Taiwan Mobile

2Q14 Results Conference Call

July 28, 2014

Moderator: Good morning, good afternoon, ladies and gentlemen. Welcome to the conference call. Rosie, please begin the call and I'll be standing 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.

Steady 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 second quarter was up 2% year on year, attributed to the continuous growth in wireless data revenue. In addition, TWM continued leading the pack with the highest ARPU for the past five quarters.

As you can see in the slide, our blended ARPU is NT$731, in comparison to FET's NT$718 and CHT's NT$591.

Please turn to the next page of our smartphone strategy.

Our Smartphone Strategy

Regarding our smartphone strategy, the eco system of 700 LTE enabled devices has been more matured than our expectations when we launched 4G service in early June. Currently we have around 20 models of smartphone and tablet products supporting the 700 LTE band provided to our customers.

In 2Q14, total smartphone sales volume was up 12% from a year ago and accounted for 93% of total handsets sold.

Therefore, mobile data adoption rate went up to 58% of the postpaid installed base, from 48% a year ago. This led to a 20% YoY growth in mobile data revenue in the second quarter.

Steady CATV Operation

On the cable TV business, as indicated in the table, our internet subscriber base increase of 5% and DTV customer base growth of 55% were both higher than the 1% subscriber rise in analogue TV service in 2Q14, representing the trend of a growing take-up rate of two or three services. Our blended ARPU for cable is NT$796, up to 2% YoY.

Growing Online Shopping Business

In 2Q14, momo's revenue increase was greatly attributed to a solid 32% YoY revenue growth in the online shopping business.

On the EBITDA front, momo's EBITDA in the online shopping business grew around 72% YoY credited to a better product mix and margin expansions. EBITDA in the TV home shopping service was up by 11% due to cost cutting measures. As a result, momo registered a 43% YoY increase in EBITDA on an expanding margin of 7% for the quarter from 5.6% a year ago.

Let's turn to the financial overview section.

Performance by Business

In terms of performance by business in 2Q14, telecom EBITDA made up 84% of 2Q total EBITDA and rose 2% YoY. This is credited to a lower SAC (Subscriber Acquisition Cost), despite continuous pressure on mobile voice business.

Thanks to a 53% YoY revenue growth in the DTV business and the continuously growing cable internet business, HBG saw a YoY increase in EBITDA and an expanding EBITDA margin compared to a year ago.

As mentioned in the previous page, momo's strong EBITDA growth came from its online shopping business and rising margins.

2Q14 consolidated EBITDA recorded a healthy YoY growth with half of the growth related to our telecom business and the rest largely from momo.

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

Results Summary

Rosie, CFO & Spokesperson: Good afternoon. Let's turn to results summary. In 2Q14, we reported total revenue of NT$26.9bn, EBITDA of NT$8.2bn, and EPS of NT$1.54.

2Q14 YoY Analysis

On a YoY basis, for 2Q14, the revenue's YoY increase of 1% was due to growth in momo's revenue, which more than offset declines in device sales and IDD revenue. EBITDA grew 4% YoY largely as a result of expense discipline in the telecom division and profit growth from momo. Although the rising D&A expense resulting from the expanding telecom and CATV businesses weighed on TWM's EBIT for the quarter, a lower non-operating expense boosted net income to increase 5% from a year ago.

2Q14 Guidance Achievement Rate Analysis

The lower-than-expected revenue was mainly due to a handset sales shortfall resulting from weaker demand for high-end smartphones. Having said that, our consolidated EBITDA still exceeded our guidance by 5% due to lower-than-expected telecom opex and higher-than-expected profit from momo. Non-operating expenses, namely write-offs and interest expenses, also came in lower than forecast. As such, 2Q14 net income was ahead of our forecast by 16%.

Let's turn to balance sheet analysis.

Balance Sheet Analysis

On the assets front, in 2Q14, cash balance decreased QoQ resulting from a higher cash capex. Compared to a year ago, cash level was lower because we raised NT$5.8bn from corporate bond issuance in the same period last year.

The QoQ increase in long-term investment in 2Q was due to momo's new TV home shopping joint venture in Thailand.

The sequential increase in PP&E mainly came from adding 4G equipment & momo's NT$1.71bn spending to build its logistics and warehousing center.

