Conference Transcription

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CONFERENCE DETAILS

Conference Date:	1 August 2012
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Chairperson:	Matija Gergolet
Speakers:	Shaikh Mohamed Bin Isa Al Khalifa Marco Regnier Peter Kaliaropoulos

KEY:	
words in bold	Unsure if words heard correctly - please check
??	Words could not be distinguished
(Inaudible - ….)	Words that are entirely inaudible for the specified reason

ACT Operator

Thank you for holding, ladies and gentlemen. Welcome to the Batelco Group conference call to discuss its second quarter and half year 2012 financial results. Throughout today's recorded presentation, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions. If any participant has difficulty hearing the presentation, please press *0 on your telephone for operator assistance.

I will now hand the conference over to Mr Matija Gergolet of Goldman Sachs, your host for today's call. Please go ahead, sir.

Matija Gergolet

Yes, hello. Good morning, ladies and gentlemen. On behalf of Goldman Sachs I would like to welcome you all to Batelco Group second quarter and half year 2012 financial results. We are delighted to be hosting the call on behalf of the Group.

Today I have the pleasure of introducing our speakers: Shaikh Mohamed Bin Isa Al Khalifa, the Group CEO; Mr Peter Kaliaropoulos, CEO for Strategic Assignments and Mr Marco Regnier, Chief Financial Officer. Following the comments the call will be open for questions from participants. Before starting the call the Group would like to make the standard forward-looking safe harbour statements and I hand over the line over to you, Shaikh Mohamed Bin Isa Al Khalifa, please. Thank you.

Laila Danesh, FinMark Communications

Thank you, Matija. Batelco Group notes that some of the forthcoming statements are expectations based on reasonable assumptions. These forward-looking statements are subject to numerous risks and uncertainties. These statements may not be regarded as a representation of anticipated results which will occur on the Group's expected objectives. The forward-looking statements are only valid until this date and Batelco Group does not undertake to update these in any form.

With that, I would now like to turn the floor over to Shaikh Mohamed Bin Isa Al Khalifa, Group CEO of Batelco.

Shaikh Mohamed Bin Isa Al Khalifa

Thank you and thank you, Matija, for the introduction and to Goldman Sachs for hosting this call today to discuss Batelco Group's second quarter and half year 2012 financial results. I would also like to thank each of you for taking the time to join me and the management team this morning.

With me today are Mr. Marco Regnier, Group CFO who will walk you through the presentation of the Group's results and performance and Mr. Peter Kaliaropoulos, who will join Marco and me in answering any questions you may have later in the call.

Looking at the results for the first six months of 2012, despite competitive pressures, we are pleased to maintain market leadership in the Kingdom of Bahrain and with the solid performance delivered from our overseas operations especially Jordan and Yemen. In Jordan the recent investments we have made in Umniah are already delivering results. The initial roll out of 3G services in mid June has exceeded expectations. Within weeks of its launch more than 11,000 new customers were added and more growth is expected as roll out continues according to plan kingdomwide during the remainder of the year.

We also saw a return to growth in Yemen. As we noted last quarter with the rationalization of the customer base behind us and a more stable domestic situation, performance will continue to strengthen. For the six-month period our financial performance reflects the anticipated declines to revenues and profits impacted by continuing effect of competition in Bahrain and across the MENA region as a whole. In Bahrain, our main market, the impact of competition is further compounded by an adverse regulatory environment. That said, for the first six months on 2012, our performance was solid. We maintained strong cash flows and ended the period with a very healthy balance sheet and significant cash balances. This positions us well for future growth and supports our ability to continue to deliver value to shareholders. For the first half of the year, we announced an interim dividend of 15 fils per share.

In terms of subscriber numbers we have shown some growth since last quarter. Our customer base now stands at 7 million users across six markets. As noted previously, the decrease year-over-year is largely due to the adjustment for the exclusion of STel operations following the announced sale of our stake in the company early in the year. Normalised, the customer numbers across our markets of operations remained steady. This includes a 43% share of the mobile market in Bahrain.

As we look ahead, we expect further customer growth with the continued roll out of 3G services in Jordan, strengthening our operations in Yemen and expected business customer growth in Saudi Arabia. We will also continue to focus our efforts on maintaining market leadership in Bahrain through innovation and efforts to become more competitive. This requires us to lower our cost structure which we are working hard to achieve whilst ensuring our customer care and service offering continues to expand and improve. Across the Group, our focus is on achieving growth and maximising operational efficiency. These priorities are unchanged. We continue to take the necessary steps to build our network both organically and through the acquisition of other operators and to strengthen our ability to deliver value to customers and shareholders throughout the remainder of the year.

With that I will now turn the call over to Marco who will take you through the presentation and the details of the Group's financial results and performance for the period. Marco?

Marco Regnier

Thank you, Shaikh Mohamed and thank you, ladies and gentlemen for joining us. I will run you through the key highlights. Looking at the highlights for the first semester, the results have gone along the lines of previous guidance. We anticipated some decline in revenue and EBITDA. For the first semester we reported a gross revenue of BD 155.3 million, EBITDA of BD 55.8 million with a 36% margin which is steady quarter-on-quarter despite the significant one-off capital investment in Q1 at Umniah in Jordan regarding the 3G license which is an amount of JD 50 million. We closed the period with a healthy cash balance of BD 87 million.

The debt level remains low. We have BD 27.5 million of debt at the end of the semester. The Group remained largely net debt negative any way. We continue to see solid contribution from overseas operation which now contributes 39% of our revenue and 35% of our EBITDA. This is inline with our focus on diversification. We announced an interim dividend of 15 fils like it was mentioned, 15 fils per share. This was approved by the board. This is lower year-on-year but that remains a healthy return.

Operationally the subscriber numbers excluding STel were stable quarter-on-quarter and year-on-year at 7 million subscribers. This is despite the competitive pressure in Bahrain and regionally. We continue to see progress in overseas operation. We will see later on some subscribers increase. The launch of 3G services in Jordan has been a success. We already have 11,000 subscribers added in only 13 days. The launch was on 17 June. During the period, Atheeb also concluded its rights issue to recapitalise the Company, positioning it very well for future growth.

Now if we look at the Group financial results in more detail at slide number five, looking at the financial performance, the result for the period was solid despite strong competitive pressure in Bahrain and across the MENA region overall. I would like to attract your attention first on the gross revenue at BD 155.3 million if we look at the semester. As compared to the previous semester, this is reflecting a strong competition in Bahrain mainly. If we look at the gross margin, you will notice that H1 2012 as compared to last year, there is a decrease in the percentage of gross margin from 78% to 75%. This is largely due to handset sales that are at lower margin.

If we look at the OpEx generally, the staff cost pretty much in line with last year although there is one-off element here of BD 2.8 million which is related to the redundancy plan to let go 46 people in Batelco Bahrain. Otherwise the staff cost – so there is this one-off item and that increased the staff cost but there are some one-off items also reducing the staff cost which is related to the capitalisation of some resources related to the 3G launch in Umniah.

If we look at the non-staff OpEx, we have reduced slightly as compared to last year. That reflects some cost initiatives and some reversal of provisions that we have for conservative cost we looked in the past. If we look at the EBITDA margin, generally speaking, we can see that there is a reduction as compared to last year but quarter-over-quarter, if we look at Q1 and Q2, we are still at 36% which is quite healthy in the situation. If we look at the depreciation and amortization as compared to last year, there is a decrease. This is aligned with the accelerated depreciation programme that was initiated in 2011. Otherwise when we look at non-operating income or non-operating expenses, we can see a change as compared to last year. Last year the BD 5.5 million negative included some losses related to STel. STel is now classified as held-for-sale, so we no longer incurred those losses. The loss that we have this year if we look in Q1 is related to Sabafon. There is a share of a loss that is related to 2011 actually that was booked in 2012. Otherwise if we look at the net profit, we now have a net profit of 22% as compared to 24% last year. If we look at the second quarter of 2012, we see a net profit margin of 24%. Again this is related to some one-off reversals of some provisions that we did in the second quarter.

If we look at the next slide, the next slide we have the revenue diversified by segment and geography. Looking at the breakdown by geography, the gross revenue for Bahrain was down by 8% year-on-year. Jordan increased gross revenue by 1% and as a percentage of total gross revenue grew its contribution from 26% to 28%. Other countries saw a 2% decrease in gross revenue but remains steady in terms of their contribution to the total at around 11%.

