% alongside the ongoing gradual erosion in subscriber base. With a similar 33% increase, TV revenue was largely shaped by near 40% Home ARPU rise.

Growth in corporate data picked up to 61%, thanks to contract renewals at revised prices at the beginning of the year. Other revenues grew 106% in lead of rental revenues from other GSM operators, equipment sales, ICT project revenues and call centre revenues. International revenue expanded by 30% over last year's high base, amid a relatively stable FX rate environment in the first quarter.

Consolidated EBITDA grew by 16% YoY to TL 4.8 billion with an EBITDA margin of 31%. Ongoing OPEX inflation, most importantly, the wage increases in January, one-off cost of the new pension scheme and earthquake related losses were the main factors pulling the margin down both QoQ and YoY. In Q1, operating expenses increased by 96% YoY to TL 10.5 billion. Annual increase was 74% in the prior quarter. Excluding IFRIC 12 costs, growth in operating expenses was 95% YoY.

When we come to the bottom line, both dollar and euro rates increased by 3.5% QoQ on average. While a relatively stable currency led lower FX losses, higher market interest rates pushed net interest expense towards north QoQ. TL 260 million net tax income included a deferred tax income, largely driven by the revaluation of assets and R&D

incentives, the current period tax expense and the one-off quake-related tax expense.

Net income of TL 645 million was 15% higher YoY, but 36% lower QoQ, largely owing to a pressured operating performance by the quakes and continued OPEX increase.

Now let's look at the earthquake related and other one-off items’ impact on our first quarter financials on the next slide, which is slide 9. We incurred a total of TL 250 million quake related revenue losses and additional OPEX. While the former was driven by the benefits we provided to the customers in quake regions, the latter reflected varying items, including quake related employee benefits, humanitarian aid, logistic expenses and more. Also, we recorded a one-off cost of TL 150 million for newly introduced pension structure by the government. Adjusted for these items, EBITDA and EBITDA margin would be TL 5.2 billion and near 34%, respectively.

At the operating profit level, the impact was around TL 570 million in total, when included an earthquake related impairment cost of TL 170 million. So, adjusted operating profit would be TL 2.7 billion instead of the reported TL 2.1 billion, with a 17% growth annually.

To adjust for the net income, we account for the one-off quake tax of TL 90 million, the implied deferred tax and the current period tax. Accordingly, net income would stand at TL 1.2 billion, with an increase of 120% YoY. Finally, inclusive of the TL 42 million quake-related CAPEX, first quarter investment spending was TL 3.3 billion. We maintain our guidance that we'll be incurring USD 50-60 million of quake related CAPEX within 2023.

Moving on to Slide 10 with debt profile. Net Debt/EBITDA increased to 1.63x from 1.47x a quarter ago, driven both by limited EBITDA growth and higher net debt QoQ. Cash and cash equivalents were TL 6.8 billion, of which around 33% is FX-based. This excludes the USD 320 million equivalent of FX protected time deposits that we book under financial investments. The share of local currency borrowings within the total debt portfolio increased to 27% from 16% a quarter ago. The FX exposure included USD equivalents of 2 billion of FX debt, 2.4 billion of total hedge position and 120 million of FX cash. As you can see at the bottom right chart, the hedged amount includes USD 320 million equivalent of FX protected time deposits, up from USD 250 million in the fourth quarter of last year.

We are now on the final slide, slide 11. Net FX exposure was USD 450 million long position as of end of the quarter. When we exclude the ineffective portion of the hedge portfolio from this number, which is mainly the existing PCCS contracts, the FX exposure was USD 370 million short position compared to USD 460 million a quarter ago. Obviously, in continued lack of long-term derivative transactions in the FX hedging market, we kept utilising short-term instruments, while the net FX exposure contracted continuously over the last 5 quarters as a result of our ongoing effort to narrow down the position.

The FX sensitivity analysis we report regularly in our quarterly financials, remain broadly unchanged from previous quarter. Assuming all else constant, a 10% increase in FX rates would have around TL 825 million negative impact on our pretax income. On the flip side, the sensitivity analysis produces around TL 900 million positive impact in case of a similar appreciation in TL.

