Taiwan Mobile 1Q10 Results Conference Call

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Moderator: Good morning, good afternoon, ladies and gentlemen. Welcome to the Taiwan Mobile 1Q 2010 results conference call. Our chairperson today is Ms. Rosie Yu and we have Mr. Harvey Chang as a speaker. Rosie, please begin your call and I will be standing by. Thank you.

Harvey Chang, CEO & President: Good afternoon. This is Harvey Chang. Welcome to our 1st quarter conference call. Before I start making our presentation on 1Q results, I'd like to direct your attention to our disclaimer page, which states:

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With that out of the way, we will start our presentation. You will see on the outline, we are going to talk about the 1Q performance on P&L, divisional performances, our mobile operational analysis as well as balance sheet and cash flow. And then we will go to our forecast for 2Q this year and then event update as well as our key message.

Results Summary

If you go to the result summary page, which is page 4, you can see that, for 1Q this year, our total revenue for this year is NT$17 bn, which is on-target with our guidance.

Although the cost of handset sales came in higher than the guidance, we managed to meet our operating income guidance through operating expense control.

In addition to a stable EBITDA in 1Q10, the 50% YoY reduction in non-operating expense, including lower assets write-off losses as well as interest expenses, lower income tax also contributed to the 11% net income growth.

If you go to the next page, we are now looking at the 1Q performance breakdown by the three business groups.

1Q Divisional Performance

CBG

On the Consumer Business Group, you can see CBG's 1Q10 EBITDA was negatively affected by our stepped-up efforts in selling more 3G smart devices as well as our data plans to our customers. In return, we saw real 3G data revenue going up 15% QoQ at the end of March this year.

HBG

On the Household Business, our HBG's revenue has been benefiting from larger subscriber base and higher speed broadband service adoption. This coupled with better economies of scale has increased its 1Q EBITDA by 13% YoY.

EBG

On the Enterprise Business Group, our EBG continued reporting a YoY increase in EBITDA for the quarter; this is primarily backed by higher roaming revenue and well-controlled operating expenses.

Let's go to the next page, which will give you some comparison among the wireless operators.

Wireless Peer Comparison

As you can see from the chart, our mobile service revenue YoY decline continued to taper off this quarter, so now we're down to less than 1% decline. This is primarily attributed to improved revenue per minute due to reduced low-yield minutes.

Coupled with good growth momentum in VAS, our ARPU stood out among our peers in this quarter.

VAS and 3G

Further look at our VAS as well as our 3G adopters, our VAS revenue continued its double-digit growth YoY this quarter and has accounted now for 14.2% of our total service revenue. It is worth noticing that revenue from mobile internet now has accounted for close to half of our VAS revenue, and is expected to further grow along with the increased popularity of smart devices.

Our 3G post-paid subscriber number in 1Q10 exceeded 3.5m, up 39%YoY, which made up 61% of total post-paid subscriber base. And our 3G data revenue was up 71% from a year ago.

Now, I will ask Rosie to talk about our balance sheet and cash flow.

Cash Flow Analysis

Rosie Yu, Finance VP & Spokesperson: Good afternoon. Let me talk you through cash flow analysis first.

Our operating cash flow remained stable in 1Q10. The 1Q10 investing activity cash outlay was mainly for NT$1.46bn in cash capex. On the financing front, we repaid altogether NT$6.45 bn in short-term debt, including NT$5.65bn of short-term borrowings and NT$0.8bn of commercial paper.

With good core business cash earnings and stable cash capex, our 1Q10 free cash flow of NT$6.44bn translated into an improved annualized FCF yield of 11.3%.

Now, let's turn to page 9 for our balance sheet numbers.

Balance Sheet Analysis

On the asset side, cash balance remained stable and net PP&E balance at the end of 1Q10 was down sequentially, with depreciation and assets write-off higher than capex.

The 2G's net book value was reduced to NT$16.0bn, and 3G's was down to NT$12.5bn as of the end of 1Q10.

Harvey: Up.

Rosie: Oh sorry. With a NT$6.45bn reduction in borrowings in the quarter as mentioned in the cash flow analysis, our gross debt dropped to NT$9.15bn and net debt to NT$6.19bn, respectively. So, that's pushing down our net debt-to-EBITDA to 0.03x at the end of the 1Q.

Let me turn this over to Harvey for 2Q guidance.