In terms of profit, the profitability in Bahrain saw a 20% decline. This is the result of intense competition as mentioned before mainly in the mobile market. In Jordan, the income was down 11% but this is essentially the result of higher tax expenses due to one-off dividends. There was a dividend of JD 11 million from subsidiaries and an additional income tax of JD 700,000 related to that and also a higher EBIT at Umniah that generates that slightly higher tax. In other countries, the variation reflects the reclassification of STel. Like I mentioned that is now held for sale.

If we look at the next slide, the revenue by product, the mobile revenue as a percentage of a total gross revenue decline by 4% year-over-year. Again that decline is essentially in Bahrain related mainly to roaming, national and international call revenue. Otherwise there is a relatively positive trend here in wholesale, data and Internet. These are all like growth markets for us. Other revenue which increased by 2% is attributed to higher handset sales in Bahrain.

If we go to the next slide, CapEx and liquidity profile, in terms of CapEx the significant rise in CapEx to BD 50.8 million in H1 reflects a one-off capital expenditure in Jordan. Essentially this is the 3G licence and it's also related to some building acquisition. The 3G licence is JD 50 million or about $70 million. The first semester, the CapEx, if we look at the ratio of CapEx to revenue, obviously it's a very high ratio here at 33%. But when we normalise for the one-off of the 3G licence, it would have been around 13%, 14%. This is well within the industry benchmark.

The Group also launched a number of cost initiatives which we expect to provide some good benefits, synergies and cost savings going forward. About free cash flow, despite decline in revenue and profitability, the Group's cash flow generation remains sound in general. The free cash flow was BD 13.3 million in the second quarter versus a negative BD 17 million in Q1. Again this is related to the licence of 3G in Umniah.

If we look at cash and debt, the Group also ended H1 with a strong net cash position of BD 87 million and this is despite the fact of the licence, $70 million in Jordan. The debt at the end of H1, we have new debt of BD 27 million. This relates to two items. There is the Group's contribution to Atheeb that was SAR 1.2 billion capital raising rights issue actually. There is BD 17 million financing related to that. There is also a second item which is a $26 million related to Umniah to help them with general expenditure but essentially related to their roll out of 3G.

Now if we have a closer look at where we stand operationally, there is a slide number 10 where we will look at subscribers generally speaking. As noted before the subscriber numbers overall normalised for STel were steady quarter-on-quarter and year-on-year reaching 7 million subscribers at the end of H1. This is all across our six operations. That exclude STel which add an amount of about 4 million.

If we look at the mobile subscribers overall, the mobile subscribers are up 2% in Q2 versus Q1. This is despite a decrease in Bahrain. We have seen some growth year-over-year in mobile data subscribers. This is very positive as we aim to build on that. This is clearly a growth area for us. If we look at Umniah in Jordan, there was some growth quarter-on-quarter and year-on-year. The roll out of the 3G service will generate also some further growth in the coming periods. For Sabafon in Yemen, there was a growth of 4% since Q1 and this is despite what I can call "a clean up" of the customer base that we did earlier this year. We expect further growth in Sabafon as the situation stabilise in Yemen and we can see that the results are going in the right direction there.

If we look at the broadband customers, some marginal declines in Kuwait and a decrease in customer numbers in Atheeb due to a number of seasonal factors resulting in slowing of renewals. That said revenue increased in Atheeb. So we have a decrease of subscriber in Atheeb but the revenue increased any way because we see a positive growth in high value business customers. In Bahrain we registered 74% growth in wireless broadband year-on-year – we are talking about broadband, mobile broadband customers here – and a 33% increase for mobile broadband customers in Jordan. This is year-on-year.

Regarding fixed subscribers in Bahrain, we are down 2% in Q2 and 7% year-on-year. This is clearly an area that we are looking at and seeking some steady numbers in the future.

If we go to next slide, the next slide shows the geography actually. You have there our current subscriber numbers by geography and by segment as well as comparable year-on-year figures. We have said before we remain a market leader in Bahrain and we continue to build our leadership across the region with some growth expected in Yemen and in Jordan.