On the Liabilities & Shareholders' Equity front, compared to a year ago, TWM's net debt increased by NT$30bn in 2Q14, mainly attributed to the LTE spectrum acquired in 4Q13. But the Company managed to reduce the debt level sequentially.

The QoQ increase in other current liabilities was due to the $15.06bn cash dividends payable paid on July 18, 2014. Let's turn to the cash flow analysis.

Cash Flow Analysis

In 2Q14, operating cash inflow decreased slightly QoQ mainly due to a corporate income tax payment made in the quarter. Compared to a year ago, larger advanced receipts/other payables booked in 2Q13 resulted in a higher operating cash inflow.

The 2Q14 net investing cash outflow was mainly a NT$4.78bn cash capex, comprising of 1) 4G network roll-out, 2) momo's logistics and warehousing center 3) Taipei New Horizon's project payments.

The main financing activity in 2Q14 was raising a NT$7bn 2-year bank loan and a NT$0.8bn commercial paper to repay the NT$11.47bn short-term borrowing. In addition, a NT$0.22bn cash dividend payment to minority shareholders was made by momo in 2Q14.

Let me turn the mic back to James for 3Q14 guidance and board resolutions.

3Q14 Guidance

James: We expect 3Q14 total revenue to be up by 5% YoY resulting from increases in both handset sales and momo revenue.

The EBITDAs of cable TV and momo will continue to rise YoY in 3Q. Telecom EBITDA, nonetheless, may not see a YoY growth as initial 4G related opex would exceed revenue increase in the early stage of 4G service launch.

Separately, we expect mobile network expansion to translate into YoY increases in both D&A and write-off charges in 3Q.

Board Resolution

This morning, TWM's board approved the issuance of a 5-year Euro-Convertible Bond of no more than US$500mn with a zero coupon, zero yield to maturity, conversion premium of 20% to 32.5%, and no conversion price adjustment for dividend yield below 5.8%.

In addition, the board also approved an additional capex budget of NT$1.82bn for 2014, bringing the revised full-year capex to NT$15.4bn.

Event Update

This page of regulatory update and awards and recognition is for your reference. One thing I would like to discuss a little bit more is the TWM and FET 5MHz spectrum swap. TWM should be able to launch 1.8 GHz LTE service by the end of September this year because the NCC has already approved the swap and also approved the returning of the respective 5MHz spectrum on the 1800 MHz band on July 16. So, the service should be able to start in September.

Key Message

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

Acceleration in the deployment of the 4G network, growing number and greater variety of LTE devices and the earlier-than-expected availability of the 1800MHz LTE spectrum will propel customers' migration to 4G services. TWM is best positioned to capture the business upside of the LTE services.

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

Q & A

Chate Bencha, Credit Suisse Singapore: ***I have four questions. The first one is related to momo. An excellent improvement we have seen so far. What's your expectation in terms of upside on margins and revenue opportunity for momo that we should be expecting?***

Another three questions related to your 4G. What's the take up in 4G services been so far?

The 2nd question is your guidance for 3Q, what kind of take up, if you can share, that you're assuming for 4G?

What would be your key differentiation if a customer would like to pick one's services compared to your peers?

James: For the first question momo, Rosie, would you like to handle this question?

Rosie: momo's situation has been much improved in the 1st half. And we expect the momentum to continue into this year and into the future. And actually its 15% growth in revenue was mainly due to its 29% growth in online shopping business in the 1st half. They will also be launching different services to expand their business potential for growth. So, we have high expectations for their margin and revenue growth. And, for the 4G take up rate, James will elaborate on this for you.

James: In terms of the 4G take up rate, I would like to say, the momentum has looked very promising. As of today, our 4G subscriber number was close to 100,000 right now. One third of them are purely new acquisitions and two thirds migrated from 3G to 4G services. So, looks pretty good. Our original target of 400,000 subscribers by the end of this year looks very promising.

And the third question, can you repeat it again?

Chate: *Your 3Q guidance, what kind of 4G take up assumptions that you are building into your guidance?*

James: I don't have the ratio right now, but we expect we will have probably around 60,000 to 70,000 new subscribers per month.

