

Orange Polska SA - OPL.WA
Earning Conference Call/Presentation (transcript)
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Corporate Participants

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department
- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO
- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

Conference Call Participants

- Maria Veronika Sutedja - Erste Group Bank AG, Research Division - Analyst
- Zbigniew Porczyk - Trigon Dom Maklerski S.A., Research Division - Research Analyst
- Herve Drouet - HSBC, Research Division - Head of EEMEA Telecoms, Media and Technologies Equity Research
- Pawel Puchalski - Dom Maklerski BZ WBK S.A., Research Division - Head of Equity Research
- Dominik Niszczyk - Raiffeisen CENTROBANK AG, Research Division - Financial Analyst
- Grzegorz Witkowski – Insignis TFI
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- Piotr Raciborski – Wood&Co
- Robert Florczykowski – PKO TFI

Presentation

- Operator - -

Ladies and gentlemen, welcome to Orange Polska Conference Call on Second Quarter 2018 Results. (Operator Instructions) Today's host is Mr. Leszek Iwaszko, Head of Investor Relations. Please go ahead, sir. The floor is yours.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

Hello. Good morning, everyone. Welcome to Orange Polska Results Conference for the Second Quarter of 2018. Speakers for today are Jean-François Fallacher, CEO of Orange Polska; and Maciej Nowohoński, CFO of Orange Polska.

So let me give the floor to Jean-François to begin the presentation. Thank you.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

Thank you very much, Leszek. Good morning, everyone. Thank you for being so many in the room despite that we are in the middle of the summer, so thanks for your interest.

So let me start directly on the Slide 6 of our presentation for the second quarter results. So this time, as you can see, we have decided to start the presentation slightly differently, but the main message is that, basically, for the second quarter results, we are, in fact, as we promised you, a stabilization of our EBITDA this year. What you can see in the results we are posting for the second quarter is that our business results are stable, even if this quarter, they are slightly distorted by some delay on some real estate sales. We also said that stabilization of revenues will happen only in 2019, next year, but we indicated that we will stabilize EBITDA this year, and that is currently happening, fuelled by cost optimization. This is, therefore, really taking place.

Please also note that the margin, the EBITDA margin, in percentage in this first half is exactly the same as last year, so we already have stabilized this EBITDA margin versus last year first half. And this is, as you know, despite the legacy services that are still dragging down our performance. So basically, I would like to confirm the ambitions that we have announced, actually, almost 1 year ago during our strategic plan announcements, Orange.one.

Let's have a look on the next slide where the improvements on the EBITDA margin is coming from, basically. So now what you can see on this chart is we present it in 2 different blocks, which contribute to this EBITDA creation and to value creation. The first one is the commercial block, and the second one is the transformation efforts that we are doing. We are, I think, doing constant progress on both fronts.

In fibre, you know that we are still at the beginning of this fibre adventure in Poland. And as you can see there, it is doing pretty well. So our top line is supporting by a strong performance of in this quarter of ICT, which is quite outstanding performance this quarter, and mobile wholesale. And you know that the deal we made last year with our competitor, Play, is also bearing its fruits now.

Regarding the transformation side of this chart, we will discuss it a bit later. We will go into more detail, but it's really significantly supported our financial results this quarter, especially in the second quarter. Cost optimization on the scale, obviously, would not be a feasible result simplification of the business processes in all our areas of our operation. This is a huge effort we have been undertaking, which is now bearing these fruits, and I would like to thank our entire organization for already having achieved these results.

You can see that the EBITDA on the reported basis was down in Q2, but again, only because we sold a lot of real estate last year, and this year, we have been a bit late with some real estate sales that are just postponed to the next quarter. And this is, as you know, real estate sales is very volatile quarter-on-quarter.

Let me go back now to core business topics. I want to comment our fibre results. We are, quarter after quarter, concerning fibre, gaining momentum. And despite, I would say, the fact that in Q2, our commercial activity was a bit affected because we had a number of -- we had a lower number of working days, you remember well in the months of April and May. And also in Poland, there is a newly introduced trading ban on Sunday that has been affecting us. But despite these, we are now having the highest quarter with 39,000 new addition -- customer additions on fibre. This is the best quarter ever on this category. And I have to report and I'm proud to report that 80% of these net additions are customers coming from competitions, so fibre is definitely confirming its offensiveness in the very high broadband market.

As we speak, our fibre network is approaching 3 million households in Poland, which are connectable. Therefore, you see that with a customer base of 286,000 customers, we are, I think, close also to reach 10% of adoption on our network. We are now present in 116 cities in Poland, which is 41 cities more than at the end of last year. And we are now entering a more and more midsized and small cities, which, obviously, also are involving single-family households' connection. And in the first half, I would say, single-family households constituted 10% of our fibre coverage, and investments in small cities constituted 20% of the investments in the first quarter.

And according to our plan, if you're going to continue in the second half, I mean, this trend of connecting single-family households, it will increase even more in the second half. So even more, this is a bit more expensive than multiple-family households, there is much higher demand for our services in the single-family households. There is interesting case, for instance, that I can quote in a small city called Podkowa Lesna where we started to sell our fibre there only at the end of March. And just 3 months after, the situation is already reaching 33%. To give you an example of the kind of a demand we are seeing in this type of area, which is, again, very positive for the future of our fibre project. There is really big demand in this type of geography.

