Taiwan Mobile
2Q17 Results Conference Call
August 2, 2017

James Jeng, President: Good afternoon. Welcome to Taiwan Mobile's conference call. 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 will start with the mobile operating performance.

Steady Recurring Telecom Business

For our telecom business, our 2Q postpaid subscriber number dropped 1.8% YoY, partially due to the termination of 2G service. The 3&4G postpaid subscriber number edged down by only 0.3% YoY during the period.

In 2Q, we focused on handset subsidy and dealer commission rationalization. As such, we achieved shorter payback, compared to a year ago. With an aim to resume growth in mobile revenue, sign-up of high-end contracts in the quarter also rose YoY and QoQ.

On a recurring basis, we managed to deliver a 0.6% YoY increase in 2Q telecom operating income, should roaming business be excluded.

Compared to our guidance for 2Q, we still beat our EPS guidance for the quarter.

Milder CATV Competition

On the cable TV business, two consecutive quarters of sequential rises in basic TV subscriptions indicate less competition in the market.

The cable broadband business also fared better, with higher-speed mix rising to 21%, up from 14% a year ago.

In view of likely pricing downward adjustments in both channel leasing and content distribution in 2017, we wrote back part of the aforementioned YTD revenue in 2Q. Should this one-off be adjusted retroactively into each month starting from Q1, cable TV's 2Q recurring revenue would be up 1% QoQ and its EBITDA would be flat QoQ.

E-commerce –The Growth Engine

The E-commerce business, growing 24% YoY in revenue and surpassing the growth rate of its closest peer in Taiwan, continued to be momo's growth engine in 2Q.

We note that momo implemented a cost-cutting measure for its TV shopping business in Taiwan, leading to a 19% YoY growth in its TV shopping EBITDA for the quarter.

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

Performance by Business

Rosie Yu, CFO & Spokesperson:

We believe that the recurring numbers excluding roaming and other one-offs better reflect our performance in 2Q.

In the quarter, our consolidated EBITDA was resilient with only a 1% YoY dip, of which telecom EBITDA was down 1% YoY while momo's EBITDA was up by a strong 12%, on a recurring basis.

Results Summary

Falling bundled handset sales, market competition, and APT's moving back to its own network resulted in a 2% YoY reduction in total revenue.

Apart from promoting iPhone6 (2017 version) to increase ARPU, we aggressively cut down major variable costs & expenses to sustain profits for 2Q. Mobile related handset subsidies and commissions came off 15% YoY in the quarter, offsetting the majority of our mobile service revenue decrease, excluding roaming.

At the non-operating level, we continued benefiting from property rental income increase, momo's growing equity income, and lower asset write-off & interest expenses in 2Q.

In a nut shell, the EPS decline in 2Q was attributable mainly to one-off factors including roaming and CATV revenue adjustments.

Year to June, accumulated EBITDA and EPS are on track and reached a respective 52% and 54% of our full-year guidance.

Balance Sheet Analysis

Now let's move on to balance sheet analysis.

On the asset front, major changes seen in 2Q included receivable reductions.
Receivable reductions in the 2Q mainly reflected our efforts to shorten international roaming receivable days and fewer bundled handset sales.

On the liability front, our good FCF generations continued to help bring down the net debt level QoQ and YoY to NT$38.9bn as of the end of 2Q. Following the AGM's approval of NT$15.2bn dividend distribution, other current liabilities increased accordingly from 1Q, while shareholders' equity reduced by the same amount which included NT$14.18bn in cash dividends from retained earnings and a NT$1.07bn cash return from capital surplus.

This resulted in a QoQ drop in current ratio while ROE further rose sequentially to 29% in 2Q17.

Cash Flow Analysis

In 2Q17, despite lower EBITDA, operating cash inflow still increased 32% from a year ago, due to favorable working capital change related largely to fewer handset payments as well as momo's stronger cash conversion capability in the quarter.

On the financing front, a 53% YoY increase in FCF enabled us to pay down more debts in 2Q.

An annualized FCF yield reached 7% while net debt to EBITDA decreased to only 1.18x in 2Q.

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

Event Updates

Upcoming Auction

James: The most important upcoming event is the 1800 & 2100 MHz spectrum auctions scheduled in 4Q this year.

