

Orange Polska (OPL_PW)

Earnings Q1 2019 Earnings Call Teleconference

Event Date: 04/30/2019

Presentation

Operator:

Ladies and gentlemen, welcome to Orange Polska First Quarter 2019 Results Conference Call. Today's host is Mr. Leszek Iwaszko, Head of Investor Relations. Please go ahead.

Leszek Iwaszko, Director of Investor Relations:

Hello, good morning. Welcome everyone to our conference for the first quarter 2019. I'm Head of Investor Relations, Leszek Iwaszko. Our speakers for today will be Jean-Francois Fallacher, the CEO of Orange Polska and Maciej Nowohoński, the CFO of Orange Polska. I hand the floor to Jean-Francois to begin the presentation. Thank you.

Jean-Francois Fallacher, Chief Executive Officer:

Thank you very much, Leszek. Welcome everyone to our conference. Let me start directly with the first slide of the presentation, which is slide number six, where you can see the highlights of our Q1 results, presented next to 2019 year guidance. So as you know, we are guiding for growth of both revenues and EBITDAaL, and with full confidence, we confirm this guidance even if the EBITDAaL in this quarter is not growing versus last year. Full-year growth doesn't necessarily mean that we grow every quarter. In Q1 and Q2 last year, basically our results benefited from some non-recurring gains, which are not repeated this year and which are weighing on the year-on-year comparison. Now if we look at revenues, so revenues, so revenues evolution was strong this quarter, as you can see, with more -- with core group revenues growing more than 3%, and they are driven by convergence and ICT. EBITDAaL, which is, if you remember, our new measure of operating performance in IFRS 16, was stable year-on-year, if we exclude different timing of closures of real estate transaction, and we expect the trend to improve going forward. CapEx this quarter were high, but this is only due to different phasing than last year. And for the full-year, we expect our CapEx to be lower than last year.

Now let's look at the next slide, slide number seven. As we highlighted many times, convergence is the cornerstone of our strategy. The Orange Love convergent offer is our key commercial formula. It's unique on the market and we are, through these offers, winning higher share of telco spending of the Polish households. It is encouraging people to consolidate their media and telecom bills under one roof, which comes both with convenience and financial benefits for them. As you know, Orange Love offers have been on the market for more than two years now. They are used by more than 1.2 million customers and basically we decided we should refresh it and to enhance it. As you can see on the charts there, the standard basic package is unchanged. And we have actually created two additional packages that you see here on the slide. These two packages are making it easier for customers who desire richer TV content and more abundant mobile data plan. Previously, creating these packages was also possible through upselling and now it's easier

and the price for customers is more attractive. And at the same time, we keep the flexibility we were having. As for customers, they can still buy additional thematic TV if they wish to. So through this offer, we clearly count on more value to be generated and it's a very concrete proof of our value strategy being implemented.

I propose we are looking now at next slide, which is about fibre. We have quite important news this quarter, as the reach of our fibre network in Poland has exceeded now 3.5 million Polish homes. This is 25% of all Polish households. However, if we look at the largest cities in Poland only, we were -- where we actually started predominantly to build, cities with population of more than 100,000 inhabitants, in these cities, our reach is close to 50%. Our fibre network today, our FTTH network today, is already bigger than the entire foothold of the number one Polish cable company, UPC, just to make sure we understand the size of this fibre network. So this is a truly fibre-to-the-home network, that is our big asset and competitive advantage that will last for the coming 20, 30 years in Poland. Now talking about the customer base, in the beginning of April, we passed the 400,000 customers milestone. Our network penetration, as you can read there, has exceeded 11% and it keeps on increasing every quarter and is completely in line with our expectation. And it is important also to note that in these larger cities I was talking about, it actually exceeds 12%. It's true that it is lower in smaller cities where we started to build a little bit later, but we wanted to report that the fibre project is absolutely on track.

