Taiwan Mobile

4Q18 Results Conference Call

January 31, 2019

James Jeng, President: Good afternoon. Welcome to Taiwan Mobile's 4th quarter investor conference call. Before I start our presentation, I'd like to direct your attention to our disclaimer page, which states:

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For the business overview, I will start with the operating performance of our telecom business.

Steady Increase in Cash Flows

For telecom service revenue and telecom EBITDA, we provide investors with YoY changes on both pre-IFRS and reported basis. Despite the adoption of IFRS15 starting from 2018, **we believe the pre-IFRS numbers better reflect our operating results and cash generation capabilities.**

In 2018, our pre-IFRS telecom service revenue declined by 8% YoY, mainly due to higher take-up rate of SIM-only plans, softer demand for high-end smartphones, and lower domestic roaming and voice revenues.

However, thanks to higher penalty income and lower expenses, **our pre-IFRS telecom EBITDA for full year 2018 increased by 3% YoY**. With prudent capex control, we further increased our free cash flow to NT$21.3bn.

Cross-Selling Supporting Growth

Now let's talk about our growth engines.

For the **video streaming** business - myVideo services, by teaming up with leading cable MSOs, we continue to expand our customer base from mobile users to fixed broadband users with big screens. In 2018, aided by richer video line-ups, we increased customer stickiness by doubling our monthly active users while the number of video viewed reached 4 times that of previous year. As a result, revenue from video streaming grew around 20% YoY.

For the **fixed broadband** business, we saw a 6% YoY increase in the subscriber base, thanks to effective cross-selling. With the fixed broadband penetration rate of our pay-TV reaching only 40% in 4Q 2018, there is still room to grow. A larger fixed broadband subscriber base also bodes well for our video streaming business in the future.

As to our **enterprise business,** ICT stood out with 94% YoY revenue increase while cloud and IoT also grew steadily. Our cooperation with Quanta and Asustek to build a national level AI cloud platform was the key highlight for the ICT business in 2018.

momo – Crown Jewel

Now let us move on to **momo's** operational highlights.

In 2018, momo's **total revenue** grew by **26% YoY** on the back of strong momentum from B2C e-commerce division, where average ticket size grew by 8% YoY, and number of transactions grew by 24% YoY. The **total EBITDA** also grew by **15% YoY**.

Let me turn the presentation over to our Rosie for the financial overview section.

Performance by Business

Rosie Yu, CFO & Spokesperson: In the fourth quarter, **consolidated revenue decreased by 1% YoY** as momo's strong revenue growth largely offset the decline in telecom business. **Pre-IFRS 15 EBITDA increased by 3% YoY**, thanks to lower handset subsidies and channel commissions in the telecom business.

For full year 2018, **consolidated revenue grew by 1% YoY**. In addition to momo's strong growth, our mobile value-added services, cloud, IoT and ICT services also grew steadily throughout the year. While **pre-IFRS 15 EBITDA grew by 3% YoY**, downward bundle sales adjustment to the **reported financials**, which had no cash flow impact, increased by NT$2bn YoY.

Let us move to the results summary page.

Results Summary

In the fourth quarter of 2018, strong showing from momo and lower non-operating expenses resulted in a 27% YoY increase in net income. We missed 4Q guidance due to lower-than-expected high rate plan and high-end phone bundled sales, despite that pre-IFRS profit came in better than expectations.

For full year **2018, revenue was 4%** lower than the Company's expectations, owing to customers' shifting appetite to lower-tier rate plans. That said, through business diversification and rigorous cost and expense rationalization, both our operating and net income achieved Company's guidance, making Taiwan Mobile the **only one amongst the big 3 telecom operators in Taiwan that achieved EPS guidance for 2018.**

<u>Balance Sheet Analysis</u>

Now let's move on to balance sheet analysis.

On the **asset front**, the YoY decrease in current asset was driven by declines in receivable and contract assets, as handset replacement cycle lengthens and demand for high end smartphone wanes. The YoY decrease in other current assets was due to lower guarantee deposits in 2018.

For non-current assets, concession and equipment values came off YoY reflecting the end of 3G service, while the increase in other non-current assets was related to the adoption of dealer commission capitalization accounting treatment since the beginning of 2018, which is IFRS 15.

On the **liability front**, our gross debts decreased nicely YoY as we paid down debts with healthy free cash flow.

In terms of **financial ratios,** our net debt to EBITDA ratio improved to 1.4x and our current ratio also rose to 69% vs. 57% a year ago. **ROE** at the end of 2018 stood firmly above 20%.

<u>Cash Flow Analysis</u>

For the full year, the **YoY decrease of operating cash inflow** was mainly related to changes in accounts payables as a result of falling handset sales.

As for **investing cash flow, the YoY decrease in outflow** was due to lower capex, higher license fee base in previous year, and more cash released from guarantee deposits with the regulator.

