

"Bezeq" The Israel Telecommunication Corp., Ltd.



Event Transcript

Q1 2020 Financial Results

Thursday, May 21st, 2020, 15:00 Israel Time

DISCLAIMER

This document includes a transcript of the conference call held on the above date regarding the Company's financial results for the first quarter of 2020, following the publication of the Company's financial statements at that date, as well as the publication of the Company's investor presentation filed under the Israeli Securities Law 1968 ("Securities Law").

This document includes statements made at that conference call and accordingly contains only partial information regarding the Company's financial results and the Company's periodic reports published under the Securities Law. The reports can be accessed at the Israeli Securities Authority's website, www.magna.isa.gov.il. A review of this transcript and/or the aforementioned investor presentation published by the Company is not a substitute for a review of the detailed reports of the Company under the Securities Law and is not meant to replace or qualify the full reports. The Company is not responsible for the accuracy or completeness of the information contained in this document. In addition, this transcript does not constitute an offer or invitation to purchase the Company's securities. The transcript and information contained therein should not be used as the basis or reliance on any contract or obligation and the Company is not responsible for any investment or decision based on the said document. This transcript does not constitute an offer or invitation to purchase or subscribe for any securities of the Company, and neither this transcript nor anything contained herein shall form the basis of or be relied upon in connection with any contract or commitment whatsoever.

Q1 2020 Financial Results

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Bezeq's first quarter 2020 results conference call. All participants are at present in a listen-only mode. Following management's formal presentation instructions will be given for the question and answer session. For operator assistance during the conference, please press * 0. As a reminder this conference is being recorded and broadcasted over the web. At this time I would like to turn the call over to Mr. Naftali Sternlicht, Investor Relations Manager for Bezeq. Mr. Sternlicht please go ahead.

Naftali Sternlicht (IR Manager, Bezeq): Thank you, Operator. Welcome everyone and thank you for joining us on the call today. With us from Bezeq Group's senior management team we have: Mr. Shlomo Rodav, Bezeq's Chairman, Mr. Dudu Mizrahi, Bezeq Fixed-Line's CEO, Mr. Ran Guron, CEO of Pelephone, Bezeq International and yes, and Mr. Yali Rothenberg, Bezeq Group's Chief Financial Officer.

The speaker's comments will generally follow the slide presentation, which is available under the Slides tab on the webcast link and may also be downloaded from Bezeq's IR website. You can go through the presentation by clicking on the arrows on the left or right hand side. I would like to draw your attention to the Safe Harbor statement on Slide number 2, which also applies to any statement made during today's call.

Let me now turn the call over to Shlomo, for prepared remarks on the Covid-19 pandemic situation and its impact on our business, after which Yali will continue the presentation with group financial highlights, followed by Dudu discussing Bezeq Fixed-Line results. Ran will pick up with results of our subsidiaries, and Yali will wrap up the presentation, after which management will be available to answer questions.

Shlomo Rodav (Chairman, Bezeq Group):

Thanks, Naftali.

Let's start on Slide 3. In the first quarter, the impact of the COVID-19 pandemic started to be felt in Israel, posing a managerial and operational challenge for us. Thanks to timely preparations and robust operational capabilities, we successfully weathered these challenges. All group companies were ready to provide continuous service to customers and were prepared for emergency situations. While we have sufficient liquidity to get through the current challenging period and there is no change in our long-term strategy, we made necessary adjustments to protect the health of our employees and to ensure the smooth operation of our business. Specifically, we increased the scope of employees working remotely while making sure that technicians

were working at full capacity while protected. We also decreased work hours in sectors where activity declined.

Moving to Slide 4 - While potential risks abound, I'd like to point out that the changing landscape of telecommunications service usage at the home and enterprise levels is also presenting us with opportunities as we see a significant slowdown in retail broadband Internet churn as well as an increase in fixed telephony usage, higher demand for TV content, and increase in business sector demand for remote access and new projects. We are mitigating the impact of the virus and shall implement ways to capitalize on new opportunities.

