

Telecom Egypt Q2 2023 Earnings Call Transcript

Final Transcript

Telecom Egypt ([ETEL.CA](#); [TEEG.LN](#)) Q1 2023 earnings call dated 14 August 2023

Call Coordinator:

Ingy El Diwany – *Beltone Holding*

Corporate Participants:

Mohamed Nasr Eldin – *Managing Director and Chief Executive Officer*

Mohamed Shamroukh – *Senior Vice President and Chief Financial Officer*

Tarek Abdelhamid – *Chief Marketing Officer*

Wael Hanafy – *Senior Director of Finance*

Investors and Analysts:

Jaynesh Bhana – *Mazi Asset Management*

Farouk Miah – *All Africa Partners*

Shady Afifi - *NI-Capital*

Ayman Elmasry - *Al Ahly Financial Investments Management*

Habib Oueijan – *RIMCO Investments*

Enas Mahmoud – *National Bank of Egypt*

Ingy El Diwany : Hello everyone, this is Ingy El Diwany from Beltone Holding. I'd like to welcome you all to Telecom Egypt's second quarter results' conference call.

I'm pleased to have on the line

- **Mr. Mohamed Nasr Eldin** - Managing Director and CEO;
- **Mr. Mohamed Shamroukh** - Chief Financial Officer;
- **Mr. Wael Hanafy** - Senior Director of Finance; and
- **Mr. Tarek Abdelhamid** - Chief Marketing Officer.

Now, I'd like to hand over the call to Telecom Egypt's management team who will start with a brief update and then we will open the floor for questions.

Mr. Wael, please go ahead. Thank you.

Wael Hanafy: Thank you Ingy, and thanks to Beltone Holding for hosting this quarter's conference call. Earlier today, we issued a press release announcing our financial results for the second quarter of 2023, as well as other operational highlights. A copy of the press release is available on our IR website.

We will start with a briefing of the operational performance in the quarter presented by our CEO, Mr. Mohamed Nasr, followed by the key financial highlights to be presented by our CFO, Mr. Mohamed Shamroukh. Our CMO, Mr. Tarek Abdelhamid will also be attending the call. Kindly note that the results presentation is available on our IR website under the quarterly results section of the financial information tab on ir.te.eg.

Now let me apologize for the inconvenience earlier this morning for part of our international investors and analysts who could not access our website due to a cybersecurity issue. Everything is okay now, and the issue has been fixed.

Without further delay, I would like to draw your attention to our safe harbour statement. We may make some forward-looking statements in the course of this conference call. These statements will be based on the information available to us as of today and you should, therefore, not assume that we continue to hold these views in the future. We do not commit to notify you if our views change. We refer to our public filings for some factors that may cause forward-looking statements to differ from actual future events or results.

I will now hand over the call to Mr. Mohamed Nasr to discuss the key operational highlights.

Mohamed Nasr: Good morning and good afternoon, everyone. Thank you for joining our call today. Our interim results year-to-date reflect the company's exemplary business model, its strong international infrastructure footprint, the strong momentum in fixed & mobile data services, and pool of talented employees -- all of which continue to show resilience against the macro-economic challenges. We continued to see impressive results from our diversified portfolio of services with total revenue landing at EGP 28bn, with the notable 75% increment in wholesale being the main driver for this growth, followed by 18% higher retail data YoY. This exceptional growth in our wholesale business comes from higher cable sales, higher value and volume of IDD, and greater infrastructure revenues. Operationally, we managed to attract new customers across the board, a positive indicator of our efforts to maintain our competitive position in the retail market.

My confidence in the company's strengths and potential is unwavering. As such, I am keen to execute our plans of becoming a regional data hub while also growing all other aspects of our business. We have a great opportunity to continue leading the data market and expand our mobile business.

