



Silknet - 1H20 update

Challenging quarter for telcos

Fixed Income Research | Georgia
Silknet
October 2, 2020

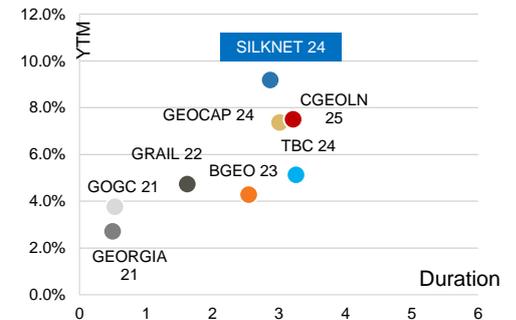
As expected 2Q20 turned out to be a challenging quarter for Silknet. Strict stay-at-home orders were in place during April and early May, with countrywide state of emergency lifted on 23 May, 2020. Since then, major business entities have resumed operations, however Georgia's borders remain closed for international tourists (with some exceptions), with limited number of flights taking place. For Silknet, mobile and fixed broadband services were hit hardest. Strong growth in mobile data revenues was not enough to offset the declines in mobile voice and other mobile service revenues. Introduction of new 'unlimited data packages' from the two largest operators lifted mobile data traffic in Georgia, which hit record high 15.7 terabytes in May 2020. Notably, Silknet's subscribers used on average 6.5GB/month in 2Q20, which is significantly higher than last year levels. Country-wide lockdowns have affected Silknet's business customers, which account for c. 25% of Silknet's commercial revenue. Although exposure to hospitality and entertainment sectors is limited (3% of total revenue), temporary closure of hotels, restaurants and casinos as well as other business entities in Georgia negatively affected Silknet's fixed revenues. In addition, new customer acquisitions have slowed. Silknet generated GEL 184.9mn in revenues (US\$ 61.0mn) and GEL 95.2mn (US\$ 31.4mn) in EBITDA in 1H20. Notably, on a quarterly basis 2Q20 revenue was down 6.8%, while 2Q20 EBITDA shrank 5.2% q/q. As GEL's weakness against USD persisted during 2Q20, Silknet's Net Debt-to-EBITDA remained elevated at 2.9x as of June 2020.

Silknet released audited 1H20 results. With GEL 184.9mn revenue and GEL 95.2mn EBITDA, Silknet maintained a second place in Georgia's telecom industry. Commercial revenue, making up c. 90% of total, was up 2.8% y/y to GEL 168.6mn or US\$ 55.6mn, however on a quarterly basis commercial revenue was down 6.6% in 2Q20. Mobile and fixed broadband were the hardest hit categories, as absence of international tourists put pressure on mobile voice and other mobile service revenues, while closure of number of business entities lowered Silknet's fixed broadband segment. Other revenue categories were also negatively affected, with pay TV revenue down 4.8% q/q, while carrier service revenue dropped by 8.6% q/q, mostly due to drastic drop in roaming revenue.

Silknet maintained strong market positions in 2Q20, remaining to be the largest fixed voice and second largest fixed broadband, Pay-TV and mobile operator in Georgia. Lower number of mobile subscribers (due to absence of international tourists), along with lower ARPU's earned, has caused overall sector revenues to decline, with April being the toughest month (revenue down 15.6% m/m). From May, mobile revenues have picked up, mostly helped by higher ARPU's. Market positions of the three major mobile operators have remained mostly unchanged in 2Q20.

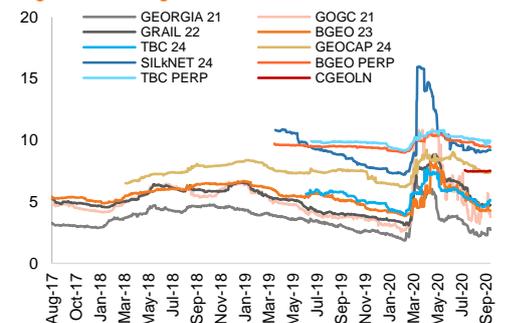
In fixed broadband, B2B revenues were under pressure. c. 27% of fixed broadband sector revenues stem from business customers. Fixed broadband market declined by 5.5% m/m in April 2020 (vs. 5.2% m/m decline for Silknet), while pay TV sector shrank by 4.6% m/m (Silknet's revenue declined in line with the market) in the same period. Notably, Silknet has maintained strong market positions by revenue, grabbing c. 35% of fixed broadband and c. 37% of pay TV segments in 1H20.

