

"Bezeq" The Israel Telecommunication Corp., Ltd.



Event Transcript

Q3 2022 Financial Results

Wednesday, November 16th, 2022, 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 second 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. 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.

Q3 2022 Financial Results**Tobi Fischbein**

Welcome everyone, and thank you for joining us on Bezeq's 2022 third-quarter earnings call. I am Tobi Fischbein, Bezeq Group CFO. With us from the Bezeq Group's senior management team are Mr. Gil Sharon, Bezeq's Chairman, Mr. Ran Guron, Bezeq's CEO, and Mr. Ilan Sigal, CEO of Pelephone, yes and Bezeq International.

Before we start, I would like to draw your attention to the Safe Harbor statement on Slide 2 of our Q3-2022 investor presentation, which also applies to any statement made during today's call. We would like to inform you that this event is being recorded. After presenting our quarterly results, you can ask questions by raising your hand virtually. Let me now turn the call over to our Chairman, Mr. Gil Sharon for his opening remarks. After his introduction, I will continue the presentation of our group financial highlights, followed by Ran, who will discuss Bezeq Fixed Line results, and Ilan, who will conclude with the results of our subsidiaries.

Gil Sharon

Thank you, Tobi. Let's start on Slide 3. We posted strong financial results in the third quarter of the year, which stand out positively versus the background of the economic turmoil that the world is experiencing, and due to the successful implementation of our growth strategy. We continued to emphasize investment in growth related infrastructure, which are well reflected in our third quarter results. In fixed-line, we had record take up of 51 thousand fiber customers and continued growth in retail broadband ARPU leading to revenue growth of 5% year-over-year. In Pelephone, roaming recovery and continued growth in 5G subscribers contributed to higher ARPU and significant improvements in Pelephone's financial results with a 12% year-over-year increase in revenues. yes launched its TV and Bezeq fiber bundle and we continued to pay down debt and distribute dividends.

Moving to the next slide, in the third quarter we saw solid top-line growth coupled by increases in Adjusted EBITDA and Adjusted Net Profit. On the balance sheet, we reduced our net debt by 600 million shekels, or 10% from a year ago, further improving our net debt to EBITDA ratio to 1.7, from 1.9 in the same quarter last year. We have 233 thousand fiber customers as of today and retail broadband Internet ARPU rose 8.4% year-over-year to reach 116 shekels, another increase of 3 shekels versus the previous quarter. Pelephone continued to show significant improvement, marking the sixth consecutive quarter with a year-over-year increase in service revenues. At the end of Q3 2022, we reached a total of 2.68 million subscribers, of which 753 thousand are on 5G plans. For yes, net subscribers grew by 7,500, the best quarterly result since 2014, bringing our total new subscribers since the beginning of the year to over 12

thousand. In the third quarter, we also launched the “triple” bundle to combine TV and Bezeq fiber, allowing it to address new customers, reduce churn and leverage Bezeq's advanced infrastructure to improve customers' experience.

We are confident in our ability to maintain good results and stability, while still keeping ESG as a focus throughout our decision-making process. In times of uncertainty in the global economy and capital markets, Bezeq offers investors strong and solid financial performance, spanning wide consumer and business customer bases, with sustainable demand for advanced telecom services, allowing us to generate strong cash flows and shareholder returns supported by our dividend policy. Now, let me turn the call back to Tobi to discuss our detailed financial results.

Tobi Fischbein

Thank you, Gil. In the next slide, we present the Group's financial highlights for the third quarter of the year. Revenues in the third quarter of 2022 amounted to 2.26 billion shekels, up 5.6% year-over-year. Adjusted EBITDA increased by 1% year-over-year to 947 million shekels. Adjusted net profit rose 6.4% year-over-year to 314 million shekels in Q3, mainly due to lower financing expenses. Free Cash Flow for the quarter was lower due to the impact of timing differences in working capital in all group companies, mainly payment for frequencies, payment of salaries in advance and timing of payments to the universal fund and early retirement. We expect free cash flow to normalize in the coming periods.

Turning to the next slide, we experienced stable growth across the board for the nine-month period, with revenues increasing by 2.7% year-over-year to 6.74 billion shekels driven by improvements in Fixed-Line and Pelephone. Adjusted EBITDA rose by 1% year-over-year to 2.83 billion shekels and Adjusted Net Profit increased 5.3% year-over-year to 946 million shekels, both driven by improvements in Pelephone. Free Cash Flow at the end of September 2022 was up 22.2% year-over-year to 959 million shekels.

