

**Company:** Kcell

**Conference Title:** Q3 2016 Financial Results Announcement

**Moderator:** Irina Shol

**Date:** Friday 21<sup>st</sup> October 2016

Operator: Good day and welcome to the Kcell Q3 2016 financial Results Announcement.

Today's conference is being recorded. At this time, I would like to turn the conference over to Irina Shol, IR. Please go ahead.

Irina Shol: Thank you, operator. Ladies and gentlemen, good morning, and thank you for dialling in to discuss Kcell's third quarter results. During today's call, we will talk you through the highlights of our business and financial performance for reporting period using presentation slides, which I hope you have in front of you. If not, please visit the IR section of our website. Participating in the call today, Arti Ots, our CEO; Trond Moe, our CFO; and myself, Irina Shol, Head of Investor Relations. Following our presentation, there will be a Q&A session. I will now hand over to our CEO, Mr Arti Ots, for his comment. Please, Arti.

Arti Ots: Good morning and good afternoon, ladies and gentlemen, and very, very warm welcome to our Q3 results call. So let me start straight away on slide number 2, where we update you on the recent progress and challenges in Q3. So, first of all, I'm happy to announce that the second quarter in a row, we see a top line growth, both on the

revenues as well as on the service revenue side, which is what we can call an early sign of the improved market conditions. This is very much supported with the second point, which is stabilisation of the market share, namely subscriber market share with a net intake in the quarter of 157,000 new customers compared to Q2. Also, it's new era for Kcell with now LTE being available in 11 cities in Kazakhstan and partially due to our network sharing agreement with Beeline that we announced earlier this quarter. And lastly, I want to mention the billing migration, which is always very challenging for any operator. And so, we faced some challenges throughout the quarter, but I'm happy to announce that now we have a stable situation. And we hope that our customers can now, more safely and with more options, move forward to the end of the year.

Still, there are a number of challenges in the market, and the marketplace itself remains relatively intense with – when it comes to the competition. We saw earlier this quarter, again, new offers – aggressive offers in the market with Beeline launching the unlimited LTE offer on their higher bundles, and also, connect[?] to Altel coming up with the more aggressive offers. Though it's limited at the moment until the year end, so we hope that it's not going to be a start of the new intense price competition.

On – when it comes to the customer, then we see that it's primarily coming from the lower end segments, and that's the main reason why also the ARPU levels in the quarter remained relatively flat with small increase due to the upsell of our very popular plans.

And I come back a little bit later on that point.

When it comes to our key priorities on slide number 3, you can see that now when we have customer intake, basically, the number of months in a row, the main focus goes to the wallet share and the ARPU stabilisation. So that's where we see the biggest opportunities at the moment. Secondly, we need to finish our LTE rollout together with our partner Beeline in 12 cities this year – what we want to cover fully. Also, as you see, the B2B solutions share is increasing and also compared to last year, we see very healthy growth. Quarter-on-quarter, though, we are relatively stable. Number of service show that we have better quality of our internet or data services in the cities where we put a lot of focus of our CapEx this year and really to meet our customer expectations. And, of course, continue to work with customer base and increase the numbers.

Moving forward to the financial results, so firstly, to the Q3 results, you see the net sales declining 13.6% year-on-year. And it was even bigger EBITDA impact with a decrease of 25.2% year-on-year. As you might recall then, last year in Q3, Kcell answered the competition with bundled offers and now moving forward in next quarter, we see, of course, a little bit different comparable base. When it comes to EBITDA margin, it was 38.6%. Trond will go more into the details – our CFO – later on in the presentation. But it primarily reflects the market situation we are currently in.

Going forward to the B2B revenues, as I mentioned earlier, it's up 20% and we are very

happy to – about this progress. And same goes for subscriber numbers, while year-on-year, we see decline, but quarter-on-quarter, we see 157,000 more customers.

Moving forward to the nine months summary, we see decrease of the net sales of 15.5% year-on-year. The underlying trends are the same that I explained earlier. And same applies to the EBITDA where the decrease is 32.8% year-on-year. And comparing the subscriber loss, you see that we decreased 175,000 customers year-on-year. As mentioned earlier, the quarter-to-quarter, we see already encouraging growth numbers.

