

Conference call transcript

29 November 2011

INTERIM RESULTS

Operator

Good afternoon and welcome to the Naspers interim results conference call. All participants are in listen-only mode and there will be an opportunity for you to ask questions after today's presentation. If you should need any assistance during the conference then please signal for an operator by pressing star and then zero. Please also note that this conference is being recorded. I would now like to turn the conference over to Meloy Horn. Please go ahead.

Meloy Horn

Thank you very much and welcome everybody to our call. I'd like to introduce to you the participants from management on the call today. We have Koos Bekker, our CEO, Steve Pacak, our CFO, Antonie Roux, the CEO of Internet and also of MIH, Eben Greyling, the CEO of Pay-TV and then dialling in from London we have Mark Sorour, our CIO and Carel Snyman, GM Finance.

Before we start the presentation I'd like to draw your attention to slide two, which is the important information. I'm not going to repeat that, but just take note. And at this stage I would like to hand you over to Koos Bekker who will start the presentation.

Koos Bekker

Thank you, Meloy. Good evening to people in Asia and good afternoon to Africa and Europe and good morning to those in the US calling in. Thank you very much for your time. We will try to keep it concise. We start with slide four which presents an overall view just to orientate yourself; a few points, some financial, some operational, some strategic. Financially we had a fairly solid six months. Revenue grew at 17%, and that indicates the speed at which the engine turns. So keep it in mind, 17%. By contrast core headline earnings per share grew 7%. Now, that is the measure of profitability we find most useful because we strip out all these accounting funnies. So you can see 17% at the top line and 7% at the sustainable profit level, the difference being that we did more development work than before which we will explain later. And all this generated about R1.5 billion of free cash flow.

Operationally you will see that the Internet division benefited almost in equal measure from organic growth and acquisitions. There is more of an emphasis on performance this time. Pay-TV delivered subscriber growth of 17% and did more development than before. The Print business is our only business that is directly exposed to the state of the economy. The other businesses don't benefit in a boom and don't suffer so much a recession. You can see some strain on Print. The Technology developed in more markets. That's [unclear].

The strategy is still the same as it was. Some shift in emphasis in that we're more focussed on organic growth rather than acquisitions, and that organic growth was funded by development across several different initiatives which we will touch on later and ended up at a cost of R1.1 billion. That's about \$160 million. By accident the development costs this year and the mergers and acquisition costs is about the same, call it \$160 million each.

Turning to slide five you will see things from a financial point of view, which will be elaborated later. Top line growth of 17% as alluded to. Core headline earnings. And then because we had some capital expenditure you will see capex about 60% higher than last year. On slide seven we touch on certain key developments during the period which are further developed later, and you will see it relates to revenue growth, development, Pay-TV and some M&A activities.

Slide eight shows that the engine is moving forward and we maintain growth of 23% over the past five years in pay television. This reflects the investment over that period. Slide nine then looks at development spend expressed as a percentage of revenue. You will see it turns around 6% but there is a kick-up in the recent six months. We did more development than usual. And then slide ten reflects the same development relative to other operating expenses. You can get an idea. It is growing about 20% a year. Now, although it is growing you can see it still represents a modest proportion of total operating expenses.

Now, turning to slide 11, in July this year we warned that the Pay-TV subscriber growth could slow. Last year we had the marvellous soccer world cup, and this year we had the rugby world cup and that pertains only to South Africa, not the whole continent. Slide 11 bears that out. You will see stronger growth in South Africa than the rest of the continent. Even so we added about 270,000 subscribers over the period, and that reflects about 17% subscriber base growth. On slide 12 you can detect that M&A activities slowed somewhat. In total we spent \$160 million as I previously touched on. That then is a rather superficial summary of our business which will now be elaborated by the different Chiefs. First turning to Steve Pacak, our Financial Head.

Steve Pacak

Thank you very much. From slide 14 onwards there is quite a bit of financial detail, so what I will do is just highlight some of the key aspects from it. You will see on slide 14 we show here the summary of the consolidated income statement. As Koos mentioned on a consolidated basis revenue continued to grow quite strongly at 17%. By contrast EBITDA declined 5% year on year as a consequence of increased development costs. We will spend some time later on analysing the development costs. Finance costs declined due to lower rates of interest which we're experiencing as most corporates in the world are. And on that line as well we show preference share dividends received, and these increased year on year.

As a group one of our growth strategies is to acquire businesses. As is the nature of such investments, some have performed better than others. We take quite a conservative view from an accounting perspective when we look at these investments and we impair them where appropriate. So this year, similar to last year, we impaired investments of R610 million net of taxes. The bulk of this impairment relates to [unclear]. This is an investment we hold in our Technology segment. The traction here at [unclear] was not what we expected, and so we have for accounting purposes impaired it fully. The actual [unclear] technology does play a highly integral part in our strategy to develop online products, so whilst we impaired it, it does still have a use for us. And then the final item on slide 14 is the consolidated core headline earnings per share which grew year on year by 7% to some R3.5 billion.

On slide 18 we analyse our segmental revenues. This is where we bring in our proportional share of associates. On this basis revenues grew year on year by 20%. Over the past three years you can see the compounded annual growth rate has been some 21%. So whichever way you look at it, revenue has continued to grow quite strongly. Once again the Internet segment delivered the strongest growth, some 50% year on year.

