

Company: Kcell
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Presenter: Irina Shol
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Operator: Good day ladies and gentlemen and welcome to the Kcell Interim Results for January – June 2016 Conference Call. For your information today’s conference is being recorded. I would now like to hand the call over to your host, Irina Shol, Head of Investor Relations, please go ahead.

Irina Shol: Thank you operator. Ladies and gentlemen, good morning and thank you for dialling in to discuss the Kcell Second Quarter 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 our IR section in our website. Participants in the call today are Arti Ots, our CEO; Trond Moe, our CFO; and myself, Irina Shol, Head of Investor Relations.

Following our presentation there will be Q&A session. Now I will hand over to Arti. Arti, please go ahead.

Arti Ots: Thank you Irina, good morning dear ladies and gentlemen and very warm welcome to our Q2 and First Half of 2016 results call. So let me go straight to the slide number 2 and walk you through the main events during the Q2. So we have been talking past six months about the first early signs of the market recovery and I'm very happy to say that now those early signs what we saw have actually started to materialise. So this is broadly reflected on our Q2 Financial Results where you see that compared to Q1 we have a slight increase in net sales and also in service revenue, while last year in the same period from Q1 to Q2 we had a slight decline. So the market has recovered a little bit. Of course the offers in the market remain generous in our point of view, especially when it comes to data allowances but at least for the new customers and for existing customers all three operators now in the market have increased prices. That has led to stabilisation of our market share. We even saw very slight increase in

June of our market share, so all the signs are very positive. When it comes to more of our own operations then we have gone through quite extensive technological upgrades during Q2, firstly we already over a year prepared billing migration, that's during first days of July but also we have upgraded our packet core network and we have made all the necessary preparations for LTE roll outs, we will be speaking about it a little bit later in the presentation. And lastly, from the positive side KASE, Kazakhstan Stock Exchange gave us the award for striving towards the greater transparency, which of course has been our goal all the time, both from financial point of view but that's the way as we operate.

So a few points on the low sides. We still lack behind the LTE coverage. We had plans to catch up within Q3 and Q4 to close this gap and the second thing which is very important for our business is that we see a slowdown of the demand of handsets that eventually will also slow down the data growth. So this is a very broad summary of Q2 results, so let me move to the next slide with our priorities, obviously as you all know we got the license for LTE early this year and we have been actually preparing throughout the last year and this year our network for LTE commercial launch. We have plans to do it in Q3 and further in Q4. The second strategic priority remains on B2B, currently we have 8% of our revenues coming already from B2B with a growth, year-on-year growth over 20% and it's primarily driven by the business solutions, so we see also similar trends on the core business on B2B side as we see on the consumer segment, we have heavy price pressure from competition, but it's very well compensated by the solutions on the B2B side. The third important point for us is data network quality, especially in the urban areas but now we have widened it a little bit. We have introduced third and fourth area in most congested sites for 3G and obviously by now we have also test networks of LP all over the Kazakhstan and some significant roll out already in our biggest city Almaty.

Last but not least we have been heavily focusing in Q2 to regain subscriber growth and I walk you through in upcoming slides what we have concretely done for that purpose. So moving to next slide, it's a bit of a side walk from our normal presentation. As you all might recall we acquired KazNet Media, the company that has licenses for 2.6 GHz band which can be, in the future used for LTE services but at the moment we are in the process of consolidating that company and that has both positive and negative effects. The company itself is operational at the moment and we are in the process of transforming that business to minimise the impact and

for financials in upcoming quarters and to make sure that we follow the license obligations to keep these frequencies available for the future, but Trond will comment more when we come to financials but just to say that we have finished the transaction, we are consolidating the financials and we have the transformation plan in place to move forward.

