"Bezeq" The Israel Telecommunication Corp., Ltd.

Event Transcript

Q2 2024 Financial Results

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Tobi Fischbein (CFO, Bezeq Group): Welcome everyone and thank you for joining us on Bezeq's 2024 second quarter earnings call. I am Tobi Fischbein, CFO of the Bezeq Group. Joining us from the senior management team today, we have Mr. Tomer Raved, Bezeq's Chairman, Mr. Nir David, Bezeq's Fixed-Line CEO, and Mr. Ilan Sigal, CEO of Pelephone and yes. Before we start the call, I would like to direct your attention to the Safe Harbor statement on Slide 2 of our Q2-2024 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, we will have a Q&A session. With that said, let me now turn the call over to Tomer, for his opening remarks. After his introduction, I will continue the presentation of our group's financial highlights, followed by Nir, who will discuss Bezeq Fixed Line results, and Ilan who will cover the results from Pelephone and yes. I will conclude the presentation with Bezeq International results.

Tomer Raved (Executive Chairman, Bezeq Group): Welcome everyone. Let's start on Slide 3. We continued to grow in our strategic drivers, which resulted in a 64% year-over-year increase in fiber take-up, 28% in 5G subscriber plans and a 6% increase in retail broadband ARPU. Both the second quarter and first half of the year results were affected by the continuation of the war in Israel. Despite this complex period, the group has shown stable core revenues and continued progress in our strategy execution - in fiber, 5G and the transition of TV subscribers to IP, along with strong free cash flow year-to-date. The group's profitability year-over-year was negatively impacted by the second tranche of the MOC telephony reform as well as several infrastructure projects that had positively impacted the corresponding quarter. Additionally, there were non-material impacts from the war, given the decrease in cellular roaming revenues and the voluntary non-billing of evacuated communities in the conflict areas. In addition, the quarter saw several developments in the regulatory environment, more specifically in the process for the removal of the structural separation by the Ministry of Communications, a hearing on the shutting down of the copper network, the wholesale market, and the universal fund. The board of directors recommended the distribution of 407 million shekels in accordance with our dividend policy, resulting in a 4% increase in terms of the total dividend amount compared to the corresponding period. On the following slide, we present the highlights of the quarter. I want to point out that free cash flow declined this quarter mainly due to timing differences in working capital, but we reported 10.8% growth for the first half of the year. The next slide shows key indicators by business. Bezeq Fixed-Line had 59 thousand fiber net adds in Q2-2024. The retail broadband ARPU is growing nicely, increasing to 129 shekels. On the mobile side, we saw continued growth in our 5G subscriber plans, reaching 1.2 million subscribers as of today, equivalent to 52% of total postpaid subscribers. Slide 6 shows where we are today in the evolution of all our businesses as well as the roadmap for the mid-term. We are on target to reach the completion of our fiber roll-out with a 40% take-up rate, reach 80% of mobile subscribers on 5G plans and complete our satellite to IP migration. Our execution on our strategy continues to be successful, and we will remain focused on free cash flow growth in the medium-term. Now I would like to turn the call over to Tobi, to discuss the financial results in more detail.

Tobi Fischbein: Thank you, Tomer. Slide 7 shows a 0.9% decline in core revenues due to lower revenues from infrastructure projects in Bezeq Fixed-Line and lower roaming revenues in Pelephone impacted by the war. Adj. EBITDA and Adj. Net Profit were impacted by lower telephony revenues, timing of infrastructure projects and the impact of the war – lower Pelephone roaming revenues and the non-billing of customers in the line of conflict, mainly in Bezeq Fixed-Line and yes. In the next slide, the half year results show a 0.6% increase in core revenues with free cash flow growth of 10.8%. Free cash flow in the last 12 months was approximately 1.4 billion shekels. Turning to the next slide, we show our operational metrics. I would like to highlight the 6% increase year-over-year in our retail broadband ARPU along with a continued increase in cellular and 5G subscribers, as well as a sequential increase in cellular and TV ARPU. The next slide shows a decrease of 400 million shekels, or 7% year-over-year, in our net debt to 5 billion shekels. We remain committed to maintaining our high credit rating, which improved in Q2 and provides further support to our dividend policy, which as of today reflects a 7% dividend yield. I will now turn the call over to Nir, who will share more detailed results from our Fixed-Line operations.