This slide shows the basic bidding rules, the quantity of spectrums for sale and their reserve prices.

We as always will have a sensible spectrum investment strategy to provide good investment return to our shareholders.

Awards and Recognitions

This highlights CSR related award we received in the 2Q.

Key Message

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

Our differentiated offerings and expense discipline have offset some of the negative impact from mobile service competition. Though the reduced domestic roaming weighed on our profit growth profile, it did reduce our capex and benefit our FCF. We will strive for steady recurring profits to maintain stable dividends through expense discipline and firm growth of 4G value-added services and momo. For the upcoming spectrum auction, we will continue implementing a good strategy to enhance 4G investment return.

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

Q & A

Patrick Chen, Nomura: ***Could you rehash on the negative revenue driver in 1Q and 2Q, in particular, and would that still be expected in the 2H of the year? And would there be any positive revenue driver that you can see in the pipeline related to the new smartphone launch, in particular?***

And secondly, could you add any color on the aforementioned revenue write-off on the cable TV business?

James: In response to your first question regarding the revenue reduction in the 1Q and 2Q, it was mainly due to a reduction in domestic roaming, especially in the 2Q. Right now, starting in March of this year, APT already turned their service back to their own network. So, in the 1Q, the reduction in domestic roaming wasn't that significant, as opposed to the 2Q when it was significant in terms of the top-line revenue.

The second reason for the reduction is the impact of the low tariffs. At this point, I don't see any sign that the low tariff competition will end. So, for the upcoming 3Q, I still see revenue receding. However, due to the handset subsidy and commission reduction, I think the bottom line in terms of EBITDA will remain the same. That means the bottom line will still remain promising.

Regarding your second question, as an MSO, we have channel leasing revenue from the TV shopping channels and since the TV shopping has become a very competitive market recently, most of the TV shopping companies have asked the MSOs to reduce the channel leasing price. Thus, we made a one-time adjustment in June. Another reason is, as an MSO, we have channel distribution revenue and, for the new entrants, we used to have a minimum guarantee, which was 15% of the population. But now it was reduced to 10% based on the NCC's request. So, we had a one-time adjustment in June regarding that revenue distribution.

Patrick Chen: *I saw from your monthly fact sheet that the postpaid mobile ARPU saw some positive trend in recent months. What was the reason for that expansion?*

Rosie: It was a mix of increasing higher-priced rate plans in our product mix.

Patrick: *And will that be expected in the remainder of the year?*

James: Yes, I would say so. A further explanation to this is that our handset policy is doing pretty well. Of our new subscriber acquisitions and retentions, about 50% chose tariffs NT$999 and above. And I see that will continue in the future.

Rosie: And that is reflective of our differentiation efforts.

JinJin Wang, UBS: ***We're very happy to see management have very good cost control in the 1H. So, operating costs declined by 9% YoY, buffering revenue decline. I'm wondering whether this is going to be sustainable. Going into the 4Q and the iPhone 8 launch, since the iPhone 7 wasn't that successful, is it going to drive up the handset costs substantially YoY and is it going to add pressure to your earnings in the 4Q?***

Second question is regarding the upcoming spectrum auction, with regards to all the details and your reserve price, do you think this is largely in line with your expectations or better or worse than expected and why?

Last question is about the potential IFRS accounting policy adoption beginning of next year and whether it's going to have a positive impact on your financial earnings and if so, are you willing to raise your dividend payout?

James: In response to your first question, I think the cost control as it relates to the handset subsidy and channel commission will sustain until the end of the year, except if the iPhone 8 comes out in the 4th quarter. If it does, as it has in the past, the handset subsidy might slightly go up. But I believe this year we will still be able to control and manage our handset subsidies and the expense control will continue. And that will keep our bottom line in a good, positive position.

Regarding the auction, the NCC set the reserve price higher compared to last time. I think the auction policy this time is not expected to induce more auction money. It is to shorten the auction period since the previous two auctions took so long. Normally, an auction takes three months. Thus, they decided to raise the reserve price. I believe the bidding price will be higher than the previous one.

Regarding the IFRS, I believe we implemented that a couple of years ago.

Rosie: JinJin, are you talking the commission capitalization?

JinJin: *Yes.*

Rosie: During the contract period, the amount won't change. Even if the policy changes, we don't really think it will have any benefit to all of us. It's just an accounting change. We are committed to a stable dividend policy, so we wouldn't be too upbeat about the capitalization or amortization of the commissions so that we would have extra money to pay for higher dividend. We are committed to a stable dividend policy, as always.

JinJin: *As a follow-up to the spectrum auction, we've noticed another major change is it's been split into two stages. Is it fair to say these two stages, as James says, is going to shorten the bidding process and also the two stages process will probably prevent the bidding price from going too high?*

James: No, in the sense that the main purpose of the two stages is to prevent the existing 3G service providers from losing their spectrum to the competitors and thus not able to continue to offer 3G services. The policy states that the NCC will keep at least 5MHz with the original operator so that they can continue their 3G services. With the two stages, the first stage is you bid on the number of blocks you want and the NCC will make sure you keep 5MHz for your existing 3G services. After that, you can negotiate with the other operators. If an agreement is reached, then fine. If not, then we will have a second bid for the location of the spectrum.

JinJin: Is it fair to say that this spectrum auction will unlikely damage our stable EPS policy because we recall even back at the end of Dec. 2013 the first 4G spectrum auction the price went up higher than expected, but at the end of the day we still had the capability to reach that –

Rosie: JinJin, you're right.

Neale Anderson, HSBC: ***I have two questions related to the network. First one is on the APT traffic. Am I right thinking that it's mostly voice traffic? And could you give an update on the average usage of your Taiwan Mobile brand customers?***

On the spectrum auction, regarding the spectrum you expect to win there, is it correct to think that you'll be using that almost immediately from the start date, so the amortization cost will kick in pretty much straight away?

Rosie: Our APT traffic includes not only voice, but also data.

Neale: *The return of APT traffic, can you quantify how much?*

James: 70% of APT traffic has been returned.

Neale: *And the usage of your Taiwan Mobile brand customers is really stable at 15GB is that right?*

James: Yes.

Rosie: Regarding the amortization of the new spectrum, no, we won't start amortization until the deployment is done.

Neale: *Any thought on the timing, might it take one or two quarters to roll out the new equipment or is that hard to say at this stage?*

James: Normally, the NCC requires a minimum of base stations to be built. Once that is passed by an NCC examination, then the amortization will start.

Peter Milliken, Deutsche Bank: On spectrum amortization, on the 1800 and 2100, do you have the number on what you're paying in terms of annual amortization on that

spectrum currently?

Do you have any number on your network utilization on mobile in terms of peak utilization?

Rosie: We don't provide peak utilization rates.

Peter: *Some of the fixed line items seem to be doing better. You seem to be growing subscribers as you mentioned. What has happened to the competitors to make this move in a better direction?*

James: Three years ago, our enterprise sector mainly focused on the mobile VPM business. We then re-organized our whole enterprise organization and started to focus back on the fixed line business, mainly leased line services. And I think we are doing pretty well in terms of solutions, which means we provide enterprises with not only mobile services but also solutions, for example, security or other telecommunication solutions as it relates to their business such as back office solutions. So, with fixed-line, I believe there is a lot of room for growth in terms of the enterprise sector.

Rosie: To answer on your previous question on the amortization. Altogether we have NT$1.73bn in amortization per year for 1800 and 2100. And NT$850mn is for 700.

Jack Hsu, Sinopac: ***First, how many 4G subscribers do you have at the end of 1H17?***

Second, what's your strategy for 4G in the 2H17?

James: At the end of 1H, we reached 67% in terms of 4G penetration, which equals to 5mn subs. And we expect our 4G penetration rate to reach 72% in terms of postpaid sub by the end of this year.

Regarding 4G strategy, we are doing surprisingly well in our 4G value-added services in the 1H, mainly in the handset warranty program and the direct carrier billing and our streaming music, video and electronic book. All are performing very well and are all profitable and we will continue these growth paths in the 2H.

Secondly, we will still control our expense, mainly in the channel commission and handset subsidy, and maintain a strong bottom line.

Varun Ahuja, Credit Suisse: ***Regarding the competition, I wanted to hear your comments with regards to whether or not in reality the competition in the low-end continues to be intense given that earlier in the conference call you mentioned that you will be focusing less on the NT$699 plan and more on the high-end even though the market still appears to be focused in the low-end?***

On APT, can you remind us right now is APT still roaming on your 3G or 4G network and if so, which segment of the technology are they still roaming? And will that revenue still go away?

James: As I mentioned earlier, 70% of APT's traffic has returned to them. The remaining 30% that is still with us will remain on our network until the end of 2018. Traffic-wise, beside voice, some of the data traffic still remains on our network. To be specific, some of their customers use handsets that require 1800MHz, which still have to remain on our network.

Regulation-wise, by the end of 2018, all their traffic has to be returned to their network.

Jack Hsu, Sinopac: ***You mentioned that you've been using fixed-line to develop your enterprise customers. Can you give a little more color such as your goals, strategy and future in this segment?***

James: As I mentioned earlier, we have been focusing quite a bit on our fixed-line business as it relates to the enterprise segment with our Metro Ethernet services and our solution services. Instead of just mobile data or voice services, we also provide solutions for the enterprise sector such as DDoS anti-hack solution, which is doing well in the financial sector.

Secondly, we will provide ICT solution services to the government sector as well as the enterprise sector.

Jack Hsu: *One follow-up question, can you give us some color about your IoT plans such as working Tesla in the 2H?*

James: In the 2H, we will have the IoT network available for trial. Regarding future plans, starting 2Q next year, the focus will be the government sector on the utility side such as gas meter, water meter, and electricity meter. That's the type of commercial projects I see at this point. Outside of that, I don't see any other type of sizeable commercial project that will yield a substantial revenue stream. Even the connected car, such as Tesla, it's still too early to be a sizeable business.

Varun Aruja, Credit Suisse: ***I wanted to hear your view on the competition in the low-end segment given that you mentioned that you believe the low-end segment will continue to be competitive, which was in contrast to your two peers earlier highlighting that they will focus on the mid- to high-end segments and in the low-end, they are cutting down on commissions.***

James: As I mentioned earlier, there doesn't appear to be any signs indicating that the end to the low tariff competition. But, for Taiwan Mobile, starting from the 2H last year until the 1H this year, our strategy of having a high percentage of our acquisitions and retentions in the high-end segment has been quite successful. Right now, that percentage is around 50%, which is quite high compared to our peers. Naturally, we will continue this strategy and assure that a high percentage of our acquisitions and retentions remain in the high-end.

Varun: *Regarding APT, by 2018 they have their own network. Once they do, do you believe they will be much more competitive?*

James: I really don't think so. I think the worst time is now in terms of competition landscape. People keep commenting on T-Star and their low tariff. I don't think our competition is from the two smaller players. It's still from the two other big operators. From the beginning, APT and T-Star had lower tariffs and it virtually had no impact or competition in the market until the big 3 introduced their own low tariffs.

Patrick Chen, Nomura: ***On IoT, there are a lot of different constituents in the IoT including hardware, software, and how do you think Taiwan Mobile will stand up against the competition in terms of engaging in the IoT opportunities? We know that Taiwan Mobile don't really have any hardware or software strengths on your core competencies, it's really on network and the infrastructure. How do you think you can leverage on your strength to compete in the IoT market?***

James: If you look at the IoT value chain, 80% is in production and manufacturing, such as the hardware, the devices, the sensor, etc. In terms of the operator, we provide the network and connectivity. While we would prefer not to disclose our IoT strategy publicly at this point, I would say, in the very near future, the only business opportunity is in the government public utility sector. In terms of the connected car or connected home, the operator currently doesn't have a significant role. The significant role is in manufacturing. But, what we can provide along with connectivity is the platform.

Patrick: *Is it fair to say that while you can't claim a major part in the value chain, it is still something incremental to your existing revenue stream and product portfolio?*

James: I don't see in even next year any significant revenue will be from the IoT sector. However, big data might if we do it right.

Patrick: *And this part will be characterized under your enterprise part of the business?*

James: Both.

Jack Hsu, Sinopac: ***How do you see EBITDA trending in the 2H17 and 2018?***

Rosie: If you are talking on a YoY comparison, I think it will probably be slightly improving because the impact of decreasing roaming revenue has already been factored in the 1H and it will, of course, be stable until the end of this year. If you want to know more about 2018, you have wait until early next year for our guidance release.