ORANGE POLSKA Q2 2015
RESULTS CONFERENCE CALL
July 28, 2015, 11:00 AM CET
Chairperson: Leszek Iwaszko

Operator [1]

Good morning, and welcome to the Orange Polska second-quarter 2015 results conference call on July 28. For your information, today's conference is being recorded. (Operator Instructions). I would now like to hand the conference over to Leszek Iwaszko. Please go ahead, sir.

Leszek Iwaszko, Orange Polska SA - Head of IR [2]

Good morning, everyone. Welcome to Orange Polska results conference for the second quarter of 2015.

My name is Leszek Iwaszko. I'm the Head of Investor Relations. We are joined by management of Orange Polska today, starting with Bruno Duthoit, Chief Executive Officer; Maciej Nowohonski, CFO; Piotr Muszynski, Chief Operating Officer; and Jacek Kowalski, who is responsible for HR.

Our results have been published yesterday and they are available on our IR website, www.orange-ir.pl.

Now I hand the floor to Bruno Duthoit to start the presentation.

Bruno Duthoit, Orange Polska SA - CEO [3]

Thank you, Leszek. Good morning, ladies and gentlemen.

The agenda for today is as follows. I will begin with highlights of the second quarter and present some of our new commercial offers. Maciej Nowohonski will follow with the financial review. Finally, I will conclude the presentation with a few takeaways after first half, before opening the Q&A session.

Let's start with Q2 financial highlights, on slide 5. Our financial results in the second quarter were satisfactory and in line with our expectations. We achieved them in a continuously competitive market environment.

As expected, year-on-year revenue decline accelerated a bit versus Q1, due to mobile equipment sales. Our EBITDA margin was lower year on year, reflecting high commercial expenses. And cash generation, however, was better than last year.

On the next page, we present highlights of our commercial activity. Our marketing efforts have translated into significant improvement in commercial momentum in post-paid mobile. Net quarterly customer additions of 170,000 were the strongest in many years. All business lines contributed to this improvement: business, mass market and also machine to machine.

In fixed service, the situation was different. Due to intense competition, we lost customers both in fixed voice and broadband ADSL. However, we have already launched a number of offensive counteractions.

On slide 7, we comment on our main operational developments. Our operational developments continue to be focused on further investment in mobile broadband and in the fiber project.

In Q2, we increased 4G coverage by a further 7 percentage points. We reached almost 80% of population coverage. And in terms of our fiber project, in Q2 we increased our coverage by 87,000 households, much more than in Q1. The investment in this area will speed up significantly in H2. We maintain our full-year target which we announced in February of this year.

On the next two slides, we present our new commercial initiatives. In order to increase our competitiveness, in October last year we cut the broadband price on newly deregulated areas. It was very well received by customers and pushed us to do the same in the rest of the country, where we see increased propensity of customers to substitute fixed Internet with mobile. We now have one Neostrada price everywhere for all speeds, which makes the communication to customers easier.

More attractive pricing and fixed service's mobile technology which we launched in April are the two short-term tools that improve our competitiveness on the fixed broadband market. We will have more tools in the mid and long term, since we are investing in fiber access network.

Let's turn the page. As we deeply believe in the benefits of convergence, we make next improvements to make Orange Open even more attractive. Firstly, we have launched dedicated mobile plans available only for the users of our fixed services. Prices in those tariffs are much more attractive than in the standalone mobile offers.

Secondly, we have reduced barriers to enter Orange Open. It is now available for all existing fixed voice tariff plans, and in mobile the minimum commitment is down to PLN29.

Number of Orange Open customers is now close to 630,000, but on the top of it we have many other bundles that combine, for example, fixed only or mobile only services. The total number of B2C customers that benefit from using multiple services is around 1.5m. We are convinced that the convergence strategy will create long-term value for Orange Polska through upselling of services and customer loyalization.

Thank you very much, and I now give the floor to Maciej for the financial review.

Maciej Nowohonski, Orange Polska SA - CFO   [4]

Thank you, Bruno. Good morning, everybody.

Let's start the financial review with the summary on slide 11. Topline dynamics in Q2 was affected by lower year-on-year growth of equipment sales, as we were flagging a quarter ago.

