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RESEARCH

Silknet – 2023 update

Continuing growth momentum from strong 2022 into 2023

Fixed Income Research
Silknet
May 31, 2024

In 2023, Silknet's total revenue grew 13.4% y/y to GEL 536.4mn, in line with our forecast. Mobile data continued to drive revenue growth, maintaining a trend observed since 2020. Overall, commercial revenue at GEL 487.9mn saw a 14.0% y/y increase, perfectly aligning with our projected growth of 13.6%. The strong revenue performance combined with the moderate growth in operating expenses propelled Silknet's adjusted EBITDA to reach GEL 337.9mn in 2023, reflecting an 18.9% y/y growth. The company's enhanced free cash flow generation facilitated record-breaking dividend distributions of GEL 128mn in 2023. Moreover, after successfully reducing leverage from 2.6x in 2021 to 1.6x in 2022, Silknet further decreased its net debt to EBITDA ratio to 1.2x in 2023. This achievement stemmed from improved cash generation over the past two years, coupled with the stability of the GEL, providing the company with operational flexibility.

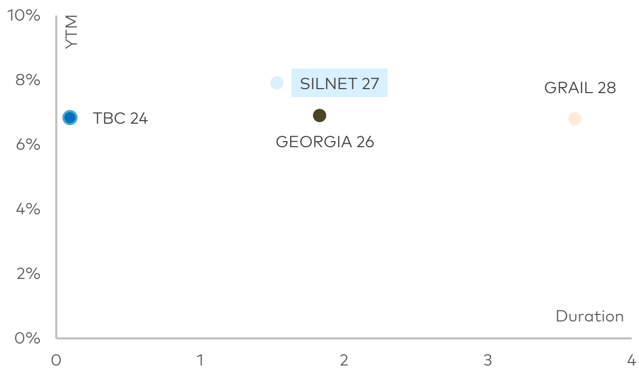
Looking ahead to 2024, we expect Silknet's revenue to grow at a mid single-digit rate, primarily fueled by mobile data. The strong double-digit revenue growth witnessed in 2022-2023 was largely attributed to multiple price increases, although some organic growth was also evident. We project this organic growth to continue in 2024, driving commercial revenue up by 8.6% y/y to GEL 529.7mn and overall revenue up by 7.1% y/y to GEL 574.6mn in 2024. We forecast adjusted EBITDA to reach GEL 353.8mn in 2024, translating into a solid 61.6% EBITDA margin including IFRS 16 adjustments.

Mobile data – key driver for revenue growth

Financial highlights, GEL mn	2020	2021	2022	2023	y/y change
Revenue	382.2	413.4	473.0	536.4	+13.4%
of which:					
Mobile data	66.3	82.7	120.4	149.3	+24.0%
Fixed broadband	98.2	102.0	114.4	132.6	+15.9%
Mobile callout	103.2	103.4	109.6	113.4	+3.5%
PayTV	45.5	46.2	50.6	55.9	+10.5%
Other	69.0	79.2	77.9	85.2	+9.3%
Adjusted EBITDA*	211.5	227.6	284.1	337.9	+18.9%
Adjusted EBITDA margin	*55.3%*	*55.1%*	*60.1%*	*63.0%*	*+2.9ppts*
Net income	-87.2	41.5	134.5	154.1	+14.6%
Net profit margin	*-22.8%*	*10.0%*	*28.4%*	*28.7%*	*+0.3ppts*
Assets	881.8	847.5	820.1	858.8	+4.7%
Liabilities	941.1	896.3	734.4	747.2	+1.7%
Equity	-59.3	-48.8	85.7	111.6	+30.2%
Net Debt	644.7	584.7	467.2	406.2	-13.0%

Source: Company information
* incl. IFRS 16

A high yielding Eurobond



Source: Bloomberg

Favorable credit and ESG ratings

Fitch Ratings	Moody's	Sustainalytics
B+	B1	26.0
Stable	Stable	
Affirmed Nov-2023	Affirmed Jan-2024	Upgraded in Mar-23

Source: Company information

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Silknet performance in 2023

Silknet's total revenue grew 13.4% y/y to GEL 536.4mn in 2023, aligning with our forecast. Commercial revenue at GEL 487.9mn saw a 14.0% y/y increase, perfectly in line with our forecast of 13.6%. Mobile data, the main driver of revenue growth since 2020, continued to lead the way with a 24.0% y/y growth. Additionally, fixed broadband, the 2nd largest revenue generator, significantly contributed to the overall growth, witnessing a 15.9% y/y increase in 2023.

