Taiwan Mobile

4Q19 Results Conference Call

March 5, 2020

Jamie Lin, President: Good afternoon. Welcome to Taiwan Mobile's 4th quarter 2019 investor conference call. Before I start our presentation, I would like to direct your attention to our disclaimer page, which states:

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Alright, let's look at the business overview, I will start with the operational highlights of 4th quarter 2019.

Operational Highlights

Please turn to page 4.

We are in an operating environment where customers continue to seek lower rate plans, delay their device upgrades in anticipation of 5G, as well as using fewer paid voice minutes. Despite all the headwinds the entire telecom industry faces, Taiwan Mobile managed to deliver outstanding results and turned the YoY trend of our telecom EBIT into positive territory in 4Q 2019, the first time since the Q2 2018 $499 frenzy.

The results can be attributed to our successful efforts in upselling our new and existing customers, our commendable momentum in "Double Play" (好速成双) unlimited mobile data and high-speed home broadband bundled plans, and the successful launch of our "Smarter Home" business, where we partnered with Google to bring its first Chinese-speaking smart speaker, the "Google Nest Mini", to Taiwanese market in 4th quarter 2019.

Also as importantly, momo continued to widen its lead in the e-commerce realm, which we will dive deeper in later slides.

As a result of our solid 4Q performance, for the full year 2019, Taiwan Mobile was able to deliver net income that beat our guidance by 1%.

Versatility

Let me now talk about our versatile strategy and results, on page 5.

During the quarter, we increased the monthly tariff of our handset bundle plans by $106 NT. The enterprise segment also continued to produce solid growth, with IoT connections rising by 25% on the back of tailwind from smart meters and connected cars. Cloud service revenue rose by 15% thanks to solid IDC demand.

On the right hand side of the slide, you can see that under our "Double Play" (好速成双) brand, we offered unlimited mobile data services bundled with different speeds of home broadband services, coupled with free video/music streaming and DTV subscription, plus a complimentary Google Nest Mini smart speaker to enable voice command on your TV and smart home appliances, all together at a very competitive price compared to what a standalone same-speed home broadband would cost from incumbents. That is why our Double Play products have proven to provide strong incentives for customers to sign up to higher rate plans while at the same time position ourselves to be a leader in the Smarter Home business.

Resilience in Pay-TV Business

Turning to our pay-TV business on page 6.

Once again, we fared better than other leading MSOs, with the smallest loss in basic TV subscriptions and much higher broadband & DTV adoptions aided by our "Double Play" bundled plans. Not only did we continue to increase broadband and DTV penetration in our cable TV customer base, we also made more strides in higher-speed broadband take-up rates. During the quarter, the percentage of customers subscribed to broadband plans with speeds of 100Mbps and higher rose by 7ppts from a year ago.

momo's Dominance in B2C Market

Last but not least, on page 7, let's take a look at momo.

In Q4, momo once again outpaced its peers by growing its B2C revenue by 33% YoY, thanks to market share gains in a growing online retail market. Average ticket size and number of transactions per customer were both higher, SKUs further increased, and a private label credit card was successfully launched. Throughout the 2019 year, momo also added 10 new satellite warehouses to further shorten its delivery time and solidify its leadership position against peers.

Overall gross margin and operating margin have declined as momo leaned towards growth and invest in its logistic capabilities. Over time we expect profitability to improve, as scale benefits and operating leverage kick in.

Now let me turn over the slide to Rosie for our financial overview.

Performance by Business

Rosie Yu, CFO & Spokesperson: Hi, Good afternoon.
On the performance by business, on page 9.

Reduced dealer commissions, lower interconnecting costs and spectrum usage fees helped us contain the YoY decline in pre-IFRS 16 telecom EBITDA at 5% in the 4th quarter. Telecom EBIT, however, went up by 1% YoY as D&A tapered off.

Reflecting the latest channel leasing pricing we charge TV home shopping companies, pre-IFRS 16 CATV EBITDA in the 4th quarter dropped by 11% YoY. However, its EBIT increased by 6% YoY, aided by falling depreciation of set-top boxes.

As for momo, in addition to its robust revenue growth, EBITDA also grew by 14% YoY in the 4th quarter, due to improved profitability in its legacy businesses.

Results Summary

Now, let's move to the results summary page.