The next slide shows the Group's key operational metrics for the past five quarters. On the Subscribers side, we saw increases in TV, cellular and retail broadband subscribers as fiber take-up offset churn from our copper network. On ARPU, retail broadband Internet grew 8.4% year-over-year, and cellular ARPU increased 5.5% year-over-year. Telephony ARPU was down due to the MOC tariff reduction implemented in Q2 2022.

Moving to the next slide, let me again emphasize Bezeq's financial strength and success in debt reduction. As Gil previously said, by the end of Q3 2022 our net debt decreased by 600 million shekels, or 10% year-over-year.

Moving on to the next slide – We would like to reaffirm the guidance updates made in Q2 2022. Adjusted EBITDA is expected to be in the range of 3.65 to 3.75 billion shekels, Adjusted Net Profit between 1.1 to 1.2 billion shekels, and Capex is expected to be between 1.7 to 1.8 billion shekels. We expect to reach 1.5 million homes passed with fiber by the end of the year. Now Ran will share with you updates on our Fixed Line operations.

Ran Guron

Thank you, Tobi. We finished another strong quarter with record fiber connections of 51 thousand for a quarter-over-quarter increase of 32%. The number of homes passed reached 1.48 million with 233 thousand fiber-connected customers as of today. Total revenues increased 5% year-over-year mainly driven by broadband Internet and business sector revenues. We achieved this strong performance despite the impact of the MOC telephony tariff reduction in April 2022.

Moving on to the next slide, Adjusted EBITDA was up moderately. Adjusted Net Profit rose by 3.8% year-over-year mainly due to reduced financing expenses. Free Cash Flow was down due to timing differences in working capital. We expect free cash flow to normalize in the coming periods.

Moving to the next slide, for the first nine months of the year, Free Cash Flow was up 7.4% year-over-year, driven by timing differences and improved working capital.

The following slide shows our achievements in broadband Internet that reached revenues of 452 million shekels for the quarter, representing an 11.1% year-over-year increase. Fiber subscriber ARPU increased significantly by 8.4% year-over-year to reach 116 shekels, and average broadband speed grew by nearly 85% year-over-year, reaching 192 megabytes, which is another record for us.

Moving onto fiber optics on the next slide. We continue to deploy fiber nationwide and have increased our focus on customer take-up for a record 51 thousand net adds in Q3. Customers with the Be Router reached 733 thousand by the end of this quarter, approximately 72% of our retail customers.

As shown in the next slide, the business sector continues to gain momentum with a 4.8% year-over-year revenue increase in transmission and data, as well as 3.8% year-over-year growth in cloud and digital services. Other revenues grew 33.3% year-over-year to 80 million shekels due to the Blue-Raman submarine cable project with Google, as well as other infrastructure development projects.

Moving forward to the next slide, we detailed our expenses and showed a slight salary increase due to employee recruitment related to the fiber project. Operating expenses were up in the quarter due to higher subcontractor and equipment expenses also related to the fiber project.

Moving to the next slide, in summary, our growth in broadband and in the business sector have offset the negative impacts caused by the MOC telephony tariff, and the accelerated fiber deployment combined with the increase in fiber customers has further solidified our strong position in Israel. Our robust results prove our strategy, and we continue to be very confident in our growth potential moving forward. With that, I'll now turn the call to Ilan to talk about Bezeq's subsidiaries.

Ilan Sigal

Thanks, Ran. I am happy to be back with the Bezeq Group during these very exciting times and looking forward to leading our subsidiaries towards future growth.

Moving to the next slide, Pelephone posted strong results with its sixth consecutive quarterly increase in service revenues driven by a recovery in roaming revenues as well as an increase in subscribers and 5G plans. As of today, Pelephone has 753 thousand subscribers with 5G plans.

In the next slide, we can see that total Pelephone revenue grew 12.4% year-over-year and reached 608 million shekels, the highest quarterly result in three years. Adjusted EBITDA increased 22.8% year-over-year to 205 million shekels, and Adjusted Net Profit grew 129% year-over-year to 55 million shekels.

Free Cash Flow is lower for this quarter, with CapEx increasing 130.9% year-over-year to 157 million shekels, of which approximately 88 million was due to a payment made to the MOC for frequencies. Most of the amount paid will be credited to us in the fourth quarter of this year.