If we look ahead, we focus on a number of core areas. On the next slide we have our key priorities. First of all, we have mentioned that in the past there are some new acquisition that we are actively pursuing in our sector. The targets include existing operators rather than greenfield operations. Batelco Bahrain, our home market, we pursue our GEAR strategy. The GEAR stands for G growing our mobility and broadband, the E excelling in customer service, and A increasing our adjacent services and we also focus on preserving margins and currently work on R reducing cost leadership programme that was mentioned before.

In the Indian market we expect to complete the sale of STel. As mentioned before, as indicated, it's in Q4 2012. That said we continue to look for opportunities in the Indian market which is proposing some interesting growth in the years to come. In Jordan, we are delighted with the launch and the results of the 3G roll out. Now the focus will be on customer retention and also customer acquisition. We are looking at becoming more competitive also and maintain our profitability as there are some economical burden related to the economy in Jordan. We have seen recently for example the electricity bill increasing by 150%. There are some other measures that are announced in Jordan, so we have already started an initiative to offset the downside of these measures.

In Atheeb, as mentioned, we have a successful recapitalization and we look to grow mainly our high value business segment and there was some good progress that was made in H1 2012. In Yemen, again as mentioned before, we look for growth. The economic situation, the political and security environment has improved in the country and we have seen some positive trends since the beginning of the year.

If we go to the next slide, in terms of guidance, if we do a quick recap of what was provided to you earlier in the year - on revenue we continue to expect a mid single digit decline; on EBITDA we will decrease probably in the teen digits and with margins continuing to come under pressure from intense competition in Bahrain. In terms of net profit, we will see a single digit increase and that includes a one-off gain for the sale of STel that is estimated in double digits million BD. This will happen in Q4.

In terms of CapEx to revenue, the ratio for the year, we have seen that it's at 33% CapEx to revenue ratio for H1 but most of the heavy investment came in H1. So for the year, we expect to be approximately at 23%. If we normalise this or if we exclude the licence in 3G, we would be slightly above 10%. In terms of free cash flow, we expect to be above $70 million positive obviously and again we see the impact of investment in Jordan during 2012. And lastly the dividend payout, this is obviously subject to Board approval but we will continue to be in line with the past trends although there was an interim dividend declared of 15 fils per share. We are still in line for the full year with the past trends.

With that we now open up the floor to questions.

ACT Operator

Thank you, sir. If any participant would like to ask a question, please press *1 on your telephone. If you wish to cancel your request, please press *2. There will be a short pause whilst participants register for a question.

Thank you. Your first question comes from Christian Kern from JP Morgan. Please go ahead.

Christian Kern – JP Morgan

Hello, this is Christian Kern from JP Morgan. Thank you for the presentation and the call. I just wanted to see if you would be willing to share some more strategic thoughts with us. I think you mentioned India in your presentation, that you are focussed on looking at opportunities in the Indian market is that something on your radar, of that region's greenfields, existing operations. I am just trying to understand your strategic goal for the Company if you want to become part of a bigger company or if you want to grow yourself or any thought you can share there with us would be much appreciated. Thank you.

Shaikh Mohamed Bin Isa Al Khalifa

OK, thanks, Christian. This is Mohamed Al Khalifa. I will just give a briefing of what the strategic thought of the Company is and may be I will invite Mr Peter Kaliaropoulos here to add to that. We are at a stage of looking at existing operations. We have tried the greenfield operation in India. We don't want to go through the latency of profits to come at a future date, so we want existing operations. We want accretive business that we can bolt-on to the existing portfolio of the Group. We want to protect shareholder value in the interim as well.

Now in terms of Batelco Group aspirations, we always look of course for organic growth. But that organic growth given the maturity of our markets that we operate in is not going to be of any significance. So we have to look for the acquisition side. Looking at acquisitions, of course we look for similar operations that are more manageable than getting into either a small shareholding of a large group. So we would like a majority control. That's what we are looking for.

We have operated a cluster now in the Middle East region. The Indian investment could have been a base for another cluster to be created around that in the operation. We look for of course opportunities as the Indian market is quite an interesting market. We just want to see clarity really on the future of that market, how it is going to be developing in order to commit for any potential investment. If there are other markets that may create for us the same cluster concept around an operation, yes, we will be looking at that. With that, I will hand over to Peter here to give you more input as well.