In terms of **financing cash flow**, the main outflow item in 4Q18 was the repayment of the 7-year corporate bond. For the full year, we issued unsecured corporate bond of NT$15bn in

April 2018 which helped pay down short-term and long-term debts.

With **capex falling by 13% YoY**, full year 2018 **free cash flow** reached NT$21.28bn, up 4% YoY, translating to **free cash flow yield** of 7.3%.

Let me turn the presentation over to James for 2019 guidance and event updates.

<u>2019 Guidance</u>

James: In terms of 2019 outlook, **for telecom business** - In 2019, NB-IoT, cloud service, IDC business and OTT related services will be on their upward trajectory. Mobile monthly fees in 2019 are expected to be similar to current levels while lower voice minutes of use and mobile interconnecting rate will weigh on mobile ARPU.

Despite our effort in mobile offering differentiation and customer acquisition cost reduction, we expect a **10% YoY decline in telecom EBIT** due to three major factors: 1) lower ARPU due to the $499 frenzy, 2) no $499-related penalty income in 2019, and 3) no domestic roaming revenue in 2019.

For other businesses, the combined EBIT of our cable TV business and momo will represent 21% of our total EBIT in 2019, with respective EBIT growth rates of 10% for cable TV and 5% for momo.

Stable free cash flow generation is expected in 2019 as savings in cash capex compensates for the decline in operating cash flow.

For Capex guidance, out of the total capex of NT$6.4bn planned for 2019, we expect telecom capex to decline by 25% YoY, cable TV capex to increase by single-digit percentage point, and momo capex to halve despite continued business expansion due to high base from 2018 for its mega automated warehouse.

<u>Event Updates</u>

The next page shows our event updates.

First, the Board resolved to participate in establishing LINE Bank, an online-only bank, with investment amount of NT$500M for a 5% stake.

Second, the recognitions we’ve received in the fourth quarter of 2018 for your reference.

Key Message

To wrap up our presentation, this slide summarizes the key message that we would like to deliver:

> With strong footholds in e-commerce and OTT services plus leveraging expanding residential broadband user base on content bundling, Taiwan Mobile is better positioned than other telcos in Taiwan. The growing cloud, AIoT, and ICT businesses, coupled with capex downtrend, will support TWM's stable free cash flow generation capabilities and future growth.

This will conclude our presentation today. Now I would like to open the floor for the Q&A section.

Q&A

Patrick Chen, Nomura: ***Regarding the D&A guidance for 2019, it seems to be rising from the 2018 level. Given that your capex has been declining in the last few years, is the rise in the D&A more related to amortization or maybe the adoption of IFRS 16 to capitalize the rental expenses?***

Separately, can you shed some color on the non-operating losses?

Rosie: Regarding your 1st question on D&A guidance, it's the latter, the implementation of IFRS 16.

On your second question, non-operating losses, it was because in 2017 we provisioned roughly NT$790mn accrued losses for the litigation with FET. In 2018, we didn't incur such losses. Also, there were some write-off losses incurred in the previous year.

Jack Hsu, Sinopac: ***What is your number of 4G subscribers at the end of 2018? Also, can you share your view about the impact of the NT$499 all-you-can-eat? It seems to have had a negative impact on the operators. But, did it really have a huge impact or was there another factor that affected the operators' revenue or profit?***

James: Regarding to your second question, the NT$499 deal did impact the operators quite a bit. For 2019, we will see bigger impact from the NT$499 deal mainly because the NT$499 deal started in May 2018, thus the full-year impact in 2019. The NT$499 monthly tariff will probably not get worse, but it will stay. Thus, we have a very conservative projection for mobile revenue because the NT$499 impact will further lower ARPU.

Regarding the 4G subscriber number, in 2018, for all five operators, SIM card penetration rate rose as a result of the NT$499 deal as well as big promotions on Double 11 Single's Day. One of our competitors offered a NT$211 plan and one of the smaller operators offered a NT$88 plan. Thus, there was 2% growth in subscribers for the whole market in 2018. For TWM, our 4G subscribers at the end of 2018 was 7.07m.

Neale Anderson, HSBC: *Two questions. First one is about the 25% reduction in capex guidance, can you share any details on the level of traffic growth you're seeing on your mobile network and how you reconcile that with the lower investment in 2019?*

Second question is about the investment in LINE bank and the rationale behind that investment.

James: We estimate 12% growth in mobile traffic. The capex for the mobile network is NT$4.1bn, which is a big part of the overall capex.

Rosie: Given that many expect that LINE Bank will provide the largest platform on the island, there are more and more applications or business synergies we could leverage from this platform.

