Turk Telekomunikasyon A.S.
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Thurs, 18th July 2013
15:30 Hrs UK time
Chaired by Onur Oz

Operator

Good afternoon everybody and welcome to the Turk Telekom's 2013 Q2 investor call.

Onur Oz

Hello everybody and sorry for the slight delay due to technical issues. We are starting our 2013 Q2 results call today. I would like to welcome everyone to our call. Before we give it a go, I would like to invite you to read our notice which is on our second page of the presentation.

With that I would like to hand the call over to Mr Hakam Kanafani, Turk Telekom Group CEO, to start today's presentation.

Hakam Kanafani

Hello everybody. It's good to be with you again. We are in our month of Ramadan, which means most of us are fasting but we still gain weight; it's been a week and I think each one of us has gained about a kilo, so go figure! That is important to disclose to everybody.

Now, on to more serious subjects, I would like to take you through the presentation we have. I understand it was sent to you by Onur and the team. Again, I would like to thank you for attending this meeting and let's go straight to the overview of our results on slide 5 of the presentation, and comment on the major highlights for the quarter. Turk Telekom Group continued our growth in the second quarter of 2013. On a consolidated basis we achieved 6% year-on-year revenue growth. We grew our fixed line business by 2%, which is actually a rarity these days in the telecom space. We did this despite the challenges we faced in our fixed voice business.

The growth momentum we achieved in non-fixed voice businesses which are very important to us (this was of course led by broadband and corporate data) enabled us to more than offset the decline we faced in fixed voice. Please note that we are fighting with all our strength to tame the challenges we face in our fixed voice businesses, and we are still best in class to control the decline here. Of course, best of all, we do have strong businesses that we run within the fixed line which more than remedies the voice side and brings us overall growth.

Our broadband business revenues in the second quarter maintained a robust growth of 9% year-on-year and rose to 838 million lira and, despite the seasonally challenging second quarter, we have continued to increase our subscriber base and realised 34,000 net additions in broadband excluding the Lokum phase-out effect. We are also pleased with our upsell trend in broadband, where we move into higher speeds and higher quota packages and have them experience our superb fiber connectivity across the nation. In fact we have increased our fiber subscriber base by 31% in the quarter and reached 360,000 fiber subscribers as of Q2. If we add our ex-DSL subscribers running on fiber to the building, we will have about 560,000 on our fiber network.

Our mobile business continues to demonstrate strong results. Revenues grew at an accelerated pace and increased 17% year-on-year. Our fantastic pace of net addition adds resulted with 161,000 net new subscribers in the second quarter. During that last quarter challenges continued in the mobile market. As you have all been witnessing, there were many variables at play that caused mounting difficulties in front of all contenders, of course; however, we do not hide behind excuses and we do not point fingers. We forge ahead and deliver value to the shareholders and strong growth on the mobile side.

On the net income side we felt the effect of appreciation in the US$ and Euro against the Turkish Lira this quarter. Our bottom line has been affected by this unrealised loss. We closed the quarter with 280 million lira net profit.

If we go to slide 6, we have the financial summary of the consolidated business. In line with our full year guidance of 5-7% annual revenue growth, our Group revenues increased by 6% in the second quarter to 3.4 billion lira; this growth is mainly driven by solid performances in broadband and mobile businesses. In terms of EBITDA we have seen a slight decline of about 21 million lira year-on-year. There are a few things that played a role in this slight decline, which my colleagues in finance will walk you through; however, we are still on track to reach our guidance with our full year EBITDA results. If there are any updates we will discuss at the Q3 results.

As for the net income, I mentioned a few minutes ago that the headline is the appreciation of the US$ and the Euro and that happened in the second quarter and, as a result, we recorded an unrealised loss of 445 million lira in the period.

Finally, I would like to talk about the transformation of our revenues and our revenue streams that we are going through and the state of that in Q2. As most of you know, two out of our three main businesses, viz. broadband and mobile are high-growth businesses. In the past 4 years we grew these businesses at healthy double-digit rates. As a result of this healthy trend these two businesses now make up 56% of our total revenues and, at the same time, our fixed voice business (albeit still very important for us) makes up 27% of our total revenues. In the past our dependence on fixed voice was much higher. This transformation of course comes with some margin pressure; however, we take the utmost care to make sure we have a smooth transition. We will continue to protect our EBITDA generation and our ability to generate EBITDA, and we will continue to protect and defend that.