Of interest is that the other impaired businesses – these will be all the impaired businesses excluding Tencent and Mail.ru. These are the two public companies we hold and you can go directly to those two public companies to get their revenue growth figures – if you exclude those from our Internet segment the remaining businesses grew year on year by 58%. So the other impaired businesses are growing revenues very strongly, which is the result of the intense development focus in this area. So it is important to note that whilst we are investing substantially – and we will cover development costs in a while – you will see there is also strong revenue coming about as a consequence of that.

On the rest of that slide 15 you will see Pay-TV revenues grew by 14% year on year. This is coming largely from subscriber growth. And also we had quite strong robust advertising revenues in the last six months. The Print Media segment remains quite sluggish.

On slide 16 here we analyse our trading profits. These grew 3% year on year. This lower rate of growth in trading profits and the consequence decline in margin is a direct result of increased development costs, which of course comes through the income statement and through the cash flow statement. This increase affected all our segments, as you can see on slide 16.

On slide 17 we show you here our development costs. We did communicate to shareholders in our June full-year results that we projected a substantial increase in organic development across all our businesses, and in particular the Internet and Pay-TV businesses. This was planned development spend. And of course the objective of the spend is to sustain the long-term growth of our group.

So you can see the spend on slide 17. Overall the development costs went up 78% to R1.1 billion. The investment in the Internet segment is largely to grow e-commerce platforms. In the Pay-TV segment the spend is largely on DTT and online Pay-TV services. We will deal with both of these when we deal with segmental reporting in a second.

On slide 18 we reflect here the contribution of associates to our core headline earnings. You will see that Tencent and Mail.ru continued to grow particularly strongly. In contrast Abril did not have a strong performance largely because of the once-off benefit of the World Cup which was in the prior year figures.

On slide 19 you will see the free cash flow from operations for the period. This came out at about R1.4 billion. It is down on the equivalent period last year. Once again this is because of the development spend. All of it flows to the operating cash flow.

And then on the final slide of the financials on slide 20 we reflect there the consolidated net debt position. You can see at closing we had net debt of R6.8 billion which translates into a group gearing ratio of some 15%, which is still quite conservative. So those are the financial highlights. I will now hand over to Antonie Roux who will deal with the Internet segment.

Antonie Roux

Thank you, Steve. Turning to slide 22 we continue our focus on the developing markets as reflected in this map. I will cover three of the companies in detail, Tencent, Mail and Allegro. I would like to point out that both Tencent and Mail are separately listed entities, and as such please direct detailed questions to their IR departments. Also please note that Tencent is in a closed period for their third quarter results.

Turning to slide 23, we've had a really good six months in terms of Allegro. A lot of our initiatives are starting to bear fruit, and I will take you through some of these. First of all let me just start off by saying the footnote on the left-hand side below the table is important to note. The data reflects 100% of the results for the half year. And the exchange rate is also reflected there.

Allegro continues to grow according to the plan that we originally set out. The revenue growth was 39% to 538 million Polish Zloty, which is the local currency. In Dollars, depending on the exchange rate of the day, it is roughly \$189 million in terms of revenue, of which roughly \$38 million trading profit was made during the period.

If you look at the revenue mix at the bottom of this slide we continue to be happy with the revenue mix that we see in the market. It is also important to note that when we acquired the business roughly three and a half years ago it was a single vertical mostly in Poland, and today you have a situation where you can see the verticals are starting to grow. And as a matter of interest, roughly only 76% of the revenue actually comes from Poland.

What is most exciting for us is the fact that we've now expanded into 15 countries with six verticals. I guess what we all want to hear is that of those 15 countries 14 territories are being monetised and five are already profitable. We continue to focus on organic development, which is really important for us. And it is also worth noting that of the revenues reflected here for the period organic growth was represented by 75%.

Then turning on to page 24, Tencent. Once again I want to point your attention to the footnote below the table on the top left-hand side of the slide. The data reflects the first half of the financial year, January to June, and the detail is available on Tencent's website. It has been released before. And we also reflect the exchange rate.

There was healthy revenue growth for the period to 13 billion RMB, 47% growth, which is really strong growth if one takes into consideration that the company is in its 11th year of operation. The revenue mix continues to be very healthy. We've also seen good growth in advertising and other categories as reflected by the chart.

On the right-hand side I think some of the key points to highlight for the year. The one is the open platforms to third parties continued to unfold and we've seen really good successes as far as that is concerned. The second thing is you will see from a user point of view that the statistics keep on growing with roughly 145 million concurrent accounts. And then lastly from a financial point of view the contribution to core headline earnings grew from R1.5 billion to R2 billion for the period.

Moving on to Mail.ru group. Once again the small little footnote on the left-hand side below the table. The data reflects 100% of Mail.ru group's first half year aggregated segment performance as reported. For IFRS results with full disclosure please refer to their website. And the exchange rate is actually listed.

Strong revenue growth. 66% as you can see there. Mail of course report their results in Dollars, therefore these results are in Dollars. You can see that the revenue growth went from \$137 million to \$228 million. And the EBITDA margin is even stronger at 51% or \$117 million. The revenue mix is very healthy. A couple of years ago when we originally invested in Mail it was all made up out of display advertising. And you can see how well that has changed over the period.

