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# Imara Sub Saharan Africa Telecoms Report

*Riding high on Africa's booming data market...*

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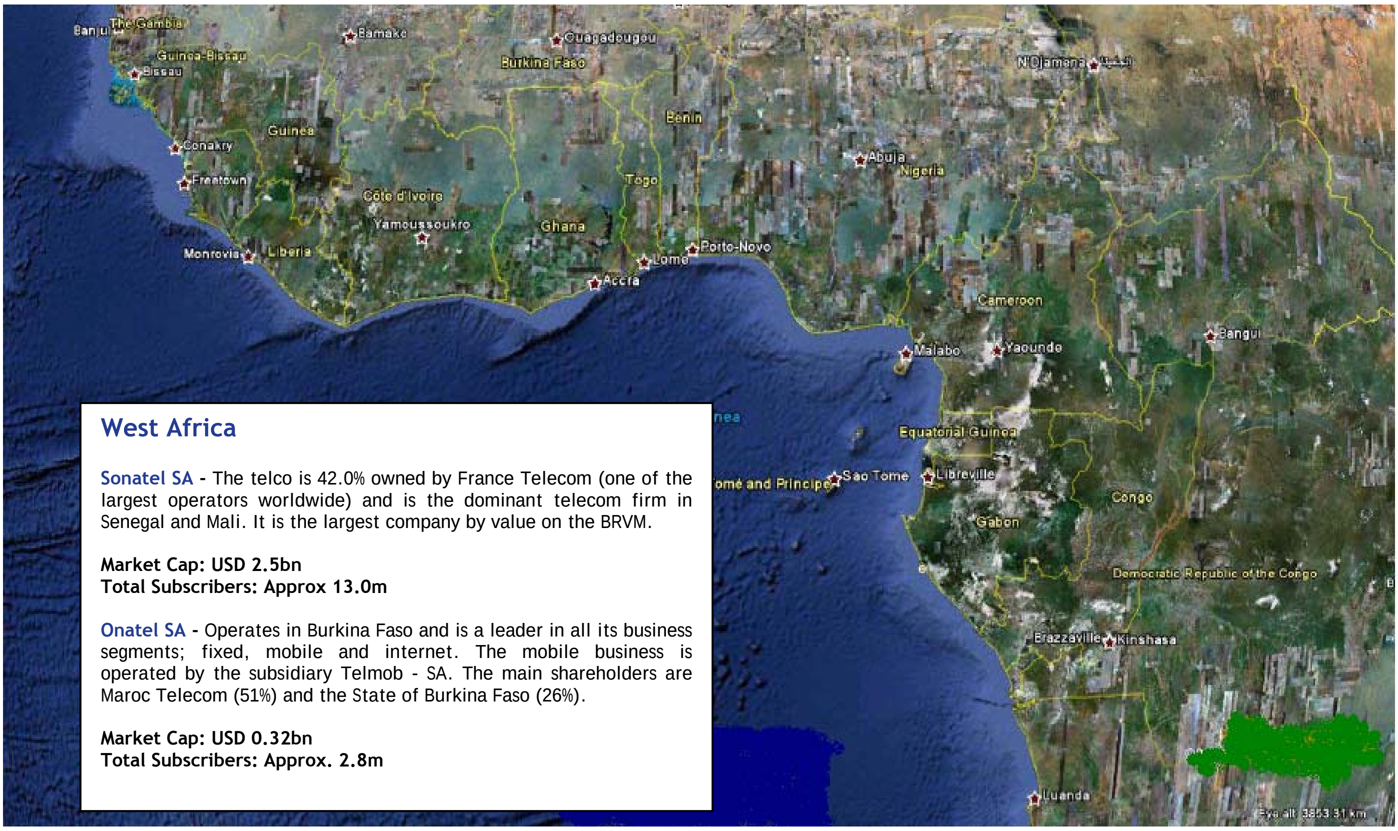
### Appendix to Abbreviations:

**ACE** : Africa Coast to Europe
**ADSL** : Asymmetric Digital Subscriber Line
**ARPU** : Average Revenue Per User
**BRVM** : Bourse Régionale des Valeurs Mobilièrs
**C** : circa
**CCK** : Communications Commission of Kenya
**EAC** : East African Community
**EASSy** : East African Submarine Systems
**GDP** : Gross Domestic Product
**IAS** : Imara Africa Securities
**ICT** : Information and Communications Technology
**ISP** : Internet Service Provider
**KES** : Kenyan Shilling
**LHS** : Left Hand Side
LION : Lower Indian Ocean Network
**LTE** : Long Term Evolution
**MoU** : Minutes of Use
**MSE** : Malawi Stock Exchange
**MVNO** : Mobile Virtual Network Operator
**RHS** : Right Hand Side
**SADC** : Southern African Development Community
**SSA** : Sub-Saharan Africa
**TEAMS** : The East African Marine System
**USD** : United States of America Dollar
**VAS** : Value Added Services
**VOIP** : Voice Over Internet Protocol
**WACS** : West African Cable Systems
**y-o-y** : year on year
**ZAR** : South African Rand
**ZSE** : Zimbabwe Stock Exchange

## Sub Saharan Africa Telecoms-Fast Facts



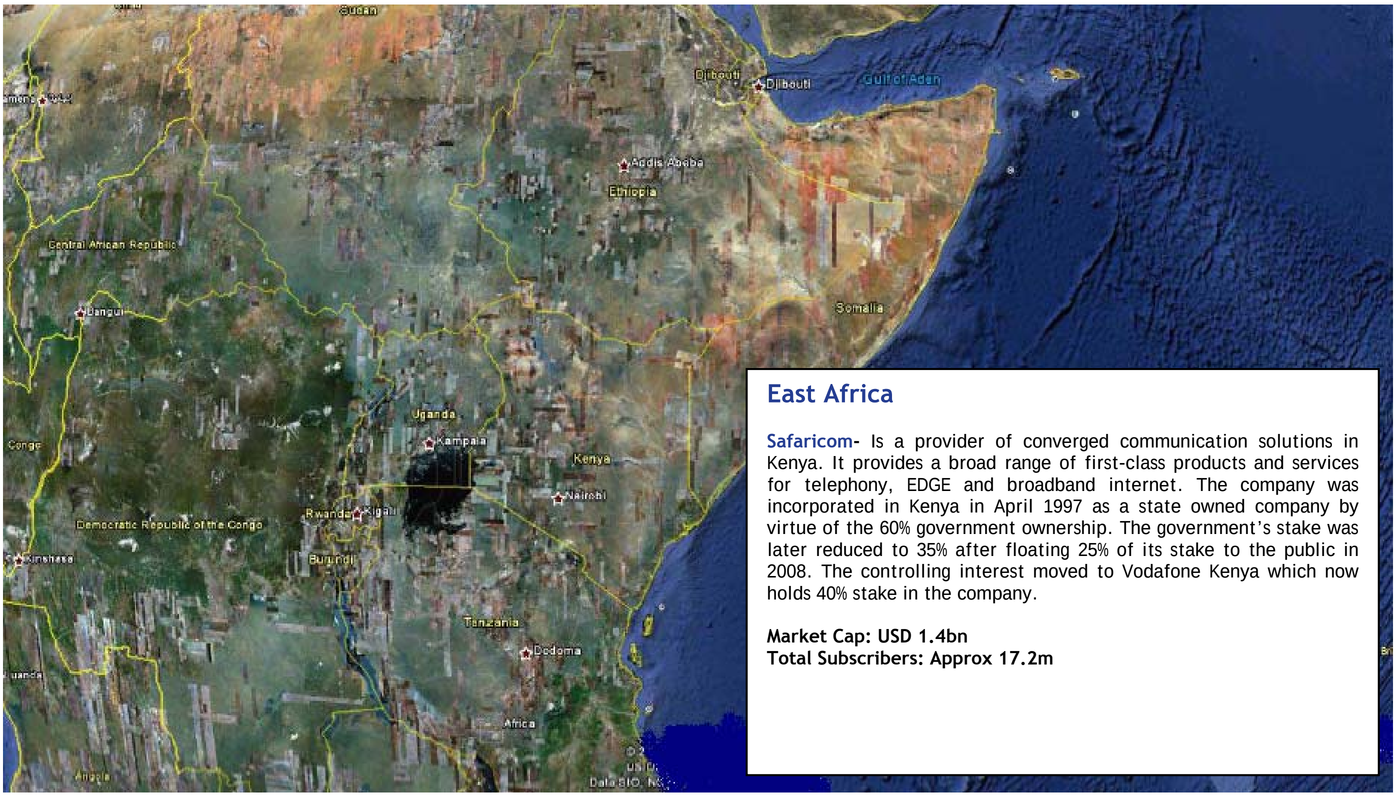

### West Africa

**Sonatel SA** - The telco is 42.0% owned by France Telecom (one of the largest operators worldwide) and is the dominant telecom firm in Senegal and Mali. It is the largest company by value on the BRVM.

