



Silknet - 9M20 update

Challenge and response

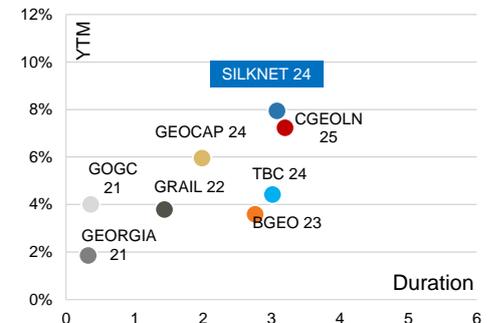
Despite challenging environment, the pace of decline decelerated in 3Q20 for Silknet. Although strict lockdown measures were lifted from late May, the absence of international tourists and certain restrictions for various businesses put pressure on telecom sector in Georgia. With recovery in economic activity and introduction of “unlimited data packages” in summer months, mobile data revenue jumped by 21.1% q/q in 3Q20, however this was insufficient to compensate losses in more traditional mobile revenue streams (SMS, mobile accessories) and fixed broadband income. Silknet generated GEL 258.2mn (up 1.0% y/y, US\$ 84.5mn) in commercial revenues in 9M20, reflecting strong performance in 1Q20 and slightly lower revenues in 2Q and 3Q (down 2.5% y/y and 2.1% y/y, respectively). On a positive note, Silknet maintained strong profitability metrics, earning GEL 156.9mn (US\$ 51.3mn) in EBITDA in 9M20, translating into an impressive EBITDA margin of 55.4%. Notably, on the back of weaker revenue generation, the company’s profitability came under pressure during 3Q20, with EBITDA (incl. IFRS) down 7.8% y/y. Weaker GEL was the main reason behind the deterioration of Net-debt-to-EBITDA ratio, which jumped to 3.04x as of September 2020. In November, Silknet issued Georgian Depository Notes, which aim to enlarge the pool of fixed income investors in Georgia.

Silknet released unaudited 9M20 results, showing slight underperformance in 3Q20, albeit at a lower pace compared to 2Q20. With GEL 282.9mn revenue and GEL 156.9mn EBITDA, Silknet maintained a strong second place in Georgia’s telecom industry. After declining by 2.5% y/y in 2Q20, commercial revenue was down 2.1% y/y to GEL 91.4mn or US\$ 29.5mn in 3Q20. Growth in mobile voice and mobile data revenues in 3Q20, was not enough to offset lower income from SMS (-46% y/y) and fixed broadband revenue categories. Notably, revival of economic activity in the summer months, helped the company to return to last year’s levels in all major revenue streams. Carrier service revenue, which makes up c.10% of total revenue, continued the decline, down 24.9% y/y in 3Q20.

The lifting of strict lockdown measures from late May, helped Silknet’s 3Q performance. With number of virus cases maintained at extremely low levels, the economic activity in the summer months in Georgia revived, with mobility and local tourism flourishing. As a result, telecom sector has experienced positive trends, particularly in mobile data, however, absence of tourists and limited operations of hospitality and entertainment sectors puts negative pressure on overall market.

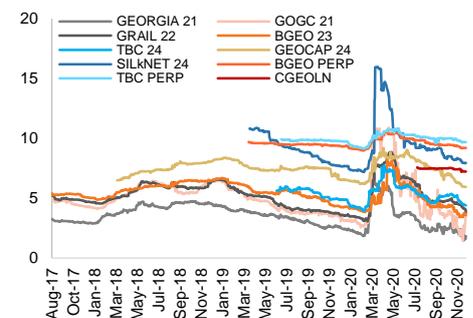
Mobile data explosion continued in Georgia, with monthly data usage hitting the highest level on record in August, boosted by “unlimited data packages” offered by the major operators. Increased usage of mobile data has put pressure on traditional mobile revenue streams, such as voice and SMS, which were down by 10.8% y/y and 21.9% y/y in 3Q20 on a sector-wide level. Overall, mobile revenues declined by 3.1% in 3Q20. The growth in fixed broadband, which used to be one of the fastest growing segments in telecom industry, has declined, with 3Q revenues up 2.4% y/y. In pay TV, after growing by 13.1% in 1Q20 and 6.0% in 2Q20, the revenues increased by 4.5% y/y in 3Q20.