The main drivers during the period were advertising and community value-added services. There is an ongoing focus on games with several new launched either having taken place or being imminent. We've listed some other stats which you can look through. I think important from a financial point of view is to highlight that the contribution to core headline earnings grew from R95 million to R178 million during the period.

Then just to highlight three other businesses. First of all BuscaPé. The market is fiercely competitive. The war is far from over. And as a result, as we've said in the past, we're not really in a position to disclose a lot of information because it will educate our competitors. Some of the points that we are willing to disclose is that we have seen revenue growth of more than 100% year on year, which is really great. The operating loss at the current point in time in this company is discretionary and depends on which verticals we're in and where we still see expansion.

Then moving on to ibibo. We have seen a strong growth especially in e-commerce in the market in general and also in ibibo. We've launched various new services, for instance an online classified platform, and we've expanded the ibibo travel service which historically only offered domestic air travel to now include hotels, busses, holiday packages etc. And ibibo also opened up their platform to third party developers.

And then lastly Markafoni, which we spoke about before. Turkey has the 12th largest internet population globally and Markafoni is the leading private sales company in Turkey and the 3rd largest e-commerce player. We've also seen the ability to leverage some of the skills in the Allegro group into Markafoni and visa versa. So with that I hand you over to Eben.

Eben Greyling

Thanks Antonie. Guys, I refer you to slide 27 to give you an overview on Pay-TV on what we're planning for the long term. Our overall strategy is really focussed on providing the DSTV content anytime, anywhere on any device. That strategy is informed with what we see is happening globally where the dominance of Pay-TV operators are increasingly being challenged with new companies delivering content online directly to consumers, or better known as over the top delivery.

Also consumer consumption of content is increasingly moving to a personalised service accessible from everywhere or anywhere and displayed on as many devices as possible. You probably see your kids watching content on their phones or on iPads or the new digital devices.

Africa lags the rest of the world considerably if you look at the online space. We do however anticipate that online video consumption is likely to increase over the next couple of years, and we have various developments in place to prepare for this shift to online distribution of content, which includes the distribution of our content on new devices.

The second part of our strategy is also to expand our service to the mass market. The rollout of digital terrestrial [?] networks in our main markets is core to this strategy. Overall positioning the business for the future is key to ensure long-term growth in the Pay-TV segment.

If you turn to slide 28 I will just touch on a couple of the main drivers in the Pay-TV business that impacted the performance of our businesses. Firstly on the top left-hand side you will see our subscriber growth. Over the last five years or four years since 2007 we've managed to increase our subscribers on average by 19% year on year. The total subscriber base in Sub-Saharan Africa

including South Africa passed the 5 million mark for the first time to just over 5.2 million at the end of September.

The second one is our programming costs on the top right-hand side. You will see the increasing programming costs for the last couple of years standing at 19%. On a year on year basis from September 2010 to September 2011 that is sitting at 15%, so it is slightly down. But that is really driven by a couple of items. The first one is a huge part of our programming cost is variable so as subscriber numbers increase our costs increase. There were some additional sports rights that we now include for the first time in our results that weren't there previously. And then lastly we continued to invest in local content and new channels. That is key for growth, especially in the lower market segments.

Now on the bottom left-hand side you will see our development costs. For the last six months that was 65% year on year, and that is directly related to the strategy that I explained earlier with the investments in [unclear], broadcasting platforms, VOD services and online. New technologies also include some capital expenditure that we will incur. If you look at the right-hand side there you will see a 21% increase on a year on year basis. That includes items such as our DTT networks in Africa.

If you turn to slide 29 you will see the results of the South African Pay-TV operations. Overall the business in South Africa delivered another solid performance in the first half of the year both from a subscriber growth and a results perspective. If you look at that first bullet on your right-hand side you will see we had growth of 209,000 subscribers for the first six months despite not having the soccer world cup and the soft world economy. We are pleased with that result. On a year on year basis that is sitting at 15%.

And growth from the compact bouquet remains strong at 13% of total growth. What is also encouraging is seeing other tiers like select starting to contribute. The PVR is a very popular device in our South African market now. It recorded growth of just over 90,000 homes for the six months and in total is now sitting at just over 570,000 PVR homes in the business.

Revenue increased by 16%, driven mainly by our increase in subscribers and also the price increase we process on 1st April every year. Advertising revenues recorded a healthy increase of 20%, and that is on the back of the overall increase in our TV ad spend in South Africa. Trading profit was also up 16% and we've managed to maintain healthy trading margins, 35%.

I talked about the delivery of online content and the challenges we face with the rollout of broadband in Africa. The good news is that we're not sitting back and waiting for proper broadband to arrive. In July we announced the launch of BoxOffice, a video on demand service that allows PVR customers to view the latest movies instantaneously on their PVR decoders. If you come home tonight at eight o'clock and want to watch a movie you can immediately see that movie on your PVR, similar to what other online players are doing in the rest of the world. This service is proving very popular with our subscribers and there are already more than 30% homes registered for the service.