Unlevered free cash flow was negative TL 2 billion, owing to subdued EBITDA growth and the usual seasonality in cash flow with sizeable payments to suppliers related to the fourth quarter of last year's CAPEX realisations.

Well, this concludes my presentation, and we can now open up the Q&A session.

OPERATOR: The first question is from the line of Kennedy-Good, Jonathan with J.P. Morgan. Please go ahead.

KENNEDY- GOOD J: Good afternoon and thank you for the opportunity to ask questions. The first question from me is in terms of your commentary around price increases that you intend to implement, some going forward. Now that revenue growth is ahead of inflation, could you give us a sense of what you believe the market will bear in terms of price increases on both the mobile and fixed broadband side? Secondly, just trying to get some more color on how you expect the recent OPEX cost increases on the personnel costs to roll over for the remainder of the year. By that, should we expect north of 100% increases for the remainder of the year? How does the pension fund scheme affect this kind of cost increase going forward? Thank you.

AKTAN K: Thank you very much. In terms of the expected price increases, obviously, the trends in the inflation will give us a certain direction, but also the inflation on our OPEX base will be a second parameter to take into account. When we look separately at the business lines, I think it will be fair to expect sizeable price adjustments in midyear for fixed line, especially for fixed broadband.

We have been silent in the last few quarters, and you should expect to catch up with a price adjustment. It should include both retail and wholesale price adjustments, which should come together; so that our retail price adjustment is more effective and more achievable.

For the mobile, we will follow our current dynamic pricing behaviour, but also, we will get good competition and try to get the best out of the all pricing opportunities in the market. As we mentioned, we are on a strong trend in terms of customer acquisition. That also gives us more comfort in getting stronger price adjustments for mobile.

Your second part of the question?

KENNEDY- GOOD J: It was related to staff costs, which were up over 120%. I was just trying to understand whether that is a likely trajectory for the rest of the year or how much the one-off pension costs boosted that number.

AKTAN K: Well, when we look at the past 12 months, our behaviour or planning versus what happened in the market, obviously, inflation as well as the government's behaviour for adjusting the minimum wage, they were not totally supporting our previous plans. This number changed, so, we have adjusted our internal decisions accordingly. If you look at our current planning for the rest of the year, we should normally see in each quarter a YoY increase in that specific OPEX line item coming down.

But with the caveat of that if there is another set of adjustments in midyear by the government or we see a totally different trend in the inflation different than what we are currently expecting, then we may have a different decision, but our current forecast is that it should come down in every quarter going forward.

There is one addition to your first part of the question, that will come from our CEO.

ÖNAL Ü: Hello, I'd like to add some information related to the price increases. As you know, we entered 2022 on the fixed broadband side I mean, we entered 2022 with the pricing action we took on 2021 December 1st. Then we made follow-up updates on the prices in June and October 1st in 2022. According to the price actions we took in the period of March 2022-'23, our fixed broadband prices have increased by approximately 70% annually.

It wouldn't be wrong to say that we will be working on price increase actions for the second half of this year. So that is to say, we can say that around midyear time, as we commence the second half of the year, we will update our price. That is valid for both wholesale and retail. Also, we should add that the pricing actions continue for re-contracting and upsell efforts.

On the mobile side, we have achieved an acceleration in pricing as of the second half of 2022. With our value focused strategy, we can say that we have achieved good results in terms of healthy number of subscribers and churn performance. And this trend is expected to continue.

KENNEDY- GOOD J: Thank you very much. That's helpful.

OPERATOR: The next question is a follow-up question from the line of Kennedy-Good, Jonathan with J.P. Morgan. Please go ahead.

KENNEDY- GOOD J: Hi again. Just wanted to clarify, I know you've made the comments that it's difficult to assess what kind of insurance reimbursement you may receive due to the quake damage, but you did mention CAPEX of about USD 60 million would be deployed to those regions. Would it be fair to say the insurance that you expect to receive would be about that amount? And when would you expect to receive it?

