

**Taiwan Mobile**  
**1Q17 Results Conference Call**  
**May 4, 2017**

**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.

**Outperformance in Telecom Business**

Once again, TWM outperformed peers in the telecom business by various metrics in 1Q17. In terms of total mobile subscribers, TWM performed better in terms of sustaining its subscriber base.

The 4G service take-up rate continuously rose to 68% at the end of 1Q17. However, growth in mobile service revenue was constrained by market competition. Having said that, TWM still posted the smallest YoY decline in mobile service revenue among rivals for the quarter, on a like-for-like basis.

Compared to our peers, we invested more rationally in 4G. Telecom D&A peaked in 2016 and started coming off this year. As such, TWM stood out in telecom operating profit growth in 1Q17.

TWM was the only one in the industry posting a positive YoY growth of 5% in EPS in the first quarter of 2017.

**Competition in CATV Tapering Off**

On the cable TV business:

The number of basic TV subscribers bottomed out from 4Q16, due to the tapered-off impact from new entrant competition in the New Taipei City service area.

Cable TV EBITDA rose QoQ in 1Q17 aided by the stabilizing CATV revenue mentioned earlier and lesser marketing efforts to defend market share. As a result, CATV EBITDA margin increased 1.5 percentage points from a quarter ago.

It is worth noting that only 27% of TWM's CATV subscribers are in an area facing new entrant competition. Our remaining service areas are still enjoying a regional monopoly.

### **E-commerce – The Bright Spot**

momo posted an 18% YoY top-line growth in the E-commerce business for the quarter, higher than that of its closest competitor in Taiwan. E-commerce made up 78% of momo's total revenue and remained the brightest spot for momo.

In 1Q17, momo's YoY contraction in EBITDA was mainly due to the revenue decline of its TV home shopping business which has higher fixed costs.

Despite the YoY drop in EBITDA, momo's equity investment income grew over 50% from a year ago and made up 12% of its net income.

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

### **Results Summary**

#### **Rosie Yu, CFO & Spokesperson:**

#### YoY Analysis

In 1Q17, despite keener market competition, TWM still managed to grow its consolidated operating profit by 1% from a year ago due to subscriber acquisition cost reductions and product offering differentiations. In addition, we had lower interest expenses and asset write-off losses coupled with a higher equity investment income for the quarter. The aforementioned led to a 5% YoY increase in net income.

#### Guidance Achievement Rate Analysis

1Q17 consolidated revenue slightly missed our forecast due to lower-than-expected handset sales and telecom service revenue. However, TWM exceeded its guidance in operating profit by 7% resulting from its stringent opex controls. Net income came in 9% higher than target, surpassing our expectations.

### **Performance by Business**

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

### **Balance Sheet Analysis**

Now let's move on to balance sheet analysis.

We maintained a healthy capital structure and a high ROE. Gross debt balance fell to

NT\$51.05bn, following a NT\$5.49bn debt repayment made in the quarter. After being partially replaced by the convertible bond in 4Q16, short-term debt only accounted for 16% of gross debt by the end of 1Q17 compared to 46% a year ago.

With short-term borrowing repayments made in 1Q17, current ratio went up while the ratios of net debt to equity and net debt to EBITDA both fell. ROE rose to 25% by the end of 1Q17.

### **Cash Flow Analysis**

In 1Q17, operating cash inflow remained stable compared to a quarter ago. Operating cash inflow was higher in 1Q16 as a result of a smaller handset payment made in that quarter.

The major investing activities in 1Q17 were a NT\$2.66bn cash capex and momo's redemption of its NT\$1.16bn time deposit for its automatic warehouse under construction.

On the financing front, we reduced our borrowings by NT\$5.49bn in 1Q17.

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

### **Event Updates**

**James:** This morning, TWM's board has approved a proposal to distribute a cash dividend of NT\$5.6 per share out of the 2016 earnings, pending AGM's approval. This demonstrates our commitment to maintaining a stable dividend policy.

The lower section lists the recognition we've received in the first quarter of 2017 for your reference.

### **Key Message**

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

Maintaining stable profits remains a key area of focus for Taiwan Mobile. Differentiated offerings to mitigate the longer-than-expected industry rationalization have helped us to increase the take-up of higher-end rate plans and lower customer acquisition costs. Looking ahead, we don't expect to see worsened competitive dynamics. Taiwan Mobile will strike a balance between responding to competition and maintaining profitability.