Slight market share improvements evident in 2023. In the key mobile sector, which represents over half of the Georgian telecoms market and Silknet's revenue, the company increased its revenue market share by 0.6ppts to 35.0% in 2023. Similarly, in the PayTV segment, Silknet saw a growth of 1.5ppts, reaching a revenue market share of 34.8%. Meanwhile, a marginal decline of 0.2ppts was recorded in the fixed broadband segment's revenue market share, settling at 33.5% in 2023. Silknet leads with a 46.2% revenue market share in the fixed telephone segment, but this segment contributes a minor share of the company's revenues and is contracting itself, reflecting the global transition towards fixed-to-mobile substitution.

Fixed voice
 # 1
56.4%
161,755 subscribers

Mobile
 # 2
33.8%
c. 1.8mn subscribers

Mobile data
 # 1
35.9%
c. 1.3mn subscribers

Fixed broadband
 # 2
30.8%
330,594 subscribers

Pay TV
 # 2
35.6%
255,652 subscribers

Silknet's adjusted EBITDA surged to GEL 337.9mn in 2023, up 18.9% y/y, following a robust 24.8% y/y increase in the preceding year. EBITDA growth was primarily attributed to strong revenue performance in 2023. Operating expenses (excluding non-recurring items) were also up 5.1% y/y, largely due to rising salary costs amid ongoing inflation. Additionally, there was growth in marketing & advertising expenses and certain other operating costs, however, these were moderate in comparison to revenue growth. As a result, Silknet's adjusted EBITDA margin further improved to 63.0% in 2023 from 60.1% in 2022.

Silknet's enhanced free cash flow generation fueled the record-breaking dividend distributions in 2023. Supported by strong KPI performance, including solid revenue growth, robust adjusted EBITDA growth, and lower-than-targeted CAPEX levels at 14%, the company achieved GEL 247.1mn[1] in operating free cash flow in 2023. This represents a 6.7ppts improvement towards achieving a 45.7% operating free cash flow margin in 2023. With bolstered free cash flow and reduced leverage (discussed below), Silknet capitalized on its increased capacity for dividend payouts, disbursing a record-high GEL 128mn in dividends in 2023.

[1] Adjusted EBITDA (excl. IFRS 16) less capital expenditures

Silknet embracing low leverage in 2023. After successfully reducing leverage from 2.6x in 2021 to 1.6x in 2022, Silknet further decreased its net debt to EBITDA ratio to 1.2x in 2023. This accomplishment was driven by improved cash generation over the last two years coupled with the stability of the GEL, providing the company with operational flexibility.

Significant FX Exposure: Silknet is highly sensitive to GEL exchange rate changes due to its foreign currency debt, nearly 80% of capex, and about a fifth of opex in foreign currencies, while most revenue being in GEL. The company ceased using hedging instruments due to their prohibitively high costs. Instead, Silknet keeps FX cash reserves and uses operational strategies to manage currency risks, such as a non-committed dividend policy, careful management of discretionary capex and pricing flexibility.

Silknet closed out 2023 with a solid liquidity position, boasting GEL 144.6mn (US$ 53.8mn) in cash & cash equivalents on its balance sheet. The company strategically focuses on keeping most of its liquidity in hard currencies to offset the open FX position of its Eurobonds, amounting to US$ 200mn by year-end. Around 85% of Silknet's cash reserves were invested in USD and EUR or USD-equivalent instruments, like deposits secured by USD forward agreements in 2023.

