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Silknet – 1Q23/2022 update

Positioned for low double-digit growth in 2023

Fixed Income Research | Georgia
Silknet
June 13, 2023

Silknet, a leading telecoms operator in Georgia, reported a strong financial performance in 2022, with a revenue growth of 14.4% y/y, primarily driven by mobile data. The company's impressive performance extended into the 1Q23, with revenue up 19.0% y/y, reaching GEL 125.4mn. This growth in 1Q23 was primarily driven by organic growth as well as the repackaging and pricing adjustments. The company maintained its revenue market shares in key segments - mobile, fixed broadband, pay-TV and fixed voice in 2022. Adjusted EBITDA reached GEL 284.1mn, marking a noteworthy 24.8% y/y increase in 2022. Furthermore, in 1Q23 the adjusted EBITDA was up 31.8% to GEL 78.9, with the appreciation of GEL contributing positively to improved profitability both in 2022 and 1Q23. The company successfully achieved significant deleveraging by reducing its net debt to EBITDA ratio to 1.6x in 2022 and further to 1.3x in 1Q23 from 3.3x in 2020.

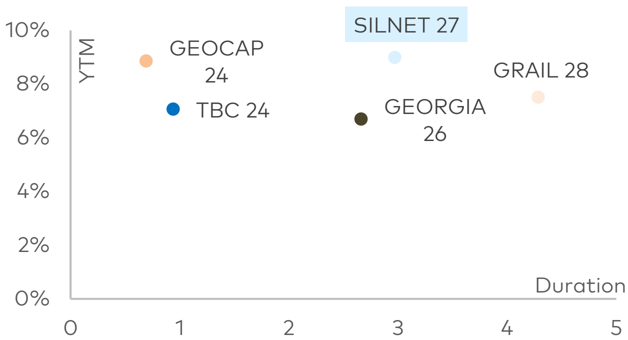
We anticipate a low double-digit revenue growth in 2023, driven by mobile data. The growth will be supported by prevailing industry trends such as increased use of digital services for work and entertainment, e-commerce, data-heavy social media platforms and greater tourism revival to some extent. Fixed broadband and Pay-TV revenues are also expected to grow, while fixed voice revenues will continue to decline. Overall, we expect commercial revenue to increase by 13.6% y/y to GEL 486.3mn in 2023, while we forecast the company's adjusted EBITDA to reach GEL 322.3mn in 2023, translating into a solid 60.8% EBITDA margin including IFRS 16.

Mobile data – key driver for revenue growth

Financial highlights, GEL mn	**2021**	**2022**	**1Q22**	**1Q23**	**y/y change**	**q/q change**
Revenue	413.4	473.0	105.4	125.4	+14.4%	+19.0%
of which:						
Mobile data	82.7	120.4	23.5	33.4	+45.7%	+41.9%
Fixed broadband	102.0	114.4	26.5	32.5	+12.2%	+22.6%
Mobile callout	103.4	109.6	24.5	26.8	+6.0%	+9.5%
PayTV	46.2	50.6	11.8	13.9	+9.7%	+17.4%
Other	79.2	77.9	19.1	18.8	-1.7%	-1.4%
Adjusted EBITDA*	227.6	284.1	59.9	78.9	+24.8%	+31.8%
Adjusted EBITDA margin	*55.1%*	*60.1%*	*56.8%*	*63.0%*	*+5.0ppts*	*+6.2ppts*
Net income	41.5	134.5	-48.1	60.1	n/a	n/a
Net profit margin	*10.0%*	*28.4%*	*n/a*	*47.93%*	*n/a*	*n/a*
Assets	847.5	820.1	898.6	833.7	-3.2%	-7.2%
Liabilities	896.3	734.4	995.5	688.0	-18.1%	-30.9%
Equity	-48.8	85.7	-96.9	145.8	n/a	n/a
Net Debt	584.7	467.2	640.8	404.3	-20.1%	-36.9%

Source: Company information
* incl. IFRS 16

A high yielding Eurobond



Source: Bloomberg

Favorable credit and ESG ratings

Source: Company information

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Silknet performance in 2022

Silknet's revenue grew 14.4% y/y to GEL 473.0mn in 2022, primarily driven by mobile data. Mobile data has been the leading contributor to revenue growth since 2020, bolstered by rising mobile data subscribers, pricing adjustments and higher per-user data consumption. The surge in digital services, e-commerce and data-heavy social media plaftorms like Instagram and Tiktok resulted into greater reliance on mobile devices for work and remote collaboration, boosting mobile data usage since 2020. Although mobile data generated the highest revenue growth, fixed broadband and mobile callout, the 2nd and 3rd largest revenue generators also recorded increase, up 12.2% y/y and 6.0% y/y, respectively in 2022.