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

## **Q & A**

**Peter Milliken, Deutsche Bank:** *My question is firstly on the mobile churn. We are also seeing mobile revenues under pressure. Thus, I'm interested in the reasons why the churn is increasing.*

*It's good to hear that you are looking to maintain profitability despite some headwinds, but should mobile tariff not increase then would we see ARPU continuing to contract going forward as people roll onto the lower price plans?*

**James:** Regarding the mobile churn, in the past, people used to have a separate sim card for their phones and a separate sim card for their tablets. Thus, they have two sims which makes up two accounts. But now, more and more subscribers combine these two accounts into one and simply use a bigger screen handset. Therefore, the churn rates of the big three operators increased a little bit. In fact, the sim penetration rate has already gone down from 125% to 123% as of today. Every year, we'll have a 1 to 2% decline in terms of sim penetration.

Regarding your second question, yes, the lower tariff does impact the ARPU, but I believe the rationalization of competition in the upcoming three quarters should improve the situation.

**Rosie:** And, also, to answer your question on the churn, our postpaid churn has been improving from 1.7% in the 4th quarter last year to 1.6% now.

**Neale Anderson, HSBC:** *You mentioned that you believe that competition should improve in the next three quarters. Where does that view come from? Is it a change in behavior of the big three operators or the two smaller companies?*

*And, secondly, normally it's the responsibility of the market share leader to bring about price repair, to raise prices. In this case, the market share leader isn't really doing that. While TWM has done well, outperforming peers, the mobile service revenue is still coming down. Is there anything you can do to accelerate the process of improving the pricing dynamics so that we can move back to an environment where we see some revenue growth in mobile?*

**James:** I personally believe differentiation in our service is quite important. I think the flat rate will not change anytime soon in the short term and will affect big operators' profitability eventually. So, that's why I think the competition will be more rational in the future. But, again, competition is very dynamic, so it's quite difficult to predict what is going to happen.

Taiwan Mobile has done pretty well in the 1Q in terms of differentiation. For instance, in April, only 12%/11% of our newly acquired/ retained customers chose NT\$699 tariff. However, those rates for the NT\$999 plan and above were 54%/51%, respectively, mainly due to the way we differentiate our handset as well as the subsidy policy.

**Neale:** *Could you give us more details on the differentiation on the handset policy? What exactly are you doing that is different?*

**James:** Apple has a new version of the iPhone 6 with a new OS and new memory size, which was produced this year. This phone is mainly for the China market. We are the sole agent for this model and the cost is extremely good so that we can provide this phone for almost free to our customers on high tariff. And that has been very successful. We are also the sole distributor of the new Samsung Galaxy C9. And we target that for the NT\$1399 tariff customers by offering it for free. So, these two exclusive handset models give us very good differentiation when compared to the other two competitors.

**Neale:** *On the network side, you have been able to maintain a decent network quality when compared to your peers without buying the spectrum auctioned in 2015. But is network a way to differentiate in the Taiwan market between the big 3 operators because each company says they have adequate capacity even though 4G traffic is growing quite quickly? Do you think users can tell the difference in network quality?*

**James:** In terms of network quality, I think the subscribers can't really tell the difference in terms of speed. However, regarding coverage, there is a difference. TWM has biggest sub-1GHz spectrum, i.e. 20MHz continuous spectrum in the 700 frequency band. So, that helps us improve the indoor penetration as well as coverage in the rural areas.