Now a few words, next page, page nine of the presentation, let's look here at value creation coming both from commercial performance and transformation. On the commercial performance side, you see that net customer additions of convergence continued to be solid, exceeding 40,000 in a quarter. They may be not as high as in the past, but please note that we are not anymore pushing wireless for fixed product. It's a result of our strategy. And if we exclude this wireless technology, our net additions on convergence are about the same than last year. I want to highlight here that the penetration of convergence in our fixed broadband base is approaching 60% now, which is, as you will agree, a significant number. And we have -- we pay a lot of attention on the proper balance between customer volume and value they are bringing, and this is why we are pleased to show on the middle on the graph -- in the middle on the top that ARPO trend has improved and we count on further progress helped by the new Love packages that I was just showing you a few minutes ago. Now on the right side, if we look at our mobile postpaid numbers, we are steadily growing the customer base. In handsets offers, net additions were better actually than last year and mainly driven by a lower churn on the B2C mono customer base.

Now on the lower row of this slide, we are presenting results of our ongoing transformation, the second part of the value creation in the Company. We have entered the second year of the implementation of the social plan and such scale of employment optimization wouldn't be possible without major simplification and automation of our business processes. This is actually one of the main drivers of overall savings in indirect costs and we are here very consistent. You can read here that with PLN38 million net indirect cost savings this quarter, we are continuing the savings of our indirect costs. On the right side, on the pink box, you can see that these savings almost entirely offset the decline of direct margin coming from our legacy business. So that's what I wanted to report on value creation.

And now let's -- let us go to next slide, where I would like to comment an announcement that we did yesterday, which is about strengthening our B2B business. So yesterday, we have announced the acquisition of an IT company called BlueSoft. Why do we do that? In our strategy, we always underline the willingness to develop so-called adjacent businesses. And ICT, as you know, is one of them offering growth potential and significant synergies with our core B2B activities. And in the recent years, these synergies have become bigger and bigger because there is bigger and bigger appetite of large enterprises and companies, thanks to digitalization of their own processes. We've been very successful, I think we can say that developing ICT in the last years in OPL through our subsidiary called Integrated Solutions, which is now among the top five IT integrators in Poland. And you can see on this chart, on the below graph, the yellow graph that in the past two years, we grew our ICT revenues by actually 50%. We were missing, in these activities, software development competencies and decided to fill this gap through this acquisition. So now a few words about BlueSoft. It's a very efficient private business with a quite long track record. It's a company existing for more than 15 years. They have proven that they grew on these markets and they are providing business to bluechip companies from multiple industries in Poland. Majorities of the revenues of BlueSoft are actually coming from development and integration of customized products, which are business application, customer-facing portal, back-office systems. These are tailor-made products created for the needs of their given customers. We believe it's a perfect match with our competencies and we believe it opens to both of us much bigger business to offer basically end-to-end solutions. And this is what we see Polish enterprises are looking for. This move will also allow us to be more competitive versus other telecom operators on the Polish market and also versus pure ICT companies. And we expect significant revenue synergies from this combination that we'll start to be realizing in 2020 from actually mutual cross-sell. And I'm strongly convinced that this deal is value accretive for Orange Polska. Last but not least, I want to say that I'm very pleased that the key managers of BlueSoft will stay with us after this transaction and they are motivated to further develop the business together with us. Well, I just need to mention now that this transaction still requires the formal approval of the anti-competition authority. And that's all for me. I will now hand the microphone -- hand the floor to Maciej Nowohoński, our CFO.

Maciej Nowohoński, Chief Financial Officer:

Thank you, Jean-Francois. Good morning, everyone. So we are starting the financial review on page number 12. Our total revenues in quarter one were up 2.6% year-on-year. The revenue that we regard as core to our future growth and margin generation increased even more, so they increased by 3.3%. As you can see on the chart, this growth rate was lower than in the previous quarters and the only reason is that the previous quarters in 2018 were supported by favorable base effect from national roaming revenues that we started to recognize in 2018. The key drivers of our revenues are unchanged. We are pushing convergence, we are minimizing decline in Mono mobile and broadband services and successfully develop ICT operations, another very strong quarter here. Overall top line trend in Q1 was also strongly -- was benefited from much higher energy resale revenues. Please note that this is not likely to be repeated in the quarters to come.