Stable market shares maintained in 2022. Silknet has been able to maintain its revenue market share at 34.4% in the key mobile segment, which accounts for over half of the Georgian telecoms market and the company's revenues. The company also maintained a steady year-on-year market shares in fixed broadband and pay-TV segments at 33.7% and 35.8% in 2022, despite a slight decline since 2016. The overall fixed telephone market continues to shrink, reflecting the global trend of fixed-to-mobile substitution, with Silknet maintaining a strong #1 position, with revenue share of 49.1% in this segment in 2022.

Fixed voice
1
56.3%
180,096 subscribers

Mobile
2
33.2%
c. 1.8mn subscribers

Mobile data
1
35.9%
c. 1.2mn subscribers

Fixed broadband
2
30.7%
311,124 subscribers

Pay TV
2
36.0%
267,073 subscribers

Silknet's adjusted EBITDA reached GEL 284.1mn in 2022, up 24.8% y/y. EBITDA growth was largely driven by an increase in revenue, as well as a decrease in certain operating expenses including pay-TV content costs, advertising and marketing expenses, interconnect fees and roaming expenses and others. Additionally, the appreciation of Georgian Lari against US dollar has positively impacted Silknet's EBITDA, as a significant portion of company's operating expenses are in USD. As a result of these factors, Silknet's adjusted EBITDA margin improved to 60.1% in 2022 from 55.1% in 2021.

Silknet has successfuly achieved significant deleveraging, as evidenced by the decline in net debt to EBITDA ratio from 3.3x in 2020 to 1.6x in 2022. The company's debt profile has been streamlined, as its only debt instrument in its capital structure is the US$ 300mn Eurobonds issued in Jan-22. Notably, Silknet has repurchased US$ 100mn Eurobonds from the open market, resulting in a nominal amount of US$ 200mn outstanding as of Dec-22. This strategic move coupled with a healthy EBITDA, has contributed to a reduction in the company's debt burden in 2022.

Silknet's vulnerability to FX fluctuations remained high in 2022, given its foreign currency-denominated debt, significant portion of capex (79%) and opex (24%) being in foreign currencies and nearly entire revenue (97%) being in GEL. Notably, the company employes a combination of operational and financial measures to mitigate currency risks, including cross-currency hedging, forward contracts and FX reserves. Although the use of cross-currency hedging was temporarily suspended in 1Q22 due to higher costs, the company continues to proactively implement operational strategies to manage currency risks. These strategies include maintaining a non-committed dividend policy, managing discretionary capex expenses and having the flexibility to adjust prices following the removal of pricing regulation by GNCC.

Credit ratings improved in 2022, indicating a more favorable outlook for the company's financial stability. Moody's revised the 'B1' rating outlook for Silknet from Negative to Stable in Jan-22. In Nov-22, Fitch also upgraded Silknet's rating from 'B' to 'B+' with a Stable outlook. Additionally, in Mar-23, Sustainalytics also improved Silknet's ESG rating, providing further evidence of company's commitment towards environmental, social and governance issues. These improved ratings enhance Silknet's financial and corporate responsibility and its reputation on the market.

Silknet performance in 1Q23

Silknet recorded an impressive 19.0% y/y growth in revenue, reaching GEL 125.4mn in 1Q23. Mobile data remained the primary catalyst driving the revenue growth, although other segments also played a role. Mobile data revenues were up 41.9% y/y to GEL 33.4mn in 1Q23. This increase was primarily fueled by substantial growth in mobile data usage as well as tariff adjustments implemented in 2022, phased in during February and July. Revenues from fixed broadband and mobile callout, the second and third largest revenue generators, were also up 22.6% y/y and 9.5% y/y, respectively, with pricing adjustments serving as the key driver for their growth.

Silknet's adjusted EBITDA was up 31.8% to GEL 78.9 in 1Q23, accompanied by a further improvement in the EBITDA margin, standing at 62.9% in 1Q23. Continued appreciation of Georgian Lari has positively influenced the profitability in 1Q23. The solid cash generation observed over the past two years combined with the positive impact of GEL appreciation has helped Silknet to maintain a leverage ratio well below the medium-term target level of 2.0x. Silknet's net debt to EBITDA stood at 1.3x as of 1Q23.

Silknet has revealed its intention to distribute a meaningful amount of dividends in the upcoming years, following a period of not paying dividends over 2019-22 (excluding 2021) at all. However, the exact timing and magnitude of these distributions will be subject to the prevailing economic, political, and market conditions. Notably, there are two specific constraints governing the dividend payments for the company. Firstly, dividends are capped at 50% of the consolidated net income from 2022 by the new Eurobond covenant. Secondly, dividends can not exceed the positive retained earnings, according to the law of Georgia on Entrepreneurs.

Emphasizing its effors to expand digital engagement, Silknet has successfully acquired myvideo.ge, the prominent video platform in Georgia with 1.6mn registered users. This strategic acquisition is anticipated to strengthen Silknet's digital video streaming portfolio in the coming years.

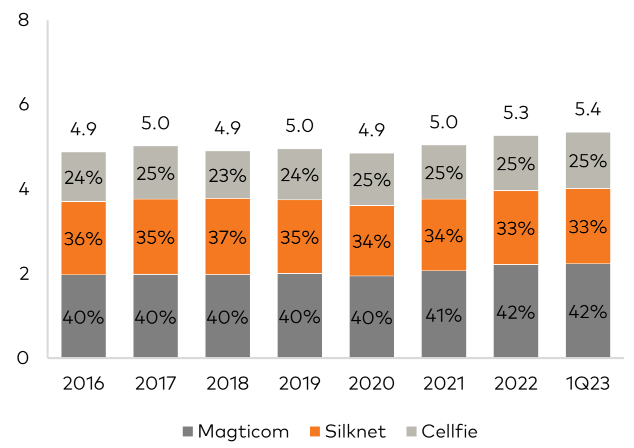
A look at telecom market in Georgia

The telecom market in Georgia is highly concentrated, with Silknet and Magticom holding a strong presence across all business segments. High concentration is common in telecom sector, with typically three to four companies serving the market in neigbouring and many Eastern European countries. Cellfie, formerly known as Veon Georgia or Beeline, is the 3rd largest mobile operator in Georgia, with a 24.8% subscriber market share as of 2022. Following its acquisition by Georgian CBS group for US$ 45mn (eqv. to a 3.5x multiple of 2021 EBITDA multiple) in 2022, Cellfie has launched a rebranding initiative aiming to increase its market share in the mobile segment. Cellfie, positioned as the most affordable mobile operator, lags behind the two largest market players, Magticom and Silknet, in terms of network infrastructure. Cellfie has announced plans for substantial capital expenditures aimed at enhancing its network, although the exact amount has not been disclosed. This strategic decision is expected to intensify competition in the medium-term.

The highly competitive environment causes a slight deviation in market shares. The competition is fierce in all segments, yet Silknet has maintained its leading position in the fixed voice segment and the strong 2nd position in mobile, fixed broadband and Pay-TV segments. Notably, Silknet has experienced a moderate market share attrition in the fixed broadband segment in recent years, with revenue and subscriber market share dropping by 7.1ppts and 8.9ppts, respectively over 2016-22. This can be attributed to the differing strategies pursued by Silknet and Magticom. Magticom focuses on expanding its presence in rural areas, while Silknet's approach aims at growing penetration in larger cities. Notably, Silknet's positions in other segments have remained relatively stable over the same period.