Let me update you some of our commercial activities. As you know, we operate under two brands – Kcell brand being the premium, and Activ as mass market brand. So we introduced during the quarter and launched just before end, the new bundles – five bundles from 2,590 to 9,590 with the data allowances 15GB to 35GB available 24/7. The main idea of this package is it's more focussed on the data, which is really the demand in the market, and reduced the off-net allowances in the packages. As a differentiator, we have added also entertainment services into these packages, and in few slides, I'll come back to that. We feel very comfortable with this new tariff line and so are our customers. So we hope to secure the high-end segment with these new offers on the Kcell brand.

Moving forward, we also updated our offers on the mass market Activ brand earlier this year, in May, where we launched, basically, new tariff lines for bundles as well as entry level tariff line with unlimited voice-only. Both of these tariff lines have been extremely

popular, both for our existing customers for upsell and also acquiring the new subscribers from the market. And here also we offer wide range of packages starting from regional packages, 1,190 to 2,490 for the bundles, and KZT590 for voice-only where you can additionally buy data and off-net packages.

Moving forward, you see that one of the differentiators I mentioned earlier is our entertainment services, and all together, over 100,000 customers now enjoy our newly launched entertainment services in the market. The most popular being the – our music service, both among standalone users who pay for it, as well as in the bundles. And we believe that being not only the mobile operator, but also offering debt and payment services, will allow us to differentiate market in a proper way.

So this is something what I wanted to update you on this morning and afternoon. And I will give over to Trond and be happy to take questions afterwards. Thank you.

Trond Moe: Thank you, Arti. I will then move into more details on the financial side, starting on slide 9 with the revenue trends. Here we can see our net sales in the third quarter, which again demonstrated a modest growth quarter-on-quarter, which we are happy to see. It is still a decrease year-on-year, but you see the improvement of this negative numbers from – comparing to last year. As you can see from the chart, we reported a slight increase of 1.4% quarter-on-quarter, and net sales amounted to KZT36.9 billion.

Just to remind you, net sales includes handsets, and therefore, we show also service revenues without handsets, and this was also up 3% compared to the second quarter. B2B revenues, as Arti mentioned earlier, is very promising – increased 19.9% year-on-year and 1.3% comparing to the second quarter this year.

Then on slide 10, we look at the revenues and the contribution to growth from our data services. In the third quarter, our data traffic increased – almost doubled year-on-year, up 89% as smartphone penetration again increased to reach 46.5% at the end of the reporting quarter. Data revenue rose more slowly, however, with pricing pressure and an increase in bundled packages leading to a fall in average revenue per megabyte. Nevertheless, revenue from data grew approximately 7% year-on-year in Q3 this year.

On slide 11, we take a look at our operational performance. MOUs increased to 235 in Q3 compared to 229 in the second quarter. Total voice traffic in Q3 rose marginally against Q2, but decreased versus Q3 last year. Blended ARPU increased by 2.8% quarter-on-quarter but was down 2.7% compared to the same quarter last year. And then, Q3 average revenue per minute per use also increased quarter-on-quarter but fell from KZT3.1 in Q3 last year to 2.5 Q3 this year. On subscriber numbers, we are happy to report, as you heard from Arti, that our base grew by 157,000 during the quarter – during the third quarter. This increase was attributable to several factors – successful widening of distribution and the promising uptake in the lower segments, especially on the so-called conversation tariff plan.

Then, moving to slide 12 on the financial highlights, you can see a summary here on this slide for Q3 and for the nine months of this year. A few highlights – comparing to last year, you can see that the revenue drop almost explains the full difference in our performance. On the cost side, there's only a slight increase compared to the same period last year, which we believe is in fact a pretty good performance given the added network capacity and many costs denominated in foreign currency during a period of difficult macroeconomic situation. The comparison on net income is very heavily influenced by a positive currency effect last year, or KZT8 billion in the quarter when we had large devaluations and kept cash deposits in US dollars.

On slide 13, you can see our EBITDA performance. In addition to the revenue drops already explained, let me remind you that from Q1 this year, we started consolidating the subsidiary KazNet Media, which was acquired at that time. The Q3 EBITDA margin this year, on a standalone basis, would be 39.5%, whereas reported including KazNet Media, is 38.6%. So if you want to compare to last year, the number to use is 39.5% compared to the 44.5% in Q3 last year.

