Türk Telekom 2024 Q3 Financial & Operational Results Conference Call

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Conductors:

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OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Vasilios, your Chorus Call operator.

Welcome and thank you for joining the Türk Telekom conference call and live webcast to present and discuss the 2024 Q3 Financial & Operational Results. We are here with the management team and today's speakers are CEO, Ümit Önal and CFO, Kaan Aktan. Before starting, I kindly remind you to review the disclaimer on the earnings presentation.

Now, I would like to turn the conference over to Mr. Ümit Önal CEO. Sir, you may now proceed.

ÖNAL Ü: Hello everyone, welcome to our 2024 Q3 results conference call. Thank you for joining us today. Whilst inflation outlook and interest rate decisions varied in different parts of the world, continued news flow on geopolitical tensions in the Middle East led significant volatility in oil prices. US elections and geopolitical developments, as well as their implications on global growth, remained on top of the watchlists.

At home, the CBRT kept its policy rate at 50% in its October meeting after the September annual inflation data, which although maintaining a downward trend, surprised to the upside at 49.4%. Recently, October inflation followed a similar path to 48.6%, this time slightly above expected 48.3%. Once again, the pace of decline in annual inflation over the next couple of months will be critical in shaping the 2025 inflation expectations and budgeting processes.

Mobile, once again, delivered beautifully with stunning subscriber and ARPU dynamics in continuation of solid trends in the postpaid segment, which were further supported by a better-than-expected recovery in the prepaid segment.

Fixed broadband geared up performance as June/July price adjustments and continued re-contracting of the subscriber base paved the way for a superb come back that we expect to extend into the final quarter of the year and beyond.

Data consumption moved with routine seasonality and stayed generally elevated across the board, confirming relatively inelastic demand to our products. Usage per LTE subscriber grew at a healthy 10% rate YoY in mobile, albeit slower compared to prior quarters. Fixed internet data usage, on the other hand, contracted 6% YoY from last year's high base.

Although standing broadly in line with our expectations, third quarter performance is thrilling with outstanding KPIs across the board. Revenue growth has picked-up as we have foreseen, adding further momentum to the EBITDA and cash flow generation.

Starting with third quarter financial operational overview on slide number 3. Consolidated revenues rose above TL 40 billion with an accelerated 16% increase YoY. Excluding the IFRIC-12 accounting impact, Q3 revenue growth was also 16%. Consolidated EBITDA surged 31% annually as EBITDA margin improved by 470 basis points YoY to 41% almost.

We generated TL 1 billion net income in the quarter. Capex spending expectedly accelerated in Q3, reaching TL 10 billion. Unlevered free cash flow was TL 5 billion, underlining an improving trend both QoQ and YoY, thanks to a robust operational performance across the board. Finally, net leverage fell below the 1x mark.

Slide number 4, net subscriber additions. We closed Q3 with 53.2 million subscribers in total, 568K higher from the prior quarter-end. Excluding the 233K lost in the fixed voice segment, total net additions surged to 800K with a broad acceleration in the high season.

Fixed broadband base inched up to 15.3 million as of the third quarter. We added 59K subscribers on net basis with similar contributions from the wholesale and retail segments. Although we have seen some pick-up in new acquisitions over the back-to-school season, the impact compared limited to previous years as new demand remained softer in general. Activations remained short of our expectation in the retail segment but surpassed our target in the wholesale segment. Churn rate picked-up QoQ, but remained nearly unchanged in annual comparison, with number of churning customers surpassing our forecast on the wholesale side, but staying in tune on the retail side.

While operators' focus on subscriber acquisition has been increasing in mobile market over the past one-year period, this tendency became even more evident in the third quarter. The competition, driven largely by promotional activity, peaked especially in August, pushing our churn rate higher, both YoY and QoQ. Still, net subscriber addition was significantly above our target.

Mobile segment added 651K subscribers on net basis, marking the highest performance since Q3’22 and expanding its reach to 27 million customers in total. Driven by a solid acquisition performance, the postpaid base recorded 568K net additions. Refreshing its historic high, postpaid net adds in the last 12 months exceeded 2 million in total for the first time. Surprising us positively both in activations and churn, relative to our quarterly targets, the prepaid base secured 83K net additions.