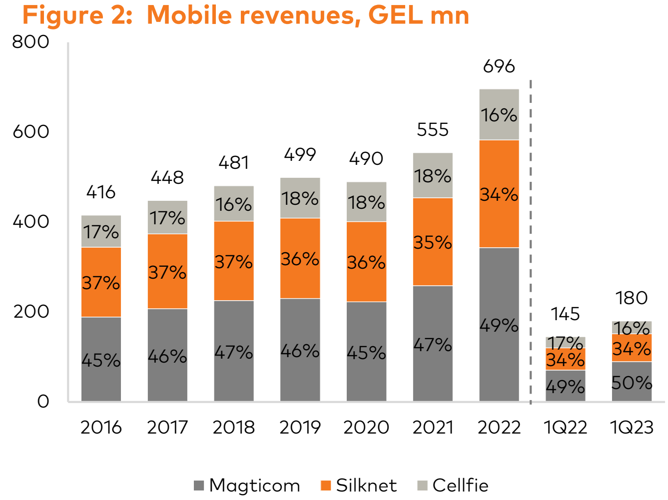
Mobile penetration already high in Georgia, with no substantial increase expected in medium-term. The number of mobile subscribers increased to a 5.3mn in 2022 from a stabilized average of 5.0mn over 2016-21, mostly driven by the demand from Russians, Belarussians and Ukrainians arriving to live in Georgia since the start of the Russia-Ukraine war. The mobile penetration in Georgia stands at 143.0%[1] of population as of 2022, above the European average of 120%, based on ITU estimates.This leaves little room for significant growth in the medium-term. Although mobile subscriber growth is limited, mobile revenues are expected to rise supported by growing mobile data usage. Mobile revenues were up 25.5% y/y to GEL 696.2mn in 2022.

Figure 1: Mobile subscribers, mn



Source: GNCC
Note: Annual figures represent the average of monthly data in respective years

Figure 2: Mobile revenues, GEL mn



Source: GNCC

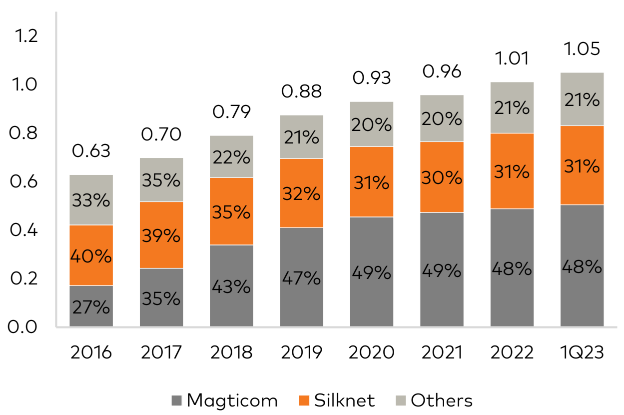
Georgia fixed broadband subscriber base reached 1.1mn in 2022, and we anticipate a steady growth of 3-4% in the medium-term. Although growth has stabilized in recent years, there is still untapped potential in the regions, where fixed broadband penetration stood at 60.4%[2] in 2022 compared to 90% in EU in 2021. We expect fixed broadband subscriber growth to be driven

[1] High penetration is explained by multi SIM ownership for various purposes, including for children's use and the ability to switch between providers based on pricing convenience. The average of monthly subscribers used as a subscriber base in 2022

[2] excluding Adjara and Abkhazia due to extremely high and low penetration rates

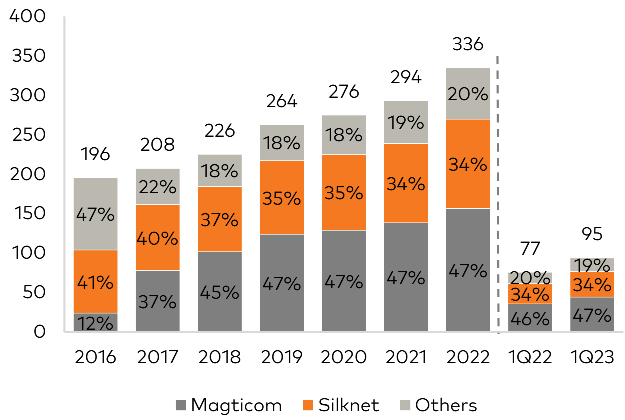
by expanding regional coverage, decreasing household size, growing tourism and related real estate investments and increasing use of digital services. Additionally, operators' continued investments in broadband infrastructure will also play a crucial role in driving growth.

Figure 3: Fixed broadband subscribers, mn



Source: GNCC
Note: Annual figures represent the average of monthly data in respective years

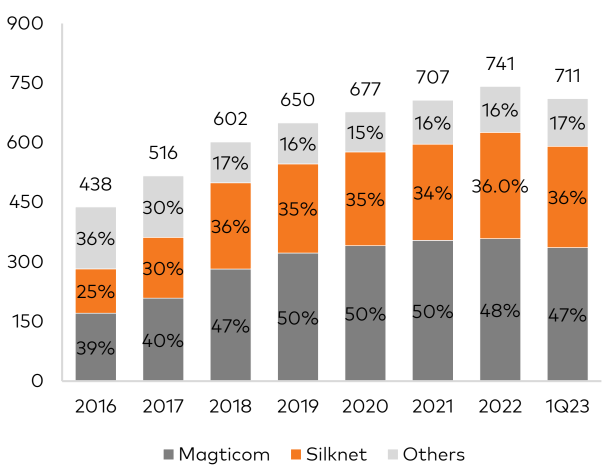
Figure 4: Fixed broadband revenues, GEL mn



Source: GNCC

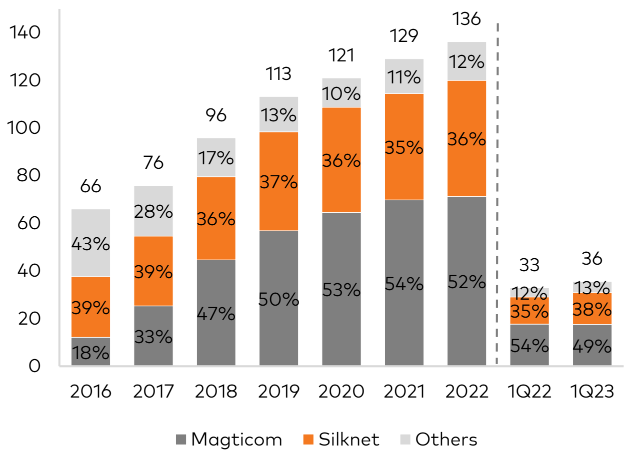
Emerging technologies expected to impact Pay-TV's long-term growth potential, while medium-term prospects remain positive. After growing at a 14.0% CAGR over 2016-19, the number of Pay-TV subscribers has stabilized, growing at 4.5% over 2019-22, reaching 755.0k subscribers in 2022. The underpenetrated regions, where TV channels are transmitted through free set-top boxes, present a major growth potential for this segment in the medium-term, however long-term growth opportunities are limited due to increasing competition from emerging technologies such as Smart-TVs and over-the-top (OTT) services like Netflix, Hulu, Amazon Prime Video, Disney+ etc.

Figure 5: Pay-TV subscribers, '000



Source: GNCC
Note: Annual figures represent the average of monthly data in respective years

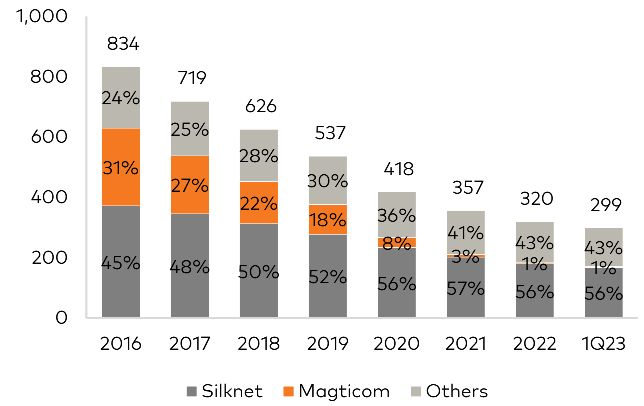
Figure 6: Pay-TV revenues, GEL mn



Source: GNCC

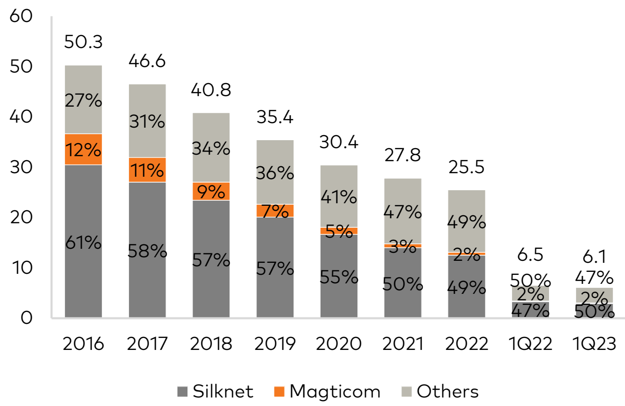
The traditional fixed voice segment is rapidly vanishing, with both the number of subscribers and revenues declining at a CAGR of 14.8% and 10.7%, respectively over 2016-22. This trend reflects the global shift towards more efficient alternatives such as mobile sevices and the internet. We believe that the substitution of fixed line with mobile services will continue to put pressure on traditional fixed line voice revenues.

