Telecom Egypt Q4 2023 Earnings Call Transcript

Final Transcript

Telecom Egypt (ETEL.CA; TEEG.LN) Q4 2023 earnings call dated 04 March 2024

Call Coordinator:

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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*
Ahmed Abdelmeguid – *Investor Relations Manager*

Mai Nehad: Hello everyone, this is Mai Nehad from CI Capital. I'd like to welcome you all to Telecom Egypt's fourth quarter results' conference call.

I have the distinct pleasure to have on the call today

- **Mr. Mohamed Nasr** - Managing Director and CEO;
- **Mr. Mohamed Shamroukh** - Chief Financial Officer;
- **Mr. Wael Hanafy** - Senior Director of Finance;
- **Mr. Tarek Abdelhamid** - Chief Marketing Officer; and
- **Ahmed Abdelmeguid** – Investor Relations Manager

As usual, we will start off with a brief presentation by the management team, and then we will open the floor for questions.

Now, I'd like to hand over the call to Telecom Egypt's management team. Please go ahead.

Wael Hanafy: Thank you Mai, and thanks to CI Capital for hosting this quarter's conference call. Earlier today, we issued a press release announcing our financial results for the full year 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, Mohamed Nasr, followed by the key financial highlights to be presented by our CFO, Mohamed Shamroukh. Our CMO, Tarek Abdelhamid, and our IR manager, Ahmed Abdelmeguid, 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.

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. As seen in the earnings release published earlier today, we have maintained our growth momentum with 2023 being another strong year for Telecom Egypt. Although market headwinds continued to challenge us, we remained focused on our strategy and forged ahead with our investment plans to support our growth opportunities, strengthen our partnerships and improve our operations—all of which contributed to the great results you see today.

Recapping our full year results, we generated EGP 56.7bn in revenues, thanks to our excellent operations across the board. Retail revenue landed at EGP 31.5bn, a 14% increase YoY, with data, being the main driving force. Wholesale operations leaped 52% YoY, reaching EGP 25bn, mainly on the back of infrastructure, IDD and cable projects growth of 27%, 76%, and 64%, respectively. We reached an EBITDA of EGP 22.7bn, marking a 40% margin, which is higher than our guidance, thanks to exceptional operational results and major cost savings from the national roaming agreement. On the back of these great results, we distributed dividends of EGP 1.5 per share.

Our customer base continues to grow, marking an 8% and 9% YoY increment for fixed voice and broadband, respectively; meanwhile, mobile customer base was flat at the end of FY 2023, but began to grow again at the start of 2024.

As we enter 2024, in addition to the price up that already came into effect starting January—which I believe will greatly support our financial position—we remain committed to driving business success with customer-centric innovation strategies. Our focus will be on improving existing services and product offerings, as well as adding new products and services—such as expanding our submarine cable footprint and 5G services—to create new earnings power and result in accretive cash flow generative capabilities in the near future. I'm confident that our action plan will unlock Telecom Egypt's full potential and ensure that it is a consistently high-performing business that delivers increased shareholder value.

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'm pleased to mention that Q4 was a continuation of our growth story. Our forward-looking management strategy helped us curb the risks posed by the instability in the region, the currency devaluation and the resulting all-time-high inflation over the last two quarters. As such, we saw total revenue increase by 23% YoY, reaching EGP 14.7bn thanks to the 50% hike in wholesale. IC&N was the largest contributor to this growth, marking a 108% YoY increase due to higher cable projects and capacity sales. We also saw ICA grow 38% YoY on higher IDD, while domestic wholesale climbed 17% YoY on higher infrastructure revenue. Our USD-denominate revenues and cost savings, as Mr. CEO mentioned earlier, managed to partially offset the inflated costs across all cost elements, resulting in an EBITDA of EGP 5.1bn and an almost flat EBITDA margin of 35%. Operating profit increased by 69% YoY, equating to EGP 1.7bn, as strong operations overshadowed the higher D&A costs related to our continued CaPEX rollouts. Our non-operational items were quite strong as VFE investment income witnessed a significant upturn, reporting a surge of almost 150% YoY and sequential growth of 10% from Q3 2023. This remarkable performance culminated in a total investment income of EGP 1.7bn. However, interest expenses increased 2.9x due to the currency devaluation, offsetting this huge jump in VFE's investment income, resulting in net profit dropping 23% YoY, recording EGP 2.3bn.

