

Far Eastone 1H 2010 Result Conference Call Transcript

Gary Lai: Hi, good afternoon ladies and gentlemen. Welcome to the Far Eastone 1H10 results conference call. Before I hand over to Jan's special announcement, allow me to have a quick reminder that today's presentation is also available on our corporate website (www.fareastone.com.tw), and please kindly pay attention to our Safe Harbor Statement in the first slide. OK. Then I turn the call over to Jan.

Jan Nilsson: Hi, there. Before we start the traditional reporting, as Gary already indicated I have a bit of an announcement to do. You know that we have been working now for quite a while with integrating the telecommunication interests in what we call the Far Eastern Group Telecommunication Sector.

As of early October, that job will be done with the event of all remaining employees of NCIC being transferred over to FET, and from October onwards, NCIC will already have merged Digital United and Seednet as you know and will be a nominal company and all activities will be organized and conducted by FET itself. But there is also Far Eastern Group Telecom Sector will cease to exist and we will go back to the original Far Eastone.

Further to that, as you have seem, after have been through a little bit of a struggling process here over the past two to three years, from the 2Q onwards this year we see that our operational business, our daily business is showing a very consistent and strong signs of recovering. So I do think that the Company has been through some tough times, now it is a fully integrated service provider and also on the right track momentum and returning to growth.

After eight years, and actually it is tomorrow exactly eight years, as President for Far Eastone, at the Board meeting today it was decided, it was approved that I step down from the position as President. I have been at it for eight years, and I think now, when the integration is done and Far Eastone is back on growth track, it is time for me to step back and handover to the next generation of management who can continue to drive our great Company into an ever improving future.

I will remain as Vice-Chairman of the Company, and I will still be half active in the Company, supporting the new management team to best of my abilities; the new management and of course our Chairman.

As the new President of Far Eastone decided to be appointed today at the Board meeting effective from September 10th is Yvonne Li. Today she is the Chief Commercial Officer, and I am sure that many of you remember her well as Chief Financial Officer at my side for the better part of seven years.

To this end, I also would like to tell you that this is the last time I am doing this presentation. From the next Board meeting onwards, you will hear the voice of Yvonne again, but this time at the capacity of President, supported of course with a very capable CFO, T.Y. Yin.

This announcement is now in parallel also done in a press release, a press conference entitled of such changes. So, as of today this is now official and it comes into effect from September 10th.

That is the announcement that Gary was hinting up. So I shall then do my last quarterly results together with you, and then after that you can have questions and answers as

many as you want. By the way, Yvonne is here with us right now, so you can take the opportunity to hear her a little bit what her plans are to the future as well.

Market Overview (slide 4)

Let us go with the reporting. If you look at the Taiwan wireless market, as we use to tell you a little bit about, the NCC statistics for the 2Q shows that the number of mobile subscribers grew by 5.7% year on year. Of course this does not show that the population has been growing all of a sudden, this is very much the effect of more people have more than one active SIM card. This counts in terms of mobile Internet and data subscription.

But you can also see from the statistics that indeed Taiwan is recovering, also when it comes to the habits of talking. We see that outgoing minutes year on year have improved 11%, and total mobile revenue when considered NCC claims 2.1%.

Of course during the 2Q the very high subsidies from smartphones, specially iPhone, have eroded all the three big operators' profits, or increased the costs, to be more specific, so very much also for us.

When it comes to the rate plans, we have had bucket plans as sort of the standard voice simply offering on the market for many years now. Here, in the middle of the year, one of our peers took initiative to test the efforts of a price warrior in July by suddenly slashing all the monthly charges for the bucket plans to even more discount. Of course, the others need to tag along. So all three of us are now, as we speak, in a situation where we are offering our bucket plans at more discounted the monthly charge from normal.

On the non-voice rate plans, of course the flat rates are still dominating. We know that in different parts of the world, operators are starting to find ways out of this wrong way route flat rate and to find a way to have a differentiated pricing. I do not think the Taiwan market is ready for that just yet, but we are following what is happening elsewhere in the world with great interest.

On the regulatory side, we got four new commissioners that took on this year on August 1st. The remaining three are continuing at that term. Among these four commissioners, we also got the new Chairperson, Ms. Su, so it is also a lady this time as our Chairperson, and all four of the new commissioners are from academic/government background.