Figure 1: Georgian Eurobond universe



Source: Bloomberg, as of 1 October 2020

Figure 2: Georgian Eurobonds



Source: Bloomberg, as of 1 October 2020

Table 1: Key financial highlights

	GEL '000	1H19	1H20	Change, y/y
Revenue		184,037	184,907	+0.4%
of which commercial:		164,091	168,622	+2.8%
Adjusted EBITDA*		94,249	95,223	+1.0%
Adjusted EBITDA margin		51.2%	51.5%	n/a
Net income		-56,032	-39,635	n/a
Net profit margin		n/a	n/a	n/a
Assets		804,713	866,843	+7.7%
Liabilities		788,757	878,631	+11.4%
Equity		15,956	-11,788	-173.8%
Net Debt		559,925	611,578	+16.2%

Source: Company data

* Note: Excl. IFRS 16

Silknet credit ratings



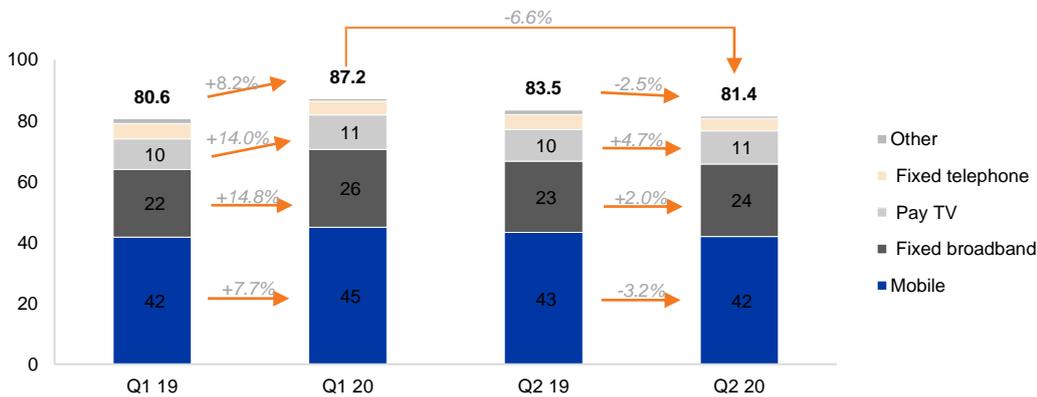
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As expected 2Q20 turned out to be a challenging quarter for Silknet. Commercial revenue was down 2.5% y/y to GEL 81.4mn in 2Q20. Notably the drop was more severe on a quarterly basis (-GEL 5.7mn or -6.6% q/q) driven by declines in almost all revenue categories and partially due to high base of 1Q20. Notably, mobile and fixed broadband services were hit hardest.

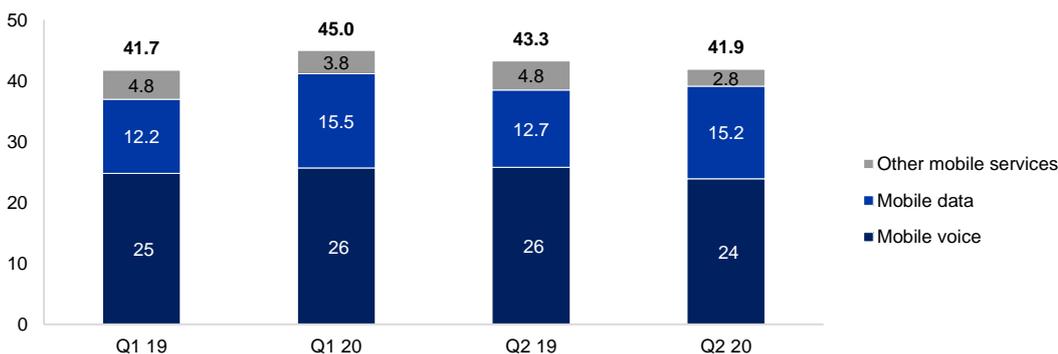
Figure 3: Commercial revenue down 2.5% y/y mostly due to lower mobile segment
Commercial revenue, GEL mn



Source: Company data, Galt & Taggart Research

Mobile segment, which combines two major categories: mobile voice and mobile data, was down 3.2% y/y to GEL 41.9mn in 2Q20. Notably, strong growth in mobile data revenue (up 19.5% y/y) driven by the new 'unlimited data packages', was not enough to offset the declines in mobile voice and other mobile service revenues. Tourism accounted for an important share of mobile revenues for the company. With absence of international tourism, income from tourists has dropped to almost zero, resulting in company's mobile voice revenues to drop 7.2% y/y in 2Q20. Notably, the decline was more severe on a quarterly basis, with mobile revenue down by GEL 3.1mn or 6.9% q/q.

