

# "Bezeq" The Israel Telecommunication Corp., Ltd.



## Event Transcript

### Q1 2021 Financial Results

Wednesday, May 26th, 2021, 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](http://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.

## **Q1 2021 Financial Results**

**Operator:** Ladies and gentlemen, thank you for standing by. Welcome to Bezeq's first quarter 2021 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. Gil Sharon, Bezeq's Chairman, Mr. Dudu Mizrahi, Bezeq Fixed-Line's CEO, Mr. Ran Guron, CEO of Pelephone, Bezeq International and yes, and Mr. Tobi Fischbein, Bezeq Group's CFO.

Before we start, 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. 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.

Let me now turn the call over to our Chairman, Mr. Gil Sharon for prepared remarks. Tobi will then continue the presentation on group financial highlights, followed by Dudu discussing Bezeq fixed line results. Ran will pick up with results of our subsidiaries, after which management will be available to answer questions.

**Gil Sharon (Chairman, Bezeq Group):** Thank you, Naftali. Let's start on Slide 3 – The strategic vision of the Bezeq Group has always been to be the leader of the Israeli telecommunications market, providing a full range of products and services for the residential and business markets. Toward that vision, we are focusing our management attention and resources on the following: 1. Accelerating the deployment of fiber optics in the residential sector as well as continuing to strengthen the business sector in Bezeq Fixed-Line. 2. Continue streamlining and cost reduction in key subsidiary companies and improve free cash flow. 3. We are implementing the restructuring in yes and Bezeq International, which will create two growth-oriented companies - one focused on the growing IT sector, and the other focused on the residential market. Lastly, Pelephone will focus on marketing 5G as a growth engine

to increase revenues and ARPU. All of these initiatives are focused on building infrastructure and growth engines for the future.

Turning to Slide 4 – We continue to push forward our strategy while delivering results. On the financial side, adjusted EBITDA was up slightly year-over-year. Free cash flow amounted to 323 million shekels, allowing us to continue to reduce the Group's net financial debt.

At Bezeq Fixed-Line, we grew revenues for the fourth consecutive quarter while continuing to improve in key operating metrics. At the subsidiary companies, Pelephone continued to grow its postpaid subscriber base, yes improved its free cash flow and increased IP subscribers. Our streamlining efforts also led to a decrease in operating expenses. However, revenues were down year-over-year due to the effect of Covid-19 on mobile roaming. We are pleased to report that the material weakness in internal controls over financial reporting in Bezeq International was removed this quarter.

The Group's strong financial results and accelerated deployment of fiber and 5G infrastructures are laying a solid foundation for our future growth. The Board of Directors approved a plan for structural change in the subsidiaries that will include the merger of Bezeq International into yes as well as the spin-off of the ICT business division to a new and separate company. This decision was driven by the convergence in activities in this sector, commercial and regulatory changes in the respective markets of both subsidiaries, as well as our intent to strengthen their operations through the sale of triple play bundles and to deepen the synergies and efficiencies of the subsidiary companies to generate value for all stakeholders.

Now let me turn the call over to Tobi to talk about our financial results. Tobi brings extensive experience in finance and capital markets as well as in-depth familiarity with Bezeq. Welcome back, Tobi. We look forward to achieving great results together.

**Tobi Fischbein (CFO, Bezeq Group):** Thank you, Gil. I'm very pleased to be back at Bezeq and join its strong and experienced management team and committed employees, just at the beginning of such an exciting and challenging phase of unprecedented infrastructure deployment. I'm excited to get to work and look forward to meeting with investors.

Let's turn to Slide 6 – The Group's strong financial results continued to validate the strength of the Group operations, the diversification of sources of revenue and the ability to streamline expenses. Revenues in the first quarter of 2021 totaled 2.22 billion shekels compared to 2.19 billion shekels in 2020, an increase of 1.6%. The increase

in Bezeq Fixed-Line revenues was partially offset by a decrease in revenues of the subsidiary companies.

Meanwhile, group-wide operating expenses increased year-over-year, mainly due to an increase in expenses in Bezeq International, which was partially offset by a decrease in expenses in yes. Group-wide salary remained stable at 480 million shekels. Decrease in salary expenses of subsidiary companies was offset by increases in Bezeq Online and Bezeq Fixed-Line.

