Telecom Egypt H1 2024 Earnings Call Transcript

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Call Coordinator:

Mariam Wael – Al Ahly Pharos

Corporate Participants:

Mohamed Nasr Eldin – *Managing Director and Chief Executive Officer*
Wael Hanafy – *Chief Financial Officer*
Tarek Abdelhamid – *Chief Consumer Sales and Marketing Officer*
Ahmed Zayed – *Investor Relations Director*

Mariam Wael: Good morning and good afternoon everyone. Thank you all for joining us for Telecom Egypt's H1 2024 results call.

From Telecom Egypt, we are pleased to be joined by:

- Mr. Mohamed Nasr - Managing Director and Chief Executive Officer;
- Mr. Wael Hanafy - Chief Financial Officer;
- Mr. Tarek Abdelhamid – Chief Consumer Sales and Marketing Officer; and
- Mr. Ahmed Zayed – Investor Relations Director

I would like to remind you that if you have any questions, please type them in the Q&A box at the bottom of your screen. With no further delays, I will now hand over the call to Telecom Egypt. The floor is yours.

Ahmed Zayed: Thank you Mariam, and thanks to Al Ahly Pharos for hosting this quarter's conference call. Earlier today, we released our financial and operational results for the first half of 2024. Kindly note that the results presentation is available on our IR website, ir.te.eg, under the quarterly results section of the financial information tab.

We will begin the call with a briefing of the key highlights of the period presented by our CEO, Mr. Mohamed Nasr, followed by more details on our financial performance to be presented by our CFO, Mr. Wael Hanafy. After that, the floor will be open to your questions. Our CMO, Mr. Tarek Abdelhamid, will also be attending the call.

Before we begin our discussion today, please allow me to read out the following disclaimer:

The information and opinions on this call, provided as of today's date, are based on general information gathered at such date and are subject to changes without notice. None of the future projections, expectations, estimates, or prospects discussed on this call should be taken as forecasts or promises. Such forward-looking statements contain known and unknown risks, uncertainties, and other important factors that may cause the company's actual results to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements.

Without further delay, I will now hand over the call to Mr. Mohamed Nasr.

Mohamed Nasr: Thank you Ahmed, and thank you all for joining our call today.

Our interim results demonstrate the company's strength and agility in navigating substantial macroeconomic headwinds, including currency depreciation, while sustaining robust growth. As you can see from our results, our strong organic performance is a reflection of being consistently laser-focused on growth as well as diversifying and monetizing our portfolio of services. We are also relentlessly looking for new ways and opportunities to improve our business and remain committed to improving quality while optimizing our costs.

Now, let me take you through a couple of the highlights: Our total revenue for the period surged by 35% YoY, reaching EGP 38 billion, underscoring our strong market position and the effectiveness of our diversified service portfolio. Notably, our retail segment revenue soared by 40% YoY, driven by a 46% increase in data revenue across all retail segments. This growth reflects our competitive edge and our dedication to delivering exceptional value to our customers. Furthermore, our international wholesale operations, including ICA and IC&N, achieved remarkable annual growth of 58% and 28%, respectively, benefiting from foreign currency appreciation and higher traffic volumes. Despite the impact of the currency devaluation on rising costs, our EBITDA reached EGP 15.5 billion, with a margin of 41%, highlighting our efficient cost management, effective infrastructure monetization, and strategic price adjustments.

We continue to attract customers across all segments, with Fixed Voice and Fixed Broadband subscribers both increasing by 8% YoY, while Mobile subscribers increased by 4% YoY. This continued momentum over the years is a testament to our competitive edge and commitment to delivering exceptional value.

We are also devoted to creating value for our investors, and we appreciate your unwavering support and confidence in Telecom Egypt. With this in mind, I want to reiterate our vision for Telecom Egypt: We aim to establish ourselves as a leading regional data hub and drive growth on all business fronts. We are focused on expanding our reach and continue to partner and collaborate with leading companies to innovate, leverage the strengths of our diversified portfolio, and enhance the quality of our products and services, which will, in turn, deliver superior returns for our shareholders. As we look ahead, we are optimistic about the company's future and that stability in the macroeconomic environment will positively influence our financial position. We are confident that our strategic growth initiatives, resilient business model, and agile execution will continue to position us for sustained success and growth.

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

Wael Hanafy: Thank you, Mr. Nasr. I will now go over our key financial results for the second quarter of 2024.

The top-line hiked up by 44% YoY, reaching EGP 20.5 billion, on a 46% YoY increase in Retail revenue and 42% YoY in Wholesale revenue. The price up across all of the Retail segment in January, alongside the 8% increase in Broadband customer base, resulted in a 48% YoY increase in data revenue, representing 38% of total revenues. Meanwhile, the IDD, Infrastructure, and Capacity Sales in the Wholesale segment showed incremental YoY growth this quarter of 73%, 46%, and 106%, respectively, partially due to the FX effect, in addition to increasing traffic.

EBITDA realized a 40% YoY increase, implying a margin of 40%. This was driven by the outstanding top-line performance and cost optimization measures, which mitigated the pressure of higher expenses resulting from the currency devaluation. Once again, we saw a surge in D&A, reaching 37% YoY, amounting to EGP 3.4 billion, related to new

CapEx additions, as well as the capitalized FX in light of the special accounting treatment that we have adopted this quarter, the previous quarter and last year.

On the other hand, income from VFE almost doubled YoY reporting EGP 2.1 billion as their profits rebounded after the realization of the FX losses related to the devaluation in the previous quarter and backed by higher operating margins caused by the price up. Meanwhile, interest expense hiked by 2.8x YoY due to appreciation of FX debt, increasing the effective interest rate to 15%.

This quarter, we saw net profit land at EGP 2.6 billion, implying a 13% margin, supported by the strong operational performance, in addition to the income recognized from VFE, yet marking a 9% drop YoY, as the robust operating performance was counterbalanced by the 2.8x YoY hike in the interest expense, the 37% YoY increase in D&A, and the recognition of 0.7 billion FX losses in this quarter due to the foreign currency appreciation.

Moving on to H1 2024 financial highlights, we see net profit landed at EGP 6.5 billion, almost flat YoY, with an implied margin of 17%. The strong operational growth, along with the substantial 52% YoY growth in VFE's income, supported by the recent price up, managed to neutralize the pressure of a 2.6x YoY higher interest expense and the EGP 0.5 billion FX losses caused by the currency devaluation.

Meanwhile, in-service CapEx recorded EGP 8 billion (representing 21% of sales). Our cash CapEx for the period amounted to EGP 27 billion, which represents 80% of our budgeted cash CapEx for this year. As such, we only have 20% cash CapEx for the next half of the year. This increase is largely attributed to EGP 7.5 billion in vendor finance payments, which represent around 70% of the budgeted amount for the whole year, and EGP 6.5 billion in license payments. This means that a significant portion of our CapEx for the year has already been expended in the first half. Our Free Cash Flow to Firm (FCFF) recorded around EGP -10billion. If we exclude license fees and account for the EGP 3.1 billion in dividends received from VFE in July 2024, FCFF would be around EGP -1billion.

Moving forward, we remain committed to optimizing future CapEx while ensuring that our business growth remains unhindered.

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

Mariam Wael: Thank you so much. I would like to remind everyone that if you have a question, please type that question in the Q&A box at the bottom of your zoom screen.

Until questions are typed in, *can you share with us your guidance on the increase in salaries and wages and depreciation expense in 2024 as a full year, given that both contributed to the pressure on margins during the second quarter.*

Wael Hanafy: Okay, let me take the first question related to the salaries increase. As you know, at the beginning of the year there was an annual merit increase, which was around 10-12%. But let me remind you that at the beginning of March, the government decided to support employee income by raising the minimum wage to EGP 6k per month. This has put pressure on our expenses in this regard. We had to react, which is why there is a minor increase in our salary expense in quarter two compared to quarter one or H1 2023.

For the depreciation expense, if we compare H1 2024 to H1 2023, we see an increase of around EGP 1.8 billion. This is due to the new additions that we have added to our property, plant and equipment, and the special accounting treatment that we adopted at the beginning of this year and also last year. This allowed us to report some of the FX expenses as capitalization of assets, which totaled around EGP 5 billion in property, plant and equipment in the last quarter. This definitely had an impact on both the quarterly and half-year depreciation expenses.

Mariam Wael: Okay, great. Thank you. I have a couple of related questions. The first one: *What is the foreign currency contribution currently to your total debt, revenue, CapEx, payables, and cash? So, what is the foreign currency contribution to your key indicators?*

Wael Hanafy: Let me take it one by one. As you know, about one-third of our top line is in foreign currency. If we are talking about the debt portion in Q2, we currently have around 63% of our net debt in foreign currency. As per our expectations and our proceeds in foreign currency, we plan to pay the debt from our own resources. Despite the increase of our total debt in EGP terms due to the currency devaluation, our foreign currency debt decreased in absolute terms compared to the previous quarter and its contribution to our total debt decreased from 70% in last quarter to 63% now. This shows our direction in this regard, which is to try to minimize our foreign currency debt in order to mitigate any future risks related to FX fluctuations. We also have another objective here, which is to try to convert all of our short-term facilities into medium/long-term ones. We have already begun by securing one transaction last May, and we will conclude another two transactions by the end of this year to try to convert all our short-term liabilities, whether in foreign currency or local currency, into medium and long-term liabilities.

I am telling you this because our aim is to decrease our current debt levels, and consequently, the debt servicing required, which we already began to witness is declining. Although our own resources in foreign currency are sufficient to cover our needs, it is good to limit our FX exposure in order to mitigate any risks to the income statement.

Mariam Wael: Okay, great. Thank you. We have a question that says, "IC&N revenue growth in Q2 was slow, at only 17%, especially given the depreciation, and that is a USD line. *Why was there a slowdown in the growth in the revenues of this business line?"*

Mohamed Nasr: This is mainly a base-effect. IC&N revenue is a mix between cable projects and capacity sales. So, one of the things that drives the revenue is the one-offs coming from cable projects. Last year we had a big project that was recognized in the same quarter. This quarter we do not have similar projects, which is why the growth is slower compared to last year. But, as you know, the nature of cable projects is that they take more time to plan, so once a project is signed off and delivered, we book the revenue. We are currently working on multiple deals that we hope will be recognized in the next half of 2024, and that will offset the slow growth witnessed in the first half.

Mariam Wael: Okay, thank you. Another question, which I believe you have answered but I will just read it in case you need to add anything: *Please remind us of your hard currency debt size compared to hard currency revenue and hard currency interest cost.*

Wael Hanafy: In absolute terms, our current total foreign currency debt is about one billion. If we look at our forward revenue, our expected foreign currency income for the year is about USD 600 million. So, after paying the interest and the principal, and covering our CapEx requirements, we are left with between USD 200-300 million that we can use. The one billion foreign currency debt we have right now is scheduled to be paid over the next five years, so it is not a one-time payment. So yes, our revenues can pay back our foreign currency debt and we have a surplus that can be used to cover other needs.

Mariam Wael: Okay, thank you. Another question asks, *"You previously guided for a positive free cash flow, while until the end of the first half you have a huge amount of* *negative free cash flow. So, could we still expect a positive free cash flow at the end of 2024?"*

Wael Hanafy: Yes, let me start with the first half of this year. As I mentioned, the majority of the cash CapEx has already been spent during H1 2024, which is around EGP 27 billion, representing about 80% of the cash CapEx. The remainder is just EGP 5 billion, which will be paid over the second half of this year. Definitely, as per our calculations, we are committed to reaching a positive free cash flow at the end of this year. If we compare it to EBITDA, it will be in the range of 20% to 30% positive free cash flow to EBITDA, excluding the license that we paid at the beginning of this year.

Mariam Wael: Okay, thank you. I would like to remind everyone, if you have a question, please type it in the Q&A box at the bottom of your zoom screen. Another question asks, "*What is the interest rate on hard currency debt? And what is the rate on local currency debt?"* This is the first part of the question.

Wael Hanafy: The interest rate on local currency is around 28%, while that for foreign currency is around 8.5%, yielding an effective interest rate of around 15% as at the end of this quarter.

Mariam Wael: Okay, thank you. The other part of the question asks, *"Can you discuss whether there are opportunities to reduce the effective interest rate?"*

Wael Hanafy: Yes, we are currently working on multiple transactions in order to monetize some of our assets, and definitely the proceeds that we are anticipating will go directly towards reducing our debt and deleveraging the company. This is from one side. On the other hand, we believe that 2024 will be the peak of the interest rate. However, it might remain unchanged at the end of this year, but it will decline after that.

Today, the Egyptian interest rate is 28%, whereas just one year ago it was around 16%. So, I believe it will keep going down quarter over quarter. I expect the same decline for the international interest rate. As per expectations, the Fed will gradually reduce the interest rate starting at the end of this year or early next year. We got the forecasts from Bloomberg, and they predict a huge decrease in the interest rates from the Fed beginning next year. We also got forecasts from the biggest investment banks here in Egypt; they are all expecting a decrease in the interest rate. This is beyond our control, but what we can do is try to minimize our exposure as much as we can. We are working around the clock to finalize the transaction to get the proceeds to deleverage the company and then reduce the interest, increase the net profit, and finally, we can increase the dividends to our shareholders.

Mariam Wael: Thank you. That was clear. Another question asks, *"Should we expect Data Center and Cloud Service revenues to be reported separately going forward? And what is the outlook on this segment?"*

Mohamed Nasr: Okay, so let me elaborate on the Data Center and Cloud Services revenue because it is a mix between two things. We provide data center services to the international market for clients that are hosted in our data center. We also offer them to the local market. The transaction type is different between the international and the domestic market. Some of the services are bundled between co-location in the data center and connectivity.

On the cloud side, the portfolio we have is a mix between complete virtual machines, plus connectivity to different entities. It is a bit difficult to segregate the revenue streams generated by them; however, we might think of providing guidance on that front in future reports so that you can have some figures about this business.

For this segment and the outlook, we invested in RDH, which was the largest data center in the Egyptian market at the time and is now fully sold out in terms of capacity. We are now expanding the second phase of RDH. We have anchor tenants who are committed to 50% of the capacity, most of them are buying co-location services. We see growth and demand; we even have a shortage on that side. However, as Wael mentioned earlier, we are making sure we control the CapEx spend to manage our debt. As such, we are not expanding aggressively in terms of building data centers; however, we are considering partnerships with key global developers in order to find a working model to expand on the data centers, capture the market demand and at the same time leverage our connectivity. So, it is a heavy CapEx business in order to grow in, and we need to be vigilant of how we manage the priorities in terms of our CapEx spend.

Mariam Wael: Okay, thank you. A question is asking: *"What are the tower monetization plans and what are the updates?"*

Wael Hanafy: The update is that we have finalized our business case and plan related to the towers' sale and updated the memorandum of information. Everything has now been passed on to the investment bank, which will begin pitching potential investors next week. They are extremely optimistic in this regard because the number of potential buyers may be double that of last year. We have a mandate or target that if the binding offer is lucrative for Telecom Egypt, we are going to conclude by the end of quarter one of next year. As you may know, these kinds of transactions require OGM approval. So, we can take advantage of the standard time to hold an OGM and complete the transaction by the end of Q1 2025.

Mariam Wael: Okay, thank you. A related question: "*Can you discuss opportunities to monetize assets to reduce that potential for tower sales?*" And you have already answered this. *"Is there land that can be sold? Can other assets, like data centers be monetized? And how much can all of this generate?"*

Mohamed Nasr: Regarding the land, the nature of our land bank is that the majority of it is allocated for the purpose of building telecom infrastructure, and as such, it might be difficult to sell on as a stand-alone. However, if these lands went into a partnership model that could be built by investors or developers in order to provide telco services or similar to telco services, such as data centers or technology hubs, they will be easier to monetize.

We are now looking at the regulatory and legal aspects of the land. We will take it step by step and see if there is any opportunity to utilize and monetize these properties. For example, we have a piece of land that could be a potential storage area with developers in Egypt who are now expanding their stock and their storage areas. So, we are exploring whether that is an opportunity. But again, we have to look into each of these properties on a case-by-case basis because each one has its own legal framework and regulations that we need to address.

We talked about data centers and monetizing our towers. Again, we look into all aspects and all the non-core assets of the company and see what could be monetized to provide immediate cash.

Mariam Wael: Thank you. A question is asking about the net income in the second quarter. The income from Vodafone was EGP 2.1 billion, and the total net profit was EGP 2.6 billion and this means that *Telecom Egypt made only EGP 600 million in profits*?

Wael Hanafy: Yes, but that is not entirely correct. You missed the tax effect; if we include it in the calculation, it would be around EGP 1.7 billion from Vodafone, as well as EGP 1 billion from Telecom Egypt's operation. However, the main driver behind the decrease in net profit is the hike in interest rates, the devaluation, and definitely the interest expense, which amounted to EGP 2.3 billion this quarter. So, interest expense is the main reason behind the decrease in the net profit this quarter. We started working on initiatives at the beginning of the year, and we have a steady vision to decrease the debt exposure as well as the interest expense.

Mariam Wael: Okay, thank you. Another question asks, *"What is your outlook for Vodafone Egypt dividends? And how do you intend to utilize them?"*

Wael Hanafy: Our dividends for this year are about EGP 3.5 billion, which we collected in July. We believe they are going to increase every year. Last year's dividends were around EGP 2.5 billion, while two years ago they were around EGP 1.2 billion. So, it is increasing year over year.

How do we intend to utilize it? It goes into Telecom Egypt's normal operations. But the majority of it goes directly to reduce our overdraft in order to decrease the interest as much as we can on the Egyptian side.

Mariam Wael: Okay, thank you. I would like to remind our participants, we have only a couple of questions left. So, if you have any questions, it is time to type them in the Q&A box.

Another question asks, *"What are the plans for the 5G business given the license cost was high? How will you ensure a good return on investment for the 5G license?"*

Mohamed Nasr: The 5G license is a long-term investment that will be used for mobile operations over the next 10 years. We anticipate the demand for 5G will increase within the next 2 years. We safeguarded ourselves by acquiring the license without having the need to invest in spectrum, which we see is a plus for us compared to other operators that may obtain the license and also invest in the spectrum. This would require more than double the investment. So, we were able to put less stress on our CapEx as we won't need to buy spectrum for the 5G.

We are ready to offer 5G-specific products to enterprises and consumers. This will help us expand our customer base, especially with high-end customers who use 5G handsets.

The E-sim will soon be on the market. Part of the strategy will be to combine the branding by offering the E-sim with the 5G products. Regarding the market, we have potential customers who are keen to try the technology and see how it differs from 4G. This will help us gain a larger customer base before our competitors. On the Enterprise side, we have begun discussing deals with specialized industrial zones who are interested in using 5G technology for machine-to-machine connectivity.

Mariam Wael: Okay, thank you. We have a question: *"Any plans to do more rounds of early retirement. What is the optimal head count in management's view?"*

Mohamed Nasr: We already had a scheme for early retirements. It is a compensation package offered to certain ages, such as those who have about 5 years till retirement. We received interest from more than 300 employees, who have already taken advantage of the scheme and retired. It is good on one hand, but on the other, it is a cash outlay that has an immediate impact on the cash flow. That is why it is critical for us to strike a balance between making the company more efficient and managing the cash flow, especially given the FX fluctuations.

One thing related to optimum head count, we can see that our operation is different from any other operator in the market, because we are the only company that has infrastructure. In comparison to the mobile side, the whole network, including the copper and fiber networks, is spread out all over Egypt. So, on the mobile side we have a smaller number of employees compared to our competitors. But in terms of infrastructure, we are the sole provider for the entire county, not only for the telecommunications industry, and it is a big country. So, our team on the ground maintaining and operating this network infrastructure is in every corner of Egypt. As such, we see the number of employees is optimum. In fact, we need more people for distribution, particularly on the technical side and field operations. This holds true even though I am counting the outsourced employees as if they are part of the payroll, but in reality, we have more than 20,000 outsourced personnel, and TE personnel themselves are in the range of 30,000. As you can see, a major part of our contracts are outsourced contracts, but I'm still counting them. So, I see the number is optimal. It is more of a matter of efficient distribution between the different requirements. We have headcount in areas where we do not need much more, but in other areas we have less than we need. One exercise we are doing now is trying to develop skills and move people from areas that do not need that much headcount and move them to areas that need more people. It is basically a reallocation of the resources within the organization rather than a reduction in the headcount.