Figure 4: COVID 19 hit tourism sector lowered Silknet's mobile voice revenues
Mobile revenue, GEL mn



Source: Company data, Galt & Taggart Research

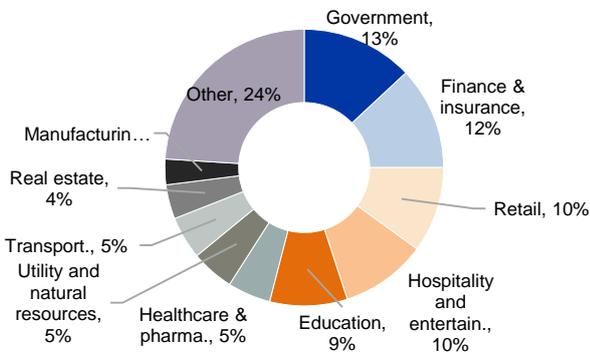
Fixed broadband, which used to be the growth engine for Silknet, stalled by temporary closure of pandemic hit companies in Georgia. B2B segment makes up c. 25% of Silknet's commercial revenue. Although exposure to hospitality and entertainment sectors is limited (3% of total revenue), country-wide lockdowns, temporary closure of hotels, restaurants and casinos as well as other business entities in Georgia negatively affected Silknet's fixed revenues. In addition, new customer acquisitions have slowed as the company introduced upfront installation fees for new subscribers to support the liquidity. The upfront fee was abandoned in August, as the economy stabilized.

Although on a yearly basis fixed broadband revenue increased, up 2.0% y/y (mostly due to larger subscriber-base, acquired throughout 2019), the category was down 6.4% to GEL 23.9mn on a quarterly basis.



Figure 5: Exposure to the most vulnerable sectors remains low

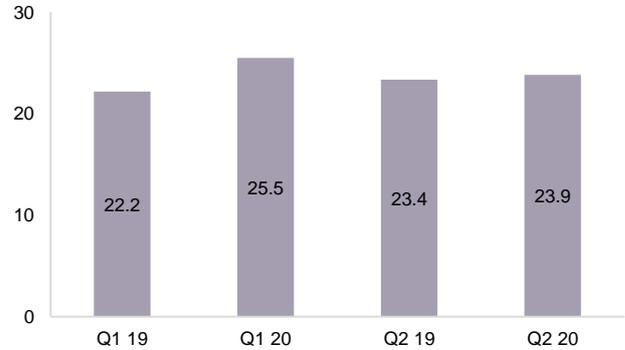
B2B revenue split by segment, GEL mn



Source: Company data
Note: composition of pre-COVID revenue

Figure 6: Fixed broadband revenues under pressure as number of business entities remain closed

Fixed broadband revenue, GEL mn



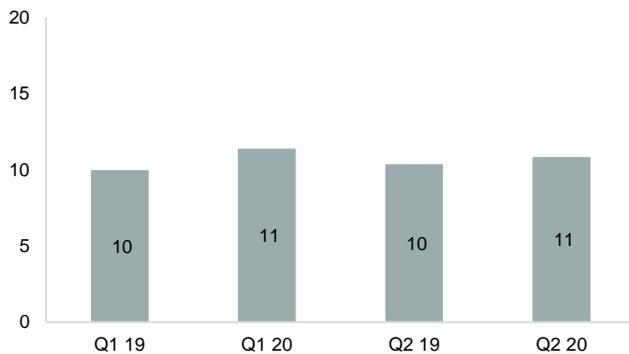
Source: Company data

Just like fixed broadband, Pay TV revenues have been under pressure during 2Q20, as number of business entities remain closed. The pace of growth in pay TV segment, which used to be the one of the fastest growing segments for Silknet (growing 14.0% y/y in 1Q20), slowed in 2Q20. Pay TV revenues increased 4.7% y/y in 2Q20, however on a quarterly basis the category shrank by 4.8% to GEL 10.9mn.