Turning to Slide 7 – Adjusted EBITDA in the first quarter totaled 918 million shekels compared to 907 million shekels in 2020, an increase of 1.2%. Group-wide adjusted net profit in the first quarter totaled 299 million shekels compared to 325 million shekels in 2020, a decrease of 8.0%. The decrease was mainly due to an increase in depreciation and financing expenses, which benefited in Q1 of last year from financing income in respect of employee benefits as a result of the increase in market yields at the outbreak of the COVID-19 pandemic in March 2020, as compared to financing expenses in the current quarter.

CAPEX in the first quarter totaled 458 million shekels compared to 338 million shekels in 2020, an increase of 35.5%. The increase was due to an increase in investments in Bezeq Fixed-Line primarily due to the launch of the fiber deployment project.

Free cash flow in the first quarter totaled 323 million shekels compared to 436 million shekels in 2020, a decrease of 25.9%. The decrease in free cash flow was due to an increase in tax payments in Bezeq Fixed-Line and changes in working capital in Pelephone, which was partially offset by an increase in proceeds from the sale of real estate in the current quarter.

On Slide 8 – We have broken down subscribers and ARPU by different business segments. Let me point out that subscribers in cellular, retail broadband and TV segments moved up during the quarter, with Pelephone posting the highest sequential growth since Q3-2019, while retail broadband ARPU grew to 103 shekels, compared to 98 shekels in the first quarter of 2020.

Turning to Slide 9 – We are adapting operations to evolving market conditions and continue to improve our debt profile. Of particular note this past quarter is the year-on-year decrease of 887 million shekels in net debt, as well as the decrease in net debt to EBITDA leverage ratio, from 2.3 in the first quarter of 2020 to 2.0 in the first quarter this year. It is worth reminding that over the past few weeks both domestic rating agencies affirmed our credit ratings with Stable outlook, with Midroog removing the negative credit review.

Lastly, on Slide 10 – For the 2021 outlook, we continue to forecast group-wide adjusted net profit of 1 billion shekels, adjusted EBITDA of 3.5 billion shekels and CAPEX of 1.7 billion shekels.

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

**Dudu Mizrahi (CEO, Bezeq Fixed Line):** Thanks Tobi. We finished another strong quarter with growth in revenues and in most operating and financial metrics. We achieved strong financial results with revenues growing 3.5% year-over-year and adjusted EBITDA up 3.7% year-over-year. In addition, continued robust sales of equipment led to increased retail broadband ARPU as we grew the number of retail broadband lines for the fourth consecutive quarter.

The first quarter saw the start of a revolution in the Israeli telecom market as Bezeq rolled out its fiber-optic project at an unprecedented speed and intensity. Turning to Slide 13 – as of now, Bezeq's fiber network already reaches 480,000 Israeli households, an unprecedented roll-out pace in the world. On the map, you can see the widespread deployment in the whole country. We expect to reach about one million households by the end of the year and yesterday we announced that we will reach about 80% of Israeli households within the next several years.

On Slide 14 – As we continue to upgrade Internet speed, key metrics of our broadband services are showing results. Revenues from broadband services grew 0.7% year-over-year despite the decrease in wholesale rates. The number of retail broadband lines grew for the fourth consecutive quarter while retail ARPU grew both quarter-over-quarter and year-over-year. Our Internet is the only product in the Israeli telecommunications market with a growing ARPU, while we are constantly adding new services and products for our customers.

On Slide 15 – Our full Wi-Fi strategy, which focuses on improving the broadband experience at home, continued to prove itself, and our revenues continued to grow at high rates. At the end of the first quarter, 579,000 customers were using the advanced Be router, with 277,000 customers benefitting from Wi-fi enhancers. The numbers continue to go up in both cases.

On Slide 16 – our telephony offering continued to see increases in traffic during the quarter, with outgoing minutes up 9% year-over-year and incoming minutes up 15% year over year. As a result, telephony ARPL increased year-over-year. In addition, there was a moderate decrease of only 9,000 access lines, compared to an average quarterly decrease of 20,000 lines in 2020.

