

Taiwan Mobile
2Q19 Results Conference Call - Edited Transcript
July 25, 2019

Jamie Lin, President: Good afternoon. Welcome to Taiwan Mobile's second 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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Let us turn to business overview; I will start with the operating performance of our telecom business.

Stabilization in Telecom Market

First, let us take a look at trends in the overall telecom market.

After the 499 frenzy last year, not only are the majority of consumers locked into contracts with the Big 3, but the gap in monthly rate between the Big 3 and the 2 smaller players has narrowed meaningfully. Therefore, the smaller players' YoY decline in telecom revenue has further deteriorated in spite of extra promotional efforts. The Big 3, on the other hand, are seeing stabilization in YoY revenue trends even with last year's high base from penalty income.

As for mobile service revenue, despite the steeper YoY decline in 2Q, TWM still posts higher spectrum yield than our peers as shown in the bottom left chart, thanks to TWM's superior spectrum investment strategy.

Versatility

Now, let us talk about our mobile strategy for consumers. To overcome the headwind on ARPU from customer shifting to SIM-only plans, in addition to promoting iPhone bundles, we have also enhanced our bundle plan offerings, such as bundling handset plus home appliance products – so called "red plus green", to encourage customers to sign up for higher monthly rate plans, and the results have been very encouraging.

As for the enterprise segment, we posted decent growth in a diverse set of cloud-based services including hybrid clouds, information security solutions, cloud PBX (which stands for Private Branch Exchange) services, etc. We were also able to produce new customer wins.

For IoT connectivity, the upbeat growth is stemming from our wins in government's Smart City project and other opportunities such as Internet of Vehicle and Smart Meters.

Last but not the least, we posted very strong ICT service growth as we strive to provide integrated solutions to our enterprise customers, from equipment procurement to data center design and to cloud and IoT services.

Resilience in Pay-TV Business

Next is our pay-TV business. We fared better vs. other leading MSOs, with a smaller loss in basic TV subscription. To provide tailwind to our ARPU, we managed to grow customer adoption rates of DTV & broadband services as of 2Q19. To strengthen customers' stickiness, we are getting ready to release a new cross-sale bundle package in 2H this year.

momo's Dominance in B2C Market

Moving on to momo, let us take a quick look at Taiwan's e-commerce market first. momo is currently the No.1 player and is one of the few e-commerce platforms that have delivered stable profits. In 2Q, momo once again outpaced its peers by growing its B2C revenue by 30% YoY. While gross margin edged down due to 3C's rising share in the product mix, operating margin still grew YoY thanks to economies of scale.

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

Performance by Business

Rosie Yu, CFO & Spokesperson: Hi, good afternoon. Let me talk about the performance by business.

In the second quarter, TWM's consolidated revenue rose by 4% YoY as momo's strong e-commerce revenue growth compensated for the decline in mobile service and pay-TV revenue.

Pre-IFRS 16 EBITDA for telecom business faced a high base due to the 499 frenzy but the YoY decline had already started to stabilize in June, aided by lessened revenue headwind and savings in traffic costs and selling expenses. For pay-TV business, even though pre-IFRS 16 EBITDA dipped by 3% due to softer basic TV revenue, operating income grew by 11%, a

function of falling depreciation of set-top boxes.

Let us go to the results summary page.

Results Summary

In the second quarter, the combined operating income of pay-TV and momo increased by 9% YoY, helping mitigate the decline in telecom operating income. For the first half of the year, the slight miss in total revenue from weak telecom performance was offset by lower traffic costs and selling expenses. Overall, operating income for all major businesses was within management expectations and net income also reached company guidance.

Balance Sheet Analysis

On the balance sheet analysis, the significant drop in other current assets was because of the reversal of interim payments accrued a year ago. The increase in inventory is a result of momo's expansion.

On the liability front, deleveraging on the back of our healthy free cash flow coupled with conversion of our CB pushed our gross debt to decline by 22% YoY to NT\$37.4bn. The outstanding CB amount at the end of June was NT\$5.1bn.

As for shareholders' equity, CB conversion value also caused our paid-in capital and capital surplus to go up by \$3.52bn in the second quarter.

Our net debt to pre-IFRS 16 EBITDA ratio further improved to 1.03x thanks to lower debt.

Cash Flow Analysis

Now let us turn to the cash flow analysis page.

For operating cash flow, the YoY decline in the second quarter reflected not only the decline in pre-tax earnings, but also a higher corporate tax rate on higher taxable income.

For investing cash flow, the YoY increase in outflow in spite of falling capex was attributable to higher cash inflows from fund redemptions in the previous year.

For financing activities, the net cash outflow mainly came from debt repayment and cash dividend payments to momo's minority shareholders.

As to our free cash flow, the FCF yield of 5.6% at the end of second quarter still stood higher than our dividend yield despite the negative impact from lower operating cash flow.

Now let me turn the presentation over to Jamie for event updates and key message.

Awards and Recognition

This slide summarizes the awards and recognitions we have received in the second quarter, for your reference.

Key Message

Finally, to wrap up our presentation, we have a key message that we would like to deliver:

TWM started seeing improved fundamentals with June operating results stabilized compared with a year ago. Joining forces with digital leaders, including momo and AppWorks companies, to offer compelling service bundles will prove to be our winning strategy.

Looking forward, as we approach the tail end of 4G deployment, we will be in a good position with more financial flexibility to make strategic moves, expand our footprint and generate healthy returns for our shareholders.

With that, I would like to open the floor for Q&A session.