AKTAN K: It should be fair to say that it shouldn't be less than that because USD 50 - 60 million is not fully recovering our damages in the whole region. We expect some more to come in the next year, especially for fixed line. Because there will be several relocations in the region, and we have to take the network to the newly built homes and apartments. But for this year, yes, USD 50 - 60 million, is the mathematics, it shouldn't be less than what we will recover through our insurance policies. Normally, I would say that starting from the date of the earthquake, we should expect to recover somewhere between 12 - 18 months period. We are trying to accelerate the process right now as this has some cash flow coming in, in this year, maybe not fully, but partially. But that's still subject to several discussions with the insurance company. It's a very large region. It's a very large damage. So even the documentation is not easy to complete, and there will be certain negotiations with the insurance companies. But we are fairly comfortable about the quality of the policy. So, we expect to recover most of the damages that we already incurred or the CAPEX that will be the result of the damages to come next year.

KENNEDY- GOOD J: Okay, thank you.

OPERATOR: The next question is from the line of Nagy Nora with Erste Group. Please go ahead.

NAGY N: Good afternoon, sir. Thank you for taking my question. I have one related to the new tax levied on earthquake. If I understood it correctly, this is one-off tax, but shall we expect it to remain in place after the elections? Does this impact your donation? You had previously announced that you intend to donate to the earthquake relief in Türkiye. Thank you.

AKTAN K: Let me answer the first question. I would kindly ask you to repeat the second part. We're not clear about the second part. The additional tax that came is a result of the quakes and all the markets call it earthquake tax; we prefer to use the same term. This should be a one-off, because of the structure of the tax, it totally relates to the tax filing of last year. So, by nature, it's a one-off tax. Normally, it shouldn't repeat. We already incurred the full impact in the first quarter numbers. Can you repeat the second part?

NAGY N: Yes, sure. The second part was about the donation that should be decided at your AGM? Does this new tax impact your decision on the amount that you intend to donate?

AKTAN K: I mean those are two separate issues and separate questions. Financially, since the tax is only relating to 2022 tax filing, so donation numbers shouldn't have any impact on the tax front this year.

NAGY N: Thank you.

OPERATOR: The next question is from the line of Farazi, Dilawer with Royal London Asset Management. Please go ahead.

FARAZI D: Can you hear me okay this time?

OPERATOR: Yes, we can, sir. Yes.

FARAZI D: Sorry about that before. So, I just wanted to ask you about the FX hedging. Now my understanding is you've got the currency protected time deposit, which is USD 320 million. You've got the regular hard currency cash and balance sheet of around USD 120 million. What about the 2 billion of hedged amount? Is that through cross currency swaps or forwards or how do you do that?

AKTAN K: Close to half of this number, less than the half, I would say like 40% of the total amount should be around USD 900 million comes from participating cross currency swaps. A large part of it is the ineffective part of our hedge portfolio since, by nature, they only protect us within a certain range in terms of the FX rates and most of these items lost their effectiveness.

In the remaining part, we use several items. We have cash, which is USD 120 million, currency protected time deposits, more than USD 300 million, as we mentioned. We also have the remaining part is coming from, very straightforward FX forward contracts or options.

So, this part by nature, because of the market conditions, it's short term and we are continuously rolling over those contracts in order to protect our current position. We are also increasing the amount of such short-term contracts at the same time since we are repaying the existing debt, the related ineffective cross currency swaps are also expiring and the results, they are coming down in terms of the short position for the last 5 quarters.

FARAZI D: That's great. That's great colour. Thank you. In terms of the average sort of duration of your forwards, what is that? Is that sort of 6 months or 3 months?

AKTAN K: We try to get to closer to 6 months, but based on the market conditions, it depends, but we may take it between 3 - 6. So, if we find the cost attractive, we try to get to 6.

FARAZI D: Great, thank you.

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

AYAZ G: Well, thank you, everyone, for joining us. We appreciate your time and interest. Have a good day. Thank you. Bye-bye.