Taiwan Mobile 4Q11 Results Conference Call
January 19, 2012

Moderator: Good morning, good afternoon, ladies and gentlemen. Welcome to Taiwan Mobile Conference call. Our chairperson today is Mr. Cliff Lai and Ms. Vivien Hsu. Vivien, please begin your call. I'll stand by for the question and answer session. Thank you.

Cliff Lai, Co-President: Good afternoon. Welcome to our 2011 and 4th quarter conference call. Before I start our presentation, I would like to direct your attention to our disclaimer page, which states:

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Let's start with business review.

<u>Robust Wireless Data Growth</u>

In the next three slides, I would like to highlight our growth areas.

First on wireless data:

In 4Q, despite regulatory interventions which dragged down our voice revenue by $575mn, we still managed to increase mobile service revenue by 2%, on the back of $1.1bn YoY growth in wireless data revenue.

In terms of data revenue as a % of mobile service revenue, Taiwan Mobile continued to lead the pack.

Please turn to the next page.

<u>Our Smartphone Strategy</u>

For our smartphone strategy:

Apart from the 8 smart device models we have introduced in 4Q , we currently have around 40 smartphone and tablet products on the market.

Smartphone users' ARPU remained at more than 2 times that of postpaid's, while their payback periods are very similar.

In 4Q11, smartphone sales volume was up 60% from a year ago and accounted for 64% of total handsets sold. As of the end of 4Q11, smartphone penetration reached 21%. Please notice that our smartphone definition is a little different from the other two competitors. In Symbian, we only include S60 5.0 Version and above, Symbian^3 and above. Other kinds of Symbian smartphone we don't count as smartphones.

Please turn to page six.

CATV Growth Catalysts

As indicated in the table, our internet subscriber number increase of 13% and DTV customer number growth of 77% are all higher than the 2% subscriber rise in analogue TV services in 4Q11. And our cable internet ARPU continued trending up, with 85% of new customers adopting 10M and above service.

Given that only 27% of our customers are using our internet services and 8% of our customers have subscribed to DTV services, we expect further expansions in internet and DTV service take-up.

Please turn to the page 7.

New Product & Service

This page of new products and services we launched during the 4th quarter is for your reference.

I will turn the mic to Vivien on our financial results.

Result Summary

Vivien Hsu, Co-President: Please turn to financial overview page.

4Q11

4Q11 service revenue rose YoY, underpinned by mobile data revenue growth.

As telecom revenue growth was sufficient to cover the increased handset subsidies in 4Q on top of contributions from momo, consolidated EBITDA grew 4% from a year ago. Due to our capital reduction, EPS for the quarter was up 15% YoY.

<u>2011 Full-Year Results</u>

For full year 2011, mobile voice revenue was negatively impacted by the mandatory tariff cuts. But operating performance stability from all three business groups as well as earnings contribution from momo allowed for solid full year earnings. Consolidated revenue and net income for the year reached 110% and 103% of their full-year guidance, respectively.

Please turn to the next page and to divisional performance.

<u>Divisional Performance</u>

Let's look at our operating performance by business group.

CBG maintained its mobile service revenue growth momentum in 4Q, with strong data revenue more than offsetting voice revenue declines. Handset sales in 4Q11 surged due to the launch of iPhone 4S in mid December and further rises in Android phone sales. EBITDA was still negatively affected by TWM's mobile data growth strategy in 4Q.

HBG's 4Q YoY revenue growth was mainly driven by the growth in broadband revenue from market share gains in the high-speed segment . The QoQ drop in HBG's revenue was explained by the reversal of over-accrued content revenue after finalization of full-year contract terms.

EBG posted double-digit YoY growth in profits, credited to the rising enterprise mobile, IP transit and IDC businesses, coupled with contained expenses.

We did not acquire momo until July 2011. momo's 4Q11 revenue increased sequentially mainly due to stronger TV home shopping and the enhancement of e-commerce competitiveness.

Let me turn this presentation to Rosie for balance sheet and cash flow analysis.

<u>Balance Sheet Analysis</u>

Rosie, CFO & Spokesperson:

On assets, in 4Q11, cash balance decreased due to cash outlays for loan repayments and capital reduction payment. Compared to 4Q10, intangible assets increased by NT$6.9bn, mainly due to the purchase of momo with the purchase price higher than its net worth.

On Liabilities & Shareholders' Equity front, NT$4.4bn in short-term borrowings was repaid in the quarter. Separately, NT$4bn of domestic unsecured bonds will be repaid in 2012 and thus was reclassified from long-term borrowings to short-term debt at the end of 4Q11. As a result, the percentage of short-term borrowings rose to 78%.