Little bit more on costs. We had a slight increase in OpEx this quarter, mainly due to an increase in sales and marketing expenses. But the result of that was actually very positive with the increased number of subscribers. On the cost of goods sold,

interconnect expenses increased in the quarter by KZT281 million, mainly due to the legacy Hello Kazakhstan tariff plan that we launched last year to meet the competitive pressure and they threw on a clause for news bits.

However, we still have about 1.1 million subscribers on this plan. And, for regulatory reasons, it is difficult to close legacy plans completely in Kazakhstan. But in early October, we did announce a price increase for all Hello Kazakhstan subscribers by about KZT200, which is about 13% increase, which should improve profitability going forward.

We are also working with the regulator on further actions to close the Hello Kazakhstan tariff plan, but it is too early to say exactly when and how that will be done. We also saw some price increases in the quarter from external suppliers in network capacity and that amounted to approximately KZT350 million. This was, however, partially compensated by a reduction in device costs of about KZT200 million, mainly because we have reduced sales of devices to wholesale partners. Now sales of devices are mainly done on contracts in our own shops, and that part of these sales has increased.

Then, on slide 14, you can see the CapEx to sales ratio. For the nine month, this ratio increased to – the CapEx increased to KZT42 billion, including the 4G frequency acquisition this year of KZT26 billion. And, the CapEx to sales ratio increased to 38.8%. However, the CapEx to sales ratio, if you exclude the frequency acquisition was at 14.9%.



Then, we have an update of dividends, which I will not talk about now.

Moving to slide 16, administrative and legal update, I just want to underline that the company is now undergoing a regular tax audit that covers the period from 2011 to 2015.

We expect results of that audit to be known by the end of 2016.

Then, we will start the Q&A sessions. Before that, let me say a little bit on the outlook for the full year. We expect our performance to remain relatively stable quarter-on-quarter for the next quarter. But, of course, there can be some pressures on the revenue sides now due to the new unlimited 4G offers which is disturbing, a little bit, the situation of the markets. CapEx for the full year is in line with earlier guidance. In total, KZT51 billion would – about KZT51 billion, including the 26 billion for the 4G frequency acquisitions.

So, then I hand over back to Irina.

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

Operator: Thank you. Thank you. If you would like to ask a question, please press \*1 on your telephone keypad. Please ensure the mute button on your telephone is switched off to allow your signal to reach our equipment. Again, please press \*1 to ask a question. We will now take our first question from Maria Sukhanova from Sberbank. Please go

ahead.

Maria Sukhanova: Yes, hello. I have a question about CapEx. So, you reiterated your full year CapEx. And I was just wondering, isn't there any down side to the signal[?] because of this network sharing agreement that you signed with Beeline, or are you – are you reiterating your 5 billion guidance for your CapEx this year?

And second, also about CapEx, so this year you have several projects which are extra, like billing system and also these are created for your rollout, would it be fair to assume that next year, you will spend less, like, several billion tenge or something like this?

Thank you.

Arti Ots: Yes. So let me start with the CapEx guidance. Yes it's the full year CapEx guidance that Trond just outlined. So, it will be around 26 billion including LTE, but excluding the frequencies. So frequencies are on top on that, and that's the full year that he was referring to. When it comes to the next year, then Trond.

Trond Moe: Yeah. First on the network sharing with Beeline, that will not reduce the CapEx spending, instead it will increase our rollout speed for 4G. So, we are able to rollout much faster and invest faster that we keep the planned CapEx at the same level.

Yes, this year, we have had a large billing project. However, that project will partially

continue until next year also. So, that will not really affect any changes comparing this year to next year. Same on 4G, we have been starting it this year, and it will continue this year – next year. But we see no big changes, really. We will not guide on the full year CapEx next year, but in general, we don't see any big changes due to these projects this year.

Maria Sukhanova: Okay. Thank you.

Operator: Again, as a reminder to ask a question, please press \*1. We'll now take our next question from Ivan Kim from VTB Capital. Please go ahead.

Ivan Kim: Yeah, good afternoon. Can you please talk about the outlook for 2017, not maybe in terms of growth or anything but like do you think the market is set to recover from 2016 levels, because they're obviously on unlimited tariffs[?] now? But, the prices for those unlimited tariffs elements create – a lot of lower end bundles have been eliminated. So net-net, but what do you think the market is going to do next year? Do you think it's, let's say, is it going to go up, you think, or it's rather going down again – maybe in these specific terms? Thank you.