Moving to the next slide, Free Cash Flow in the first nine months of 2022 was up nearly 530% year-over-year to 264 million shekels compared to 42 million in the corresponding period last year. This increase is mainly attributed to timing differences related to customer debt collection, as well as improved profitability and working capital.

The graph displayed on the next slide shows the continued turnaround in service revenues over the last six quarters, showcasing the strong execution of our strategy.

The following slide shows key operational metrics. Pelephone's ARPU rose 5.5% year-over-year in Q3 2022, while total subscribers increased by 5% year-over-year to reach over 2.67 million, of which 39 thousand were added during the quarter.

Moving to the next slide, yes posted the highest quarterly subscriber growth since 2014 with 7,500 net adds in Q3 and over 12,000 since the beginning of the year. yes is the largest IPTV operator in Israel today with 317 thousand customers watching TV through IP broadcasting, of which 103 thousand are STING TV customers. During the quarter yes continued to market agreements with Disney plus and Discovery plus.

Looking at the key financial metrics for yes in the next slide, revenues were down slightly due to lower ARPU caused by the change in subscriber mix with growth in STINGTV. Profitability metrics were down due to an increase in content expenses as well as salary expenses impacted by the collective labor agreement.

Moving onto the following slide, we see stable Revenues and Adjusted Net Loss. Free Cash Flow was impacted by timing differences and payments for content.

The next slide shows yes' key operational metrics. Net subscribers grew by 2.7% year-over-year to 575 thousand, and 55% of yes subscribers are now watching IPTV as we move toward our goal of 100% IP by 2026.

Turning to the next slide – Bezeq International in Q3 2022 achieved good results with revenue and profitability growth. Growth in cloud solutions and business services, including the CloudEdge acquisition, helped offset the reduction in ISP revenues. During the quarter, we reached an understanding with the labor union for the voluntary retirement of permanent employees that will result in significant cost savings.

On the next slide, for Q3 2022, Bezeq International saw an 8.4% year-over-year increase in revenue due to growth in business services, driven by increased cloud and integration services activities. Adjusted Net Profit increased by 111.1% year-over-year to 19 million shekels due to lower depreciation and amortization expenses.

Moving to the next slide, revenue in the first nine months increased 1.2% year-over-year to 920 million shekels. Adjusted Net Profit was 30 million shekels, an increase of 130.8% year-over-year, and Free Cash Flow decreased to 51 million shekels due to timing differences in working capital. Now, with that, let me now turn the call back to Tobi for concluding remarks.

Tobi Fischbein

Turning to our last slide, Bezeq's Q3 results show strong results and growth in numerous metrics, once again testifying that we are on the right track with our strategy. Moving forward, we are devoted to continuing our momentum in implementing the growth strategy by advancing our fiber optics deployment, focusing on fiber take-up, promoting additional subscriber growth in Pelephone and yes, and generating cost-efficiencies across the Group.

I would also like to mention that we will attend two conferences over the next few weeks to further engage with investors and analysts. The Morgan Stanley European Technology, Media, and Telecom Conference in Barcelona tomorrow, November 17th - and the UBS TMT Conference in New York on the 5th and 6th of December. We look forward to meeting you there.

With that, I will open the Q&A session. If you would like to ask a question, please raise your hand virtually using the "Raise Hand" button in the "Participants" tab. In the mobile app, you can raise your hand by tapping the "Raise Hand" option in the "More" tab. As you hear your name, please be sure to unmute your microphone, and ask your question. For the benefit of the people in the room, please introduce yourself and share the name of the company you represent. We will address questions as we see the hands raised. If you later change your mind about raising your hand, you can lower it by clicking "Lower Hand." I will now pause to poll for questions. The first question is from Tavy Rosner. Good afternoon, Tavy. Tavy, we can't hear you.

Tavy Rosner (Barclays)

Hi. Can you hear me?

Tobi Fischbein

Yes. We can now hear you. Hi, Tavy.

Tavy Rosner (Barclays)

Hi. Sorry, I couldn't unmute myself. I wanted to ask about regulations. Are there any topics that we should be aware, something that's in the pipeline with the MoC, something that might weigh positively or negatively on Bezeq in the coming quarters? I'm asking in the context of the new government being formed. Are you hearing anything against Bezeq, like we've seen in the past when we had some populist minister taking charge of a specific portfolio. So, I guess, my question is, anything we should be worried about?