On slide 30 you will see an update on our business in the rest of Africa. If you look at the top right-hand side we recorded growth of 60,000 subscribers for the six months to just under 1.5 million. Without the benefit of the soccer world cup that comes around only every four years the slow-down of growth was expected. But also the general slow-down in economic growth in most of our markets on the African continent and the revaluation of local currencies against the Dollar also played a part in the first six months. Year on year we still however managed to record a 21% increase in net subscribers.

Our top line performance remained healthy with a 16% increase in revenue year on year. And as I explained to those who were on the call in June when we talked about the year-end results we are investing in the African business for future growth with the result that profit margins will reduce during this period with incremental cost increases. If you look at trading profit it reduced 22% year on year. That is directly the result of incremental costs of probably about \$40 million incurred in the business on some of the following items. Firstly, the costs related to the rollout of our broadcasting platforms, DTT and Mobile TV, the investment in local content and new channels, sports rights included for the first time in the Africa results and also increased decoder subsidies.

And then lastly you will see on the right-hand side we talk about our DTT services. The rollout of those low-cost DTT services is key to our mass market penetration strategy and we have made good progress on this front. We launched the DTT service in four markets in Africa under a new brand called GOTV. The first launch was in Zambia, followed by Uganda, Kenya and most recently in Nigeria. We will expand the service to more cities in these markets and also roll out additional countries over the next two to three years. That covers the Pay-TV segment. I will hand back to Koos.

Koos Bekker

Thank you, Eben. I will briefly touch on Print. The key figure there is the revenue growth of 7%, which is not stellar but in the current circumstances not too bad. The reason Print suffers or why you don't see the same trend with Pay-TV and the Internet is that they have a bigger exposure to advertising. When people lose their bonuses they don't stop viewing Pay-TV. They don't read less. They might even read more. But what happens is that is half your income. The other half of your income is actually advertising. And if the retailer suspects Christmas won't be too great then he starts cutting his advertising right away. So Print being exposed to advertising is more in sync with the economic cycle. The economic cycle being somewhat recessionary you see that in Print.

We have responded by cutting down on capex, which you will see at the bottom of slide 31. There is quite a lot of development. We tried to move the print titles into tablets, iPads and these sorts of tablets. The print product looks very attractive there, so we hope in the long-term we can shift away from the physical print product.

Lastly, on slide 33 I would like to summarise some of the trends that we have detected in our presentation so far. There are three headings, strategy, operational and financial. On the strategy side you will see considerable investment trying to prompt long-term growth to see if we can keep up the 17% growth that you see here, or in fact 20% growth if you take out our share of equity accounted investments. We expense all these developments wherever possible, so you see R1.1 billion development cost and about the same amount of acquisition cost.

Operationally Eben has explained the rollout in DTT and also the rollout in internet-based Pay-TV services. And we will build our Internet businesses, especially e-commerce, organically. All over our business you can detect that competition and regulation are factors we have to keep into account.

Financially then we expect the next six months to maintain fairly robust revenue growth, the same essentially that you saw in the past six months. There will still be strong organic development spend, more than last year. And then when you look at the profit we don't predict or guide to profit, but the trends that you see currently are still in evidence as we speak and we consequently believe the pace at which our profits grow will be slower than the pace of last year.

Now, folks, that is the end of our commercial parrotry. You're welcome to ask questions. I will hand back to our moderator, Dylan.

Operator

Thank you very much, sir. Ladies and gentlemen, at this time if you'd like to ask a question please press star and then one on your touchtone phone. If you then decide to withdraw your question please press star and then two. Our first question comes from Duncan McLeod of TechCentral. Please go ahead.

Duncan McLeod

Thank you. Good afternoon gentlemen. I was just wondering if you could give insight into Naspers' decision to exit the social media business MXit. What was your thinking in selling that stake? And also could you give us some detail on how much you sold it for?

Antonie Roux

Duncan, good afternoon. Antonie speaking. We are a minority shareholder and from a strategic point of view there wasn't really a fit for us in terms of our other focus areas here in the continent, which is predominantly e-commerce. As far as the price is concerned I'm not willing to disclose that. Well, let me say I'm not able to disclose that due to a confidentiality that we have.

Duncan McLeod

Thank you.

Operator

Our next question comes from Kevin Mattison from Avior Research. Please go ahead.

Kevin Mattison

Hi Koos. Two questions. The first one is what sort of cycle do you see revenue growth and expense growth being different for? Is it one year, two years or a much longer time when you look at the gap between how fast your expenses are growing and the revenues and contracting margins? And then my second question is you commented over the last couple of reports that acquisitions have become quite difficult and expensive. Have you seen any change in that environment?

Koos Bekker

Kevin, you write such good reports that we should actually be asking you questions. Your predictions will probably be more accurate than ours. The revenue, I think what you alluded to is the engines turn fast at 17% and shows 7% more profit on a headline earnings per share basis. And that share that one would expect in the long term to equate more. How long it will last I can't say. It depends on the development cycle. In Pay-TV I would imagine Eben's current focus on DTT and internet will abate and the gap will close up within a reasonable time. Two years or so, but not forever. Internet is a bit different because we have all these discreet growing elements of e-commerce. So when you finish one set of developments, let's say on classified, we might well start another one on price comparison. So it's quite difficult on the internet side to predict how hard and how long it will run.