So moving to financials, on the high level, we are heavily impacted still by both macro-economics as well as the tough competition in Q2. This is especially reflected to our EBITDA but also to our service revenues which is down by 15.51% compared to Q2 last year, but up a few percentage points when you compare to Q1. EBITDA margin is 39.4, here we have already slight impact from KazNet Media and without this impact our EBITDA is slightly above 40%. The good news here is that the data revenues are growing, the increase is not so big about 3.8% compared to Q2 2015 and also we have stopped the heavy bleeding on our subscriber base and the decline of subscriber base was 107,000 during the quarter, with positive signs on the further end of the quarter.

I mentioned B2B revenues, 2.9 billion, already 8% of our total revenues and increased 22.6%. On the next slide you see our H1, 2016 summary with very similar trends like in Q2, so I leave Trond to comment further on that.

So now let me walk you through some of the activities that we have done in order to turn around the trends of subscriber numbers. Firstly, we have now launched new tariff line, bundle tariff line, our flagship tariff line Active which is primarily focused on data and have less off net minuting which should have a positive impact and we already see its two hour interconnect balance. Another important strategic step we took is moving to the lower end segments, the segment that's primarily wireless voice but also wants to use a limited amount of data, so we launched during the quarter tariff line called Conversation, which the monthly fee is 590 but of course the ARPU from these customers is far higher because of the usage of data as well as the other services. This tariff line especially works well for feature phone users and under this tariff then we see that 60/65% of all users actually use feature phones. Also important to note is that we closed subscription to Hello Kazakhstan and also removed the PSTN from the offering which will have again a positive impact on our interconnect balance.

Moving to the next slide you see what we have done on the distribution side, we started promo distribution with small amount of balance, customers need to top up in the low market share regions. This has been relatively successful with 51% of the customers remaining after their second month, so this is more or less on the level of what we expected and the team is working hard to remain these customers into our network and grow them further into the data users and eventually our bundle of our customers.

The second important point that we started earlier this quarter was expansion of our sales network. Of course it will not have near as much impact as we are present in most of the popular places but just to increase visibility we have now increased our point of sales during the quarter by 2,500 points and we expect also this to have a good impact to our subscriber numbers as well as the revenues going forward. Lastly, we also started direct delivery to the end corporation with consumer electronic change which in Kazakhstan represents the majority of this smartphone sales so we want to be present also in this channel and we already have close contact with two companies on that side.

Moving forward on the consumer segment, as you remember we announced in February our new line of OTT services, here you see our earlier results on that. We have all the services, paid services, with a trial period, here we have an overview how many TV customers, music customers and very successful book reading service customers we have, so respectively we have 11,000; 29,000 and 15,000 customers in our OTT range. This is the area that is not contributing so much to the revenues yet but we will leave it, definitely a cornerstone of our future strategy and a source of differentiation in the market. By saying that I would like to hand over to Trond and I will be available for questions later on in the presentation.

Trond Moe: Thank you very much Arti. If you then move to slide 10 and look at your revenue trends. I'm quite happy to report that for the first time in a long time we actually see an increase in our revenues quarter-on-quarter. It's not big, but we do believe that this may be a trend shift following the market consolidation and early signs of pricing recovery, especially in the lower price segments. On our B2B revenues you see that this did not increase as much as earlier following tough competition also in this segment but it is developing very subtly compared to a year ago and we continue to have a very strong position in this segment.

On slide 11 we look further at the revenues and the contribution to growth from our data services. In the second quarter our data traffic increased with quite a lot compared to a year ago, up 117.7%. Our smartphone penetration again increased and reached a level of about 45% at the end of the first half for this year. We're very happy to report that data revenue increased this quarter on a quarterly comparison and also on a yearly comparison reflecting the signs of the market improvements that I just talked about earlier.

On pricing, data pricing per MB is still very low on Kazakhstan with abundant data packages still being offered by all operators but on a positive note we see that the pricing has remained stable over the last quarter and this is not falling anymore following the move from Pay as You Go data pricing to bundle packages which has stabilised now.

