Kcell JSC

Q2 2015 Interim Report

Contents

Kcell JSC
Interim Results for January – June 2015

Almaty, 17 July, 2015 – Kcell Joint Stock Company ("Kcell" or the "Company") (LSE, KASE: KCEL), the leading provider of mobile telecommunications services in Kazakhstan by market share in terms of revenue and subscribers, announces its interim results for January – June 2015.

Second quarter

- Net sales decreased by 10.5 percent to KZT 42,980 million (48,035). Service revenue down 14.5 percent to KZT 40,079 million (46,904).
- EBITDA, excluding non-recurring items, declined by 19.4 percent to KZT 22,184 million (27,536). EBITDA margin decreased to 51.6 percent (57.3).
- Operating income, excluding non-recurring items, decreased by 24.4 percent to KZT 16,057 million (21,238).
- Net finance cost increased to KZT 1,405 million (219).
- Net income 31.5 percent lower at KZT 11,319 million (16,512).
- Free cash flow decreased to KZT 11,221 million (16,213).
- The total number of subscriptions decreased by 82 thousand.

First half

- Net sales 6.6 percent lower at KZT 86,064 million (92,142). Service revenue decreased by 12.3 percent to KZT 79,835 million (91,011).
- EBITDA, excluding non-recurring items, declined by 13.5 percent to KZT 46,001 million (53,208). EBITDA margin was 53.4 percent (57.7).
- Operating income, excluding non-recurring items, down 17.8 percent to KZT 33,759 million (41,093).
- Net finance cost increased to KZT 1,991 million (499).
- Net income down 23.6 percent to KZT 24,553 million (32,147).
- Free cash flow decreased to KZT 14,410 million (34,201).
- The number of subscriptions decreased by 653 thousand from the end of the second quarter of 2014.

Financial highlights

KZT in millions, except key ratios, per share data and changes	**Apr-Jun 2015**	Apr-Jun 2014	Chg (%)	**Jan-Jun 2015**	Jan-Jun 2014	Chg (%)
Net sales	42,980	48,035	-10.5	86,064	92,142	-6.6
of which service revenue	40,079	46,904	-14.5	79,835	91,011	-12.3
EBITDA excl. non-recurring items	22,184	27,536	-19.4	46,001	53,208	-13.5
Margin (%)	51.6	57.3		53.4	57.7	
Operating income	16,057	21,033	-23.7	33,432	40,888	-18.2
Operating income excl. non-recurring items	16,057	21,238	-24.4	33,759	41,093	-17.8
Net income attributable to owners of the parent	11,319	16,512	-31.5	24,553	32,147	-23.6
Earnings per share (KZT)	56.6	82.6	-31.5	122.8	160.7	-23.6
CAPEX-to-sales (%)	8.9	3.9		6.9	4.6	
Free cash flow	11,221	16,213		14,410	34,201	

In this report, comparative figures are provided in parentheses following the operational and financial results and refer to the same item in the second quarter of 2014, unless otherwise stated.

Comments by Arti Ots, CEO

”Further intensification of competition, with notably aggressive pricing, has impacted our results for the second quarter of 2015. Despite this pressure, however, we generated a double-digit increase in data revenue in the reporting period and doubled our revenue from handset sales on the back of strong demand for smartphones. In June 2015 we launched a nationwide bundled offering - “Hello Kazakhstan” – which provides an attractive combination of calls to all networks and Internet services to meet rising customer demand for fast and reliable data services. In addition, our ongoing cost discipline has resulted in an EBITDA margin that remains at an industry leading level.

We achieved a further operational milestone during the quarter with the launch of two more Kcell branded stores in Almaty and Astana. Our branded store concept has proved very popular and early results are demonstrating the effectiveness of this recently introduced business model. In addition, we are further developing our products and services, alongside new revenue streams from content such as music, video and mobile financial services.

Looking ahead, our focus remains on delivering our customer-centric strategy of providing innovative products to strengthen our market leading position and to drive growth in our business-to-business operations. At the same time, we will continue to invest in enhancing the capacity and quality of our network to ensure the long-term sustainability of our business.”

Almaty, 17 July 2015

Conference call

Kcell will host an analyst conference call on 17 July, 2015 at 10:30 UK time / 15:30 Almaty / 12:30 Moscow. The conference will be held in English, audio webcast will be available at
http://www.audio-webcast.com/cgi-bin/visitors.ssp?fn=visitor&id=2883

Dial in details are as follows:

UK Toll Free:	**0800 279 5004**
Standard International Dial-in:	**+44 20 3427 1901**
Russia Toll Free:	**8 800 500 9312**
Russia Local Call number:	**+ 7 495 705 9451**
USA Toll Free:	**1 877 280 1254**
USA Dial-In:	**+1212 444 0412**
Conference ID	**7502059**

A presentation will be available on the Company website shortly before the conference call on www.investors.kcell.kz./en

A replay will be available at: http://kcell170715-live.audio-webcast.com/

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Review of the second quarter 2015
Net sales

Net sales decreased by 10.5 percent to KZT 42,980 million (48,035). Service revenue fell 14.5 percent to KZT 40,079 million (46,904).

Revenue from voice services decreased by 21.1 percent to KZT 27,013 million (34,240). Data revenue increased by 18.0 percent to KZT 9,873 million (8,368). Revenue from value-added services was down 24.5 percent to KZT 3,198 million (4,237). Other revenue increased to KZT 2,896 million (1,190).

KZT in millions, except percentages	Apr-Jun 2015	% of total	Apr-Jun 2014	% of total
Voice services	27,013	62.9	34,240	71.3
Data services	9,873	23.0	8,368	17.4
Value added services	3,198	7.4	4,237	8.8
Other revenues	2,896	6.7	1,190	2.5
Total revenues	**42,980**	**100**	**48,035**	**100**

Voice service revenue
Revenue from voice services decreased by 21.1 percent to KZT 27,013 million (34,240). Voice traffic declined to 5,737 million minutes (5,848), while ARMU fell to KZT 3.4 (4.4).

Interconnect revenue was 13.4 percent lower at KZT 5,703 million (6,586). This decrease was mainly due to a reduction of mobile termination rate.

Data service revenue
Data revenue was 18.0 percent higher at KZT 9,873 million (8,368). Data traffic increased by 64.2 percent to 11,174,325 GB (6,803,701). Growth in data traffic was partially offset by offering packages with lower tariffs per MB, which led to a decrease in average revenue per MB (ARMB) to KZT 0.9 (1.2).

Value-added service revenue
Revenue from value-added services decreased by 24.5 percent to KZT 3,198 million (4,237), largely as a result of declining SMS and MMS revenue.

Other revenue
Other revenue more than doubled to KZT 2,896 million (1,190), reflecting higher sales of handsets.

Expenses

Cost of sales

Cost of sales rose 2.8 percent to KZT 21,449 million (20,870), primarily due to an increase in cost of goods sold attributable to the cost of handsets.

Selling and marketing expenses

Selling and marketing expenses decreased by 15.7 percent to KZT 2,680 million (3,179). The decrease was primarily driven by lower commissions.

General and administrative expenses

General and administrative expenses increased by 4.2 percent to KZT 2,966 million (2,847), mainly due to an increase in mobile tax rate.

Earnings, financial position and cash flow

EBITDA, excluding non-recurring items, decreased by 19.4 percent to KZT 22,184 million (27,536). The EBITDA margin was 51.6 percent (57.3).

Net finance cost increased to KZT 1,405 million (219), which is related to net interest expenses.

Income tax expense decreased by 22.5 percent to KZT 3,333 million (4,302).

Net income attributable to owners of the parent company decreased by 31.5 percent to KZT 11,319 million (16,512) and earnings per share decreased to KZT 56.6 (82.6).

CAPEX grew to KZT 3,845 million (1,888) and CAPEX-to-sales ratio increased to 8.9 percent (3.9).

Free cash flow was down to KZT 11,221 million (16,213), primarily due to a change in working capital and increase in cash capex.

Review of the first half of 2015

Net sales

Net sales were down 6.6 percent to KZT 86,064 million (92,142). Service revenue decreased by 12.3 percent to KZT 79,835 million (91,011).

Revenue from voice services declined by 18.2 percent to KZT 53,643 million (65,606). Data revenue was 16.5 percent higher at KZT 19,453 million (16,693). Revenue from value-added services decreased by 20.8 percent to KZT 6,739 million (8,512). Other revenue increased to KZT 6,229 million (1,331).