Figure 1: Georgian Eurobond universe



Source: Bloomberg, as of 16 December 2020

Figure 2: Georgian Eurobonds



Source: Bloomberg, as of 16 December 2020

Table 1: Key financial highlights

	GEL '000	9M19	9M20	Change, y/y
Revenue		286,721	282,908	-1.3%
of which commercial:		255,529	258,176	+1.0%
Adjusted EBITDA*		150,548	146,697	-2.6%
Adjusted EBITDA margin		52.5%	51.9%	-65bps
Net income		-61,097	-81,282	n/a
Net profit margin		n/a	n/a	n/a

Assets	812,000	892,537	+9.9%
Liabilities	796,000	945,969	+18.8%
Equity	16,000	-53,432	n/a
Net Debt	543,000	646,800	+19.1%

* Note: Excl. IFRS 16

Silknet credit ratings



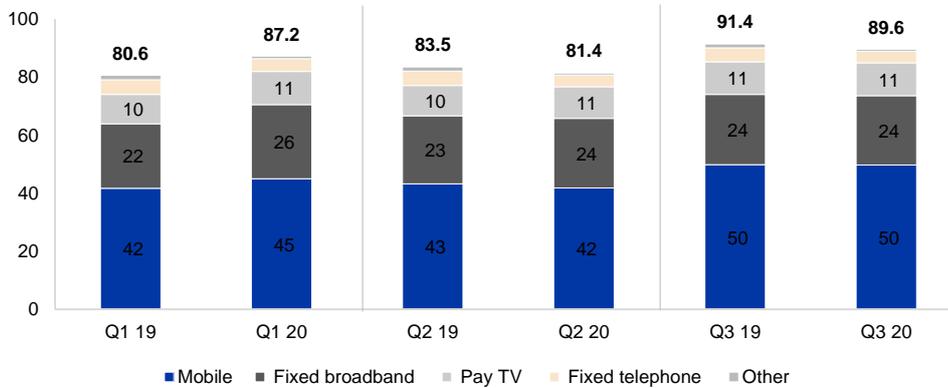
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Figure 3: Commercial revenue down 2.1% y/y in 3Q20, mostly due to lower SMS revenues

Commercial revenue, GEL mn



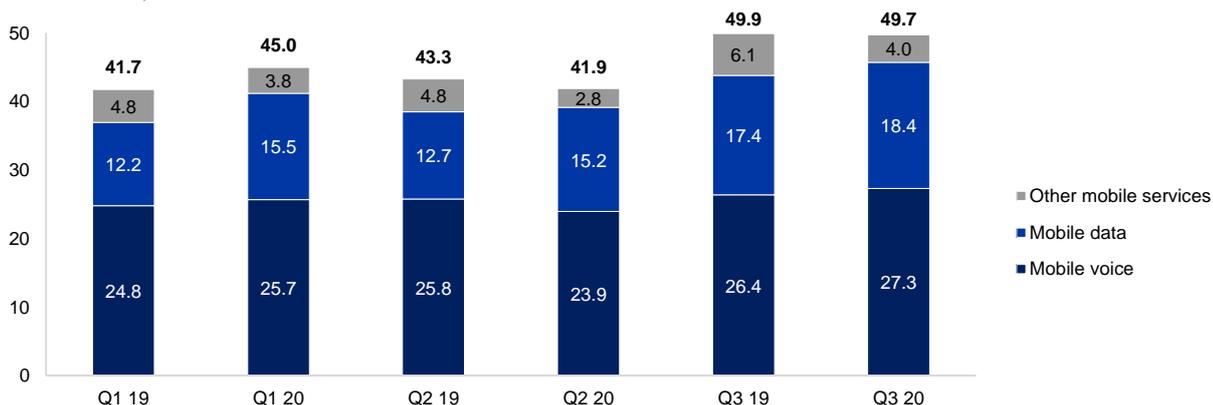
Source: Company data, Galt & Taggart Research

Mobile segment, which combines two major categories: mobile voice and mobile data, remained mostly flat in 3Q20, down 0.4% y/y to GEL 49.7mn. The growth in mobile data continued, albeit at a slower pace. Mobile data revenue increased 5.6% y/y in 3Q20, despite non-existent tourism sector. Mobile voice revenues, which make up more than half of total mobile revenues, also rebounded in 3Q20, up 3.6% y/y (after a 7.2% y/y decline in 2Q20) helped by increased mobility in summer months.

