

# Orange Polska

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CONFERENCE CALL DEDICATED TO ORANGE POLSKA FINANCIAL RESULTS 3Q 2021

**Company:** Orange Polska

**Date:** 26.10.2021

**Participants:**

- Julien Ducarroz, Chief Executive Officer
  - Jacek Kunicki, Chief Financial Officer
  - Leszek Iwaszko, Head of Investor Relations
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Operator:

Good morning, ladies and gentlemen. Leszek, please go ahead.

Leszek Iwaszko:

Good morning, everyone. Welcome to Orange Polska results for first quarter, nine months of 2021. We are joined today by our Chief Executive Officer, Julien Ducarroz, and our Chief Financial Officer, Jacek Kunicki who will be giving the presentation. I hand the floor to Julien to begin the presentation.

Julien Ducarroz:

Good morning, everyone. Welcome everyone on our conference, summarizing third quarter and nine months of this year. As usually, I will start with the highlight of the quarter. Jacek, will follow with the financial review. Then I will come back for our final conclusion, and open the floor for your questions. So let's go on slide number five, and I will highlight the third quarter main events. So Q3 was another quarter of strong financial result. Our value strategy drives robust performance of our core telecom services. This quarter, it was helped by further recovery of roaming over the summer. As we were flagging before, from July, our revenue reflect cuts in mobile and fixed termination rates, which mean that the dynamic is lower, but impact on profit is not material. Commercial results were solid. And when comparing versus last year, please note that Q3 2020 enjoyed demand catch up phased after the lockdown.

Julien Ducarroz:

We see some increased promotional activities on the market, but at least so far, it does not impact our result in any significant way. We are pleased about high customer loyalty and resulting in low churn, as

well as strong result in fiber. On a different front, it is worth to mention that from September, our company works in hybrid mode with minimum two days in the office. Office work is mainly focused on creative meetings and brainstorming while home for the individual desk work. Finally, as you know, we have finalized FiberCo deal fully, according our schedule. This fact influenced a lot of our financial statement of this quarter.

Julien Ducarroz:

Going on slide number six. Our result for nine months of this year were strong and in line with our plan. Revenues increased by almost 4% driven by convergence and ICT business. As I mentioned, this dynamic slowdown in Q3, due to the regulatory impact. Growing retail revenue fueled over 5% EBITDA growth. These growth accelerate to above 6% in Q3, but that much high dynamic should not be extrapolated going forward. Economic CapEx is 10% lower year on year. As in Q3, we sold some fiber network connections to FiberCo. Jacek will comment more on that. Our sales of real estate continue to be weak due to ongoing slowdown on this market. Going to page seven to look at our commercial result. Let's start with convergence and fiber. We presented together, as fiber is a key driving force for performance in convergence, both in volume and value terms.

Julien Ducarroz:

Convergence revenue were up almost 17% this quarter. This came almost equally from growth of customer base and growth of ARPO. Customer net additions were similar to the previous quarter, but below last year. On the one hand, net addition of fiber was strong. Almost similar to last year and better than in Q2. On the other end, other broadband technologies, such as copper and fixed wireless, were below last year, which negatively influenced overall net additions in convergence. We have just put in place some action to improve our performance in fixed wireless, where competition recently increased. Coming back to fiber, we continue to expand our footprint. We grow it at steady pace of around 200K household a quarter in line with our strategy, now more relying on partnerships. Of the total footprint of 5.6 million at the end of September. Please note that 1.9 million accounted for third party infrastructure. That number increased a lot this quarter as we move around 700K households to FiberCo.