I would also like to reiterate my priorities to provide a distinctive customer experience at all levels, grow our customer base, as well as expand and diversify the company's mix of services to suit our rapidly evolving customer needs. We will continue focusing on our contribution to the international submarine infrastructure by offering state-of-the-art solutions to partners and customers both locally and internationally. As such, we will leave no stone unturned to keep improving our customer-centric strategy, look for possibilities to optimize the monetization of our infrastructure, and boost shareholder returns.

With that, I have completed my operational and strategic brief and will now hand the call over to Mr. Mohamed Shamroukh, our CFO, to discuss the key financial highlights.

Mohamed Shamroukh: Thank you Mr. CEO. I will begin with a look at Q2 results. As you see, top-line increased 29% YoY on higher cable revenues, mainly driven by further monetization of our cable projects by almost USD 40mn, followed by strong data performance thanks to healthy operational KPIs, and higher ICA revenue due to higher inbound traffic and USD appreciation.

Mobile customers increased to 12.6mn subscribers, with revenue making up a low double-digit of total retail revenue growth YoY, backed by an increasing ARPU QoQ.

EBITDA realized a strong margin of 41%, exceeding management's guidance, due to high margin revenues, particularly cables and data-related revenues, as previously mentioned.

Adjusted for forex and provisions, net profit grew 25% YoY, backed by strong operational performance & higher investment income, which managed to offset and compensate for the increase in D&A and interest expense.

Moving on to H1 2023 results, total revenue increased by 38% YoY, landing at EGP 28.1bn fuelled by the 75% YoY hike in wholesale revenue, constituting 71% of top line growth, followed by strong retail performance.

EBITDA margin came in at 43% and operating profit grew by 45% YoY basis, while organic net profit marked a growth of 76% YoY. We have been working hard to monetize our infrastructure and reduce costs through multiple initiatives -- including the newly effected national roaming agreement that took place at the beginning of this year, which is driving great savings of about 50% of the previously incurred cost for the same item versus last year. These initiatives are helping to keep our margins positive despite the inflationary pressures witnessed across several cost elements. Normalized net profit reached EGP 7.0bn, marking a profound 67% increase YoY, thanks to excellent operational results and higher investment income, which compensated for the surge in interest expense.

Cash capEx, excluding license fees, reached EGP 11.2bn, representing 40% of sales. I want to highlight that in addition to paying our past vendor finance dues and obligations, we are strategically pursuing a proactive approach to secure future capEx requirements through upfront payments to guard against supply chain volatility and other macro challenges, related to FX fluctuations, which is why we see this increase in capEx.

Based on our modified Shareholder's Agreement with Vodafone Egypt, we collected EGP 2.1bn dividends in July 2023, turning our FCFF into EGP 0.5bn for H1 2023. We expect additional FCFF improvements in Q3 and Q4 2023 due to this dividend collection, which will be supported organically by successful operations & the collection of revenues from the new cable projects recognized during Q2.

Finally, I want to highlight that we are doing our utmost to manage our financial leverage, which is why the net debt/EBITDA on an annualized basis came flat at 1.4x vs. FY 2022 despite the 43% upside in gross debt due to the retranslation or revaluation of the USD part of our total debt.

With that, I have reached the end of my comments. We are now ready to open the floor for the Q&A session. Thanks.

Ingy El Diwany: Dear ladies and gentlemen, please type in your questions in the chat box at the bottom of your screen, or press the raise hand button, if you want to speak directly to management.

We have a question from the line of Jaynesh Bhana: *Are there any plans to unlock the value in Vodafone Egypt for Telecom Egypt shareholders?*

Wael Hanafy: We have tried to unlock the value of our investment in Vodafone a lot before; an example is what we did just a year and half ago when we modified the shareholder agreement that we secured the dividend from Vodafone on an annual basis, which is equal to 60% of the FCF. As mentioned by Mr. CFO earlier, we collected EGP 2.1bn in dividends from Vodafone in July. So we are trying to do the best to unlock the value and try to get the dividends from Vodafone to pass to our shareholders.