Gil Sharon

Hi, Tavy. It's Gil. It's too early to say. We do not know yet who will be the next minister,

but on the professional team's table, we know that we have the issue that they started exploring in regards to the business sector at Bezeq Fixed Line. We talked about that in the past already. And there's the examination of the wholesale prices. Again, it's work in progress. They hired Axon, an international consulting firm, and work is being done. So these are the things that we already know about and talked about in previous calls. We do not see any new issues on the table, and of course, we cannot predict what the new minister would bring. So, it's, again, nothing new but it's too early.

Tavy Rosner (Barclays)

Thanks for that. I wanted a follow-up on the dividends. How should we be thinking about the payout policy in the future? On the one hand, you generate significant free cash flow and you do invest a lot in the fiber infrastructure. So should we assume that unless the investment is done, you will not be raising the payout ratio for now?

Tobi Fischbein

I will take that question. As you know, we reintroduced dividends with a formal dividend policy as of Q1 of this year, and it's a bit too early to change it. Looking forward, as long as our business momentum continues and we continue to generate significant free cash flow, as you mentioned, we do see the potential for some increase in the payout ratio - but this is something that will be discussed, probably at the beginning of next year.

Tavy Rosner (Barclays)

Okay, great. Thanks for taking my questions.

Tobi Fischbein

Thank you. The next question is from Ondrej, from UBS. Let me please ask that whoever is asking questions, if you can open your cameras, it will be helpful for us. Hi, Ondrej. Ondrej? Can you open your microphone, please? Great.

Ondrej Cabejsek (UBS)

Hi. Apologies. I did that and it reverted, for some reason. So, hello, everyone, Ondrej here from UBS. Thanks for the presentation, congratulations on the results. I wanted to follow up on regulation, but more backward looking, too. You entered this year with a cautious guidance, citing several impacts from the change in regulations. I was just wondering if you can give us an update, in terms of what impact you're seeing. Whether, for example, the rate cut on the fixed voice, and the impact that it has on the business, is progressing as expected. Same thing with the wholesale changes and the ISP changes. Second question, on the fiber home pass. It seems like you're very close to achieving the 1.5 million target of homes passed. Is this something you feel you will maybe exceed, even the upgraded target? And whether you're planning to apply to

invest in the additional areas that you were not initially targeting. And third question, if I may, just a general comment around competition in fiber and mobile. So, in fiber, last time, you commented on more competition in the ISP fees, and – and mobile, obviously, we've had some consolidation, some upward pricing in terms of 5G and also, just general price increases. So if you can just generally comment on the competitive landscape in both fiber and mobile. Thank you.

Tobi Fischbein

Let me just make sure we understood all of your questions. The first one was about the regulatory impact on, mainly, telephony, ISP and wholesale. These are things that have happened already. We will discuss this in a moment. The second one is about fiber deployment and take-up. And the third one, if you could just repeat it, because I didn't get it.

Ondrej Cabejsek (UBS)

Yes, the third question is just a general comment on competitive dynamics in terms of fiber and mobile, in particular, please.

Tobi Fischbein

Great. So, let me suggest that Ran start with the first questions, and then we will share with Ilan.

Ran Guron

I'll take the first two questions, and maybe part of the third question. The MoC tariff reduction is working as expected. We are quite satisfied that we can offset some of the reduction by increased broadband revenues, but it is working as planned. For the ISP, we do not publish the figures, but we are very satisfied with the pace. It is progressing better than we expected, but those figures are not out yet. As for homes passed, we published guidance of 1.5 million homes by the end of this year. We have not published the estimates for 2023 yet, but we are ahead of plan, and it helps us in take-up as well. I believe the third question, you asked about was the competitive momentum, or competitive arena in the fiber. So, it's a highly competitive market. We are gaining momentum, getting some market share back, but we still have a long way to go before we can lead this market in terms of retail customers. However, as you saw, our pace is picking up, so it looks better for us, and we continue to accelerate the fiber take-up.

Ilan Sigal

About the mobile, I'll take that question. Pelephone was the first player that launched 5G and as of now we have over 750 thousand customers that have 5G packages. As you know, we have more than 2.6 million customers, so probably there will be more and more Pelephone customers that will transfer from regular packages to 5G

packages. So we see a future of customers that will move to 5G plans.