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

Mai Nehad: Thank you to Telecom Egypt's management team for the presentation. We will now open the floor for questions. If you would like to ask a question, please use the raise hand button to have your microphone unmuted to speak directly with company management or you may type them in the Q&A box.

We will wait a few moments for attendees to place their questions.

We have a question in the chat box from Darren Smith: *Has there been any progress on the tower sales?*

Mohamed Nasr: I think we are in the process of getting bids from different tower sharing companies. We had internal discussions with the board about the offers received and concluded that they are not suitable for Telecom Egypt: either they offer a low value for the towers or the offers associated with the deal will not be lucrative at the operational level. That's why we prefer to wait and see – as the market position and macroeconomic conditions improve, we might be in a better position to receive better deals or clearer offerings from our other tower sharing companies.

We have also noticed that we haven't received many offers from many global and regional tower sharing companies, maybe because of the macroeconomic situation. So, with the enhancement we are seeing and with the good news in the market about the availability of foreign currency. I think we might receive interest from different tower sharing companies and get better offers. That's why, we will wait and see the macroeconomic improvement.

Mai Nehad: Ok, thank you. We now have Farouk Miah on the line. Please go ahead, your line is open.

Farouk Miah: Hi everyone, thank you for the call. I'll ask three questions please. Firstly, congratulations on the strong results but the consistent miss has been on spending too much on CapEX as well as free cash flow also being not as strong as expected. These are the two misses; these are the two areas that have been difficult over the past two years. *What are your plans to get these two items back in line with what you expect over the coming 12 to 24 months?*

Mohamed Shamroukh: Management remains committed to reducing CapEX spend, as we said before. But again, we have to consider what has happened at the macro level and the instability in the region around us. The FX shortage has negatively impacted the whole market, not just Telecom Egypt. That's why management considered this different financing structure, where we paid most of our CapEX upfront for the upcoming year and a half. This has had a huge impact on the CapEX spend, especially Cash CapEX, which reported around EGP 23bn. Accordingly, this negatively impacted the free cash flow. However, this was done to mitigate risks on the macro level and fulfil the necessary requirements (equipment) to maintain the operations of the company and our growth story. Our commitment to reduce the CapEX spend is still there and we hope that by the end of Q1 or maximum by the end of Q2, the macro level will improve and the FX regime issue will be resolved. This will allow us to return to our normal financing structure and our commitment to the CapEX spend.

Wael Hanafy: We can now answer questions on the screen. We have one from John about the CapEX and I believe Mohamed Shamroukh answered this question. The question from Shady is asking about the profitability margin for the next quarter:

We are committed to the guidance that we released at the end of last year and the price up should give good support to our margins. As such, we are aiming to present our board with a reviewed budget. Once we get approval from the board, we will release a new guidance, which should be by the middle of 2024.

Mai Nehad: We have a raised hand from Ziad. Please go ahead, your line is open.

Ziad Itani: Hi, thank you for the presentation. Just a couple of questions form our end. *First, what's your strategy with regards to VFE? Are you still open to potentially selling this asset? And can you give us any idea on roughly how much you got or expect to get in terms of dividends from this entity?*

The second question is with regards to the price ups in the market: *Is it possible to quantify these and what has been the market reaction so far?* You mentioned price increases and we should see the effect in Q1. *Are you seeing any sort of subscriber churn or downgrade in packages?*

Wael Hanafy: Let me start with the first question: As you know, we have a shareholder agreement that requires 60% of the free cash flow to be distributed on a yearly basis. The amount we got last year was around EGP 2.1bn; we assume that this year it could be around EGP 2.5-3bn, if everything goes smoothly. This would be the total expected amount that we are going to get from VFE in terms of dividends.

We can now jump to the next question, which is about the effect of the price up and its effects on churn. After that, maybe Mr. CFO could give us more colour about the VFE asset and our views in the future regarding exploring these kinds of assets.

Tarek Abdelhamid: Regarding the price adjustments that we've done at the beginning of January this year, so far we have seen a positive yield in terms of customer base stability and growth. We've also seen a minor decline on the consumption side; however, it is a lot lower than the price difference. Overall, it's very positive; yet, we need another couple of months to tell the exact amount that we have reached compared to the previous year. In general, the results on the outcome of the price adjustments are very positive both on the broadband and mobile side. Mind you, the whole market has moved so there is no direct impact on shares.