As of March 31, 2020, there was primarily a decrease in revenues from roaming services and retail sales of end-user equipment in Pelephone, as well as some decrease in revenues from the business sector in all the Group companies. However, the total impact of the COVID-19 pandemic on the financial condition of the Group companies was immaterial in the first quarter of 2020, especially since the pandemic impacted only the last few weeks of the quarter.

Looking out to the rest of the year, assuming that the balance of the restrictions that still slow down economic activity will be removed by the end of June, and from the second half of 2020 the economy will gradually return to normal without any additional significant restrictions except for incoming and outgoing tourism, we expect a decrease in Pelephone's revenues and operating profit of approximately 150 million shekels and 100 million shekels, respectively, mainly from the decrease in revenues from roaming services and, to a lesser extent, in retail sales of end-user equipment, as a result of the pandemic's effect on tourism and retail sectors.

Now I'll turn the call to Yali to talk about our financial results.

Yali Rothenberg (CFO, Bezeq Group):

Thanks Shlomo. Turning to Slide 6 – Let me start off by saying we entered the pandemic from a position of financial strength with robust liquidity, continued decline in financial debt and significant improvement in the Group's debt structure. During the quarter, group-wide revenues totaled 2.19 billion shekels, down 3.1% from the prior year quarter. The decrease in revenues was due to lower revenues in Bezeq Fixed-Line mainly due to a decrease in revenues from telephony services further to the ongoing trend. In addition, Bezeq International revenues decreased due to lower revenues from the sales of communications equipment to businesses, Internet services and international calls.

On Slide 7 – Group-wide gross salary expenses decreased from 492 million shekels a year ago to 479 million shekels in the first quarter of 2020, a decrease of 2.6%. The decrease was due to the reduction in the number of employees and associated salary expenses in all key group business segments further to the streamlining plans that we continue to execute over the last few quarters.

Group-wide operating expenses decreased from 812 million shekels a year ago to 793 million shekels in the first quarter of 2020, a decrease of 2.3%. The decrease in operating expenses was primarily due to lower equipment expenses for businesses and lower international call expenses in-line with a reduction in revenues in Bezeq International.

Turning to Slide 8 – After adjusting for other operating income and expenses, group-wide adjusted EBITDA in the first quarter totaled 915 million shekels, compared to 952 million shekels a year ago. The decline was primarily in Bezeq Fixed-Line and Telephone.

Group-wide adjusted net profit increased to 330 million shekels in the first quarter from 291 million shekels a year ago, mainly due to a decrease in financing expenses as Dudu will explain later in the fixed-line section of the presentation.

Moving to Slide 9 – Free cash flow in the first quarter was 436 million shekels, compared to 316 million shekels in the same quarter of 2019, an increase of 38%. The increase in free cash flow was primarily due to increased cash flow in Bezeq Fixed-Line due to changes in working capital and a tax refund received in the current quarter.

Gross capex in the first quarter amounted to 338 million shekels, compared to 373 million shekels in the same quarter a year ago, a decrease of 9.4%. The decrease was mainly due to timing differences in payments for equipment in yes.

On Slide 10 – We have broken down subscribers and ARPU by different business segments. Let me just point out that yes updated its ARPU definition in the first quarter so that ARPU does not include revenues from content sales to external broadcasters. As a result, ARPU data for 2019 was adjusted retroactively.

Lastly turning to Slide 11 – We are continuing to improve our debt profile. We recently published a shelf prospectus increasing the Company's financial flexibility. Debt service of principal and interest for the next 12 months significantly improved over the year and there was a year-on-year decrease of more than one billion shekels in net debt, as well as a decrease in net debt to EBITDA leverage ratio, from 2.5 in Q1 2019 to 2.3 in Q1 2020.

Now Dudu will share with you updates on Fixed Line operations.