Turning to the next Slide – We saw revenue growth across our other segments as well. Quarterly revenues for the transmission & data segment were up 9.8% year-over-year due to an increase in revenues from transmission services for ISPs and business customers. Quarterly revenues for the cloud & digital segment were up 13.8% year-over-year due to an increase in virtual exchanges and cloud services for businesses. Quarterly revenues of the other segment were up 7.8% year-over-year due an increase in revenues from the sale of cellular handsets.

Turning to Slide 18 – Salary expenses were impacted by the recognition of stock-based compensation of NIS 5 million in the first quarter. Operating expenses were impacted by an increase in subcontractor expenses.

On the next Slide – Adjusted EBITDA in the first quarter totaled 671 million shekels compared to 647 million shekels in the prior year quarter, an increase of 3.7%. Adjusted net profit in the quarter totaled 290 million shekels mostly in line with the same quarter last year.

In summary, we continue to grow broadband Internet revenues which is driven by an increase in subscribers and ARPU. Sales of the BE router and Wifi enhancers are seeing tremendous success. The launch of nationwide deployment of fiber will drive continued growth. We are at the start of an exciting and challenging time, as we get ready to launch innovative services and products, which will revolutionize Internet capabilities in every household in Israel.

With that, I'll now turn the call to Ran to talk about Bezeq's subsidiaries.

**Ran Guron (CEO of Pelephone, Bezeq International and yes):** Thanks, Dudu. Two years into the Alpha Project, we are pleased to report that it has been a significant success. We saved 230 million shekels in 2020 compared to 2018 by appointing one unified management team to streamline operations. We reduced senior management positions by 45% and reduced employee headcount by 1,300 over the last two years, as we also lowered operating expenses through joint procurement for all three companies and savings in real estate. Going forward, we are planning for more savings in investments and costs of support through a switch to one CRM system, joint sales and service packages, continued streamlining in operating expenses as well as further development of ICT operations.

We ended a strong quarter, and we can already see the pathway out of the COVID-19 period. As you can see on Slide 23 – we saw continued growth in Pelephone and yes subscribers. At yes, we are continuing to grow the number of subscribers, and already 29% of the customer base is using IP services, along with a significant improvement

in free cash flow. Pelephone continues to deploy its 5G network with significant growth in 5G subscribers. At Bezeq International, with the launch of the FIBER+ network and growth in business and data operations, we are seeing stable revenues, increased free cash flow and growth in the company's commercial services.

During the first quarter of 2021, we progressed full steam ahead with the Alpha 2 program to develop the synergies between the companies. The core of the Alpha 2 program entails a merger of Bezeq International into yes, spinning off the ICT business division of Bezeq International into a separate company, and continued streamlining. We have already approached the Ministry of Communications and we will be starting negotiations with the labor unions next month. The continuation and extension of the Alpha project will allow us to provide customers with a significant value experience, to offer triple cost-effective packages based on approval from the Anti-Trust Authority to yes, and to increase competition in the Israeli telecom market.

Technologically, Project Alpha continues to march forward onto next generation offerings in 5G mobile, Internet over Fiber Optics and IP broadcasting across the subsidiaries as we execute our structural and organizational transition.

Turning to Slides 26 through 28, let's briefly look at some key financial metrics for the subsidiary companies. We continued to lower salary expenses during the quarter. Since 2018, salary expenses decreased by 23%. Revenues went down slightly year over year for the quarter. Expenses were relatively stable during the quarter with a moderate increase due to ongoing impairment in Bezeq International assets. Adjusted EBITDA decreased year over year due to the pandemic's impact on roaming revenues, which was partially offset by improved results in yes and Pelephone through the quick adaption of expenditures to lower revenues. Adjusted net profit was down year over year for the quarter.

Turning to Slides 29 and 30 – At Pelephone, for the next generation of cellular in Israel, we are looking to provide our customers with diverse handsets, record speed, private broadband and wide-coverage 5G services. Leveraging new and improved services, we continued to grow the number of postpaid subscribers for the fifth consecutive year. Adjusted EBITDA was up year-over-year. The slight decrease in revenues was primarily due to decline in roaming revenues as a result of the impact of the pandemic, which was mostly offset by an increase in revenues from incoming calls and increase in equipment sales due to the launch of the new iPhone model.