Then moving to slide 12 we can take a closer look at our operational performance. You will see that the minute per usage increased to 229 minutes in Q2, that's an increase both quarter-on-quarter and year-on-year. Just to remind you prepaid subscriptions are counted if a subscriber has been active during the last three months. Total voice traffic, just a second, I will move to ARPU because ARPU you can also see an increase and this is very positive on a quarter-to-quarter basis. It's still lower than last year, however. You probably remember that at Q2 last year we had not yet been exposed to the most heavy price competition that really started to have an effect in the second half of that year.

Q2 average pricing per minute is exactly the same now as a year ago and we do see a slight increase from the previous quarter reflecting an adjustment in pricing and less off net minutes being offered for six monthly prices. Subscriber numbers also show a positive development, it is a slight decrease quarter-on-quarter, but that is all due to a decrease in April, whereas the two last months of the quarter, May and June, has actually showed a slightly positive development in subscriber numbers for Kcell.

Then moving to slide 13, you will see a summary of our financial highlights for the second quarter and first half of 2016. I'd like to remind you here that these numbers now include the consolidation of KazNet Media which had a negative effect on first half EBITDA of

KZT 307 million. The full effect of this consolidation is booked in Q2 but on the next slide we show how this affects operations split on the two first quarters. So on slide 14 we show this effect. You can see the consolidation effects split from Q1 and Q2. The negative EBITDA effect on consolidating KazNet Media is KZT 134 million in Q1 and KZT 173 million in Q2. Going forward as Arti mentioned these negative effects will decrease.

Since we do not restate our Q1 numbers in the reports, the combined effect of these two quarters which is KZT 307 million is booked in Q2 and reported Q2 EBITDA margin is therefore 39.4%.

On slide 15 we show you our capex development. You see that capex in Q2 is relatively low compared to our usual level but this reflects a delay in the first phase of launching our new billing system which was moved from Q2 to Q3, actually happening now in July and it also reflects the fact that our EBITDA roll out will happen in the second half of the year. So that means that the second half capex will be higher than the first half and our full year outlooks on capex remain unchanged. On slide 16 as we reported earlier, the company's dividend policy aims for the distribution of at least 70% of the company's net income for the previous reported year but taking into consideration available cash flow and strategic investments and as you know this year we had significant cash outflows for the acquisition of 4G spectrum and a dividend for 2015, we therefore decided that 50% on net income and this will be paid out according to plan in the beginning of August.

On slide 17 very briefly the legal overview, you can see an update of two cases that we have reported on earlier. On the Daytime Unlimited case the new billing system now being launched will close this issue going forward. And on slide 18 on subsequent events, we are happy to report that we have rolled over and increased our main funding facilities as earlier tranche. In general funding in local currency has become a bit easier in the market and we currently have no issues on the funding side.

So that concludes the actual presentation. Let me just mention that our outlook for the full year remains unchanged. This means that we believe service revenue for the full year will be below 2015, the same goes for EBITDA. Capex will be slightly higher than 2015 plus in addition the

capex for the 4G frequencies which is KZT 26 billion and the 4G roll out which will be around KZT 5 billion for this year. So with this I'd like to hand it back to Irina.

Irina Shol: Thank you Trond. Operator we are ready to take questions now. Thank you.

Operator: Thank you. Ladies and gentlemen if you would like to ask a question please press the * or asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has already been answered you may remove yourself from the queue by pressing *2. Again please press *1 to ask a question. We will pause for just a moment to allow everyone to signal.

We will take our first question today from Maria Sukhanova of Sberbank, please go ahead.

Maria Sukhanova: Yes, hello, about price increases in the market that you mentioned. How do you think when we will translate in revenue growth and should we already expect revenue growth this year or is this like the story of 2016? Thank you.

Arti Ots: Thank you for your question. We expect the price increases to have impacts on the second half of the year as we said earlier. The magnitude of course is not clear yet because what we have seen happening in the market after all operators have increased prices, the consumers have adjusted their spending a little bit but on the positive note when it comes to our customers, then we see a positive up sell actually from our former tariff plans to the new tariff plans, so we actually see a slight up sell in our base but when it comes to market overall I believe that it takes a few months for customers to basically get used to our new price levels, but some recovery already this year.

