Taiwan Mobile 2Q13 Results Conference Call
July 30, 2013

Moderator: Good afternoon, ladies and gentlemen. Welcome to Taiwan Mobile Conference call. Our chairperson today is Mr. Cliff Lai and Ms. Vivien Hsu. Mr. Lai, please begin your call. I'll stand by for the question and answer session. Thank you.

Cliff Lai, Co-President: Ok, let's start this conference call. Good afternoon. Welcome to our 2013 2nd quarter results conference call. Before I start our presentation, I would like to direct your attention to our disclaimer page, which states:

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Higher Mobile Revenue Growth

In the next three slides, I would like to highlight our growth areas.

First on the mobile business, on a like-for-like basis with our peers, TWM's mobile service revenue in the second quarter was up NT$997m or 7% year on year, the highest among the big three.
This is credited to healthy growth momentum in mobile data and decelerating declines in voice revenue.

Please turn to the next page.

Our Smartphone Strategy
Regarding our smartphone strategy, apart from the 20 exclusive smartphone models we currently have (listed on the slide), we also have around 52 smartphone and tablet products on the market. Besides several exclusive high-end smartphones from leading vendors, we recently added several mid-to-low range own-brand products Amazing A1~A6 as shown in the chart.

In 2Q13, smartphone sales volume was up 47% from a year ago and accounted for 86% of total handsets sold.

Therefore, mobile data adoption rate went up to 48% of the postpaid installed base, from 34% a year ago. This led to a 41% YoY growth in mobile data revenue in the second quarter.

Please turn to the next page.

CATV Growth Catalysts

As indicated in the table, our internet subscriber base increase of 8% and DTV customer base growth of 58% were both higher than the 1% subscriber rise in analogue TV service in 2Q13, representing the trend of an expanding penetration rate in both the DTV and cable internet businesses.

Please turn to the next page.

New Product & Service

This page of new products and services we launched during the 1st quarter is for your reference.

I will turn the mic to Vivien on our financial results.

Results Summary

Vivien Hsu, Co-President: Please turn to page 9 of your financial results summary.

In 2Q, we reported total revenue of NT$26.8bn, EBITDA of NT$7.8bn, and EPS of NT$1.47.

Telecom revenue / cost

In 2Q13, our telecom service revenue showed a 2% year on year increase versus a 4% YoY reduction in telecom cash cost. Therefore, telecom service profit increased.

Handset sales / cost

2Q13 handset subsidies remained relatively flattish YoY because the handset sales revenue and its costs increased by a similar magnitude from 2Q12.

Opex: The main opex increase was due to adding 108 more company stores from a year ago.

EBITDA

As CBG, EBG, HBG, and momo all had healthy revenue growth, this led to a 2% YoY increase in EBITDA in the quarter, versus a 2% YoY EBITDA drop in 1Q13.
Net income
2Q13 asset write-off losses came in higher than a year ago. Having said that, accumulative consolidated net income for the first half was still ahead of our guidance.

Please turn to the page of divisional performance.

Divisional Performance
CBG's revenue growth rate accelerated to 10% in 2Q, compared to 5% in 1Q. Therefore, CBG's 2Q13 top-line growth more than offset expense increases related to handset subsidies, 3G base station increases, and new store openings. This helped CBG's EBITDA to grow 1% YoY in 2Q, improved from a 3% EBITDA drop in 1Q.
EBG's 2Q13 EBITDA YoY growth largely resulted from mobile business growth coupled with stable costs/expenses.

HBG has been benefiting from operating leverage and reported a YoY EBITDA growth.

In contrast to a 39% YoY drop in its 1Q13 EBITDA, momo's 2Q13 EBITDA delivered a 30% YoY jump, boosted not only by a revenue increase but also by margin expansions in both the online and TV home shopping businesses.

Let me turn the presentation over to Rosie for balance sheet and cash flow analyses.

Balance Sheet Analysis
Rosie, CFO & Spokesperson:
In 2Q13, cash balance rose QoQ due to higher operating cash inflows resulting from a rise in accounts payable and a decrease in inventories. Compared to a year ago, 2Q13 cash level was higher mainly due to the increased financing cash inflows.