KZT in millions, except percentages	Jan-Jun 2015	% of total	Jan-Jun 2014	% of total
Voice services	53,643	62.3	65,606	71.2
Data services	19,453	22.6	16,693	18.1
Value added services	6,739	7.8	8,512	9.3
Other revenues	6,229	7.3	1,331	1.4
Total revenues	**86,064**	**100**	**92,142**	**100**

Voice service revenue

Revenue from voice services decreased to KZT 53,643 million (65,606). Voice traffic was stable year-on-year and amounted to 11,420 million minutes (11,424). ARMU decreased to KZT 3.5 (4.4).

Interconnect revenue decreased by 14.5 percent to KZT 10,736 million (12,555). The decrease was mainly driven by a reduction of mobile termination rate.

Data service revenue

Data revenue rose by 16.5 percent to KZT 19,453 million (16,693). Data traffic increased by 63.8 percent to 21,753,607 GB (13,281,367). Growth in data traffic was partially offset by offering packages with lower tariffs per MB, which resulted in a decrease in average revenue per MB (ARMB) to KZT 0.9 (1.2).

Value-added service revenue

Revenue from value-added services was 20.8 percent lower at KZT 6,739 million (8,512), largely as a result of declining SMS and MMS revenue.

Other revenue

Other revenue increased to KZT 6,229 million (1,331). The increase was mainly attributable to higher sales of handsets.

Expenses

Cost of sales

Cost of sales rose by 8.2 percent to KZT 42,571 million (39,338), driven largely by an increase in cost of goods sold, which, in turn, was attributable to the cost of handsets.

Selling and marketing expenses

Selling and marketing expenses decreased by 21.2 percent to KZT 4,824 million (6,122). The decrease was primarily due to lower commissions.

General and administrative expenses

General and administrative expenses increased by 12.7 percent to KZT 5,918 million (5,249) reflecting an increase in mobile tax rate.

Earnings, financial position and cash flow

EBITDA, excluding non-recurring items, decreased by 13.5 percent to KZT 46,001 million (53,208). The EBITDA margin was 53.4 percent (57.7).

Net finance cost increased to KZT 1,991 million (499) which is related to net interest expenses.

Income tax expense decreased by 16.4 percent to KZT 6,887 million (8,242).

Net income attributable to owners of the parent company decreased by 23.6 percent to KZT 24,553 million (32,147) and earnings per share fell to KZT 122.8 (160.7).

CAPEX increased to KZT 5,935 million (4,261) and the CAPEX-to-sales ratio increased to 6.9 percent (4.6).

Free cash flow declined to KZT 14,410 million (34,201), primarily due to a change in working capital and increase in cash capex.

Net debt/equity ratio was 42.1 percent (6.0).

Net debt/EBITDA ratio was 0.34 (0.05).

The equity/assets ratio was 38.3 percent (58.3).

Key milestones 2015

January

- Kcell's Board of Directors approved the Relationship Agreement and Services Agreement between Kcell and TeliaSonera AB (TS). These agreements are designed to regulate the provision of certain corporate services by TS to Kcell, so that Kcell will benefit from TS's strategic guidance whilst maintaining corporate independence. Kcell and TS confirmed that agreements and transactions with any member of the TS Group shall be undertaken on arm's length terms and on a normal commercial basis.
- Mr. Trond Moe was appointed the Company's Finance Director, subject to receiving relevant regulatory authorisation.

February

- Kcell informed about progress in its internal investigation. The investigation has concluded that Kcell has formal grounds to file a report with the General Prosecutor's office of the Republic of Kazakhstan requesting it to commence an investigation into the activities of a number of former employees who allegedly failed to follow the Company's internal policies and procedures. The Board has filed the matter to the relevant criminal authorities. The employees allegedly responsible for these failures are no longer employed by the Company. There remains no indication that any of the matters under investigation will have any material effect on the Company's balance sheet or on the results of its operations.
- The EGM approved an increase in the number of Board members from six to seven. Mr. Douglas Gordon Lubbe, a representative of the shareholder Fintur Holdings B.V, has been elected as the seventh member to Kcell's Board of Directors.

March

- Kcell announced the opening of its first Kcell branded Store in Almaty. The Company has changed its retail business model and is setting a new trend in the telecoms market by combining a shop and club to deliver a superior customer experience. The new store concept provides customers with an opportunity to seek advice on different gadgets and various mobile applications from Kcell's store consultants, as well as the ability to test all smartphone features prior to making a purchase. The Company plans to open Kcell Stores in other major cities of Kazakhstan.
- The Board of Directors recommended paying an annual dividend ("Annual Dividend") of 70 percent of the Company's net income for the twelve months ending 31 December 2014 ("the Period"). Additionally, the Board of Directors has recommended the payment of a special dividend ("Special Dividend", together with the Annual Dividend – "the Dividends"), representing 30 percent of the Company's net income for the Period. This decision was approved by the AGM on 17 April 2015.
- In total, the Dividends amounted to KZT 58,260 million, or KZT 291.30 per share, representing 100 percent of the Company's net income for the full year of 2014.The record date of Shareholders entitled to receive the dividends was 20 April 2015, (01:00 Almaty time). The Annual Dividend was paid on 29 May 2015, and the proposed Special Dividend will be paid not later than 30 October 2015.

April

- Kcell has completed the drawdown of a KZT 22 billion tranche of the approved credit line with Halyk Bank of Kazakhstan JSC. This tranche was obtained under the bank loan agreement signed between Kcell and Halyk Bank of Kazakhstan JSC for KZT 30 billion for working capital financing.

May

- Kcell opened its Kcell branded Store in Astana. The opening of Kcell Store in Astana is another step towards implementing Kcell's larger-scale expansion programme in Kazakhstan.

June

- Kcell opened its third branded store in Almaty. The first results of the implementation of the new business model demonstrated the effectiveness of the store and customer club concept, which have proved to be very popular. The Company is planning to launch four more stores by the end of 2015.

17 July 2015
Arti Ots
Chief Executive Officer

Regulatory overview

The "Daytime Unlimited" and failure to disconnect calls on Kcell network

During 2013, an investigation was initiated by the Agency for Competition Protection of the Republic of Kazakhstan (the "ACP"), in relation to the "Daytime Unlimited" service under the Activ brand and non-interruption of services when a customer's balance reaches zero under the Kcell brand.

The ACP ordered that the Company should comply with the following on or before 21 April 2014:

1. to stop collection of subscription fees under the tariff plan "Daytime Unlimited" in case of insufficiency of funds on a subscriber's account;
2. to ensure interruption of connection (voice or Internet access) when a subscriber's balance reaches zero;
3. to ensure a refund to subscribers, any fees received as a result of failure to interrupt the connection when a subscriber's balance reaches zero.

The Company complied with point 1; however, due to technical limitations of the billing system, the Company is currently unable to implement point 2. However, the Company is in the process of introducing a new billing system that will enable the interruption of the connection.

The Company has challenged the ACP findings and decision through courts system in Kazakhstan, culminating in an appeal to the Supreme Court. On 30 June 2015, the Supreme Court of the Republic of Kazakhstan dismissed the Company's supervisory appeal. On 15 June 2015 ACP filed a claim with court seeking for enforcement of the order. On 9 July 2015 the court issued a resolution on satisfying ACP claim to enforce the order, and as a result the Company must now enforce points 2 and 3 in the above ACP order.

In December 2014, the Company accrued a provision in the amount of 1.6 billion Tenge covering the refund to subscribers for the period from January 2012 to September 2013. Management is currently assessing the additional potential liability for subsequent periods and related provision, as a result of court resolution above.

Regulatory Updates

New Rules of rendering cellular communication services came in force on 16 June 2015. An operator can only change conditions of communication service tariffs upon subscribers' consent, notifying subscribers not less than one month before these changes come into effect.

Kcell is going to apply to the Regulator to request the new Rules to be amended. In case if the Regulator refuses, Kcell will consider applying to the court.

The January–June 2015 financial statements have been reviewed by the Kcell external auditors, and their report will be available on the Kcell website starting from 1 August 2015.

The information was submitted for publication at 09:00 ALMT on 17 July 2015.

Financial information

Interim Report January–September 2015	20 October 2015
Year-end Report January–December 2015	29 January 2016

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Definitions

EBITDA: Earnings Before Interest, Tax, Depreciation and Amortisation. Equals operating income before depreciation, amortisation and impairment losses and before income from associated companies.

CAPEX: Capital expenditures and advances paid for property, plant and equipment as well as software and licenses including investments in tangible and intangible non-current assets, but excluding goodwill and fair value adjustments recognized in acquisitions, and excluding the recording of assets retirement obligations.

ARMB: Average revenue per MB

Condensed Consolidated Statements of Comprehensive Income

KZT in millions, except per share data, number of shares and changes	**Apr-Jun 2015**	Apr-Jun 2014	Chg (%)	**Jan-Jun 2015**	Jan-Jun 2014	Chg (%)
Revenues	42,980	48,035	-10.5	86,064	92,142	-6.6
Cost of sales	-21,449	-20,870	2.8	-42,571	-39,338	8.2
Gross profit	21,530	27,165	-20.7	43,493	52,804	-17.6
Selling and marketing expenses	-2,680	-3,179	-15.7	-4,824	-6,122	-21.2
General and administrative expenses	-2,966	-2,847	4.2	-5,918	-5,249	12.7
Other operating income and expenses, net	174	-106		680	-545	
Operating income	16,057	21,033	-23.7	33,432	40,888	-18.2
Finance costs and other financial items, net	-1,405	-219		-1,991	-499	
Income after financial items	14,652	20,814	-29.6	31,440	40,389	-22.2
Income taxes	-3,333	-4,302	-22.5	-6,887	-8,242	-16.4
Net income	**11,319**	**16,512**	**-31.5**	**24,553**	**32,147**	**-23.6**
Total comprehensive income Total comprehensive income attributable to owners of the parent	11,319	16,512	-31.5	24,553	32,147	-23.6
Earnings per share (KZT), basic and diluted	56.6	82.6	-31.5	122.8	160.7	-23.6
Number of shares (thousands)						
Outstanding at period-end	200,000	200,000		200,000	200,000	
Weighted average, basic and diluted	200,000	200,000		200,000	200,000	
EBITDA	22,184	27,331	-18.8	45,674	53,003	-13.8
EBITDA excl. non-recurring items	22,184	27,536	-19.4	46,001	53,208	-13.5
Depreciation, amortization and impairment losses	-6,126	-6,298	-2.7	-12,242	-12,115	1.0
Operating income excl. non-recurring items	16,057	21,238	-24.4	33,759	41,093	-17.8

Condensed Consolidated Statements of Financial Position

KZT in millions	**30 Jun 2015**	31 Dec 2014
Assets		
Intangible assets	13,877	12,494
Property, plant and equipment	101,272	108,955
Other non-current assets	492	145
Total non-current assets	115,641	121,594
Inventories	3,300	2,336
Trade and other receivables	18,033	14,543
Cash and cash equivalents	15,452	19,520
Total current assets	36,785	36,399
Total assets	**152,426**	**157,993**
Equity and liabilities		
Share capital	33,800	33,800
Retained earnings	24,567	58,274
Total equity attributable to owners of the parent	58,367	92,074
Deferred tax liabilities	4,271	4,442
Other long-term liabilities	1,362	1,376
Total non-current liabilities	5,633	5,818
Short-term borrowings	47,155	25,020
Trade payables, and other current liabilities	41,271	35,081
Total current liabilities	88,426	60,101
Total equity and liabilities	**152,426**	**157,993**

Condensed Consolidated Statements of Cash Flows

KZT in millions	**Apr-Jun 2015**	Apr-Jun 2014	**Jan-Jun 2015**	Jan-Jun 2014
Cash flow before change in working capital	17,794	24,767	36,856	45,616
Change in working capital	-1,418	-4,732	-8,725	-5,045
Cash flow from operating activities	16,376	20,035	28,131	40,571
Cash CAPEX	-5,155	-3,822	-13,721	-6,370
Free cash flow	**11,221**	**16,213**	**14,410**	**34,201**
Total cash flow from investing activities	-5,155	-3,822	-13,721	-6,370
Cash flow before financing activities	11,221	16,213	14,410	34,201
Cash flow from financing activities	-18,782	-47,362	-18,782	-48,312
Cash flow for the period	**-7,561**	**-31,149**	**-4,372**	**-14,111**
Cash and cash equivalents, opening balance	**22,972**	**35,954**	**19,520**	**18,916**
Cash flow for the period	-7,561	-31,149	-4,372	-14,111
Exchange rate difference	41		304	
Cash and cash equivalents, closing balance	**15,452**	**4,805**	**15,452**	**4,805**