That’s it for me and I would like to hand it over to Turk Telekom’s CEO, Tahsin Yilmaz, for the Fixed Line business update.

Tahsin Yilmaz

In the Fixed Line business we continued to grow in the second quarter driven by broadband and corporate data services businesses. Revenues increased by 2% and reached 2.5 billion lira in the quarter. As Hakam pointed out, we are facing big challenges in fixed voice and our team is doing a great job in limiting the decline. Nevertheless, we can more than offset that decline with our growing businesses and in the end we are able to sustain the progress in our fixed line segments.

Let me take you through some details and, starting with slide 9, I'll provide you with the key highlights of our broadband business. After a great Q1 our broadband business continued to show strong growth in this quarter. Revenues increased 9% year-on-year. Accordingly, broadband revenues reached 838 million lira in the second quarter of 2013. This comprises 25% of Turk Telekom Group revenues in the second quarter of 2013. The growth in broadband revenues was driven by increased in both subscriber numbers and ARPU.

Despite the seasonally challenging second quarter, we recorded 17,000 net additions. If we exclude the phasing out of Lokum subscribers, net broadband subscriber additions in Q2 reached 34,000. On the ARPU front the increasing trend continued with 8% year-on-year growth and we reached a broadband ARPU of TL 39.4. Price increases, growing data usage and upselling to higher speeds and capacity packages were the main drivers supporting ARPU growth. Given the consumers unwavering need and demand for higher speed and capacity, we believe we still have room to drive ARPU up.

Moving on to slide 10, I'll provide you with the recent highlights of our fiber network. As the clear leader in fiber connectivity in Turkey, Turk Telekom continued its fiber transformation program in the second quarter of 2013. Our customers continued their tendency towards using higher speeds and data packages within fiber. We recorded a 31% increase in fiber subscriptions in the current quarter, and as a result the number of our fiber customers reached 360,000 as of Q2 2013.

In addition to our efforts to increase fiber penetration, we also continued our fiber network expansion. As of Q2 2013 our fiber optic network in Turkey reached 171,000km. In parallel to this we increased our Fiber to the Home and Fiber to the Curb homepass numbers. By the end of the second quarter, Turk Telekom's Fiber to the Home and Building Complex reached 2.2 million houses. Our Fiber to the Curb coverage reached 5.1 million. With our unmatched network and high quality value-added services we will continue to be the undisputed leaders in this area.

On slide 11 we have key highlights on the upsell trend in broadband. As Turk Telekom Group we are well positioned to address the increasing demand for high speed and capacity broadband. Through our upsell efforts we provide more value to our customers and generate higher ARPU. On the left side of the page we see that the level of unlimited quota subscribers reached 79% of our total base. This ratio is a great improvement over the 68% we had a year ago. In addition to servicing our current customers in the limited quota packages into unlimited packages, we observe that the preference of new subscribers is towards unlimited packages as well.

On the top right chart you can see the trend in broadband monthly data usage in our network. Average usage increased to 33GB as of June 2013. There is a remarkable increasing trend in total data usage which, again, is a favourable development for our broadband business. In terms of speed, up to 8 megabits per second and higher speed packages are now 93% of total subscribers. With this slide we demonstrate how the usage trend will support an environment where we are able to upsell customers. Turkish consumers continue to increase broadband data usage with multiple devices and higher speeds. At Turk Telekom we have the right ingredients of technology platforms to meet our customers' dynamic needs.

Moving on to page 12, we have the highlights of our Fixed Voice business. As of the second quarter of this year we have a total of 13.9 million access lines, including almost 900,000 naked broadband lines. There is a slight deceleration in access line decline and this was driven by our team's efforts. This quarter we launched some campaigns in order to prevent the increase in PSTN churn, such as free minutes to mobile directions from 7pm to 7am. On high interest from our subscribers, we extended the campaign in a slightly different shape. We observed an encouraging effect of this campaign on our PSTN churn level. At the same time we continued our brand partnership programs and joint offers with our Group companies. As a result, our quarter-over-quarter decline in access lines came down to 1.3% from 1.8% a year ago.