Now let's turn to profitability on the next page. First, a quick reminder what is EBITDAaL. Under new IFRS 16 accounting standard, EBITDA derived from the financial statements in our view is not relevant because it

excludes operating expenses related to leases. EBITDAaL, so EBITDA after leases, integrates back these expenses and gives much better picture on operating performance. We also provided estimation of EBITDAaL for 2018 to allow you year-on-year comparison. EBITDAaL in Q1 was 2% lower than last year. This performance was impacted by timing of real estate disposal transactions. Neutralizing this factor, EBITDAaL would be almost flat. It was another good quarter for indirect cost savings. We continue to transform and optimize our business. We expect additional savings in the quarters to come. Q1 savings almost entirely offset lower direct margin, as Jean-Francois mentioned, which continues to be under pressure from our legacy business. Improving direct margin trends, savings from business transformation, and gains from real estate transactions are going to be the main drivers for EBITDAaL growth in the next quarters.

Let's look now at the bottom line on the next slide. Due to change in accounting standard, bottom line for Q1 this year is not entirely comparable for Q1 of last year. Net profit was supported by lower depreciation and lower financial costs. Depreciation benefited from the extension of useful life of certain fixed assets with the impact of PLN48 million, this item we've been flagging to you a quarter ago. Financial costs reflected impact of lower hedging costs. Now on the next slide, we review the cash generation. As usual, cash generation in the first quarter was lower, but better than last year. CapEx phasing this year is going to be more even in the quarters. That's what we were flagging as well. That's why we have more CapEx in Q1 than a year ago. Working capital requirement was around PLN100 million lower than last year, mainly due to lower incremental growth of instalment receivables and higher year-on-year positive effect of reverse factoring transactions. Q1 cash includes the proceeds from sale of assets from transactions finalized in 2018. We've been also vocal on that point a quarter ago with the Q4 results. Thank you very much for your attention and I hand the floor back to Jean-Francois for a conclusion.

Jean-Francois Fallacher, Chief Executive Officer:

So let me quickly summarize the quarter. So quarter one results, both commercial and financial, are in line with our expectation and turnaround ambitions. And we are confident, as you understand, to confirm our guidance for growth of revenues and EBITDAaL in 2019 as well as our CapEx range. So where will these improvements come from? We stick to our priorities. You know them well now; focus on value, continued business transformation, and we also count on better results in real estate disposals. And in Q2, stay tuned, because we plan some important commercial actions that would be value accretive for us. That's all from me. Thank you for your attention and we are ready to take your questions.

Leszek Iwaszko, Director of Investor Relations:

Thank you. We'll start as usually with questions from the floor, if there are any. Yes, please, Malgosia.

Questions And Answers

Operator:

Thank you. Ladies and gentlemen, we'll now start question-and-answer session. (Operator Instructions)

Malgorzata Żelazko, Analyst:

Malgorzata Żelazko, PKO BP Securities. I have a question on the fibre uptake in Q1, because it was flattish year-over-year, while your coverage increased significantly. So are you satisfied with that? And should we expect the trends to improve?

Jean-Francois Fallacher, Chief Executive Officer:

Thank you for the question. So yes, the net additions were flattish, if we compare them with Q1 last year. But the effect of this is mainly due to the churn because our gross adds were 10% higher this quarter than last year quarter. But as you can imagine, the base is growing, and this is the explanation. And this is normal. It's not that the churn -- the churn is very good on fibre, if not higher, but simply the fact that the base is growing explains these effects.