Nir David (CEO, Bezeq Fixed-Line): Thank you, Tobi. On the next slide, Fixed-Line core revenues decreased 1.8% due to lower revenues from infrastructure projects and were partially offset by higher revenues from broadband services and transmission and data communications. Fiber take-up continued to grow while broadband retail ARPU rose 5.7% to 129 shekels. This quarter, we launched our electricity supply activities and JV with Powergen. On the following two slides, we show that revenues and profitability metrics in the second quarter and in the first half were impacted by the MOC telephony tariff reduction in July 2023 as well as timing of infrastructure projects. Turning to slide 14, in the second quarter we saw moderate growth in broadband revenues mainly due to a decrease in wholesale tariffs for use of the passive network.

Moving to the next slide, we show the take-up trend. Q2 saw 35 thousand retail fiber net adds and 24 thousand wholesale fiber net adds. Turning to the next slide, we show continued fiber deployment with an increased focus on take-up. Today, we have over 2.3 million homes passed and more than 700 thousand active subscribers in our fiber network, resulting in continued growth of our take-up rate, which has reached approximately 30% as of today. Slide 17 shows continued revenue growth in the second quarter of 2024 in Transmission & Data Communications. Telephony revenues declined, as explained, due to the second reduction in MOC tariffs, and Other

Revenues were impacted by the completion of various infrastructure projects in the corresponding quarter, including Bezeq's part in the Blue-Raman submarine cable. The next slide shows a 5.1% decrease in operating expenses due to lower sub-contractor expenses related to fiber deployment and infrastructure projects, partially offset by higher advertising expenses. With that, I'll now turn the call to Ilan to discuss Pelephone and yes.

Ilan Sigal (CEO, Pelephone and yes): Thank you, Nir. Moving to the next slide, Pelephone posted growth in revenues, Adjusted EBITDA and Free Cash Flow despite the impact of the war on roaming revenues. The results were driven by higher ARPU from cellular plans and an increase in equipment revenues. In addition, 5G subscriber plans continued to grow with 60 thousand net adds in the quarter. Moving to slide 20, we show 5G subscriber plans reached approximately 1.2 million subscribers as of today. Subscribers on 5G plans amounted to 45% of total subscribers and 52% of total postpaid subscribers. Revenues from services were stable year-over-year, despite the impact of the war on roaming revenues. On the next slide, total revenues rose 1.2% and Adjusted EBITDA increased 2.1%. Free cash flow improved significantly due to the payment of frequency fees for all 2023 in the corresponding quarter when compared to the quarterly payments in 2024. We saw similar trends in the half year results. Slide 23 shows the Q2 key operating metrics. As you can see, we saw a continued increase in postpaid subscribers, including 5G subscriber plans and a decline in prepaid subscribers due to the impact of the war. ARPU rose 1 shekel from the previous quarter despite the impact of the war on roaming revenues. This is our second consecutive quarter with an increase in ARPU. Turning to yes on the next slide. We continued the migration from satellite to IP with 440 IP thousand customers today. We continue to grow in fiber subscribers and have reached 60 thousand as of today. In addition, we recently signed an agreement with Partner for the distribution of STING+ to its customers, which is subject to certain approvals. The Q2 and half year financial highlight slides show declines in revenues and profitability mainly due to increased market competition and the non-billing of customers in the line of conflict due to the war, as well as higher sales of content in the corresponding periods. The decrease was partially offset by higher revenues from the TV/fiber bundle. On slide 27, we show yes' Q2 key operational metrics. yes saw continued growth in IP-based TV subscribers, which increased 18.4% in the period. As of today, 80% of yes subscribers are watching TV through IP. We also saw continued growth in fiber subscribers, up 163%. With that, let me now turn the call back to Tobi.

Tobi Fischbein: Thanks, Ilan. Moving on to Bezeq International, revenues were impacted by lower consumer and business ISP revenues due to the MOC unified Internet regulatory reform, as well as lower ILD revenues. The decrease was partially offset by higher ICT revenues from cloud services and data centers. On the next slides, we saw similar trends in the quarterly and half year results. Let me point out that

Adjusted Net Profit in Q2-2024 increased to 19 million shekels from 13 million shekels in Q2-2023, mainly due to lower depreciation expenses. Free Cash Flow in the quarter and half year was impacted by employee severance payments as well as timing differences in working capital. Turning to the last slide, I want to reiterate that we remain focused on executing our strategy by focusing on our key growth drivers – robust fiber take-up in Bezeq and yes, and a consistent growth in 5G subscriber plans in Pelephone. We continue to focus on ESG and were recently awarded a Platinum rating for the first time by "Maala" rating agency in Israel. Finally, I would also like to mention that we will be attending the following three conferences in September to further engage with international investors. We will participate in Citi's Global TMT Conference in New York on September 4th, Jefferies' Tech Trek in Tel Aviv on September 11th, and Goldman Sachs' European Communacopia Conference in London on September 18th. 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. 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. I will now pause to poll for questions. First question, Sabina.