On ratios, net debt to equity and net debt to EBITDA at the end of 4Q11 remained at healthy levels. Current ratio came off due to the rise in short-term borrowings as half of corporate bonds will mature in 2012. ROE and ROA in 4Q11 stayed at reasonably high levels.

Now, let's turn to cash flow analysis.

Cash Flow Analysis

4Q11 net cash inflow from operating activities grew QoQ on higher inflows of changes in working capital. That said, 2011 full-year operating cash flow remained stable from 2010.

In terms of financing activities, NT$4.4bn of debt repayment and close to NT$3bn of capital return to shareholders were the main cash outflows in 4Q11. In 2011, in total we returned NT$15.43bn of cash to shareholders, in which NT$12.44bn in cash dividend & $2.99bn in capital return, higher than NT$15.03bn in 2010.

On Capex and Free Cash Flow analysis, for 2011, cash capex was NT$6.42bn lower than the guidance of NT$7.3bn due to the delays in making payments of 1) NT$0.4bn capex related to purchase of Nokia equipment to replace Chinese ones and 2) about NT$0.2bn of IDC construction. The deferral in receiving 3G equipment import approval from NCC also explained the decrease in our cash capex for the year.

With stable capex, 2011 free cash flow was at NT$18.84bn, translating into a 6% yield.

2012 Forecast

On revenue, we forecast telecom (mobile & fixed-line) revenue together with cable TV related business to grow 6% YoY or NT$4bn in 2012, with 39% or NT$5bn rise in mobile data revenue. Aided by its organic growth and a full-year contribution vs. 5.5 months in 2011, momo's revenue contribution will increase to account for 19% of consolidated revenue. The remaining revenue growth will come largely from higher handset sales revenue.

On cash cost, momo's expanding revenue and more months of contributions to TWM will lead to some NT$10bn increase in cost of goods sold. Mobile device related sales cost will also increase by more than NT$5bn. The remaining cash cost increase will come from traffic/network costs.

On SG&A, around 51% of the YoY increase will stem from momo due to more operating month contributions. The remaining increase will come largely from our expansion of company stores in 2012.

On net Income & EPS, a healthy growth in EBITDA, higher contributions from our 51%-owned momo, and lower non-operating expense will allow our net income to rise 7% in 2012. EPS is expected to benefit from our recent capital reduction and to grow 14% in 2012.

Event Update

Vivien: The first slide of our event update, which stated our 2012 capex guidance and the regulatory update, we would like to highlight that the increase in 2012 capex vs. a year ago includes NT$2.1bn increase in contract payments for the new IDC currently under construction, NT$1.2bn rise in mobile for adding new 3G base stations and increasing HSPA+ capacity.

(The slide shows:

2012 Capex Guidance

The board has approved 2012 capex of NT$10.8bn, including NT$5.8bn for mobile, NT$4.1bn for fixed-line, NT$0.7bn for CATV, and the balance for other subsidiaries.

Regulatory Update

In December, 2011, the Legislative Yuan approved revisions to the Company Act to allow direct cash distribution from legal reserve and capital surplus through AGM's approval. For legal reserve, only the excess of 25% of paid-in capital can be used for distribution.)

The second slide of the event update which shows the awards we received for the quarter is for your reference as well.

(The slide shows:
Award & Recognition

- The Chairman of Taiwan Mobile, Richard Tsai, received the "Asia Innovator of the Year Award" from CNBC.
- TWM received the "CG6006 Certification" from the Corporate Governance Association.
- TWM's efforts in corporate governance have been included in "The Stories of Integrity from Taiwan Enterprises", published by the Industrial Development Bureau of The Ministry of Economic Affairs.
- TWM was granted the "R.O.C. Enterprises Environmental Protection Award" by the Environmental Protection Administration of the Executive Yuan for the third consecutive year.)

Please turn to the key message.

<u>Key Message</u>

To wrap our presentation, this last slide summarizes the key message we would like to deliver.

In line with our expectations, we have achieved our 2011 target. For 2012, in addition to exceeding consumer expectations with unparalleled communication products & application services in a digital convergence world, TWM will also expedite smart device penetration to maintain growth momentum. The Euro crisis though may cast some economic uncertainties, we are cautiously optimistic about 2012 outlook. As always, enhancing shareholders return remains the top priority of the Company.

<u>Q & A</u>

Chate Benchavitvilai, Credit Suisse HK: ***I have five questions. The first one is regarding iPhone 4S launch, the impact seems to be higher than iPhone 4. Can you help compare the popularity of iPhone 4S and iPhone4 a little bit? And whether the impact on margins will continue for how long?***

The second question is regarding your store expansion plan. You guided that part of the increase in cost would be related to this. Can you help explain how

much do you have now and how much are you expanding?

The third part is regarding to the Internet Data Center. How should we view the revenue potential and return on your investment in this?

The fourth question is also related to the Internet Data Center. How should we view the capex on this beyond 2012? Is it where you want it to be or is actually just the first step of a much bigger plan for IDC?

And the fifth question is regarding the change in regulatory; would this affect your dividend policy? Does it mean that you can now declare special dividend instead of doing capital reduction?

Cliff: As for the iPhone 4S, the reason of iPhone 4S creating impacts in our December financial statement is that the supply of iPhone 4S is much larger than iPhone 4. At this moment, I can not tell whether the iPhone 4S is more popular or less popular than the iPhone 4. But we think the impact of iPhone 4S will be carried into the 1Q of 2012.

Regarding the store expansion, the total number of stores we are going to have is roughly between 700 and 750. Out of those, maybe 40% is directly owned by Taiwan Mobile, and then the 50-60% is owned by the franchise stores.

As for IDC, I'll turn it over to Rosie.

Rosie: IDC, the capex will mostly be spent in 2012 because the construction of IDC is expected to be completed by the end of this year. So the revenue stream will come next year. And beyond 2012, we expect much less capex on IDC in Neihu that we are building.

Cliff: The cloud IDC business case is still evolving. Currently, we have seen a shortage of IDC space in Taiwan because most of the current IDC were built in year 2000. So, in the last 10-12 years, we didn't see any new IDC get built. So, we are still very positive on the return on IDC. This is one reason we started building the new IDC. By the end of this year, we will have a more solid forecast on the return on our IDC.

Rosie: As to the regulatory change on the potential pool for dividend distribution, the only thing I can share with you is, based on the year end balance, we do have a capital surplus of NT$12.4bn and return earnings of NT$3bn and NT$8.2bn of legal reserve in excess of ¼ of the paid-in capital. So the pool for dividend distribution is definitely higher, but we did not discuss earning distribution in this morning's board meeting. It will be up for discussion in the next board meeting in April.

Chate: *Just one follow up question regarding the store expansion. So currently how much do you have now and where will you get to again?*

Rosie: We now have 280.

Chate: *-direct owned stores?*

Cliff: Currently, we have 280 direct stores. And 356 franchise stores. So, total we plan to have around 700 to 750 stores for this year.

Steven Liu, Standard Chartered HK: ***One question regarding capex. I noticed an increase in the fixed-line capex. Can you give me what kind of spending for the increase in the fixed-line capex?***

Second question regarding the momo business, what kind of growth rate can we expect over the coming few years and what kind of gross margin for the momo business?

My third question regarding the ARPU, the mobile blended ARPU, do you see a stable uptrend in the mobile ARPU given that your smartphone penetration is increasing?

And, lastly, about the mobile EBITDA margin, would you expect a stable sustainable EBITDA margin expansion in the mobile business over the coming three years?

Rosie: On the capex of fixed-line business, it is related to the construction of the Internet Data Center. The total construction cost is NT$2.8bn and equipment procurement will be somewhere around NT$0.5-0.6 bn for 2012. But, out of this NT$2.8bn construction cost, half of a billion was included in last year's capex. So, this year you still see NT$2.3bn in capex in our total overall fixed-line capex of NT$4bn. But if you strip out the IDC, the fixed-line capex remains stable as compared to previous year.

Steven: *For momo business, what kind of growth rate and gross margin going forward for momo?*

Rosie: momo is expected to have an increase in revenue of about NT$4bn this year, mainly contributed by its home shopping and internet business. The growth will still come from the internet business in terms of percentage growth rate. And its Chinese investment in Beijing could be of more growth potential ahead, but it just started operation in August last year, so it could take 2-3 years to turn around. But before that, we still foresee some losses in that operation. But, I believe you would all agree that China is a big market, so they do stand a chance of growing their business there.

Steven: *So, how about the mobile EBITDA margin trend?*

Rosie: Mobile EBITDA margin is facing some pressure. For some time, the mobile voice revenue is facing severe pressure from mandatory tariff cuts and other regulatory interventions. For last year alone, the regulatory interventions cost us NT$2.4bn in revenue and NT$1.7 or NT$1.8bn in EBITDA. This year, regulatory intervention actually increased, not only including the mandatory tariff cuts, but also long distance calls to be priced as local calls and also they have raised some calculations for us to pay more spectrum usage fees. So, in total, on the revenue front, the regulatory interventions will have about NT$862m impact on us. And on the EBITDA front, it will be NT$979m and net income by about NT$812m.