In the aftermath of these dynamics, the ratio of postpaid subscribers in total portfolio further rose to 74%, reaching its highest level.

Slide number 5, fixed broadband performance. Competitive environment remained largely unchanged in the fixed internet market over the third quarter. Starting in mid-June, we updated our new acquisition prices in retail segment, followed by the adjustments in wholesale prices in early July and retail prices for existing subscribers in early August. Although competition followed suit, the widely distorted retail price parities hardly moved away from the levels they have settled on since H2’23. On the contracting side, we have moved to a simplified 15-month flat fee structure, both in re-contracting and new acquisitions in August/September, replacing the earlier 3+12 structure introduced in mid-June.

Under these dynamics, we have carefully balanced pricing, acquisition & churn, and ARPU growth, preserving our somewhat greater focus on the ARPU side. As such, the subscriber activity remained subdued over the third quarter, driven both by our strategy and the prevailing soft demand overall. Re-contracting and upsell performances remained strong and within our targets.

50 Mbps+ packages made 67% of new sales and 35 Mbps+ packages made 66% of re-contracting, both confirming a very strong trend in demand for high-speed packages and no signs of softening among the existing subscriber base. Average package speed of our subscriber base increased by 45% YoY to 61 Mbps. 44% of our subscribers now use 50 Mbps+ packages compared to 31% a year ago.

We have successfully managed market dynamics, thanks to our solid positioning in the fixed internet domain, proven track record as the best-in-class internet service provider and advanced capabilities in customer retention in a highly competitive environment. In-line with our budget, our strategy produced a very strong 21% ARPU growth, moving up from 6% a quarter ago. We expect this remarkable performance to prevail in the coming quarters.

Moving onto mobile performance, slide number 6. We managed to sizably expand our subscriber base without diluting our ARPU growth during the quarter. Although all operators revised their mobile tariff prices around end-June/early-July, sizably discounted promotional offerings overtook most of the quarter.

We secured our best ever net add performance in July, followed by an impulsively elevated competition in August. At last, September was the month when the breathless racing has toned down a bit, with focus shifted towards regional campaigns. The MNP market has swollen to its largest size seen since Q1'20. Although the picture has varied across months, once again we topped the MNP market as the most preferred operator overall in the quarter.

Postpaid tariffs continued their popularity, but we have also observed a better-than-expected recovery in the prepaid segment. It is yet to be seen if the pick-up in new sales will turn into a lasting trend, given the volatile performance in the prepaid market in general over the past few quarters.

Accelerating from last quarter's 15%, annual growth in mobile blended ARPU surged to 17.5%, with respective 1% and 21% increases in the prepaid and postpaid segments. Over 3%

annual growth in average number of subscribers in addition paved the way for 19% growth in mobile revenue.

Let's take a look at our YTD performance and FY outlook now on slide 7. Our operational and financial performance has been on an improving trend every quarter but Q3 results are particularly satisfying with an orchestrated solid contribution from all lines of business. 11% real growth in operational revenue, more than 500 basis points improvement in EBITDA margin, 25% real growth in EBITDA, and TL 10.5 billion cash flow within the past nine-month period altogether is an obvious manifestation of our efforts turning into real value.

An accelerated operational revenue formation over the course of Q3 brought us closer to our maintained guidance of 11-13% growth. We remain confident that we will achieve our guidance, but Q4 inflation will be one of the important factors determining where in the range we will close the year.

EBITDA margin nicely exceeded the high end of our earlier target of 36-38%. Filled with more confidence from Q3 performance, we now set our EBITDA margin expectation at 38% slashing the low end of the range. Fourth quarters' tendency to deliver a lower margin compared to other quarters of the year due to low seasonality in some of our businesses as well as some one-off revenue and opex items materialising in the final months of the year explain the rationale for a lower target compared to 39% achieved in the nine-month period.

We maintain our FY guidance for 27-28% capex intensity in expectation of a typical acceleration in investment spending over Q4.