On the back of the increased data usage, traditional revenue streams came under pressure. SMS revenue, which made up 4% of 9M19 commercial revenue dropped sharply in 3Q20, down 46.0% y/y to GEL 2.3mn (notably in 9M20 SMS revenue has declined by 33% y/y). The drop in SMS revenue, was the main reason behind the decline in overall commercial revenues for the company.

Figure 4: Traditional mobile revenue streams under pressure as mobile data continues expansion

Mobile revenue, GEL mn



Source: Company data, Galt & Taggart Research

Fixed broadband, which used to be the growth engine for Silknet, has been stalled by COVID-19 pandemic. Fixed broadband revenue was down 0.8% y/y to GEL 23.9mn in 3Q20 as number of businesses remain closed down. Furthermore, new customer acquisitions have slowed as COVID-19 related economic disruptions put pressure on income levels of Georgian people, while upfront installation fees for new subscribers (introduced by the company in 2Q20 and cancelled in August) was additional burden.



Pay TV revenues have remained mostly flat in 3Q20. GEL 11.3mn was generated in pay TV segment in 3Q20, which is 0.2% lower compared to the same period last year and 3.6% higher than 2Q20. The quarterly growth is associated with the gradual opening of economy in 3Q20, with domestic tourism flourishing. It should be mentioned that COVID-19 still has significant negative impact on Pay TV, which used to be one of the fastest growing segments for Silknet (growing 14.0% y/y in 1Q20).

Carrier and other service revenues continued decline in 3Q20, with revenue down 24.9% y/y to GEL 8.4mn. The largest declines were observed in roaming (which dropped 87% y/y in 3Q due to non-existent tourism) and interconnection service revenues.

Georgia managed to contain the spread of COVID-19 during the first wave, due to imposition of timely measures for a period of April-June. As restrictions were loosened during the summer months, the mobility in the country increased, which resulted in acceleration of virus spread. By September, Georgia was recording c. 4,500 daily cases, with no strict measures taken to contain the spread (October was election month in Georgia, followed by political demonstrations in early November). As the spread of the virus continued, on 26 November the Government announced about the imposition of stricted restrictions for a period of 2 months, starting from 28 November. Unlike the first restrictions applied in spring 2020, recent restrictions are less strict as no restrictions apply to large segments of businesses (construction activities, banking and finance institutions, groceries, pharmacies and hygienic shops, pet shops, press shops, beauty salons, car services, home appliance repair services, agricultural markets, taxi services, or private transportation).

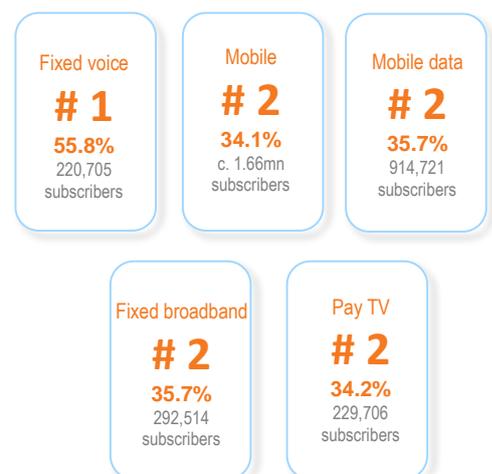
By our rough estimates, the 2nd lockdown will widen economic contraction to 5.5% in 2020, revised downwards from our existing forecast of -5.1%. Although the imposed restrictions will have negative impact on overall economy, the impact on telecom industry is expected to be less severe than in the spring months.

Market position

Silknet maintained strong market positions in 3Q20 as the largest fixed voice and second largest fixed broadband, as well as Pay-TV and mobile operator in Georgia. The company had 1.66mn mobile subscribers as of Sep-20, of which c. 915,000 were data users. Notably by this measure Silknet is the market leader, holding an approximate share of 35.7% (excluding M2M subscribers). In addition, Silknet had c. 292,500 fixed broadband and 229,700 pay-TV subscribers.