Dudu Mizrahi (CEO, Bezeq Fixed-Line):

Thanks Yali. The COVID-19 pandemic has created a complex and challenging reality, but thanks to early preparations and comprehensive operational systems, we continued to operate and provide full service to our private and business customers even at the peak of the pandemic. At the same time, we have been very successful in dealing with increased usage that reached new highs. Beyond the challenges that businesses in Israel are presently facing, we also see emerging opportunities in various fields and sectors.

I will now discuss the fixed line highlights for the first quarter of 2020. Turning to Slide 13 – Despite our competitors' deployment of fiber as well as lower market pricing, we managed to achieve stability in broadband retail lines for the first time in 5 years. In addition, there was a significant increase in telephony service traffic during the quarter.

On the next Slide – You can see broadband retail lines over the last thirteen quarters and the significant slowdown in churn.

Turning to Slide 15 – We are focusing on the customer premises through a three-part strategy which consists of our BE router as the base; home products that ensure broadband quality such as Bspot and Be Mesh; and value-added services such as cyber protection, anti-virus and network support.

The number of customers with the BE router increased from 159,000 in the first quarter of 2019 to 378,000 in the first quarter of 2020. About 38% of our retail customers choose to connect with the BE router. Meanwhile, the number of customers with Wi-Fi enhancers such as Bspot and Be Mesh increased by 140% over the same period.

Moving on to Slide 16 – our retail ARPU has grown as a result of increased penetration in customer premises services as well as valued-added services.

Moving to Slide 17 - We are leading the business sector through advanced telecommunication solutions supported by our high-quality infrastructure. The outbreak of COVID-19 presents many difficulties for businesses. The ability for businesses to operate remotely and continue to provide service is critical these days. Toward that end, we stepped up our offering of video conferencing and remote access solutions to businesses in addition to virtual exchanges and other IT solutions.

On the next Slide – Our business services also include data hosting solutions with high quality and secure IT systems. As you can see on the map, we have nationwide deployment of data centers with two large sites and ten boutique data centers.

Moving to Slide 19 – Revenues in the first quarter were 1.02 billion shekels, compared to 1.04 billion shekels in the prior year quarter. The slight decrease in revenues was primarily due to a decrease in revenues from telephony services. The other revenue items were stable compared to the corresponding quarter in 2019. Meanwhile, total operating expenses were mostly in line with last year.

Turning to Slide 20 – After adjusting for the impact of other operating income, Adjusted EBITDA in the first quarter was 647 million shekels compared to 669 million shekels in the same quarter of 2019. The moderate decrease was mainly due to lower telephony revenues. Meanwhile, adjusted net profit increased 9% year over year to 295 million shekels, mainly due to a decrease in financing expenses relating to the repayment of debt during the year as well as actuarial adjustments for employee benefits resulting in financing income.

Now I'll turn the call to Ran to talk about Bezeq's subsidiaries.

Ran Guron (CEO, Pelephone, Bezeq International, yes):

Thanks, Dudu. With the outbreak of the COVID-19 pandemic, this quarter we saw the strength of the three subsidiary companies, offering products and services that have become more essential than ever. The three companies grew their subscribers' base - Pelephone for the fourth consecutive year, and yes, for the first time in two years, with a significant increase in the number of new subscribers in the IP broadcasting platform, most notably STING TV. During the quarter, yes got back to profitability and achieved improvement across all financial metrics, balancing the decrease in Pelephone's revenues from cellular services. Meanwhile, Bezeq International continues to maintain revenue and profitability, despite the slowdown in its business sector activity.

On Slide 22 – yes continues to make progress with its IP customer migration as multi-platform launch and quality content are popular among customers. As of the last few weeks, yes took another significant step with the launch of the yes+ service for Android devices. Together with our STING TV, there was a significant increase in IP broadcasting while we continued with our basic satellite broadcasting as well.

Turning to Slide 23 – High rates of customer satisfaction translated into a return to growth in subscribers. In the first quarter, yes returned to subscriber growth for the

first time since 2018 and added 1,600 subscribers, while also improving financial and operational metrics.

Moving to Slide 24 – I'm pleased to share that Pelephone continued to increase subscribers for the fourth consecutive year and in the first quarter added 29,000 subscribers.