Rosie: By the end of this year, we expect to achieve our target of 400,000 4G customers.

James: And the last question is the key differentiation of our 4G services? I think the key to success of 4G services, first, is coverage. I think by the end of this year, we should have about 6,000 4G base stations. That will basically translate into 90-95% population coverage, which will put us in very good shape. Secondly is the speed. We have 15 MHz on 700 band and in September we will have an extra 5 MHz on 1800 spectrum. We are going to do the carrier aggregation trial in the 4Q and that total up will be 20 MHz. That will translate into a theoretical maximum speed of 140 Mbps. I will say it is the highest right now among our competitors. So, the speed we have will be in a leading position.

The third one is the add-on value-added services in 4G. With our early bird program, we have video services, which we will give the customers six month free trial. And after that, we will start to charge them. We can see the traffic growth in 4G and it looks pretty good. The usage rate for these video services also looks very promising. I think that will put us in good shape in terms of competition among all these three major competitors.

Chate: *If I may, just one follow-up question for momo, without new plan for expansion, just your existing online business, what kind of EBITDA margin improvement that you think would be quite fair for momo? Going to 10% or could it be higher than that?*

Rosie: momo is already trading on the Tiger board. I don't think we can announce the numbers for them. They should have a public announcement of their results maybe in mid-August. I don't know the dates, but they plan to be more transparent with investors soon. But we do believe they will outperform their budget for this year.

Anand Ramachandran, Barclays Singapore: ***I have three questions. Firstly, for the competitive threat from the two newcomers, do you have anything you can observe or would like to share with us from what you've seen from the market? Obviously, they have been very quiet on what they plan to do, so I want to hear your views on that.***

Question two, if I look at the 3Q D&A guidance, is the amortization for the 4G license fee also kicking in 3Q or have you already reflected that in 2Q in your numbers?

Thirdly and lastly, I look at the convertible bond and I'm thinking a couple of things which I appreciate your guidance on. First of all, why are you raising this? Is this re-financing of something or is this a new debt? And I noticed that 5.8% number, why 5.8%? Why is it not 5%, why is it not 6%? Is it related to the DPS you issued this year?

James: I will answer your first question regarding the two 4G newcomers. Taiwan Star, they will probably start to run service in 3Q, probably August, September time frame. In terms of the competition, I can see the competition will be keen, but I don't think it will be a big threat to the big three mainly because Taiwan Star doesn't have fixed line infrastructure. They only have mobile services. So, of course, we can foresee there will be some price competition. We will see how it goes. The other one is APTG and Hon Hai, which just announced to merge with APTG. The full merger will take place next year, but they will probably launch 4G service in 4Q this year. So, at this point, in terms of competition in the 3Q, I think we are ok.

And, in terms of the depreciation and amortization, we have already started the spectrum amortization in June.

And, in terms of ECB, I will turn it to Rosie to explain more why it's 5.8%.

Rosie: 5.8% is a number decided by the board. It's a re-financing. And we try to set up some dividend protection for us so that the dilution will not be too substantial or we try to mitigate the dilution impact by building in a dividend protection of 5.8%. So, that's a re-financing. We're trying to diversify our funding methods.

Also, to elaborate a bit on the competitive landscape of 4G, James just mentioned to you that Taiwan Star doesn't have fixed line network. Nor does it have sufficient spectrum to compete with the big three. Don't forget, 5MHz of the spectrum won by Taiwan Star actually is blocked by APTG. So, they are facing a lot of challenges. So, we don't think they will be able to deliver quality services, especially compared to the big three.

Anand: *One more question regarding the spectrum swap with FET, that has no financial implications whatsoever, right?*

James: No, not so far.

Letitia Yu, Macquarie HK: ***We have four questions in total. Number one is regarding your mobile service revenue outlook. I've noticed that mobile voice revenue decline actually accelerated in the 2Q vs. the 1Q. How much downside do you see from here regarding both voice tariff as well as MOU? I've noticed that data revenue growth also slowed down in the 2Q vs. the 1Q 2014. I want to know what's the reason behind it.***

The 2nd question is about mobile capex outlook. The company raised momo FY capex, it was revised up to $2.5bn. I've noticed that for 2Q14 the company already spent $2.2bn cash capex on momo. So, what's the thinking behind this quite unexpected warehousing center investment? I guess we shouldn't expect this kind of abnormal spending for the next two quarters, right?

