Taiwan Mobile

1Q14 Results Conference Call

April 29, 2014

Moderator: Good morning, good afternoon, ladies and gentlemen. Welcome to Taiwan Mobile Conference call. Our chairpersons today are Mr. James Jeng and Ms. Rosie Yu. Mr. Jeng, please begin your call. I'll stand by for the question and answer session. Thank you.

James Jeng, President: Good afternoon. Before I start our presentation, I'd like to direct your attention to our disclaimer page, which states:

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Let's turn to business overview.

Healthy Mobile Revenue Growth

In the next few 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 first quarter was up 5% year on year, attributed to an increase in ARPU. TWM continued leading the pack with the highest ARPU for the fifth consecutive quarter.

This is credited to healthy growth momentum in mobile data and contained declines in voice revenue.

Our Smartphone Strategy

Regarding our smartphone strategy, the consumer's choice for smartphones has been very polarized into high-end and entry-level models. Thus, we have introduced over 10 models of our own-brand mid-to-low-end smartphones, with their sales volume ranking fifth in the market for the quarter.

In 1Q14, total smartphone sales volume was up 26% from a year ago and accounted for 93%

of total handsets sold.

Therefore, mobile data adoption rate went up to 56% of the postpaid installed base, from 45% a year ago. This led to a 25% YoY growth in mobile data revenue in the first quarter.

CATV Growth Catalysts

As indicated in the table, our internet subscriber base increase of 5% and DTV customer base growth of 64% were both higher than the 1% subscriber rise in analogue TV service in 1Q14, representing the trend of an expanding take-up rate of two or three services.

Growing Online Shopping Business

In 1Q14, momo's revenue increase was greatly attributed to a solid 27% YoY revenue growth in the online shopping business.

On the EBITDA front, momo's EBITDA in the online shopping business grew around 90% YoY credited to a better product mix and margin expansions. EBITDA in the TV home shopping service stabilized due to a mild increase in revenue and cost cutting measures.

For the unprofitable physical channels, momo has announced the sale of its cosmetics stores on March 28, 2014. Accordingly, in the P&L, this has been reclassified as discontinued operations.

As a result, momo registered a 35% YoY increase in EBITDA on an expanding margin of 5.6% for the quarter from 4.8% a year ago.

Let's turn to the financial overview section.

Performance by Business

In terms of performance by business in 1Q14, telecom revenue was up by 3% YoY due to a 23% data revenue increase and another 6% rise in handset sales revenue. Its EBITDA YoY change turned positive with a 2% YoY increase after a 2% YoY decline a quarter ago, benefiting from savings as a result of expense discipline.

Thanks to a 61% YoY revenue growth in the DTV business and contained cost and expenses in 1Q14, HBG saw a YoY increase in EBITDA and an expanding EBITDA margin.

As mentioned in the previous page, momo's strong EBITDA growth came from the virtual channels' expanding business scale and loss reductions from the sale of the physical channels.

In a nutshell, 1Q14, consolidated EBITDA recorded a healthy YoY growth with half of the increase coming from the telecom business and the rest largely from momo.

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

Results Summary

Rosie, CFO & Spokesperson: Good afternoon. Let's look at the results summary. In 1Q14, we reported total revenue of NT$27.7bn, EBITDA of NT$7.8bn, and EPS of NT$1.52.

YoY Analysis

In addition to the revenue growth drivers James just went through, the expense discipline implemented across all divisions also contributed to the 3% YoY increase in consolidated EBITDA in 1Q14. Non-operating expense declined YoY due to a lesser asset write-off loss and a one-off gain from the disposal of an unused parcel of land by TFN. As a result, our net income was up by 7% YoY for the quarter.

Guidance Achievement Rate Analysis

In terms of guidance achievement rate, our 1Q14 consolidated EBITDA was ahead of our guidance by 4% due to lower-than-expected telecom cost and higher-than-expected profits from momo. On the non-operating front, interest expense came in much lower than our expectations due to the lower-than-expected interest rate we negotiated. So, our 1Q14 net income was ahead of our forecast by 4%.

Balance Sheet Analysis

Assets

Inventories decreased QoQ on faster turnover for the mobile business in 1Q14. For your information, Taipei New Horizon (TNH), our 49.9%-held subsidiary, has been consolidated into TWM's financials since Feb. 21, 2014 because our Chairman has concurrently been the chairman of TNH since then.

