Taiwan Mobile
2Q16 Results Conference Call
July 27, 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

In 2Q16, Taiwan Mobile was the only operator reporting positive YoY growth in different metrics. TWM saw a 0.4% YoY increase in the number of total subscribers, while those of its peers both declined. The 4G service take-up rate reached 55% of the postpaid installed base and helped mobile postpaid ARPU grow by 3% YoY in 2Q16. As a result, TWM was the only one among the big three to report a positive YoY increase of 1.2% in mobile service revenue, on a like-for-like basis. TWM also stood out in telecom EBITDA growth, aided by above-industry top-line growth and larger expense savings.

Margin Expansion in Retail Business

With an 18% YoY top-line growth, online shopping remained as the brightest spot for momo. In Q2, online shopping contributed 60% of momo's total EBITDA. For 2Q, momo's solid 13% YoY increase in EBITDA came not only from its online shopping business but also from the business turnaround in China.

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

Performance by Business

Rosie Yu, CFO & Spokesperson: Let's review our performance by divisions. In 2Q16, TWM reported YoY EBITDA growth in all business lines. 85% of its EBITDA was contributed by the telecom business, while cable and momo accounted for 10% and 4%, respectively.

Telecom EBITDA increased 5% YoY, credited to decreasing handset subsidies. Despite competition from new entrants, total revenue and EBITDA in the cable business both managed to show positive YoY growth, aided by rising revenues from cable broadband, content agency and digital TV services. momo's growth in revenue and EBITDA were already elaborated on previous slide by James.

Results Summary

In 2Q16, TWM delivered solid financial results with net income increasing by 4% YoY, the only operator showing positive earnings growth in the industry.

In terms of 2Q16 guidance achievement rate, consolidated revenue slightly missed our forecast for the quarter mainly due to lower-than-expected handset sales. However, our EBITDA and net profit benefited from fewer-than-expected handset subsidies and interest expenses. Therefore, we managed to beat our EBITDA and EPS targets by 5% and 13% in 2Q16, respectively.

Year to June, our consolidated EBITDA was up by 8% from a year ago, credited to operating leverage. In addition, 1H16 EPS accumulated to NT$2.9 and reached 56% of our full-year target.

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

Balance Sheet Analysis

Let's turn to the balance sheet analysis. Following AGM's approval of NT$15.2bn dividend distribution, our current liabilities increased accordingly from 1Q, while shareholders equity reduced by the same amount in 2Q16. This resulted in a QoQ drop in current ratio while ROE further rose sequentially to 31% in 2Q16. In 2Q16, our net debt to EBITDA dropped to a low of 1.29x, arising from continuous debt repayments. Additionally, we also increased the portion of long-term borrowings to 65% in the quarter, up from 43% a year ago.

Cash Flow Analysis

Despite higher cash earnings, 2Q16 operating cash inflows decreased sequentially due to the payment of the 2015 corporate income tax and more handset payments. Compared to a year ago, 2Q16 operating cash inflows were larger on the back of higher earnings.

We note that investing cash outflow in 2Q decreased both QoQ and YoY because of continuous declines in mobile capex, which has been providing a positive boost to our free cash flow.

On the financing front, apart from paying NT$0.54bn in dividends to momo's minority shareholders, we further reduced our bank borrowings by NT$3.73bn in the quarter. This is compared to the NT$1.72bn debt repayment and NT$0.67bn in dividends to momo's minority shareholders a year ago. FCF netted NT$10.83bn in 1H16, translating into an annualized FCF yield of 7%.

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

Event Update

This page lists the awards and recognition we've received in the second quarter of 2016 for your reference.

Key Message

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

The big three's rational moves regarding the 4G rate plans and contained handset subsidies set the tone for a healthier growth path for the industry. Taiwan Mobile will continue to create shareholder value through discipline in both mobile spectrum investments and handset subsidies.

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

Q & A

Peter Milliken, Deutsche Bank: ***You were quite disciplined on the subsidy side, why did you still manage to beat the market in terms of subscriber growth?***

Although you have done relatively well, profits are quite sluggish for the sector. Do you think there is something we can look forward to driving growth ahead? And if that is the price increase, when can you expect to see that come through in terms of results?

James: This is a saturated market and the net subscriber increase, especially in postpaid, remained flat. However, I think where Taiwan Mobile outperforms its peers is churn reduction. In the 2Q, I believe we had a lower churn rate compared to our peers.