Carrier and other service revenues continued decline, with 2Q20 revenue down 27.2% y/y to GEL 7.8mn. The largest declines were observed in interconnection service and roaming revenues, which plummeted in 2Q20 as borders were entirely closed. Notably, on a quarterly basis carrier and other service revenues declined by 8.6%.

Figure 7: Pay TV contracted 4.8% q/q in 2Q20

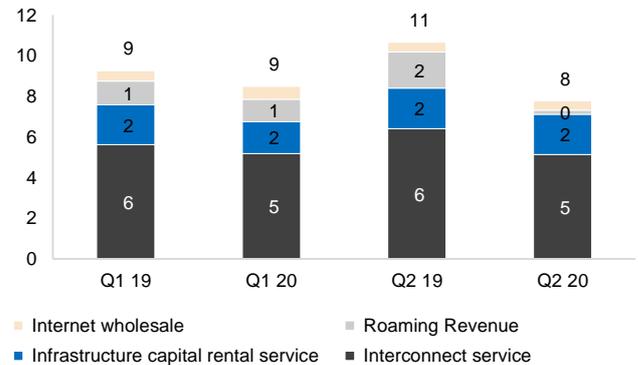
Pay TV revenue, GEL mn



Source: Company data

Figure 8: Roaming revenues plummeted in 2Q20

Carrier and other service revenues, GEL mn



Source: Company data

The situation improved in July-August, as domestic tourism revived and economic activity somewhat improved. Economic contraction in Georgia slowed to 5.5% in July from 7.7% in June and 12.6% in 2Q20, while VAT revenue growth turned positive in August 2020 for the first time since March. On the other hand, COVID-19 cases have risen in recent days, prompting the government to reintroduce some light restrictions (e.g. banning wedding celebrations) and postpone the opening of some businesses (indoor concerts, sporting events), regular international flights (until November 1, 2020) and schools (physical learning process suspended in big cities until October 1). Although we do not assume the reimposition of strict lockdown measures, further deterioration of the epidemiological situation could trigger additional measures from the government. Silknet's preliminary data on July and August show promising trends, according to the company information, revenues have rebounded to last year's results, despite absence of international tourism which is the driving force in Q3.



Market position

Silknet maintained strong market positions in 2Q20, remaining to be the largest fixed voice and second largest fixed broadband, Pay-TV and mobile operator in Georgia. As of Jun-20 the company had 1.65mn mobile subscribers, of which c. 815,000 were mobile data users, 291,000 fixed broadband and 229,000 pay-TV subscribers.

Mobile: Competition in the mobile market remained mostly unchanged in 2Q20. Notably, total number of subscribers has declined by 3.2% y/y or 158,000 in June. The decline is likely associated with the absence of international tourists in Georgia. Magticom and Silknet lost 77,000 and 96,400 subscribers over June 2019-20 respectively, while Veon added 15,000 new clients over the same period. As a result, market shares changed slightly, with Silknet's share down by 0.8ppts to 34.4%, Magticom lost 0.3ppts to 40.0%, while Veon gained 1.1ppts.

Silknet's mobile revenues (based on GNCC data) were down 8.4% q/q in 2Q20, compared to 7.5% q/q decline for Magticom and 9.3% q/q decline for Veon. Notably, on a yearly basis, Silknet showed the most resilient performance among the peers, with 2Q20 mobile revenues down 6.2% y/y vs. 9.6% and 8.7% y/y declines for Magticom and Veon, respectively.

Overall ARPUs in the market have been on the downward trajectory since 4Q19, particularly in the retail segment. Nevertheless, Silknet maintains higher ARPUs in retail segment, while leadership in the corporate segment (both in subscribers and in ARPUs) helps Magticom to grab the majority of the sector's revenue (Magticom manages to grab 45.4% of the total sectorial revenues with only 40% of subscribers).