If we look at the total fixed broadband base, these are the charts you see on the right side of the graph, now exceeds the 2.5 million, so I think this is quite an impressive number. And what you can see that fibre is constituting now more than 11% of this base. And also, the good thing, if we look at the year-on-year evolution of this base, you can see that the ratio of ADSL customers in this base is now below 50%. So there is also strong evolution in the way this base is -- the departure of the base from this technology. And more than half of the base is now on very high broadband technologies.

Now let me go to the next page, and I would like to comment the announcements that we have made 2 days ago, actually. As you know, we have signed an agreement with T-Mobile to give them access to our fibre network. I mean, this is not a big news to you because it's something we have announced at the end of last year. We announced that we signed the LOI. It took us slightly bit longer because we were planning to sign this deal before the end of June. It took us a month longer to reach an agreement, but we are pleased to -- we have been pleased to announce that 2 days ago. Now I wouldn't like to comment the terms of the deal, which I believe were quite well described in our announcement to the stock exchange on Monday. I just want to concentrate on explaining why we do this.

So first of all, wholesale in Orange Polska has always been an important part of our business. And when we decided a few years ago to invest in fibre and to build this fibre network in the original business case, we always had assumed that, at some point in time, there would be wholesale as an integral part of this investment. Now is the time. After 3, 4 years of construction of this network, we thought the moment was the right one to open it to competitors of ours in terms that, I believe, are rather favourable to Orange Polska. Naturally, this obviously means that we will have higher competition on the retail front, but overall, this is definitely value accretive for Orange Polska, this deal, and it will return -- it will, sorry, increase the return on investment on our fibre investment and shorten the payback period versus not having such a deal.

Obviously, we also believe that by adding one of our competitors that we'll be able to resell fibre. This will mean, in the Polish market, more promotion of fibre, more promotion of convergence, so -- which is, we believe, better for us and going in the direction of our strategy in Poland.

Last comment I would like to have on in this deal is that, obviously, it is not exclusive, and we could potentially negotiate with other interested competitors to open the fibre network to others.

So that was all for me now. Maciej, you want to go further?

- Maciej Nowochoński - Orange Polska S.A. - CFO & Member of the Management Board

Thanks a lot. Hi, everyone.

So we are starting the financial review on Page 11 of the presentation. I will go through this slide very quickly. So first of all, the top line evolution has slightly changed versus Q1. And I will explain in a moment what are the main drivers behind it. Then secondly, EBITDA trend is impacted by strong cost optimization, on one hand, and on the second hand, it is the impact of the lower gains on the real estate disposals. And then on CapEx, we see increase of the CapEx year-over-year, and it is reflected in the cash generation. But this is as expected.

So let's go to revenue on the next page. Here, the revenue dynamics in Q2 are impacted by the trends in equipment sales. So just to recall you, in 2017, this revenue line was supported -- supporting the revenue in total quite substantially, especially when you are looking at year-over-year situation throughout all quarters of 2017. Basically, this was driven by the robust growth of the volumes in instalment offers. Those are strong migration from subsidized offers to instalment offers throughout the whole year of last, 2017. And this is behind us. Basically, the saturation is now achieved. And we have a stable situation. We are subsidizing much less versus in the past, and that translates into lower handset sales.

There is a low subsidy policy that is in place in our company, so that affects the revenue line, but it generates more value on the EBITDA level. And excluding the equipment sales, the revenue trends improves, and this is driven by convergence, one thing; ICT services, second thing, excellent growth here; and mobile wholesale.

On the slides, we are presenting these growing categories, along with the mobile and broadband mono services as one group. And we consider that these revenue lines are core to our future rebound and margin generation. The trend here is constantly improving, and we believe this is sustainable.

As far as the equipment is concerned, we have plans to make handsets that we sell more attractive to customers. This week, we have launched a possibility to buy a new handset in instalments any time during the lifetime of the contract. So each customer right now that is an Orange customer can buy a handset, additional one, or the first one, if there is a contract with Orange. So, so far, to get a new phone, the customer had to wait until the end of the contract. Right now, there is no obstacle at all from that perspective. A new offer gives our customers, of course, much more flexibility, so this is just going in front of what our -- what our customers are expecting.

So I mentioned convergence as one element, which is performing very well. Let's take a look closer on that business line. In convergence, on the next slide, we are especially pleased with the stabilization of the average revenue per offer. Here, the year-on-year evolution has greatly improved, and it's increased slightly versus the Quarter 1 of this year. And we believe, again, here, that this is a sustainable improvement.

Average customer bills that we see here is about PLN 100, so this is much more than the price of the Orange Love 4P package, excluding VAT, which is PLN 84. So why is that? We have a situation that the bill is actually boosted by additional services, which we are selling to customers, on top of the basic 4P package, and these are mainly additional SIM cards. So customers are basically buying from us family offers. And every convergent customer has, on average, in the package today, close to 2 SIMs.

Upsell of TV services is also improving. Here, it went up by 8 percentage points over the past 12 months. We also made a few changes in Orange Love offer that's improved average revenue per offer level, and these are the things which have been done consequently, if you may recall, in September last year and the second, actually, in Q1 of this year. So we perceive Orange Love products as well-priced and properly packaged. It will be still enhanced for customer value proposition. At the same time, it will be made even more value accretive for the company.

In terms of future customer net additions here in convergence, we will run at full speed, however, without necessary push to reprice the product or without a lot of excessive value at customer migration from mono services. So this value orientation suggests, actually, no revolution in the net additions in the quarters to come. We will not be repricing. We will not be excessively migrating those customers who do not feel that they want to stay on the single product. Value is very important for us.