Rosie: On your 2nd question, we think the price increase or the benign competitiveness landscape gave us some room to pave the way for steady or more optimistic growth down the road. But it will take time for the growth to be seen. As you know, CHT raised the threshold for the unlimited rate plans. So, we now see very good momentum for the higher priced rate plans. We think the momentum will continue into this quarter as well. James may elaborate on this for you. In this month, we actually have seen some momentum picking up, but we think it will take time. As you know, the rate plans are paid monthly, so even for the higher plans to be reflective on the books, it will take a couple of months for you to see it.

James: In June, of those subscribers signing up for a new rate plan, 36% chose $1,399 unlimited rate plan or higher. And, if we expand that range to include $1,000 or higher, it would be 45%. Thus, in terms of acquisition quality, it's been quite good. So, hopefully this will be reflective in the coming few months in terms of mobile service revenue growth.

Peter: *One question. momo has been doing pretty well. Can you provide a bit of color on the online shopping market in Taiwan in terms of industry volume growth or competition?*

James: Right now, in the online shipping business, momo has already reached 2nd place, only behind PCHome. So, the momentum is good. And, by the end of the year, we should be able to open the logistics center in Taoyuan, which should enhance our competitive capabilities. Thus, given that 3Q is traditionally a hot season, I expect momo to perform even better.

JinJin Wang, UBS: ***You mentioned that the churn rate has been very good in 2Q. What is the underlying reason? Is that related to any specific marketing strategy or practices?***

Can you provide more color on the upcoming spectrum auction next year in terms of the timeline, is it likely in 1H or 2H? I know it's difficult to gauge right now, but what's your sense of the potential spending? Is it going to be like the one in 2013 or more rational like in 2015?

Is there a chance that the big 3 can totally remove the unlimited 4G data offering in the future?

James: In terms of churn rate, for Taiwan Mobile, it dropped to a historical low in 2Q. And there are two reasons for this. First is the network quality in terms of speed and coverage. Being on the 700 frequency band, we take advantage of good coverage as well as indoor penetration. Thus, that helps a lot in terms of 4G service quality. Secondly, the customer acquisition quality has improved quite a lot. In 1Q, our competitors offered NT$499 tariff plan and we put a lot of subsidy into that, but the acquisition quality was not good. However, when we resumed the NT$1,399 plan, the quality of the acquisition improved quite significantly and

I expect that will continue in 3Q.

Regarding the upcoming auction of the 2.1GHz spectrum, 2.1GHz still carries a lot of 3G customers, so it's very important. Even though we have 4G in place now, I would say 3G will remain for quite a while because VoLTE is still not very popular in the market and, thus, is not currently a practical replacement for voice circuit fallback to 3G. So, Taiwan Mobile will definitely pursue this spectrum.

Regarding the 3rd question, I don't think the unlimited rate plans will go away entirely in the near future. One of the main reasons is that customers' data consumption, which we have been monitoring for months, remains growing slightly. In addition, with the two smaller players' aggressive rate plans, I don't think the unlimited plans will be removed anytime soon.

Livia Wu, Yuanta: ***You mentioned that EBITDA margin increased YoY because of lower subscriber acquisition cost. Is it because of higher mix of low-end handset sales and lower mix of high-end sales that leads to a lower total handset subsidy?***

Do you have a separate figure for depreciation and amortization cost for 2Q?

James: In terms of the 1st question regarding the EBITDA improvement, while service revenue remained, the handset subsidy was reduced mainly due to the average sales price of the handsets dropping quite significantly.

Rosie: The 2Q depreciation was NT$2.7bn and amortization is close to NT$0.8bn.

Livia: *You mentioned in 2Q the customer mix of the NT$1,399 rate plan and above was 40%. How does that number compared to the previous quarter's or last year's?*

James: I don't have last year's figure with me, but the trend is quite good and going up.

Richard Chen, AIA: ***Last month, there was news regarding Taiwan Mobile having oversea investment regarding Indonesia and India.***

Rosie: No, no, we have made a clarification already. Please go to our website to see our clarification. It's been clarified a while ago.

Richard: ***Do you have strategy to focus on the early bird 4G users whose contracts will be expiring soon?***

Also, this year your capex is much lower compared to last year's level. If we exclude the next round of auction, how do you compare next year's capex to this year's?

James: With regards to the early bird 4G subscribers, we typically start a retention plan six months before their contracts expire. And the results have been pretty good as you can see from the low churn rate.

In terms of the capex, this year is low since we didn't have 2.6GHz spectrum to deploy and I expect the capex for next year to be low as well, especially compared to our peers, because most of the deployment for the 700 and 1800 frequency bands has already been done. We have already done a lot to increase the number of base stations and to enhance network coverage this year and the previous year. So, next year, I don't expect rising investment on the mobile network side.

In Young Chung, Goldman Sachs: ***How has your 4G monthly data consumption changed since the new tariff adoption? I know you previously mentioned it was 10GB per month per 4G user and how is that trending after the new tariff.***

You mentioned the rising competition in cable TV sector, and we noticed that the ARPU or the overall revenue trend on the pay TV side is not so exciting. Can you give us an update on what's happening in the market? And how much of a threat do you think the new competitors can be in the near term?

It was useful that you shared the subsidy trend in the 1Q. I remember you said the overall subsidy fell 30% YoY in 1Q. How has that magnitude change in the 2Q and what do you think the overall trend is going to be toward the end of year? And how much savings can we expect from the subsidy side into next year?

Do you expect any changes in the regulations of pay TV given the new Presidential administration?

James: For the 4G subscriber, the average consumption reached 13GB per month per sub. And it has been in this range for the past six months. So, as I have said, the consumption is reaching a saturation point.

For cable TV, due to a lot of new entrants who are offering disruptive pricing, their presence has affected the market. However, those new entrants, in my opinion, are not strong enough financially to sustain for long. The competition is rather keen at this stage, but I would say the competition will come to an end by the end of this year because the financial situations for those new entrants are quite bad. The government requires the new entrants to deploy digital cable TV network. With disruptive pricing, i.e., 1/3 of the regular price, and subsidizing customers with free set-top boxes, their financials won't sustain for a long time. So, I can foresee the new entrants facing a very difficult financial problem.

Regarding handset subsidy, the trend for the high-end handsets is not very optimistic for the coming year. Even though the iPhone 7 is scheduled to come out, I've been told that it won't be a significant change in terms of features. Thus, I can foresee the trend of lower handset subsidy will continue, at least, in 3Q before the iPhone comes out.

Regarding potential new cable TV regulations proposed by the new government, it's hard to say right now because it's only been two months since the new government took office. But, in my opinion, I don't foresee any regulations to be lifted or relaxed. So, it will probably be the same as before.

Jack Hsu, Sinopac: ***Any update regarding the C1 and C4 spectrum blocks dispute between TWM and FET?***

What's the current percentage of customers who chose the 30-month rate plan and the percentage of those who chose the 24-month data rate plan?

Has there been any major development in the enterprise market?

James: Regarding the spectrum dispute, it's still ongoing so there isn't much I can say right now.

As to the percentage of customers choosing the 30-month plans, I don't have the percentages right now, but most of our customers prefer the 24-month plans.

With the enterprise sector, we have been reforming our enterprise business for the last one or two years. We have been trying to convert our offering of products into comprehensive solutions. And it has been going quite well. So, I expect the growth momentum for the enterprise business to continue in 2H.

Varun Ahuja, Credit Suisse: ***On capex, given the 4G penetration, your subscriber base is increasing and the usage is pretty high (13-14GB/month), do you think you will soon***

reach a capacity constraint and thus would need to make more investments on the network? Or do you think this kind of high usage is manageable for a long period of time?

The 36% of your new customers in June had NT$1,399 plans. Are most of them re-contracting customers? My understanding is that new customers you acquired will be at the lower end, because you have already got most of the high-end customers through 4G acquisition. And, going forward, given that most of the customers are coming from other plans, do you think these customers will move to NT$1,399 or will they move to NT$1,199 where you are still offering a generous 25GB of data? I just want to understand the psyche of the customers. Is the unlimited plan attractive to them?

How much of that roaming revenue from APTG is helping your EBITDA and net profit?

James: In terms of the network capacity of 4G, it is sufficient enough for the next two or three years. So, I don't see there's a need for further network capacity capex investment.

For the NT$1,399, when I said acquisition, it means a new customer acquired, either from a competitor through number porting or as a pure new customer. It's not re-contracted.

Regarding the roaming question, since we have signed a NDA with APTG, we cannot disclose this information.

JinJin Wang, UBS: ***You mentioned that, in your judgment, the new entrant risk in cable TV will not be sustainable and will come down by the end of the year. How is the new entrant risk in telecom? The consensus view seems like the two smaller operators, Taiwan Star and ATP, haven't been a big threat. Any chance the competition could pick up or do you think because of the lack of financial power, the two entrants cannot present a meaningful threat for the big three?***

What is your timeline on 5G in Taiwan given that in China, commercial launch is said to be 2020? What is your normal range of capex-to-sales ratio, low teens or high single digits?

James: In terms of the new entrants, my personal view is that, in a mature market, there are two very important factors needed in order to be successful. One is economies of scale. And the second is that the business has to be diversified or being able to find a special niche market such as IoT or a new service they could market. If they just stay in the traditional core telecom business, the smaller players wouldn't have much chance to survive.

JinJin: *According to my own calculations, for the two smaller operators to turn profitable or reach breakeven, seems like they have to accumulate a market share of 15%. Would you agree with that calculation?*

James: I cannot comment on that. In response to your 2nd question, I think 5G is still in an early stage mainly because the 5G spec from 3GPP will not be finalized until June 2018. Before that, I don't see any equipment will be available for large-scale deployment. Right now, we've seen some telcos starting to try 5G, but those are not standardized 5G equipment. They were just for demonstration purposes. So, I agree with you, I think the commercial launch of 5G services will be 2020. Before that, I think it will be more of the experimental type of networks.

JinJin: *In your view, do you think the 5G capex will be a step up or a substantial increase as we saw in 2013 and 2014 or will it be a progressive capex increase?*

James: I think the main purpose of 5G is machine-to-machine, mainly IoT. And that probably will not be a mass market in the early stages. Therefore, 3G and even 4G will sustain for another ten years because their main communication are man-to-man and man-to-machine. With machine-to-machine, there are so many alternatives like Narrowband IoT or LoRa (Long Range) Low-Power Network. And those kinds of service don't necessarily have to be provided by the operators. It can be any company. So, as for the machine-to-machine connection, for instance the autonomous car that requires a very short latency time, only that kind of service requires 5G. Otherwise, I don't see 5G being a mass market in the beginning stage. Thus, 3G for voice and 4G for data communication will be around for a while.

JinJin: *So, seems like 5G capex is going to be more progressive, so is it reasonable to assume that your capex-to-sales ratio in the medium to longer term, the range should be 12-13%?*

Rosie: Actually, in 2Q, it has dropped to below 10%. In our management report, it has been disclosed. In the next two years, we don't think it will pick up. So, we think it will be on the decline and then maybe stabilize.

In Young Chung, Goldman Sachs: ***Since it looks like your capex is going to be stable into next year and your subsidy continues to be quite stable as well, so the free cash***

flow will be quite positive into next year. With that said, what is your cash usage plan in the medium- to long-term? Are you focusing on growing other businesses? It seems like, in terms of top-line growth, your content sales in cable TV grows faster than the others and online shopping also performs better than other business lines. Are you willing to invest in those areas where there is better top-line growth or do you plan to focus more on the shareholder returns?

James: momo invested a lot of capex last year in the logistics center. So, they might focus on another area like fleet management.

Rosie: To answer your question on the use of cash, in the future, how we could use is really dependent on the opportunity to grow our business. If the cable law can be amended, then the free cash flow will be partially used for that particular purpose. Without that, it's more opportunity-driven and we think we are very committal to enhancing shareholder returns, meaning we will definitely commit to a stable dividend policy.

In Young: *Will you consider raising your payout ratio beyond 100% in the next two years?*

Rosie: It's to be decided by our Board every April. And from our balance sheet, you can tell that we do have more than NT$30bn in excess reserves that can be used for topping up our dividends. But it's decided by the Board, so we can't give you any concrete numbers.

Jack Hsu, Sinopac: ***How is the mobile payment services doing? Are there any revenues generated from this or will there be any in the 2H this year?***

James: Right now, it's in the very early stage. We don't have any revenue yet from the Wali service so far. But, in terms of number of subscribers when compared with our peers, we are number one in the market and leading quite significantly. But, right now, we are improving the economies of scale and exploring business models that can really make a profit from Wali.

Richard Chen, AIA: ***Regarding a Smart Home concept opportunity for you, have you considered building possible working relationships with Taiwan security companies such as Shin Kong Security to enhance the Smart Home business?***

James: Thanks to our cable business, which includes TFN and Kbro, we have 1/3 of the household market share. So, Connected Home services is a focus for us. Currently, a lot of bundled services are being developed. Our focus is on home surveillance. So, we would like to explore the chance to cooperate with Shin Kong or Taiwan SECOM.