Sabina Levy (Leader): Hi. Good afternoon. Sabina Levy from Leader Capital Markets. I wanted to ask about the results of the Fixed-Line segment. Especially the infrastructure segment. We are still seeing a decrease in the number of retail subscribers. The quarter looks a little better than the previous one, but still, the numbers are negative. So, I was wondering, how should we forecast the next quarters? And if this trend should continue, or are you taking measures in order to improve the trend? And also, I saw a decrease in the total fiber connections, wholesale and retail together, in the quarter. And I was wondering if it represents the trend going forward or is it something just for this quarter.

Tomer Raved: I'll address that also from a Group perspective. And thank you, Sabina, for the question. First, remember that from the fiber rollout perspective, we are targeting de facto a smaller market. Meaning, if copper subs represent 100% of the households, we elected to deploy slightly less than 90% of the country. So the market shows that Bezeq is targeting 90% on fiber, versus 100%. Okay? We're not allowed to roll out or compete in the more than 10%, which are areas that are covered by the Universal Fund, as you are familiar with. So, put that into perspective. Secondly, from a Group perspective, while retail subs are slightly less on the Bezeq side, although in line with expectations, we also have yes, a very strong growth driver from a retail customers perspective. So together, you actually see growth in our market share, retail market share, from a Group perspective. And from that perspective it's very important, that we count these customers as part of the Group. On the wholesale market, we did see a slightly slower pace this quarter, but we still see all the players using our infrastructure,

including Cellcom and Partner, taking more and more subs on wholesale. And we expect to continue as you see more and more deployment of fiber, which is faster than the pace we planned. You will see the take-up growing on both the retail and the wholesale sides.
Tobi Fischbein: I would like to add to those comments two important facts. One is that the economics of a fiber subscriber are much better than a copper one, and we are increasing our fiber market share. You've seen this over the previous quarters as well. So this is very important. And the other factor is that we are also an infrastructure company. So the blend between retail and wholesale in fiber, as we see the market upgrade themselves over to fiber, it's an important trend that will benefit Bezeq in the long term.

Sabina Levy (Leader): Thank you.

Tobi Fischbein: Thank you, Sabina. Next question from Tavy. Hi, Tavy.

Tavy Rosner (Barclays): Hi, guys. Thanks for taking my question. I only have one. It's about the regulatory outlook. So, in your prepared remarks and the press release this morning, you mentioned seeing a positive horizon for regulation. And I'm always skeptical when we talk about positive outlook for things that are beyond the company's control. So – I'm wondering, is it because you have a high degree of confidence that the outlook will improve? Or it's just based on conversations with the MoC or based on committees happening right now. Anything that you can share will be great.

Tomer Raved: Thank you, Tavy. I'll start. So, first, I don't think we mentioned positive, although I think we mentioned meaningful. And there were meaningful announcements by the MoC over the past few months with a few significant developments. Some relate to competition, some relate to the cellular market, and some to the fixed line market. I highlighted a few of them. One, the discussion around the wholesale market, which we reported, that the MoC is evaluating the need to intervene in the active wholesale market, and it significantly reduced the rates on the passive wholesale market which had, obviously, negative – marginal, but negative impact on the Group. Secondly, the announcement regarding structural separation. The first is the fact that it's under review, that doesn't mean we have a timeline or can quantify the chances of that happening. In addition to that, the decommissioning of the copper network, currently a hearing, is an important development for the market and for the evolution of the telecommunications market. So, all these announcements were meaningful. I don't want to grade them as positive or negative, but they are meaningful to the market, to the competition, and to the Group specifically.

Tavy Rosner (Barclays): Right, that's all for me. Thank you.

Tobi Fischbein: Thank you, Tavy. Next question from Liran Lublin. Hi, Liran.

Liran Lublin (IBI): Hi, guys. Thank you for taking my question. My question is on the TV market, and specifically on yes. We're seeing some movements in the market after many years of nothing really happening. We see the impact, or it's the first time that you stated there's an impact from Free TV, and then there's your agreement with Partner. And still, the numbers from yes are not very good. To say the least. How do you look at it over the coming years? How do you see the Israeli TV market?

Ilan Sigal: Thank you, Liran, for the question. The Q2 results was impacted, first of all by the war, because we stopped charging subscribers in the conflict areas, in the North, and in the South. We stopped from October 7th until now, it's a few million shekels every month. Secondly, the competition is also reflected in the results. Because we see a trend that our customers are moving from premium packages to Sting discount packages. And third, there was a one-time impact from Q2 2023 where we sold content - the Beauty Queen of Jerusalem, and we didn't see this in the current quarter. There is competition in the market right now and yes is actively migrating customers from satellite to IP. We'll see the impact in the next few quarters, until we disconnect from the satellite in 2026. So, those are the main impacts that we see right now in yes.

Tobi Fischbein: I would like to add that even ARPU grew sequentially. I think it's important in a challenging market as Ilan described before, Liran. yes is utilizing various tools to try to maintain both its subscriber base and revenue base, and at the end of the day, undergo this migration from satellite to IP that will enable it, as of 2026, to reduce a significant amount of OpEx, as well as CapEx going forward. This is very important for yes and for the Group.

Liran Lublin (IBI): Thank you very much.

Tobi Fischbein: Thank you. We have another question from Ondrej from UBS. Hi, Ondrej.

Ondrej Cabejsek (UBS): Hi, everyone. Thank you for the presentation and for taking my questions. I've got two, please. Maybe just, first of all, if you could speak about the non-billed revenues that you highlight were a bit of a headwind this quarter. Can you just put some numbers on that, where primarily they are. I presume there may be personal services, but presumably, maybe just on the connectivity side. And what is the outlook going forward. Is this something that you see as very temporary. Is this something that could even get worse over the next couple of quarters? That's one question, please. And then, the second question would be, if you could elaborate a bit more on the impact that you're seeing in international. I think specifically you mentioned some kind of retail impact, primarily due to some migrations, et cetera. So if you could speak a bit about that, please. Thank you.

Tobi Fischbein: Okay. Ondrej, I apologize, but I don't think any of us heard the last part of your second question. If you could please raise your voice a little bit. I got the first question, and the second one is about international, I guess, investors?

Ondrej Cabejsek (UBS): No. You flagged in the report today, some negative impacts from international. And I think it was related to some customer migration. So if you could maybe elaborate on that, and the future of that drag, that would be helpful. Thank you.

Tobi Fischbein: Okay. So you mean at Bezeq International, right?

Ondrej Cabejsek (UBS): Yes.

Tobi Fischbein: Okay. So I'll explain. In terms of the non-billing, since the beginning of the conflict both Bezeq Fixed Line and yes, as of Q4 of last year, have voluntarily stopped billing customers in the conflict areas. That's specifically in the south, near Gaza, and in the north, close to the border. In the first half of this year, these amounts were not significant for the Group. But still, were a couple of dozens of millions of shekels together, both for Bezeq and for yes. Of course, for yes, given the relative size, it's more significant, it's a couple of shekels of ARPU for them. So that's on the first question. On the second question, if I understood it correctly, Bezeq International is undergoing a transition, as a result of the regulatory reform of the unified internet, where we see the consumer business declining. Most of those consumers which were on the ISP side are moving over to Bezeq Fixed Line. And Bezeq International is increasingly focusing on growing in the ICT space. So far it's going well. We see growth in cloud activity, in data centers, and also in some of the integration activities that they are promoting. But this is a relatively longer transition, it's not just, half a year, or even one year. It takes a number of years, I think we said that in the past. And we should also highlight that the company, along with this transition, is being able to streamline their operations and expenses. And I think you have seen that in the quarter, and also in the first half of the year.

Ondrej Cabejsek (UBS): Thank you. And then just a follow up. Is there pressure on the ISP ARPU, due to what's happening in the market? Or it's just a case of pure migration, one to one, from international to fixed, or is there maybe more competition that is leading to some of the dilution now that the regulatory changes are allowing for the ISP unification with the infrastructure bit?

Tomer Raved: So, I want to address this, and also give a little background. The first step in removing structural separation, taking you three years back – structural separation was basically TV, ISP and infrastructure. And the first major step in removing that, because of the different milestones that the market and the company achieved, was fully removing the separation between ISP and infrastructure, allowing Bezeq to offer a unified service similar to the rest of the world. In the past two years this resulted in the migration of customers from Bezeq International to Bezeq Fixed Line. Today, roughly 80% of Bezeq customers are unified customers. Meaning, they have ISP and infrastructure together. I know, Ondrej, for you it is obvious, but for us in Israel, it took a couple of decades to get there. So these are the trends that you see in the ISP market. And as a result, we basically went into a restructuring plan, and a re-transitioning of the business to an ICT business and telco services, which includes the submarine cable, telco services, data centers, and integration services. Basically a newborn ICT that is now reaching slightly less than a billion shekels of revenues, mostly without these ISP customers, the legacy revenue. In our core revenues that we report, we exclude this consumer ISP revenue, because it's just going away, from one side of the house to the other. So don't get confused by the stand-alone Bezeq International picture.