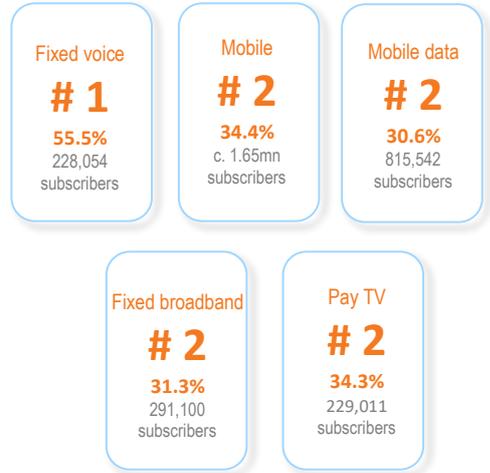
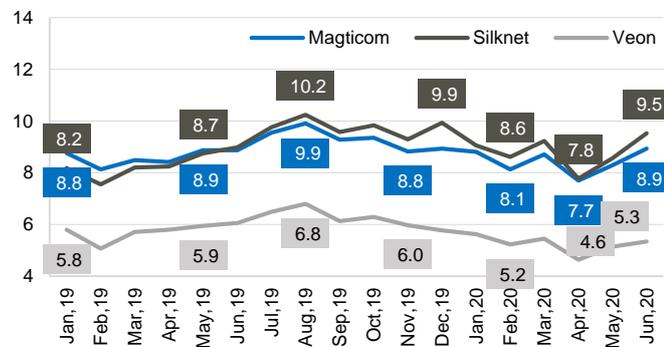


Figure 9: Silknet earns higher ARPUs in retail segment

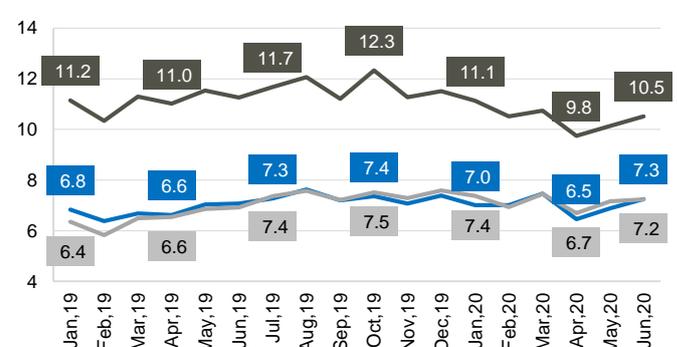
Mobile ARPUs in retail, GEL



Source: GNCC

Figure 10: Magticom is ultimate leader in corporate segment

Mobile ARPUs in corporate, GEL



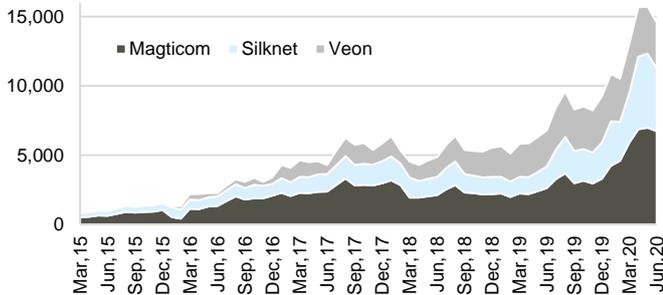
Source: GNCC

Amid pandemic related lockdowns and stay-at-home orders, the two leading mobile operators in Georgia, Magticom and Silknet, launched new campaign, offering unlimited data packages to the customers. This has **boosted data traffic in Georgia**, with mobile data traffic hitting all-time high of 15.7 terabytes in May 2020. Notably, Silknet achieved the fastest growth (bolstered by improved infrastructure), with per user data traffic jumping 4.0x over May 2019-20. With lifted restrictions and partial re-opening of the country, demand on mobile data traffic slightly declined in June 2020, down 7.4% m/m. It should be noted that the drop in per user data usage was most severe for Silknet.

Silknet's customers used 6.5GB/month in 2Q20, which is 3.8x higher than 2Q19 volume, however it is significantly lower compared to its competitor Magticom

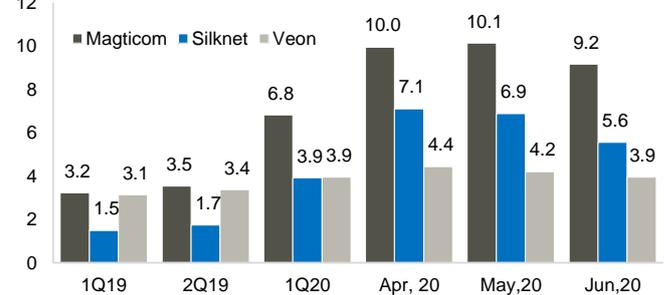


Figure 11: Data traffic hits record-high level in May, 2020
Mobile data traffic, terabytes