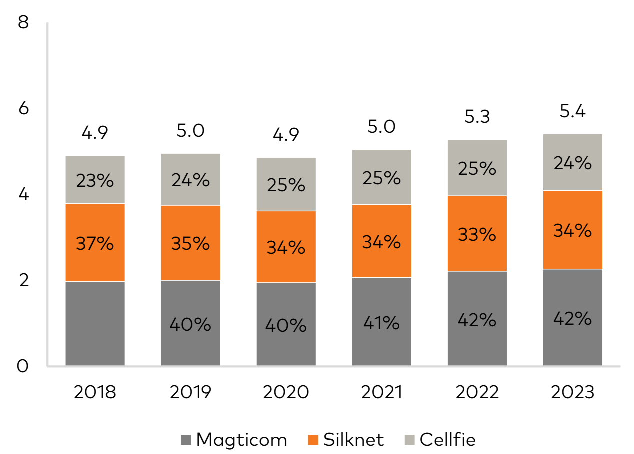
Silknet's credit ratings remained stable in 2023. Fitch maintained Silknet's rating at B+ with a Stable outlook. Additionally, Fitch upgraded the rating of Silknet's Eurobond to BB-/RR3, one notch above the company's rating. The expected recovery rate for the Eurobond is capped at 70%, the highest possible for Georgian issuers. Meanwhile, Moody's maintained the company rating at B1/stable, and Sustainalytics kept its ESG risk rating for Silknet at 26.0 in 2023.

A look at telecom market in Georgia

In 2023, the focus was on 5G development. In early 2023, the GNCC initiated an auction for mobile operators to adopt 5G technology. Cellfie was the sole participant in the auction, Silknet and Magticom chose not to participate due to disagreements with the GNCC over certain requirements, such as mandatory MVNO access and coverage and speed obligations. Consequently, Cellfie Mobile emerged as the sole 5G operator in Georgia. However, Silknet took a different approach and launched its 5G service in December 2023, utilizing existing frequencies to cover the center of Tbilisi. The company is confident that its current spectrum holdings, combined with widely deployed gigabit-LTE technology in urban areas and the newly introduced 5G, are adequate to provide high-quality mobile data services to its subscribers in the short and medium term. Looking ahead, Silknet hopes for collaborative efforts with the GNCC and other operators to secure additional spectrum for long-term 5G implementation.

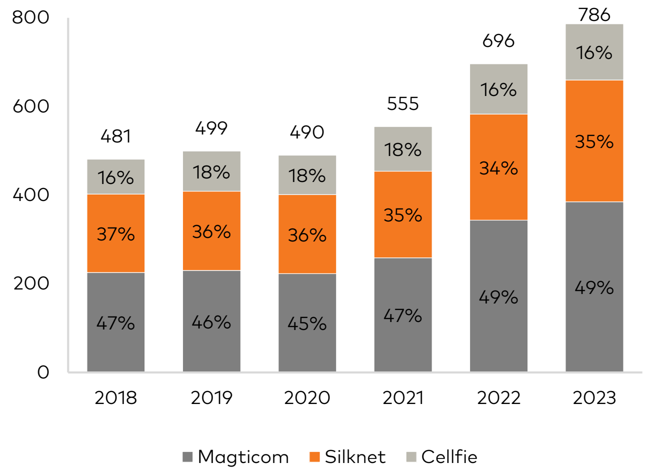
The number of mobile subscribers increased 2.6% y/y to a 5.4mn in 2023. Mobile penetration already high in Georgia, standing at 146.4%[2] of population as of 2023, above the European average of 123%, based on ITU estimates. This leaves little room for significant growth in the medium-term. Although mobile subscriber growth is limited, mobile revenues are expected to rise supported by growing mobile data usage. Mobile revenues were up 12.9% y/y to GEL 786.3mn in 2023.

