Taiwan Mobile 3Q09 Results Conference Call

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Harvey Chang, CEO & President: Ok, thank you. Thanks, everyone. Welcome to our this quarter conference call. Before we started, I would like to direct your attention to page 2 of our handout, which states:

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With that out of the way, we will begin this quarter’s presentation. You see that the basic outline is the same. I will direct your attention to page 4, which gives you a summary of our last quarter results.

Results Summary

Our last quarter revenue reached NT$17.4bn, which remain at a stable QoQ and down 1% on YoY basis.

Lower-than-expected mobile subscriber acquisition cost and good G&A expense control resulted in better than expected 3Q EBTIDA, exceeding our guidance by 1%.

On the non-operating front, as network optimization was slightly ahead of our schedule, there are NT$470mn of asset write-off losses happened in 3Q09, which exceeded our guidance by NT$82mn. We estimate full-year write-off loss will be around NT$1.7bn.

To sum up, 3Q09 net income reached 101% of the guidance number. And net profits for the first nine months of this year totaled NT$10.37bn, or NT$3.49 in EPS, reaching 75% of our full-year target.

The next page will tell you about our divisional performances.

3Q Divisional Performance

CBG

First, let's take a look at our consumer business. In 3Q, CBG recorded a sequential improvement and narrowed YoY decline in revenue. But mobile voice revenue weakness, more company stores opened and higher advertising expense to promote new rate plans and launch of new Blackberry and Android phones had a negative impact on its EBITDA.

HBG

On our household business, we continue to grow our pay-TV, content, and broadband business and HBG reported a healthy 2% QoQ and 15% YoY increase in EBITDA. It is noteworthy that cable broadband EBITDA margin expanded to 43.7% in 3Q09, from 28.2% a year ago, due to economies of scale.

EBG

And then, for our enterprise business, our EBG mobile revenue remained stable YoY basis while our fixed-line revenue dropped on YoY during 3Q. That said, EBG still reported a YoY growth in EBITDA, attributable to opex savings.

Next page, we will take a look at our comparison of our peers.

Wireless Peer Comparison

You can see our mobile subscriber number rose 3.1% YoY, coming largely from 119K data card new subscribers.

Despite rising opex in last quarter as a result of more company store openings and more spending on marketing campaigns, TWM still managed to surpass our closest competitor in terms of mobile EBITDA as well as EBITDA margin.

The next page has outlined the VAS and 3G.

VAS and 3G

As you can see that TWM's VAS revenue growth reached 28% last quarter and that number is among the most pronounced among the three operators. This is primarily aided by 67% revenue increase in mobile internet. Last quarter, revenue from data card users went up to 19% of total data revenue, vs. 7% a year ago.

As far as our 3G post-paid subscriber number is concerned, our 3G post-paid subscriber number last quarter exceeded 3m, up 59%YoY, making up 54% of total post-paid customers. And our 3G data revenue was up 91% on YoY basis.

I will turn the mic over to Rosie to talk about our balance sheet and cash flow.

Balance Sheet Analysis

Rosie: On BS, cash balance was down by NT$3.69bn from previous quarter, which was mainly due to dividend payment of NT$14bn on July 24. We raised some short term borrowing of NT$3.8bn and long term debts of NT$2.3bn to fund this payout. As such, net debt to EBITDA went up to 0.64x at the end of the 3Q.

Net PP&E balance at the end of 3Q09 was down sequentially. The 2G telecom equipment net book value was reduced to NT$17.92bn at the end of 3Q09.

Following the closing of recently announced cable acquisition deal, we estimate our total capital surplus to reach NT$21.2bn, taking into account the NT$8.8bn increase in capital surplus from the transaction. That was boosted by capital gains realized as a result of treasury share sale.

Cash Flow Analysis

And, on the cash flow part, our 3Q09 operating cash flow rose from 2Q09 partially due to fewer payments of corporate tax this quarter.

Since we have already made payments ahead of time in 2Q for some capex spending, our 3Q cash capex was lower compared to the 2Q number. Year to date, the accumulative capex reached NT$4.84bn versus our full-year target of NT$6.5bn.

In terms of financing cash activities, total borrowings increased by NT$6.1bn to facilitate the NT$14bn dividend payment in 3Q09. NT$0.38bn cash inflows were from selling treasury shares to employees in 3Q09.

The QoQ rise in 3Q09 FCF was a result of escalated operating cash inflows and lower cash capex as mentioned earlier. Year to date, FCF reached NT$11bn.

So, let me turn this over back to Harvey for 4Q forecast.

4Q09 Forecast

Harvey: For this quarter, we expect cable related revenue and profits to trend up on sequential basis and to record double digit YoY growth; this is primarily caused by continuous growth in pay-TV, content distribution, and cable broadband business.

Mobile revenue this quarter is not expected to further trend up from 3Q due to seasonality but is estimated to be resilient, compared to the level a year ago. Operating expenses control will lead to a positive YoY growth in EBITDA for this quarter.

As to our fixed network, the EBITDA generated by fixed network this quarter is expected to be stable on a QoQ basis and have a small YoY increase, due to the expense control.