Increasing number of Wholesale Line Rental subscribers has a slight dilutive impact on Voice ARPU. As a result, Fixed Voice ARPU was TL 21.6 in Q2 2013. Wholesale Line Rental is a product that also benefits us when it comes to multiple offers and the majority of our dominant large players utilise TTNET. TTNET utilises Wholesale Line Rental in its unique multiple bundle packages and continues to the broadband market with innovative offers. With TTNET we are able to offer broadband, fixed voice, TV and WiFi in single packages. Furthermore, these offers come with unmatched value added services and this is one of the solid demonstrations where, as leaders and incumbent players, we exemplify how to be a value player rather than a price discounter in our market.

In fixed voice one of the important things we look at is how successful we are in terms of stabilising our revenue stream. As of Q2, we have 75 of our fixed voice revenues recurring every month.

This was a brief summary of the fixed line business performance and now I would like to hand over the call to our CEO, Mr Erkan Akdemir.

Erkan Akdemir

Thank you Tahsin, and good afternoon to you all. Following the fierce competition in Q1, there has been more stabilising in the conditions in the second quarter of 2013. The progress for the last 3 years in terms of both revenue and profitability has continued and the Company's revenue for Q2 has reached a new record of TL 1,005 billion growing by 17% year-on-year basis and breaking through the one billion mark for the first time in the Company's history.

Revenue growth is mainly attributable to increasing voice and data traffic, maintaining strong performance thanks to the commercial focus on innovative targets and campaigns and the contribution from the new customer acquisitions. We managed to increase EBITDA by 20% on a quarter-over-quarter basis, reaching TL 129 million in Q2 and showing a significant growth by 49% on a year-on-year basis. Not only have we grown on an absolute level but also the profitability margin has marked 3 points growth on a year-on-year basis, reaching to 13%.

Moving on to the next slide, our subscriber base grew by 7% year-on-year and 1% on a quarter-over-quarter basis, reaching almost 14 million, 161K net additions in Q2, generating 11.6% which includes 2 points on a year-on-year basis thanks to the effective strong management strategy. We are consistently maintaining our leadership in postpaid subscriber ratio in the market with 44% and our ARPU and MoU have consistently grown for the last 3 years.

Avea MoU in Q2 reached 378, which is higher by 8% on a year-on-year basis and Avea persistently achieved the highest MoU in the market for the past 5 years, and ARPU grew by 10% year-on-year, as a result of increasing data usage and incoming traffic with a strong subscriber mix and, as of Q1, Avea has achieved the highest ARPU in the market. As you will see on the coming slide, we are still the most preferred operator with 477K MNP acquisition in Q1, outperforming competitors and achieving highest MNP in the market in the first half of the year.

Moving on to the next slide, the share of the Mobile Data revenues now constitute 30% of the total sales revenue, with a growth of 42% on a year-on-year basis, thanks to the smartphone campaigns and unique innovative internet packages addressing different customer segment needs. Finally, a few words about the smartphone market – in paralleled growth in the smartphone market – Avea keeps increasing its penetration, reaching 30% in Q2, and Avea continues its device portfolio in every segment with regular updates incorporating multiple brands, solving different needs of customers.

Now I will hand the call over to Erhan Merdanoglu for the financial review.

Erhan Merdanoglu

Thank you, Erkan. This is Erhan Merdanoglu, Turk Telekom Group Finance Director. I will take you through the financial section of the presentation. I want to mention that all financials are in Turkish Lira, except if otherwise stated.

Starting with page 20, we have the Summary Consolidated Income Statements. Turk Telekom Group recorded 6% year-over-year top-line growth in the second quarter and this growth rate is in line with our guidance for the full year revenue growth and we have reached historically highest revenue. Compared to Q1 2013, EBITDA increased by 9% and as you'll remember we had around a TL 78 million one-off expense related to the personnel incentive program in Q1 2013. On a year-over-year basis we had a slight decline in EBITDA of 2%.

Now we look into the drivers in the Consolidated OPEX section. Net income decreased by 55% year-over-year to 180 million in Q2 2013 on the back of 445 million net financial expense, compared to 21 million net financial expense in Q2 2012. 411 million FX and hedging loss is driven by the depreciation of the TL against the US$ and the Euro in Q2 2013. US$ appreciated 6% and Euro appreciated 8% against the TL in Q2 2013.