Peter Kaliaropoulos

Thank you, Shaikh Mohamed. Christian and ladies and gentlemen, if I can support the comments that were made by Shaikh Mohamed and give you a little bit more granularity, we have really four strategic drivers. One is to diversify the revenue and the profit pool. We depend on few existing markets for the majority of our revenue and profit pool today, so strategically we are looking at other opportunities to diversify the sources of future revenue growth and profit. That's priority number one.

Second priority strategically is adjacent business to our core business. We're still a connectivity, we're still a predominantly mobile company. But there are some interesting opportunities especially in the enterprise space in terms of ICT and high value customers. If we just remain a connectivity provider, that will potentially jeopardise the growth prospects. So we are looking at complementing the core business with ICT line of business in those markets that we understand. It's a natural progression.

The third priority for us is what we call a B2B migration. If you look at our customer base with the exception of Bahrain where we are very strong B2B and enterprise solutions organisation, outside Bahrain we just are predominantly a prepaid residential customer base. So we are working to shift and migrate more into B2B, into business solutions, wireless and fixed business customers because we believe that's where the value will come from.

And the fourth strategic driver we have is what we call operational excellence, getting the basic rights, connecting on time, serving customers, cost of acquiring customers. All those aspects that are very important ensuring consistency in the customer relationship. And a key part of that fourth pillar of course is the cost leadership. Again we are benchmarking on our operations. We are looking at best practices of other companies outside the Group as well as companies inside the Group. It is important as part of operational excellence that the cost profile of the Company is adjusted.

In summing up, diverse the revenue and profit, adjacent business such as ICT, B2B migration and operational excellence with a cost focus, I would sum up that these would be the four strategic priorities we have.

Christian Kern – JP Morgan

That's very kind and thanks for sharing these thoughts with us. Is there any financial criteria you can share on these kind of investments you are searching for?

Peter Kaliaropoulos

Absolutely. As Shaikh Mohamed said, accretive is the word that we use in terms of expansion. We did try a couple of greenfield environments and certainly I think we strongly feel that for the next few years greenfields in telco is not a way of creating value for customers unless the market has low penetration, there is only one other player and that doesn't exist almost anywhere in the world. We are looking for accretion. We also are looking for a strong IRR. I think our Board is always looking somewhere between north of 15. Otherwise we don't go anywhere near some of these business cases. And of course we are looking to fund these with the debt levels which are we think the right levels within the rating we have, so certainly maximum two and half times EBITDA or thereabouts will be the leverage of the company. The financial criteria are always very important to us. It is not diversification and growth for the sake of it. It has got to be accretive. And more importantly we can't be jeopardising the dividends, the stream of dividends of the Company from new acquisitions. We take that into account very strongly. The word dividend maintenance is very important in our priorities of running the Company.

ACT Operator

Thank you. Once again if you would like to ask a question, please press *1 on your telephone.

The next question comes from Ranjan Sharma from JP Morgan. Please go ahead.

Ranjan Sharma – JP Morgan

Hi, good afternoon and thank you for the call. Just a couple of question. Firstly, in Jordan, have you completed the roll out of your 3G network or are you still continuing with it and what are your roll out plans? Secondly, any further regulatory downsize that you see in Bahrain? And may be a last question on the corporate strategy in Atheeb. I know you said that you want to target the high value customers but if you could share more colour on that. Thank you.

Shaikh Mohamed Bin Isa Al Khalifa

I let Peter answer the first part of the question. The second part I will take up.

Peter Kaliaropoulos

Certainly, Jordan 3G roll out, we were very aggressive in our roll out phase. We didn't do it in two or three stages. We rolled out across 1,200 or about 1,450 base stations. We have a massive roll out from day one to make sure the customer experience is positive, capacity and coverage and we are encouraged as we said from the customer take up and the usage of mobile data. Of course we will continue because we have another 200 to 300 base stations which are not 3.75G enabled. But again that will be driven by customer demand and it will be part of our normal CapEx. You are not going to see any additional sort of CapEx for that. 90% of the roll out for 3G has really taken place.