Your second question is a bit easier. The interesting phenomenon at the moment in the internet is that listed internet investments are not extensive, at least not in my view. We're not a shareholder in Google. Just look at Google's price. I think it is very well priced. And so with a lot of assets. eBay, even [unclear] in China. At 10c on the historical PEF 22 and given their growth rate I think that is pretty well

priced. We don't see the same trend in unlisted investments. So when we go to India or Brazil and talk about buying a company we still get quite bold values. And because of that we have been somewhat cautious in buying companies. Whether the current economic crisis will weaken the resolve of the entrepreneurs to get top dollar, I'm not sure. What do you think, Antonie?

Antonie Roux

I don't know. It's difficult to say. At the moment the general trend is that it is very difficult to find engineers. A lot of the internet companies sit on an enormous amount of cash, and therefore I think our biggest challenge currently is to find really good engineers and to maintain them. So it's sort of like this conflicting situation in the market. A lot of companies struggling due to the recession with uncertainties in the economy, but on the other side they have the cash to attract the sharpest engineers.

Kevin Mattison

So it's still difficult to do acquisitions and you still see the way forward as being internal development.

Koos Bekker

Yes, Kevin. Quite correct. The problem with acquisitions is we looked in the last calendar year at 200 different acquisitions, led by Mark Sorour and Charles Searle, and we closed 20 deals. Along the way we willowed them out. In this case the management was weak. In that case there was a regulatory or a patent issue. I expect much the same going forward. The problem is these things are lumpy. They're not all the same size. You work on a big deal and it doesn't come off or it does come off. So on the M&A side there isn't an even, predictable flow like there is on organic development. You basically look at the number of deals, and if they come off you have a lump and if they don't come off there is a valley.

Kevin Mattison

Thank you.

Operator

Our next question comes from Cornelius Makari of Anibok Investments. Please go ahead.

Cornelius Makari

What are you finding in terms of the trend on margins South Africa versus the rest of Africa? And the second one is to do with [unclear]. There has been a negative trend in operating cash flow. When can we expect that trend to turn?

Eben Greyling

Cornelius, I will try and answer your margin question and Steve can do the cash flow. First, if you compare South Africa and Africa the two businesses in terms of size are quite different. So if you just take a look at the overall bottom line if you have a \$10 million expense in Africa the impact on margins is quite significant, where a \$10 million expense in South Africa the impact on margin is much smaller. I think that's why you can see in South Africa it is a lot easier to maintain the margins without a significant movement on a year on year basis when we invest for the future. Africa, because it is a smaller base, that investment will have a much more significant impact. Steve?

Steve Pacak

Cornelius, your question on cash flow. I think the important metric to look at is free cash flow. In other words the cash that the operations themselves are generating before any gearing and before

acquisitions we make and so forth. If you look on slide 19 you will see we generated free cash flow of R1.4 billion in the last six months. But more importantly we show you a five year history there. You can see over five years the compound annual growth rate of our free cash flow is about 16% per annum. Now, that is free cash flow, and that is the important metric. On a net basis clearly we have periods where we have substantial outflows and from time to time substantial inflows. That is largely because of the acquisitions we've made over the last five years or so, and of course things like dividends and interest payments and so forth. But the really important metric of free cash flow is actually growing reasonably well. I hope that addresses your question.

Cornelius Makari

Somewhat. [Inaudible segment].

Steve Pacak

That we can show you. It's difficult to do that now online, but that we can show you. But I think slide 19 does give you a very good indication of our operating cash flow.

Operator

Ladies and gentlemen, a reminder that if you'd like to ask a question please press star and then one now. Our next question comes from Craig Hackney of Religare. Please go ahead.

Craig Hackney

Good afternoon. On KPB [?] content costs could you give us an indication whether competition for content is decreasing or staying the same?

Eben Greyling

There is a mixture of content that you need to look at. Firstly you talk about competition. Now, I mean that is something that has been with us now for a couple of years. Competition will always have an impact on driving the content cost up. Our focus in the last couple of years is really investing in local content and increasing our spend on local content, both from a sport perspective where we now broadcast leagues from places like Kenya, Nigeria, Zambia, Angola and Uganda and even PSL in South Africa that is becoming substantial. And you will see last year we invested in a new channel, Mzansi Magic in South Africa, that increased our spend on local content significantly. And a lot of it is where we invest our money directly with producers in driving the production industry in the markets where we operate, which is probably slightly different to competitors bidding for the same content in the market.

Craig Hackney

If you look at things like international sports rights is there is still significant upward price [unclear] there or is it [unclear]?

Eben Greyling

I think it is always difficult to predict what is going to happen in the future. So when the rights come up it will all depend on the players in the market. And we have always said there is a walk-away price for us as well. So if you start to look at some of these rights I think they're getting very close to a level where if it goes up significantly we will walk away. So it all depends on the situation at the time when we bid for those rights.

Craig Hackney

It is interesting the English premier league in England has shown a decline in [unclear].

Eben Greyling

And you've also seen probably on the French league where there was an article recently where government intervened to make sure that they actually do get some money for their local leagues. So you definitely see European soccer becoming under pressure in terms of their rights and the fees that they demand from an international audience.