Our main non-operating item in 4Q will be asset write-off losses around NT$366m.

For the full-year, we expect net profit to be NT$13.9bn and on EPS terms will be NT$4.67, which are in line with our guidance.

Event/ Regulatory update

If you turn over to the next page, just give you a quick update on this acquisition of Kbro deal. We have filed with FTC (Fair Trade Commission) on October 9th, that's about three weeks ago. We now in communication with them and waiting for their approval.

Also, this year, again we won the A+ award on Information Disclosure and Transparency Assessments conducted by Securities and Futures Institution. This is the four year, four times in a row, that we got this award and, also, demonstrate our commitment to higher transparency.

Key Message

Our key message for this quarter is basically that we expect to meet the guidance for the year for our existing businesses

And then we look forward to receive approvals from the regulatory body on this acquisition deal, so that we have more platforms to work out, to further increase shareholder return.

And that concludes my presentation and would be happy to take questions.

<u>Q & A</u>

Kathy Chen, Goldman Sachs: ***Hi, thanks for taking my question. I have three questions I'd like to start off with. Firstly, in terms of the comment about shareholder returns, can you give us an update on what the board is thinking about capital management outlook in terms of dividends to paid from '09 earnings given that, with the Kbro acquisition closing end of this year, presumably there will be a hit to the dividend returns given that those shares will be forgoing dividends. So, is there any update on whether or not we can see any buffering as a result of that?***

The second question is on the cable broadband EBITDA margins. In the prepared comments, you mentioned that the 3Q EBITDA margins have gone up to 44%. Can you share some color on how much higher this could continue to go as you gain more scale on the broadband side?

And, lastly, on the regulatory side, can you give an update on discussion with regulators regarding the price cap as we're heading to the end of the year?

Harvey: Kathy, I'm afraid I really don't have much to share on your 3rd question. I think you will agree that we certainly will not like to see that they lower the price cap on the cable rates. But this is very fragmented because it varies from each operating region and really we don't have that much to share with you. And we certainly will work on trying to retain what we have.

On the capital management, I think we have indicated for the year 2009 that if the deal goes through and certainly we will make up the difference. We will not let this deal impact our dividend payments for the year. So, you can certainly expect without this deal the amount of dividend that is going to be pay out, I think that will be our commitment to shareholders when we get to next year, the board get to discuss this. And whether we will be able to have more aggressive capital management activity, we need to take further look after the deal is done because the consolidated balance sheet will look quite different since the cable is highly leveraged. So, I don't think we will be able to do too much until we had a closer look at the situation.

On the cable broadband, I tend to be conservative. I think our team has done an excellent job in terms of boosting up the EBITDA margin to the mid-40 EBITDA margin level. Probably there won't be too much upside from where we have already reached. But if we are able to provide services to more operating areas, that's where the upside is.

Kathy: *Ok, thank you. Just to follow up on the dividend comment. So, are you saying that you'll try to maintain the dividend level from last year or should we just assume that there's some net profit decline for the full year this year so there will be maximum payout from that lower earnings level plus the buffer from the treasury shares forgoing dividends?*

Harvey: It's not a comparison with last year. It's a comparison with where we are now. So, basically, there are some profit decline. If you calculate that, you will see that cash dividend level will not be the same as before. This does not say that we are not going to pay anything higher than that. That's up to the board. We haven't really getting into that discussion yet because we need to wait until, we just want to make sure that if the deal actually went through, I think there are a lot of things to re-assess. So, right now, I don't really have a good answer for you.

Kathy: *Ok, thanks. So, not letting the deal impact the dividend payment means more the treasury share buffering difference, right?*

Harvey: Yeah.

Kathy: *Ok, thank you.*

Jimmy Cheong, JP Morgan HK: ***Hi, thanks for the call. I have two questions. Could you provide us with a view on when change in Taiwan company law to enable higher payout ratio will pass the Legislative Yuan? I recall a URI(?) team gave some guidance a couple of months ago. I was wondering if there was any update to that. And, if so, if you expect it to pass through in 2010, would this be the lever you use to buffer the dividend?***

2nd question is could there be some downside to full year CAPEX numbers? I think you previously guided NT$6.5bn this year and to meet that you would need to spend about NT$2.3bn, NT$2.4bn in the 4Q, which would make it one of the highest quarterly CAPEX number for a number of years. Is there something earmarked for a large CAPEX payment in the 4Q or could we possibly see NT$0.5bn to NT$1bn CAPEX come below guidance?

Rosie: On the possible rescission of corporate act in Taiwan, we don't know when it will be passed by the Legislative Yuan. Currently, the bill has passed the first reading, but it's the second reading that really counts. So, we are waiting for the Legislative Yuan to give the approval.

On your 2nd question, our full year CAPEX was NT$6.5bn and, as of the end of 3Q, it's already NT$4.8bn. So, I'm not quite sure why you have this NT$2.3bn number.

Jimmy: *That's the amount you would need to spend in the 4Q to get to NT$6.5.*

Rosie: No, it should be NT$1.7. NT$6.5 minus NT$4.8.