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

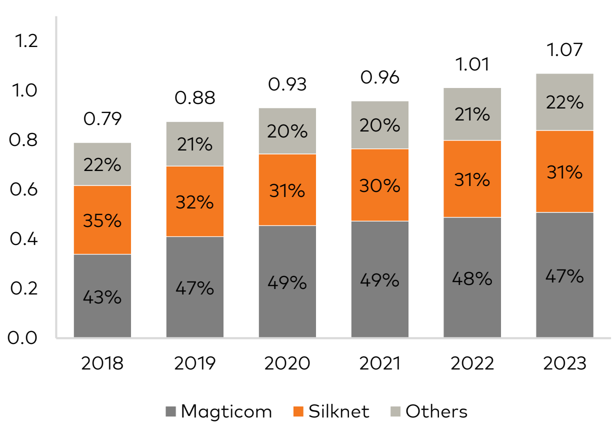


Source: GNCC

[2] 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 2023

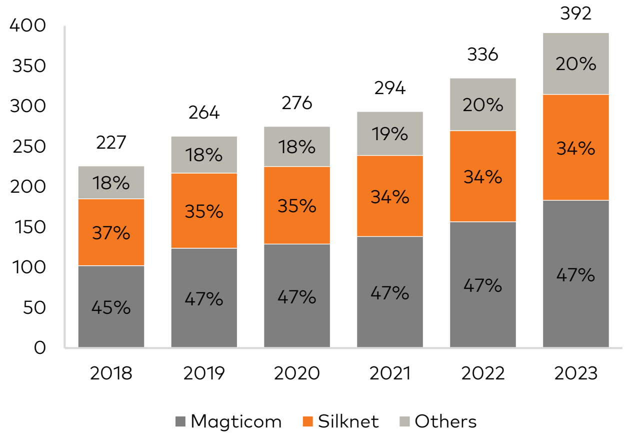
Georgia's fixed broadband subscriber base reached 1.07mn in 2023, up 5.7% y/y. Conversely, fixed broadband revenue surged by 16.8% y/y to GEL 392.2mn, primarily attributed to the repricing adjustments implemented by Silknet and Magticom in 2022. FTTH technology emerged as the primary driver for the fixed broadband segment, with c. 91% of total subscribers opting for FTTH connections. While subscriber growth has stabilized in recent years, there remains untapped potential, driven by low penetration rates in regional areas, urbanization trends, declining household sizes, growing tourism and related real estate investments, and a rising reliance on digital services.

Figure 3: Fixed broadband subscribers, mn



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

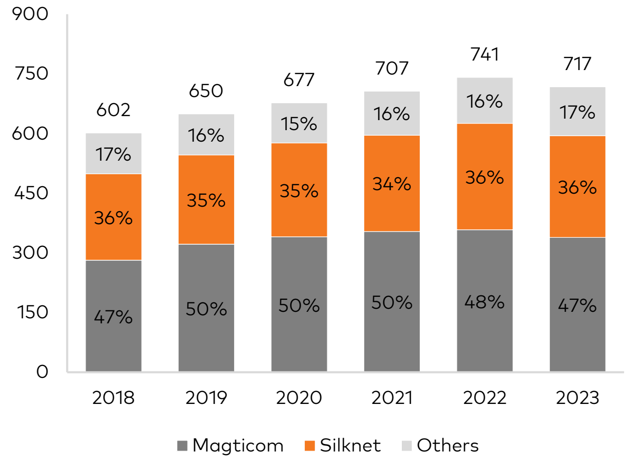
Figure 4: Fixed broadband revenues, GEL mn



Source: GNCC

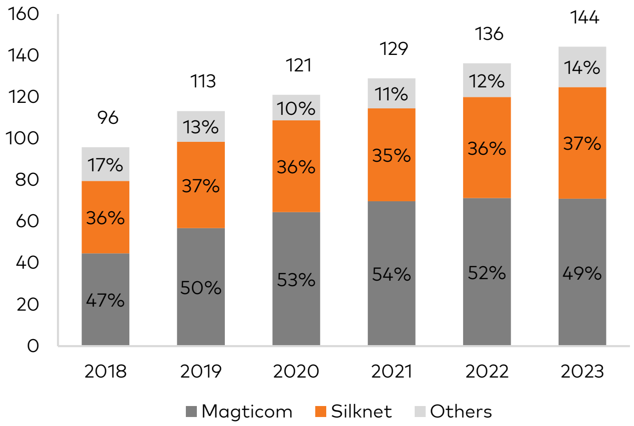
The number of Pay-TV subscribers was down 3.2% y/y to 717.4k in 2023. This decline was primarily attributable to Magticom discontinuing its satellite TV service in 2023. Conversely, Pay-TV revenues were up 5.9% y/y to 144.3mn in the same period. Notably, underpenetrated regions, where TV channels are accessible via free set-top boxes, present significant growth potential for the Pay-TV segment in the medium term. However, the long-term outlook is constrained by intensifying competition from emerging technologies like Smart-TVs and over-the-top (OTT) streaming services such as Netflix, Hulu, Amazon Prime Video, and Disney+. These services offer consumers greater flexibility and variety in content consumption, posing challenges to traditional Pay-TV providers.