The YoY increase in accounts receivable mainly reflected the expanding bundled handset sales and mobile service revenue. But the average collection days remained stable at 46 days.

The inventory level rose YoY, as a result of more smartphone procurements.

The QoQ increase in other current liabilities was due to the NT$0.3bn payable of cash returns from legal reserve and the $14.5bn dividends payable paid on July 26, 2013.

Gross debt grew to NT$19.56bn at the end of 2Q13, following a reduction in short-term borrowings and the issuance of the corporate bond. Net debt was only 16% of equity, and accounted for 27% of full-year EBITDA.

So, let's turn to cash flow analysis.

Cash Flow Analysis

In 2Q13, operating cash inflow increased sequentially due to a rise in accounts payable and a decrease in inventories.

2Q13 investing cash outflow rose YoY because of higher mobile capex and more equity investments. Net investing cash outflow in 2Q13 including mainly NT$2.67bn cash capex; NT$384m capital injections into our 49.9%-held Taipei New Horizon and 19%-owned Trusted Service Management, the NFC consortium in Taiwan; NT$1bn refundable deposits with NCC for the upcoming spectrum auction.

2Q financing cash inflows increased both QoQ and YoY due to the issuance of a corporate bond in the quarter. The net inflow of NT$2.89bn was mainly a combination of 1) a NT$2.65bn repayment of short-term borrowings, and 2) a 5-year NT$5.8bn straight corporate bond with a coupon rate of 1.29% issued on April 25.

I'll turn the mic back to Vivien for event updates and key message.

Event Updates

Vivien: This slide lists the awards we have recently received for your reference.

Please turn to the next page for the key message.

Key Message

To wrap our presentation, this last slide summarizes the key message that we would like to deliver.

As expected, we achieved our goals for the first half and have recently completed the spinoff of our direct stores. Looking ahead, the most important task for all the telcos will be the 4G spectrum auction. TWM is confident in its preparation for the challenge.

Q & A

Chate Bencha, Credit Suisse HK: ***I have four questions. The first one is regarding the results. I understand that you have achieved EBITDA and the profit ahead of your guidance. I just want to understand a little better, what you think is the key driver behind the set of results that allowed you to beat guidance? Basically, what turned out better than you expected? Is it revenue, is it cost or timing of some cost item?***

The second question is regarding the fixed line. I understand that fixed line revenue is coming down quite naturally in the first half. We discussed a little before, but maybe you can update us on how the progress on turning around the business or what's actually going on in terms of the revenue mix in the fixed line side?

The third one is you mentioned in the presentation about m-commerce. Would you be able to chat with you the details on that a little bit and what time frame you see this will contribute to you more?

And the last question is regarding momo. It's quite encouraging to see momo start to turn around. But do you see a significant turnaround this year for the operation yet or would it still take some time for it to turn around?

Cliff: As for the first question, the revenue of the 2nd quarter was better than we expected. And, at the same time, the expense is lower than what we have projected. As you know, the high-end smartphone sales are not as high as we expected. Originally, people expected the HTC One and Samsung S4 would sell better, but it turned out not to generate that kind of sales revenue. The expense item is lower, in the meantime, the revenue is higher. So, it turned out we beat our 2Q guidance.

As for the fixed-line business, we tend to look at the fixed-line business as a legacy business. So, we try to focus to provide complete solutions to our enterprise customers and focusing on providing mobility solutions instead of simply fixed-line solutions, therefore we have de-emphasize to sell only fixed-line service to our enterprise customers. Therefore, you can see that there's a slowdown in revenue or drop in revenue in our fixed-line business. But, in the meantime, our enterprise mobile service revenue is increasing, so you can see that it contributed positively in the EBITDA in our enterprise business unit.

As for m-commerce, we are still testing the waters. And most likely more significant results will show up next year, not this year.

As for momo, I think the management team is doing certain actions to address certain operations and we see that they are moving in the right direction. So, we expect the performance will be better in the future.