In the 4th quarter, operating costs increased along with the growing e-commerce business and handset sales, however, our consolidated operating income showed YoY growth for the second consecutive quarter, thanks to effective expense rationalization. The low-single-digit YoY decline in pre-tax and net income was mainly due to one-off equipment write-off losses.

For the full year of last year, telecom EBIT came in ahead of expectations, while the combined EBIT of cable TV and momo also surpassed our expectations, accounting for 22% of our total EBIT in 2019.

Balance Sheet Analysis

Now let's turn to balance sheet analysis.

On the asset & liability front, the YoY surge in inventory and accounts payable was driven by momo's business expansion and solid iPhone demand.

Gross debt declined by 17% YoY to $43bn, following CB holders' conversions and repayment of our 7-year straight bond matured in 2019.

As for shareholders' equity, the increase in paid-in capital and capital surplus is reflective of the conversion of our convertible bond, which had an outstanding balance of NT$0.93bn at the end of the 4th quarter last year. As a result, share count for 2019 EPS calculation totaled 2.768 billion shares.

Benefiting from lower debt, our net debt to pre-IFRS 16 EBITDA remained at a low level of 1.16x.

Cash Flow Analysis

Now let's turn to page 12, cash flow analysis.

In the 4th quarter, the QoQ and YoY drop in pre-IFRS 16 operating cash flow was mainly due to momo's payment delaying from end of 3rd quarter to 4th quarter, as well as higher iPhone 11 payment.

Investing cash outflow increased YoY in the 4th quarter as a result of the NT$1bn deposit with NCC for 5G spectrum auction.

As for financing activities, the YoY increase in financing cash outflow was mainly related to the implementation of IFRS 16.

Full year 2019 mobile CapEx came off YoY, as 4G approached the tail-end of the investment cycle. Separately, momo's cash CapEx recorded a YoY decline, because only 10% of the land acquisition cost for its Southern Distribution Center was paid in 2019.

For the whole year of 2019, free cash flow of NT$19.19bn translates into free cash flow yield of roughly 6%.

Now let me turn the presentation back to Jamie for 2020 guidance and event updates.

2020 Guidance

Jamie Lin, President: Now let's turn to page 14 for our 2020 guidance.

In terms of 2020 outlook, 5G, cloud gaming, streaming content revenue, enterprise cloud and enterprise connectivity solutions will be the growing areas among telecom business, leading to 2% YoY growth in telecom revenue inclusive of device sales. momo's top-line will grow 18% YoY underpinned by expanding e-commerce business; pay-TV to return to growth trajectory, aided by premium fixed broadband bundle services, our 好速成双(Double Play).

As for profitability, the combined EBIT of the cable TV business and momo will grow 4% YoY and make up 25% of our total EBIT in 2020. That said, consolidated EBIT is forecasted to decrease. This is because profitability for 5G, cloud gaming, streaming content investments, etc. takes time to kick in.

For 2020 CapEx, a total of NT$14.5bn was approved by the board. You can see the breakdown in the slide. We expect telecom CapEx to double YoY, driven mainly by 5G infrastructure rollouts; cable TV CapEx to increase due largely to more demands for advanced set-top-boxes; momo CapEx to rise as major payments for its new South Automated Center will start in 2020.

Next, let's go to event updates.

Event Updates: 5G Spectrum Auction Results

With the conclusion of the 5G spectrum auction, TWM acquired 60MHz in the 3.5GHz frequency band for NT$30.45bn, and 200MHz in the 28GHz frequency band for NT$0.21bn. Total spectrum cost is NT$30.66bn. Following our board's recent resolution, TWM is filing for issuance of an unsecured straight bond with total amount of NT$20bn by end of March.

Awards and Recognition

And on page 16, you can see the summary of awards and recognitions we received during the quarter.

Key Message

Now finally on page 17, I'd like to wrap up our presentation with the key message that we would like to deliver.

Taiwan Mobile will be the only telco among the big three in Taiwan to be able to have partnerships on 5G network/spectrum sharing and create incremental benefits.

60MHz of spectrum in the 3.5GHz frequency band is sufficient for Taiwan Mobile's 5G business in the next ten years. In due course, we won't have CapEx inefficiency issues that others may encounter.

We believe we have a sensible 5G winning strategy in view that our total 5G spectrum and CapEx spend in the 20-year spectrum concession period may be the least among the big three without sacrificing 5G network quality. Progressing on the 5G journey, our overarching goal is to maximize related investment returns.