Mobile: Total number of subscribers have been slowly growing during 3Q20. Magticom added c. 43,400 new subscribers in 3Q20 compared to previous quarter, followed by Veon with additional of 18,800 subscribers and Silknet adding 10,100 subscribers in the same period. Notably, on a yearly basis Silknet and Magticom have lost 86,500 and 80,200 subscribers, respectively, which is likely related to the absence of incoming tourists during summer months. Overall, market shares of the mobile operators have remained unchanged in 3Q, with Magticom firming 40% of the market, closely followed by Silknet with 34.1% share.

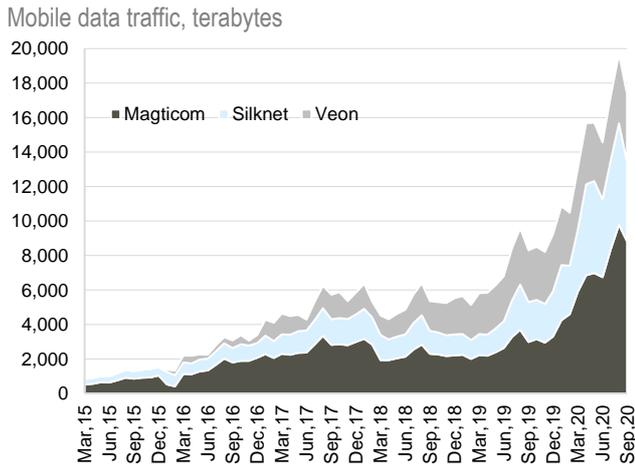
For the first time since 4Q19 mobile ARPUs have reversed and are on the upward trajectory in 3Q20. Growth was driven by higher ARPUs earned in both retail and corporate segments by all market players. Silknet maintains to earn highest ARPUs on retail customers, while in corporate segment Magticom holds the leadership position.





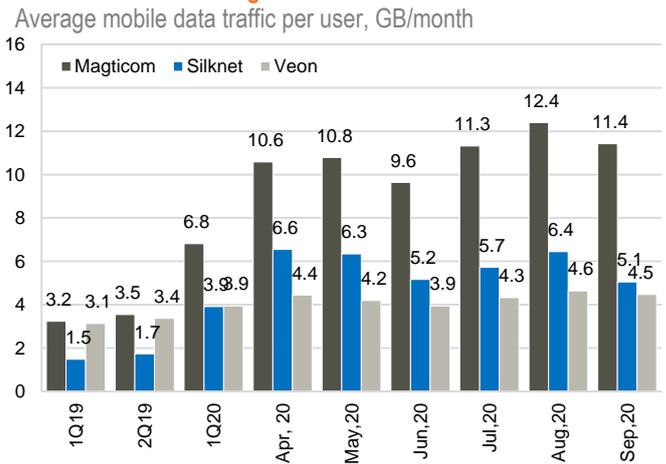
Mobile data traffic explosion continues in Georgia, with monthly data usage hitting another record of 19.7 terabytes in August. The jump in data traffic is related to the introduction of unlimited data packages by Magticom and Silknet. Although, Silknet has achieved tremendous growth in per user data (doubled in 3Q20 over 3Q19), Magticom's subscribers remain to be more data intensive, with the gap between the two operators remaining still significant.

Figure 5: Data traffic hits record-high level in August, 2020



Source: GNCC

Figure 6: The gap in per user data usage between Magticom and Silknet remains significant



Source: GNCC

Note: data excludes M2M customers

Fixed broadband: After the decline in 2Q20, total number of fixed broadband subscribers increased in 3Q20. A total of 9,600 net additions were recorded in 3Q, of which most of the additions took place in September. Notably, Magticom added 3,600 subscribers in 3Q20, while Silknet added another 1,400 clients. Market shares have remained mostly unchanged in fixed broadband segment in 3Q20.

ARPU on fixed broadband services have remained mostly stable in 3Q20, albeit slightly lower compared to the 1Q20 level. The major decline in ARPU is related to the closure of business entities due to COVID-19 and shrinking disposable income of Georgians.