The third question is regarding the company's capex guidance practice. TWM revised capex twice both at the 1Q and 2Q results announcements, So, going forward, should we expect more relevant capex guidance to be given on a quarterly basis rather than annual basis? Same as the company's operational guidance practices here?

The last question is regarding the 4G rollout progress as well as relevant capex. The company raised 2014 mobile capex guidance in the 1Q announcement, but I noticed the 4G base station build-out progress was behind its peers as of 1H14. Also, recently CHT commented that it plans to shorten its 4G investment build-out time frame from four years to three years. Is there any possibility that TWM will need to further review capex budget for 4G in order to speed up 4G build-out in 2H14?

James: In response to the telecom revenue, it's actually kept flat. The trend of voice revenue still declines in an 8%-14% YoY basis. But TWM, as you can see in the previous viewgraph, we are still in a good position because our voice decline is about 7% or 8% in comparison to our peers; they have 12-13%.

In terms of data revenue, the rate also slowed down. In 1Q, data revenue was about 20% growth on a YoY basis. 2Q dropped to around 17% or 18%. But if you noticed in the viewgraph, our penetration rate for our data services is up to 58%. I would say it's probably the highest right now among the big three. Data penetration is already reaching 60%, so I would expect in the coming quarters, the growth rate will remain flat around the 18% to 20% range.

The fourth question, to speed up the 4G rollout, our deployment is even more aggressive than CHT. As I mentioned, by the end of this year, we will be able to reach 6,000 base stations for the 700 band. In addition, we will have another 2,000 base stations for the 1800 band. So, the total coverage I would expect at the end of 1H15, we should reach almost 100% population coverage. But, at end of this year, we will be able to reach 90-95% population coverage, which I believe is still one of the best among these three competitors.

Rosie: What's James mentioned was that we are not slower than our peers. I think you may be misled by the newspaper reports, which was because of some NCC process. Actually, our 4G buildup has always been comparable to our peers if not faster.

And on your question on whether we would revise our 4G capex for this year, we will review this and maybe make a decision when we have a clearer view of our capex spending for this year. As you can tell, the big three will definitely shorten the deployment period for 4G. There are chances that we may raise the 4G capex. As to whether we would release annual guidance or quarterly guidance. You know this year why we change to release only quarterly guidance is because of the unpredictability of the 4G service. Even until now, what we have shared with you is still not a good sampling. So, we would like to be more conservative in releasing the guidance. Before the 4G clarity is good, we may continue doing the quarterly guidance.

James: I would like to add some more words regarding the base stations. We will probably reach 3,000 base stations by the end of this month. However, the NCC may only approve more than 2,000 by the end of this month. Actually, there is congestion in the NCC right now. I think they are short on manpower to process the approval. In the past years, NCC never announced the base station number for the 2G or 3G deployment. A lot of misleading reports from the newspapers may lead the people to think that we have the least amount of base stations, which is not true. Generally, by the end of this month, we will be one of the leaders in terms of having the most base stations in place and in service.

Letitia: *Just two follow-up questions. One is regarding the mobile voice service revenue, do you see more downside from tariff or MOU?*

The second question is regarding momo EBITDA margin. So, post-logistics and warehousing center build-out, should we expect momo opex to go up a bit? As a result, this 7% EBITDA margin might be a bit difficult to sustain going forward

James: In response to your first question, in terms of the voice MOU, yes, it will decline. I think it will be in the 7% range. However, as I mentioned, the data revenue will pick up. And one thing, if you disregard the handset sales and just see the mobile service revenue, I will still see it flat or with a little bit upside. But it's still too early to say that because for the 4G, once we pick up the momentum, the upside of the mobile service revenue should be more than expected.

Rosie: On whether momo's EBITDA margin can be sustained at this level, it's up to how they expand their business. Based on their budget for this year, I would say that the set-up of their warehousing and logistics center will not have any impact because they just spent the money to acquire the land only for this year. Next year, it's still under construction and we haven't got their budget for next year. So, I cannot comment on that at this stage. But, at least, we have that their core business is doing very well and even for their offshore investment that they made recently could be doing well, too. So, we think they are in much better shape than before.