Now, with that, I would like to open the floor for Q&A session

<u>Q&A</u>

Amber Lee, Yuanta Securities: ***For CapEx, I think it looks like Taiwan Mobile has the highest expectation for this year among your peers, as you're guiding to double spending to NT$14bn. I think that CHT and FET each guided around NT$7bn and NT$6bn of CapEx for this year, that is specifically for 5G. My question is, firstly, how much of the NT$11bn CapEx for mobile is specifically for 5G? And secondly, what's driving the more aggressive thinking on 5G compared to the others?***

Rosie: The 5G CapEx inclusive of fixed network actually is not over $9bn for us, so actually our mobile CapEx is very similar to our peers.

Amber: Okay, then what's your view on your CapEx level going forward?

Rosie: Actually, for the CapEx of 2021, the internal calculation will only be completed around January next year, so we won't have a guidance for you at this moment.

Jamie: And just to add to that, like I said in our key message page, we are expecting quite some level of savings in terms of spectrum amortization versus our peers. So even if we would incur similar amount of network CapEx, we're still in a much better position financially versus our peers.

Amber: But that $9bn is still a bit higher than your peers. Does that mean for the less spending on amortization will be going into CapEx and result in depreciation in the coming years?

Jamie: What we understand is we're spending similar amount versus our peers this year. In terms of the year after, we will comment once we have our CapEx plan approved by the board.

Amber: For the guided D&A of around 16 billion for this year, could we have the respective number on depreciation and amortization?

Shirley Chu, Vice President: The amortizations is quite straightforward. We will amortize the new 5G spectrum over the 20-year period. And for the existing spectrum, amortization expense will stay the same.

Amber: Do you also expect to launch your 5G service in 3rd quarter?

Jamie: That is correct.

Peter Milliken, Deutsche Bank: ***My question is about the CapEx and how you believe it will be lower through the cycle than your peers? Presumably, that's because you say that you can have these 5G partnerships. Why are you the only one able to do a 5G partnership?***

Jamie: Right now, based on NCC's rules, if your spectrum and the other party's spectrum exceed 100MHz at the 3.5GHz band, you will not be better off. In this case, the spectrum that can be shared will be limited to less than 100MHz, making it non-sensible to any telcos that hold spectrum of 80 or 90MHz. But our 3.5GHz spectrum holding will enable us to have the options to share with some of other carriers who are holding equal or less than 40MHz of spectrum at the 3.5GHz range.

Peter: And my other question is about dividends. Have you announced what your DPS is likely to be this year?

Rosie: No, it will only be decided in April's board meeting. You may have noticed from our 2019 balance sheet. If you calculate our excess reserves, you'll find out we have roughly NT$40bn of excess reserves, which is NT$8bn up as compared to the past because of the CB conversion.

Peter: Okay, so you sound confident going into that decision. And final question is about content, gaming and streaming, that you mentioned as sources of CapEx. Are there any other details you'd be able to provide on what you're planning there?

Jamie: Right now, we don't have any details to share, except for the news that was already announced, which is our partnership with Riot Games, and the plan to publish 3 to 4 of their upcoming games in the next year or two.

Neale Anderson, HSBC: ***Good afternoon, query on the cable business. Last year, we had 11% decline, and that was because of the channel leasing pricing to the TV Home***

Shopping companies. Despite that, there was a 6% improvement in EBIT to lower set-top-box depreciation. So, is that trend going to remain the same? Presumably, you've got a full year of the lower lease charges, but are you expecting to again make that back up this year with the lower depreciation?

Shirley: The number was for 4Q last year, not for the whole year. So for the whole year last year, the EBITDA decline was much less. And this year, it will have similar trends with a small dip in EBITDA, while the earnings will go up.

Neale: Those are the two main drivers in cable, I guess you're going to be pushing your double mobile and broadband promotion. Is that expected to be a significant contributor?

Jamie: Yes, that is actually a hot selling product right now. And we're expecting for it to be contributing to both our mobile carrier business and our cable business.

Jack Hsu, SinoPac Securities: ***I have two questions. The first question is that we worry about the business a bit, especially for the mobile service business this year, because of the COVID-19 outbreak. We worry about our enterprise segment development in this year. And my second question is about the announced cooperation with the SK Telecom in Korea. Could you elaborate some details about our cooperation, our plan in the future?***

Jamie: Thank you, Jack. We're worried about the coronavirus situation regarding the threat it might pose to our employees' and our customers' health. But for our enterprise segment, it's actually doing better than expected due to increased demand for data transmission, remote meeting and remote working needs. So it's actually turning out to be a tailwind to our enterprise business.