Julien Ducarroz:

Going to slide number eight. Mobile handset customer base is growing at the steady pace of 5% year on year. On the past three quarter, net addition, where broadly similar fueled by both B2C and B2B. We are pleased that our customer base are more loyal. As you can see on the bottom right chart, churn rate fell to 1.8% in this quarter. ARPO is growing both in postpaid and prepay. In postpaid growth accelerated to 2.5% due to roaming. In Q3 roaming revenue recovered to almost 80% of pre-pandemic level of Q3 2019. ARPO trends reflect our value strategy, as we started to monetize price hikes that we have introduced back in May. Customer continue to need more data and 5G is already a trigger. In B2C, we observe that data consumption among 5G user, is around 20% higher versus 4G user. That's all for me now. I hand the floor to Jacek.

Jacek Kunicki:

Thank you Julien. Good morning, everyone. Let's start the financial review on slide 10, where we present the highlights of our performance.

Jacek Kunicki:

Our financial results in Q2 were strong, both in terms of profits and cash generation. Revenue expansion slowed down as expected, impacted by the regulated cuts of the wholesale termination rates, both in fixed and in mobile. Growth of our core business accelerated, fueled by all major product lines. Profitable revenue expansion resulted in an almost 7% EBITDA growth in Q3. After nine months of the year, our EBITDA is up more than 5% and it is well on track to meet the full year objectives. The economic CapEx was particularly low this quarter. This stems from around 140 millions zloty of proceeds from the sale of fiber network assets to the FiberCo - Swiatlowod Inwestycje.

Jacek Kunicki:

These are assets that OPL had started to construct before the signing of the FiberCo transaction and only finalize the construction right now. We will continue this transitional process in Q4, and in the first months of next year, albeit at a much smaller scale than in Q3. Finally, cash generation continues to be solid this year. After nine months of 2021, net cash from operating activities is 13% higher than last year reflecting the growing EBITDA as well as favorable timing of the working capital requirements. Now let's review our results in more detail, starting with the top line. Our Q3 revenue was expanded by 3.3% year over year. As mentioned, the dynamic was affected by the cuts of the wholesale termination rates. If we were to exclude these, the revenue growth would have amounted to around 6% year over year. It resulted from two key developments.

Jacek Kunicki:

Firstly, the growth rate of revenues from our core telecom services improved to more than 8% year on year. This very strong performance combined, continued solid customer base uptake in convergence and in mobile only, as well as good ARPO trends. As mentioned by Julien, the main, ARPO further benefited from recovery of roaming, with Q3 being the peak season for this activity for roaming. Secondly, ICT revenues were up by 37% year over year. This was fueled by the contribution of Craftware, and by strong organic performance, it benefited from a low comparable base of Q3 last year, when ICT performance was affected by pandemic related markets slowdown. This year on the other hand, Q3 is strong, is very strong. While the outlook for Q4 is less positive, due to chip set shortages and different timing of projects between the quarters of 2020 and 2021. Now let's take a closer look at our profitability.

Jacek Kunicki:

We're pleased to report a 6.6% EBITDA growth in Q3. This strong achievement benefited from our high operating leverage, converting the growth of our core service revenues to higher profits. This is visible in the expansion of the direct margin, which increased by more than 5% year on year. The indirect costs grew by 4% year on year in the third quarter. We're continuing our cost savings plan. This is mainly contributing to an underlying decrease of labor costs, CRM subcontracting, and general expenses. The combined costs of these categories, decreased by around 3% year on year. However, this was more than offset by other mostly non-recurring developments.

Jacek Kunicki:

First, our advertising spending, which were significantly scaled down during the pandemic a year ago and which have now returned to a more normal level necessary to support the sales. Secondly, we've created provisions for certain risks as well as onerous contracts in the energy resale business, which is obviously experiencing a bit of a tougher period. Finally, this quarter, we had a particularly low income from the dismantling of our copper network due to timing of works.