Chate: *Just one follow-up on the first question. So, it's because of the lower-than-expected smartphone sales on the higher end side, not the medium-to-lower end, so is it fair to say that the key to achieve the guidance or to surpass the guidance would be whether there are popular high-end smartphones to come in the 2nd half and hit the market? And if that does not happen, it's very likely that you would surpass the overall guidance for the full year?*

Cliff: It's very hard to say for the 2nd half because, as you know, there are several factors that may affect the 2nd half. For instance, the market rumors say that Apple is going to introduce the low-cost iPhone. And last year, we did not project there will be a low-cost iPhone. So, if a low-cost iPhone is introduced into the marketplace, it's going to generate significant sales. Plus, it's not clear at the moment, what kind of specifications for the iPhone 5S. If the iPhone 5S turns out to have a larger screen, then it tends to drive more sales. So we are still very cautious about the outlook for the 2H because the Apple potentially can be a wild factor in the 2H forecast.

Anand Ramachandran, Barclays Singapore: ***I have two questions. One, you completed this spin-off of the company stores, so I guess it is now sitting as a 100% subsidiary. What impact do you see on the business model? And, second, what's the next step toward this particular initiative now that the spinoff is done for the next twelve months that you can share with us?***

Question 2, on the 4G spectrum auction, given the radio frequency lots on offer, how should we be thinking about Taiwan Mobile approaching this spectrum auction to the extent that you can share your thoughts with us? Anything would be very useful.

Cliff: Well, the spinoff really doesn't impact the business model. So, we expect it's as usual for the next 12 months.

Rosie: It's a wholly owned subsidiary of Taiwan Mobile. And, on your 2nd question on 4G auction, I think at this point in time, we cannot share with you any of our thoughts.

Anand: *Understood, understood. So, what was the motive behind the spinoff? Why did you do it then if I could check?*

Cliff: Well, the direct store has a very different business model; it's a retail business model. It has a lot of employees, the organizational structure, the promotion system, and the salary system, a lot of things are very different from a traditional telco. So, we think it's better for them to be spinoff so that they can establish a truly retail business structure and system. That's the main purpose for the spinoff.

Anand: *Ok, would you be thinking of doing something else with it, maybe listing it or letting it spread off into other retail operations over the next twelve months?*

Cliff: I think it's a little too far off for us to think about this because up to now, it's still a 100% subsidiary. The focus right now is doing a lot of sales for Taiwan Mobile. We tend to think that it needs to be 100% owned by Taiwan Mobile.

Lucy Liu, JP Morgan HK: ***I have mainly two sets of questions. One is on your cable TV business. We noticed that recently there are a lot of regulatory changes regarding introducing re-zoning policy as well as encouraging digitalization, potentially to introduce tiered pricing, so it seems like the policy trend is to introduce competition and, in the longer term, to benefit the customer by lowering the price and also to encourage the operator to spend more capex. So, I'm just wondering what's your thought and strategy in response to these policy trends.***

Cliff: Well, certainly, there are a lot of regulations regarding the cable TV business and, as you said, there is re-zoning. So, we are also thinking about whether we should enter the other markets. So, we are under consideration. Secondly is the digital TV, we are pushing digital TV strongly and currently the digital TV penetration in our areas is more than 20%, so hopefully by the end of the next year we can push to 40% to 50%. So, the digital TV is our strategy. The intervention or instruction by the NCC really doesn't affect our business because it's within our strategy to push digital TV.

As for whether there are tiering, the tiering of the programs is an issue, but from what we see, the Taiwanese has enjoyed all-you-can-eat for over 100 channels for a long time. Right now, NCC wants to introduce the tiering, this will not only affect the system operator, but also affect the television station tremendously. Up to now, we are still talking with the television station and they have a lot of concerns regarding how to do the tiering. Therefore, even though the government has indicated they want to push for tiering, but, at this moment, no existing operator seems to come up with any recommendation regarding how to do this tiering. I think this issue will not get resolved in the next three or six months because there are so many parties involved and trying to come out with a package which can please the regulators, system operators, television station, and customers is very difficult. So, I think the implementation is going to be an issue. At this moment, I cannot predict or project what will happen, but I think this will not happen in the next three months or six months.