In terms of SK telecom partnership, SK has been our partner for a long time in telecom business. We had been exchanging best practices and know-hows with regard to mobile carrier business. And they are the first mover in 5G deployment and 5G rollout. During the process, they were able to successfully increase their leadership in the Korean market. I think this partnership would help us learn from their experience and be able to fare better versus our peers in the Taiwanese market.

Jack: Ok, just one follow-up question. For the collaboration with SK Telecom, will we learn how to build a 5G business plan or will we learn their strategy to develop, to build up 5G network? Which direction will TWM take in the future?

Jamie: Both network deployment and market penetration strategies, are among the things we are exchanging with SK.

Amber Lee, Yuanta Securities: ***I saw the operating data. As you mentioned that the enterprise segment has seen strong momentum with 32% of YoY growth in last year. What's the sales contribution in that segment in 2019? And how's the margin?***

Rosie: If you are talking about the enterprise segment, the 32% revenue increase in 2019 only refers to the combined revenue of ICT, IoT and cloud.

Amber: What's the sales contribution of the enterprise segment?

Shirley: If we separate the enterprise fixed business into the growing part and legacy part, the growing part made up for 75% of its fixed line revenue.

Amber Lee, Yuanta Securities: ***I have another question. I think the 2020 guidance of EBITDA implied that your EBITDA margin for this year will be 23.5%. That's more than 3% decline comparing to last year. What's driving the decline for this year?***

Shirley: As we mentioned, this year we will have several new businesses which will take time to have its profitability kick in. For example, we will start to offer cloud gaming service. We will also invest more into so called "Taiwan Mobile original content". On the conservative side, we estimate that for our TWM original content business, the margin will be lower compared to the telecom business. And also, 5G is the main factor for this short-term lower margin situation.

Amber: For the investment that you mentioned, do you expect these to go into next year as well?

Shirley: On the EBITDA side, the margin won't go down further, in the sense that 5G revenue will gradually pick up. On the cloud gaming and original content investment, we normally have a higher initial cost. When revenue gradually picks up, we will fare better with better margins.

Amber, Yuanta Securities: ***And lastly for me, what's your expectation on the payout ratio of your 2019 DPS? Historically, your payout has been lower than or about 110%. Now, I'm just wondering about your view going forward on payout.***

Rosie: As I mentioned earlier, it's decided by the board every April. So we can't share anything with you at this moment. The only thing I can share with you, is on the excess reserves, which I've already done so.

Billy Lee, Crédit Suisse AG: ***Good afternoon, Jamie and Rosie. I have a couple of questions. The first one is regarding your 5G strategy. I noticed and you also mentioned that Taiwan Mobile is actually having fewer 3.5GHz spectrum than your peers which has 80 or 90MHz. The industry has been saying that 80-100MHz is a minimum for optimal efficiency. How are you going to have decent amount of efficiency with just 60MHz? I want to understand on the relative shortfall versus your competitor.***

Jamie: Thanks for giving us the chance to clarify it. If you look at spectrum holding, the most important element is capacity to provide data transmission for customers. And based on our projection of 5G take-up rate and data traffic growth for next 5 to 10 years, 60MHz of 3.5GHz spectrum plus 200MHz of 28GHz spectrum is more than enough to service our 7.1~7.2 million users for the next 5 to 10 years.

Any spectrum holding more than that is going to give you the luxury of results in speed test, but 99% of the customers don't decide their carrier based on the test results. Otherwise, most of the customers will be using CHT at this moment, but that's not the case. What some of our peers are saying create a false impression of "spectrum holding equals to market share". You can easily confirm that information based on 4G spectrum holding and market share.

Only CHT and we have market shares that are higher than our spectrum holdings. But there are three carriers that have lower market shares than their spectrum holdings. So spectrum holding does not equal to your market share. If the spectrum price is high, holding more than enough spectrum for yourself is only creating a drag on your bottom line. That's why we think that owning 60MHz of 3.5GHz spectrum and 200MHz of 28GHz is our best combination right now. On top of that, the government already announced that in 2 to 3 years, they will release the next wave of spectrum.