Notably, Magticom has managed to increase its ARPU on corporate clients by 10% m/m in September (reaching GEL 201.4). Overall, Magticom's average corporate ARPU in 3Q20 are c. 1.5% higher than the same number in 1Q20. On the other hand, Silknet's average corporate ARPU stood at GEL 143.7 (vs. GEL 188.3 for Magticom) in 3Q20 which is almost 5% lower than the same number in 1Q20.

In retail, ARPU have declined by 1.4% for Silknet, while Magticom managed to maintain same level. Nevertheless, Silknet earns c. 1.1% higher ARPU on retail clients compared to the main competitor, Magticom.

Pay TV: After record-high number of subscribers cancelled their pay-TV subscriptions in Jan-Feb (c. 26,000) related to Magticom's phase out of satellite TV, the trend has been rather positive in 2Q-3Q. After adding c. 24,000 customers in 2Q20, the pace of customer re-acquisition has declined, however it still remains positive in 3Q20, with c. 3,700 new pay-TV subscribers added. Notably, in 3Q20 Magticom added c. 2,000 subscribers, while Silknet added only 700 subscribers.

Overall, market positions of the key players haven't changed much, with Magticom holding 51.2% market share, while Silknet secures the second position with 34.2% share. ARPU in the pay-TV segment have remained mostly flat in 3Q, but still below than the levels found in 1Q20. Notably, the gap between the two companies in pay-TV ARPU has disappeared with GEL 15.7 earned by both, Magticom and Silknet.



Fixed Voice: The pace of decline in fixed telephone segment accelerated in 3Q20, with total number of subscribers down by 25% y/y. To put this in numbers, only in 3Q20 c. 17,500 customers cancelled their subscriptions, of which 7,300 were Silknet's customers. Nevertheless, Silknet maintains a leadership position in the fixed voice segment, accounting for 55.8% of the market.

Financial performance

Silknet's maintains strong profitability on operational level. Silknet generated GEL 156.9mn in EBITDA in 9M20, which was 1.9% lower compared to the same period last year. While EBITDA, that excludes IFRS 16 was down 2.6% y/y to GEL 146.7mn in 9M20. Notably, with slight weaknesses in revenue generation, the company's profitability came under pressure during 2Q20 and 3Q20. Silknet's EBITDA (incl. IFRS) was down 7.8% y/y in 3Q20 after declining by 4.8% y/y in 2Q20. Despite slight deterioration, Silknet maintains strong, above 50% EBITDA margin.

FX remains to be the major risk factor for Silknet. In summer months, despite improved economic sentiments, GEL continued depreciation, with GEL/USD exchange rate reaching 3.29 by end of September (vs. 3.05/USD by 30 June). As 95% of Silknet's debt is USD denominated (with 73% of total debt unhedged), weaker GEL puts additional strain on the company. Silknet recognized a large, GEL 93.0mn, non-cash FX loss in 9M20, bringing the bottom line to a negative GEL 81.3mn. Weaker GEL on the one hand and slightly lower profitability on the other, contributed to the deterioration of **Net-debt-to-EBITDA ratio, which came in at 3.04x as of September 2020** (vs 2.75x by end-2019).