Steven: *What's current smartphone penetration?*

Rosie: 21%

Chate Benchavitvilai, Credit Suisse HK: ***On regulatory side for FY12, you mentioned briefly about the potential increase in spectrum usage fee, would you mind elaborating on that again?***

And regarding the impact of NT$862m on the revenue side and NT$812m on the net profit, that is over what time frame?

Rosie: Total impact on the spectrum usage fee is NT$131mn. That will not affect our revenue, but will affect our expense. They change the formula a bit to raise one factor from 0.5 to 0.85, so NCC can charge us more, to put it simply.

Lucy Liu, JP Morgan HK: *I have three questions. The first one on some of your promotions that you're doing now this year, bundled free on-net calls plus post-paid data plan, just wondering, such promotion will carry over to the new year or is there any strategy change for penetrating this market?*

And, secondly on momo, I did a rough calculation, seems like your new guidance actually implies, even adjusted for the full year, you only included slightly less than six months last year but will include the full year impact this year, but even adjusted for this factor, seems like you're suggesting momo revenue will grow by 30% year-on-year. I'm just wondering what's changing on momo's business alone and why you're projecting such a high growth?

And, lastly, on the dividend or capital management side, are you saying that the whole thing is pending on the Kbro acquisition potential in the future or any change on that front?

Rosie: Could you please repeat your first question?

Lucy: *First question is, in the new year, in tapping smartphone market, whether there's any strategy change or whether there's any promotion change, last year you launched free on-net call plus a post-paid data plan last year, I understand this plan will stop by the end of last year, so I was just wondering whether it will still carry on or whether there's any new promotion you will be launching this year.*

Cliff: Regarding the first one, in order to help the penetration of smartphones, this year's strategy is to increase the penetration of smartphones in the middle end and low end customers. So, the execution is the same. The strategy is no different from last year. As far as for the promotion, we're currently evaluating whether or not we should continue or stop the on-net free call program. And we wouldn't come to conclusion until after the Chinese New Year. So, by March or by the end of 1Q, we can give you more information regarding whether some of the promotion will continue or stop. As for momo, Rosie will answer that.

Rosie: momo's growth on the revenue front will come largely from its TV shopping. Last year, their TV shopping was hard hit by the dietary supplement advertisement issue, the content issue in the food. There were a lot of challenges last year. For 2012, they expect these businesses to be back on track. That's why they forecast to have about NT$4bn increase in revenue for this year.

And, on your question on our dividend policy, we don't think the acquisition of Kbro will impact our dividend policy. First of all, we have ample debt capacity. Secondly, even if the cable law is revised, we would consider various options to pay the consideration. While we don't rule out the possibility of swapping shares with them as long as it is EPS-accretive as we mentioned a few years ago. Cable business actually is highly cash generative so we don't think it will affect our dividend policy.

Lucy: *Are you talking normal dividend policy or the capital management policy?*

Rosie: I was answering your question of dividend policy you raised.

Lucy: *Let me clarify, previously I was referring to your special dividend or any capital management potential. Not referring to the normal policy.*

Rosie: As I've mentioned with the numbers earlier, I just want to let you know there is more flexibility for us to distribute dividends. But whether we will do capital management this year or not, it's up to the board to decide.

Lucy: *I was looking at your margin guidance for 2012, it's actually at 28% so declining by 5% YoY. I understand higher smartphone equipment sales revenue or maybe some impact from iPhone. But if I look at your December margin actually which is 21%, I think it's already started to get impacted by iPhone. With that number as the base, it seems like you're assuming the margin for the full year will only slightly improve from the very low base in December. Is that mostly because of iPhone or because some other smartphone devices that are also going to launch?*

Shirley Chu, Director of Investor Relations: I think the margin erosion that you see this year is largely due to higher revenue mix from momo because momo's EBITDA margin is only single digits.

Joyce Zhou, Barclays HK: ***In your revenue forecast for 2012 of NT$102bn, how much of the revenue you're expecting from the device sales part?***

On your EBITDA full year guidance of 28%, what is your EBITDA assumption for momo business stand-alone?

Rosie: About NT$10bn in device sales for this year. momo's EBITDA margin is about 7%.