2Q10 Forecast

Harvey: As we look at the forecast for the 2nd quarter, starting April, we will be facing this mandatory mobile price cut, which will result in a negatively revenue impact of roughly NT$315mn for 2Q10.

We plan to reduce our SG&A expense in 2Q10 by 9% YoY or NT$324mn to mitigate the negative revenue impact from the tariff cuts.

Separately, we are also optimistic about mobile data revenue growth and forecast more than 20% YoY growth in 2Q10. Nevertheless, our strategy of leveling up smart device take-up will lead to a YoY increase in handset sales costs in 2Q10. Therefore, 2Q10 EBITDA is expected to be down both QoQ as well as YoY.

Non-operating expense in 2Q10 is estimated to be NT$329m, down 16% YoY, with less asset write-off loss and interest expense than a year ago. Our EPS in 2Q10 is estimated to be NT$1.04.

And then, let me talk about the next page, which is the dividend proposal.

Event update

The board has approved the proposal to disperse NT$15 billion cash dividend to the shareholders, this will translate into NT$5.03 per share based on 2,989mn shares outstanding, which means that the shares held by our subsidiaries will not claim any cash dividends from us. So, that portion also distributed to the remaining shareholders, so it goes up to NT$5.03 per share.

The next page is some updates on the regulatory events.

Event update – Cont'd

You can read it when you have the time.

Key Message

Our key message for this quarter is the mandatory price cut has phased in to affect our 2Q earnings. SG&A savings are expected to mitigate the impact to a certain extent. With our stepped-up efforts in data, more resources will be deployed to beef up the take-up rate to ensure growth. We expect to see these efforts pay off over the medium term.

That has wrapped up our presentation. There are a couple of pages, but you can read them at your leisure.

Moderator: Thank you. Ladies and gentlemen, we will now are poll for questions. If you would like to register for a question, please press #1.

Q & A

Kathy Chen, Goldman Sachs: ***Hi, thanks for taking my question. I would like to start with three questions. The first one is on the 2Q EBITDA guidance. It looks like you expect to reduce SG&A by enough to fully offset the negative mobile revenue impact from the price cut. And, on top of that, you mention that you expect mobile data revenue to grow about 20% YoY, so that looks like it should add NT$330mn to your revenues. And then your cable business is also growing EBITDA and fixed should be relatively stable. So, can you explain to us why you expect EBITDA to fall by NT$870mn YoY? How much of this is attributed to the handset subsidies increasing? And I just have two questions on the cable side?***

Rosie: On the EBITDA number for the 2Q, the impact is all from handset subsidy if you can figure out later from the fact sheet we'll release later. But, basically, you know we will have NT$324mn savings in our SG&A and we will have some impact, NT$315mn impact, from the mandatory price cut and an increase of about NT$0.7bn in handset subsidies. That's roughly the number for the decrease in EBITDA.

Kathy: ***Ok, thanks. I have two questions on the Kbro deal. Can you give us an update how you're doing with government ownership issue and can you give us any estimate on when you expect the deal to close by? And, secondly, related to this completion date, if the deal doesn't close by the ex-dividend date in July, does that***

mean that all of the treasury shares forego dividends so that the remaining shareholders get more cash?

Harvey: Kathy, we have already foregone all the treasury shares' dividends. Whether this deal goes through or not, I think Carlyle, the shares they get will not be paid dividends for this year.

Kathy: ***Ok, understood.***

Harvey: As to the status of that, basically we are still wrestling with the regulators. It's a tough one. It's not exactly in our control. So, we'll have to wait and see.

Dee Senaratne, CSLA HK: ***Yeah, hi, guys. Thanks very much for the call. Just have one question. On the slide where you mentioned some of the regulatory changes that are in the works and one specifically relating to cable TV operators being allowed to branch out into other service areas. I was wondering if you could elaborate a bit more on what this is and does that mean essentially you will have cable TV operator competing in different parts of Taiwan as opposed as to it was before, more of a geographic monopoly. And then, if that goes through, what's sort of impact you can see for your Taiwan Fixed Network and even Kbro when you are hopefully allowed to finally acquire it?***

Harvey: I think this is something ongoing within NCC right now. It's still there are quite a few steps they have to take before it becomes affect. Right now, what they are proposing is right now the island is divided into 50+ operating zones. They want to reduce that number from 51 to, actually they have several different versions, most likely scenario is 20+. So, I think the operating region will be expanded a little bit. To the existing operators, it might mean some threat, but also it might mean some opportunity as well. Unless, when you're reducing from 50 some to 20 some, of course you combining two or three operating regions, if you have already have licenses in all three of those licenses, there's only one you're facing a bit more competitive pressure. Otherwise, they are both threats as far as opportunities. This is something that we are keeping our eyes on. We will still need to see exactly how it plays out.