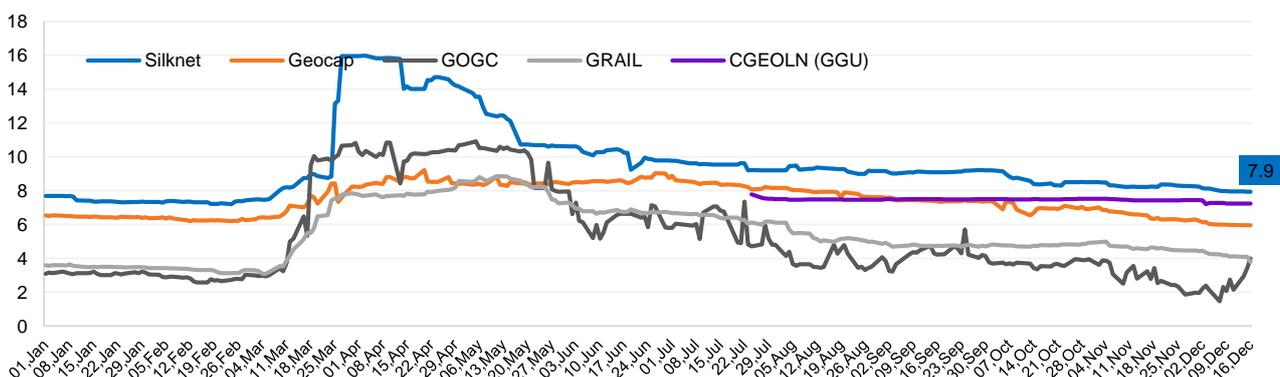
Eurobond performance

With improved investor sentiments, boosted by vaccine news, the interest towards Emerging Markets, including regional fixed income universe has increased in the second half of the year. For the past couple of months, yields on Georgian Eurobonds have been on the downward trajectory, dropping to pre-pandemic levels. Silknet wasn't the exceptions, with the yield on SILKET 24 dropping to 7.9% as of 16 December, the level last seen in early March.

In November Silknet launched Georgian Depository Notes, which are linked to US\$ 200mn Eurobonds. The issuance of the notes, with US\$ 1,000 denomination, is aimed to increase local demand on Eurobonds, by removing the barriers (minimum investment US\$ 200,000), which make purchase of Eurobonds unaffordable for many Georgians. Notably, this is the debut issuance of depository instruments in Georgia.

Figure 7: Yields on Georgian Eurobonds dropped to pre-pandemic levels in 3Q20

YTM on selected Georgian Eurobonds



Source: Bloomberg, as of 16 December 2020



Annex 1: Financials

Income Statement, GEL mn

	9M19	9M20
Total revenue	286.70	282.90
Commercial revenue	255.50	258.20
Carrier services	31.20	24.70
EBITDA, incl. IFRS 16	159.90	156.80
EBITDA margin	55.77%	55.44%
EBITDA, excl. IFRS 16	150.50	146.70
EBITDA margin	52.51%	51.85%
D&A	-83.80	-87.80
Financial costs (income), net	-128.20	-146.70
PBT	-59.30	-81.90
Tax expense	-1.20	-0.60
Net income	-61.10	-81.30
Net margin	-21.31%	-28.73%

Note: EBITDA is excluding IFRS 16 adjustments

Income Statement, US\$ mn

	9M19	9M20
Total revenue	103.26	92.58
Commercial revenue	92.02	84.50
Carrier services	11.24	8.08
EBITDA, incl. IFRS 16	57.59	51.31
EBITDA margin	55.77%	55.44%
EBITDA, excl. IFRS 16	54.21	48.01
EBITDA margin	52.51%	51.85%
D&A	-30.18	-28.73
Financial costs (income), net	-46.17	-48.01
PBT	-21.36	-26.80
Tax expense	-0.43	-0.20
Net income	-22.01	-26.61
Net margin	-21.31%	-28.73%

Balance Sheet, GEL mn

	9M19	9M20
Non-current assets	627	752
Net PP&E	369	378.5
Intangible assets and	204	198.2
Other	54	175.3
Current assets	185	140.2
Cash & equivalents	125	95.4
Receivables & prepayments	36	31.3
Other	24	13.5
Total assets	812	892.5
Shareholders' equity	16	-53.5
Non-current liabilities	664	751.8
LT interest bearing debt	635	670.3
Other	29	81.6
Current liabilities	132	194.2
ST loans	33	72.0
Trade payables & prepaym.	76	87.3
Other	23	34.9
Total liabilities & equity	812	892.5

Balance Sheet, US\$ mn

	9M19	9M20
Non-current assets	212.2	228.7
Net PP&E	124.9	115.1
Intangible assets and	69.0	60.3
Other	18.3	53.3
Current assets	62.6	42.6
Cash & equivalents	42.3	29.0
Receivables & prepayments	12.2	9.5
Other	8.1	4.1
Total assets	274.8	271.5
Shareholders' equity	5.4	-16.3
Non-current liabilities	224.7	228.7
LT interest bearing debt	214.9	203.9
Other	9.8	24.8
Current liabilities	44.7	59.1
ST loans	11.2	21.9
Trade payables & prepaym.	25.7	26.6
Other	7.8	10.6
Total liabilities & equity	274.8	271.5



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