Figure 7: Fixed voice subscribers, '000



Source: GNCC
Note: Annual figures represent the average of monthly data in respective years

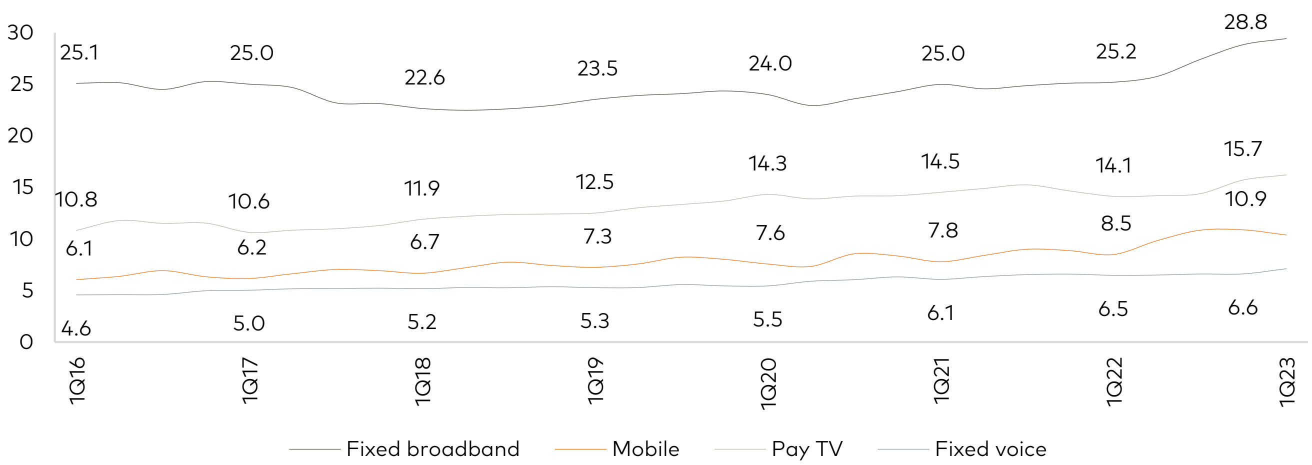
Figure 8: Fixed voice revenues, GEL mn



Source: GNCC

The average revenue per user (ARPU) is on the rise across all segments, with mobile segment experiencing the highest growth in 2022. This growth can be attributed to the Georgian Communications Commission's decision to abolish retail pricing regulation in 2021, which allowed operators to adjust their prices accordingly. The surge in mobile ARPU was also largely supported by the growing usage of mobile data.

Figure 9: ARPU by segment, GEL

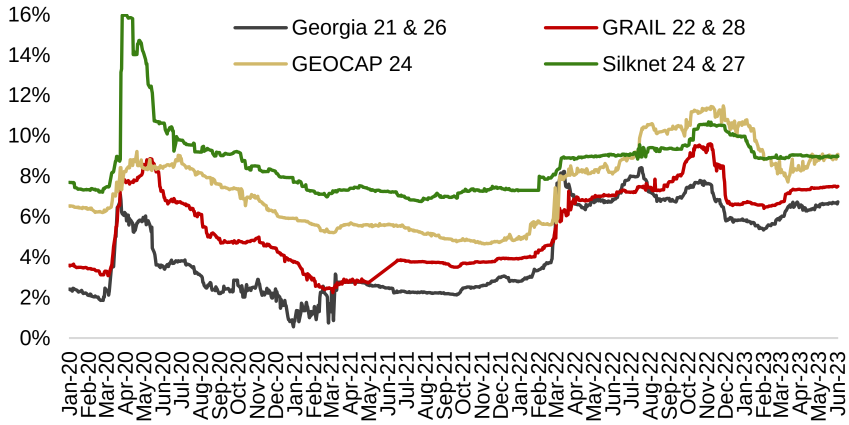


Source: GNCC

Eurobond performance

US$ 200mn Silknet Eurobonds outstanding as of end-2022. After issuing US$ 300mn in Eurobonds in Jan-22, Silknet has repurchased US$ 100mn in the open market, leaving the outstanding amount at US$ 200mn as of end-2022. Silknet Eurobond remains as one of the highest yielding Eurobonds in Georgia, yielding 9.0% as of Jun-23.