Lucy: *I have another set of questions mainly on 4G. I understand you can't comment on that too much, but, generally, on the 4G strategy after gaining the license. Do you think you want to move away from the unlimited data pricing plan to some tiered pricing on the mobile side? Or do you think it's not quite achievable in Taiwan's environment and also do you feel that 4G will see a large continuation of your 3G running strategy, marketing campaign or pricing plan from 3G evolving to 4G or do you think 4G will be something quite different?*

Cliff: I think it's possible that we can introduce tiered pricing for 4G. Based on what is written in the newspapers, we can see that the government officers or the regulators seem to feel that this current all-you-can-eat pricing scheme cannot last forever and the most appropriate time to change this pricing scheme is at 4G. Plus, 4G will offer higher speed and, for those people who really want to switch to 4G, in the beginning will be more likely the high-end users, so introducing tiered pricing to them seems to be a more appropriate offering. So, we are optimistic regarding whether we can introduce tiering in 4G. That's what we think at the moment.

Lucy: *So, do you feel that you need to reach consensus with the other two major operators in order to do that or even by yourself you can take the lead or just take a stand-alone move to launch something like that?*

Cliff: We cannot reach consensus with the other operators because that's against the law. I think we would do it by our own independent thinking.

Lucy: *My second part of the question is on your 4G strategy. Do you feel that in terms of capex rollout progression as well as the marketing campaign targeting* *customer segment, I think 4G will be a large continuation of 3G. Not sure whether you agree about that.*

Cliff: I'm not sure exactly what you mean about continuation of 3G.

Lucy: *I mean, because they're running both on the wireless data concept, so I think instead of now selling 3G, I'm not sure whether you can really charge higher ARPU because of it's in the higher speed of data on the high-end of devices or it's just a replacement, a simple replacement to sell 4G in the current 3G kind of price plan.*

Cliff: I think it's really not easy to answer that because, in reality, if an operator cannot make an ARPU increase from 4G then it's not easy to come up with a 4G business model because if you provide a better network, provide higher speed but, in the meantime, you cannot charge more, then certainly the new entrants should be more concerned than the incumbent operators. But we think it's possible, but who knows.

Lucy: *My last question is from the capex perspective, do you feel that you can take time to gradually rollout 4G or do you think you have to expand 4G coverage as extensively as you can in a relatively quicker shape?*

Cliff: Well, that's a very sensitive issue. I'm afraid I cannot tell you.

Stephen Liu, Standard Chartered HK: ***I have several questions. First, regarding on the capex, can you guide on what level that you can reduce the 3G capex when you start to rollout 4G? This year you budgeting NT$8.8 bn for 3G, you've been expanding 3G coverage for many years, can you reduce to NT$3 bn, NT$4 bn a year when you start the 4G rollout after next year?***

Cliff: If we build a 4G network, of course we have to slow down our 3G buildup, so it's very natural. So, if we get a license for 4G and if we roll out our 4G network next year, then most likely we will reduce our 3G capex for next year.

Steven: *Likely to what level, NT$3 bn, NT$4 bn for 3G?*

Cliff: Well, as I said, that's a very sensitive issue.

Steven: *Regarding debt level, I know you just issue a new bond, do you think your* *current debt level now for the spectrum acquisition and the future capex requirements for the 4G rollout, do you need to raise more debt going forward?*

Rosie: As you know, we're already at net debt situation, so inevitably to cope with financing requirements or the financial needs, we definitely would have to raise our debts levels and we have enough debt capacity to raise the debt.

Steven: *So, mainly through the bank loans or new bonds?*

Rosie: For unsecured bonds, I think we have already reached the limit. For bank loans, we got a lot of credit lines available. So, that's not an issue for us.

