

**Company:** Kcell  
**Host:** Irina Shol  
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**Operator:** Good day and welcome to the Kcell Quarter 1 2016 Financial Results Announcement conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms Irina Shol, Head of Investor Relations. Please go ahead, madam.

**Irina Shol:** Thank you, operator. Ladies and gentlemen, good morning or good afternoon, and thank you for dialling in to discuss Kcell's first quarter of 2016 results. As always, during today's call we will talk you through the highlights of our business and financial performance for the reporting period, using presentation slides which I hope you have in front of you. If not, please visit the IR section of our website, where you can access the slides from our investors page. Participants in the call today are Arti Ots, our Chief Executive Officer; Trond Moe, our Chief Financial Officer; and myself, Irina Shol, Head of Investor Relations. Following our presentation, there will be a Q&A session. I will now hand over to Arti, who will talk you through our first quarter performance.

**Arti Ots:** Thank you very much, Irina, and welcome, everybody, to our Q1 call. Firstly, it has been a very tough quarter for the company to begin with, even though we see some slight improvements in the market as we speak, but it's still too early to make final conclusions out of it. Despite that, we'd like to update you firstly on the slide 2 with the progress of Q1 and then some of the achievements and main developments.

Firstly, let me remind you that from now on all operators have the LTE licence and everybody can introduce LTE, so has done Kcell. We have now pilot zones all over Kazakhstan which are operating with tens of thousands of users as we speak, and we are very happy about the first results on technical point of view. From pricing side and overall competitive side, it remains tough, as two main competitors haven't actually moved since last fall with their primary offering on bundles, while Altel was quite aggressive on increasing prices and decreasing content in

many aspects. So we can say that one out of three competitors have now followed our price adjustment done last year. I am fairly positive about our trends in B2B, where we show good growth. I'll come back on the later stage on that one, and it's primarily driven by our strategy to move into the business solutions that has been now starting to pay off with almost 30% revenue increase compared to Q1 2015. Also to strengthen our position in the market, we have been awarded by Crystal [unclear] about our call centre as a very innovative one, which I am very proud of, and we are being the best call centre in Kazakhstan in many aspects.

Let me remind some key strategic priorities. Firstly, like I already said, we are working on the LTE commercial launch and the network rollout. We have almost done with our network tender, which allows us to do it, and we also update you on the latest capex increase for that, but Trond will come back in the later stage of the presentation. Secondly, we will continue working on the B2B side and further increase our presence in the solutions part, as well as being very competitive in the traditional mobile services side.

One of the key areas this year has been improvement of data quality, especially in the urban areas. As you'll remember, last year we had very tough competition with a lot of allowances increased on the data side, which of course put a lot of pressure to our network, and this year we have been improving our network quality, primarily in Almaty and Astana region but also in other urban areas, where the consumption increased a lot. And alongside with that, I am also happy to say that we have introduced our new content line, if you may, including television, music services and a Bookmate service – which is basically on-demand books – quite successfully. We have tens of thousands of customers using it, but of course these are not the mass products yet so we need to work further on that direction. So all in all, I would say a lot of good foundational topics that we have been moving forward in Q1.

Moving into the financial results, which we are not happy about but they very much reflect the market reality we are operating, both from the macro as well as the competition point of view. So Trond will talk us later on to details, but let me start with the service revenue, which is the primary focus for us. Then compared to last year we see a 15.7% drop, which is primarily driven by the tough competition and moving from pay as you go to bundled tariffs with very high speed. Also one might remember that Q1 last year was very much the quarter where Beeline

didn't react yet on to smaller players' price war. It started in Q4, so that's why we – sorry, Q2 last year, so that's why we see a very strong Q1 last year. On B2B side, you can see though the percentage is not big yet, but it's starting to approach 10% of our revenues with the increase of 33% compared to last year.