Figure 10: YTM on selected Georgian Eurobonds



Source: Bloomberg

Future outlook

We anticipate a low double-digit growth in Silknet's revenue for 2023, driven by mobile data. Mobile data revenue grew 45.7% y/y in 2022, and we expect growth of 29.3% y/y in 2023. We anticipate this growth to stem more from increased mobile data traffic per user rather than a surge in subscribers, although there will still be some expansion in the subscriber base.

Silknet has witnessed a remarkable surge in mobile data traffic, with per user data traffic growing at a 67.3% CAGR over 2019-22, primarily driven by the pandemic. However, we anticipate a slower, but still robust growth rate of 21.9% y/y for 2023, considering the lessened pandemic impact and the high base established in 2022. The growth in mobile data usage will be supported by prevailing trends such as the expansion of digital services and e-commerce, the growing popularity of visual social media platforms like Instagram and TikTok, the increased reliance on mobile devices for work and remote collaboration, and the revival of the tourism industry to some extent. However, we believe that the impact of tourism on mobile data usage may not be significant due to the increased availability of e-SIMS, Airalo and similar network support options for tourists in recent years.

We expect a 13.0% y/y increase in fixed broadband revenues for 2023, compared to a 12.3% y/y growth in 2022. Our projections are based on two key factors: the effect of price adjustments and organic growth. In Aug-22, there were pricing adjustments in the fixed broadband category, that were not fully reflected in the average revenue per user (ARPU) for that year. Taking this into account, we estimate Silknet's ARPU for individual subscribers to increase 11.2% y/y in 2023, capturing the full impact of the price increases. Additionally, we anticipate a 2.8% y/y growth in fixed broadband subscribers, following a 6.5% growth in 2022. We believe that the growth observed in 2022 was driven by the migrant effect, which is expected to be less prominent in 2023. The growth in subscribers is projected to come from organic growth related to newly constructed houses, primarily in Tbilisi and Batumi. Pay-TV revenues are forecasted to grow 2.3% y/y (vs +9.1% y/y in 2022). Meanwhile, fixed voice revenues are anticipated to continue declining by 17.0% y/y in 2023 (-10.6% y/y in 2022). Note, that we make above stated revenue projectons based on indicators from GNCC.

Overall**,** we forecast commercial revenue to increase by 13.6% y/y to GEL 486.3mn in 2023, while carrier service revenue is expected to decline 2.4% y/y to GEL 43.8mn. **We forecast adjusted EBITDA to reach GEL 322.3mn in 2023, translating into a solid 60.8% EBITDA margin** including IFRS 16 adjustments.

We anticipate the company's adoption of 5G technology, but not in the immediate future. The exact timeline and the development pace will be subject to the GNCC tender requirements, which are expected to be determined throughout 2023. The company foresees a gradual deployment of 5G over the span of several years. Notably, there are no significant capex expenditures planned for 5G over 2023-24, with projected capex levels expected to remain around 18%-20% of revenue in these years.

Annex 1: Financials

Income Statement, '000 GEL

	2020	2021	2022	2023F	2024F	2025F
Total revenue	382,155	413,419	472,965	530,157	574,085	615,564
Commercial revenue	347,557	369,681	428,088	486,342	531,854	574,332
Carrier services	34,598	43,738	44,877	43,816	42,232	41,231
EBITDA, incl. IFRS 16	211,502	227,591	284,124	322,337	351,712	380,010
EBITDA margin	55.3%	55.1%	60.1%	60.8%	61.3%	61.7%
EBITDA, excl. IFRS 16	197,702	213,684	270,378	308,590	337,964	366,261
EBITDA margin	51.7%	51.7%	57.2%	58.2%	58.9%	59.5%
D&A	-117,444	-116,995	-119,505	122,497	124,022	125,759
Financial costs (income), net	-171,666	-63,264	-22,752	-22,585	-41,474	-40,806
PBT	-87,883	41,828	134,856	170,244	179,205	206,433
Tax expense	723	-334	-340	-	-	-
Net income	-87,160	41,494	134,516	170,244	179,205	206,433
Net margin	n/a	10.0%	28.4%	32.1%	31.2%	33.5%