Marcin Nowak, Analyst:

Good morning. Marcin Nowak, IPOPEMA Securities. A follow-up to the FTTH question. It was mentioned that the gross adds increased by 10% year-on-year, but your total household base increased much more. And you're adding -- were adding more single-family houses, which should have higher penetration. So do you still think that this net adds may return to the more growing trend going forward?

Jean-Francois Fallacher, Chief Executive Officer:

What I have to say as well is if you compare year-on-year, we have built less this quarter than the quarter before. So we are relying more on the third-party infrastructure. And if you look at the SFH, I mean, we're just starting to build single-family households. POPC as well is starting. So this effect that you are referring to is not yet happening actually.

Marcin Nowak, Analyst:

Okay. Thank you. And with regards to yesterday's acquisition, do you plan to proceed with more purchases going forward in the ICT business or maybe any other IT related?

Jean-Francois Fallacher, Chief Executive Officer:

I mean, to be clear, our strategy is, first, turn around the core business of Orange Polska, you understood it. I mean, through this acquisition, we decided to go faster in the B2B area that is growing. I mean, as you have seen, our ICT integration business has been growing by 50% in the last two years. So here we decided that to boost the growth, it was better to buy these competencies than recreating them ourselves. So this is why we went to this transaction. So if any other similar value accretive opportunities appear, we will be open, but to be clear, there is not a plan at this stage to go further in that direction. The plan has been executed in the B2B area IT and software through this acquisition.

Marcin Nowak, Analyst:

Okay. Thank you for the answer. And the last question, in regards to the accounting changes for -- related to the IFRS 15 from the last year, which was the heavy issue last year with declining versus the previous standards in 2017, could you please comment about the accounting effect in first quarter of '19 on year-on-year basis related to IFRS 15 on EBITDA?

Maciej Nowohoński, Chief Financial Officer:

Thank you very much for this question. This is one of my favorite questions, as you can imagine. First of all, I would like to give you a good business perspective to the accounting impacts of IFRS 15. So the company since 18 last month is consequently implementing the strategy of low subsidy, first of all. Second of all, margin on handsets that we are selling to our customers together with our services. And we have been very successful on that front. We did very good things for the Company and for the value creation through limiting of the subsidy and through bringing more value through additional margin that we are able today to achieve on that part of the business. So this is the first item, and this is the business fundament of how the accounting is behaving then.

So giving that fact, obviously, the future deltas between the old accounting system and the new accounting system will be smaller and smaller. But it's -- you have to know that the accounting system that you are referring to, this is like two generations back. We've been through last two years, through two important accounting changes in the entire industry and can say all business world, so IFRS 15 and IFRS 16. Today we are in the IFRS 16 and IFRS 15 world, so we are behind two important changes. So it will be better to focus on these trends. We have made an effort for you to transpose our long-term strategic guidance towards the freshest view on the accounting system, how we will develop. And it is always better to look at that.

The complexities of accounting implementation also are in the way that the standards are being implemented by the different companies. Some companies implement standards prospectively; the other ones retrospectively. So it does have an effect on the corrections that we have been reporting to you last year because if we have reported -- if we have implemented the IFRS 15 retrospectively, the level of the correction would not be negative last year, but would be positive year-on-year 2018 versus 2017. So it is very important not to get into a trap of reconciling between the different accounting standards, which is, I must admit, a big complexity, a big complexity. So what we have decided is to cut short on those complexities towards you, towards the market, and to transpose our long-term objective into the newest accounting system. So that's the easiest way, we believe, and this is with the benefit of concentrating on the business factors rather than accounting changes.

Leszek Iwaszko, Director of Investor Relations:

So if we have no more questions from the floor, I suggest we switch to the teleconference listeners. Operator, please.

Operator:

Thank you. (Operator Instructions) Our first question comes from Pawel Szpigiel for mBank. Please go ahead.