Craig Hackney

Being too high?

Eben Greyling

Yes.

Craig Hackney

Thank you.

Operator

Our next question comes from Chris Grundberg of UBS. Please go ahead.

Chris Grundberg

Thanks so much. On your development expenditure on your Internet business could you give some colour on how you assess those development projects, what your criteria are in terms of development expenditure? What timeframe do you look for for payback? Do you use uniform criteria across your various segments or do you tailor them to the local markets? Thanks.

Antonie Roux

That's a good question. There isn't a straightforward answer. Neither is there a standard formula. We clearly understand the competitive situation in each of our markets and we clearly understand where our own businesses are operating. And in certain cases, let's take Allegro in Eastern Europe, we have a locomotive as we refer to it, and we will do bolt-on transactions in terms of certain verticals where the acquisition cost for the individual deal is minimal. And quite frankly there isn't a measure afterwards in terms of the return on the investment because the business actually gets integrated right into the Allegro platform. On the other hand, if you would take markets where our position is not that strong, for instance Latin America, not that we've bought much there, but I would imagine there you would find yourself in a situation where you might end up paying a hefty premium for something chunky, which we don't know of currently in the market but you would possibly pay a premium because you're in such a fiercely competitive environment. So it really varies from market to market, our position relative to competitors, the margins you can make in the different sectors etc. There is an enormous amount of criteria that gets applied to each of the deals. There is unfortunately not a straightforward, simple answer.

Koos Bekker

It's Koos. There is an interesting phenomenon, the difference between something like Print or Pay-TV and the Internet in this regard. So if you ever launched in a new country it is going to need massive research, [unclear] for three years, launch, run hundreds of millions of Rands of losses. And then it is very easy to detect whether it is a success or a failure because it is stand-alone and easy to identify.

The Internet is quite different. The group Internet company is basically throw spaghetti on the wall as fast as possible, and some pieces stick and some pieces fall off. The cost of throwing the spaghetti is very low. Then if you see you get traction on something you add five engineers, and then if it works better you add 30 engineers, and you resource success and you kill failure. Often these things get integrated into the mother company pretty fast. So you develop a service. It doesn't generate revenue itself but it enhances the consumer experience. Then you absorb it back into the mother company. You can of course track how well the mother company is doing. But to take out that discreet development and to separate that from the rest of the company is often quite difficult. In the Internet the projects tend to be very short term with a rapid integration [?]. So if you're successful you resource it, and if you fail you get out as fast as you can.

Chris Grundberg

That's very interesting. Thank you very much.

Operator

Our next question comes from Ziyad Joosub of JP Morgan. Please go ahead.

Ziyad Joosub

Hi. Thank you for taking my question. I'd just like to get a better feel around what peak development spend is, particularly in let's say the internet. I fully appreciate the view that it is more opportunity-driven and will depend on what initiatives come out, but at the moment development spend let's say in this half was 22% of revenue in the Internet segment. What should we benchmark as a peak level where development spend can go? Can it go to 26%? Can it go to 30%? And will that peak be in the next 12 months or the next 24 months? Surely there has to be a stage where you'll hold back on your spend and the spend can't increase any more as a percent of revenue.

Antonie Roux

A difficult question. The answer is I think it is really difficult. You're asking us to do a forecast. We don't give forecasts or guidance. A second point is that this is sort of like gazing into the crystal ball in terms of the competitive environment. The competitive environment may very well change overnight where you find that a competitor in a really important market for you starts spending an enormous amount of money on marketing etc. and you have to respond. I would like to believe that these types of percentages that we currently see is at the top end of what one could expect. But it is a difficult guidance because of the uncertainty of the market. The sector is growing so fast, it's really difficult.

Koos Bekker

Ziyad, what we must be quite clear on is what we are saying for the next six months is that costs are going to accelerate. We invested R1.1 billion in the past six months. In the next six months it is going to be at least that. So it is not going to slow down in the short term, the short term being the next six months. I think we must be quite clear on that.

Ziyad Joosub

Thank you.

Operator

Ladies and gentlemen, a final reminder that if you'd like to ask a question please press star and then one. We have a follow-up question from Cornelius Makari. Please go ahead, sir.

Cornelius Makari

I just want to understand what the difference between DTT that you're rolling out in the rest of Africa with the compact and with the other stuff that you already have. Can you just educate me a bit there?

Eben Greyling

If you look at DTT in the rest of Africa that is really a mass market product, very low priced. So on average you're sitting with revenues of about 7%.

Koos Bekker

Eben, just explain how DTT works and contrasts with satellite.