So now after convergence, I propose to go to the next slide for the review of mobile-only and fixed-only. Mobile mono net customer additions are naturally going down, and this is due to the customer migration to convergence. And this is not a new trend. We have been with this trend, and we will be with this trend for quarters to come.

In Q2, the trend has improved, and this is thanks to our efforts in churn limitation. And we have achieved, actually, in Q2, the best churn result since almost 2 years. Last time we have such churn was in Q3 '16.

In April, we have enhanced our higher tariff plans. If you recall, we were talking about that just a quarter ago. And here, we have the first results. The customer mix of acts has already

improved considerably. In new customer acquisitions, the share of the PLN 50 and PLN 70 tariff plans went up 2x. It's a very good achievement.

Structurally, post-paid category is going to be under pressure as long as prepaid pricing on the markets remains at the current low levels. We have to say the levels of -- on the prepaid market are low. However, prepaid may pose an issue for post-paid. The prepaid itself is performing really great with base growth and very satisfactory financial indicators. So we are really happy with the prepaid, even if that is posing a little bit on the pressure on the markets on the post-paid.

Fibre and B2B in broadband offers are supporting good trends in average revenue per offer. Here, you can see that we are progressing also nicely. We are just 1 percentage away from the year-over-year evolution, and we expect a stabilization quarter-after-quarter going forward.

So now let's go to the profitability EBITDA on the next page, Page 15. In Q2, our adjusted EBITDA was around 4% below the previous year. Last year, the second quarter was particularly strong for the real estate disposals. Last year, we had generated something around PLN 57 million, PLN 55 million of EBITDA. As I explained many times, this area is very volatile from quarter-to-quarter, and it is difficult to predict the closing of such transactions. We are working on a number of them. However, the negotiations are not yet closed, so we are intensively working on closing them. Once we have closed to them, we will properly inform the market.

If we exclude the impact of asset disposal on EBITDA, our EBITDA was higher than last year. And the key drivers of this improvement are the results of our business transformation that Jean-Francois already talked about.

Indirect costs were actually down 10% year-over-year in Q2, and this is more than in the previous quarters.

Direct margin was negatively affected by competition in mono mobile. In addition, big cuts in handset subsidies are already done, as I was explaining, so those cuts are behind us. And they do not support year-over-year direct margin evolution that much as it was in the case of the previous quarters. Nonetheless, even if we see it in Q2, we are expecting the improvement in the evolution of the direct margin starting from Q3. And please note that in Q3 last year, we were hit by Roam Like at Home, so this will now work in our favour.

So I propose to zoom on the business transformation and cost optimization on the next slide. The transformation itself is not a simple cost-cutting exercise for us. It would not be possible without simplification of many processes. As I explained to you in September last year, when we have been announcing the Orange.one strategy, our business model is a chain of interconnected processes that allow us to render our services. These processes are usually complex, which is partly attributed to the former incumbent operator status of Orange Polska. And implementing Orange.one, we have introduced the comprehensive transformation to simplify and, where possible, to automate or to digitize these processes. And this program is still ongoing, as you probably think. However, the first tangible results are already visible, and these are the cost optimizations that we are happy to present to you today. A list of the most important initiatives that's -- that have been implemented are on the slide. This is just a selection, and there are tens of others that we are working on right now.

As you remember, when announcing Orange.one in September last year, we committed to optimize the underlying indirect costs by 12% to 15%, starting from 2016 by the end of 2020. And I think, right now, we are maybe not even halfway from the time perspective, but it's a good moment to stop here and to try to summarize. We are after 6 quarters today and versus the end of 2016, and we did already, versus 2016, 8% of the cost reduction. And this is halfway from the value perspective. Looking at the higher range, 15%, we said. So we are 8% today. However, we are not halfway in time. We are just after 6 quarters, out of 16 in total. So 10 quarters to go, and the result is very satisfactory.

So now I propose to jump quickly to Page 17 to take a look at the net income situation. Bottom line for Q2 came at PLN 46 million, and it was PLN 25 million below last year. So this is the evolution of the operating profit, which, basically, was reflected in the net profit. Net financial costs are flat. Nothing is really changing here. Even if we have reshuffled our financing in Q2, as we've been saying, everything is under control here.

So going further, let's take a look at the CapEx. As I said at the beginning, the CapEx is up, and this is 14% year-on-year, which is as expected. And no surprise, we are basically concentrating our activity on connectivity. And this is the fibre, and this is the mobile investments that are in the core of our CapEx investments.

For mobile investments, these grew considerably. It is mainly related to spectrum refarming. As we highlighted to you at the beginning of the year, we plan to optimize spectrum to allocate more of that spectrum towards LTE. Why is that? No surprise, traffic is still increasing very sharply, and we see our customers using more and more. We need to dedicate more spectrum to LTE. As a result of that technical reshuffle, there will be more bandwidth dedicated to LTE. There will be 45 megahertz versus 33 megahertz currently. So it's a considerable improvement of the capacity available for our customers. The project is gradually progressing. We are about the middle of the way here, and the full functionality will be available by 2020. So that's on mobile.