As we fast approach year-end, we prepare ourselves for the next year, which we believe will be an equally, if not a more exciting year than 2024 for Türk Telekom. Unabated, our focus will be on further strengthening our position in the markets we operate, augmenting our engagement with customers and preserving a vigorous financial performance.

Moving on to the next slide. At Türk Telekom, we are working to improve our financial performance, integrate our sustainability efforts into our company strategies and grow our environmental and social contributions. Hence, we embarked on a new journey this year and presented our first Integrated Annual Report.

This report differs from our previous Annual and Sustainability Reports in three important aspects. Firstly, we deep dive into explaining Türk Telekom Group's approach to creating value and driving sustainable growth. Secondly, in the "Environmental Investments and Contribution" section, we share comprehensive information with our stakeholders in a more holistic and transparent way, we believe. We focus on our environmental contribution through energy and emissions management, responsible use and management of natural resources, circular economy and waste management, as well as our concrete plans for the future. Further, we elaborate on our social contribution through our leadership in digitalisation and digital inclusion fueled by our unabated investments, both in fibre and mobile technologies across Türkiye. And finally, we present our full carbon inventory including Scope 1, 2 and 3 at Türk Telekom Group level. The calculation, for the first time encompassed all companies within Türk Telekom Group and was comprehensive in all respects. In this way, we aim to develop carbon reduction strategies at the scale of Türk Telekom Group. All emission calculations have been verified by an independent third party.

Last but not the least, we have submitted our 2023 report to the Carbon Disclosure Platform in an expanded coverage. CDP report should always be considered complementary to our İntegrated Report in order to build a more complete understanding around our climate-related initiatives.

This concludes my part. Thank you. Kaan, over to you now.

AKTAN K: Thank you very much. Good afternoon, everyone. We are now on slide 10 with financial performance. Consolidated revenues rose to TL 40 billion from TL 35 billion a year ago with an accelerated 16% increase. All our business lines, except for the fixed voice segment posted real revenue growth in this quarter, thanks to our strategies, devised to overcome macroeconomic and other challenges, paying-off in time and reasonably fulfilling high season.

Fixed internet this time came to the fore in growth as mobile remained a very strong contributor. Excluding the IFRIC 12 accounting impact, Q3 revenue was TL 38 billion, also up 16% YoY, including the 23% increase in fixed broadband, 19% in mobile, 15% TV, 9% in international, and 4% in corporate data, and the 6% contraction in fixed voice. The gap between consolidated and operational revenue growth disappeared in this quarter with a normalised trend in IFRIC 12 revenues.

Excluding the IFRIC 12 accounting impact, 9M revenue was TL 104 billion, up nearly 11% YoY compared to 7% a quarter ago, advancing nicely towards the guidance range.

Fixed internet and mobile together made almost more than 74% of operating revenue in this quarter. The two lines of businesses made significant contribution to growth with almost TL 5 billion higher revenues in total YoY. Revenue acceleration was largely a result of impressive ARPU growth performances of 21% in fixed internet and 17% in mobile.

Corporate data continued its advance QoQ and expectedly moved to positive territory in YoY comparison with 4% increase thanks to re-pricing of long-term contracts in certain product groups and some one-time project revenues. International revenue was another line of business that shifted to positive growth YoY with 9% increase.

Moving onto EBITDA, on the opex front, direct cost rose merely 3% YoY together with interconnection and equipment & technology sales costs contracting 12% and 8% respectively. Commercial costs also declined 6% YoY whereas other costs rose 10%. Annual trend in commercial costs can largely be attributed to prior year's high base but we also observed some minor deceleration QoQ.

Finally, rising other costs YoY was mostly driven by increased personnel and network costs at respective rates of 7% and 3%. The expected pick-up in these items was a result of electricity tariff hikes and salary adjustments which became effective from July and August respectively. Still, opex sales ratio dropped to 59% compared to 61% in second quarter of this year and 64% in the same period of last year thanks to an improving operational leverage.