Joyce: *So, if momo's EBITDA margin is 7% and my calculation is right, then you should assume other division to see EBITDA margin decline for 2012, which business divisions do you expect to margin decline?*

Shirley: Our consumer business group EBITDA margin will see a very minor decrease this year, but, as I said, overall EBITDA margin decline is due to higher revenue contribution from momo.

Joyce: *Final question on the regulatory side, previously you mention there's some regulation on the holding of the cable and media businesses. Is there an update on that side?*

Rosie: No update can be shared at this moment because we just finished the election of the new legislators recently as you know. The legislative Yuan will not start their session until probably March.

Chate Benchavitvilai, Credit Suisse HK: ***Regarding the total dividend potential, I understand that it's up to the board, but in theory how much would you able to distribute in terms of the special dividend? Second question is regarding any long-term gearing level you would want to achieve or that you're comfortable with?***

Rosie: The maximum capacity that we can top up our dividend is the number that I mentioned to you which totals NT$23.6bn. Of which, $12.4bn comes from capital surplus, NT$8.2bn from legal reserve and NT$3bn from retained earnings. This is the extra room that we can top up our dividends on top of our current year earnings. So that's the maximum.

Chate: *Any longer-term gearing level that you like to achieve or that you would be comfortable with?*

Rosie: We are comfortable with our gearing level as long as the spending could enhance shareholders' returns.

Piyush Mubayi, Goldman Sachs: ***I want to understand how you determine the level of equipment growth that you want to see in a year. You're going to see a big number in 2012, but when we look ahead, for example in 2013, could we expect***

there will be a slowdown in equipment growth and there will commensurate improvement of 500 basis points or so in EBITDA margin. Can you comment on that please?

Cliff: It's very hard to say at the moment. As you know, it's very hard to predict what will happen in 2013 because there's so much uncertainly. But the reason we have great equipment sales is that starting last year, we have increased the sales of handset and bundles in our shops. That's why this year you see tremendous growth in equipment sales revenue. I foresee 2013, we will still see handset sales increase, but the growth rate wouldn't be as high as this year.

Piyush: *So, it will be less than the NT$10bn you're provisioning for 2012. Could you remind us what is the margin for the flow through handset sales that you're doing?*

Cliff: It really depends. I think we are still trying to increase our margin. At this moment, I'm not at liberty to disclose our margin.

Piyush: *My last question, when we think of each customer who's coming on board as a smartphone customer, what do you think the average longevity is likely to be? And, are they coming from your existing customer base or are you importing them from one of our competitors?*

Cliff: Right now, I think more than 50% of the new smartphones are from our existing customer base and the rest is from new subscriber.

Piyush: *And my last question, where are you now on LTE and LTE launch?*

Cliff: We are still a long way from LTE launch. Based on recent government information, NCC was originally not going to auction the LTE frequency until 2015, but there was a strong push from the industry and the media to push for a earlier release of the LTE license. But now we feel that it's possible the government will auction the LTE license in 2014, but the exact date is still not finalized.

Steven Liu, Standard Chartered HK: ***On the smartphone strategy, in China, a lot of low-priced smartphones are very popular and got a lot of traction by the mass market users. How about Taiwan, do you see the demand for the mid-range priced smartphone sales? What is your strategy in the future such as introducing mid-range smartphones?***

Cliff: This year, we intend to introduce more mid-range, low-range smartphone models. In our budget, we have increase quite substantially the number of subscribers using low-end and middle-end smartphones. So, this is the reason why we can see further smartphone penetration increase. So, that's the strategy we are going to use this year.

Steven: *Your smartphone users more than doubled. With the introduction of more mid-range smartphones, do you see an impact on ARPU?*

Cliff: I think so because the subsidy level is lower, so, of course, the ARPU level is lower. But I do think when they adopt smartphones, the overall ARPU will increase. Therefore, I am still quite optimistic about our ARPU for this year.

Steven: *So, basically you think the net handset subsidy ARPU for smartphone users should be also higher than the non-smartphone ARPU.*

Cliff: Smartphone users ARPU in general are higher than non-smartphone users' because the formers have voice tariff plus data tariff.

Steven: *How about after excluding the handset subsidy, the net ARPU?*

Cliff: We don't calculate this way. After subtracting the handset subsidy, the smartphone users' profit contribution is still higher than the feature phone users.

Rosie: And the subsidy is expensed upfront.

Piyush Mubayi, Goldman Sachs: ***What's your roaming exposure on both a gross and net basis? And if you're seeing any weakness on that front.***

Rosie: Only 2-3%.