And then on the fibre front here, the CapEx has increased. There are 2 reasons. First of all, we are connecting, as Jean-François commented, more customers, and that's visible in the CapEx dedicated to deliver and the CapEx dedicated to set-top boxes and to routers that we deliver to the customers, together with the connectivity. Here, there is, basically, a stable situation from the unitary cost perspective of those devices or the delivery cost. We basically see higher volumes, and naturally, that CapEx category goes up. And there is a second reason for the fibre CapEx increase. It's actually a change of the mix of our investments. Today, we are more investing into single-family houses. That's represented in Q2 something around 10% of our volumes connected versus only 1% a year ago. So it's a considerable change. The unitary CapEx for single-family houses is considerably higher than the unitary CapEx for the multi-family. So that's an important reason. And as Jean-François said, we are connecting, right now, customers in smaller cities. There is part of the backhaul, which is kind of a fixed cost to deliver the good backhaul to the cities. So more cities connected, more costs on the backhaul are a natural development, and that is visible in our CapEx.

For the full year expectations, we keep to what we said previously. So we want to take 1 million additional households at the end of this year. We are well on track.

Now let's talk about cash. Level of cash generated in the second quarter reflected some developments. So first of all, net cash from operating activities are -- is impacted by 2 elements. Basically, we have accelerated in time the headcount optimization, so that's visible in more severance payments compared to the situation from last year. And the second impact is much more significant, and this is the fact that we have higher roaming costs, higher roaming cash costs at this moment because we pay today a nominal cost to our operators that we cooperate with on the international front, mainly in Germany, because 40% of our traffic on the roaming front is there. And we are expecting to receive very considerable discounts, which are not yet in cash but will be in cash in 2019. So from the P&L perspective, everything is flying because it's properly accrued. But from the cash perspective, we are paying the nominal prices right now, and we will receive very considerable discounts next year.

Second element important for the cash evolution is the CapEx. Since it grows, it is visible in higher cash outflows on that category. And finally, as we have commented already, the lower disposals on the fixed assets front is impacting less cash in Q2. That's a temporary situation.

So how these factors may look like in the future, especially in Q3? We will maintain high level - high levels of the investments in Q3 as well. So we do not stop. We go with the normal business trend here on the CapEx front. Year-over-year evolution of the working capital should improve partly because higher roaming will be already -- have been already with us in the second semester, so this will be on the year-over-year front already much more

comparable. And of course, we would like to finalize as much as possible large real estate transactions. Here, however, I cannot commit to the timing of the amounts or the amounts. Obviously, cash generation in Q3 will be boosted by the first tranche of money that we will receive after we have signed a deal on the wholesale front with T-Mobile. So we will see the first tranche in Q3.

To conclude that part, let's take a look at the net debt on Page 20. So even though our net debt has slightly increased, this is not visible on the net debt-to-EBITDA parameter. It's fixed to 2.2. Anticipating higher future interest rates, we have increased the portion based on the fixed interest rate. So right now, we are 95% hedged from the interest rate movements. We are fully hedged from the ForEx perspective, and that's for the debt.

And our future leverage ratio basically depends mainly on the outlook of the EC fine payments. Well, I think more news on that topic should be available today, later as the verdict, I think, more or less announced now, and we will not comment it at this moment because we don't even know it now.

That's all from my side. Thank you for your attention. And I hand the floor back to Jean-François for conclusions.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

Thank you, Maciej. So let me conclude this presentation by, first of all, sharing with you my takeaways from the first half: so strong performance of convergence, especially, we are happy that we have managed to stabilize the ARPO; fibre, as you can see, is gaining momentum; strong performance on business market, especially in the ICT -- on the ICT side; improving trends in prepaid; and last but not least, the strong effects of our cost transformation. As Maciej was commenting, we have saved 8% of indirect costs in 1 semester, which, again, I'm congratulating the teams of Orange Polska for this strong achievement.

Now if we look at the second half, let me share with you what our main focus will be about in the second half. So first of all, we will continue fuelling the momentum on fibre and convergence. Second, we are aiming to improve our trends on the pure mobile but always sticking to our value strategy approach. And obviously, we are continuing to prepare the optimization initiatives that we will need for next year, 2019. And the last point, obviously, I'm - - we are reiterating our guidance, our EBITDA guidance under both accounting standards for the full year.

Thank you for your attention. And now I hand over the floor back to you for question.

Question And Answers

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Yes, thank you very much. We start usually with questions from the floor. And usually, Pawel volunteers as the first. So the floor is yours, Pawel.

- Pawel Puchalski - Dom Maklerski BZ WBK S.A., Research Division - Head of Equity Research

Q. Pawel Puchalski, BZ WBK. First question, what is the amount of Roam Like at Home charging Quarter 2 and first half of 2011 -- sorry, that's 2018? The other would be related to T-Mobile transaction. First of all, the first tranche is coming in quarter 3. When shall we expect the second tranche? Would it be fourth quarter or first quarter of 2019? And the other question, will the amount -- or I see the amount you received from T-Mobile as high, so I would expect the discount received by T-Mobile for future clients will also be high as well. Can you comment to the scale of discounts granted to T-Mobile for its future clients and future payments to Orange?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. So I will take your first question, Pawel. Thank you very much, first of all, for the question. I'm not surprised. You may probably have noticed that we are not giving, in the presentation, any insights to that. That's basically explained by the fact that we have done all the things that we were supposed to do on that front. So we have introduced the roaming surcharges for those customers who are subject to those surcharges. We are actively informing those customers who are using excessively the roaming above the level of -- fair usage policy. That's done. We have renegotiated the wholesale contract with all important for us operators, and as a consequence of that, the situation is stable. And there are no particularly negative year-over-year losses on that front, and we are not expecting to suffer from that situation in the future. So that's to respond to question number one. The second question was about the wholesale contract, so...

- Pawel Puchalski - Dom Maklerski BZ WBK S.A., Research Division - Head of Equity Research

Q. The second was about timing of the second tranche of T-Mobile.

Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board A. The second tranche is basically triggered when the service is available for our partners. So once the service will be available, then we can expect the second tranche.