Jimmy: *Ok, maybe I think maybe re-stated some 1Q or 4Q numbers that are different from what I have. So, I'll double-check that.*

Rosie: Yeah.

Gary Yu, Morgan Stanley HK: ***Ok, thanks for the call. I got three questions from my side. The first question is a follow-up to Kathy's question on dividends. So, if I assume TWM achieve FY EPS of NT$4.67 for 2009 and putting a 90% payout for dividends, is that the amount you will be committing to, which is the NT$4.2/ share for dividends for full year?***

Second question I have is regarding your cable acquisition. Do you expect any goodwill? And if so, what is the expect amount that you will record on the balance sheet?

And the third question, for your remaining treasury shares, do you have any near-term plans for that because that's still 5%, 6% of the total share count?

Harvey: Gary, you are correct in your assumption in your 1st question. To the remaining treasury shares, frankly speaking, right now we are busy with the acquisition transaction. I don't think we have the energy to entertain that and actually we also have no plans for the time being.

As far as the goodwill number, I'll let Rosie give it to you.

Rosie: Currently, on Kbro's books, the total goodwill amounts to NT$36bn roughly. And because of the transaction, there will be NT$20bn more. So, that's the number you are asking about.

Gary: *If I can follow up on the treasury share question, for the remaining 5%, 6%, are you also going to forgo dividends from '10 onwards?*

Harvey: Oh yeah, oh yeah. If that they remain on book, I think we will continue to forgo dividends.

Gary: *Ok, thanks.*

Arthurs, RBS Singapore: ***Thank you for the call. I have two questions. One common theme coming up in the Taiwanese market is the potential for cross-border investments between Taiwan and China. I was just wondering if TWM plans to participate this and, if so, in what form?***

Second question I have is with regards to competition. Do you actually see this as potentially stiffening in the 4Q? I understand that all your competitors initially had expected a more competitive environment in the 3Q, but had to scale back due to inventory problems, which has since been addressed. Do you see a risk of them ramping up activities in the 4Q?

Harvey: The competition actually has never died down in this market. But, on the other hand, I also don't see that we are really going to cut-throat competition. It might happen in some small segments, but, on overall basis, I think it will continue intense competition among all the operators, but I don't see anybody really try to jump the gun and get everybody killed.

On the cross-border investment, the answer is actually "we don't know". We are not really that knowledgeable about the China market. We pay attention to it. I personally visit China often these days, in touch with people; we try to get some cooperation going. But whether if this will really lead us to cross border investments either with other major operators or other upstream or downstream business, actually we don't know. I guess it's "maybe".

Kathy Chen, Goldman Sachs HK: ***Thank you for taking my questions again. Just two follow-up questions from my side. Just to check on the 4Q revenue***

guidance in terms of each segment, if I'm reading the text correctly, you basically expect that the CBG revenue will be flat QoQ and then, for the EBG, you say stable QoQ for EBITDA, but do you expect the revenue will also be stable QoQ?

And then, secondly, on the cable side, is there any update in terms of quantifying more of the synergies from the deal that you expect to materialize next year?

Harvey: I'll let Rosie talk about this. Before we get the transaction approved, we are not that excited about trying to quantifying all those synergies. What has to come will come. That might be the philosophy for the time being.

Rosie: Kathy, on your EBG revenue, will it be stable QoQ? Mainly yes. But the fixed-line business is still declining. We are counting more on expense control to keep the EBITDA in line with our guidance. And we expect to see the expense control continuing into the 4Q.

Kathy: *Ok, great, I guess then so that implies the cable revenue you expect for 4Q is quite strong, right? Up something like 8% QoQ?*

Rosie: Yeah, that's our guidance.

Shirley Tse, UBS HK: ***Hi, thanks very much for taking my questions. My first question relates to the minutes of use. I noticed that the number of minutes have come off in the 3Q even though tariff/ minute has increased. I was wondering is that was because of some changes in your tariff and price packages or you seeing that people are actually using less their mobile phones?***

Secondly, you mentioned something about the fixed broadband or the cable broadband margins have improved. I was wondering if you started breaking out the mobile broadband margins vs. your mobile margins and how that has been trending.

And, finally, I noticed there were some recent press reports about potential to cut cable tariffs within the Taipei area. I was wondering if you have any comments on that.

Harvey: I really don't know what kind of comments we can make on the cable tariff in Taipei. Currently, we are not operating in that region. So, at this point, we really…each year, I think we always face that risk.

On the minutes of use, actually they are, starting last year, we have noticed some declining on the minute of use. It also depends on which segment we are looking at. The most obvious declining coming from one is the prepaid. Because I think that is the one segment we have more intensifying competition among the operators. The rest, I guess, is really…I don't see anything particularly noteworthy. Maybe Rosie can compliment.

Rosie: Shirley, the free minute users, the bucket plan users actually reduce their usage of free minutes. So, that's also causing the slower than expected growth in MOU. Actually, for non-bucket plan users, their usage has come up.

Mobile broadband margin, sorry, we still don't have the mobile broadband EBITDA margin for you at this moment.

Harvey: Ok, if there are no more questions, we will adjourn this session. And thank you all for attending our conference call. And we'll talk to you again next quarter. Thank you.

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