Source: GNCC

Figure 12: Data traffic usage slowed in June
Average mobile data traffic per user, GB/month



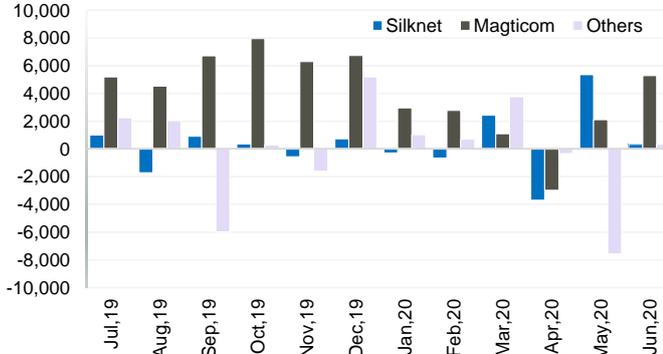
Source: GNCC
Note: data excludes M2M customers

Fixed broadband: After the strong growth in subscriber base during 2019, new customer acquisitions have stalled, particularly in 2Q20 (partially due to introduction of upfront installation fee by the company). Overall, c. 14,500 customers cancelled their fixed broadband subscriptions in 2Q20 (c. 1.5% total subscribers), as number of business entities were forced to close down due to COVID 19 pandemic. From May customer acquisitions for Magticom and Silknet have turned positive, with Silknet adding c. 5,400 customers in May, while Magticom added c. 7,400 over May-June. Notably, this came in on the back of lost subscribers of other fixed broadband operators (c. 7,600 lost customers in May, mostly Akhali Kselebi, Akhteli).

Silknet's fixed broadband revenues (based on GNCC data) were down 3.7% q/q in 2Q20, compared to 3.0% q/q decline for Magticom. Notably, on a yearly basis, Silknet's and Magticom's fixed broadband revenues increased at similar rates (1.1% and 1.2% y/y growth rates).

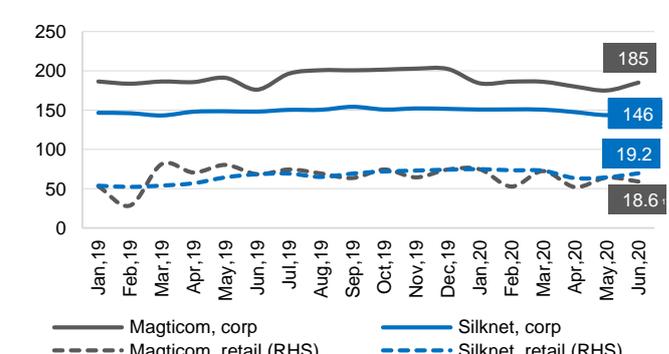
ARPU on fixed broadband services have been on the downward trajectory in 2Q20 due to temporary suspension of services. In May 2020, corporate ARPU dropped to GEL 175 for Magticom (-2.8% m/m) and to GEL 144 for Silknet (-2.5% m/m). The decline in earnings seems to have bottomed out in May, with June ARPU rebounding (Magticom returned to pre-crisis ARPU in corporate segment). In retail, ARPU have declined for both of the major players, with Silknet maintaining slightly higher ARPU compared to Magticom.

Figure 13: New customer acquisitions stalled by COVID 19
Number of new customers added, m/m



Source: GNCC

Figure 14: Fixed broadband ARPU on downward trajectory
Fixed broadband ARPU, GEL



Source: GNCC

Pay TV: Number of pay TV subscribers has dropped, with c. 30,000 customers cancelling their subscriptions in 1Q20. However, the loss was mostly incurred by Silknet's competitors. Notably, from May, both of the major companies have managed to add new customers (c. 6,400 customers). As of June 2020, Magticom holds 51.3% market share, while Silknet held 34.3%. Silknet's pay TV ARPU have been on the

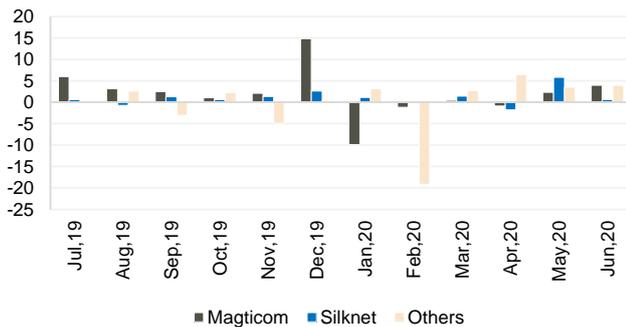


downward trajectory during 2020, with the pace of decline accelerating in 2Q20. Although Magticom has managed to increase ARPU, Silknet still earns higher.