Ondrej Cabejsek (UBS)

Thank you very much.

Tobi Fischbein

The next question is from Jerry Dellis. Hi, Jerry.

Jerry Dellis (Jefferies)

Hi, yes. Good afternoon, everybody. Thank you for taking my questions. I've got three questions, please. Firstly, in relation to your full year 2022 guidance. Looks to me as though you're sort of on track to beat high end on, net income, and also EBIDTA. Be grateful for your thoughts as to whether that is the case, and how management will think about the appropriate guidance range over the next few weeks. Secondly, in relation to free cash flow. I think consensus is looking for about 1.4 billion shekels of free cash flow for the full year, which would imply about 400 million in Q4. Could you discuss with us whether that's a sort of a doable objective? And perhaps go through some of the moving parts on free cash flow in Q3. I understand there were some sort of exceptional one-time payments, some of which might reverse into the fourth quarter. And then, finally, please, in relation to retail broadband customers. Your retail broadband base across the group has been extremely stable over the last few quarters, even as the retail fiber base has been increasing. I understand it's a competitive market, but could you explain to us how the retail base has been kept that stable. Is that essentially a management decision to keep it stable? And in terms of the retail fiber net ads, where are those coming from in terms of internal upgrades versus new customers being sucked into the base? Thank you.

Tobi Fischbein

Thank you, Jerry. I'll take the first two questions and let Ran address the third one. Regarding our full year guidance for 2022 - we didn't change it this time. At the end of the day, not every quarter is the same. As you remember, part of the regulatory changes came in April only. So the second half of the year has two full quarters with lower tariff reductions versus the first half of the year. That's one part of the answer. The other part is that we are really looking to end the year around the higher end of the range that we gave. However, as long as we don't see that for sure we will go above it by more than 5%, which is the threshold that we said, we didn't feel that it was right for us to update the guidance right now. On the second question, regarding the free cash flow. Perhaps it's a good opportunity to explain the timing differences that we had in Q3. Some of which related to Q2 and others to Q4. There were about four or five timing differences across the group, which in total amounted to about 350 million shekels. If you add that to the Q3 free cash flow, you will see that it's more or less the same as

the same quarter last year. Across the group, we made payments for the universal fund. This is about 45 million shekels group wide, and this year it was paid in September. Last year it was paid in October, in Q4. At the subsidiaries, we made advance payments for salaries, due to the timing of the Jewish Holidays in the beginning of October. We made these payments in September, versus last year in October. We paid employees at Bezeq Fixed Line 35 million shekels in July for convalescent pay and historically we usually pay this in April. We made a significant payment to employees for early retirement at Bezeq Fixed Line on the first of July versus last year on June 30th. Just one day of a difference, but it's a 100 million shekels difference. And then, there were some VAT payments that were postponed last year from Q3 to Q4, and this year we paid them in Q3. The last one, which is quite large, is at Pelephone. We paid 88 million shekels, Ilan mentioned this before, for frequencies following the tender that was made two years ago. We will be receiving a credit for most of this payment in Q4. So it's just timing. We don't give specific guidance on free cash flow for a specific quarter, but we plan to end the year not far from where you mentioned before. Ran?

Ran Guron

I'll address the retail customer base. First of all, we returned to growth this quarter. So this is good news for us, and it's been after a while. Our plan is to continue to grow in retail customers, and we are satisfied to see a good beginning at that. Of course, the main effect is on fiber, as long as we recruit more and more fiber customers, it reflects on our ability to grow in the retail market as well. Even though we don't break down that number, we have around one million retail customers, of which, still not a large enough portion is fiber. We have a lot of work to do there, in upgrades, and new customers. We do not release the number, but we were surprised by the number of new customers that we recruited both by Bezeq, and by yes, who started to sell their bundle of Internet and TV. We are quite satisfied with that, but there is a lot of work to do in the future.

Jerry Dellis (Jefferies)

Just as a follow-up, please, if I may. Of your retail fiber intake, is it possible to get some idea as to the rough proportion that are new customers to the Bezeq platform?

Ran Guron

We do not release this number - but it's quite significant.

Jerry Dellis (Jefferies)

Thank you.

Tobi Fischbein

Thank you, Jerry. If there are no further questions at this time, 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. We look forward to speaking to you on the fourth quarter 2022 earnings call in March of next year. Thank you and have a nice day.

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