2010 YTD Performance

Operational Performance (slide 6)

If we look at our own performance year-to-date and for the 2Q, you can see that we have returned to growth when it comes to total number of subscribers. 2G subscribers continue to give way for 3G subscribers, and also when it comes to prepaid, actually we are returning to growth. And let us underline here, this is active growth, it is not so that we are giving away a lot of SIM cards, these are active users. This is very reasonable when you look at the right side of this slide, where you see that the ARPU is improving, as well as the total minutes of use.

Now, you can see that this trend has been quite stable for two months, August probably will not to be any break of this trend, we continue this quite strong development momentum.

Non-Voice Performance I (slide 7)

When it comes to the non-voice side, we continue to be on the lead. Yes, I admit that the lead is not that big any longer, but we are very happy to report to you that now almost 16% of our total service revenue comes from non-voice revenue.

Our non-voice service subscribers continue to grow very substantially, and when we are saying non-voice service subscribers is data rate plans for smartphones, as well as data cards, and other kinds of more non-voice specific subscriptions. We are very soon counting 1 million of such subscriptions.

Non-Voice Performance II (slide 8)

As follows with the counts to the more increased multimedia use, you see that the proportion of SMS becomes less and less of an issue when it comes to non-voice revenue. If you look at the 1H10, it was down to 35%, and this figure continues to decline and rather the number of SMS is actually improving a little bit while other kinds of non-voice services are growing much faster. If you look at the non-service revenue on the right-hand side you can see the wireless broadband of course dominates, then we have transmission, mobile advertising, music, and so on and so forth.

Consolidated Financial Achievement (slide 9)

On the financial side, we closed July with a total revenue of NT\$34.7 billion, service revenue of NT\$31.3 billion, and EBITDA of NT\$12.9 billion, giving an EBITDA margin of 44.7%. This translates over to a net income of close to NT\$5.1 billion, or an EPS of NT\$1.56. The team here has given you an achievement rate compared to the full-year forecast. If you do an arithmetic translation to this, you can see that year-to-date, July should translate to 58% achievement if you calculate correlated with the year, but this is not the case for us. So let me give you a little bit more details around these figures.

When it comes to service revenue, we are a little bit shy, it is less than 1% shy of our target settings. We were already in our forecast predicting a relative strong 2H, we are still very much confident that this strength indeed will be there. Not so when it comes to the net income and EPS, we are very confident that we will be able to deliver net income according to our forecast that we have given.

Consolidated Financial (slide 10)

If you look at our balance sheet characteristics, two years ago I would say that I am very happy with this balance sheet, that we are totally debt free. Two years ago we were in the middle of the worst financial crisis in the modern history, and cash was king. Now we are getting out of this recession at least for Taiwan, we will see what happens.

We are underleveraged, and we are very cash-rich, and of course most of this cash will be used for the dividend payout coming here in September, and of course, secondary and not least, to buy NCIC outstanding shares. So for a bridge period of 1.5 year, a little bit less actually, we will have some debt. But as we are calculating it, we have totally paid off this debt, we are debt free again now 100% owner of NCIC before the end of 2012. So we are still financially very strong to take whatever actions that we or

specifically the new management see as opportunities for future growth and strength of the market as well as the capital management options.

Business Update

Smartphone Statistics (slide 12)

On the business side, our smartphones continue to be a very strong part of our sales. If we look into it, as of end of July this year 7.7% of our postpaid subscriber base were actually smartphone users. And if we look into the 2Q10, some 20% of all new handset takers from us choose smartphones.

Of course, this is costly when it comes to the subsidies, but we should not forget, and I think this is proven in the United States and elsewhere that have been having these smartphones, i.e. iPhones, for longer time than we have, that the ARPU is some 50% higher than non-smartphone users. And of course the data usage is much higher; it is actually 17x higher than the so-called feature phone users.

So, the ARPU is much higher and in the long run this has positive effects for us. And this was not to have an impact already in the 2H10, you will see the contribution from this, you can say “short-term costly activities” during the 2Q, but the revenues will start kicking in here from 3Q onwards.

Smartphone Portfolio (slide 13)

Talking about smartphones, you know that we went into this year with quite a thin portfolio of smartphones. We have been selling iPhones very successfully. Actually, I think that we were one of the strongest sellers. We were the strongest seller of iPhones in Taiwan during the 2Q.