Moving on to page 21, we have the Group Balance Sheet highlights, and if you look at the liabilities' side you will see that the Reserves and Retained Earnings declined by 2.1

billion in the second quarter and this is on the back of our 2.4 billion dividend payment in the second quarter. Again on the liabilities' side, Interest Bearing Liabilities increased by 1.5 billion in the second quarter, compared to the last year. We will talk about our debt profile in the following slides, but this increase is mainly related to an increase in our short-term TL financing for dividend payment, and increase in US$ funding and the exchange rate impact. Compared to last year, the cash position increased by 43 million to 973 million as of end June.

Going to page 22, we have Cash Flow details. Cash Flow operation increased by 24% year-over-year. Usually Q1 operating cash flow is low due to the Capex payment cycle and upfront cash-out for some annual Opex items such as brand, etc. In the first half we generated very strong cash flow despite incentives related to cash-out, and cash flow from financing activities as related to our recent dividend payments.

Next is page 23 where we have our Consolidated Revenue Breakdown showing different revenue items the Fixed Line segment and Mobile segment revenues. Much of this has been already covered in the earlier page, but still some additional highlights:

- We had 2% fixed line revenue growth and 17% mobile revenue growth.
- Our growth engines in the Fixed Line segment, Broadband and Corporate Data services, continued to be strong performance recording 9% and 33% year-over-year revenue increase respectively in Q2 2013.
- Mobile revenue continued its strong growth, driven by data and income revenues.
- We had 49% year-over-year increase in Mobile absolute EBITDA, which is very important for us.
- EBITDA margin continues to improve and Mobile operating profit is getting closer to break-even.
- Construction revenue is down by 25% compared to last year, with less fiber investments this year which plans the pace for construction revenues.

Moving on to page 24, we show OPEX at the Consolidated level. Personnel expenses are up 7% year-over-year. As you'll remember we had a Personnel Retirement Incentive last quarter, and there was a minor cost spilled over into this quarter, due to a few more employees departing. In addition, employee numbers in our growing call centre business increased year-over-year, and of course there was the wage increase of around 6%. In general personnel incentive benefits are felt throughout the year.

Commercial expenses declined 4% year-over-year to 255 million in the second quarter, and the main reasons are lower advertising marketing expenses and lower promotion expenses year-over-year. Doubtful receivables expenses increased by 46 million year-over-year on the back of changes in the calculation methodology. Cost of equipment and technology sales including modems and software, etc, corresponds with the revenue increasing margin for us.

Skipping the Fixed Line and Mobile slides and moving on to page 29, we have Debt Profile details. There is no change in the overall funding strategy; similar to last year, we financed our dividend payout through the local currency loans. FX debt, mainly US$ and Euro, and the average maturity of the FX debt is 2.2 years and we are comfortable with the net debt/EBITDA ratio of 1.48.

With that, I complete the financial section and I'll hand it back to Onur for the Q&A.

Onur Oz

Thank you, Erhan. We can now open up for Q&A.

Questions and Answers

Cesar Tiron – Morgan Stanley

I have a two questions, please, and the first one would be on the mobile segment. You have made some very interesting developments in May this year by initiating some of the price increases that we have seen in the market and your competitors have followed. What is your view for the second half? Do you think this trend that we have seen in May and June can continue and, if your competitors don't move to cut back prices on the back of the cut in MTRs, do you think there is room for prices to continue increasing in the mobile market?

My second question is basically a follow-up from the first one. I think you need to deliver quite an impressive performance in the second part of the year to deliver your full-year guidance. Can you please explain what will change in the second part of the year, both on revenues and the cost base, for that? I think everyone is aware of the seasonal impact, so if you could focus your answer just on the operational factors; thank you very much for that.

Thank you for your questions. Let me answer the second question first. There is no change in our guidance. For H2 we think that Broadband and Mobile growth are on track, 10% and 17% year-over-year revenue increase realised in H1, and we expect that this trend is going to continue. We have 9% year-over-year in H1 growth on Corporate Data business which is high margin, and this is something that will continue. There are Fixed Voice initiatives that will become much more effective in H2 and of course there are OPEX control initiatives and bad debt reduction, and personnel incentives kicking in. Gradually the personnel incentive is going to be a positive, so this is how we are going about it and, if there are any changes and if there's anything we see, we have this quarter to see how things are happening and I want to emphasize that there are lots of good things we see in these results.

We are happy with the transformation of the revenue. We think we are paying a price for that but we think the price is definitely worth it. We are a long-term company and we are going through really massive challenges but the results are very encouraging. We are happy where we are on the revenue streams with the other business - the green category is growing today. For the first time we have the Mobile segment the highest in revenue. The Mobile segment plus Broadband is more than 56-57% of our revenue stream and that entails new management technique and transformation.

That is what we are working on, how we can become slimmer and more efficient, and how we can put to the front the new initiatives of the programs that have higher margins, etc, so we cannot be a Fixed Line incumbent in 3 years and then quarter-over-quarter and year-over-year everything is going to grow and we are going to transform ourselves. There are these costing effects that we have to go through and I think the management team is doing a fantastic job managing that, given the very difficult challenges we face in the market. I am very happy with these results but I acknowledge that there are tremendous challenges and the road ahead is still long, but that is what we get paid for. We know we are going to succeed at the end and bring forward the new Turk Telekom Group that we all aspire towards, shareholders and management.

On your first question on Mobile, thank you for highlighting that we have led these price changes in Q1 and I dare say before, but still there is an incumbent who is responsible for how the market is going to go and we are going to follow through. If we see that there are good responses and the market leader is positioning their plans based on value and not based on competing with the third operator in price, then we will follow suit. If we see that there is more competition and there is more focus on the pricing, we will also follow suit and we will continue to do this.

Thank you.

San Dhillon – Barclays

Just two questions, both on PSTN – how do you expect PSTN revenue declines to trend going forward? We have witnessed accelerating declines in each of the last 3 quarters and growth is now negative 13, which I guess is quite surprising given that you've put through inflationary price increases and 75% of Fixed Voice revenues are now recurring.

The second question (which is quite technical) is, historically, your PSTN revenues used to be quite simply the ARPU number quoted times the average access lines but ever since mid-2011 that calculation just does not seem to work anymore; it generates revenues that tend to be higher than the reported PSTN revenues, so there seems to be this other negative revenue line and I was wondering what that was, if you have an answer. Thank you.

I don't know about the second part of the question. We need to study what you mean exactly. On the first part, look, we had to make a decision 3 years ago; no matter how strong the EBITDA is and no matter how good we're doing on the PSTN we must change. This is a decision that was taken that we would need to change the way we are; the way we are thinking and the way we're doing business on the ground; the way we are looking at broadband and the way we're looking at mobile.

Again, we are a long-term company and I am getting an answer for the second part, by the way – they are working on it and I can update you – so this is a conscious decision that we're all aware of. It takes a long time to go through this transformation and make sure that we are able to hedge the risk and put new revenue streams and new products and services that take us not only from quarter to quarter or year on year, but take us the next 3-5 years, the next 5-7 years; we have to transform, so we looked at how we're going to do the fiber carpeting of the nation, if I may, and how we're going to move into the corporate section and bring new corporate solutions.

Today we have much better corporate solutions. We have corporate products that are at 9% increase. We have better traction on ADSL and fiber. Our Mobile unit is doing an excellent job. They have actually put much better numbers than we expected and we have depended on PSTN successfully but we are facing some challenges these two quarters, so what are we doing? We have lots of efforts, in terms of incentive tools, how we can incentivise a little bit on the PSTN and at the same time grow Broadband, and make sure we also take a step where the competition is going to be so that we have a defensive position before the competition takes us anywhere. We think we are on the right track and we are happy with these schemes that we are putting in place, but there is pressure on the PSTN and the teams are trying to solve that. We have done a lot of things in H1 and I think there will be more things done in H2.

**VP of Consumer Departmant - Ali Yılmaz:*

Let me briefly update you about the campaigns and upsell initiatives as well. As we ended the off-peak campaign on GSM, right now we are able to have an upsell potential on a significant number of customers and we will continue to have this upsell campaign. Other than that we are also trying to balance our () initiatives on PSTN as well and right now we are forced(?) to incentivise PSTN sales on dealers and also on the employee staff side as well. Both of those two initiatives will bring us to a better shape in Q3.

We have a positive effect on MoU and we have a positive effect on churn; with these initiatives the PSTN is becoming more relevant. We are going to continue to do that and also focus on how we can improve the margins and how we can improve the business models for Broadband and Mobile.