Varun Aruja, Credit Suisse: *A few questions from me. Firstly can you provide clarity on how much is APT is now contributing in terms of roaming revenue? My understanding was most of it was done in 2018, so how much is still left?*

Secondly, regarding capex, looking at your competitors, CHT's capex guidance is always to increase and they're investing a lot. Given that you're also looking at ICT and all these cloud initiatives to be growth drivers, it's surprising to see your capex coming down? Just want clarification because if you're looking to invest in these future technologies and your fixed-line network infrastructure, in my opinion, is much less than CHT, shouldn't you be investing more on those fronts in preparation for 5G?

Thirdly, any update on the 5G auction and when should we expect any increase in 5G capex?

James: In response to your second question about ICT and capex, the 2019 capex for IDC investment is mainly for incremental revenue basis because the heavy investments already happened in 2017 and 2018.

Regarding the 5G auction, based on indications from the NCC, the spectrum auction will take place end of 1Q20. So, the 5G capex or the network investment will start in the 3^{rd} or 4^{th} quarter of 2020. While the capex going from 2018 to 2019 will not be significant when it comes to spectrum auction and network deployment, it will begin to increase in 2020.

Regarding your first question, according to the NCC regulation, domestic roaming from APT actually stopped at the end of 2018. However, the NCC gave APT a grace period of one month, so by the end of January, all of the domestic roaming will reset to zero.

Varun: *In light of that, do you think your guidance of a 10% decline in telecom EBIT is a bit conservative given that roaming will be zero and not many of your customers have converted to NT$499? Can you elaborate on how many of your customers are in NT$499?*

James: For our guidance, we prefer to be more conservative as you can see over the past few years. For instance, in 2018, no one could have expected the NT$499 frenzy, and at the end of the day, TWM was the only operator to meet its guidance thanks to our conservative approach. Hopefully, in 2019, we will outperform our projections.

Varun: *Okay. Lastly for me, the earnings have been on a declining trajectory for some time now. Obviously 2019 is a declining trend but when do you think we can see some recovery in earnings? I know your ROE is improving, but that is largely because you're paying dividends out of your reserves. But your core earnings seems to be on a declining trajectory, so how should investors look at earnings in the next 3-5 years? Is there any view were you think you can have some recovery in earnings?*

Rosie: Well, you know we're very committed to a stable dividend policy. So even with declining earnings, we are still committed. But of course, it's up to the Board meeting in April. And you know we do have ample reserves to top-up dividends if necessary.

Patrick Chen, Nomura: ***Can you share with us the Board's thoughts behind the change in leadership?***

James: This morning, the Board appointed a new GM for Taiwan Mobile mainly because I reached 65 years of age, which is the company policy's retirement age for senior management. But I will still stay on the Board and serve as an advisor to the new GM as part of the Fubon group. I will also help with the coordination between Taiwan Mobile and its subsidiaries such as momo and Kbro. I've appreciated all the support from the investors over the last five years.

The new GM is Jamie Lin and he comes from the venture capital and new business development background. Since mobile connectivity has become commoditized, it's time to have a new start and a new mindset for telecom industry. So hopefully, the new management and the new management team will bring about, I wouldn't say an evolution, but a revolution in the medium term that will generate new services and thus new avenues of revenues.

Amber Lee, Yuanta: *You mentioned momo will represent 21% of your EBIT this year. What is that number based on? What kind of EBITDA margin are we looking at for momo? Is it trending up, or is it kind of flattish?*

James: The 21% is not just from momo, but also includes the cable TV business. I would say, in terms of EBITDA margin for momo, it will be flat for 2019. But the top-line will grow quite significantly - our revenue projection is very conservative. So, even with flattish EBITDA margins, I believe the total EBITDA will outperform what we projected. Cable TV will contribute quite a lot to the EBIT in 2019 because the 2-year depreciation for the set-top boxes is already complete.

Jack Hsu, Sinopac: *Given that the NT$499 plans will likely persist over the next two years, how will you increase your cash flow?*

Will capex continue to decrease until the start of 5G?

James: The impact from the NT$499 plans on the top-line has been pretty significant. At the same time, the NT$499 frenzy brought about a change in customer behavior as more and more subscribers shift to SIM only plans. This change led to a significant reduction in handset subsidies and channel commissions in 2018, thereby keeping our EBITDA in good shape. With more and more customers opting for SIM-only plans, the virtual channels will become more important in 2019 and beyond as we reduce the role of the direct stores and increase the capabilities of the virtual channels. This will greatly reduce expenses and costs and that will hopefully compensate the loss in ARPU, resulting in a stable EBITDA.

Capex for 5G will not take place until 3Q, 4Q of 2020 as I previously mentioned even if we start to deploy the network. From what I see now, business model in 5G will mainly be B2B2C instead of B2C in 2G, 3G and 4G. In the initial stages, since it will be primarily for B2B, 5G deployment will be customer-specific. The large-scale deployment of the 5G network will only take place when the B2C model is justified.