The QoQ increase in other non-current assets was a reflection of TNH's NT$7.46bn superficies granted by the government. On a YoY basis, in addition to TNH, the rise in this account was a result of the NT$29bn 4G spectrum fee paid in 4Q13.

Liabilities & Shareholders' Equity

Despite the inclusion of TNH's net debt of NT$2.6bn, TWM's consolidated net debt decreased to NT$40.45bn from NT$42.84bn a quarter ago due largely to the repayment of some short-term borrowings.

Other non-current liabilities increased arising from TNH's payables to the government related to the superficies and payables to the contractor.

Let's turn to the cash flow analysis.

Cash Flow Analysis

The 1Q14 operating cash inflow decreased QoQ mainly because the employee bonuses booked in 4Q13 was paid in 1Q14. Compared to a year ago, a large handset payment made in 1Q13 resulted in a higher cash outflow a year ago.

In contrast to a big jump in investment in the new mobile spectrum in 4Q13, investment cash outflow was a mere NT$1bn in 1Q14. Our 1Q net investing cash outflow mainly comprised of 1) NT$2.27bn in cash capex and 2) NT$1.19bn in cash included arising from the consolidation of TNH. Our 1Q14 cash capex was mainly for expanding wireless capacity and continuously procuring set-top-boxes to boost DTV penetration.

With regard to financing activity in 1Q14, the reduction in investing cash outflow allowed us to repay NT$8.66bn of short-term borrowings in the quarter.

Let me turn the mic back to James for 2Q14 guidance and board resolutions.

2Q14 Guidance

James: We expect 2Q14 total revenue to be up by 6% YoY mainly driven by increases in handset sales and momo revenue.

EBITDA increases from cable TV and momo are forecasted to mitigate pressure on telecom EBITDA resulting from rising opex related to adding more 3G and 4G base stations and company stores for the quarter.

Taiwan Mobile's total D&A, reflecting expanding telecom and digital TV businesses, is expected to weigh on profits in 2Q14.

Let's turn to the next page.

Board Resolution

As you can see from the upper portion of the slide, TWM's board has approved a proposal to distribute 2013 dividend of NT$5.6 per share, translating into a 97% payout to shareholders, pending AGM's approval.

Regarding the lower portion of the slide, the board also approved an additional capex budget of NT$0.8bn for 2014, bringing the revised full-year capex to NT$13.6bn.

Event Update

Regulatory Update

TWM has obtained the system technology validation approval for the roll-out of 4G base stations from NCC and has also filed an application for the 4G commercial launch.

It seems to me the process this time is very quick, so we can expect the operational license will be obtain probably a little bit earlier than we expect. The original plan was in the July timeframe, but, from my personal view, we will obtain the operational license as early as end of May.

Key Message

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

The LTE network deployment, expected service offerings and handset availabilities have been very promising. TWM is aiming to maintain operating stability in the near term and as always to ensure shareholders' returns.

Now I would like to open the floor for the Q&A section.

Q & A

Chate Bencha, Credit Suisse Singapore: ***The first question is regarding your LTE commercial license that you have already filed an application for the commercial launch and hopefully it will, as you said, earlier than expected. Does it mean that you are now targeting to launch the service as soon as the license is out or is there any other prerequisite before that?***

James: The criteria to obtain the operational license are really low. In general, it's a 250 base stations approval then you will get the operational license. However, that kind of coverage will not be able to support the commercial launch. So, we will still target it in July for a commercial launch. During this period of time, a month or month and a half, we will probably invite our users or subscribers to have a trial of our 4G services and then in July we will have our official launch.

Chate: *That's very fair. Just a follow-up question on the back of that, in the commercial launch, am I right to think that there's nothing to do with tariffs? So, you have not submitted a tariff plan for approval and again just to check whether your tariff plan would require any formal approval from NCC at all?*

James: Well, actually, that's one of the requirements, you have to submit the tariff plan to NCC in order to get an operational license, so we did submit a preliminary tariff plan. However, when we start to launch our commercial launch or services, that tariff plan would be more solid.

Chate: *Right, so there's still room for adjustments before you actually commercial launch compared to what you've already submitted.*

James: Yes.