Eben Greyling

The main difference between DTT and satellite is if you look at satellite you need to go and buy a decoder and a dish to receive the service. On DTT we physically roll out the network on the ground. You go out and you buy the decoder, and most of the time depending on network density you need a little sub-antenna inside your house. So it is really a plug and play solution. It takes away a significant part of your upfront costs or your barrier to entry for the consumer. So as the box prices come down your subscriber acquisition cost reduces significantly because you don't have to subsidise anything in terms of the installation. So what we're driving in Africa is really a low-cost proposition where the consumer will be able to go and buy a decoder, take it home. He doesn't have to wait for an installer. Plug the decoder in, put up the sub-aerial on the window and you will be able to receive the TV signal. And you can use one frequency on DTT two about 20 channels. At this stage we're pricing that at about \$7. The difference to that if you look at compact in South Africa is that satellite is more aimed at the middle market, where DTT is at the real lower end of the market. A significant factor to keep in mind is the whole analogue migration where all the countries in the world in terms of regulations by 2015 have to migrate from analogue to digital broadcasting. So with that happening it really creates an opportunity for us to play in that market, and to make sure we take part in that migration process and provide digital content to consumers across the African continent.

Cornelius Makari

You say \$7. Is that installation?

Eben Greyling

No, \$7 is your monthly subscription.

Cornelius Makari

Okay. Thanks a lot.

Operator

Our next question comes from Mark Ashton of Finweek. Please go ahead.

Mark Ashton

Hi guys. Just two quick questions here. There have been quite a few questions about competitiveness from the various analysts. Do you have a view on this for China? And then maybe some comment on geographies you guys see opportunities in going forward.

Koos Bekker

Mark, if we can explain China's future we can probably deprive the Financial Times of half its circulation for the next year. What we see there is that it is still growing at about 9%. And while every country in the world has problems in this turbulent environment I think China is managing their economy especially astutely. I see more upside than downside. The rest of the world. Europe clearly has problems. We are fairly lightly exposed to Western Europe. We are more exposed to Eastern Europe outside the eurozone. There is an interesting phenomenon that the economy in a particular country might grow by 1% or even be static, and yet the internet may grow by 15% or 16% because it is a technological change. It's like saying this is the year 1910. In Hungary the economy is growing at 2% but the auto industry is growing by 20% because the auto industry is replacing horses and consequently overtaking something else.

So I think we can maintain the growth in double figures even with the current recession. Of course if the whole thing blows up if Italy goes belly-up and so on, it is difficult to calculate the effect of that mess. Our business tends to be relatively unconnected to sentiments in the market. In the past we have often commented that we seem to do better when things are a little bit tough because people spend more time at home. The only business we have really that is exposed to the internet would be Print. And then some internet portals. Although it is not a big part of our internet we have some smattering of portals somewhere, and they derive advertising income. But ad income is very sensitive to the cycle so you can even anticipate the economic cycle. So if this is October and retailers see by December consumers will not be spending they are cutting back now, so you anticipate that and then cut back.

There is obviously the contrast that sometimes long before the economy starts improving advertising builds up. So it predicts the economy. In total our advertising income is about 13% of revenue, so it is not too large. So I think net net we are not dependant on a boom to do well. We can do well in the current environment. But if there is a complete blow-up of something of course that is unpredictable territory.

Mark Ashton

Thanks

Operator

Our next question comes from Philip Short of Fairtree Capital. Please go ahead. [Pause]. Our next question comes from Edward Sellwood of Morgan Stanley. Please go ahead.

Edward Sellwood

Good afternoon. I have two questions please. Firstly just on the DTT rollout in Africa. Could you just explain to me how dependant it is on the acquisition of licenses and frequencies relative to how much of that is a barrier to your development plans? And have you got any new or major significant blocks of frequencies or licenses coming up in the near term? And the second question relates to Pay-TV's slowdown in the net adds. You mentioned there was to some degree a [unclear] on the World Cup, which is fairly true, but could you also say whether or not there is any sign of economic weakness in customer numbers, particularly on the premium side. That is only up 2% in SA.

Eben Greyling

Maybe I will start with your second question. If you look at your slow-down in net adds I think especially in the African markets where you definitely have seen some impact in the premium base with the local currencies devaluating. In a lot of our markets we bill in dollars or dollar related to the local currency, so

if the currency goes by 25% or 30% you see the increase which does become expensive for some of our premium markets. So there has definitely been some impact on that. But take a market like Kenya where the Kenyan Shilling depreciated significantly and then last week recovered by 14% again over a short space of time. So it is up and down. And you will see that volatility moving over the years. On DTT it is always 100% linked to licenses and frequencies. There are no blocks of licenses coming out in Africa. We go through the process in every country where we follow a specific regulatory process, and as we obtain the licenses and frequencies we will roll out the service.

Edward Sellwood

Does that mean there is a batch of new rollouts about to be launched, or are you some way down the line and it is just a basic [unclear] process.

Eben Greyling

It is a spread process. And remember also if you roll out in a country you start with your main city with one transponder, and then as you work on your network coverage to provide better coverage for the customers and also expand to additional cities it will become more financially feasible. So it is not ten countries that will happen in the next three months, if that's your question. It will phase out over the next 24 months.

Edward Sellwood

That's great. And if I may just be very greedy and just ask one more, it relates to the previous question on whether there was a slow-down in the revenue profile of the group. How committed is the development spend going forward for the next six to 12 months? How much could be used, or is it non-variable on revenue conditions?