As Bruno already mentioned, our results were influenced by higher marketing spending necessary to support customer acquisitions, which had an impact on profitability. It is worth noting that cost savings in H1 have more than compensated entire revenue loss. Cash generation was up year on year in Q2, supported by real estate disposals and lower cash CapEx.

On the next slide, we take a closer look at revenue evolution. Revenue performance in Q2 was solid. Even though mobile equipment revenues grew less than in the previous quarters, in nominal terms they were high. Other revenue grew by almost 50% as a result of ICT and, more importantly, infrastructure projects.

In Q2 we generated PLN65m from infrastructure projects, PLN48m more than a year ago. Looking forward, please note that these projects are scheduled to be completed in Q3, so their contribution to revenue in the second semester will decrease.

As you can see on the slide, in Q2 fixed revenues improved performance. This is due to specific projects in enterprise solutions. Improvement in this category may not be sustainable. Fierce competition on B2B market triggers repricing of contracts in retention, which may still weigh on second-semester performance.

Let's now look at mobile revenue in more detail, and that is on page 13. As Bruno mentioned, our marketing efforts translated into very strong net additions in post-paid in all customer groups. Post-paid base was up more than 2% quarter to quarter and almost 6% year on year.

Trend in mobile service revenue has been stable. However, looking at the details, you will notice worse performance of data and messaging line. This is entirely due to messaging part, which is under pressure from unlimited packages. Data part continues to show healthy growth. Both tendencies are reflected in SMS and data ARPU, which you can find in our reporting.

Overall ARPU performance in Q2 was quite similar to Q1, with still significant decrease in B2B and stabilization in B2C. B2C is supported by good performance of prepaid, which benefits from growing incoming traffic and successful commercial animation of offers and promotions.

Let's turn the page to fixed broadband, on slide 14. Performance of fixed broadband revenues has been quite stable for the past few quarters, but this is a combination of falling number of users and slightly better customer mix, which is reflected in small ARPU improvement.

In Q2, our ADSL base continued to be under pressure, especially in regulated zones. Our action plan to counteract this trend has been described earlier by Bruno. Please note that we intensively loyalize fixed broadband customers. Already more than 40% of them benefit from different types of product bundling.

On the next slide, we take a closer look at fixed voice. Highly competitive environment on the fixed broadband market is also reflected in the performance of the fixed voice business. Customer erosion has slightly accelerated in Q2, due to aggressive offers from mobile competitors. To contain growing customer losses, we count on new initiatives in convergence but also revival of Neostrada base, which naturally should support fixed voice.

Our revenue trend is quite stable, due to slightly lower pressure on ARPU.

That concludes the review of our topline. Now let's turn to EBITDA on page 16.

In Q2, we delivered almost PLN960m of EBITDA. That was almost 8% lower versus the previous year. Corresponding margin fell 1.9 percentage points to 31.8%

There were a few factors that contributed to the margin dilution. Firstly, higher costs of commercial activity as a result of more sales acts with handsets. Secondly, lower growth of mobile equipment sales, which significantly contributed to margin improvement last year. Thirdly, activity related to ICT and infrastructure projects, which generate margin lower than the average. And finally, growing interconnect costs.

Factors that positively influenced EBITDA in Q2 include mainly 8% higher year-on-year sustainable cost savings, PLN85m in Q2. I draw your attention to wide diversification of sources of these savings presented on the slide. And, second point, high gain on sale of assets.

Let's now look at net income. Net income amounted to PLN126m in Q2, up versus PLN94m a year ago. This growth is a consequence of two factors. Much lower financial costs as a result of debt refinancing; have in mind that Q2 was the last quarter when we saw this positive effect in year-on-year comparison. And, second factor, lower depreciation following the extension of economic life for certain assets, which we have already highlighted a quarter ago; nothing new.

On slide 18, we review our cash flow generation. Organic cash flow amounted to nearly PLN380m in Q2, growing by more than PLN50m versus last year. That improvement was a consequence of less cash paid for CapEx, as we said, and higher net proceeds from sale of assets.

In February, I talked about our plan to intensify disposal of unused properties, and this is happening. Our cash proceeds from this source almost tripled year on year in the first semester. On the other hand, cash was negatively affected by higher working capital requirement as a result of higher payments for handsets.

For the avoidance of doubt, LTE auction deposits are excluded from our guidance definition.

Please bear in mind that in the second semester cash generation will be lower year on year, mainly due to higher CapEx and pressure on EBITDA, but such evolution was already embedded in our guidance.

Let's conclude financial review taking a quick look at our net debt position. As you can see, at the end of June our net debt decreased immaterially as cash flow generation slightly exceeded payment of LTE auction deposit. Our debt ratios are unchanged, at stable and low level.

On July 9, we paid dividend of PLN656m. Consequently, the net debt will inevitably increase at the end of Q3.

Ladies and gentlemen, thank you for your attention. This concludes the financial review and I hand the floor back to Bruno for conclusion.

Bruno Duthoit, Orange Polska SA - CEO   [5]

Thank you, Maciej. Let me wrap up and give you a short update on our H2 expectations.

In the first half, we continued to operate in a very competitive environment both in mobile and fixed areas. In Q2, we managed to react to weak Q1 and deliver a much better commercial result. We refresh our brands, and on the back of it we keep on improving our customer care and sales channels. Our financial results were satisfactory and we confirm our full-year cash flow guidance.

We are aware that you would like to hear from us some comments about spectrum auction, which has been ongoing for more than five months. However, please understand that such comments would not be appropriate both from commercial and legal point of view.

In H2, commercial focus will top our agenda. We will fight to maintain good momentum in mobile and improve fixed broadband and convergence. In line with the plan, we'll put more resources to fiber rollout.

I do not think I need to repeat our usual strong commitments to our cost optimizations. Our results in this area speak for themselves.

Let's now turn to the last slide to look how it fits into our full-year expectation. We confirm our full-year outlook and trend expectations which we presented at the beginning of the year.

Our year-on-year revenue dynamics in H2 are likely to deteriorate compared to H1, as it will no longer be supported by infrastructure projects and equipment sales. Intensive marketing agenda which I just spoke about will affect our profitability in the second half.

Maciej has already mentioned that cash generation will be lower year on year in H2. Nonetheless, it remains under full control and we feel comfortable with our full-year targets.

Thank you very much for your attention. This concludes the presentation. We are now open to questions.

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Questions and Answers

Leszek Iwaszko, Orange Polska SA - Head of IR   [1]

Let's start with the questions from the floor, if there are any.

Przemyslaw Sawala-Uryasz, Pekao Investment Banking - Analyst   [2]

Przemyslaw Sawala-Uryasz, Pekao Investment Banking. Looking at the low level of indebtedness, 1.1 times leverage, what is the optimal level that the management would see it to evaluate towards, given the actions still pending? That's one of the questions.

And also, on page 14 you are showing that 19,000 out of the 50,000 customers that left the ADSL business base was transferred to the higher technology, meaning VDSL or broadband or fiber optic. Would that mean that the rest of the customers is out of your system? Where are they migrating to, the competitors or are they migrating to the mobile Internet access services?

Bruno Duthoit, Orange Polska SA - CEO   [3]

Maciej for the first question. I will take the second.

Maciej Nowohonski, Orange Polska SA - CFO [4]

Thank you, Bruno. Thanks for the question. In terms of the net debt to EBITDA, our thinking is persistently not changing. So we believe that in the long term the, I would say, target net debt to EBITDA is below 1.5. However, we do not exclude that for certain assets we could increase this net debt to EBITDA for short or midterm. It is not excluded. And one of these assets could be, for example, spectrum.

Bruno Duthoit, Orange Polska SA - CEO [5]

For the second question, you talk about very high broadband. There is in fact three technologies which are available for clients. The most, let's say, popular is migration from ADSL to VDSL. We have approximately 4.5m households in the country which are accessible to VDSL that we propose migration either when it's a case of retention, either for new clients. And we have a base of now approximately 230,000 VDSL customers and it is growing.

But parallely, you know that we start to roll out FTTH. We have a bit less than 5,000 customers at the end of June in FTTH, and most of these customers were connected in fact in H1, particularly in Q2.

Last but not least, we launched another tool just recently. It's a bit more. It's now three months ago, a so-called fixed LTE offer, to satisfy some clients who prefer to have, let's say, wireless. Even if it's not really mobile, it's wireless. And we have approximately 10,000 clients at the end of June in this technology, but they are not in the figure that you are looking at. In the figure, it's only fixed technology, if I don't make mistake.