Jacek Kunicki:

As we have closed the FiberCo transaction various lines of our profit and loss will progressively reflect our business activity with the FiberCo, with Swiatlowod Inwestycje. The net impact of these settlements is broadly neutral for the EBITDA and you can find more details on the nature of those settlements in a dedicated slide in the appendix. We're happy with our EBITDA performance in Q4. At the same time, we're observing a more challenging macro environment. We closely monitoring the potential impacts that this may have on us due to increased inflation, which is fueled by the energy prices. Now let's take a look at the net income on slide 13. Net income for Q3 was exceptionally high, as it was boosted by the gain on the FiberCo transaction. That net gain amounted to around 1.4 billion zloty net of tax. If we exclude this item, our net income came in at around 165 million and increased around three times versus the third quarter of 2020.

Jacek Kunicki:

This resulted from a higher EBITDA, which we've already analyzed as well as from lower depreciation. And here similar to Q2, depreciation was down year on year, as we were able to use our assets more efficiently and for a longer time than originally estimated. As you can see, our performance in Q3 was strong in all areas of the income statements.

Jacek Kunicki:

Now let's take a look at cash generation. We generated around 740 million zloty of organic cash flow over the nine months of this year. It's almost 80% more than last year. This strong achievement is driven by the EBITDA growth translating into growing operating cash flow and by lower year on year working capital requirements. The latter was a partly thanks to timing and particularly it was supported by the settlements with some of the operators. Very solid organic cash generation and almost 900 million installment received from the sale of 50% of FiberCo, has resulted in our leverage decreasing to the level of 1.5 times EBITDA.

Jacek Kunicki:

This is below our long term leverage corridor. However, please bear in mind that we are still ahead of the 5G auction. And we are eagerly awaiting the announcement of the new process and the conditions. This concludes the financial review. Let me hand the flow back to Julien for the conclusions.

Julien Ducarroz:

Okay. So on slide 16, let me briefly summarize our presentation and our focus for the coming months. Our financial result for nine months was strong, coupled with a satisfactory commercial performance. This means that we are comfortably heading to reach our full year objectives. We will soon enter a traditional peak sale season. And as usually, we have ambitious commercial goals. Going forward, also in Q4, we will focus on preparation of next year. This embraces commercial ambition and adapting to the more volatile macro environment, which obviously include growing inflation and in particular, energy prices. We are as well, watching out carefully as a supply crisis and especially on equipment that will be putting some pressure on the Q4 commercial value. Nonetheless, we are confident that despite this challenges, we will be able to deliver growth next year and meet our growth strategy goals. That is all from us. We are now ready to take your question.

Leszek Iwaszko:

We are now taking the questions from the call.

Operator:

Thank you. If you have a question, please press \*2, if you are dialed in by phone, if you're dialed in by the web, please type your question in a box provided or click the button to ask a voice question. We'll just leave it a moment or two to gather questions. Thank you. (silence).

Leszek Iwaszko:

Hello?

Operator:

Yes. Hi, we're just gathering questions. If you bear with us just 20 seconds, we'll come back with some questions. Thank you. (Silence)

Leszek Iwaszko:

Hello. While we are waiting for the questions from the call, let me read the questions that we've received online from one of the analysts. From Konrad Ksiezopolski. We have three questions. I will read them one by one. First question; Having in mind, growing energy prices and inflationary pressure in economy, do you plan further price increases of your telco services? If yes, when we should have expect them and in what product categories? In all product, or maybe mobile only or fixed only? That's the first question. I will read them one by one.

Jacek Kunicki:

Thank you very much for your question. I think it's fair to say that well, we've been pursuing the more-for-more strategy for quite a long time. We are not giving up on it. We think that it remains to be the main answer for value creation, but also especially relevant in the times of growing inflation, which will inevitably put pressure on the cost of the industry, as a whole. We've performed the series of more formal price adjustments this year, and we can say this relates to mobile, relates to convergence, it relates to prepaid. So a lot has been done. I think the efforts going forward, the immediate effort going forward is to make sure that we are able to monetize these price increases, so that we are able to sell our services to new customers, but also to retain in existing customers onto the new, higher valued tariff plans and tariff options. And, this would be our immediate focus. Now, regarding any further pricing moves, I will not elaborate on that as this is commercially sensitive, but I do confirm the value strategy is the most natural answer that we can give to inflation.