- Pawel Puchalski - Dom Maklerski BZ WBK S.A., Research Division - Head of Equity Research

Q. And the service will be available in Quarter 4 or on Quarter 1?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. We are working on that.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. Quarter 1.

- Pawel Puchalski - Dom Maklerski BZ WBK S.A., Research Division - Head of Equity Research

Q. And the last one, the scale of discounts?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. We are not going to disclose any scales of discount or any pricing because as you can imagine, we are quite tight with some strong confidentiality agreements in this contract.

- Pawel Puchalski - Dom Maklerski BZ WBK S.A., Research Division - Head of Equity Research

Q. Okay. And if I might go back to the response, number one. You suggested -- if I get correctly, you suggest that the payment, the negative charges from Roam Like at Home were counterbalanced with positive surcharges from clients. So the net impact of Roam Like at Home was at 0 in Quarter 2?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. I will probably repeat once again. So I mentioned 3 elements: Surcharges; proper information policy for the customers who are crossing the fair usage policy, and that is triggering the -- triggering back the proper behaviour of the customers; and number three,

positive result of the renegotiation of the wholesale rates with our wholesale partners. That is impacting positively our wholesale cost. All of these 3 elements.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. To be clear, I mean this is still a negative impact versus when we were invoicing roaming, so just a smooth and very strong in the effect verses what you saw in the first quarter after this recommendation. This is still weighing on our P&L versus prior years where we were invoicing roaming. That is obvious.

- Pawel Puchalski - Dom Maklerski BZ WBK S.A., Research Division - Head of Equity Research

Q. Okay. And so again, first question, why you don't want to disclose the net figure of Roam Like at Home in Quarter 2? And the other question would be shall I expect what happened in Quarter 2 to be continued in quarters 3, 4 and going forward?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. Because it is much less material than it used to be in the start of this regulation, first of all, so that's why we are not disclosing any more specific amounts. And now, this is again, a recommendation that is behind us. So we are back in the normal, I would say, operations as concerns from [roam like home]. So this strong effect from this regulation is behind us now.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Anyone else on the floor? No. Yes?

- Zbigniew Porczyk - Trigon Dom Maklerski S.A., Research Division - Research Analyst

Q. Zbigniew Porczyk from Trigon. And maybe a little follow-up on this T-Mobile deal. First of all, how do you see the impact on your KPIs in the future when you have already opened your network? And the second question, are you in any kind of talks with any -- with other operators concerning your FTTH network opening?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. So on -- sorry, on your first question, how do we see the future outlook after this deal? So there will be obviously 2 effects we see. So we see additional revenues on the wholesale front. So that's going to be the upside starting with the one offs that T-Mobile is going to pay to us. So that's one. And obviously, we will -- we are foreseeing also some, what we call, cannibalization on the retail side where, obviously, we should, we believe, sell a bit less than we planned because we will have a new competitor on this front, on the retail side. However, we believe as well, there will be halo effect because when more providers are advertising and selling fibre and convergence, this is driving the entire market even more into these categories of products. So that's why we see also exponential effect that is going to come. So I mean, today, it's difficult for me to tell you that we are not in discussions. We are not engaged as we used to be with T-Mobile at this stage with any other operator. But once again, this is a nonexclusive deal. So there might be in the future, if any operator is interested, such discussion going on. But not now.

- Zbigniew Porczyk - Trigon Dom Maklerski S.A., Research Division - Research Analyst

Q. Okay. And maybe this EU fine as it's now officially announced. Would you comment on that?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. We just learned that a minute ago like you. So I mean there is not much to comment. So the EJC has decided to apply the fine. So this was provisioned, so we will pay the fine, full stop.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Let's switch to the teleconference listeners. Operator, please?

- Operator - -

A. (Operator Instructions) Our first question comes from Maria Sutedia, Erste.

- Maria Veronika Sutedia - Erste Group Bank AG, Research Division - Analyst

Q. My first question is related to the T-Mobile agreement. As you just said, that is going to improve, in the second half, the revenue on the wholesale and, in the long run, it might cannibalize the retail customer net adds. But let's look in the near term. Is these revenues that you're going to book on the second half of this year, is it already excluded from your EBITDA target or is it included in your EBITDA target? That's my first question. Second question is on EC fine. Could you please remind me how much you have provisioned this for? And the third question is on the convergence. If I am not mistaken, Maciej said about that there won't be any repricing in order to push further more net adds. Does that mean we have seen already the highest level of the net adds in the last quarter, and going forwards, it will stay at this level at best and probably not going to grow at higher rate anymore?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Thanks a lot, Vera, for the question. So answering your first question on the impact on the financials of the deal. So I will explain that in a little bit longer speech. So first of all, we are getting an upfront, which is non-refundable. So this is PLN 275 million. And then we have a normal business operation for which we will receive for each wholesale customer, a monthly fee. So the upfront, most probably, I'd say, most probably because we are still working on the recognition of the upfront, will be recognized for the next 10 years. And the question is, how it will be recognized. So it is, today, not yet granted for free. But in the second semester of this year, we will see a substantial chunk of these up fronts to be recognized in our EBITDA. Then, the monthly fee for each customer, we will start to receive once the cooperation is live from the business perspective. So this will be live when we give the access, well, physically to our network and all systems will be in place and our business partner starts to connect the customers. From that moment on, we will start to recognize a monthly fee for each customer. So that's how we -- how it looks from the mechanics of recognition of that deal in the EBITDA.