Turning to Slides 31 and 32 - During the quarter, Bezeq International launched its FIBER+ network. Revenues were down slightly year-over-year due to the decrease in

revenues from Internet services and international calls, partially offset by an increase in sales of business communication services.

Moving to Slides 33 and 34 - At yes, we are returning to subscriber growth while customers continue to migrate to IP. The success of IP migration continues to manifest itself through improved cash flow.

I will now turn the call back to Tobi.

**Tobi Fischbein (CFO, Bezeq Group):** Thanks, Ran. 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, I wanted to talk a little bit about fiber deployment - guidance for CapEx at 1.7 billion. I'm just wondering, given the pace of deployment, do you think that looking ahead, it's sustainable, like, is it enough to support the rollout? And I guess as a follow up, perhaps related to this, we saw an increase in operating expense at Bezeq fixed and you pointed to an increase in subcontractor expenses. Is it related to the fiber rollout?

**Dudu Mizrahi:** Hi, Tavy. We said at the beginning of the year that we expect to reach about 1 million households by the end of the year and that the CapEx guidance we gave supports that deployment. Regarding your second question, part of it relates to the fiber optic project and other parts are related to other segments and services.

**Tavy Rosner (Barclays):** Understood. Thanks for that. And I guess as a follow up to the CapEx question is really, the question about dividends, it's something that investors frequently ask us about, timing of resumption. On the last quarter you guys mentioned you were exploring it or had hired a consultant to look into it. I guess when we see you generating positive free cash flows, I'm wondering what's the thought process behind the timing of resumption?

**Gil Sharon:** Hi, Tavy, this is Gil. Yes, we started looking at dividends and we will continue to examine the issue later this year, looking carefully at all aspects including

lowering our debt and retaining our credit ratings as well as the total return to shareholders.

**Tavy Rosner (Barclays):** Okay. Thanks for that. Perhaps one last question from me. On 5G, it seems that, unless I'm mistaken, most of the carriers are offering it for the same price as 4G. So is there, an opportunity to offer more for more or did we already lose that battle and 5G is just taken for granted?

**Ran Guron:** Hi, Tavy. This is Ran. In fact, this time it works differently. All operators in Israel are offering more for more, meaning 5G costs more than 4G. At Pelephone, we have a significant number of customers and the take-up is really surprising and good. We didn't publish the numbers but we are very satisfied with the pace. So it's going quite well, I would say.

**Tavy Rosner (Barclays):** Okay. Thanks for that. I'll go back to the queue.

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

**Ondrej Cabejsek (UBS):** Hi and thank you for the presentation. I wanted to follow up on the fiber side of things. I was wondering if from your perspective, now that you're clearly launching the service on a reasonable scale your competitors are clearly doing everything they can to lock in the former wholesale customers and their retail side. How bad do you think the wholesale trends get before the retail pick up, starts compensating for it? If we look at where your peers are in terms of homes, you will clearly be surpassing that pretty soon and within a couple of months. Do you think that we're seeing the worst, kind of second quarter/third quarter, and then the retail pick up will take over in that sense? And related to that, how or where are we in terms of the ISP infrastructure separation which I presume from your perspective will help a lot in turning the revenue trends around as you start to collect the ISP fee and you get a much more direct relationship with the customer? That would be my first question, please.

**Dudu Mizrahi:** Hi, this is Dudu. Regarding your first question, the negative trend we see in wholesale is of course coming from the fact that Cellcom and Partner are taking customers from wholesale in the Bezeq network to their own fiber optic networks. This is offset by the growth in retail customers and we expect to see further increases in retail customers as the fiber rollout continues and we start aggressively adding more and more retail customers to the network. In addition, Bezeq's subsidiaries are expected to start offering fiber services on a wholesale basis and we expect that to have a positive effect on the wholesale numbers. Trying now to see whether it will be fully mitigated or not is still too early, but these are the main trends in the market.

Regarding the second question about the ISP, the hearing process is already done. The political situation in Israel now requires the minister to take the decision. They are looking into the legal aspect of that, whether they can take the decision right now or whether they should wait for the new government. Either way, we think there's a good chance that in the following weeks we'll have a decision. Bear in mind that the process will be roughly nine months until we will be able to fully offer a unified broadband service.