Q&A

Neale Anderson, HSBC: *I would like to ask about the TV business. Could you elaborate a bit about the softness in basic TV revenue? Rosie also mentioned an increase in operating income. On the cost side, you mentioned lower traffic cost as one of the offsetting factors in the quarter. Why is that and is that likely to continue?*

Rosie: For the TV business, the earnings increase came largely from much lower depreciation expenses. Majority of the set-top boxes we procured a few years ago have been fully depreciated. For the telecom business, traffic costs decreased due to the lower interconnecting rate. We also have lower minutes of use.

Jack Hsu, SinoPac Securities: *I have 2 questions. First, will the company change its forecast in the following years? Second, what is our view on the future of 5G, especially for TWM? What are our advantages and disadvantages when we develop 5G?*

Rosie: Let me answer your first question regarding the financial forecast. We have not started doing our financial forecast for the next year and we do not have any plans on revising our financial forecasts for the second half of this year.

Jamie: In terms of 5G, we are seeing it as a long-term play. The 5G license will be a 20-year license so we are going to be methodical about it. In terms of bidding, we are going to consider that as confidential information. For the 5G business model, we will be working with services that build end-to-end integrated solutions on top of horizontal connectivity products.

Jack: So you will start from IoT then go to other segments?

Jamie: IoT is definitely a key piece of the puzzle in terms of 5G service offerings but it depends on the vertical that you are going after. With 5G, we are going after verticals such as industry use, medical use, retail use, smart city, etc. In many of these different verticals, we see that there will be a need to integrate IoT products to offer the best solutions for these industry users.

Jack: What is our viewpoint on the cable business for the second half of the year? Is there any chance we will see growth?

Jamie: I think the overall market is still facing headwinds in terms of subscriber retention but we will continue to push our DTV and broadband services. Right now the penetration rate of these 2 services are still below 50% so we still see a lot of upside in terms of signing up our customers to these services.

Jack: Will the price competition in this segment be fiercer?

Jamie: We do not see price competition intensifying in the second half of the year but these things are hard to say.

Neale Anderson, HSBC: *One question regarding slide 7 on momo's dominance in the B2C market. Could you give us your view on how sustainable you think that dominance is? I am presuming those other companies are not doing so well and they are trying to turn their performance around. Is it feasible to take share from momo? Or do you believe it's more sustainable than that?*

Jamie: I think e-commerce has gotten to a point where the competition is really in the warehouse buildout. Right now, momo is actually in a leading position with a big gap from other players so we see that in the short run, there is no possibility for any other player to catch up with momo. Of course, in the mid to long run, a lot of things can happen but at least for the next 12 to 24 months, we do not see any threat to momo's dominance.

Billy Lee, Credit Suisse: *I have a question on 5G. What is the latest timeline, based on your expectation, of when the spectrum will be auctioned and when are you seeing commercialization of 5G?*

Jamie: To the best of our knowledge, the government is planning on hosting the auction in December this year. Chances are, it will be completed early next year. Some spectrums are trickier, but if a telecom company wins the middle section of the spectrum - which is the cleaner one - they can immediately start building out. It will probably take another 6 months or so from there to the commercial launch.

Billy: You mentioned earlier that bidding strategy is confidential. Any expectations on the landscape in terms of the competition?

Jamie: It is very hard to predict but right now, it looks like the first wave of 5G deployment will be non-standalone, which means that chances are the competition will be between the existing players.

Billy: Do you have guidance for dividend payout this year and possibly even for next year?

Rosie: We are always very committed to a stable dividend policy. As to what the definition of "stable" is, that is for the Board to decide, every April.

Billy: So it could mean absolute or as a percentage of earnings?

Rosie: It is hard to tell, it is to be decided by the Board every April.

Billy: Regarding telecom competition space, you mentioned that competition revenue and overall market has stabilized. On the ground, do you see really stable competition between the Big 3 and the smaller players or are other smaller players becoming more aggressive? How are the other bigger players responding to such a stabilized market?

Jamie: As we presented in the slides, the smaller players continue to compete pretty hard but we are seeing their strategies becoming less effective. In terms of the Big 3, we are not seeing intensified competition.

Billy: I saw that the growth of the new businesses such as IoT and cloud solution, and information security are doing pretty well. Can you disclose the revenue of these categories?

Jamie: These are below 10%; single-digit percentages of total revenue.

Amber Lee, Yuanta Securities: *A question to follow up Billy's. In the 5G infrastructure investment, you mentioned that commercialization would come early next year. When can we see the spike in investment amount? Is it going to be next year or the year after?*

Rosie: The capex for next year will be released in January or February. We have not completed our forecast for the next year.

Jack Hsu, SinoPac Securities: *I have a few follow up questions. I am interested in your roaming business. You have a cooperation agreement with the 2 smaller players and it seems that the NCC also approves the roaming cooperation with APT, so what is the company's viewpoint regarding roaming? How about roaming in 5G? How much profit can be generated from this kind of business?*

Jamie: In terms of roaming, since the revision of the Telecom Management Act, the NCC has been supportive of these types of collaborations between telecom companies so we will continue to look for opportunities to grow this type of business.

Rosie: I think the roaming agreement or roaming cooperation with smaller players are just commercial negotiations so it is hard to predict the profits at this stage. The agreement to be signed will be kept in strict confidence so I cannot share information regarding roaming profits with you.

Jack: I am also interested in the kind of profits we can get from roaming. Is it only the roaming fee? Can we also sell services or content through roaming?

Rosie: Just the roaming charge.