**JinJin Wang, UBS:** *Regarding your cable TV business, you mentioned that only 27% of your subscribers are in areas facing new entrant competition. How about the rest of the 70% of subscribers, do you think they are in the areas where there will be new entrant competition sooner or later? And, if so, what does the timeline look like?*

*Regarding momo, momo has 14% YoY decline in EBITDA, but you mentioned that its equity investment income increased by 52%. Can you help us understand the difference between the two?*

*Regarding your DPS, we're very glad to see you maintain a DPS of NT\$5.6, which has*

***been stable for the last four years. Foreseeably you are guiding an EPS or earning decline for 2017, so will you still maintain a DPS of NT\$5.6, which won't to be difficult because your free cash flow will still be relatively stable, even increase, given your capex decline. From management's perspective, what is your preference, maintaining a stable DPS or you would have your dividend payout exceeding 100%?***

**James:** In terms of cable TV, it's very unlikely that the remaining 70% of customers will face new entrant competition. As I touched on it previously, with those new entrants, their pockets are simply not deep enough to sustain a high cash burn rate. In our other service areas, in 1Q, we didn't see any network deployment or market activity. So, right now our cable TV is going back on track. Thus, I can assure that in the coming three quarters, it will get better and better in terms of basic cable subscription.

**Rosie:** Regarding your question on momo's decline in EBITDA, it's mainly for seasonal reasons. In 1Q16, momo's product sold very well because it was extremely cold, so they were able to sell a lot of winter clothing, which earned them quite a hefty profit. But this year, the weather was quite warm, so the product mix may not be that good. So, they showed quite a drop in profits. On their equity earnings side, they were very successful in their investment overseas. Their investments in China and Thailand have given them more investment earnings. They have been very good at identifying overseas opportunities. And they will continue their expansion overseas.

**James:** Even though TV shopping revenues dropped in Taiwan, the TV shopping in Southeast Asia area is very popular. It's even more popular than shopping on the internet. So, currently momo is exploring setting up a joint venture in Southeast Asia. Right now, they have one in Thailand and are exploring the possibility in Malaysia and the Philippines.

**JinJin:** *Regarding the upcoming spectrum auction later this year, I know it's difficult to gauge what kind of potential cash outflow that might occur, my only concern is if we include this potential spectrum fee, our free cash flow could decline compared to last year, which might be a risk to our stable DPS. At your capital structure, you mentioned that your capital structure looks very healthy. Do you think you have the room to raise your debt level to pay those spectrum fees?*

**Rosie:** We don't feel we have any debt capacity issues. Basically our financial condition is still very sound and we are very committal to a stable dividend policy. Inevitably, this year we will have extra cash outflow because of the upcoming spectrum auction. But, after this year, we still think we will have very healthy cash inflows and the financial condition will be back to

normal.

**JinJin:** *What's your view on the upcoming auction? Do you think it will be quite competitive?*

**James:** Hard to say because the auction rules have been changed. The NCC is going to have a new two-step bidding process. Basically, they divided the spectrum into units of 5MHz each. In the first step, you bid on the number of units you need, and then the second step, you bid on your position, where the spectrum is located. But, before the second step, if all the bidders can reach a consensus regarding the spectrum position, then there won't be any second bidding.

This new process is basically trying to prevent the existing 3G operator from occupying others' territories and to guarantee incumbents to have 5MHz spectrum in their existing position so the expiration of the 3G license won't affect the current 3G services. Thus, I don't expect the competition of the auction to be very keen.

**Jack Hsu, Sinopac:** *Could you share with us your 4G subscriber target by the end of 2017?*

*Recently, your network has experienced some problems, which has caused the network to be disconnected. There has been some news indicating some expense will occur. So, will you change your financial forecast in the 2Q or 2017?*

**James:** I think what you're referring to is the 20-minute stoppage that happened to the network. But that was only for the outgoing traffic. That was an internal issue when we started to adjust the network parameter at midnight. The vendor had a mistake regarding the adjustments so it caused an outage. But, the effect was very insignificant and there will be no financial impact in 2Q.

Regarding 4G penetration rate, it will be 72% by the end of this year.

**Jack:** *You just mentioned cable TV business will turn around starting in 2Q. Could you share with us your forecast or some strategy in the cable business because the government is focusing on developing some businesses related to cable TV?*

**James:** I am really optimistic about the cable TV penetration because, as I mentioned, from what we have noticed in 1Q, the market activity of the new entrants has slowed. So, in the areas where our subscriber base experienced decline, it is now showing an increase. Our

other main focuses are in broadband. After our HFC network is fully digitized, it will free up a lot of spectrum. That means it will allow us to provide very high speed internet services for very low prices because the costs is very low. Also, when the network is fully digitized, the freed-up spectrum will also allow us to provide a lot of value-added services such as 4K or 8K high-definition TV services.