Then the provision for EC fine is around PLN 650 million.

And regarding the repricing, yes, we have commented like that. And I have also commented that we will run full speed for the net adds of convergence. However, without an unnecessary push on the value loss when migrating such customers or where connecting new customers. So we believe that the product is priced well. It deserves the price it has, and the volumes that we expect shall be in continuum to what we have been achieving so far in Q1 and Q2.

- Maria Veronika Sutedia - Erste Group Bank AG, Research Division - Analyst

Q. My understanding correct, regarding the T-Mobile agreement. So, if you will not book the upfront fee in once -- in one go, but you will spread it over 10 years?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. It's for sure, not going to be a one-shot into EBITDA. For sure, not.

- Maria Veronika Sutedja - Erste Group Bank AG, Research Division - Analyst

Q. Got it, okay.

- Operator - -

A. Our next question comes from Herve Drouet, HSBC.

- Herve Drouet - HSBC, Research Division - Head of EEMEA Telecoms, Media and Technologies Equity Research

Q. First question is again, regarding the T-Mobile deal. Just wondering, is there any specificities in terms of the way you are going to provide since it's only purely fibre as far as I understand? Could there be as well wireless broadband services being provided as part of this deal or it's not at all the case? Second question is about the -- during the conference call, you said about now users have visibility to have a new handset during their contract. Is these new handsets going to be partially subsidized or there is no subsidies at all for these new handsets? And finally, just on the working capital requirements, which had a negative impact on your cash flow. I was wondering how much of that is potentially part of international roaming. Is it related to what you mentioned with potentially discounting costs you have on roaming, but you cannot recognize as such? Or is it something different in terms of what's driving the working capital requirements?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Herve, I will take the question number two and three, first. So regarding the new model of making handsets available for our customers, these are handsets on which we are normally earning money. So there is a small margin. No subsidy. Then, the second question was about the impact of the roaming on the cash. You mentioned something that we cannot recognize. Actually, we are properly recognizing the roaming rebates in the P&L. It is just the fact that the cash impact of receiving the discounts in this business, in the wholesale business, is coming later. And this is normal because such discounts are basically reconciled with each operator on a full year basis after the year is closed. So they will come to us in 2019. For the first semester, the impact is quite considerable because out of the 6 first months, we are expecting to receive in 2019 something like PLN 100 million. So that's the effect. Then, any specificities for T-Mobile. This is the deal for the BSA on fibre in the regulated zones.

It is pure fibre in multifamily houses. There is no wireless

- Herve Drouet - HSBC, Research Division - Head of EEMEA Telecoms, Media and Technologies Equity Research

Q. Okay. And is it only on multifamily house or...

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Exactly. The single-family houses are excluded from that contract.

- Herve Drouet - HSBC, Research Division - Head of EEMEA Telecoms, Media and Technologies Equity Research

Q. So maybe just to clarify for the working capital requirements. As a change of working capital, just I was wondering during the first half of the year, you still have this negative impact of change of working capital. What is the biggest element in that change in working capital, which is impacting negatively the cash flow?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Yes. It's actually roaming rebates.

- Herve Drouet - HSBC, Research Division - Head of EEMEA Telecoms, Media and Technologies Equity Research

Q. Okay, so it's roaming rebate, okay. So it's mostly that part?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Not anymore, Herve. The growth of the installment receivables because those installment receivables are not growing anymore. That's why we're saying, the previous quarters that sometimes, in the middle of 2018, we will achieve the kind of plateau at that basis. So it's -- those receivables were not growing in Q2.

- Operator - -

A. Our following question comes from Grzegorz Witkowski

- Grzegorz Witkowski – Insignis TFI

Q. Congratulations on the good cost control and the stabilization of the EBITDA margin. I would like to ask a question about the trends in the fixed broadband customer base evolution. Actually, I ask it in the past but I think it's still up-to-date if we could go back to Slide #8. On the right-hand side, you show the split. If you exclude the LTE customers, actually, you can see that the core broadband stays flat, already for a few quarters, you got stuck at 2 million customers. So I would like to reiterate the question. Can we really count on this that you will start to add more in fibre than you'll lose in the ADSL, which actually, as you admitted in the past, you charged exactly the same price for. So as I understand, the revenues for the core fixed broadband stay flat for quite a few -- for quite some time, and you spent a lot of CapEx on this fibre investment. So if you could elaborate more on this, so what we can see in the future.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. Yes, we can elaborate more on this. I mean indeed, your statement is right. So if we would exclude LTE for fixed, the base is stable. So with fibre, we're just compensating the churn in DSL. The reason is very simple is that the footprint of fibre is far of being the footprint we have on DSL. So of course, it's growing quarter-after-quarter. As we were commenting, we are, as we speak, reaching the 3 million households connected, whereas the footprint of ADSL is far beyond that. So that explains why, I mean, this fibre and the DSL net, positive -- net additions are actually just covering the still loses on ADSL. Nonetheless, I remind everyone that LTE for fixed is real, fixed broadband using wireless technology, but still, I mean, these are very solid ARPUs behind that. So very solid revenues.

- Grzegorz Witkowski – Insignis TFI

Q. All right, but the CapEx is for fibre. You spent huge CapEx on these things to be on the defensive for the replacement CapEx not growth CapEx, if you look at the trends for the past quarters.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. As I was commenting, if you look at our gross adds and net adds on fibre, 80% of these are coming from competition. So there, I have to disagree with you. I mean, fibre is a very offensive weapon for us on the fixed broadband side. And I remind you that the investments on the mobile network have not been at nil so the mobile is still a very important part of our business. Mobile is an infrastructure as you can see. Maciej commented that where we invest

still and we'll continue to invest. So this is not far from being a negligible part of our investment.