Figure 5: Pay-TV subscribers, '000



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

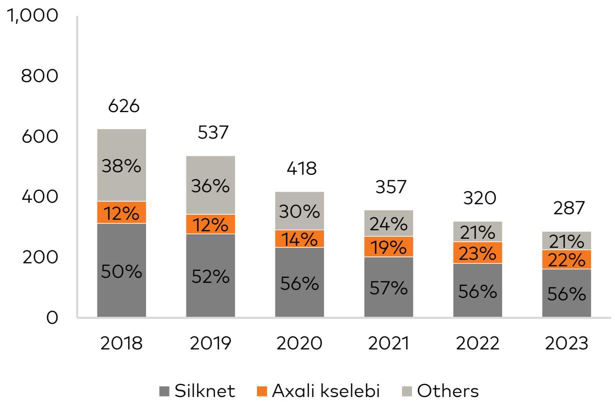
Figure 6: Pay-TV revenues, GEL mn



Source: GNCC

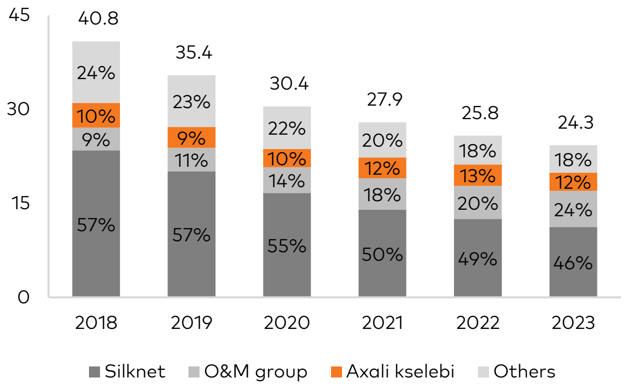
Number of fixed voice subscribers decreased 10.4% y/y to 286.8k, and fixed voice revenue also declined by 5.9% y/y to GEL 24.3mn. This segment is steadily declining, reflecting the global shift towards more efficient alternatives such as mobile sevices and the internet. We expect this trend to continue.