Chate: *Last question for me. Is there any statistic you can chat in terms of mobile data usage? What's the average smartphone data usage now on your network and also maybe what's the rough percentage of subscribers that actually use more than 3GB?*

James: Well, right now, the data adoption rate for TWM is 56% and, in terms of smartphone handsets sales volume, it's reached as high as 93% last month. In terms of traffic usage, it is around 3GB per sub and I would expect when we start to launch 4G, it will reach 4GB in the beginning.

Chate: *What's the percentage of your smartphone subscriber base that actually uses more than 3GB a month?*

James: I don't have this figure with me right now. The average is 3GB, so I can expect quite a lot would be over 3GB, but again I don't have a very solid number for you.

Sydney Zhang, Bank of America/ Merrill Lynch: ***I have questions just reading the news today or previously talking about Taiwan Mobile and Hon Hai are interested in cooperating with each other. Can you elaborate on what kind of cooperation you would like to have?***

The second question is on the spectrum swap with FET. Any progress?

James: In response to your first question, we do have a cooperation with Hon Hai, but so far it's mainly in the handset cooperation because Hon Hai is very good at manufacturing, especially the 700 band handsets. So, initially, when we start to launch the services, they are going to provide one or two low-to-mid-end handsets for us.

In response to your second question regarding the spectrum swap with FET, we are still under negotiations right now, there's no further comment on it, but we expect hopefully we will reach a consensus in the near future.

Sydney: *Can I add to the first question? Any indication from Apple whether the iPhone 6 will support 700 MHz?*

James: No, we don't have any information at this point, but one good news is for the 700 band handset. I think the ecosystem is much better than I initially expected because right now when we start to launch the services in the July timeframe, I expect we would have eleven handsets and four tablets available. And, from these eleven handsets, it's mainly from Samsung, HTC, Sony and also our brand Amazing and also LG may have one handset. So, in terms of handset availability, it's much better than I expected at the beginning of the year.

Danny Chu, Macquarie HK: ***Just two questions. The first question, with regard to guidance given for 2nd quarter, management is guiding for a 10% YoY decline in the earnings. I read in the management report, it was mentioned that it's because of the D&A increase reflecting expanding telecom and digital TV businesses. Should I assume part of the increase in D&A is because the company will begin to depreciate the 4G fixed asset in the 2nd quarter? If we assume 4G network is commercialized in the 2nd half and then sales and marketing expense may go, does it mean that the net profit will drop even more severe in the 2nd half of this year?***

The 2nd question is related to the first question, given now the company is giving guidance on a quarterly basis, once 4G services is launched, will the company revert back to the previous practice of providing annual guidance?

James: Well, in terms of the 2nd quarter guidance, you just mentioned a 10% decline in profits. I think, we are installing the 4G base stations and they start to generate a lot of opex, for instance the base station lease, the rent, and electricity. Meanwhile, we also increase, in the 1st quarter and 2nd quarter, a lot of 3G base stations. As you may have noticed, when we started the 4G services, because the voice has to circuit fallback to 3G, so we still have to enhance our 3G coverage. So, that increased our opex quite a lot. And, meanwhile, as I just mentioned, we might get the 4G operational license a bit earlier than we expect. So, in the 2nd quarter, probably in the June timeframe, we have to amortize our spectrum even though we have not commercially launched yet, but once you get an operational license, you have to amortize the spectrum.

You said in the 3rd quarter and 4th quarter will we decline even more? There's a possibility because there are more and more 4G base stations and more opex being generated. I think the D&A will increase significantly and, secondly, the revenue is not generated proportional to capex. As you know, in the beginning we start to launch 4G services, the revenue from the 4G won't be that significant to offset the opex. So, I would expect in the 3rd quarter, it maybe a little worse, but again it's hard to say because we have a very strict expense discipline. In the 4th quarter, we expect to gain a little more 4G subscribers. We expect from the 3rd quarter and 4th quarter altogether, we will have about a half million 4G subscribers. That will generate a little bit revenue. So, the 4Q guidance will probably be a little bit better, but the 3rd quarter will probably be the worst.

Danny: *So, if I may follow up on that, would it be possible that when the company announces its interim results in late July, the company will return to its previous practice of providing guidance on the full-year basis or will the company continue this practice of providing only quarterly guidance going forward?*

James: Well, this year, we will basically follow our quarterly guidance. There's no plan to announce the annual guidance at this point because a lot of uncertainties are still there in terms of the 4G deployment progress as well as the new subscriber acquisition.