On Slide 25 – Bezeq International continues to maintain its position as a leading player in the ICT market and recently won a number of tenders for projects with large customers. COVID-19 led to a significant increase in corporate demand for larger bandwidth based on Bezeq International's Internet infrastructure both for businesses as well as private customers. In addition, there was an increase in demand for remote access solutions, cloud services and the use of videoconferencing platforms.

Moving to Slide 26 – While subsidiary revenues experienced a small decline year over year, the companies continued to streamline through synergy processes that resulted in a decrease in the key expense items.

On Slide 27 – Specifically, the streamlining processes resulted in a decrease of 15% in salary expenses over a two-year period.

On Slide 28 – Adjusted net profit for the quarter grew to 20 million shekels due to an increase in subscribers and ongoing reduction in expenses that offset the revenue decrease.

I would now turn the call back to Yali who will update you on our 2020 outlook.

Yali Rothenberg (CFO, Bezeq Group):

Thanks Ran. As stated previously, given the outbreak of the COVID-19 pandemic and the resulting and ongoing uncertainty in the global and local economy, at this stage, we are unable to publish an accurate outlook for the Group's results for 2020.

We consider it important to continue to provide guidance and will therefore continue to closely monitor developments in the coming months, and will consider, depending on the situation, the appropriate date for publishing a forecast for the Group's 2020 results.

Let me remind you that we will be holding a virtual analyst conference in Hebrew for the local market after this call.

This concludes our prepared remarks. Operator, let's begin the Q&A session.

Operator: Thank you. Ladies and gentlemen, at this time we will begin the question-and-answer session. If you have a question, please press star-one. If you wish to cancel your request, please press star-two. If you are using speaker equipment, kindly lift the handset before pressing the numbers. Your questions will be polled in the order they are received. Please stand by we poll for your questions. *[pause]* The first question is from Tavy Rosner of Barclay's. Please go ahead.

Tavy Rosner (Barclays): Good afternoon. Thanks for taking my questions. First one for Shlomo, if I may. Over the few past quarters we've been talking about the outlook for fiber at Bezeq, and the key takeaway was that without any ministry in place that would be difficult. So, I guess, given the fact that a new one was appointed last week, how do you see the outlook? And, I guess, have you guys already discussed with the MOC since the new appointment? Any additional color would be helpful.

Shlomo Rodav (Chairman, Bezeq Group): Let me begin, and then Dudu can provide you additional information. It's good that at last in Israel we have a government, and an appointed Minister of Communication. We hope that the minister will see – and the ministry itself – will continue with the existing plan that the ministry have. And it doesn't matter whether we like it or not. We believe that it's better to implement a not perfect plan, rather than re-evaluating the whole story from the beginning, which will only result in months of additional delays. We understand that the ministry is prepared with its recommendation and plans, and the question is whether they will pass it through a normal procedure or through the Arrangements Law in the forthcoming annual budget, which may speed things up. The minister came with a statement yesterday that he's looking for a universal service obligation. In the current framework, there is some solution for this, but we hope that it will not mean that the whole issue will be reopened and reconsidered. Although, as we say, we don't believe it's a perfect plan by the government, but at least in my opinion, a non-perfect plan for execution is better than looking and studying what's a perfect one for the future. Dudu?

Dudu Mizrahi (CEO, Bezeq Fixed-Line): Just to add that, referring to your question, we haven't met the new minister yet. Hopefully we'll have that meeting in the coming days. As Shlomo said, we are looking forward for them to push forward the fiber plan.

Tavy Rosner (Barclays): Understood. That's very helpful. And, I guess, my second question was with regards to the OpEx, the group level. So you did flag the fact that OpEx has been going down since you started the streamlining measures. Where do we stand in terms of the streamlining measures? I mean it's a multi-year plan, and you already started to do a lot. I guess, the first question and the second would be, first one on the employee side. What's the outline? And on the non-employee-related side, in the past you talked about closing down offices, or moving out of your headquarters,

out of Tel Aviv, I guess – is there an outline and a way for us to quantify the savings down the road, on an OpEx side?