Pawel Szpigiel, Analyst:

Good morning. Thank you for the presentation. My first question is about wireless for fixed services. You said that you are not pushing the sale of that services, but you're actually in possession of two blocks from 800 megahertz range. It's difficult to understand why you decided not to push the sale of the services.

Jean-Francois Fallacher, Chief Executive Officer:

Let me answer this question. Simply because we have quite a large base of LTE for fixed customers at this stage, more than 400,000 customers of this technology. And what we're seeing is that even if this base is representing a few percent of our total customer base, they are eating a very large amount of resources on our mobile network. So basically, as we are both obviously a fixed and a mobile operator, but also a fixed operator and because we are having quite a dense DSL, VDSL infrastructure and also fibre infrastructure now, we are obviously pushing customers, which are buying fixed Internet access to go to our fixed products because they are more suited for them. So that is the reason basically why we are not pushing the sales of fixed wireless Internet. I mean, we are providing this service, but in our sales network, we are privileging putting customers on the fibre and VDSL rather than on the fixed LTE.

Pawel Szpigiel, Analyst:

Okay. Thank you. And my second question is, could you please quantify additional savings that you mentioned during the presentation to come in next quarters?

Maciej Nowohoński, Chief Financial Officer:

Hi, Pawel. Thank you very much for the question. I just would like to remind you that in the strategy that we have announced in September 2017, we have set the target for ourselves to cut the cost base by 12% to 15%. At that time, this was supposed to be achieved by end of 2020. And we are in April 2019 and we are well in advance of the objective that we have set. So we have achieved what we have promised already at the end of 2018. And with this quarter, we are bringing to the Company additional PLN45 million to PLN50 million savings that you have seen in the report. I can assure you that we have a vast number of initiatives, which are ongoing in the Company, which will bring additional savings. We will probably not quantify them today, but you can be assured that this is a tangible and significant figure for 2019 and for 2020. So no reason not to continue with the trend that we have seen in the past.

Pawel Szpigiel, Analyst:

Okay. And when we can expect any details about that?

Maciej Nowohoński, Chief Financial Officer:

We will be glad to report to you the results of these initiatives in the quarters to come.

Pawel Szpigiel, Analyst:

Okay.

Maciej Nowohoński, Chief Financial Officer:

And take my point about the continuation of the trends as a valid one.

Pawel Szpigiel, Analyst:

Okay. Thank you. Thank you.

Operator:

(Operator Instructions) We have no further question. Speaker, back to you.

Leszek Iwaszko, Director of Investor Relations:

Yes, we have one question that was asked online from Raiffeisen analyst. The question is on BlueSoft acquisition. Would you treat an EBITDA of PLN25 million in 2018 at BlueSoft as a recurring figure? Do you expect that BlueSoft generates at least as good EBITDA results this year?

Jean-Francois Fallacher, Chief Executive Officer:

I can say yes for the second question and for the first one.

Maciej Nowohoński, Chief Financial Officer

Of course, we count on the growth of EBITDA in the future. So it's not only a recurring item, but it's going to be a growing number.

Jean-Francois Fallacher, Chief Executive Officer:

To add on what Maciej is saying, I mean, the BlueSoft acquisition is representing 1% of our EBITDA. So this is not for the EBITDA of this year that we are doing that. This is really for the growth we are expecting through this acquisition, and not only to growth of BlueSoft itself, but the growth of both of our businesses. This is where the synergies are and this why we did this acquisition basically. We see this really as a catalyst of our B2B, ICT and integration business, and again, there is a lot of appetite because all the businesses in Poland are running through this digital transformation.

Leszek Iwaszko, Director of Investor Relations:

Do we have any follow-up questions from the floor? I cannot see so. If there are no questions from the teleconference, I would like to thank you for the participation, for your attention, and see you back in July for the second quarter results. Thank you. Good-bye.

Operator:

Thank you. This concludes today's conference call. Thank you for your participation. You may now disconnect.