Silknet's Pay TV revenues (based on GNCC data) were down 2.7% q/q in 2Q20, compared to 3.4% q/q decline for Magticom. Notably, on a yearly basis, Silknet's pay TV revenue was up 6.3% y/y in 2Q20 against the 14.6% y/y growth of Magticom.

Figure 15: New customer acquisitions at a slower pace

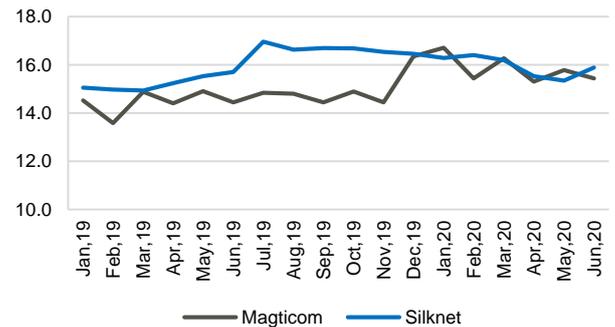
Number of Pay TV subscribers, '000



Source: GNCC

Figure 16: Pay TV ARPUs have been declining

Pay TV ARPUs, GEL



Source: GNCC

Fixed Voice: Silknet maintains leadership position in the shrinking, fixed telephone market, holding 55.5% market share as of June 2020. Notably the pace of market reduction accelerated during pandemic, with c.17,200 clients cancelling their subscriptions only in June 2020, most of whom were Silknet's clients (c. 15,000).

Financial performance

With deteriorated operating performance during 2Q20, Silknet's EBITDA (including IFRS 16) declined 5.2% q/q to GEL 49.6mn. However, strong performance during 1Q20, helped the company, with 1H20 EBITDA coming in at GEL 102.0 mn, which is 1.6% higher compared to the same period last year and translates into EBITDA margin of 55.2%. Excluding IFRS 16, 1H20 EBITDA stood at GEL 95.2mn or US\$ 31.4mn, translating into EBITDA margin of 51.5% (vs. 51.2% in 1H19). Notably, the company has managed to maintain high profitability margins in a challenging quarter.

Due to continued weakness of GEL (during 1H20 GEL depreciated by 6.5% against dollar, to 3.05/USD by 30 June), **Silknet's open FX position** remains to be the risk factor, as 95% of Silknet's debt is USD denominated, while 73% of total debt remains unhedged.

Net-debt-to-EBITDA remains elevated. 1H20 net-debt-to-EBITDA ratio jumped to 2.90x from 2.75x by end-2019 (2.95x from 1Q20).

On 3 September, 2020 a major change in shareholder structure was announced. After the approval from the regulator, **Kazakh investor, Yerkin Tatishev, became the beneficial shareholder of Silknet, with 36.3% equity stake.** As a result, Giorgi Ramishvili's shareholding was reduced to 36.3%. Alexi Topuria holds the remaining 16.8%, while David Borger and David Mamulaishvili retained 5.6% and 5.0% shares, respectively.