Ingy El Diwany: We have others question from Farouk Miah: *1.What is the target profile for debt in terms of long term/short term, hard currency vs. local? [USD debt has increased by 50% over the past 5 years (US\$ 700mn to US\$ 1bn), while short-term debt has increased vs. long-term.] 2. FCF/EBITDA and FCFF in general remains weak, despite being a target for several years. Why will coming years be different?*

Mohamed Shamroukh: Again, as mentioned before, when we approach the debt market in the last quarters, in a time where the macro level was unsupportive especially related to the EGP interest rate, which created a healthy effective interest rate over the last 4 years at around 4%. Again, our debt obligation is fully hedged against due to the revenue coming in US dollars, especially from the submarine cables and international voice calls. The exposure as we have mentioned before, which is translated in FX losses is just recorded on the P&L; it has no impact on the cash flow. Our strategy for the debt structure is to maintain a portion of it in hard currency that will be hedged against the US dollar revenue as long as the macro level isn't supportive, especially with the hike in interest rate recently announced by the Central Bank. The short-term debt is all in EGP; nothing is in hard currency and most of it is short-term facilities. Regarding the negotiation related to the Vodafone stake, we as management preferred not to have a long-term facility for the EGP part until we have more visibility on the Vodafone stake.

In general, during the last year we started to see a positive FCF – Q1 FCF was positive while the negative FCF in Q2 was related to two things – as previously mentioned, we had a 2.5 year grace period vendor financing facility which was due in 2023. So, the bulk cash outflow during this quarter was to settle these dues, in addition to management's direction to secure as much of the capEX with upfront payment in EGP to avoid any fluctuation in the macro environment

or supply chain volatility. As such, the hike witnessed in Q2 was due to these upfront payments and settlement of the old vendor dues signed during the past three years, which wasn't the case in previous quarters. We don't expect the negative FCF to continue as most the vendor financing dues have been settled with upfront payment. However, there might be a small portion in Q3 and Q4 to secure most of the equipment for 2023 and 2024.

Ingy El Diwany: We have a final question Farouk Miah: *Home, Consumer and Enterprise revenue growth is significantly below inflation; what have been the recent price increases and upcoming increases to at least match inflation?*

Tarek Abdelhamid: Over the last few months, we have been in discussions with NTRA related to the need for a price up on all retail services: Enterprise & Consumer – Mobile & Fixed. The discussions are taking some time as inflation is affecting different services in the market and the telecom sector is a vital commodity that's why any change in the price will greatly affect the consumers in Egypt. This is why the discussions are taking some time, but we are expecting a movement in the price soon in the different products; we will start with the mobile services and then we move to the fixed services. The movement in Enterprise is because part of the services are indexed to equipment in US dollars – this is why some of those services are affected but it's not a material change. As such, some of the changes in the equipment prices are reflected in the enterprise but the price of the service itself hasn't changed yet.

Ingy El Diwany: Thank you. We have a question from Shady: *If you could please justify the high cash capEX figure in Q2 2023?*

Mohamed Shamroukh: I've just answered this question, but I will repeat myself again. We signed a vendor financing agreement three years ago, with a grace period for Telecom Egypt of two and a half years. This vendor financing facility became due in 2023, which translated into the bulk cash outflow. In addition, due to the macro level situation and the volatility in the supply chain, we started to convert our agreements with suppliers into 100% upfront payments for equipment to hedge against any fluctuation in FX or inflation hikes. This also translated into bulk cash outflow during Q2. We have now secured most of the capEX for 2023 and 2024. A small bulk will be paid in Q3 and Q4 to secure the remaining part of the capEX requirements for 2023 and 2024.