Maria Sukhanova: Okay, thank you.

Operator: Thank you. Ladies and gentlemen as a reminder to ask a question please press *1. We will now take a question from Anna Karazhan of VTB Capital, please go ahead.

Anna Karazhan: Yes, hello, thank you for taking my question. I would like to clarify when do you expect to reverse this negative effect on EBITDA from KazNet Media consolidation and could you explain the nature or why the costs of KazNet Media exceed the revenue? Thank you.

Trond Moe: Yeah, let me answer that. KazNet Media is a company providing WiMAX services in Kazakhstan. This is not any more a profitable business and the revenues are declining from that company. However, on the cost side they have some operational costs which we are now reducing so gradually towards the end of the year those will be reduced significantly. However, there are some cost elements which is the fees for the spectrum which will not go away and we need to keep this business operating also commercially but at the minimum level with the only, let's say, significant cost being the yearly spectrum fees and this is exactly why we acquired this company to keep these frequencies available for the future. So I can't give you an exact amount but towards the end of the year we should see a significant reduction in this negative EBITDA impact.

Anna Karazhan: Okay, thank you.

Operator: Once again, please press *1 to ask a question. Our next question today comes from Artem Yamschikov of Renaissance Capital, please go ahead.

Artem Yamschikov: Hello, thank you for the presentation, one follow up question on KazNet Media. When approximately do you expect to get permission to use these frequencies for LTE services and regarding second tranche have you already paid it or will you pay it in the future and how much will it cost you?

Trond Moe: Yes, so let me take the first part of the question first. We are in contact with the regulators, currently it's not allowed to use these frequencies for LTE services though it is allowed to use it in many other markets, so we are in contact with the regulator. We are not in a hurry though to solve this issue as some of these frequencies are still also distributed for the companies that are not operating under the mobile communications license, so for us it's important to of course get this cleared up soon, but also with the clear clause that the other parts of these bands should be cleared and not be used for LTE for various reasons. So it might

take another year but why we are not in a hurry is that we have currently enough frequencies to serve our customer needs and our projections say that we need to take this band into use in a few years' perspective so we are not in a hurry, very strategic moving forward. When it comes to the second tranche it's been agreed that the second tranche will be paid out after we can use those frequencies for LTE services and the amount is not specified though it's agreed that it will be market price and on the time, I'm not going into the details how the market price will be calculated but...

Arti Ots: It's capped upwards at the maximum on \$70 million but the important fact that it will be based on share market value based on independent valuations.

Trond Moe: Yes, after we get the use of these frequencies.

Operator: Thank you. Our next question comes from Oxana Lyalina of TRP, please go ahead.

Oxana Lyalina: Good morning, thank you very much for the presentation. I wanted to ask you, do you have any view how much money do you need to spend on the 4G roll out next year, you mentioned it's 5 billion this year, that's right? Thank you.

Arti Ots: Yes, as we have been speaking before the current network equipment is not anymore that much related with technology so next year might not be in position to comment next year, but it will definitely not stick too much out from our next year budget and it will be covered through our normal network roll out. Let me also remind you that we are undergoing many technology upgrades, primarily the billing system this year that occupies a large proportion of our capex, so that of course we don't have next year, so all in all, it shouldn't have the significant material impact for our next year capex.

Oxana Lyalina: So it's 5 billion for the second half so it's kind of fair to assume that it's double of that next year?

Arti Ots: I am not commenting on that extent but like I said it will be part of our normal capex, so it's not going to have, so definitely this year it was a little bit more of the extra project but for next year we consider it as business as usual, network modernisation including LTE.

Oxana Lyalina: Okay, thank you.

Operator: It appears we have no further questions at this time.

Irina Shol: Thank you very much, that concludes our today's presentation. Thank you for dialling in and participating. Thank you and goodbye.

Arti Ots: Thank you, bye.

Trond Moe: Bye, bye.

Operator: Thank you. Ladies and gentlemen that will conclude today's conference call. Thank you for your participation, you may now disconnect.