Trond Moe: Thank you, Ivan for the questions. That is the best question we are also wondering almost every day here, so how the market would go. We see that throughout

the summer, and actually for the full year, the market shows somewhat recovery signs, and despite these recent campaigns, I would say that the underlying trends are encouraging.

That said, of course, we don't know what exactly the competition is thinking, but purely from economical point of view when we and other operators face huge investments both for network capacity buildout as well as meeting the license obligations, I would say that it's likely to be stable – little bit positive outlook for next year.

But, we can definitely come back later this year to see how the – how the offers and markets will move. We also see small positive signs of the economy recovering. That should encourage again the spending. So, remaining positive at the very moment with some cautious steps.

Ivan Kim: Great. Thank you.

Operator: As a reminder to ask a question, please press \*1. We'll not take our next question from Olga Bystrova from Credit Suisse. Please go ahead.

Olga Bystrova: Yes. Good afternoon. How do you think between your current leverage and potential dividend distribution going forward? You're currently towards the high end of

your target leverage, as far as I understand. You obviously have quite significant CapEx payments. How should I think about your willingness and ability to pay dividends and the magnitude of that for next year?

Trond Moe: Yeah. We are at – we are now at the net debt to EBITDA of almost 0.7 so that is at the higher end of the band in our dividend policy. And, we have communicated earlier that this is where we see that we will be also going into next year – maybe even somewhat higher on this rate.

We are looking to increase our loan portfolio somewhat this year. The market for borrowing has improved. Liquidity in the banking sector is better. Rates are a little bit lower. Durations offered are a little bit longer. So, all in all that situation is showing promising development. Our dividend policy remains as it is, 70% of previous net income, taking into account then cash flow and possible strategic investments like we had this year with the very big payments for frequency acquisitions.

Olga Bystrova: Okay. So you probably – then you will try to maintain 70% of payout like you did last year. Is that the correct understanding?

Trond Moe: Yeah. The policy remains as it is. There is no changes.

Olga Bystrova: Okay. And also about long term borrowing, you've – this quarter you have KZT8 billion on a long term debt that is new. Can you mention maybe some terms or which – part of which credit line or loan it is? And also, your notes, I don't see – I don't think you're including in calculation of net debt in your press releases, is there any reason for that?

Trond Moe: Now all our borrowings and new loans are announced on our investor website, you can find details for all the facilities there. In general, I can say that we borrow from the best rated, biggest banks. So, we have long term relationship with Kazkommertsbank, with Halyk Bank, with Altyn Bank and this year, we've also have a new facility with Alfa-Bank. So these are the main facilities. It used to be one-year facilities which were rolled over and at the beginning of the year, the interest rate was in the range of 18%, 19 %. We see now that the rates are a bit lower. So what is being offered now is 15%, 16% and we can even have durations up to three years.

Olga Bystrova: Okay, perfect. And then the final question on – you may have mentioned and I may have missed. How do you think about MTR outlook for next year? Do you see any comments from the regulator? What is your expectation?

Arti Ots: Yes. So, so far the MTRs have agreed between the operators this is the way Kazakhstan operates and at the moment, we don't see any changes on that front. So, it's

currently between the operators KZT5.

Olga Bystrova: Okay. Thank you.

Operator: As a reminder to ask a question, please press \*1. We'll not take a follow up question from Olga Bystrova from Credit Suisse. Please go ahead.

Olga Bystrova: Sorry, I – since no more questions. Can you talk at all about the status of TeliaSonera stake sale, as this could give some visibility on potential timing into where it stands currently?

Trond Moe: Yes. So, of course like we always do on these calls, we refer this question back to Telia. And today, they made announcement around the sales process, so, we know exactly as much as you do from that announcement. So, I, even, don't have nothing more to comment. So, you can check the Telia's today's announcement around that.

Olga Bystrova: Okay.

Arti Ots: But there is not much we know more.

Olga Bystrova: Thank you.

Arti Ots: Thank you.

Operator: There are no further questions in the queue. But again, a final reminder to ask a question, please press \*1. As there are no further questions in the queue, I'd like to hand the call back over to your hosts for any additional or closing remarks.

Irina Sohl: Let's close the session by this.

Arti Ots: Thank you very much for –

Irina Shol: Thank you for calling.

Arti Ots: Bye.

Trond Moe: Bye.

Irina Shol: Thank you.

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