Ingy El Diwany: We have a question from Jaynesh Bhana: *When will the pass-through of VFE dividends start happening? From a cash-flow perspective, TE has 43% EBITDA margin but is spending 40% of revenue on capEX, this means there is no more free cash to deleverage or pay dividends (without the VFE dividend).*

Wael Hanafy: If you look at the dividends we received from Vodafone last year, it was about EGP 1bn, today, a year later, we have received EGP 2bn. So based on our expectations, the dividends we are getting from Vodafone are increasing YoY. Despite our FCF status, we are trying to pay dividends to our shareholders, like what we did last year; we got EG 1bn from Vodafone yet we increased our dividend pay-out by 25% YoY. I want to clarify that despite our FCF level, we are trying to maintain our shareholder dividends at the same ratio or increase it a bit. Yes, the FCF is negative, as clarified by Mr. CFO, due to the proactive strategic approach of Telecom Egypt's management to pay upfront for capEX to guard against any fluctuation or negative effect that could happen to Telecom Egypt related to the supply chain or any other macro-dynamic challenges. This is why the cash flow related to the capEX is high, but from a dividend perspective, we as management are keen to keep it as is or increase it a bit.

Ingy El Diwany: Thank you. We have a question from Ayman ElMasry: *Is there any update regarding the tower sale program?*

Wael Hanafy: I think the question from Habib Oueijan is the same, so we can answer them both at the same time.

Mohamed Nasr: We are waiting for the bids from our potential partners in the tower sales, which we are expecting to receive at the end of this month. However, some of them have asked for an extension. We are currently evaluating if we will agree to this extension or not. I hope we will have more visibility by the next quarter after we receive the bids on the tower sales.

Ingy El Diwany: We have another question from Jaynesh Bhayna: *When does the cash-capEX intensity start to decline?*

Mohamed Shamroukh: If you remember, the cash capEX we are paying right now is related to the higher ratio of CapEX/Sales in the last five years. This was part of the project of translating all of the old networks into fibre, which reached 40% of CapEX/Sales ratio at that time. We as management have a mandate from the Board to reduce the CapEX/Sales ratio to mid-20s over 5 years. We have already started to reduce this, but the impact of cash outflow related to the capEX is ongoing. The last vendor financing dues are in 2023, and we will continue to reduce cash capEX going forward; this will be translated into less cash capEX and more enhanced FCF. We already began reducing the cash capEX over the last two years to be less than 30%. It is still high because of the previous capEX spend. However, we will reduce in-service capEX YoY until we reach 25%; this will also be translated into lower cash capEX. We are expecting to reduce this further and see positive FCF this year. What happened in Q2 was a one-off event just to secure against the volatility in the macro environment and supply chain.

Ingy El Diwany: Shady is asking: *Net Debt/EBITDA in Q1 2023 was around 1.2x, while it increased during Q2 2023 to 1.48x, so what is your target Net Debt/EBITDA?*

Mohamed Shamroukh: Our target before the devaluation was to reduce it to 0.6x or 1x over 5 years. Again, part of this debt was translated or revaluated according to the devaluation of the EGP, which resulted in the current level of 1.4x. During Q1, yes it was 1.2x, this was due to the dividend payment to the shareholders which was reflected in a higher Net Debt/EBITDA. If we look at the total debt structure, the US dollar portion has declined significantly, while the EGP portion has increased to reflect the dividend payment in Q1 and the upfront EGP payment to secure equipment and hedge against any FX losses going forward.

Ingy El Diwany: Thank you. I have a few questions: Do you consider the hike in cable revenue to be one-time?

Wael Hanafy: The cable revenue is not one-time. What we mean by one-time is related to the cash capEX in Q2.

Ingy El Diwany: I mean the high cable revenue recorded during Q2; *can we expect another strong quarter of growing cable revenue?*

Mohamed Nasr: One thing related to cables is that we recognize revenue when we deliver the service to the customer. We are currently working on multiple major projects for subsea cables crossing Egypt between Asia and Africa to Europe. One of the things that determines the time of booking the revenue is delivering the service itself, which is under the control of the cable developer itself. It also has something to do with the permits in the different waters – the Red Sea and the Mediterranean Sea – the supply chain related to the subsea cable supplier. We forecast more projects to go into service in the next two quarters; however, whether they will be in Q3 or Q4, or split between them is still unclear – it changes day after day because it is based on the project delivery by the suppliers.