For your first question, this is the effect of the Wholesale Line Rental where it comes with a little bit lower ARPU, so that is the answer to your question right there.

Thank you.

Ivan Kim – VTB Capital

I have one question on the Mobile business and another one on the cost side. On the Mobile business your smartphone penetration added 3% in the quarter and reached 30% but at the same time the contribution of Mobile Data to the revenue dropped to13% in Q2 compared to 14% in Q1; can you elaborate on the reasons for that and what kind of data demand, data consumption and data pricing you're seeing?

Secondly, can you please elaborate on the personnel cuts? What is the progress there and what will be the magnitude, and when should we expect those? Thank you.

Thank you, Ivan, and on your first question the service revenues have increased very fast. That is why data share looks a little bit lower. You have to take that into consideration.

I understand that but, at the same time, the smartphone penetration growth has remained healthy so I understand that's probably just the higher Voice contribution because of seasonality, but what do you see in the Mobile Data market, whether the demand is still robust and what is happening to the Mobile Data pricing?

You will see that there is over 40% growth in Data. That is evident. I think you will see that the percentage will continue that healthy growth because we are focusing on increasing the penetration of our handsets. Avea has also rebranded themselves and have put a new brand value and different offerings in the market, and we feel very strongly this is going to help us push forward more incentives and realise more value.

Your second question was on personnel – the net positive on personnel, net-net it's about 25 million that we have seen positive, but you will see that gradually throughout the year we are going to retrieve the amount that we have put on Q1.

Erhan Merdanoglu

At the end of the year we will see the result of the incentive payments and we will recover the incentive payments from the cost reduction of the personnel.

And because of our growing business you will see also that on the call centre lines some personnel are growing and that is why we talked about the net-net. Thank you, Ivan.

Thank you.

Torsten Achtmann – JPMorgan

ICTA has announced Voice and SMS termination rate cuts. Is it possible to give a rough estimate how much these cuts would impact your revenue generation in H2 without any follow-on effects?

The second question is on the FX loss you incurred this year. Will that impact your dividend distribution in terms of net income or is it seen as a one-off non-operational and therefore not impacting dividends? Thank you.

For the second question it's very early to talk about the impact on the dividend. This is unrealised loss and we want to see how this transpires throughout the year. The end of December is very important. We have explained our policy continuously and we can get into that in a bit of detail if there are further questions on that policy with the FX, but it is very early to discuss any impact on dividend; that is the answer for the second question.

For the first question, maybe our colleagues will give you just a general note on how we view it, because we don't really see it as an MTR cut and we'll explain why, but I would like to say that Avea has demonstrated that through thick and thin – I don't want to sound very dramatic but it is the truth ... whether it's tough conditions – they have grown and they have steadily grown. They have improved their offerings and they have improved their competitive skills, and improved their network; their payment methods; their relationships with customers, and their value chain in terms of the distribution. I think Avea is definitely on track to continue that and we put a lot of weight on Avea and the work that they are doing, especially the last two years. We think this year and next year are crucial years for us because Avea will start benefiting from some of the investments we've put in and some of the good work they have done.

As for the MTR, do you want to make a comment?

**VP of Marketing of Avea Dehşan Ertürk:*

Actually, we usually don't want to give out any numbers for revenue loss forecasts, but let me assure you – I promise you, in fact, we'll continue to grow our revenue. On the political side, as Hakam said in the beginning of his speech, why we don't consider this as a regular MTR cut is we think there was a great opportunity for the mobile market before this MTR cut; as you guys all know, we were expecting a post impact of the regulatory activity for the incumbent in the market. When we first heard about the MTR cut we were a little bit disappointed and now actually we are a bit confused and we are cautious to see what is going to happen in the market. In accordance with the developments in the market the impacts of the MTR on revenue could vary.

Hakam Kanafani, Turk Telekom Group CEO:

The story is on the floor ceiling for the incumbent pricing – that is the story there and that's where we're looking at it, and again we emphasize that Avea will always be a very strong competitor. If there is market rationalisation we'll follow suit and if there is competition we're all for it.

Thank you.

Closing Comments

Thank you, everyone, for joining our call. If you have any follow-up questions please contact our Investor Relations team. Thanks a lot for joining and have a good evening.