Dudu Mizrahi (CEO, Bezeq Fixed-Line): We have a long term plan, in terms of streamlining the business, both in Bezeq and in the subsidiaries, and we are doing our best to follow that plan. Both in terms of employee streamlining and other things, like real estate and all kind of other costs. And there's not – nothing much to update, other than, we're trying our best to follow that plan.

Yali Rothenberg (CFO, Bezeq Group): Just to add on this note, Tavy, for the facts of the numbers that you can already see in our financial statements. So you can already see both on operating and salary costs since the beginning of 2019, we already gained 200 million shekels. So just proves to you, we have spoken of this before, and we already have put numbers in.

Tavy Rosner (Barclays): Yeah, that's really helpful. I think, a quick last one, if I may. You talked also about the debt level, with the net debt to EBIDTA being one of the lowest in recent history. And, I guess, – can that trigger an improvement of your debt rating, down the road? And therefore even further decrease your interest payments? Are you anywhere near that, in the near future?

Yali Rothenberg (CFO, Bezeq Group): So, right now, we are rated AA- (minus) with a stable outlook, or equivalent, in both rating agencies. We are satisfied to be in this vicinity of the rating. I don't think you'll see a rating increase in the near future, and we are firm in our intention to keep this rating.

Tavy Rosner (Barclays): Thanks, guys. Much appreciated.

Operator: The next question is from Ondrej Cabejsek of UBS. Please go ahead.

Ondrej Cabejsek (UBS): Hi there, and thank you for taking my questions. I wanted to ask, could there be an improvement across trends, especially with certain KPIs and ARPU trends. So, I was wondering, just directionally, in terms of what you're seeing, in this pandemic, specifically around TV and fixed broadband, has clearly been sequential improvement for a couple of quarters now. Based on what you're seeing today, what should we expect in these trends for the next couple of quarters? Do you expect, for example, that you could turn around the fixed broadband business in the current environment in terms of net adds? That would be my first question, so TV and then fixed broadband in particular, please.

Yali Rothenberg (CFO, Bezeq Group): Dudu will take the question on the fixed broadband trends and ARPU, and then Ran will take the question on the TV.

Dudu Mizrahi (CEO, Bezeq Fixed-Line): So, the growth in ARPU on the fixed broadband market is – in Bezeq – is mainly based on our customer premises strategy, which consist of the BE router and other services that we install in the customer premises, and value added services. That's what is fueling the growth in ARPU over the last few quarters, and we expect that to continue. We are still selling those services in very high numbers. We expect that to move forward more or less at the same trends that we've seen over the last few quarters. In terms of churn, you could see that the churn rate on fixed line broadband declined dramatically. This is basically a trend that we're seeing over the last few quarters, and we hope to see it continue over the next few quarters ahead.

Ran Guron (CEO, Pelephone, Bezeq International, yes): This is Ran. As for TV services, what we see is a relatively stable ARPU, that it is decreasing over time because we sell more Sting TV which is our discount product. The ARPU mix takes it down a little bit, but it's relatively stable. As for net adds, we grew in the first quarter. Fourth quarter of last year was a little behind, but the overall trend is improving. We expect that to continue, so less churn, and ARPU decreasing, but moderately.

Ondrej Cabejsek (UBS): Thank you. And just a question on mobile, similar one. So, you reported an improvement and, obviously you're continuing to grow your customer base. But then in terms of ARPU, could you quantify what impact the roaming hit that you mentioned in the press release had in the quarter on your ARPU trends. And is there any visibility on, you know, ARPU floors relative to what you're seeing commercially happening in the market? Because clearly you're doing a good job in terms of net additions, but the net is a bit diluted by the ARPU trends, which don't seem to be improving by that much. So, any comment on that would be helpful.