Figure 7: Fixed voice subscribers, '000



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

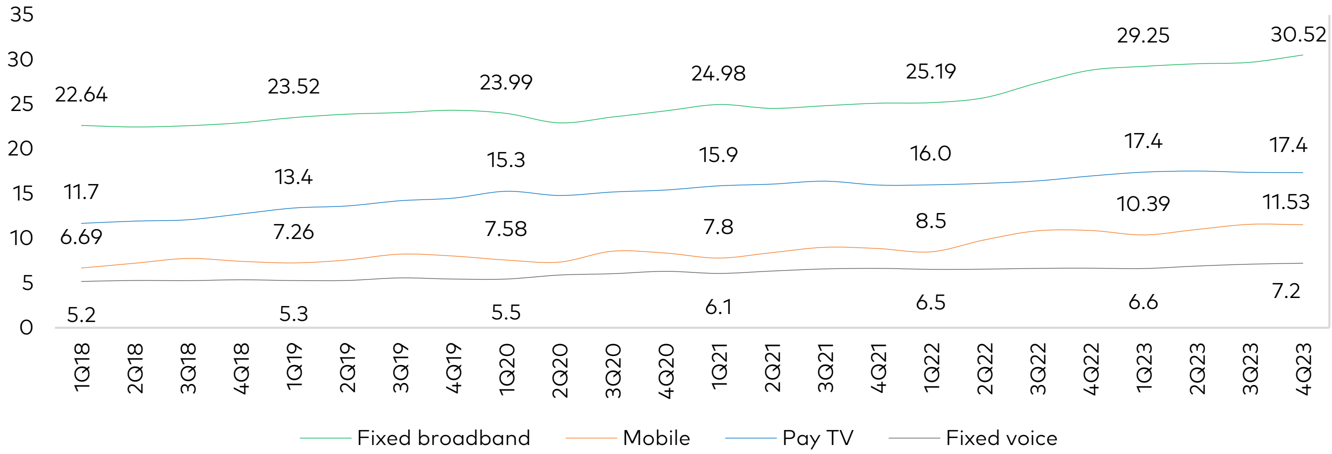
Figure 8: Fixed voice revenues, GEL mn



Source: GNCC

The average revenue per user (ARPU) showed an upward trend across all segments in 2023, primarily driven by pricing adjustments implemented since 2022. This was facilitated by the Georgian Communications Commission's decision to eliminate retail pricing regulation in 2021, granting operators the flexibility to adapt their pricing strategies. The mobile segment experienced the highest growth in 2023, also largely supported by the growing usage of mobile data in addition to pricing adjustments.

Figure 9: ARPU by segment, GEL

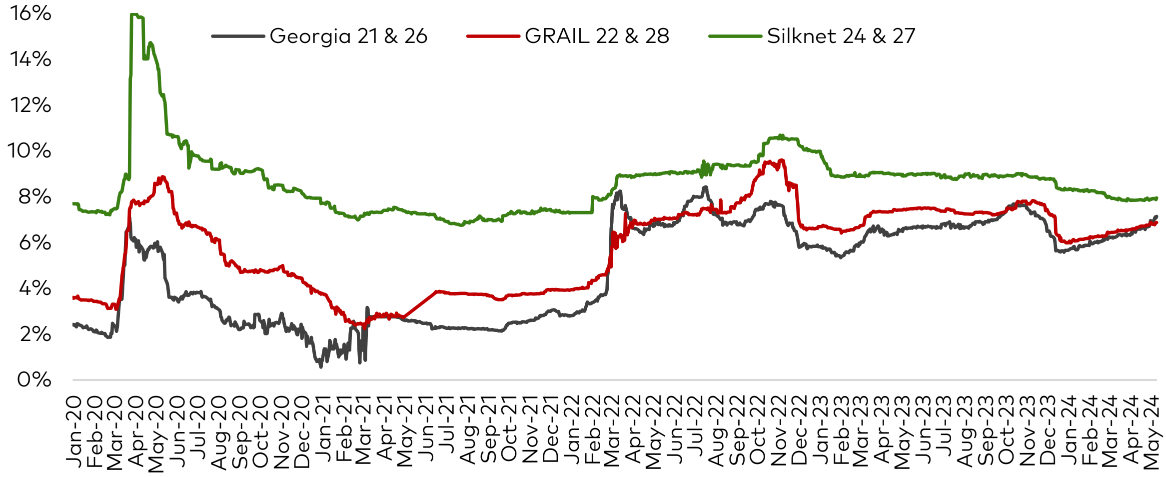


Source: GNCC

Eurobond performance

US$ 200mn Silknet Eurobonds outstanding as of end-2023. Initially, the company issued US$ 300mn in Eurobonds at 8.375% in Jan-22 to refinance all existing debt instruments. Later, Silknet repurchased US$ 100mn in the open market, leaving the outstanding amount at US$ 200mn. The repurchased notes have not been cancelled and are still held by Silknet. Silknet Eurobond remains the highest yielding corporate Eurobonds in Georgia, yielding 7.9% as of Apr-24.

Figure 10: YTM on selected Georgian Eurobonds



Source: Bloomberg

Future outlook

We expect Silknet's revenue to grow at a mid single-digit rate in 2024, primarily fueled by mobile data. The strong double-digit revenue growth witnessed in 2022-2023 was largely attributed to multiple price increases, although some organic growth was also evident. We anticipate this organic growth to continue in 2024, driving commercial revenue up by 8.6% y/y to GEL 529.7mn and overall revenue up by 7.1% y/y to GEL 574.6mn in 2024.