Leszek Iwaszko:

The second question from Konrad Ksiezopolski. Could you comment your view on the recent Play UPC deal? Do you expect competition in convergence market to intensify? Having in mind Play price, competition, generics, would you expect Play UPC to build its market share through attractive pricing?

Julien Ducarroz:

So let me take this question. Thank you for the question. So my first answer will be on this acquisition that it's a confirmation of the strategy that Orange Polska has followed since now, the Dot One program, and that it's at the center of our dot grow strategy, which is the market is moving and the customer demand is moving toward a convergence, for which we have already a few years of practice. And I will

say building knowledge and operational excellence. So for me, it's not a big surprise, because this is where the market is going. So I would expect that our competitor in order to answer the demand on the market will build up their own convergence strategy. I will not necessarily comment on what do I expect as a commercial move or how they will enter from a pricing perspectives, but as you probably know, following the market Play has already some offer via are third parties network. So I'm not expecting that it will fundamentally change the market, just that their footprint will increase. And probably still there is some months before all of this will become effective and operational.

Leszek Iwaszko:

And the final question from Konrad, could you comment on TowerCo plans? How possible is that you follow Polkomtel and Play and sell your, TowerCo to Cellnex?

Jacek Kunicki:

Thank you for that question. As we've indicated before, the moment that we will close the FiberCo transaction is a good moment to start looking at the options for the towers. We've obviously closed the FiberCo transaction. We are very happy with doing that. So now it is a good time to analyze what are the possibilities and the options to create value by a possible tower project. We haven't decided on anything. So I will not elaborate on the probabilities of this happening. I think you still need to be a little bit more patient so that we structure the project in the process and then we are able to come back to you with more thought through and detailed guidelines as to what we would like to do and why.

Leszek Iwaszko:

Okay. Thank you. Now we are, I think, ready to take the questions from the call.

Rohit Modi:

Hi, Rohit Modi from Citi. May I?

Leszek Iwaszko:

Please go ahead.

Rohit Modi:

Hi, thanks for the opportunity. Just a couple of questions from my side. Firstly, in terms of your EBITDA growth, you already got 5.3% in first nine months, and I know you have a guidance of low to a mid single digit. Just getting a sense in terms of what you think about what's driving EBITDA more cautious on 4Q, or you expect similar kind of growth in 4Q as well that can meet your guidance. Secondly, on Huawei, can you give more color, what's the situation on Huawei ban right now. And what kind of impact do you see if Huawei's ban on your CapEx is introduced? Any ballpark number would be really helpful. And thirdly, in terms of energy prices as you said, you're keeping an eye on energy prices, inflationary situation right now. Just more color on what percentage of your energy usage has been hedged for next year and what kind of impact do you see if the inflationary trends can go on? Thank you.

Jacek Kunicki:

Okay. I guess I will take the question about the EBITDA and energy prices, and I will let Julien comment the question of cyber security. With regards to, to the EBITDA we're well within our guidance plans, the guidance is low to mid single digits. As you can see after the three quarters, the EBITDA is increasing by

5.3%. So naturally we are closer to the mid digit than to the low single digits. With regards to Q4, we're not precising that right now, we're not guiding specifically for Q4. This is a period where we really want to focus on maximizing sales, maximizing the customer base and the revenue base, that we will have with us when we enter the new year. But overall, the EBITDA growth this year is very good. It's rather closer to the mid, single digit than to the low single digit. And I would expect it to be rather more positive for the full year.

Jacek Kunicki:

Regarding energy prices. So here, the average spending that we have per year, it's more or less 200 million zloty per year. It's slightly about 200 millions zloty per year. Roughly half of this is distribution fees, and various associated charges. So this is not impacted by the price itself. And from the 100 million remaining. I'm talking about 2021 prices. From the 100 million remaining, we've been able to hedge around 50% as we stand today.

Jacek Kunicki:

And, we will observe the market for how to hedge and when to buy the other 50%. The 50% that we did hedge, it is at the price which is slightly higher than what we have been incurring in 2021. It's about 25% to 30% higher than the cost that we've bought in 2020 and we've been seeing this in the P&L in 2021. As for the rest, well, it's something that I will not elaborate on, because this is where we are attempting to strike a balance between the short term cost and the commitments that we may have for the longer term. So it's not something that we will hedge within the next week or two or three. It's something which till today still is an area of uncertainty for us. We are monitoring the energy prices basically on a daily rate, to observe the trends that are now being developed. And then over to Julien for the cyber security, maybe.

Julien Ducarroz:

Yeah. So, first of all, as you probably know, there is a draft that has been published regarding this cyber security law, a few days back, and we are in the process of discussion. But just some generic principle on this cyber security law. It does not rule out any infrastructure, vendors or equipment at this stage. So the law itself, it does not require us to replace any equipment. However, it establishes an administrative procedure upon which equipment of a given vendor will be analyzed on the security criteria. So I would say at the moment we don't have any impact analysis, because we are not in such a situation. And when the law will be published, we will be in a measure to better assess. Obviously, we are in a close discussion with authorities. As a law, we do expect will be soon final, which will be as well, an opening of the 5G and the C-band auction that we have been waiting for quite some time now.

Rohit Modi:

Thank you. Very helpful. (silence)

Leszek Iwaszko:

Let me read another question that came to us online then. This is question from Piotr Raciborski from Wood&Co The question is, could you please comment on Polish 5G JV project, recently announced by the government? Would you be interested in corporation with Polish government on 700 MHz network rollout? What is the amount of OPL B2B or B2G he wrote, so business to government revenues.

Julien Ducarroz:

Okay. So thank you for the question. I will take part of it and Jacek to comment. First of all, as I just commented before, and this is an ongoing consultation that we are having with authorities and as well as the industry, as it is something that touch frequency. So it is a matter of industry. And at this stage, we have no, I would say, formal position to communicate outside, as we are discussing with authorities, and I would not like to disclose those discussion. We do expect that by mid of November, the government will finalize this draft law. And I will be able afterward to comment on our position, including whether or not we will participate inside a potential JV, that could include public operator and private operator.

Jacek Kunicki:

Then maybe to complement that or to supplement that, as for the strategic network operator. Yes, the cyber security law introduces the idea of the creation of a strategic security network. And it's operator state owned company would provide telco and cyber security services in a specific field of defense, state security and public safety. The company should be appointed by the PM roughly 30 days after the law comes into force. So right now the optimistic calendar will be the lowest accepted by the government in November. It comes into force in the first quarter of next year. And then the company would be appointed by the PM.

Jacek Kunicki:

The proposed law doesn't precise which institutions would be included in this network and with which services. This is what doesn't enable us to estimate what kind of size of revenue and when could be affected by this. I think we need to remember while analyzing this, that contracts with B2B, but also with public customers are usually four or five years long, and it's usually not so easy to replace them, to replace some of the services which we are providing without a proper infrastructure. So, that's for the B2G business.

Leszek Iwaszko:

The operator, do we have any questions online that you can open those lines? If not, we have one more question that came to us, but it was already answered. This is question from Dominik Niszcz from Trigon, but this is a question regarding cost of electricity in the group. What prices we expect in 2022, that's been already tackled. If we do not have any other questions... Please, if you have any technical problems, please accept our sincere apologies, and please contact us directly for any questions that were not answered by us. You know how to find us. Otherwise, thank you very much for listening to us, and talk to you February next year.

Jacek Kunicki:

Thank you very much.

Julien Ducarroz:

Thank you.