Mariam Wael: Okay, thank you. We have a follow-up question on the 5G license: "Why would other MNO's pay double what Telecom Egypt paid for the 5G license. Is it denominated in EGP or USD?"

Mohamed Nasr: To clarify this point, I meant that the regulator might issue a 5G license combined with a spectrum. In this case, the payment will not be only for the license, it will be for the license plus spectrum. If this happens, we are talking about an investment of around USD 500 million for a spectrum plus license. However, if they go for a license without a spectrum, they will pay within the same amount that we paid. So, the amount we mitigated is if the license sale will be combined with spectrum, the amount will be double what we paid. This is what I meant.

Mariam Wael: Okay, thank you. We have one last question: *"The number of Enterprise, fixed voice customers has been trending lower for the last 4 quarters. Why is that? And do you expect this trend to reverse?"* This is the very first part of the question.

Wael Hanafy: You mean the decline in the number of the fixed voice customers related to Enterprise?

Mariam Wael: Yes, Enterprise fixed voice number of customers.

Mohamed Nasr: We are doing a cleansing exercise for different fixed voice customers. So, part of this is managing the cleansing of data, and you will see it is imposed on both the Enterprise and the Consumer. But it might be more obvious on the Enterprise side rather than the Home and Consumer.

Tarek Abdelhamid: I think the enterprise segment is also seeing development on the technology side. So, most of the large corporates, and even government customers, are moving from traditional legacy services to managed services and interconnection of their premises is done through totally separate deals. So, the Enterprise revenue from Managed Services is growing exponentially while the segment of the legacy standalone fixed lines is declining. So, it is largely compensated for and even more with the managed services segment.

Mariam Wael: Okay, thank you. Another question: *"Is your mobile business profit making on a standalone basis?"*

Tarek Abdelhamid: Yes, considering the fact that we have a national roaming agreement. One of the key milestones is that we changed the national roaming partner, which consequently decreased the cost by 50%.

On the marginality of standalone products, we are pretty much aligned with the market. On the overheads side, our mobile supporting functions like marketing, sales, technology etc. are very small in number compared to the competition. So, the overall mobile portfolio is profitable, however, with a different cost structure and a lot of synergies with other business units and segments.

Mariam Wael: Okay, thank you. A question is asking, "*Dividend payments were mentioned in the management remarks. What is the outlook on this given the payout is quite low?"*

Wael Hanafy: What we mentioned in the management remarks is the dividends that we received from Vodafone. But if you mean the dividends that we are going to distribute from Telecom Egypt, yes, certainly, our financial position, or cash position, will be different at the end of this year to what it is right now. So, it will be based on our cash position at the time. But definitely it will not be less than that we have distributed this year because we have a mandate, even internally, between the management, to try to maintain the dividends or increase them as much as we can.

Mariam Wael: Okay, thank you. We have a final question: *"If we look at implied mobile ARPUs, they seem quite lower than other competitors, or are you struggling to penetrate high value segments? Who are your main customers?"*

Tarek Abdelhamid: Yes, when considering the overall client base, our ARPU is lower than the market average. However, our consumer base differs from our competitors. We have what we call *mega projects*, or *mega deals* with the Ministry of Education and Ministry of Solidarity. By nature, this customer has a much lower ARPU than the market average. However, our organic customer base derived from the mainstream products is as high as the competition. The split between these projects, or the natural acquisition of customers is diminishing over time because we are now focusing on higher value customers. We recently revamped our postpaid product portfolio, and we have seen a lot of traction in this segment, which has increased the overall ARPU base. With that momentum, we expect that our customer base ARPU will be normalized within the next couple of years.

Mariam Wael: Okay, thank you. There are no further questions in the Q&A box. So, I will now leave the floor to management for any closing remarks.

Management: Thank you

Mariam Wael: This concludes our call for today. I would like to thank Telecom Egypt's management for their time and valuable input. I would also like to thank everyone for joining and wish you a good rest of the day.