Condensed Consolidated Statements of Changes in Equity

	Jan-Jun 2015			Jan-Jun 2014		
KZT in millions	**Share capital**	**Retained earnings**	**Total equity**	Share capital	Retained earnings	Total equity
Opening balance	33,800	58,274	92,074	33,800	63,393	97,193
Dividends	–	-58,260	-58,260	–	-63,390	-63,390
Total comprehensive income	–	24,553	24,553	–	32,147	32,147
Closing balance	**33,800**	**24,567**	**58,367**	**33,800**	**32,150**	**65,950**

Basis of preparation

As in the annual accounts for 2014, Kcell's consolidated financial statements of and for the six-month period ended 30 June 2015, have been prepared in accordance with International Financial Reporting Standards (IFRSs). This report has been prepared in accordance with IAS 34 Interim Financial Reporting. The accounting policies adopted are consistent with those of the previous financial year. All amounts in this report are presented in KZT millions, unless otherwise stated. Rounding differences may occur.

Non-recurring items

KZT in millions	**Apr-Jun 2015**	Apr-Jun 2014	**Jan-Jun 2015**	Jan-Jun 2014
Within EBITDA				
Restructuring charges, synergy implementation costs, etc.	–	205	327	205
Total	**–**	**205**	**327**	**205**

Investments

KZT in millions	**Apr-Jun 2015**	Apr-Jun 2014	**Jan-Jun 2015**	Jan-Jun 2014
CAPEX				
Intangible assets	2,484	525	2,817	525
Property, plant and equipment	1,361	1,363	3,118	3,736
Total	**3,845**	**1,888**	**5,935**	**4,261**

Related party transactions

For the six months ended 30 June 2015, Kcell purchased services for KZT 2,187 million and sold services for a value of KZT 878 million. Related parties in these transactions were mainly TeliaSonera and its group entities, Turkcell, Fintur Holding B.V. and KazTransCom.

KZT in millions	**30 Jun 2015**	31 Dec 2014
Long-term and short-term borrowings	47,155	25,020
Less short-term investments, cash and bank	-15,452	-19,520
Net debt	**31,703**	**5,500**

Financial key ratios

	30 Jun 2015	31 Dec 2014
Return on equity (%, rolling 12 months)	67.4	63.3
Return on capital employed (%, rolling 12 months)	101.9	75.7
Equity/assets ratio (%)	38.3	58.3
Net debt/equity ratio (%)	42.1	6.0
Net debt/EBITDA rate (multiple, rolling 12 months)	0.34	0.05
Owners' equity per share (KZT)	291.8	460.4

Operational data

	Apr-Jun 2015	Apr-Jun 2014	Chg (%)	Jan-Jun 2015	Jan-Jun 2014	Chg (%)
Subscribers, period-end (thousands)*	10,747	11,400	-5.7	10,747	11,400	-5.7
Of which prepaid	9,421	9,754	-3.4	9,421	9,754	-3.4
MOU (min/month)	198	188	5.3	192	182	5.5
ARPU (KZT)	1,227	1,363	-10.0	1,205	1,311	-8.1
Churn rate (%)	40	36	11.1	44	51	-13.7
Employees, period-end	1,792	1,690	6.0	1,792	1,690	6.0

*In Q1 2015 the definition of number of mobile prepaid subscriptions has been changed. Prepaid subscriptions are counted if the subscriber has been active during the last three months. Prior periods have been restated for comparability.

Forward-looking statements

This report contains statements concerning, among other things, Kcell's financial condition and results of operations that are forward-looking in nature. Such statements are not historical facts but, rather, represent Kcell's future expectations. Kcell believes that the expectations reflected in these forward-looking statements are based on reasonable assumptions; however, forward-looking statements involve inherent risks and uncertainties, and a number of important factors could cause actual results or outcomes to differ materially from those expressed in any forward-looking statement. Such important factors include, but may not be limited to: Kcell's market position; growth in the telecommunications industry; and the effects of competition and other economic, business, competitive and/or regulatory factors affecting the business of Kcell and the telecommunications industry in general. Forward-looking statements speak only as of the date they were made, and, other than as required by applicable law, Kcell undertakes no obligation to update any of them in light of new information or future events.