Steven: *Last question regarding the mobile service revenue 2Q, you got 7% YoY, much above your peers, can you explain why your mobile service revenue grew so fast, is it mainly due to the accounting change from residual to fair value or some other reason?*

Cliff: The reason for our service revenue is, first, our voice revenue didn't drop so much. In the meantime, as you can see, our value-added service revenue, the YoY increase in mobile data for the 2Q is higher than that in 1Q, so due to these two reasons our voice revenue drop is not significant and, in the meantime, our value-added service revenue increase in the 2Q is higher than the 1Q. So, it contributed to our revenue growth.

Rosie: 7% on the residual method basis.

Steven: *Can I understand the reason is mainly due to your customer focus more on the high-end than CHT and FET?*

Cliff: Not really. I think we have a pretty good mix. Actually, we have increased our focus on the middle and low-end segments. Therefore, we see an increase in the adoption rate in the middle-end and low-end segments. Maybe, that's part of the reason why the mobile data increased.

Steven: *Last question regarding the wireless data usage, what's the monthly data usage for the smartphone user and what's the data usage of the postpaid user?*

Cliff: Smartphone user is 2GB. Tablet is more than 2GB.

Joseph Quinn, Macquarie Taiwan: ***Just two quick questions for myself. Firstly, on your new rate plans, can you go over some of the targets in terms of the market? Because you did talk about looking more at the mid, low-end, can you just discuss a little more about the super saver plan and particularly what market segments you're targeting? It does seem similar in ways to CHT's recent package, but we haven't seen anything so far from FET, so I'm just interested in what you're doing on that front.***

And the second question is on the direct stores, what is your plan at the moment for the China market? I do believe there is some discussion about you wanting to expand into that area as well.

Cliff: As you know, even though we try very hard, but there are still 50% of users that do not use smartphones. And most of these users are really middle-end and low-end subscribers, so our focus is to really penetrate that market because if you don't penetrate that market, then the 2G service will last forever. So, the intention is when we introduce 4G, we try to de-emphasize on the 2G network. Therefore, we will try to migrate users from the 2G to 3G. In order to migrate from 2G to 3G, the most important thing is mobile internet. And these customers tend to be low-end, so the phone needs to be inexpensive. That's why we introduce the A1 to A6. The A3 model only cost less than NT$2,000 without bundle package. In the meantime, these customers need a data package, but they don't really need all-you-can-eat because it's too expensive. So, they are casual users of mobile internet. Our focus is trying to penetrate that segment and try to move the 2G subscribers to 3G.

As for direct stores, we are still talking with China. We are very cautious. Maybe something will happen, but, at this moment, we haven't made a firm decision regarding China and when we should enter China because the economic situation in China is not at the best moment. The real estate rent rate is very high and the economic situation is not very good. So, we are very cautious regarding when is the best time for us to enter the market.

Joseph: *Just a follow-up when you were talking about the mid-to-low-end, is there a certain demographic, are you finding the ones more reluctant to move forward? I would assume, maybe wrongly, that mostly the teenager group would have already adopted this. I'm just wondering what age you're looking at as well?*

Cliff: The older people tend to have, for those people who are over 50 years old and they reside in the central and southern regions, especially in the southern region, they don't use smartphone and the purchasing power of these people are not very high.

Joseph: *Ok, so I assume marketing plans will be focused on those areas as well to try to get those users on board.*

Gary Yu, Morgan Stanley HK: ***I just have one question following up on the recent question on mobile service revenue. You mentioned that the voice revenue decline has been better than your competitors and also data revenue growth has also accelerated during the quarter. Can I know what's the driver behind the difference in performance between TWM and your peers on the voice revenue part? And also, on data revenue, do you expect further acceleration in growth in coming quarters given that the penetration of mobile data is already at around 48%?***

Cliff: I think our strategy at the moment is that we try to focus on not so much at acquisition, we focus more on to acquire a real user, a user who can contribute revenue. So, that's our focus. Instead of acquisition, pure subscriber number, we focus on acquiring a customer with voice revenue and also data revenue. That's a strategy that maybe is a little different from our competitors.