Gary Yu, Morgan Stanley HK: ***I have two questions, both on the mobile business. First on the 4G take-up, which plans are the most popular plans among early adopters of 4G and how does ARPU compare to the 3G ARPU before the migration of same customers?***

Second question, on capex, where do we see capex going in 2015 given that we may still have some coverage to complete on 4G network? And, also, if you can give us some guidance on the cash capex for this year compared to the accrued capex.

James: In response to your first question, among the 4G new adopters, I think 75% are the subscribers that fall into the rate plans of NT$1,000 and above, and most of them are in the

NT$1,299 rate plan. So, we're in good shape, compared to our average postpaid ARPU of NT$831. I would say right now from the figures I see, it's very good. But again this is too early to make a fair statement that we can get more of a premium from these 4G services because the number of samples is not sufficient enough to justify the statement.

Secondly, as I mentioned earlier, out of the 2/3 4G subscribers that migrated from 3G, most of them are high ARPU customers. But I don't have the data around to say what's the average ARPU for the 4G users. But, by looking at the rate plans, I think we are in good shape. Hopefully, for the next quarter or coming year, if the new subscribers could also fall into these rate plans, then we will be in a good shape.

And the final statement I would like to make, all the investors might ask the question, how much of a premium can you get out of these 4G services? As I mentioned, it's really too early to say that, but, right now, I think we are in a good shape. The key factor is in tiered pricing. All these three competitors have their own early bird programs. If you migrate from 3G, then basically the 4G data allowance we provided is unlimited. But by the end of this September, if all three competitors can end this kind of early bird promotion program and go back to tiered pricing, then I think it's very promising to get a high premium out of these 4G subscribers.

And the second question, I'll pass it to Rosie.

Rosie: Gary, you just asked how much capex we would spend going into 2015. As we haven't done any budget for 2015, so I can't comment on that. And as to your cash capex for this year, I don't have the numbers either because it's up to the inspection speed as well, so it's difficult for me to share with you the numbers.

But one thing is for sure, just as I mentioned to you, I believe the big three will speed up the deployment work for 4G and, as I mentioned earlier in several conferences or in our meetings with you guys, I have already said that there might be some short-term hiccups inevitably due to the 4G deployment as the 4G deployment speed will be much faster as compared to 3G. For 3G, as you all remember, it took us a long time to complete a full coverage of 3G network. But now, the 4G handset development is accelerating and we need to ensure a quality service. That's why we need to speed up our deployment.

Tina Hou, Goldman Sachs HK: ***I have two questions. The first one is regarding capex. So, for 2014, we have assigned NT$9.8bn mobile capex and we're targeting over 90% population coverage. So, that leaves us with only 10% population to cover in 2015. So, if this logic carries on, should we expect the mobile capex to decline pretty sharply in***

2015?

The second one is that if the new entrants come into the market with unlimited data plans for 24 months entire contract period, not only limited to the promotion period, is there a possibility that you would prolong your 4G unlimited promotion as well?

James: I think in terms of capex for 2015, would there be a reduced capex, I think it's hard to say right now because we still have the 1800 spectrum we need to deploy the base stations with. So, it's too early to say how many base stations we're going to deploy on the 1800 band.

And, for the new entrants, you mentioned that if they offer all-you-can-eat, would the big three follow or prolong the current early bird promotion, I don't' have an answer right now. We will see.

Jack Shu, Sinopac Taiwan: ***My question is how much the 4G promotion fee will be in 2014 and 2015?***

The second question is that what is your advantage in the 4G rollout in the early stage?

James: In response to your first question, I do not have a figure with me right now as to what is the marketing expense in 2014 or 2015.

I think people are expecting more video services or interactive services for 4G and that requires high speeds for the mobile services. I think the differentiation between 4G and 3G, as I mentioned, is speed. And, also, the value-added services will be more important in 4G than in 3G because right now. The speed of 4G services could reach 50 mbps up to 100 mbps or higher. Going forward, when we start our carrier aggregation, we should be able to reach 140 mbps. So, a lot of new services can be introduced in 4G. That's our expectation.