**Varun Ahuja, Credit Suisse:** *One of your peers recently highlighted that they are going to focus on the high-end segment of the market. So, can you comment on what is happening? Are you seeing competition shifting from low-end to high-end where you would have to subsidize more?*

*Secondly, on dividends, what do you think will make the board increase the payout ratio as in the absolute amount? I'm not looking for any guidance. I'm asking what sort of parameters would the board look at to increase payouts given that you have a lot of reserves to pay from dividends?*

**James:** Regarding your first question about competition moving from the low-end segment to the high-end, it's quite normal. Competition is quite dynamic and it moves from quarter to quarter. But the most important part for us is how to differentiate our services from peers. Thus, we continuously think about new marketing strategies and try to grab more and more high-tariff customers.

**Rosie:** The board looks at numbers the same way you do. So, if the board is pretty sure the cashflow is on the upward trend, they will consider doing something. But it's not something I guarantee you because as I've mentioned many times, the dividend policy is decided by the board every second quarter in April or May depending on our board meeting date. But what is certain is the board is very positive and committal to enhancing shareholder returns.

**JinJin Wang, UBS:** *You recorded the smallest mobile service decline in 1Q among your peers. How much is this attributable to the roaming revenue from APT? I know APT plans to cut down their roaming on your network, but it's probably going to be a rather progressive during the course of the year. So, if we excluded the roaming fee, is it fair to say your revenue decline is probably the same as the industry average, like 3-4%?*

**Rosie:** No. Actually, we outperformed our peers. Even if we excluded roaming revenues from the calculations, we registered better numbers than our peers.



**James:** Actually, starting in mid-February, APTG started to move their customers back. So, in March, the roaming revenue decreased quite significantly, but the impact on our mobile service revenues as well as EBITDA was not that significant. So, even if you excluded the roaming revenues, our mobile service revenues still outperform our peers, on a like-for-like basis.

**Varun Ahuja, Credit Suisse:** *In the last few quarters, your other two peers have been showing subscriber loss in mobile while you have been saying you have not seen that pressure, but now this quarter, you saw a decline in subscribers and you have attributed to multi-sim card consolidation in the market. So, I want to hear what was different this quarter?*

*Anything on the two smaller operators? Are they remaining irrelevant or are they still contributing to the competition in the market?*

**James:** Regarding the other two smaller operators, I would say they still struggle to survive. This competition landscape is tough.

With regards to your first question, in terms of the postpaid subscriber decline, it will continue because it is an industry trend. More and more people who had two sim cards are going to consolidate them.

**Richard Chen, AIA Taiwan:** *It seems like the company is more focused on profitability. Could you share with us your longer perspective in terms of which segment or business unit that you see can help your overall profitability?*

**James:** We foresee momo is going to have significant growth in both top line and bottom line. And, as I mentioned earlier, while CATV's top line and EBITDA dropped last year, they have both been improving starting from 1Q this year. So, I expect the cable TV business to be in a very strong position.

But, in terms of mobile business, I would say the top line including handset sales will continue to slightly decline due to competition in the lower tariff. Thus, I expect mobile service revenue to slightly drop in the upcoming three quarters, but the other two areas (momo, CATV) should have strong growth. Regardless, we will continue to put in a lot of effort to maintain stability in the telecom segment.

**Richard:** *So, we can assume the top line of the telecom business will face some competition,*

*however, the company hope the bottom line will remain, at least, flat on a YoY basis. Is that correct?*

**James:** I will say the handset subsidy and channel commission will continue to slightly decline, which will improve our bottom line quite significantly.

**Jack Hsu, Sinopac:** *Can you talk more about your value-added services?*

**James:** We are doing extremely well there, especially handset insurance, Google Pay and Apple Pay, and also the my series such as myVideo, etc. All the value-added services contributed to the top line and bottom line.

**Rosie:** The growth rate was quite phenomenal in 1Q, close to 30% YoY in terms of revenue.

**Jack:** *Are there any plans to finance the spectrum auction?*

**Rosie:** We have no concern over how to finance the spectrum auction. As I mentioned during the presentation, while we have told you our short-term debt has been on the decline, it's very easy to raise short-term debt to finance this spectrum auction and we also have ample debt capacity. It's all underutilized.