We understand that our portfolio has been a little bit thin, so already now, as we speak, we have already launched five new smartphones and we have actually another more than five to come here later on in the fall. So, very soon here, we will have a full and complete portfolio of smartphones. Not to mention that in the 4Q, we will see the tablets start to come in, and the tablets by themselves will then again change the characteristics of the mobile operators or the wireless operators here in Taiwan.

‘S Mart’ Performance (slide 14)

Meanwhile, our S Mart, our application to all that is focusing on ethnic Chinese applications, continue to grow and continue to create a lot of interests on the market as a whole. Out of those users that go in and download here, 70% of them are actually non-FET subscribers, who are totally representative in the market, because FET holds about close to 30% of the market. So, you can see that the users of our applications have spread across all the different operators here, which is exactly what we wanted to achieve and we are very happy about this and we continue to work very hard to launch new applications and continue to promote the usage of this. 1/3 of these downloads is entertainment; then we have different kind of utilities and tools, lifestyle, content, games, social networking, and finance and business applications.

‘e-Book Town’ Launched (slide 15)

Then you should not forget our launch of the e-Book Town; we launched it in the middle of the year. At the time of the launch, we had more than 5,000 publications

coming from over 40 publishers, who have in an agreement with us launched their products onto our platform. We have 11 broad categories, anything from deep-rooted science over to magazines with the latest fashion and so on and so forth.

What is also important with our e-Book initiative is that it is delivered over a cloud computing platform, which supports all different kinds of wireless devices, from smartphones to tablets, to laptops and PCs. It is not a smartphone application; this is a general application that can be downloaded in all kinds of devices, which for us is very important. And please do not forget, again this is fully open for everybody to use; you do not need to be Far Eastone subscriber.

'e-Book Town' Initiative (slide 16)

So, we had our debut in the middle of the year in July, with as I said 5,000 listed e-Books with some 40+ contracted publishers. Before year-end, we will pass 10,000 titles and we will also actively launch tablets and e-Book offering over the tablets, which we believe will be the really take-off of the e-Books here in Taiwan, and that is the tablet format because this is very suitable for this kind of application. Especially when you look into magazines that are showing on the down right side, we believe that we will see a lot of people reading the magazines on the tablet rather than on paper copies.

Enter into 'Digital Music' Arena (slide 17)

The third big initiative of ours is the digital music arena. We have now gone through and got approval from the Fair Trade Committee to set up this joint venture that I think we have mentioned to you before, where FET together with the seven largest music labels here in Taiwan are forming a joint venture together with a technology company. This joint venture will be 50% owned by Far Eastone and the remainder spread among the music labels and this technology partner.

This means that we will have a direct relation with the different music labels. Our focus here is of course to, on one hand, explore new ways of marketing music over the wireless media, but not any music. Our focus is Taiwanese popular music for the wider Taiwanese audience, not limited to Taiwan and of course our eyes are very much directed across the strait where Taiwanese music is actually very popular.

So, these are the three big launches that we have had now during the summer period, but the music joint venture is not just formally launched; it is under set up and the first initial launch with the ringtones will come here in October.

So, you see that we are quite bullish about our future because all these contents are something that we are working with a long time and finally we are able to put it to the market. The response from the market is very strongly positive. And we are very optimistic about becoming the wireless service provider of choice here in Taiwan going forward.

NCIC Transaction Highlight (slide 18)

Moving over to the corporate side, you know that we launched a tender offer for the outstanding shares in NCIC a while ago, and this was launched on June 28th and it was closed on August 16th. I have to extend a big thank you to our Finance Department, T.Y. and the team, for a very successful handling of the tender offer. At the closing, we are formally now controlling 95% of all outstanding shares in NCIC, but in reality it is actually 98% because the difference of shares is still held by other parts of Far Eastern

Group and we do like that, just to be able to retain a functioning Board of Directors in the process with the two, you remember this is a three-step acquisition process, and we need to maintain a functioning Board without having to go through re-elections and so on.

There is no delinquent shareholder at all that has registered. So, for us it is a clear success. The issue is now a bureaucratic process to the end of final closing, and the final closing where FET will be the remaining 100% shareholder of NCIC is going to be in the month of April of next year.