One other point, I'd like to draw to your attention to the subscriber numbers, where we lost over 500,000 subscribers in Q1. This is driven by two reasons. So firstly, there is tendency in the market to drop the second SIM card, while the bundles now everybody offers offnet minutes, and also it reflects our higher price levels for Q4 and Q1, while the competition hasn't followed yet but we hope happening now in Q2.

So moving to the last slide, let me summarise what I told before handing over to Trond. So we don't see any significant market recovery yet, though the early signs with Altel are very encouraging. Secondly, the B2B share is doing good, being almost 8.1% in Q1, and quarter-to-quarter growth is quite significant. So on LTE part, it will be the game changer this year, meaning that not only one operator in the market can enjoy this technology but all operators will cover, most likely, at least the urban areas or bigger urban areas in the country, and the last point I want to just emphasise is MNP, which was launched in January 2016 and has resulted 0.3% net port-out from Kcell with the slowing down trend in later part of the quarter.

So by saying that, I am giving the word to Trond before we enter into Q&A and I am happy to answer questions then.

Trond Moe: Thank you, Arti. Let's then dive into the financial numbers, starting on slide 6, where we first look at our revenue trend. As Arti mentioned, our net sales were down quite a lot year-on-year, 17.7%. Net sales of course is the very top line; that includes also handset sales, which were down by 41% actually from a year back as handsets became very much more expensive in local currency in Q1 this year.

Then moving to service revenues, which is the main line that we follow on revenue that is revenues excluding handsets. That also fell substantially year-on-year by 15.7% to an amount of KZT 33.5 billion in Q1 this year. The reason for this is, as you probably know, that in the second

half of 2015 we were very much affected by both a price war and a severe macroeconomic shock with a devaluation much bigger than what was expected. This hit us very hard in Q3 last year, and we moved then to a lower margin level than what we have had before and in a territory where we still find ourselves in Q1 this year.

Comparing then quarter-on-quarter development from last quarter, Q4 of last year to Q1 of this year, we were affected because we did adjust our offerings in Q4 by reducing offnet allowances, which successfully stopped the increase of interconnect expenses but also led to us becoming less competitive in the market, which started then to affect our subscriber numbers, and this effect we have seen in Q1 as well. Moreover, in this quarter our revenues were affected by the reduction of MTR – mobile termination rates – from KZT 8.00 to KZT 5.00 per minute, which took effect January 1 this year. That, in itself, led to a reduction in interconnect revenues of KZT 2.3 billion in this quarter. The other part of service revenues is then billed revenues and the drop here, which was mostly explained by the subscriber drop, was KZT 2.1 billion. The subscribers we lost were mostly in the lower price segments, which is more price-sensitive during these difficult economic times we see in Kazakhstan now. We also saw some drop in ARPU, which is due to the continued price pressure in the market.

Moving on then on slide 7 you can see our data usage and revenues. We see that data revenues remained fairly stable year-on-year, mainly as a result of the pricing pressure and an increase in bundled packages. So even though traffic data increased, prices remained stable.

On slide 8, some of the operational statistics underlying what I have just said you can see. I will not comment further on this, but can take questions later on, if you like.

On slide 9, you see then the summary of our financials for the first quarter and, as Arti already highlighted, our performance reflects very much the challenging environment in which we have been operating. Intense competition combined with an extremely weak and volatile macroenvironment has again resulted in severe pricing pressure, and this has impacted both our revenue and earnings.

Moving on to slide 10, let's take a look then at the profitability and the EBITDA development and the interconnect balance, which has been very much in focus in the last quarters. As we have already discussed earlier, our EBITDA and EBITDA margin decreased year-on-year, and as I already mentioned, Q3 last year saw a trend shift for us, and in Q1 this year we continued to see some weakening of our margin. The MTR rate drop that I mentioned had a negative effect on revenues, as I said already, but it also had a positive impact on our interconnect costs. But that, however, did not fully compensate for the reduction in revenues, as we still have a negative interconnect balance with the other telcos in Kazakhstan. That balanced out – improved significantly during this quarter, mostly due to a reduction in our offnet traffic but also due to an increase in traffic to our network from the other mobile operators, as they too now have increased the amount of offnet minutes in their packages.