Koos Bekker

Maybe I can respond. We had a phase where we developed projects that we would commit to, let's say launching a Pay-TV system in a country. We've committed to a spend for let's say three years, so there is not much you can do about it. You just barrel down that hill and you'd better turn, and if you don't turn there will be problems. But developments we do now are completely different. You can basically turn it off with 30 days' notice. What you have to do is fire an engineer. And it depends on how quick that happens in different countries. So it is almost entirely discretionary. With notice of two or three months you can probably terminate any project. So if we see success we reinforce it. If something doesn't work we just turn it down.

Edward Sellwood

That's pretty helpful. Thank you very much.

Operator

Thank you. We have a question again from Philip Short of Fairtree Capital. Please go ahead.

Philip Short

Afternoon. Koos, I think you intimated earlier that internet valuations are a bit lost to you at the moment. And the information was that that was driving the relevant spend internally, organic growth. If valuations came off somewhat and you found something attractive, and you sought to do an acquisition, would you still be driving internal development spend to the point that you have? That's my first question. And then I will ask the second one later, thanks.

Koos Bekker

I think your question has already implied the answer. There is a trade-off. For example, our financial chief, Steve Pacak, has \$30 million. Now, for him it is entirely immaterial if Mark Sorour, the M&A chief, spends that on buying an internet asset or whether Antonie Roux spends the same amount of money developing something, for example a combination of engineering time and advertising costs building exactly the same asset. If Steve says I'm out of pocket \$30 million, and whether you acquire or whether you build, I don't care. However, the financial effects are fundamentally different if we buy. Nothing happens in the income statement because most of the companies we buy are at break-even or making a small profit. So the income statement doesn't get affected. But the moment we shift that, although intellectually everyone agrees it is the same \$30 million it does flow through the income statement. And that's what you see this six months. People say, great growth, but your profit line is hit. Yes, we shifted from an M&A approach. We do emphasise that and emphasise organic growth. And your question implies that if prices come down you switch back. That's entirely true. What will then happen is the profit line will grow faster than your revenue line for a while. Then from an objective point of view it doesn't matter which way you do it. You spend \$30 million.

Phillip Short

If there was an opportunity and you're spending \$30 million in development and there was an opportunity to acquire something different for \$30 million would you do both simultaneously?

Koos Bekker

It depends how much discipline we have. Our financial chief I think will not allow it, but I have no doubt that's exactly what the internet people would love to do. I think the answer is you'll have an internal fight because to some extent we could trade off. I need this component. I can either build it or buy it. But of course people are ambitious and they like to grow as fast as possible. We often have arguments. We actually encourage them. People come up with ideas. I think I alluded to 200 projects being debated last year. So you have advocates in the group that believe in this fiercely, and the fight and cry and complain. And sometimes we say no, and other times we say yes. The trade-off is basically how much money we have, how we assess the opportunity and how well it fits the broad group. I think in general though there is a bit of a trade-off. I think we won't do both with equal vigour at the same time, also because we have to calibrate the speed with which you can integrate things. If you attempt too many thing simultaneously it might overwhelm you a bit.

Philip Short

My second question is of the R470 million in development costs for e-commerce can you direct me to where exactly... I appreciate you can't disclose the company specifics, but maybe then just the geographic region where that e-commerce spend is being spent.

Antonie Roux

That is a question that I don't want to answer because I may educate the competitors. That's about my answer.

Philip Short

Thank you very much. If you can then just help me to try to understand when you see break-even in that operation where you're spending this money.

Antonie Roux

It varies from business to business. The business specifics disclosed to you from an e-commerce point of view is Allegro group, and you can see the results. It is profitable. We've said before, and we disclosed it again this time around in terms of BuscaPé that the business is discretionary and running at a break-even point with very strong top line growth of over 100%. As far as the rest of the e-commerce specific businesses are concerned I'm not really willing to disclose the information. It's fiercely competitive.

Philip Short

Okay, I understand. Thank you.

Operator

Our next question is a follow-up from Craig Hackney of Religare. Please go ahead.

Craig Hackney

Thank you. The South African Pay-TV subscription increase has been over the last few years about 5% or 6% per year. As your premium composition decreases going forward do you think it is unrealistic to expect the subscriber base to be able to absorb those sorts of increases going forward?

Eben Greyling

If you look at the increases over the last five or six years it has always been roughly around inflation in South Africa. So I think we definitely will be able to sustain the increases that are slightly below inflation going forward.

Craig Hackney

Okay. So the decision around the increase is driven more by cost [unclear] as opposed to the estimate of what you think the subscriber base is going to [unclear].

Eben Greyling

That's true. If you go back a couple of years when the Rand went to almost R12 against the dollar you would have seen that if the business requires it we have interim increases, where we didn't wait for April. We said we need to increase the price to absorb the increased Rand equivalent of our dollar expenses, and we put that through.

Koos Bekker

I think though we are quite sensitive to the increase it has to be justified either by something happening to the Rand or be in line with inflation. What we don't want to do is to shock the subscriber base. We're very delicate with the sort of things you foist on them because the long-term relationship is being [unclear]. I think your average life of subscriber is more than five years.

Craig Hackney

Thank you.

Operator

Ladies and gentlemen, we have no further questions. Do you have any closing comments?

Meloy Horn

Yes, thank you to everybody for joining our call. We will be reporting our next set of results at the end of June next year. Thank you very much for dialling in.

Operator

Thank you very much. On behalf of Naspers that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT