Taiwan Mobile

1Q16 Results Conference Call

April 28, 2016

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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For the business overview, I would like to highlight our growth areas.

Mobile Growth Leading the Pack

As you can see from the slide, In 1Q16, Taiwan Mobile's performance was ahead of the pack. TWM saw a 1% YoY increase in total subscriber number, while the rivals' both declined. The 4G service take-up rate reached 49% of the postpaid installed base and helped mobile postpaid ARPU grow by 4% YoY in 1Q16. As a result, TWM reported a 2% YoY increase in mobile service revenue, the highest among peers, on a like-for-like basis. Due to a steadily increasing mobile service revenue, coupled with lower handset subsidies, YoY growth rate in 1Q16 telecom EBITDA accelerated to 12%, the largest in the industry.

Please turn to the next page for our CATV operations.

Margin Expansion in Retail Business

momo derived 71% of its revenue from the online shopping business which registered a robust 23% YoY growth in 1Q16. In 1Q16, momo posted strong QoQ and YoY EBITDA increases of 42% and 20%, respectively, due to its margin expansion, robust revenue growth in the online shopping business and loss reduction from shaping up the TV home shopping operations in China.

Separately, momo's TV home shopping ventures in Thailand and China contributed to 6% of its net income in 1Q16. As a result, momo's net income rose 25% YoY in the quarter.

Let me turn the presentation over to Rosie for the financial overview section.

Results Summary

Rosie Yu, CFO & Spokesperson: TWM delivered solid operating leverage in 1Q16. A steady increase in the 4G subscriber base has resulted in a 2% YoY rise in telecom service revenue. The lowered handset subsidy provided, during the period of tapping into the mid-to-low end segment, coupled with momo's healthy EBITDA growth, led to a brisk 11% YoY growth in consolidated EBITDA in 1Q16.

Operating income registered an even higher YoY increase of 15% as the magnitude of the D&A expense increase was smaller than that of the EBITDA growth. 1Q16 recurring net income would have been up by 13% YoY if the one-off gains related to income tax had been excluded in 1Q15.

On the guidance achievement rate, we met our consolidated revenue target for the quarter. With strict expense discipline and less-than-expected non-operating expenses, we managed to beat our EBITDA and EPS targets by 7% and 15% in 1Q16, respectively.

Performance by Business

This slide provides revenue and EBITDA breakdown by products for your reference.

Balance Sheet Analysis

Let's turn to the balance sheet analysis. The QoQ decrease in inventory was mainly due to lesser demand for the iPhone 6S in 1Q16, the second quarter after its launch.

Long-term investment increased sequentially to reflect the rising mark-to-market value appraised on our investments in THSR. TWM's original 14.9% stake in Ambit translated into a 3.45% shareholding in APT after their merger, effective Feb 15, 2016.

On the liabilities & shareholders' equity, with higher cash flows from operations, gross debt balance fell to NT$54.91bn, following a NT$6.84bn debt repayment made in the quarter. Therefore, the ratios of net debt to equity and net debt to EBITDA both came off from a quarter ago.

Cash Flow Analysis

In 1Q16, operating cash inflows increased sequentially aided by healthy operating results as well as more cash inflow from decreases in inventory.

The major investing activities in 1Q16 were a NT$2.75bn capex and a NT$0.2bn money market fund investment made by momo for cash management purposes. The YoY decrease in investing cash outflow was mainly due to a NT$3.43bn payment to acquire 5MHz spectrum from Ambit in 1Q15.

Net cash outflow from financing activities increased QoQ and YoY mainly due to a total of NT$6.84bn in borrowings repaid in the quarter supported by improving free cash flows. As a result, our 1Q16 FCF more than tripled from the level a year ago.

Let me turn the presentation back to James for the event updates.

Event Update

This morning, TWM's board has approved a proposal to distribute a cash dividend of NT$5.6 per share out of the 2015 earnings, pending AGM's approval. This demonstrates our commitment to maintain stable dividends.

In addition, I would like to highlight that our better spectrum holdings has enabled us to win the recognition as the fastest mobile network in Taiwan from Ookla, the internationally recognized standard for internet connection testing.

TWM's Latest 4G Rate Plans

Effective May 1, we will cancel the unlimited data offerings for our 4G NT$999 and NT$1,199 plans. These two plans will have respective data usage caps for the second half of the contract period. The minimum monthly fee required to enjoy unlimited data usage through the contract period will be raised to NT$1,399.

Key Message

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

The mobile industry's rational moves on 4G rate plans set the tone for a healthier growth path for the industry. Taiwan Mobile is expected to benefit from better operating leverage and stronger free cash flow generation going forward.

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

Q & A

Gopa Kumar, Nomura: ***Firstly, how do you see overall competition in the market and***

can you expect further increase in these prices once you have more subscribers up for recontracting in the next few months?

Secondly, can you talk a bit on momo and what exactly are you doing because we are seeing improving trends? Also, it seems like the home shopping segment isn't doing that well, so what's the issue there?

James: Regarding the competition, after a period of keen and cutthroat competition for the past two, three months, I think we are back to normal and competition has become quite rational. And that will contribute to the corporate bottom line. Thus, I think competition in the second quarter will be mild and, in terms of earnings, we are quite optimistic.

Rosie: momo's business actually fared better the 1Q of this year. Its revenues were up 12% in total, of which, online shopping business actually grew 23%. And, also, its growth margin, EBITDA margin, and EBITDA all grew. So, it's back on the right track. It has already turned around since 4Q of last year due to better product mix and better management of its online shopping margin. So, it is now on a normal track. And, also, it has different partnerships in China and Thailand. Its investments in China actually fared better and its losses are shrinking. And the new business they entered into with a new partner in China actually has delivered some profitability for them and a similar situation has happened in Thailand.

Gopa: *You mentioned the TV home shopping business in Taiwan remains lackluster. Is that a concern? Is there a possibility of exiting that business?*

Rosie: TV home shopping business is slightly on the decline, but it is still a very profitable business. So, we don't think it's too much of a concern. Actually, if we compare its growth margin in the 1Q for TV shopping, it still shows an upward trend in terms of gross margins and gross profits.

In Young Chung, Goldman Sachs HK: ***Could you elaborate more about your outperformance in ARPU, subscriber growth, and earnings growth? What marketing strategies worked well in 1Q that delivered such performances?***

You also mentioned the lower handset subsidy as a result of targeting low-end subscribers, how did that translate to your faster ARPU growth compared to one of your peers?

Overall total subscriber market, your competitor claims that there's a decline in SIMs.

Are you observing the same trend among your customers?

James: In terms of ARPU, we have managed quite well even though, in 1Q, TWM and one of our peers offered a NT$499 tariff. But, in terms of net NP-in subscribers in 1Q, TWM outperformed its peers by quite a lot. And that contributed a bit on our mobile service revenue. Also, we did very well in VAS. For instance, we offer handset insurance, GooglePlay, myVideo, myBook, music, games, shopping, etc. They all performed very well in 1Q. So, that also contributed to the ARPU increase.

In terms of postpaid subscribers, in 1Q, TWM have the lowest churn rate compared to the other two major competitors. Thus, that also contributes a lot to our total sub increase.

Regarding a decline in SIMs, in terms of postpaid, it declined a little bit. However, TWM had the smallest decline. The main reason behind the decline is not due to handset, but due to tablets. I think the same thing has happened with our peers. Less and less subscribers will pay extra money for the tablet. Thus, that reduces the numbers of SIMs, but at this point, it isn't that significant.

In Young: *Regarding your new tariffs, can you give us a picture of ARPU growth into the 2nd half? Do you expect accelerating ARPU growth as a result of this?*

Regarding spectrum, your competitors are claiming that with the 2.6GHz spectrum, they have a larger spectrum capacity. How will that speed advantage impact your business going forward?

James: In terms of ARPU, if you examine the past two or three quarters, in general, 2Q compared to 1Q, ARPU increases because 1Q has the Chinese New Year in February. For that month, ARPU is lower. So, if the tariff remains the same, in general, ARPU will increase a little bit in 2Q. Now, with the new tariff, I would expect the ARPU will increase slightly more. So, I can foresee an improvement in ARPU for the second quarter due to the new tariff plan.