On the costs side, I want to mention cost for subcontractors, which is mainly support and maintenance. This cost was very low in Q4 last year, due to some year end savings that we realised with our main vendors. We also had savings in Q1 but this was negatively affected by the continued steep currency depreciation we saw in the beginning of this year, especially in January. We did have also some cost increases in our network capacity due to increases in leased transmission capacity as our traffic grows, and added yearly licence fees on our new LTE spectrum.

On slide 11, we take a closer look at the support and maintenance cost savings that I mentioned. These are predominantly denominated in foreign currency and we did have a pretty big devaluation effect on those costs. At the same time, however, we successfully implemented a number of cost saving programs that almost fully compensate for this increased cost due to the devaluation, so this we are quite happy about.

On slide 12, then let's move on to capex. 80% of these are also in foreign currency, but here also we have managed to be very prudent and careful during last year and continue into this Q1 of this year. So even though our network traffic, especially data, increased quite a lot and capex prices increased also a lot in local currency, we have kept the capex level at a fairly modest level in order to safeguard our cash flow as much as possible. We will continue this approach this year and we will realise substantial savings by modernising and optimising our network, which we are

doing simultaneously with the LTE rollout in the second half of this year. We have earlier communicated that the capex part of LTE should be fairly modest since we utilised the upgrade – or we upgrade our existing network in a maximum smart way for this. We have now completed our homework on this and made our LTE rollout plans, and we now estimate that LTE capex for this year will be around KZT 5 billion.

Then on slide 13, dividends. The Board of Directors did recommend a dividend payout of 50% of net income of 2015. Our dividend policy states minimum 70% of net income, but taking into account available cash flow and strategic investments. This year, available cash is limited due to the LTE spectrum purchases of KZT 26 billion and also the LTE related capex that I mentioned. Also, our borrowing capacity is limited by our net debt to EBITDA leverage target of 0.5 to 0.9, and we estimate that we will be close to the upper level of that corridor by the end of this year. I would like to mention that our dividend policy remains in force, and this year should be seen as an exception due to the strategic LTE investments.

So I think that completes our presentation so far. I want to conclude only with some comments on the outlook for the rest of the year. It is quite difficult today to give an accurate outlook for full year results, given the uncertain economic situation in Kazakhstan and the continued tough price pressure in the mobile market, which has not really recovered yet. So at present, what I can say is just that we expect both service revenues and EBITDA to be – EBITDA margin to be at a lower level than in 2015. Capex, there we have more visibility. We believe we will be about at the same level as in 2015 in absolute terms, plus the LTE spectrum acquisitions and LTE capex of, as I mentioned, around KZT 5 billion. So with that, I will hand over to Irina.

Irina Shol: Thank you, Trond. Operator, now we are ready for the Q&A session. Thank you.

Operator: Thank you very much. Ladies and gentlemen, if you would like to ask a question at this time, please press the star or asterisk key followed by the digit 1 on your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find your question has already been answered, you may remove yourself from the queue by pressing \*2. So once again, please press \*1 to ask a question. We'll pause for just a moment to allow everyone to signal.

Our first question comes from Kalim Aziz from Duet Asset Management. Please go ahead.

Kalim Aziz: Thank you very much for the call. I have questions relating to the funding side firstly, secondly on the margin side, and the third on the capex side. So with respect to your dividend, which you say that a cut of dividend below the stated policy is essentially a one-off, was there an issue with respect to liquidity in terms of trying to borrow money from the market, because the leverage still looks manageable? And if so what was the hurdles and why – given that tenge has already devalued to KZT 350 to a dollar, KZT 340, KZT 350 to a dollar, what are your thoughts about dollar funding or borrowing in dollars rather than tenge? Please could you talk about that first, then I can ask you a bit more about the margins.