- Grzegorz Witkowski – Insignis TFI

Q. But would you expect that in the future, in the coming quarters, the additions of fibre, can surpass the clients that you are losing from ADSL, or do you think this will net out?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. I mean, that's what we are working on, on a daily basis. So the more we will go, the more the fibre footprint will extend. Now we have added another operator. A competitor will use this network, this fibre network. So all what we are actually doing on a day-to-day basis is to indeed reach the stage that you are describing where, I mean, we will have positive net addition on the fixed technologies. But once again, these are real customers. The technology is something, but look at the customer base and this is real customers paying real ARPUs for getting fixed access at their home. By the way, we are migrating a number of these fixed LTE customers to fixed technologies as well. So this is a real customer pool.

- Operator - -

A. (Operator Instructions) We have no other questions. Mr. Leszek Iwaszko, to you for the conclusion.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Yes, we had a few questions via email. Let me read them. You wrote in the presentation that you will -- you are preparing new transformation initiatives. Could you please give us more details on that?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. So we are working on a number of different initiatives. So it's actually, the whole Orange Polska organization, which is part of the program. Since we are a big organization, we have big processes behind the customer care, behind the distribution, behind our network, behind our investments that we are doing. All these major processes, are subject to our work, simplification, digitization and automation work, where possible. We have, today, more than 140 different initiatives of a different scale. Some of these initiatives you have seen on the slides that I was presenting to you. There are many more. We prefer to speak about them once they have been concluded and once they have been implemented and they are visible in the results. So we will keep to that way of working with you.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Okay. The second question is what is the size of employment reductions you expect in to 2H '18?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. We stick to the plan that we have communicated to you in the beginning of the year, once the Social Plan has been announced. We are well on track as we have expected, and we want to continue with the good path. So the total figures for the full year are not going to be different from those ones that we have communicated to you.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Next question, what is the size of asset sales you expect in 2H '18?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Okay, thank you very much for that question. As you for sure will understand, we will not disclose anything on that front before the negotiations are concluded and the deals are closed. That's -- the activity likes silence and proper approach.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. And here's another question for Maciej. Some time ago, you were working on sale of receivables. Can we expect such a move in 2H '18?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. We will be more talkative on that while passing to you Q3 results.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. And the last question is a request to confirm. Could we confirm that the PLN 3 billion of EBITDA, which is guidance for this year under IAS 18, is excluding any contribution from T-Mobile?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. It excludes. So guidance is without it.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Yes, there is another question. It's about the EC fine. When are we going to pay it, basically?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Well, I propose that we come back with that once we have read properly everything what we have received. We have not read, and I wouldn't like to comment the things that I was not properly informed about. So we will leave that details for later once we have fully understood the situation.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. This is really happening in real time because the judgment is not yet available to us and we don't...

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Exactly, so we have not - we haven't...

We have not even seen what is actually in the judgment, so let's wait.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. If there -- no, there are follow-ups, so on the floor.

- Robert Florczykowski, PKO TFI

Q. You mentioned that you want to start with this new offer for handsets that will be available in the whole life of the contract, so not just at the beginning of the contract. And if I remember correctly, you said that they won't be subsidized. But given you have a positive margin, should we expect that this margin, on average, will be lower? So the question is actually about whether the pricing of the handsets will be lower versus what you offer now?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. No. Actually, we will not stop. We have started. So it's available since a few days. What I want to say there is that there is no subsidization of the handsets. On the contrary, yes, we are making a margin on these handsets, but there is appetite from customers and -- sorry, it is obviously open to Orange customers. So it can happen anytime in your contract lifetime but still, to benefit from that, you must be an Orange customer. And the value is obviously, the fact that, I mean, these devices, I mean, the high-end devices are still quite expensive devices. So rather than buying a phone for PLN 3,000, obviously, you can buy it for this amount, divided by 24 months. So that's already an obvious benefit. The level of the margin we are taking is still quite thin, as you can imagine. So this is not something on which we are doing a lot of margin, but it's more for convenience, a positive for our customers that we introduce that and on the fact that the level of the SIM only that we are selling is, to our opinion, too high. So we want to come back under the handset sales as well. So that is the whole idea.

Robert Florczykowski, PKO TFI Q. And the second question. As you said, you can't reveal right now how much you can achieve from real estate sales. But given this quarter was sort of built in terms of the ARPU or even better in terms of the cost control, so how much, at this stage, in your opinion, is assumed in the guidance for the second part of the year? And then the third question, again, as given the quarter was sort of good and certainly better than expectations, what would need to happen so that you increase the guidance at the next conference call? So I'm just wondering what would need to happen for you to increase the guidance?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Thanks a lot. For the second question, I propose not to answer because that would be speculation, so we will not develop. For the third question about the guidance, we are middle-of-the-road for this year. So please, give us a chance to work properly for the second semester to -- in order to confirm the guidance or to improve it. But it's not the proper moment today to speak. We are confirming we will do the guidance that we have shared with you for the Q4 of 2017.