Wael Hanafy: Tarek, can you please give us the level of the price up before we jump to Mr. CFO?

Tarek AbdelHamid: The price change on the fixed broadband was a direct price adjustment of 30%, on average, across all packages. On the mobile side it is different because we have a lot of products and services. For the main product -- mobile data -- we have removed the flexible data charging system between social media and non-social media usage, but the price of the bundle remains the same. This is expected to yield an increase in consumption. Regarding other services such as post-paid and fixed wireless access, we made a direct price up of something between 15-20%.

Mohamed Shamroukh: I think management has been clear that we will continue to monitor our investment in VFE. First of all, we are happy with the changes in the shareholder agreement, which generates a decent amount of cash every year. I also think with the current macro level, we cannot decide on an asset like VFE, especially that even for a small ticket like the tower sales we did not receive an appropriate offer. We will continue to monitor the market as I believe we must first wait for the macro issues to be resolved before we can decide on the tower transaction and then VFE. With the current conditions, I believe we will not receive a good offer if we decide to sell. So, even if we decide to keep the asset, we are very satisfied because it generates a lot of cash as one of the best operators in terms of performance in the mobile segment. The price up, which impacted the mobile market as a whole, will possibly impact VFE and lead to an increase in cash for Telecom Egypt. I think the current situation does not give management any appetite to explore further options with the VFE asset.

Ziad Itani: That makes sense. Thank you.

Mai Nehad: Thank you. We have Farouk back, please go ahead your line is open.

Farouk Miah: Second and third questions are on the international cable business, as well as the VFE incoming Q4 - I think it more than doubled for both. *Can you clarify if there are any one-offs or is that normal business?* And *what was there to produce such strong numbers?* The last question is on this big issue of the FX macro situation. It seems a very fluid situation, you know with lots of things happening. *What is your approach to budgeting for 2024 given there are so many moving parts when it comes to your CapEX guidance and free cash flow guidance, both of which you are assuming will improve? What have you assumed in-house on the FX?*

Wael Hanafy: Okay, let me start with the first question which is related to the revenue recognized in the cable business. It is not a one-off. It is recurring, but as you may know, it's a service that we provide to international carriers for dropping their capacity here in Egypt and we record this kind of revenue after receiving confirmation from the international carrier that all their capacity has been connected. This may cause a delay in the recognition until the end of the year--but it is recurring. Maybe next year, part of it could be recognized on a quarterly basis, but for sure the big bulk of it will be recorded at the end of Q4.

Mohamed Shamroukh: Regarding the FX, we witnessed a hike in the black market at the end of December 2023. But after hearing news from the government about huge amounts of incoming FX, we can see a decline in the black market. I think we are also waiting for news from the government to change to a floating FX regime.

As far as the cash CapEX is concerned, again, we are committed to the numbers, but if the situation remains like it was last year, we will continue as before. Unfortunately, this will negatively impact our cash flow because we have to secure upfront payments to our suppliers to ensure that we can continue our growth story and continue with our CapEX rollout. If the situation improves and the government resolves most of the macro issues, I think we will return to our normal cash flow. In addition, if you compare the cash CapEX for 2023 with that for 2022, you will see that it has doubled because of these upfront payments.

Either way, we are keeping a close eye on the macro level. Internally, we have budgeted for several scenarios. We have plan A and plan B. We have a different response for every situation and we are working on a lot of restructuring options for our financing facilities. We are also working with more of our suppliers regarding vendor financing options try to mitigate the FX effect. Given the high interest rates, especially in USD terms, the good news is that we are working with the Chinese market to get lower interest rates and to bring our effective interest rate back to a lower value like before. This is to mitigate the huge CapEX expenditure that we could face if the macro situation is not resolved. We are doing as much as we can to mitigate the risk in any what-if scenario. In addition, we have set an aggressive target on the commercial side to get more revenue and more cash. We lobbied with the government to get the price up to mitigate the impact of the CapEX spend. At the moment we are waiting, as is the rest of the market, for government action in the next month or two max.

Farouk Miah: *Could you just clarify the numbers from VFE*? They were very strong and almost double for the year and more than double for Q4. *What's behind their strength?*

Wael Hanafy: This is normal performance for VFE, as Mohamed Shamroukh said, "They are doing well. They are the number one mobile operator in the market and generating lots of money. So, this is normal performance." Also, this does not include the effect of the price up which will generate much more revenue for 2024.