Trond Moe: Yes. On the funding side, we do borrow so far only in tenge, and tenge is – there is limited availability of tenge funding in the market, so this is a difficulty. It's not impossible to obtain more funding, and we do plan to increase our funding somewhat this year, which we need in order to support our LTE payments. We believe we can increase the leverage by about KZT 10 billion, moving from KZT 50 billion to KZT 60 billion. That is possible but going below that, we have explored in the market, that will be difficult.

On dollar funding, yes, of course, tenge funding is expensive now, at a cost of roughly 19% to 20% in the market. If the currency will continue to be stable against dollars, that could be a possibility. But we do believe it's too early to make that conclusion, as there is still volatility on the currency market and not complete visibility whether the currency is actually really floating. So we will wait on that one. It's too risky at the moment to do dollar funding, but it's a question that we monitor and may come back to in the second half of the year.

Kalim Aziz: Sorry, so what is the cost of – if you were to go and borrow in dollars, what would it cost you? You said tenge is 18% or 19%, right?

Trond Moe: That is difficult to say because that depends what kind of funding we would have and what kind of risk profile. But it would be a LIBOR plus, I don't know, 3% or 4%, I would estimate today.

Kalim Aziz: Okay, so is that one of the reasons for the cut in dividends?

Trond Moe: Yes. The cut – no, the cut in dividends is simply cash flow and leverage where, as I said, we will with our current plans probably hit the upper end of the leverage target. That is also part of our dividend policy of 0.5 to 0.9 net debt to EBITDA.

Kalim Aziz: Okay, so you also mentioned that the EBITDA margin will be less than last year. Last year it was 49%, but that is not – 48.6% was the last year's EBITDA margin but that is based on a very good EBITDA margin in the first half and deteriorating EBITDA margin in the second half. So when you mentioned that the dividend margin will be lower this year, are we talking about levels similar to what we've seen in the first quarter or are you expecting any improvement from that level to end up with about 45-46%? What do you mean by...?

Trond Moe: This is very difficult to answer because there is so much uncertainty both on the macro level and on the competition level. We do hope that the market recovers in the second half of the year, and then we might see some improvement in margin compared to what we have now. But it's also possible that that will not happen, and then we will not see improvement from the level we are at now. So that's why we can't say anything more accurate, unfortunately, than that.

Kalim Aziz: Okay, the trickier – or a difficult question, if I may, now with respect to the relationship that we have with – that Kcell has with its majority shareholders, any thoughts or any developments on that front? Will it change the way this business is run? Will it change the way that this business or Kcell has its relationships with the minorities because the parent has a different indication? Do you know what is the status on that front? Have they done due diligence on you again or more, or is that a transaction in the offing within this year?

Arti Ots: Yes, so let me take that question. Firstly, we can only say what Telia publically said, and then today on the call they referred that the divestment is going according to the plan. So as we are publically traded, we are not actually part of these discussions. When it comes to operations, then we continue operating very similarly as we operated last year. We get the



support from the Group in the areas where we had needs, and also there is no changes in the way the company is governed.

So my short answer to it, that Kcell continues to operate as a stock listed company with the majority shareholder as Telia, but no real changes on that front, and we actually don't let too much of the sales process to affect the daily operations, because it gives the wrong incentive to employees. Then everybody starts waiting that something happens, and we know that these kind of deals happen when they happen. So we as an operational management only focus on the goals and basically now preparing that the market starts to recover, which should be then also positive both on the customer side as well as on the profitability side of the business. So this is what we do – we operate normally.

Kalim Aziz: Thank you very much.

Operator: Ladies and gentlemen, as a reminder, to ask a question at this time, please press \*1 on your telephone keypad now. We take our next question from Askar Akhmedov from Halyk Finance. Please go ahead, your line is open.