As a result, consolidated EBITDA surged 31% annually to TL 16.5 billion with EBITDA margin expanding by 470 basis points YoY to almost 41%. Excluding the IFRIC 12 accounting impact, EBITDA margin was close to 43%. Looking into 9M performance, opex to sales ratio dropped 61% from 66% in the same period of last year, paving the way for a 520 basis point improvement in EBITDA margin YoY to 39%. 9M EBITDA expanded by 25%

YoY to TL 43 billion. Excluding the IFRIC 12 accounting impact, EBITDA margin was 40% on YTD basis.

Further down, operating profit was TL 6 billion in this quarter comparing significantly higher to less than TL 1 billion of the same quarter of last year. That brought the 9M figure to TL 10 billion mark, recovering significantly from almost TL 2 billion operating loss in the same period of last year, driven by macroeconomic volatilities and the earthquake.

Coming to the bottom line, TRY6 billion of net financial expense grew 29% YoY in this quarter due to 28% higher FX rates on average compared to a year ago and much higher interest rates driven by a major shift in monetary policy. That said, financial expense line has been pretty stable over quarters since the beginning of the year, with even some 4% decline QoQ. As such, 9M net financial expense increased moderately by 7% to TL 19 billion, thanks to the maintained calm in financial markets and successful management of financial risks in this environment.

Finally, we recorded TL 2 billion of tax expense, moving the quarterly effective tax rate from 18% in the second quarter to 66%. The increase, which has no major implications for this year's cash flow, was largely driven by the indexation of last year's tax assets to Q3’24 as per the inflation accounting principles and the wider gap between producer price index and consumer price index in Q3. Net profit for the period was TL 1 billion as a result, carrying the 9M figure to TL 4 billion in total.

As you know, there have been some important changes in Turkish Corporate Tax Legislation lately. It's worth noting that the new regime will likely have some implications for our Balance Sheet and P&L statement. Therefore, it will be reasonable to expect this impact materialising in our Q4'24 reporting period when we will also take into consideration the results of our regular annual assessment of future utilisation of existing tax assets in light of our long-term business plans.

We are now moving on to slide 11. Capex spending expectedly accelerated in the third quarter, reaching TL 10 billion with respective increases of 26% QoQ and 15% YoY. 9M capex increased to TL 23 billion, carrying the capex intensity ratio to 21% on a YTD basis.

And now we are moving onto slide 12 with debt profile. Net debt/EBITDA fell below 1x multiple from 1.1 a quarter ago and 1.2x as of the end of last year, thanks to a stable macro environment and a continuously improving operational performance.

Cash and cash equivalents, of which 48% is FX-based, totaled TL 8 billion. This excludes the USD 260 million equivalent of FX-protected time deposit that we book under financial investment. The share of local currency borrowings within the total debt portfolio was 14%. The FX exposure included US dollar equivalents of 1.8 billion of FX denominated debt, 1.7 billion of total hedge position and over 100 million of hard currency cash. The hedged amount included a 260 million USD equivalent of FX-protected time deposit, which was unchanged from the last quarter.

As a reminder, the outstanding balance for the upcoming Eurobond maturity in February 2025 is now USD 200 million. We feel rather comfortable about servicing this debt at maturity, thanks to the ample liquidity in hand and also improving cash flow outlook.

We also believe that our strong balance sheet improves operating metrics, and a much promising debt market would support us in case we need fresh financing as a result of potential license payments under 5G or fixed line concession.

We are now on slide 13. We closed the third quarter with a neutral FX position, excluding the ineffective portion of the hedge portfolio, namely participating cross currency swap contracts, foreign currency exposure was USD 190 million short FX position.

According to the sensitivity of the P&L statement to exchange rate movements, a 10% depreciation of TL would have a negative TL 600 million impact on Q3 PBT, assuming all else constant. Similarly, a 10% appreciation of TL would have a positive TL 900 million impact.

Unlevered free cash flow was TL 5 billion compared to TL 3.5 billion in Q2’24 and TL 3 billion in Q3’24, underlining an improving trend both QoQ and YoY. With that, unlevered free cash flow surpassed TL 10.5 billion in the 9M period, more than tripling YoY. Well, this will conclude my presentation. We can now open up the Q&A session.

OPERATOR: The first question comes from the line of Mandacı Ece with ÜNLÜ Securities. Please go ahead.