Shaikh Mohamed Bin Isa Al Khalifa

OK, on the regulatory side, of course here in Bahrain, we are looking with interest on the third national plan that was announced yesterday by the regulatory authority. Now there is still no clarity from the announcement. They are I guess in the process of developing their approach on how to address broadband connectivity in the nation as well as other issues with regards to regulation. We are comfortable as we stand today that there are no major issues that we are facing. It's going to be interesting how the third national plan by the government is going to be implemented with regards to broadband.

Peter Kaliaropoulos

And if I can take the third question, if I understood it correctly and I apologise if not, about the high value customer strategy and let me make a couple of comments. If you look at our customer results today and I think some of them we will probably share with you, we are putting a huge focus on postpaid in business customers. If you look at our customer base in Jordan, year-on-year we grew the first phase – we actually doubled effectively the customer base in postpaid from about 35,000 to 53,000 and also we manage in Jordan to increase the ARPU of our postpaid customers. That's one example of our strategy. If you look also - even in Bahrain where prepaid customer base is shrinking and there are some reasons for that but basically our postpaid customer base again year-on-year has grown by about 10% and the ARPUs are steady for postpaid. The third example is if you look into Atheeb in Saudi which Marco made some comments earlier, our revenues are growing because we are really chasing the B2B customers, data solution to B2B customers and wholesale voice as well.

The strategy in terms of refocusing and I am not suggesting we will drop the emphasis on the mass market – that's where our cash flows come from. But the refocusing and reorientation in terms of becoming more relevant across various geographies in the B2B has started and again we are working with a different management teams to encourage them to come up with new products, new services and really pursue more and more the SME and B2B customer base with enterprise solutions rather than just stay with mass market prepaid voice and mobile.

Ranjan Sharma – JP Morgan

OK, that's very clear. Thank you.

Peter Kaliaropoulos

Thank you.

ACT Operator

Thank you. Your next question comes from Umar Faruqui from Global Investment House. Please go ahead.

Umar Faruqui – Global Investment House

Hello, I have a couple of questions. First of all, I mean the dividend payout was 15 fils for the first half compared 20 fils last year. Do you think there is a change in dividend policy and what are you looking forward for? Is it safe to assume that the current dividend payout will continue or we might see further reductions in the future? The second question is that yesterday a news came about issuing of 4G licenses in Bahrain. How do you see 4G working out in Bahrain? Will it be feasible or economically a better option for companies to go for 4G right now or still better to delay and look at it later?

Shaikh Mohamed Bin Isa Al Khalifa

OK, thank you. On the first issue regarding the dividend. The dividend policy that the Board has adopted is a percentage of the total net profits that are generated. Now with that said, the Board has decided to reduce the interim dividend to 15% to keep the cash in the Company, 15 fils per share, to keep the cash in the Company and wait until the end of the year to see the overall revenues and net profit that are generated. We are working hard of course to maintain dividend levels where they have historically been. It's no indication of course that the final dividend at the end of the year will be reduced by the same percentage in the recommendation for the shareholders. I don't really have right now a clear indication whether there will be a reduction in dividend or not. However, there is – the importance that is being placed by us as management to maintain cash flow and the cash generation of the business in order for the dividend payout remains the same.

On the other issue of 4G in Bahrain, of course I did mention that we are looking at this third national plan, telecommunication national plan which was announced yesterday by the regulatory authority. There is no clear indication now exactly how 4G is going to be addressed. We know since they publicly said that they will be freeing up spectrum during the end of the year or first quarter of 2013. What we have seen yesterday in the press has been not consistent between the different press releases, so I think right now we don't have clarity on how Bahrain is going to approach the 4G license.

Umar Faruqui – Global Investment House

OK, thank you.

ACT Operator

As a final reminder, if you would like to ask a question, please press *1 on your telephone.

Thank you. There appear to be no further questions. Please continue, sir.

Shaikh Mohamed Bin Isa Al Khalifa

OK, well, if there are no further questions I would like to thank you all, ladies and gentlemen, for being with us this morning. And again I thank Goldman Sachs for hosting the call. We look forward to keeping you appraised of the Group's progress over the coming months. Good bye. Thank you.

ACT Operator

That concludes the Batelco Group conference call. Thank you for participating. You may now disconnect.

END OF CONFERENCE