Akhmedov Askar: Hello, Askar from Halyk Finance. I just wanted to ask if you know about any further reductions in the interconnect rate that, as you said, was down by KZT 3.00 starting from this year, and do you expect any further reductions in this rate in the next years?

Arti Ots: Thank you for the question, Askar. Firstly, there might be somewhat reductions in the MTRs, though we are not discussing it at the moment. There are a few important aspects that actually influence the discussion around the MTRs. So firstly, in Kazakhstan the operators should agree, and right now we have agreed MTR of KZT 5. Also when we look the neighbouring markets, then the MTR starts to be in parity with the MTR we have in Russia, with the MTR we have in European countries, similarly to Uzbekistan. So I think that we have reached the right level of MTR by KZT 5 on this market situation, and also you see that the MTR allows all operators now to offer the products with offnet minutes included. So my analysis is that there is no need to go further down on MTR, but if it happens, it's rather very limited from now on.

Akhmedov Askar: Okay, thanks for that. Just another question. So we see that traffic is continuing to rise very quickly, and at the same time the rate per megabyte falls down as quick. So basically, the data transfer revenues, are they stable? What are the company's plans maybe, or how it's planning to increase the revenues, if it's planning at all?

Arti Ots: Yes, so here the answer is very, very simple. If you look how the market is structured right now, then the start level bundles start in Kazakhstan with 10 gigabytes. If you go to any other market, then this is rather higher end bucket size, and in order to start recovering from that one, we need to introduce, as a whole market, data buckets starting from 0.5 and 1 GB and then moving up to 10 and then perhaps 20 GB for very heavy users, with high price.

So this is the way out of it, but that requires that the whole market actually appreciates this move, because there is no business model to monitor this data otherwise. So we are following the market. Of course, we can't make ourselves only non-competitive. But as moving forwards, as an industry, we can't afford having these price levels, and at least in public words, probably you have seen it yourself, all operators actually understand that. Now is the question how to explain it to the customers as well, after so tough almost one and a half year running. So that's going to be very, very difficult.

Akhmedov Askar: Regarding that question and your words, we see Altel, that it abandoned its unlimited data plans and also rose, it has risen prices for – sorry, raised prices for its tariffs. So is that a sign of what you are saying, that the market is trying to pull back on these very generous tariff plans?

Arti Ots: Yes, I believe it's the right sign, because it's basically Tele2 who is raising the prices, not Altel, though the Altel brand in a way is not of course the mass brand for the new joint venture, and you are very correct in your analysis that the levels we see now, they're still pretty generous, but these are the levels that also when people start to use the full allowances, allow operators to maintain the investment capability. So my hope is that we're seeing the first steps. Also we're seeing that the market reacted quite strongly. So the consumers, once you get used to some tariff levels, you are of course not extremely happy to see such moves.

Akhmedov Askar: Thank you very much, that's it.

Arti Ots: Thank you, Askar.

Operator: Our next question is from Maria Sukhanova from Sberbank. Please go ahead, your line is open.

Maria Sukhanova: Yes, hello. My question is about SG&A costs. So you mentioned in the press release that the increase that we saw in the first quarter is because of the staff costs, so maybe could you elaborate on this in more details? So you had some taxation or this increase in headcount, and also how sustainable is this increase? Should we see it throughout the year? Thank you.

Trond Moe: Yes, we in fact don't have really an increase in headcount. We keep it at a fairly stable level now on a net basis. We have some increases in new business areas but we also try to optimise and decrease in some other areas. There is a little bit increase in expenses due to some devaluation effects and bonuses and things like that, but we try to keep headcount very stable. On retail, of course we have some increase in headcount because we are opening, on a limited scale, shops on our high end Kcell brand but that is not anything significant.

Maria Sukhanova: Okay, so you mean that this increase is more like a one-off, right; this is because of bonuses. So we shouldn't see this gaining throughout the year?

Trond Moe: Yes, that is correct.