MANDACI E: Hi, thank you very much for the presentation. First, I would like to thank you for all your efforts in your disclosures and excel file that you are providing in your Investor Relations website, because you are providing the historic quarterly figures and you are rebasing them every quarter. That's really helpful for analysts, for us. I very much appreciate your efforts. Thank you again for that.

I have a couple of questions. One is about the competitive environment, as you have mentioned. So, after July's price adjustments, you have mentioned that there was more competition ongoing, but how should we think about the price adjustments going forward? Will there be a price adjustment maybe with the minimum wage increase in January? And could there be the continuation of this above CPI or real growth going forward in the upcoming quarters?

My second question will be about the current ongoing process regarding your application for the extension of the concession. When should we see a concrete development there? Because we were expecting this to conclude by year-end latest.

And the third question is would you have any comments regarding the recent news on Türkiye Wealth Fund regarding their intention for an SPO in Türk Telekom in the long run? Thank you very much.

ÖNAL Ü: Thank you very much for your questions. First of all, allow me to answer your first question by saying a couple of words related to competitive environment and pricing. As you know, we have been following a dynamic pricing and we are definitely unabatedly following this. And we are following the market dynamics. We always aim to have a healthy ARPU and subscriber growth. I mean, this is the centre of our dynamic pricing, and we are still preserving it.

And with that, you know, we have been following what's going on, on the inflation front and in 2025 we will be following the same path just like before by preserving the balance between ARPU and subscriber side.

When you have a look at our results, we can easily say that we have been following a very healthy subscriber acquisition. It's an ongoing trend and we are also able to keep up with good growth numbers. So, we will be following the same performance in line with the market dynamics in 2025.

Related to your second question, I mean, in terms of this concession issue, we still preserve our faith that this concession matter will be sorted out by the end of 2024, and we have been following this occasion very closely. And just like we have mentioned beforehand in previous quarters, we have been working very closely with the Privatisation Authority and another institution, the Industrial Development Bank, which is also affiliated to the Ministry of Finance and Treasury. So, they have been following their processes, they are evaluating the process right now officially and we are waiting for this process to come to a conclusion.

And with that, allow me to answer your third question as well. From today, with the hats that we carry on top of our hats as of today, I can't say anything, or I can't comment on anything related to an SPO. It wouldn't be correct because, you know, I can't say anything binding from today at this point.

I can clearly state that there is no development related to a SPO or anything that came to our side as of now. So, I can clearly say that we don't have any information to that.

OPERATOR: The next question comes from the line of Campos, Gustavo with Jefferies. Please, go ahead.

CAMPOS G: Okay, perfect. I was wondering if you could just provide, I understand that you may not be able to comment on the privatisation at this point. But, could you please elaborate if you have like a timeline on when should we expect it or what is the current goal around that? If you could provide any updates as well on the 5G tender rollout, that would be much appreciated. That's my first question. Thank you.

AKTAN K: Regarding your first question, are you referring to a potential SPO process?

CAMPOS G: Yes.

AKTAN K: All right. Well, in the older days, when the Türkiye Wealth Fund acquired the majority stake in the company, it was combined with the shares that the Ministry of Treasury and Finance already holds, so the government overall came to an 87% shareholder holding level in the company. And probably with that number on hand, Türkiye Wealth Fund in these days was saying that there will be many ways to create value from their investment in this company.

And one of them may be a future SPO project. But at the same time, I think there are certain conditions that not only the company but also the market and the economic environment in the country should meet. So, in that context, we are not hearing anything new since then.

But also, we are seeing that the economic conditions are improving, the operating metrics in the company are improving. And in some future dates, that may be again, an option for creating value or a return from their investments. But the rules of the games are clearly not defined, which also includes the timing of such projects. So, when we hear something or Türkiye Wealth Fund has something to say, I think they will clearly inform the market.

OPERATOR: The next question comes from the line of Bystrova, Evgeniya with Barclays. Please go ahead.

AKTAN K: I'm sorry, just before that, I think there was a question on 5G, is the second part.

OPERATOR: Mr. Gustavos, line has dropped. We are moving forward with the next participant. Thank you.