Farouk, you are very interested in the cables and the USD generated revenues. I think Mr. CEO can give us some views about this.

Mohamed Nasr: I understand that the concern with the subsea cable deals is that most of them are one-offs. But five years ago, it was the norm for projects to take a long time to deploy, especially if there was more than one key project at a time -- then we would see the peak of multiple projects coming into service at the same time. As you can see, what's happening now in the subsea cable industry is that hyperscalers are seeking diversity because of the geopolitical situations all over the world. So, the number of systems needed to carry the traffic of hyperscalers and carriers is becoming more and more necessary for diversity, which requires investment in multiple systems to secure their data over multiple routes.

We also noticed what's happening in the Red Sea, which is causing concern about the traffic on one side, but also creating opportunities for additional routes, especially those coming from the Gulf of Oman and from the UAE across Saudi and back to the Red Sea. We are currently in discussions with our Saudi and Gulf partners to deploy infrastructure across the Red Sea, which will also be used as a gateway from the Indian Ocean and from Southeast Asia towards Europe. At the same time, we are collaborating with multiple Western players to deploy infrastructure in the Mediterranean. The target is to create as much traffic as possible on both sides – either coming from the Gulf and or from the Red Sea, because the situation in Bab al-Mandab is temporary and will eventually be resolved. As such, people will continue to invest in the Red Sea side and across Saudi Arabia.

At the same, time there are matching investments coming from the Mediterranean side as investors want to carry traffic from the East and from Africa towards Europe. So, with this increase in diversity, we will see subsea projects become mainstream.

There are two sides to such projects: first of all, the cost, which is in EGP, because the trenching and fibre deployment of infrastructure are invested in EGP, and all the returns are in USD. Then there is the operational maintenance, which is the recurring annual fee that they pay for maintenance – the cost here is mainly the labour cost associated with electricity and power, and this is in USD. As a result, as the number of cables increases - and each cable has a life of around 15 to 25 years - the operations and services provided will generate recurring revenues. This will dilute the impact of one-offs and make cable revenues more mainstream.

Farouk Miah: Okay, thank you very much.

Mai Nehad: Thank you, we have a couple of more questions in the chat box. The first from Nadine: *How do you see the FX fluctuations in 2024? How do you plan to mitigate the risks and continue in your expansion plan?*

Mohamed Shamroukh: In 2023, we witnessed a move towards a parallel market, which was somewhat stable during the first three quarters, until we saw what happened in the last quarter. However, I think with all the good news coming in about a lot of FDIs, we will see more stability on the macro level. Even our suppliers are now pricing in EGP to mitigate against the FX parallel market. We also see some positive moves from the Central Bank; we even managed to obtain a line of credit in the last 2 weeks. It's not huge, but again it's a good sign of the news we're getting about the macro situation.

We also signed a vendor financing deal at a very competitive interest rate--because we are borrowing in Chinese currency. It's for USD 500m, but it's paid in Yuan and the interest is in Yuan.

Given the fact that more than 60% of our CapEX comes from China, this will help to meet the required CapEX for 2024 with greater certainty, while mitigating the impact of the FX regime.
On the other hand, some of the CapEX still needs to be financed in hard currency as it's not from Chinese suppliers. As such, we are currently working with GCC banks to try to close our current facility and obtain a longer term financing facility to enable the management to have the necessary cash to spend on CapEX from non-Chinese suppliers. We have also made up-front EGP payments to local suppliers who are able to get hard currency and purchase supplies from the international market.

Mai Nehad: Clear, thank you. We have one last question in the chat box. If you can talk about the recent 5G license acquisition. *The USD 150m acquisition cost, has this been included in the numbers? When do you expect to roll out the 5G network and what return on investment do you expect from it?*