Maria Sukhanova: Okay, thank you.

Operator: Our next question is from Regina Galimova from Credit Suisse. Please go ahead, your line is open.

Olga Bystrova: Yes, hi, this is actually Olga Bystrova from Credit Suisse. I have two questions. One is about the approved purchase of KazNet Media from TeliaSonera which I think the Board approved in October. I want to understand how likely that you will have to make that

acquisition, or this is definitely out of the question, that you will have to – it's a liability for you at this stage. And the second question is on capex. It looks like you're thinking about capex now in two tranches. One is for maintenance and one for LTE. I would appreciate if you could suggest how much in total do you think you will have to spend this year, both on maintenance and LTE, or at least suggest how much total for LTE you're expecting to spend and over how many years. Thank you very much.

Arti Ots: Yes, thank you for the question. Let me start with KazNet Media. On the KazNet Media side, we have now paid \$5 million for the first tranche, and the second tranche will be paid when those frequencies which are on the 2.6 band will be available for use for LTE. As of now, firstly, the regulator is not allowing to use those frequencies for LTE, and we are working on it but it might take a year to two to complete that work, and the primary reason why the regulator is not allowing to use those frequencies on LTE is that they are still also in the hands of non-mobile companies and it wouldn't be good if there will be LTE without payment to government. But we continue working on that direction, because in future this is very lucrative bands we have there. But we pay only after we get approval from the government to use those frequencies, and the reference we have said is more the reference price, as the band is more similar to 1800 bandwidth purchase. So we believe that this is the reference to look into while trying to understand what's the potential payment.

I hand over to Trond to the capex part.

Trond Moe: Yes. Just to be clear, on capex, we say that the, let's say, first tranche of the capex, if you like, would be about the same as last year, which is about KZT 19 billion. Then we need to add KZT 5 billion for LTE capex this year, so let's say KZT 24-25 billion, because we say around KZT 5 billion and then we need to add also this year the spectrum acquisitions of KZT 26 billion. So that's all.

Olga Bystrova: Okay, thank you very much for two answers. Just two very quick questions clarifying these answers. One is on the KazNet Media. So what I'm hearing is that you think it most likely will be a liability for you over the next two years, you think it's worthwhile working on net neutrality in that band. Is that correct?

Arti Ots: Yes. It's worth definitely working on it because, like I said, it's a valuable band to use as addition to existing bands, and then we can say that we are on the safe side also and futureproof for data services. But how long it's going to take, we really don't know, but we are good right now with our existing frequencies.

Trond Moe: And on the financial liability, let me just add here that the maximum \$70 million mentioned for the second tranche is of course an upper limit, and what the agreement does say is that we shall pay for those frequencies if and when they become available at a market rate or at fair valuation, and in that respect, if you calculate the fair valuation, you should look at the other awards that were done recently and also the 1800 band that was awarded just now in Kazakhstan for KZT 4 billion. So this is of course much lower than that upper level that is in the agreement.

Olga Bystrova: Okay, thank you and on LTE, this KZT 5 billion LTE capex, you think it will be – should we take that into account for the next 3-5 years for your rollout, or this, you think this year will be a big LTE capex year?

Trond Moe: No, we can't really comment on years beyond this year on that. That is too early to guide on capex for year 2017 and further, so we will need to come back to that towards the end of this year.

Olga Bystrova: Okay, thank you very much.

Arti Ots: Thank you.

Operator: There are no further questions at present but I'll give a further reminder that if anyone wishes to place a question, please press \*1. And just to confirm, there are no further questions at present so I'd like to turn the call back to you for any additional or closing remarks. Thank you.

Irina Shol: Thank you very much. That concludes the conference call for today.

Arti Ots: Thank you.

Irina Shol: Thank you and goodbye.

Operator: Thank you, ladies and gentlemen. Just to confirm that this now concludes today's conference call. Thank you for your participation. You may now disconnect.