BYSTROVA E: Yes, I also had the same question. So, we could go to that. But thank you very much for the presentation and congrats on the results. And yes, as a follow up on the 5G tender, if there is a timeline for the rollout or any other details, if you could share, it would be very helpful. Thank you.

ÖNAL Ü: I mean, we can say that the latest information we shared with you regarding the 5G calendar and the auction is still up to date. There are no different issues that have changed, nothing new, as far as I can say. You know, the statements made by the relevant administrators say that in the first half of 2025, there will be the auction for 5G. And during 2026, we will have the first commercial use. That's the information.

BYSTROVA E: Okay, thank you.

OPERATOR: The next question comes from the line of Pradyumna Mishra with HSBC. Please go ahead.

PRADYUMNA M: Hi, can you hear me?

OPERATOR: Yes, we can hear you. Please go ahead.

PRADYUMNA M: Okay, hi. Thanks for the opportunity to ask a question. I have two questions. So, can you give us what was the quantum of price increase during the last quarter? And the second one is around since the balance sheet looks in good shape now, what is the scope of dividend assumption? Thank you.

AYAZ G: Sorry, can you repeat your second question?

PRADYUMNA M: So, the second question is about dividends. So, since the balance sheet looks in better position now, is there any scope for dividend assumption?

ÖNAL Ü: Allow me to answer your question relating to pricing first. We had a similar kind of maybe a question before. You know that the balance between subscribers and ARPU is very important for us, and it is very important for us to carry out the dynamic pricing and we are very good at it as an operator. Therefore, in the coming period, we will also manage our pricing actions in line with dynamic pricing, both considering the competitive environment and the market conditions.

For example, on the fixed broadband side in the retail segment, we have implemented 6+12 and 9+9 contract structures and revised prices as of 1st of December 2023 for new sales and then 3rd of January 2024 for existing customers. And as a continuation of that, as we have planned we have revised the tariff prices for new sales on 14th of June and for the existing customers on 1st of August. And we have moved to a linear, more simple 15-month flat fee contract structure in August for the existing customer and in September for the new sales from the previous 3+12 contract structure.

In mobile, we can roughly say that we had around 15% increase as of the third quarter. And on the FBB side, we had price increase on the wholesale side in July and on the retail side in June. The price increase on the retail side was about 20%.

AKTAN K: I just want to make a remark here. So, I think the more difficult part for the company for creating a revenue growth momentum was what we did not only in the last quarter, but in the many quarters before that. Because as you know, we are operating on fixed term contracts with our customers and especially our longer contract term in fixed broadband created certain challenges in the sense that the price increases that we make did have only limited impact on the overall revenue growth.

But now, there is clearly a strong momentum in both mobile and fixed line businesses. Even the fixed line business now growing at 23%, which is higher than 20% of mobile. So, that momentum is very critical because going forward, what we will need is make more moderate adjustments to the prices to keep that momentum alive, rather than having a significant increase to create the inertia.

So, we are in a much better position compared to a year ago, and that's also being reflected into our numbers. Since the beginning of the year we were very confident in giving the message that you will see a better revenue growth in every new quarter, and also that fixed broadband will be a major supporting factor in that. We will definitely come closer to mobile revenue in the later quarters of the year, and this is really the quarter which everything is falling to the right place.

And the second question was, I think, around dividend. Again, it's a bit early to make a comment and give you a direction on the dividend performance. Let's see how we will close the year, especially on the net income. As you see, there are some moving parts that sometimes we are a bit challenged in making a reasonable forecast because now we are operating with inflation adjustment standards, and there is a different index used in the statutory accounts versus different indexed used in the reporting accounts, and that creates some unpredicted impact on the bottom line. Let's see how it goes at the year-end, and then there will be a better understanding of what it might be.

PRADYUMNA M: Thank you.

OPERATOR: Ladies and gentlemen, there are no further questions at this time. I will now turn the conference over to Türk Telekom Management for any closing comments. Thank you.

AYAZ G: Thank you, everyone, for being with us today. We'll see you next time. Thank you. Have a nice day. Bye-bye.