NCIC Operational Performance (slide 19)

To give you a little glimpse of NCIC's operational performance, revenue year on year has been growing with 7.2%, and you say, "This is not so impressive". I agree with you. But look on the right hand side, the EBITDA has been growing 45% year on year. How can this come? Well, a big chunk of NCIC's historical revenue has been i.e. simple voice reselling, voice transit business. This has little or no margin. So, as we have been growing the more healthy enterprise solutions, we have been pushing down or pulling down our activities on the NCIC side. So, it is by the sign we are keeping down the gross revenue, because we are more interested in EBITDA margin and bottom line and, of course, a healthy business rather than to do this low or no margin trading of minutes.

Key Drivers (slide 20)

So, if you look at the key drivers for NCIC as of now, it is first and foremost the enterprise market, where we have positioned ourselves quite successfully as a solution provider. We are not a provider of wireline access, nor a provider of wholesale mobile subscriptions. We are providers of complete enterprise solutions.

We are giving here five different examples of where we are working and where we are very successful. It is the one single number for the enterprise user; whether it is using wireline phone or a wireless phone or a computer, he has the same number. If a cross strait roaming, where we have launched a very attractive roaming rate for frequent travelers across the strait – I will come back to that later when we talk about the China business development. The Internet of things, cloud services, and information security are other areas where we have shown a very strong growth.

Over and above this, of course NCIC is also providing transmission solutions for FET's wireless environment. This is why I have said so many times before it is no longer possible to keep wireless and wireline in two separate companies. It makes no sense. Wireless is the last mile; wireline is everything behind it.

CMCC Strategic Cooperation Update (slide 21)

Just to mention a little bit of our activities cross straits, we have, as I said, launched a very competitive roaming fee program together with China Mobile for the cross strait travelers. In the first instant, it covers three cities and two provinces, and we are now for the 2H planning to expand it to another seven provinces.

Then, we are talking about and we have been talking a lot about our plans to launch distant non-voice service across the strait in China Mobile's network. This is progressing and is progressing very well. You know, China is a very big place, China Mobile is a very big company and also they have a complicated process they have to

go through but we are working through this too. And we have established a very cooperation with China Mobile and they are helping us, actively helping us to be approved as a content provider in China.

One example is that we here in August participated in the exhibitions around the 2010 China Internet Conference, we were the only Taiwanese operator/content provider who was there. Well, we were content provider because there were some 20 content providers from Taiwan, those who develop confidence, who went with us over there in our booths and presented their solutions and their ideas. We got a lot of attention not only from the industry, not only from China Mobile, but also from the Ministry over there which was very positive and very encouraging to our attempt to establish our business in China.

Management Highlight (slide 23)

So, if you summarize what we are saying, we are confident that we are going to deliver on the full 2010 year forecast, and that goes when accounted net income, we will be able to pick up the growth as we predicted.

Our core operations overall continue to improve and they are improving with substantial numbers. And we are now in a position where we are able to offer a full range portfolio of smartphones and when it accounts to the coming tablets, we are very much in the fore front, we are not going to fall behind, we are going to be the leader when it comes to tablets and applications on tablets.

I have already talked about our very innovative services, the S-Mart, e-Book Town and our digital music services, a very strong offering here in Taiwan, even stronger also when we now in the later part of this year will bring it over and operate in the China market.

The integration of FET and NCIC is coming close to final efficiency, there are still cost synergies to be taken and we are harvesting them as we speak, you can see that by the way when it comes to our general and administrative costs that shows very good numbers even compared to our most aggressive forecast.

We are very optimistic of our enterprise solutions, this far you can say that our enterprise business has been growing with over 10%. And we believe that the growth potential in this in the near future will be double that, we are looking at the 20% growth momentum on our enterprise business. OK, I agree with you, it is relative small than when we started, we have something like 17% market share so that gives a lot of room for growth, but we are already and we will be even more a very strong contender to the big elephant Chunghwa Telecom on this area and continue to take market share from them.

Our close relationship with China Mobile continues and the strategic cooperation between the two companies continues to be very strong and very healthy, waiting for the respective governments, or specifically our government to feel more relaxed and open heart for China Mobile to also confirm this relationship with the relative stake that is part of the strategic agreement of ours.

OK, guys, that was all of my presentation. That was all for me. I will open for the Q&A, I would say thank you, good-bye, I am signing out.

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