Regarding the 2.6GHz spectrum, the spectrum increase only makes sense if you have the base stations to deploy it. Let's set aside the three band carrier aggregation and talk about two band carrier aggregation. In terms of the number of base stations that can provide two band carrier aggregation, 88% of TWM's base stations can provide two band carrier aggregation while, for the other two big operators, it's 68% and 33%. So, we are definitely ahead in that respect. So, if the 2CA base stations are at such a low percentage for the other two peers, then the base stations for 3CA will likely be even lower. And actually according to the figures I have, their percentages is in single digits. Another issue regarding 3CA is the handset for 3CA is still very limited. They are two or three handsets. So, for marketing purposes, yes, you can announce you have a bigger spectrum, but, in reality, the customer won't feel it. That's why with the Ookla speedtest, in terms of 3G or 4G, we still have the highest speed as of today.

Varun Ahuja, Credit Suisse: ***My question is regarding the pricing. If you look at the NT$999 and NT$1199 plans, the data allowance continues to be quite generous. When do you think the sector will move through tiered pricing or do you think you're at an optimal pricing for the next 2-3 years?***

On dividends, given that you've seen the strong growth in EBITDA and your capex seems to be coming down and, hence, free cash flow should increase as it was reflected in your 1Q results, will management look into free cash generation while looking at dividend payout?

James: In response to your first question, I can foresee for the coming year, I won't say for the next 2-3 years, this tariff plan will remain the same outside of some small differences here and there. As I mentioned earlier, the competition will be very mild and rational, so I think the tariff pricing will be pretty stable for the coming year.

Rosie: Regarding the second question, we cannot give you any color on future payouts as always. But, as I mentioned many times, Taiwan Mobile is a company who is very committed to stable dividend policy, as you can see from the DPS declared by our Board today. So, if you do foresee better free cash in the future, it could bode well for a better payout, but that's not something we can discuss now. We will decide dividend policy based on free cash and future plans.

Varun: *I believe from 2nd half of 2016, you will see first set of 4G subscribers getting renewed. Do you see some down trending risk from the current plans? Or will they move onto higher plans?*

In terms of competition from the two smaller players, how do you view competitive intensity from them because they continue to offer unlimited plans at lower pricing? Are you worried about them getting much more aggressive and getting more market share if the top three increase prices?

James: Right now, our 4G penetration rate is close to 50%, so in June, it will reach 50%. The remaining 4G subscribers that will allow us to reach 50% are low-ARPU subscribers. We designed the NT$199 tariff plan for those subscribers, especially those still using 2G. For the higher plans (such as more than NT$1000), our percentage of high tariff plan subscribers still remains very strong because of the higher handset subsidy and there are still a lot of people who enjoy unlimited plan for the full contract period. So, for the second half of the year, I can see our percentage of high tariff plan subscribers still remaining strong while we encourage our 2G subscribers to move to 4G.

In term of total market share, I would say it will remain the same. But, in terms of 4G penetration rate, I would say, in the 2nd half, the two smaller players will catch up. Right now, in comparison to their fixed rate, they are a little bit lower. But, in the 2nd half, their penetration rate will pick up because the price of their unlimited plan will remain relatively low.

Varun: *On 2G, have you talked to the regulators regarding plans to shut down the 2G network?*

James: The NCC announced next year, in June 2017, 2G will officially be shut down. However, we might see a lot of people not willing to migrate to 3G or 4G depending on the NCC regulatory decision. If it's a mandatory shutdown, then, of course, they will have to migrate. If not, and more likely it will not, then we will have to keep a small spectrum for those 2G subscribers. But, we will first see how small that portion of subscribers is and then we'll make a decision of whether or not we will officially shut it down.

Varun: *If you indeed shut down, will there be any cost savings?*

James: There will be quite a lot of cost savings. We won't need to maintain the 2G network. The maintenance cost will be lower as it relates to base stations, rent, power consumption. So, that's where the trade-off exists. We have to look at the number of 2G subscribers that are unwilling to move up to 3G or 4G. If the cost savings in power or maintenance cost from shutting down 2G network justifies it, then we'll shut down 2G.

Livia Wu, Yuanta TW: ***The blended ARPU grew 1.2% in 1Q and, with the new data plans, do we expect the YoY growth trend to accelerate from 2Q to 4Q? And what's the overall ARPU growth rate for these years?***

Also, what is the number of SIM cards from tablets as a percentage of the total subscriber number?

James: Postpaid blended ARPU is projected at 3%. Regarding the second question, I don't have a figure, but I can tell you a figure that will surprise you. The number of tablets in the past year dropped 30% to 40%. If you look at the equipment vendors such as Apple and Samsung, the number of tablets sold dropped quite significantly. Same thing at the operator level. So, I will say it will continue to drop 20% to 30% further.