Secondly because the penetration of data is so high, you have a lot of repeated subscribers, therefore the growth rate of data revenue is not easy to maintain. This is part of the reason we try to penetrate the middle-end and low-end segments because for high-end segment, most likely a lot of sales are really from the repeated subscribers, they have subscribed to the data service already. So, in order to maintain a better growth rate in data, you really have to penetrate the middle-end and the low-end sector. If we are successful, then I think we can still maintain the growth rate.

Gary: *One follow-up question, right now, for your mobile data users, how many of them are using the highest tier unlimited data plan?*

Cliff: More than 70%.

Chate Bencha, Credit Suisse HK: ***Just one follow-up question regarding the potential introduction of tiered pricing after you launch 4G. Do you think that would be an opportunity for you to remove it from 3G as well or the removal of that or the introduction of tiered pricing would just be mainly on the 4G services?***

Cliff: I think the tiered pricing is mainly for 4G. They wouldn't allow us to change the pricing for 3G.

Alexias Jones, New Street Research UK: ***I just have one question. You talked about moving to the mid or low segment of the market or consumers. I just wonder if you could talk about the profitability of those consumers relative to the high-end? Obviously lower subsidies, but obviously they have lower ARPUs as well, so I was wondering if you look EBITDA margins, how does that impact your margins as you go forward and they contribute a bigger proportion of revenues?***

Cliff: Actually, the low-end subscribers, the EBITDA margin may not be so bad because the subsidy level is not so high, but the total EBITDA return is lower. But EBITDA margin, in general, is not so bad. So, when you penetrate that sector, I don't think it's going to affect EBITDA margin so much.

Steven Liu, Standard Chartered HK: ***I have a follow-up question on smartphone sales breakdown, can you give me a breakdown on smartphone sales by price, high-end, low-end, and mid range, what percentage in each category?***

Shirley Chu, Director of Investor Relations: For the 2Q, high-end smartphones accounted 47% of total smartphone sales and the balance is mid-to-low-end.

Steven: *How do you define a high-end smartphone? What price level?*

Cliff: Over NT$15,000.

Sydney Zhang, Merrill Lynch HK: ***Just a follow-up on the mid-to-low-end focus, can you say that one of your competitors may have focused on the mid-to-low-end maybe earlier than you and now you're just trying to tap into this potential a little bit later, but now you're delivering high growth or otherwise are you doing this earlier than your competitors?***

Cliff: Well, the fact is that we are doing this earlier than our competitors. If you look at the portfolio of smartphones we offer, you can see that we offer ranging from NT$2,000 to NT$5,000, we offer a series of low-end smartphones to penetrate the market. If you want to penetrate our market, you not only need to have a tariff, but also you need to have a smartphone package and the only way to reduce your cost of the smartphone is use your own brand because currently branded vendors like Samsung, Sony, LG or HTC wouldn't come out with a smartphone which only sells at NT$2,000 or NT$3,000. So, we are earlier than our competitors.

Sydney: *So, are you actually partnering more with the mainland vendors to roll out these low-end phones?*

Cliff: We have mainland manufacturers. We also have Taiwanese manufacturers.

Sydney: *My second question is related to the 4G license. I know you probably can't talk too much about it on the license auction, but would you comment on the new entrants. I know there are now seven players who have filed applications for the auction. How would you comment on the future competition in terms of so many new entrants coming into the 4G and whether they're going to launch more disruptive data plans and marketing campaigns?*

Cliff: Well, it's really hard to comment, but I think God bless them.

Steven Liu, Standard Chartered HK: ***I have one last question. I just noticed you have your brand smartphone. Can you let me know the price range and what percentage of smartphone sales are your own brand smartphone?***

Cliff: Our own brand smartphones covers from NT$2,000, NT$4,000, NT$5,000, NT$7,000. We are No. 6, ahead of LG, based on the recent GFK report.

Steven: ***No.*** *6 in Taiwan?*

Cliff: No. 6 in Taiwan.

Steven: *You sell them to other operators?*

Cliff: No.

Cliff: If there is no further question, then thank you for attending the conference call.