By that time, if we realize our projection is too conservative and our users will need a little bit more bandwidth, we can easily obtain more spectrum. We also have an option of sharing spectrum with two of the peers that hold 40MHz or less spectrum on 3.5GHz range. On top of that, NCC chair also announced that on the 3.57GHz plus spectrum, there's a possibility that they're going to clean up some amount of the spectrum in that neighborhood. If it does happen, we also have an option to obtain the spectrum right next to our holding. It's only beneficial to us because the neighborhood is only connected to ours.

Therefore, we have three or more options that we can take in the next three years if things turn out to be more aggressive than we expected. Right now, it's only sensible for us to hold just enough spectrum so that we create the largest ROI for our shareholders.

Billy Lee, Crédit Suisse AG: ***Thank you for that logic. It makes a lot of sense, but I just have a couple of follow-ups on this. You said NCC has actually talked about the possibility of a neighboring spectrum. Is that right next to you, like 3.5GHz or 3.6GHz? And then second question is, you said in terms of spectrum sharing with your peers, there's a cap of 100MHz combined and you also mentioned 120MHz. Can you clarify a little bit on that as well?***

Jamie: In terms of additional 3.5GHz spectrum releasing, NCC talked about moving the 3.57GHz plus range spectrum that satellite is using right now, in the next 1 to 2 years. We're expecting that to be somewhere less than 50MHz. If that's opened up, only we will be benefiting from this contiguous spectrum. If we have to bid on that, there will be much less incentive for our peers to outbid us. Concerning spectrum sharing, NCC has ruled that if you own 80MHz of spectrum, and to share it with another peer that's only holding 40MHz of 3.5GHz spectrum, the most that can be shared between the two of you is 80MHz. Therefore the 80MHz player will not gain anything by sharing with the 40MHz player. Based on the current 3.5GHz spectrum holding, among the big three, only we have the capability to share with two of the smaller players that hold 40MHz or less.

Billy: But is that technically possible? For example, Taiwan Star, which are very far from you and they are next to FET. Technically speaking, can you share the 40MHz of them?

Jamie: Yes, as of today, the equipment on the base stations already support that. We're expecting smartphones to support this so called "Carrier Aggregation" feature in the next 1 to 2 years.

Billy: Okay, got it, so it's possible. I haven't got this clearly yet. The maximum of spectrum sharing is 100MHz? 120MHz?

Jamie: 100MHz. If two telcos have more than 100MHz combined, the spectrum over 100MHz will be deducted from the individual company’s available spectrum for sharing. If you hold 90MHz and the other smaller player is holding 20MHz, then the two combined can only share

90MHz. If you hold 80MHz and the smaller player holds 40MHz, then the two of you combined can only share 80MHz, which makes no sense for the 80MHz player to share with the 40MHz player.

Billy Lee, Crédit Suisse AG: ***Okay, got it. And one last question. I appreciate that Taiwan Mobile actually adopts a conservative strategy in bidding. I'm just wondering, does that also reflect that your view that you are actually quite conservative on the 5G outlook in terms of monetization? In a 1 to 3 years view, what's your expectation on 5G monetization opportunities? For example, in the consumer side, I saw that you guys already launch some of the 5G phone plan. What should we expect the pricing going forward?***

Jamie: We're bullish on customers' willingness to pay for 5G, but they're not willing to pay for just the speed test result. If you look at what's happening in the first mover countries, people want 5G to be highly usable. So for 5G strategy, that's what we're thinking about.

Billy: Could you also share some of your revenue outlook that you have embedded in your guidance this year? And also about 5G contribution in 2021?

Rosie: We think that the 5G service take-up rate this year will be low. It's still too early tell the contribution for the next year. But for sure, 5G ARPU will be higher than the current level.

Billy Lee, Crédit Suisse AG: ***One last question, it is related to 4G. What's your view on the 4G competitive landscape right now? Should we expect a stabilization in ARPU? Or are you seeing a continuous increase in competition?***

Jamie: Right now, we're seeing a stabilizing ARPU environment, but it's still facing some headwinds. As with all the previous technology upgrade, once 5G rolls a run, the higher ARPU users are usually the first batch to upgrade to 5G. So that's going to increase the drag on 4G blended ARPU.

Jack Hsu, SinoPac Securities: ***I have just one question. Will we let SIM-only plan go on in 5G?***

Jamie: Right now, we're not ruling that out. Since our 5G launch is actually in Q3, we'll have a more clear view the next time we have this conference.