Mohamed Nasr: The license acquisition cost of USD 150m is not included in the 2023 numbers, as we paid it in January 2024. We had the advantage of having our sites 5G ready from day one, because coming late into the mobile market gave us the advantage of having 4G sites that are 5G ready. That's why it's only the software license that needs to be added to the sites. So, we have been deploying or opening sites every day. Currently, we have covered more than 200 sites with the 5G service.
We are not announcing the commercial side yet, as we have to agree with NTRA on the commercial service, and they still need to do some tests. But technically, our sites are 5G ready and have been deployed. For us, 5G is part of the mobile story. It's not a stand-alone thing. It's part of our selling point that we offer the highest technology. As such, part of the service offering that we're going to do is fixed wireless access. This will enable users to access 5G, especially in areas where we don't have a fibre network, we will provide a fibre equivalent service. So, it will actually complement our fixed broadband.
In addition, we will focus on the enterprise side in the upcoming quarters. We are pushing hard on leveraging the 5G plus our fibre network to offer enterprise solutions. As such, we have created a new vertical for SMEs to increase our focus on them. SMEs need technology and latency because IoT solutions require low latency networks, which will be enabled by 5G. That's why we will use 5G as an enabler for enterprise solutions and at the same time try to bridge the gap of not having fibre in certain sites. So, 5G is part of both the retail and enterprise return stories. Furthermore, because we're the first 5G provider, we've immunised ourselves from having to pay excessive charges, because if the government hadn't sold the 5G licence at the price offered, it might have been offered again at a different price. At the same time, we have the advantage of being the first mover.

Mai Nehad: Ok, thank you. We have one more follow up question from Farouk: *How concerned are you on the Net Debt to EBITDA increasing for the last three years? And do you see slowing down CapEX as an option to keep the debt needs lower?*

Mohamed Shamroukh: I just need to explain how the management reacted and managed to plan for the CapEX spend in 2023 and also the 5G license acquisition. We were expecting the government to move and we were also expecting competition, especially from international players and traditional players. The closest competitor was Etisalat Misr -- they offered the government payment from their proceeds with no debt liability and no hedging on revenues. This gave the government time to ask for USD proceeds from operational performance rather than the debt market. That's why we did two things in 2023: we paid most of our CapEX spend upfront to mitigate any changes in FX and mitigate the risk of more exposure to hard currency, which comes at a higher interest rate because of the Central Bank's regulations. In the mean time we hoarded our dollars proceeds, which accounted for almost USD 250m as end of 2023, and we kept paying in EGP. This was reflected in a much higher blended effective interest rate and, accordingly, the interest expense also quadrupled from the number that we witnessed in 2022. In the meantime, the net debt structure has definitely seen an increase because of two things: number one, the retranslation of the hard currency liability on the balance sheet to EGP has almost doubled because of the devaluation. We have a balance sheet liability of almost USD 1bn, and all these liabilities were retranslated after the devaluation. However, almost 30% of our revenue is in hard currency, which helped mitigate the effect on the Net Debt to EBITDA margin. Again, if you look at the debt structure, you will see that the USD portion has decreased and the Egyptian portion has increased. And this was management's main target in order to mitigate further exposure to hard currency.

Given the government movement, we believe that the FX situation will be resolved sooner rather than later and we are working in parallel to obtain another hard currency facility. We closed the Chinese vendor financing deal at the end of 2023, at a very competitive rate, which will be reflected in 2024. In the meantime, we are working on hard currency financing from GCC banks. We are also waiting for the government to mobilize the macro level and clear the FX backlog. Accordingly, we will stop paying a lot of CapEX in EGP -- which comes at very high interest rate. So, yes, the CapEX can decrease. As I said, we purchased less CapEX in 2023 in terms of equipment, but the cash CapEX almost doubled as the CapEX requirements for the next two years were paid in full, instead of being paid in instalments over three years to mitigate any FX risk. Most of the suppliers asked for 100% upfront payment because of the FX regime. But again, in terms of the amount of purchased equipment, it is lower than 2022. I hope I have clarified management's strategy in 2023.

Mai Nehad: Yes, very clear. Thank you. I think we've come to the end of our questions. I will hand the call over back to you for any concluding remarks.

Mohamed Nasr: I'd like to thank the investors for their trust in Telecom Egypt and its management team. We hope to do the best for our shareholders and to continue to increase the value. I would also like to thank the team and the executive management for all of their support in 2023, which helped us to achieve these amazing results. I am confident that we will do even better in 2024 and I look forward to great results at the end of 2024.

Mai Nehad: Thank you very much. On behalf of CI Capital, I would like to thank Telecom Egypt's management team for their time and comprehensive responses today. Thank you all for dialling in and have a great rest of the day.