Tobi Fischbein: And in terms of the ARPU that you asked about, although we don't disclose ISP ARPU at Bezeq Fixed Line it's just internet service. We charge what we charge for that, we disclose the total retail broadband ARPU, you've seen that it has increased nicely. So there are two impacts here. One, subscribers that leave Bezeq International, of course stop paying Bezeq International, and are paying what they are paying to Bezeq Fixed Line or maybe to other players. But at the same time, Bezeq International is able to reduce payments to Bezeq in terms of transmission services, to provide those services to the ISP consumers, and at the same time, to streamline their operations, as I said before.

Ondrej Cabejsek (UBS): Thank you.

Tobi Fischbein: Thank you Ondrej. We have a question from Siyi, from Citi. Hi, Siyi.

Siyi He (Citigroup): Hi. Good afternoon. Siyi from Citigroup. I just have two questions, please. The first one, I just want to circle back to your comment on the competition in the TV market. Just wondering if you can just talk us through, where do you see the competition coming from? Are they streaming services, or your traditional telco operators? And if you can talk about the competition in general in Israel on the fixed and the mobile side. And my second question is, I'm wondering if you can give us some indication of the drag from the MoC changes? And also, the roaming, and how should we think about the development for the rest of the year? Thank you.

Tomer Raved: Okay. I'll start, and I'll let the team add. So, different from the rest of the market, we sell fixed line and fiber on one side of the house, and TV and also bundle on the other side of the house. Our competition deviates between internet-only players and bundle players. The TV market in Israel, most of the players are streaming, or offering skinny bundles. There are only two real multi-channel TV players, yes and HOT. We see migration to skinny bundles, our discount model, but still, a lot of the households are paying for multi-channel TV. This market is under very fierce competition. But still, most of the households are not going into cord-cutting trends that you see elsewhere. More than 70% of the households are still paying for multi channel TV, whether it's discount or premium, and we have both. But the market is probably under the fiercest competition between Fixed Line, cellular and TV. TV is the most competitive one, with a lot of rising discount players. Free TV is one of them. And others are also offering skinny bundles. On the fixed line market, we play both the retail and wholesale you are familiar with. It's a two-infrastructure market, which we have the benefit of being the largest infrastructure operator, with now more than 2.3 million households. We will finish the deployment of most of the country by mid-next year, as previously communicated. But there you see a rational market, with rational competition, stable prices, and very high demand for fiber. Both Bezeq, yes and the rest of the players in the market are benefiting from the demand for fiber, both in the number of subscribers, and also in the ARPU and the demand for higher speeds – from 300 to 600 to 1 gig. Now people buying slightly more - 2.5 and 5 gigs, which is what we probably are going to see more in the next three to five years. And we enjoy both worlds - the retail and the wholesale market as well.

Ilan Sigal: I'll talk about TV and mobile. First of all, there is intense competition in the Israeli TV market. Five players, skinny bundles and regular players, multi-channel TV, and also streaming from abroad, the international streamers like Netflix and Disney are also in Israel. But as Tomer mentioned, we see that 70 to 80% of our customers are still using our premium packages, the multi-channel TV. In order to deal with the competition, we are also selling bundles. The TV and the fiber together, and that helps retain our customers in yes. Also, the mobile market has very intensive competition. There are nine players in the mobile market. Pelephone is doing well, as you saw, we are growing, 15 thousand in this quarter, and 60 thousand 5G subscribers, and Pelephone has around 25% market share.

Tobi Fischbein: And I will address the last part of your question, Siyi, which, if I understood correctly, was about the impact of the MoC telephony tariff reduction, and the impact on roaming, in terms of the conflict. Is that right?

Siyi He (Citigroup): Right.

Tobi Fischbein: Okay. So, in telephony, we disclosed these figures in our report, telephony revenues came down by almost 40 million shekels in the quarter, and close to 80 million shekels in the first half of the year. This was fully expected, and as planned, due to the second and last tranche of the MoC driven tariff reductions. On the roaming side, we do not disclose specifically the amounts. But I can say that if you look at our core revenues, the figure increased in the first half of the year, by 0.6% despite the impact of the conflict on roaming revenues and on the non-billing at Bezeq and yes. Had it not been for the war, we would have been at a positive core revenue figure, in terms of change in the quarter, and much higher growth in the first half of the year. I think that that underlines the importance of remaining focused on our strategy and on the growth engines that we have defined in this strategy.

Siyi He (Citigroup): Thank you very much.

Tobi Fischbein: 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 third quarter 2024 earnings call. Thank you.