- Marcin Nowak – Ipopema

Q. Two questions from me. First, could you please provide some outlook for third quarter with regards to international roaming on a year-on-year basis? If there is a possibility to see a positive impact on the year-on-year after the surcharges being active? And the second question is, do you think that the slower net adds in mobile handsets in comparison to B2C convergence net adds is something to be worried about? Do you think that there is a risk that at some point, you may decide to return to more subsidizing approach to acquiring new customers?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Okay. To answer your second question, first. The trends on the mono postpaid offers has improved in Q2. So the net adds are 2x less distractive than they were in the second -- in the first semester. So the improvement is already visible to answer precisely your question. Second thing is that what is improving the situation is our hard work on retentions and on the churn front. We are, today, quite happy to see the lowest churn ever since the 2 years, and that's visible precisely in the area that you're asking about. Second, the net adds on the mono postpaid will not naturally be positive or close to 0 because of the migration to convergent

offers. So this is the category in which we are sourcing our future convergent customers. So for many quarters, this will still be a fishing pool for us for convergence.

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. If I may, Maciej, add to what you are saying. I do not want to give the impression that we are not in the market. So just for you to know, on a weekly basis, we are observing the price on pure mobile on devices from our competitors. So this is something that we are following very, very closely. So we are in a very competitive market on mobile, with four players in Poland. So this is something we are looking very carefully at. So it's not that we are outside the market. When we say we've made a lot of efforts in terms of subsidy reduction, that was last year, by the way, and again, I mean, we are absolutely in the market, and else, we wouldn't have the numbers we are posting today. So don't leave with the impression that, for instance, we are much more expensive or things like that. This is not the case.

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. And regarding your first question on the outlook for roaming. I will not probably speak about the figures, but we would like to continue with quite secure situation that we have achieved in Q2. So this is something that we would like to continue.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. One more -- 2 more follow-ups.

- Piotr Raciborski – Wood&Co

Q. I have 2 questions. First one considering direct cost. You've cut it significantly in the second quarter. What share of those cuts are recurring? Second question, consider a ban on international calls charges, that were probably being charged shortly. What impact of the regulation would you expect on your results?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Okay. So for the direct costs, since these costs are mainly driven by the level of the commercial activity, that is fully dependent on that. What is fixed in that area is our wish to generate value. So our wish is to continue with the level of the subsidy policy that we have today.

- Piotr Raciborski – Wood&Co

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Q. I've meant indirect costs

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. You meant indirect?

- Piotr Raciborski – Wood&Co

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Q. Indirect. Okay, what share of them are recurring and whether there are some one-offs?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Well, a lot of them are recurring, not all of them, because some of those costs are savings but achieved on the short-term basis. A lot of them are recurring. So they're part of the portfolio of the big program that I spoke about. And then on the ban, you mentioned ban on...

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. On international calls.

- Piotr Raciborski – Wood&Co
-

Q. Yes, there's this project of regulation banning the surcharges on international calls.

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. But that's a project, which is a project. So we would be happy to come back with you with the exact amounts once we know exactly when and how it will be implemented, if implemented, of course. But it's not a very, very significant item, I believe. It's not insignificant, but it is not very significant.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. The last question from Dominik.

- Dominik Niszcz - Raiffeisen CENTROBANK AG, Research Division - Financial Analyst

Q. Dominik Niszcz, Raiffeisen. Just a question on this Sunday trading ban. Do you think it had a positive impact on your costs? Maybe it had also a positive impact on churn as your competitors also could not sell as much?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. So if you look at the MNP evolution in the last months, so that didn't have a positive impact from churn because our competitors couldn't sell. The impact is of course, we lost sales versus a period where there was no Sunday ban, so roughly speaking, it's like, our estimation is around 5% and these are sales we have not recovered. But again, this is happening not only to us. This is happening to the entire market, to all the operators. So in that case, we are fairly treated. So -- and indeed, we've saved a bit of costs because there are people that we don't have to have in the shops on Sundays. So the effect is neutral, I would say. And again, the most important is that we are all treated equal, so that doesn't benefit to any of us individual.

- Dominik Niszcz - Raiffeisen CENTROBANK AG, Research Division - Financial Analyst

Q. Okay. So the 640 workforce cuts in 2Q was related partly to this Sunday ban?

- Jean-François Fallacher - Orange Polska S.A. - President of the Management Board & CEO

A. Not at all.

- Dominik Niszcz - Raiffeisen CENTROBANK AG, Research Division - Financial Analyst

Q. Okay. And on universal service, how much cash do you still expect to receive in future, in total from this?

- Maciej Nowohoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Well, this is not going to be commented too extensively since a number of different cases from a number of years is still in operation. So we basically have to be patient here and wait for a proper moment when that could be available for us. There's not too much to be available, I believe, by the end of this year.

- Dominik Niszczyński - Raiffeisen CENTROBANK AG, Research Division - Financial Analyst

Q. It's just, it's 50-something payment, right?

- Maciej Nowochoński - Orange Polska S.A. - CFO & Member of the Management Board

A. It's not exactly the cash that we received. The press information that I had seen yesterday evening is not corresponding to the real cash that we are getting. The cash is much smaller.

- Dominik Niszczyński - Raiffeisen CENTROBANK AG, Research Division - Financial Analyst

Q. And just the last question on domestic roaming with Play. Can we assume this PLN 110 million is spread equally this year, every quarter, right?

- Maciej Nowochoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Yes.

- Leszek Iwaszko - Orange Polska S.A. - Director of IR Department

A. Okay. Thank you very much. That ends our conference. See you back in October. Thank you.

- Maciej Nowochoński - Orange Polska S.A. - CFO & Member of the Management Board

A. Thank you very much.

- Operator - -

A. Ladies and gentlemen, this concludes our conference call. You may now disconnect.