**Ondrej Cabejsek (UBS):** So 1Q 22 kind of the earliest that you would say, if it passes next week?

**Dudu Mizrahi:** Yes

**Ondrej Cabejsek (UBS):** Then that would be when you're ready to roll out the unified service?

**Dudu Mizrahi:** That's the earliest - as it seems now.

**Ondrej Cabejsek (UBS):** Thank you. And a second question if I may. Your board has decided to merge yes and Bezeq International. Is there any chance that the two combined along with some efficiencies could have a net income positive enough to warrant a second look at the tax asset coming back to the balance sheet somehow?

**Gil Sharon:** Hi, it's Gil and I'll also let Toby answer. Let me first answer it strategically. We've decided to split the ICT business division and merge the residential portion of the operations of Bezeq International into yes. The reasons for the merger are two. One is that the regulation, as you know, is ending the ISP as a standalone business. And the second and most important, is that the market is a combined market of triple play, so we need to change our way of doing business and sell a unified product of a bundle of triple play services. This will be better done as a united company. Of course, through the improved sales on one hand and the efficiencies on the other hand, it will improve the bottom line. To what extent exactly we do not know yet but we are on the spreadsheets right now. So Toby, would you like to say anything more?

**Tobi Fischbein:** I just would reaffirm that it's still early and every quarter we need to make those assessments - in relation to the external experts that make the appraisals on yes and on Bezeq International and then we will also do this on the merger. So it's a bit too early. We plan to merge these two companies later on, towards the end of the year.

**Ondrej Cabejsek (UBS):** Thank you very much.

**Tobi Fischbein:** You're welcome.

**Operator:** The next question is from Jerry Dellis of Jefferies. Please go ahead.

**Jerry Dellis (Jefferies):** Yes, good afternoon. I have two questions, please. Firstly, in terms of the Pelephone ARPU outlook. You talked about 5G driving a return to growth. So I'm interested to understand, please, the shape of ARPU recovery that you expect and whether at this early stage you're already seeing positive signs in the market, perhaps some of the peripheral players are struggling. Is that producing any positive developments in market pricing before we get to 5G? And then the second thing has to do with triple play. We read different articles that suggest that the Ministry of Communications is objecting to the marketing of triple play services by Bezeq International and yes, I just would be interested in your perspectives on those articles, please. Thank you.

**Ran Guron:** Okay, so, this is Ran, I'll start with the second question because this might be confusing. The Ministry of Communications does not object to a triple play offer between the subsidiaries. In fact, it was just approved by the Antitrust Authority and allows us to offer this kind of bundle. What you may have read or may have heard is that the Ministry of Communications did not approve a triple play offer between Bezeq Fixed-line and the subsidiaries but this has been the situation ever since the subsidiaries were established. Our optimistic outlook for a triple play offer is a significant part of the growth in the group and the merger of Bezeq International's residential division into yes will help us improve our offering to market. The first question is about Pelephone or cellular ARPU. We see three drivers, three trends that drive ARPU forward. First of all - roaming services which is expected to come back. We are now at 30% roaming comparing to 2019. That means there is a lot to recover. So recovery of roaming services will help a lot. Second, the take up of 5G packages will help as well. This is all based on a market that is relatively stable over the last year or two, and that was not the situation in the past. So if you take a stable market and two drivers, we can be kind of optimistic, I will not refer to prices because we never do but it looks promising, I would say.

**Jerry Dellis (Jefferies):** Thank you. Could I just ask you a quick follow up question. The merger of Bezeq International and yes by the Ministry of Communications. Do you have visibility as to when a decision will be forthcoming on that, please?

**Ran Guron:** We submitted our request to the Ministry of Communications. The process should take a few months and we expect the request to be approved during 2021 - but it's not for us to decide so we await their decision.

**Jerry Dellis (Jefferies):** Understood. 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. There are no further questions at this time. I would like to remind participants that a replay is scheduled to begin in the period of three hours on the company's website at [www.bezeq.co.il](http://www.bezeq.co.il). Mr. Fischbein, would you like to make your concluding statement?

**Tobi Fischbein:** Thank you. 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 in the second quarter of 2021 earnings call. Thank you.

**Operator:** Thank you. This concludes Bezeq's first quarter 2021 results conference call. Thank you for your participation. You may go ahead and disconnect.

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