Livia: *Will this drop in SIMs card from tablets help overall ARPU because the tariff pricing for handset is generally higher than for tablets?*

James: Yes, in general, our handset ARPU is higher than tablet's. The decrease in tablet subscribers will increase our average ARPU.

Neale Anderson, HSBC HK: ***I have a question on competition and, particularly, as it relates to handset subsidy. Presumably, at the start of the year when you set your guidance, you weren't reflecting this increase in tariffs that is happening now. I think, generally, handset replacement cycles are slowing and possibly the new tariffs maybe even accelerate that trend. Can you tell me how you see the new handset subsidy budget or total spending evolving this year?***

James: I think, if you look at service revenue, you will see a mild increase or even a slight downward trend. However, the upside is handset subsidy will be significantly reduced. Comparing 1Q this year and 1Q last year, handset subsidy probably dropped 25%. And that generated a good bottom line in terms of EBITDA margin. I foresee handset subsidy will drop further down because the CP value for the handsets is getting higher and higher. And that is a good development for the operators in terms of the handset subsidy reducing. Thus, if you look at the service revenue of the big three operators, you will see that it slightly increased, remained the same or even slightly decreased. But, if you look at the bottom line, the EBITDA, for all three of us, increased. And that's mainly due to the handset subsidy decreasing. And I foresee this continuing in the 2^{nd} half.

Neale: *That fall by 25%, is that larger than you expected or was it in line with your expectations going into the quarter?*

James: Actually, it was beyond our expectations and I think it was mainly due to the iPhone. The sales amount between last year's iPhone 6 and this iPhone 6S dropped significantly. And that directly relates to handset subsidy also dropping.

Danny Chu, MacQuarie HK: ***With regards to the three band carrier aggregation, based***

on your estimates that there only two or three handset models compatible with three band carrier aggregation, how many smartphone handset model can we expect to be compatible with three band carrier aggregation by the end of 2017?

By the end of 2017 or the year after, what is the rough percentage of the base stations in Taiwan that will be compatible with three band CA?

James: That's really tough to say. That depends on every company's capex strategy. As I mentioned before, regardless of 3CA, our strategy is to largely deploy 2CA to reach 88%. However, that might not be the strategy of the other two peers because of their capex considerations. Also, first quarter next year, there's another auction coming up for the current 3G frequency band, 2.1GHz. In terms of 3CA, Taiwan Mobile will definitely be shooting for the 2100 frequency band. So, we will offer 3CA next year after the auction. You might argue that the other peers will have 4CA and, as of today, I don't see the chipset available for 4CA.

In terms of the number of 3CA handsets by the end of 2017, I really don't have a figure for that. By the end of this year, most of the handsets will offer 2CA. And that's why we focus on increasing the percentage of the base stations that can offer 2CA. Right now, we are at 88%. By the end of the year, we will try to reach more than 90%. So, most of the subscribers, no matter where you go, will experience very stable speed.

Jack Hsu, Sinopac: ***What is your 4G subscriber target for 2016? Is there any change? My second question is, now that you changed your tariff plan, will you change your tariff plan again in the near future?***

James: By the end of this year, our 4G penetration rate will reach 64%, very close to 4.8 mn 4G subscribers. In terms of tariff plans, if the tariff plans that we will begin to offer in May can remain very stable, I don't see modifying this plan for the 2nd half. But, that's hard to guarantee because it's really depends on the competitive landscape.

Gopa Kumar, Nomura Singapore: ***In terms of guidance, now it seems you're expecting a stronger ARPU growth, a much lower handset subsidy in the 2H, and overall competition also seems to be moderating, so what's your guidance now? Are you revising it?***

Can you remind whether you're expecting the 2100MHz auction in 1Q next year?

James: In terms of ARPU, we see it will increase, but, again, there is one factor that will reduce the growth rate, which is migrating the lower ARPU customers from 2G to 4G. They might reduce 4G ARPU a little bit, but, in terms of the overall ARPU, I can foresee a 3% growth in the postpaid.

Rosie: We don't have any plans to revise our guidance at the moment, but we are optimistically about achieving our annual target. We normally just don't revise our guidance.