Przemyslaw Sawala-Uryasz, Pekao Investment Banking - Analyst [6]

Thank you.

Leszek Iwaszko, Orange Polska SA - Head of IR [7]

If there are no questions from the floor, I suggest we switch to our conference listeners. Operator?

Operator [8]

(Operator Instructions). Henry Drouet, HSBC.

Herve Drouet, HSBC - Analyst [9]

Yes. Good morning. Two questions on my side. The first one is in terms of the change of broadband price that was initially done, I believe, in October last year, and then my understanding is you rolled out as well those new offers in April. I was wondering, have you seen a change of trend in terms of some of the subscribers churning out of the fixed broadband business, suppose ADSL or VDSL and FTTH, if we sum up all the subscribers? I would have thought we would have seen already more stabilization of the trend, but it looks like in Q2 we still have a decline of those numbers of subscribers. I just wanted to have -- if you can shed a bit more light on that, on when you think potentially the curve may change trends, looking forward.

And the second question is how do you account on the Orange Open discount? Do you apply that discount to the fixed business in terms of accounting, or do you apply it to the mobile side? Thank you.

Bruno Duthoit, Orange Polska SA - CEO [10]

I think I will take the question. For the first question, you know that in October, just after deregulation of approximately 30% of the households in the country, we decreased the price because we had this flexibility which was not possible before. And we saw for the last, let's say, nine months a very good trend versus the still regulated areas. It means we have a much better trend, really a much better trend in gross adds and as well in churn.

And it is the reason why, after naturally a discussion with regulator, we decided to launch to mitigate the obviously not very good story we have today in ADSL. In the regulated areas, we launched at the end of June. It's exactly, therefore, one month ago. We launched the same offers. We extended the same offers which were implemented in deregulated areas in October to all the country. Now we have one price ADSL for all types of speed, from 10 to 80 meg, and from 1P, 2P and 3P. Naturally the prices are different, but it is harmonized, very easy to sell.

And we expect to have already the first -- after a few weeks, it looks promising. We expect to have, let's say, at the end of the day, the same trend in regulated areas than we had since nine months in deregulated areas. Excuse me. It's a bit complex to say. But we have now an offer which is cheap, which is competitive versus, let's say, the major cable TV and the small ISP, which are very present in small towns particularly, and which is very simple to communicate, because it is harmonized. No complexity for the clients.

And for your second question, I can say that all the discounts on Orange Open, our convergence offer, is implemented on accounting on mobile side.

Herve Drouet, HSBC - Analyst   [11]

All right.

Maciej Nowohonski, Orange Polska SA - CFO   [12]

Can I just -- one supplement to what was suggested in the question, that we have implemented the new pricing on the regulated area in April. In fact, it happened on June 26.

Herve Drouet, HSBC - Analyst   [13]

Okay.

Bruno Duthoit, Orange Polska SA - CEO   [14]

Apologize. It's a mistake. It's June 26.

Herve Drouet, HSBC - Analyst   [15]

Okay. So we haven't seen yet the impact, really, in the Q2 of the rollout of those new pricing in the regulated area? Am I correct saying that?

Maciej Nowohonski, Orange Polska SA - CFO   [16]

Yes, that's too early to see the results.

Herve Drouet, HSBC - Analyst   [17]

Thank you.

Operator   [18]

Vera Sutedja of Erste Bank.

Vera Sutedja, Erste Bank - Analyst [19]

Yes. Thank you for taking my question. I have a question regarding the B2B pressure. Can you elaborate a bit on how many already negotiated for lower tariffs, especially in the mobile? And how far are we already? Maybe it's two-thirds, or is it still 50%?

And the second question is regarding your comment on the net debt to EBITDA, where you said that we could increase or breach this 1.5 times for short or medium term. Can you elaborate what you mean with short or medium term? Is this meaning months or is it for several years? Thank you.

Bruno Duthoit, Orange Polska SA - CEO [20]

I will take the first one. Second will be for Maciej. On the first, I can say the pressure is continuing on B2B, particularly for mobile for key accounts, let's say large companies, and as well, let's say, for managed networks and data networks.

What we can say, but it's just rough, if I don't make mistake we have more than now 55% of mobile package in B2B which are already, let's say, unlimited. And most probably let's say we can expect at least for small and middle size companies that the ARPU will stabilize and why not increase.

And for managed networks, data networks, which obviously are under big, big pressure particularly, when it's open tender, renewal of contract after generally two or three years, we can say that if I don't make mistake approximately two-thirds, let's say, of the big contracts were already repriced since the last 18 months. We can expect still a decrease, unfortunately, but probably at a lower percentage than it was before.

Vera Sutedja, Erste Bank - Analyst [21]

So you mean the speed should be -- speed of conversion into lower tariffs should be less than before?

Bruno Duthoit, Orange Polska SA - CEO [22]

Yes. The rate of decrease will be smaller than it was for the last semesters, but there will be still a decrease, quarter on quarter.

Vera Sutedja, Erste Bank - Analyst [23]

And what did you mean with the two-thirds? I couldn't hear you very well (multiple speakers).

Bruno Duthoit, Orange Polska SA - CEO [24]

Approximately, but the two -- we have a significant stream of revenue for managed networks, mainly IPVPN and B2B. And among that, naturally it's very linked to big clients, and we can say that approximately two-thirds, let's say, of the contracts were already significantly repriced, taking opportunity for the clients of the tender also during the last 18 months. And one-third, more or less, a bit less, remain, let's say, to be most probably repriced during the next tender for renewal of this contract.

Vera Sutedja, Erste Bank - Analyst [25]

Okay. That's for the enterprise solutions, for the network solutions, right?

Bruno Duthoit, Orange Polska SA - CEO [26]

Yes.

Vera Sutedja, Erste Bank - Analyst [27]

Okay. Understand. And the net debt/EBITDA?

Maciej Nowohonski, Orange Polska SA - CFO [28]

Vera, to answer your question about the net debt to EBITDA, the amount of time that we could be at a potentially higher level than 1.5 is purely a function of -- we can cut the story to two elements. The long-term cash flow generation for the Company and prospects for that, and the second is the price of the asset that could potentially increase the level of debt above 1.5. So these are the two basic elements which impact how long it will take. And in my meaning, midterm is more than 12 months.

Vera Sutedja, Erste Bank - Analyst [29]

And if I have -- may I ask one more question? There was, several weeks ago, probably more political ideas about taxing the telecoms. Do you have any comment regarding this, how likely it is going to happen?

Bruno Duthoit, Orange Polska SA - CEO [30]

No comments, at this stage.

Vera Sutedja, Erste Bank - Analyst [31]

Okay. Thank you.

Operator [32]

There are no more questions over the telephone.

Leszek Iwaszko, Orange Polska SA - Head of IR [33]

Do we have any follow-ups? Yes, we do have from the floor.

Pawel Puchalski, BZ WBK - Analyst [34]

Pawel Puchalski, BZ WBK. You suggested commercial costs will weigh on EBITDA in the second half of the year. Could you comment more on the scale of those commercial costs, because I remember in the third quarter 2014 you reported a very decent EBITDA margin, reported at 34% and restated 35%? Could such a quarter come true in 2015 again?

Maciej Nowohonski, Orange Polska SA - CFO [35]

I am rather expecting that it is more and more costly to get the net adds on the market. It is visible in our results of Q2. We had, I would say, very good net adds, 170,000 in Q2, was probably never that high in the last five to six years, in a quarter which is not a Christmas quarter. We have very strong ambitions in terms of the next build ups of the customer base. So it is absolutely not excluded that it will weigh on our EBITDA even in Q3.

Pawel Puchalski, BZ WBK - Analyst   [36]

Another question. Auction, mobile auction; in your view, what are the odds of cancellation, nullification of an auction?

Bruno Duthoit, Orange Polska SA - CEO   [37]

You understand that I cannot -- we cannot comment on that, I think. It is not in our hands. We are bidding and a serious bidder. We cannot comment on the possibility, opportunity or risk of cancellation.

Pawel Puchalski, BZ WBK - Analyst   [38]

Thank you very much.

Leszek Iwaszko, Orange Polska SA - Head of IR   [39]

If there are no further questions, then thank you very much. We will be reporting Q3 results in October. Thank you. Bye.