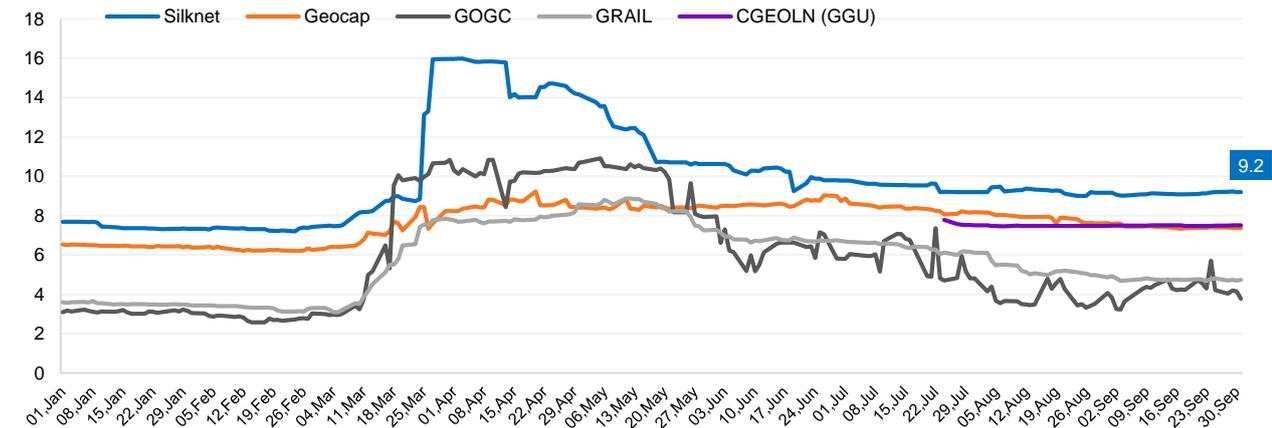
Born in Kazakhstan, Yerkin Tatishev is the Chairmen of a Singapore based Kusto Group. Mr. Tatishev has a long history of co-investing with the Silk Road Group (parent company of Silknet) and has also carried out many cultural and philanthropic projects in Georgia. According to company information, no major changes are expected in either Silknet or in other Silk Road Group companies, including on management and supervisory board level.



Eurobond performance

After the significant hike in Silknet's yield during March-April (to 15.9% by mid-Apr) the yield started to decline in summer months, in line with other Georgian Eurobonds. Yield on SILKNET 24 dropped to average 9.1% in September, 2020.

Figure 17: Yields on Georgian Eurobonds have been declining during 2Q20 and remain slightly above the pre-crisis levels
YTM on selected Georgian Eurobonds



Source: Bloomberg, as of 1 October 2020



Annex 1: Financials

Income Statement, GEL mn

	1H19	1H20
Total revenue	184.0	184.9
Commercial revenue	164.1	168.6
Carrier services	19.9	16.3
EBITDA, incl. IFRS 16	100.4	102.0
EBITDA margin	54.6%	55.2%
EBITDA, excl. IFRS 16	94.3	95.2
EBITDA margin	51.2%	51.5%
D&A	-56.4	-58.3
Financial costs (income), net	-51.5	-36.2
PBT	-54.9	-40.5
Tax expense	-1.1	0.8
Net income	-56.0	-39.7
Net margin	-30.4%	-21.5%

Note: EBITDA is excluding IFRS 16 adjustments

Income Statement, US\$ mn

	1H19	1H20
Total revenue	60.6	61.0
Commercial revenue	54.1	55.6
Carrier services	6.6	5.4
EBITDA, incl. IFRS 16	33.1	33.6
EBITDA margin	54.6%	55.2%
EBITDA, excl. IFRS 16	31.1	31.4
EBITDA margin	51.2%	51.5%
D&A	-18.6	-19.3
Financial costs (income), net	-17.0	-11.9
PBT	-18.1	-13.4
Tax expense	-0.4	0.3
Net income	-18.5	-13.1
Net margin	-30.4%	-21.5%

Balance Sheet, GEL mn

	1H19	1H20
Non-current assets	639.1	757.0
Net PP&E	366.8	374.8
Intangible assets and	205.5	206.9
Other	139.6	175.3
Current assets	165.6	109.8
Cash & equivalents	105.9	63.1
Receivables & prepayments	35.6	33.1
Other	24.1	13.6
Total assets	804.7	866.8
Shareholders' equity	15.9	-11.8
Non-current liabilities	668.1	705.7
LT interest bearing debt	616.7	625.3
Other	51.4	80.4
Current liabilities	120.7	172.9
ST loans	15.7	49.5
Trade payables & prepaym.	72.7	89.9
Other	32.3	33.5
Total liabilities & equity	804.7	866.8

Balance Sheet, US\$ mn

	1H19	1H20
Non-current assets	209.2	247.8
Net PP&E	120.1	122.7
Intangible assets and	67.3	67.7
Other	45.7	57.4
Current assets	54.2	35.9
Cash & equivalents	34.7	20.7
Receivables & prepayments	11.7	10.8
Other	7.9	4.5
Total assets	263.4	283.7
Shareholders' equity	5.2	-3.9
Non-current liabilities	218.7	231
LT interest bearing debt	201.9	204.7
Other	16.8	26.3
Current liabilities	39.5	56.6
ST loans	5.1	16.2
Trade payables & prepaym.	23.8	29.4
Other	10.6	11
Total liabilities & equity	263.4	283.7



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