Mobile data has been a key growth driver in recent years and we anticipate this trend to persist. We expect mobile data to contribute 5.3ppts to the overall revenue growth in 2024, supported by increased mobile data consumption. This growth in consumption will be supported by prevailing trends such as the expansion of digital services and e-commerce, the rising popularity of visual social media platforms like Instagram and TikTok, the growing reliance on mobile devices for work and remote collaboration, and tourism revival, to some extent.

We project that Silknet will maintain its strong cash flow generation, supported by its high EBITDA margin and moderate capex requirements. **We forecast adjusted EBITDA to reach GEL 353.8mn in 2024, translating into a solid 61.6% EBITDA margin** including IFRS 16 adjustments. Furthermore, the company intends to maintain its CAPEX levels between 16-18%, even in the scenario of obtaining the 5G license, a CAPEX of 20% still appears sustainable for the company in the mid-term.

We foresee Silknet adopting 5G technology, but the timeline remains uncertain. The decision by Silknet and Magticom to abstain from participating in the 5G spectrum auction in Aug-23 has created some uncertainty in the market. Although 5G is not currently a significant service differentiator for Silknet, given its substantial existing spectrum that could potentially be repurposed for 5G, the absence of dedicated 5G spectrum stategy may pose long-term challenges unless the industry reaches a consensus. Currently the market seems to remain stable, despite Cellfie's aggressive Capex plans for enhancing its network, the company has experienced a slight decline in market share in 2023.

In early 2024, the GNCC published a price comparison assessment of telecom services between Georgia and Europe. Certain packages, like high-speed fixed broadband and high-capacity mobile data bundles, were found to be pricier in Georgia, creating uncertainties in price expectations on the market. There will be discussions on the study's findings with telecom operators, until which we do not anticipate any further price revisions in the market.

Annex 1: Financials

Income Statement, '000 GEL

	2020	2021	2022	2023	2024F	2025F	2026F
Total revenue	382,155	413,419	472,965	536,433	574,579	605,308	634,251
Commercial revenue	347,557	369,681	428,088	487,851	529,746	561,824	592,489
Carrier services	34,598	43,738	44,877	48,582	44,833	43,484	41,762
EBITDA, incl. IFRS 16	211,502	227,591	284,124	337,893	353,790	375,630	397,386
EBITDA margin	55.3%	55.1%	60.1%	63.0%	61.6%	62.1%	62.7%
EBITDA, excl. IFRS 16	197,702	213,684	270,378	324,424	340,043	361,882	383,637
EBITDA margin	51.7%	51.7%	57.2%	60.5%	59.2%	59.8%	60.5%
D&A	-117,444	-116,995	-119,505	-118,737	-121,251	-123,327	-125,160
Financial costs (income), net	-171,666	-63,264	-22,752	-34,847	-42,921	-42,379	-41,122
PBT	-87,883	41,828	134,856	154,355	182,607	202,912	224,093
Tax expense	723	-334	-340	-258			
Net income	-87,160	41,494	134,516	154,097	182,607	202,912	224,093
Net margin	n/a	10.0%	28.4%	28.7%	31.8%	33.5%	35.3%

Income Statement, '000 US$

	2020	2021	2022	2023	2024F	2025F	2026F
Total revenue	122,891	128,354	162,219	204,134	206,683	211,646	221,766
Commercial revenue	111,766	114,775	146,827	185,646	190,556	196,442	207,164
Carrier services	11,126	13,579	15,392	18,487	16,127	15,204	14,602
EBITDA, incl. IFRS 16	68,014	70,660	97,450	128,582	127,263	131,339	138,946
EBITDA margin	55.3%	55.1%	60.1%	63.0%	61.6%	62.1%	62.7%
EBITDA, excl. IFRS 16	63,576	66,342	92,735	123,456	122,318	126,532	134,139
EBITDA margin	51.7%	51.7%	57.2%	60.5%	59.2%	59.8%	60.5%
D&A	-37,767	-36,323	-40,988	-45,184	-43,616	-43,121	-43,762
Financial costs (income), net	-55,203	-19,642	-7,804	-13,261	-15,439	-14,818	-14,378
PBT	-28,261	12,986	46,253	58,738	65,686	70,948	78,354
Tax expense	232	-104	-117	-98			
Net income	-28,028	12,883	46,137	58,640	65,686	70,948	78,354
Net margin	n/a	10.0%	28.4%	28.7%	31.8%	33.5%	35.3%