Mohamed Shamroukh: If I may add something: Mr. Nasr comes from the submarine cables background. The good news is that his experience will help in some initiatives materialising in the coming few years, which will be reflected in better performance and higher revenue from the international segment.

Ingy El Diwany: We have another follow up question from Farouk Miah: *Vendor financing obligations continue to grow; please provide further colour on vendor financing terms for these remaining obligations.*

Wael Hanafy: Let me take this. We can separate vendor financing obligations into two parts: The first is the balance before Q2 and the second is related to the increase you have witnessed in Q2, which will be settled in during the remainder of this year and next year. The increase that you witnessed in Q2 of around EGP 3.6bn comprises EGP1.6bn related to revaluation of the vendor financing that is in US dollars, while the remaining EGP 2bn is a new addition. The normal vendor financing term is a two-year grace period and then payments are settled over another two or three years.

Mohamed Shamroukh: If I may add, looking at the vendor financing obligations in Q1 and Q2 in terms of US dollars versus the translation into EGP isn't the norm. The total vendor financing liability during Q1 was USD 538m while in Q2 it was USD 460m, which means that we are reducing our vendor financing obligation over time. This gives Telecom Egypt a better rate and improved cash flow because of the grace period. However, due to the macro situation last year, we didn't use any vendor financing. However, we will leverage USD 100m in vendor financing for the coming period, which will match with our cash flow from our USD-based revenue. I hope I have made it clear that in terms of USD value, our vendor financing obligation is actually declining and the USD 100m is a new facility for the coming period.

Ingy El Diwany: I have a new question: *Do you have any intention to apply for the digital banking license in cooperation with a financial institution?*

Mohamed Nasr: We are currently evaluating this. As you have seen from the requirements, interested parties should have a consortium that includes a financial institution. So, we are currently discussing with a few of the financial institutions about the possibility of a partnership. As such, we can say things are now under discussion and under further review. We might have more visibility soon and something might be announced soon about our steps in this direction. But again, we are very interested in this step.

Ingy El Diwany: I'd like to remind all our participants to type in your questions in the chat box or press the raise hand button.

We have a question from Ines: *What's your target for the revenue growth & net profit for the year 2023?*

Wael Hanafy: Our guidance was early double-digit. I know we beat the target by 78% YoY, but we will keep our target as is from a conservative perspective because based on our 6+6 budget exercise, it will be more or less the same as our guidance. So, we will keep our guidance the

same for now. Regarding the net profit for 2023, we do not disclose this kind of information, but if I give you some light on that – it will be more or less the same as what we recorded last year.

Ingy El Diwany: *So are you expecting a flat net profit?*

Wael Hanafy: No, not flat. Definitely there will be an increase but I cannot disclose that right now.

Ingy El Diwany: We have another question from Farouk Miah: *Any changes to the competitive situation in the mobile market?*

Tarek Abdelhamid: There are no material changes in the market landscape. The four players are still active in the market and there are no significant changes to the competitive situation.

Ingy El Diwany: Another reminder – please type your questions in the chat box or press the raise hand button if you would like to speak directly to management. I believe there are no further questions; I'll hand over back to the management team to conclude the call.

Mohamed Nasr: Thank you so much to all the attendees. We really hope to continue our successful results in the next quarter. I thank my team at Telecom Egypt for driving the growth of the company and achieving these fantastic results. I also thank our investors for their trust in our shares and their investment. We hope that the next quarter results will be more impressive.

Ingy El Diwany: I would like to thank the management team for their time and valuable input. We also want to thank all of our participants for attending the call. Have a great day everyone. Thank you and goodbye.