Henry Cobbe, Nevsky London: ***Hi, thanks so much for the call. Could you possibly update where the financials close for Kbro in 2009? Full Year numbers?***

Rosie: Kbro numbers?

Henry: *Yeah, Kbro, Kbro, the target acquisition.*

Rosie: We don't have their final numbers yet.

Henry: *I missed the earlier part of the call. Did you give any comment on the timing of the deal and what needs to clear beforehand?*

Harvey: The statement we made on timing is still uncertain.

Henry: *But, in the absence of the conclusion of the deal, we can assume the dividend policy remains the same in terms of the payout to eligible shareholders.*

Harvey: Yeah, yeah, actually, after today, dividend for the year 2009 is already fixed. No event will change that. You will be getting a definite amount of NT$5.03 per share.

Henry: *And, very lastly, once the Kbro deal is concluded, will you then review your additional capital management option?*

Harvey: Yeah, of course, we will. But there are other things we need to deal with before closing the deal. We also have to look at our cash position. It might change a little bit because Kbro does bear a lot of debt on the balance sheet.

Henry: *And the NT$300 mn revenue adjustment that you forecasted for the 2Q, is that to reflect the full-year impact of the tariff change or is it just for those three months?*

Harvey: Just for the three months.

Henry: *How did you get to that number? Isn't it just a 5% tariff cut?*

Rosie: Yeah.

Henry: *So, that's 5% of your quarterly revenues.*

Rosie: Yeah, that's based on the mandatory price cut that we came up with is

NT$315mn impact quarterly basis.

Henry: *So, you're not forecasting any elasticity adjustment?*

Rosie: No.

Dee Senaratne, CSLA HK: ***Just one follow-up question again pertaining to cable. Looks like you've done a pretty good job in terms of migrating to cable TV subscribers to also taking cable broadband. The percentage has gone up to also taking cable broadband; 22% now. Are you guys more focused on bundling these two services together? What's driving this continual take-up of cable broadband? Where do you see that going to? Do you have any forecast into the next few years as to how that percentage of cable TV subscribers also taking cable broadband can go to?***

Harvey: We are bundling primarily the new digital TV service together with the broadband service because this digital TV is a new service, which has become hopeful for us 40% of the consumers want to give it a try what it looks like.

As to adoption rate, I think it will continue to go up. If you look at US, it's 30%. It will continue to go up. 30% is a realistic number.

Dee: *Over what period do you say 30%, the next year or two years, you think? What sort of time frame?*

Harvey: I think a year time frame going to 30% is a reasonable estimate.

Mr. Ling, UBS: ***Hi. The 2Q EBITDA guidance is a little bit below consensus primarily due to increased handset subsidies. Do you expect this to continue for the future quarters or do you expect the future quarters to show some kind of recovery?***

Harvey: I think this is because we are introducing iPhone as well as pushing the other smart devices a bit harder. I don't think it will continue forever because we certainly expect when we sell more of these high-cost devices, they will bring us more revenue. You will see a gradually offsetting effect from the increase of the data revenue.

Kathy Chen, Goldman Sachs: ***Hi. A follow-up question on guidance, could you show us the outlook on a segmental basis in terms of revenue margin for CBG, EBG, and HBG?***

Rosie: Sorry, we don't disclose the numbers broken down by the business groups.

Kathy: *Ok, based on your earlier comments, is it reasonable to assume that actually it's the mobile EBITDA margin that will show a pretty significant drop and the fixed and cable are still pretty stable in terms of margin?*

Rosie: Well, CBG, of course, will be affected the most because of the handset subsidies. HBG is always very conservative on their estimate of the numbers. So, that may not give you a clear picture of what we expect the real situation to be. I think we would rather say they would be quite stable.

Moderator: Excuse me, Rosie, there seems to be no further questions at this point in time.

Harvey: Thank you very much for attending this call. We'll see you at the next conference call. Thank you. Bye.