Balance Sheet, '000 GEL

	2020	2021	2022	2023	2024F	2025F	2026F
Non-current assets	760,839	724,767	691,605	663,007	642,103	628,561	620,513
Net PP&E	393,887	374,534	366,654	347,604	346,013	342,851	348,025
Intangible assets and contract costs	196,229	210,120	191,360	179,262	169,831	166,504	159,783
Other	170,723	140,113	133,591	136,141	126,259	119,207	112,705
Current assets	120,959	122,720	128,532	195,822	282,777	330,219	352,839
Cash & equivalents	77,791	71,539	84,908	144,614	229,971	276,695	298,945
Receivables & prepayments	32,522	33,923	33,746	39,738	40,835	41,244	41,375
Other	10,645	17,258	9,878	11,470	11,971	12,279	12,519
Total assets	**881,798**	**847,487**	**820,137**	**858,829**	**924,880**	**958,780**	**973,351**
Shareholders' equity	**(59,313)**	**(48,820)**	**85,696**	**111,593**	**188,931**	**237,737**	**272,714**
Non-current liabilities	754,810	679,510	595,473	597,492	599,964	597,535	593,456
LT interest bearing debt	668,084	599,444	532,139	529,658	530,953	530,953	530,953
Other	86,726	80,066	63,334	67,834	69,011	66,582	62,502
Current liabilities	186,300	216,797	138,968	149,744	135,985	123,507	107,182
ST loans	54,399	56,790	19,925	21,176	19,881	19,881	19,881
Trade payables & prepayments	96,446	123,406	80,605	88,724	79,291	66,948	52,773
Other	35,455	36,601	38,438	39,844	36,813	36,679	34,528
Total liabilities & equity	**881,798**	**847,487**	**820,137**	**858,829**	**924,880**	**958,780**	**973,351**

Balance Sheet, '000 US$

	2020	2021	2022	2023	2024F	2025F	2026F
Non-current assets	232,204	233,977	255,960	246,526	221,415	210,221	207,529
Net PP&E	120,212	120,911	135,697	129,250	119,315	114,666	116,396
Intangible assets and contract costs	59,888	67,833	70,822	66,655	58,563	55,687	53,439
Other	52,104	45,233	49,442	50,621	43,537	39,868	37,694
Current assets	36,916	39,618	47,569	72,813	97,509	110,441	118,006
Cash & equivalents	23,741	23,095	31,424	53,772	79,300	92,540	99,982
Receivables & prepayments	9,926	10,951	12,489	14,776	14,081	13,794	13,838
Other	3,249	5,571	3,656	4,265	4,128	4,107	4,187
Total assets	**269,120**	**273,595**	**303,530**	**319,339**	**318,924**	**320,662**	**325,536**
Shareholders' equity	-18,102	-15,761	31,716	41,494	65,149	79,511	91,209
Non-current liabilities	230,364	219,367	220,382	222,166	206,884	199,845	198,480
LT interest bearing debt	203,896	193,519	196,943	196,943	183,087	177,576	177,576
Other	26,468	25,848	23,440	25,223	23,797	22,268	20,904
Current liabilities	56,858	69,989	51,432	55,679	46,891	41,307	35,847
ST loans	16,602	18,334	7,374	7,874	6,855	6,649	6,649
Trade payables & prepayments	29,435	39,839	29,832	32,990	27,342	22,391	17,650
Other	10,821	11,816	14,226	14,815	12,694	12,267	11,548
Total liabilities & equity	**269,120**	**273,595**	**303,530**	**319,339**	**318,924**	**320,662**	**325,536**

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