Income Statement, '000 US$

	2020	2021	2022	2023F	2024F	2025F
Total revenue	122,891	128,354	162,219	207,905	220,802	236,755
Commercial revenue	111,766	114,775	146,827	190,722	204,559	220,897
Carrier services	11,126	13,579	15,392	17,183	16,243	15,858
EBITDA, incl. IFRS 16	68,014	70,660	97,450	126,407	135,274	146,158
EBITDA margin	55.3%	55.1%	60.1%	60.8%	61.3%	61.7%
EBITDA, excl. IFRS 16	63,576	66,342	92,735	121,016	129,986	140,870
EBITDA margin	51.7%	51.7%	57.2%	58.2%	58.9%	59.5%
D&A	-37,767	-36,323	-40,988	48,038	47,701	48,369
Financial costs (income), net	-55,203	-19,642	-7,804	-8,857	-15,951	-15,695
PBT	-28,261	12,986	46,253	66,762	68,925	79,397
Tax expense	232	-104	-117	48,038	47,701	48,369
Net income	-28,028	12,883	46,137	66,762	68,925	79,397
Net margin	n/a	10.0%	28.4%	32.1%	31.2%	33.5%

Note: FX rates used in forecast: GEL 2.55/US$ in 2023, GEL 2.60/US$ in 2024-25

Balance Sheet, '000 GEL

	2020	2021	2022	2023F	2024F	2025F
Non-current assets	760,839	724,767	691,605	681,275	667,848	668,410
Net PP&E	393,887	374,534	366,654	362,679	361,242	369,837
Intangible assets and contract costs	196,229	210,120	191,360	185,171	184,335	181,548
Other	170,723	140,113	133,591	133,425	122,271	117,025
Current assets	120,959	122,720	128,532	196,999	243,747	260,457
Cash & equivalents	77,791	71,539	84,908	150,106	195,036	210,407
Receivables & prepayments	32,522	33,923	33,746	36,111	37,351	38,206
Other	10,645	17,258	9,878	10,782	11,361	11,844
Total assets	**881,798**	**847,487**	**820,137**	**878,274**	**911,595**	**928,868**
Shareholders' equity	**(59,313)**	**(48,820)**	**85,696**	**173,801**	**222,298**	**260,129**
Non-current liabilities	754,810	679,510	595,473	571,431	567,274	562,233
LT interest bearing debt	668,084	599,444	532,139	510,871	510,871	510,871
Other	86,726	80,066	63,334	60,560	56,403	51,361
Current liabilities	186,300	216,797	138,968	133,042	122,023	106,507
ST loans	54,399	56,790	19,925	19,129	19,129	19,129
Trade payables & prepayments	96,446	123,406	80,605	75,827	66,382	54,313
Other	35,455	36,601	38,438	38,086	36,512	33,065
Total liabilities & equity	**881,798**	**847,487**	**820,137**	**878,274**	**911,595**	**928,868**

Balance Sheet, '000 US$

	2020	2021	2022	2023F	2024F	2025F
Non-current assets	232,204	233,977	255,960	267,166	256,864	257,081
Net PP&E	120,212	120,911	135,697	142,227	138,939	142,245
Intangible assets and contract costs	59,888	67,833	70,822	72,616	70,898	69,826
Other	52,104	45,233	49,442	52,323	47,027	45,010
Current assets	36,916	39,618	47,569	77,255	93,749	100,176
Cash & equivalents	23,741	23,095	31,424	58,865	75,014	80,926
Receivables & prepayments	9,926	10,951	12,489	14,161	14,366	14,695
Other	3,249	5,571	3,656	4,228	4,370	4,556
Total assets	**269,120**	**273,595**	**303,530**	**344,421**	**350,613**	**357,257**
Shareholders' equity	-18,102	-15,761	31,716	68,157	85,499	100,049
Non-current liabilities	230,364	219,367	220,382	224,091	218,182	216,243
LT interest bearing debt	203,896	193,519	196,943	200,342	196,489	196,489
Other	26,468	25,848	23,440	23,749	21,693	19,754
Current liabilities	56,858	69,989	51,432	52,173	46,932	40,964
ST loans	16,602	18,334	7,374	7,501	7,357	7,357
Trade payables & prepayments	29,435	39,839	29,832	29,736	25,531	20,890
Other	10,821	11,816	14,226	14,936	14,043	12,717
Total liabilities & equity	**269,120**	**273,595**	**303,530**	**344,421**	**350,613**	**357,257**

Note: FX rates used in forecast: GEL 2.55/US$ in 2023, GEL 2.60/US$ in 2024-25

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