Ran Guron (CEO, Pelephone, Bezeq International, yes): Well, I'm not going to give any projections about ARPU or commercial trends in the market. We'll see how the market behaves. But we're doing a job in the last four years in compensating by growing the number of customers over the ARPU erosion, which brings us to a minor decrease. As for roaming, roaming takes a few shekels out of the ARPU and we have to see how that behaves. We assume roaming will come back and will reach 50% of normal revenues, and fly by December. But the summer is the high season, this summer we'll have, almost a shutdown. This is the effect that we describe in our projections about the loss because of roaming services.

Ondrej Cabejsek (UBS): Thank you. A final question from me, if I may. In terms of

working capital and receivables, you mentioned some potential issues with the B2B segment. Are there any comments that you can give in terms of, you know, about that, expenses, or receivables, growth related to the current crisis?

Yali Rothenberg (CFO, Bezeq Group): Okay, this is Yali. So far we haven't seen a worsening in our collection of receivables. The situation is better relative to what we initially thought. We think that a part of the collection might be postponed to next year. But we thus far haven't seen a substantial worsening in that or – to that end.

It's okay. We analyze everything by different customer bases. We know the differences between them, lines of business, etc. And so far – there are some reasons for that, but so far, we see the debt collection behaving in line with what we thought.

Ondrej Cabejek (UBS): Great. That's all for me. Thank you very much.

Operator: The next question is from Avraham Keren of Halomot Itzhak. Please go ahead.

Avraham Keren (Halomot Itzhak): Good afternoon to everyone, and wonderful result in an unstable environment. I have a few questions. The first one is regarding the influence of the work force that went to work at part time, or 70 or 80% in the second quarter, at April. How much can we see a decrease in the work force cost at the second quarter of 2020?

Yali Rothenberg (CFO, Bezeq Group): I'm sorry, we can only talk about the results of the first quarter of 2020. We don't give forecasts for the results of the second quarter. We can say that in all of the group companies, many of the employees did still work. Most of the work force still worked, because we are considered essential companies-infrastructure companies. We've had employees who took some leave of absence or vacation, and gradually are coming back. So that's my comment on this.

Avraham Keren (Halomot Itzhak): Okay. And the second question is regarding the fiber. Can we see – I heard before that there is a new government, that you guys said, and there is maybe a new ministry that is more open to move ahead, even if it's not the best for Bezeq. But do we see any schedule regarding that issues, of the fibers?

Shlomo Rodav (Chairman, Bezeq Group): Well, currently, there's no real schedule for that. The new minister has just entered his office, and we hope that in the coming weeks we'll have more details regarding the ministry's plan of moving ahead with the fiber deployment.

Avraham Keren (Halomot Itzhak): Okay. And the last question is regarding the CapEx of the fixed line. Are we supposed to see any increase or increases due to the Covid epidemic regarding costs of – of things that are related to the CapEx?

Avraham Keren (Halomot Itzhak): The CapEx of the fixed line. Do we see any changes in costs of services regarding the CapEx, or the costs of materials, cost of shipping, cost of whatever it is, on the CapEx?

Yali Rothenberg (CFO, Bezeq Group): No, not as a result of the Covid-19.

Avraham Keren (Halomot Itzhak): Okay. Thank you very much, and wonderful results.

Yali Rothenberg (CFO, Bezeq Group): Thank you.

Operator: If there are any additional questions, please press star-one. If you wish to cancel your request, please press star-two. Please stand by while we poll for more questions. *[pause]* There are no further questions at this time. I would like to remind participants that a replay is scheduled to begin in a period of 3 hours, on the company's website, at <https://ir.bezeq.co.il/>. Mr. Rothenberg, would you like to make your concluding statement?

Yali Rothenberg (CFO, Bezeq Group): I would like to thank you all for taking the time to join us today. Should you have any follow up questions, please feel free to contact our Investor Relations department. Management looks forward to speaking to you on the Second Quarter 2020 Earnings call. Thank you.

Operator: Thank you. This concludes Bezeq's First Quarter 2020 Results conference call. Thank you for your participation. You may go ahead and disconnect. *[End of conference call.]*

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