**Market Cap: USD 2.5bn**
**Total Subscribers: Approx 13.0m**

**Onatel SA** - Operates in Burkina Faso and is a leader in all its business segments; fixed, mobile and internet. The mobile business is operated by the subsidiary Telmob - SA. The main shareholders are Maroc Telecom (51%) and the State of Burkina Faso (26%).

**Market Cap: USD 0.32bn**
**Total Subscribers: Approx. 2.8m**

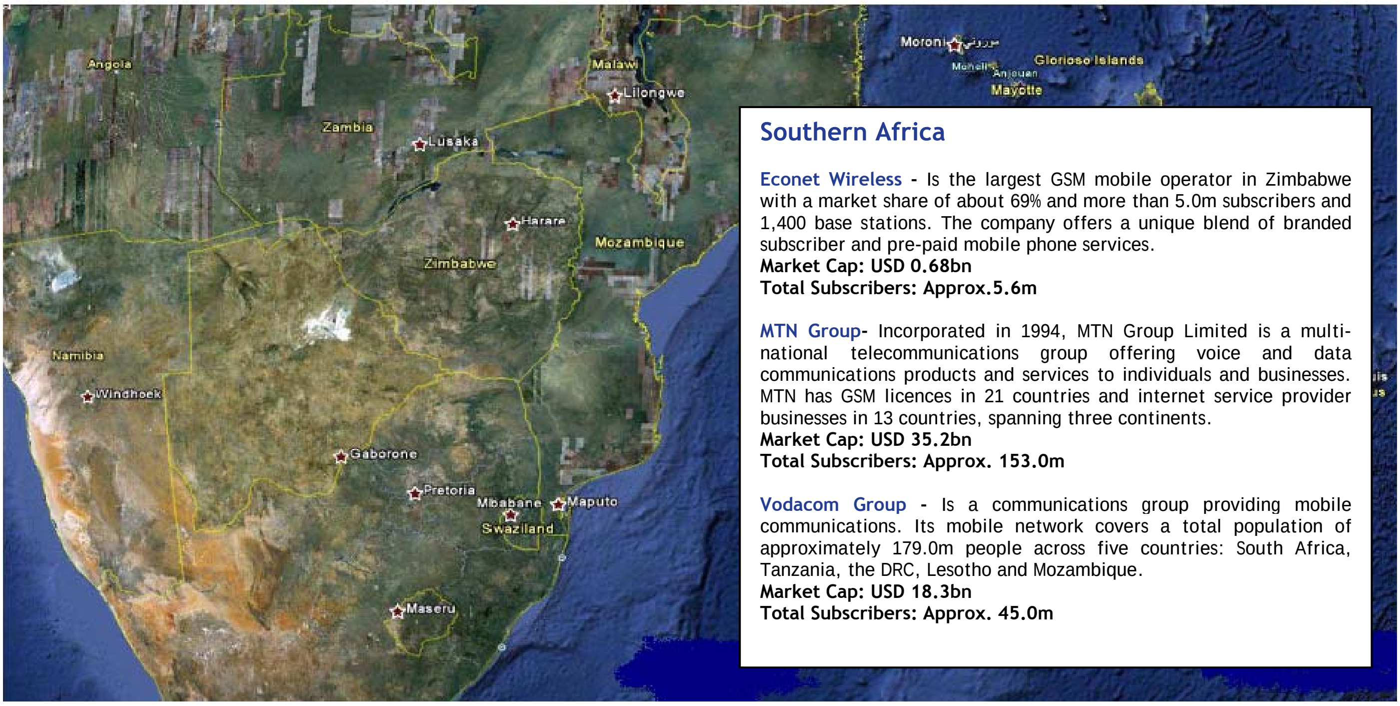



### East Africa

**Safaricom**- Is a provider of converged communication solutions in Kenya. It provides a broad range of first-class products and services for telephony, EDGE and broadband internet. The company was incorporated in Kenya in April 1997 as a state owned company by virtue of the 60% government ownership. The government's stake was later reduced to 35% after floating 25% of its stake to the public in 2008. The controlling interest moved to Vodafone Kenya which now holds 40% stake in the company.

**Market Cap: USD 1.4bn**
**Total Subscribers: Approx 17.2m**

## Sub Saharan Africa Telecoms-Fast Facts



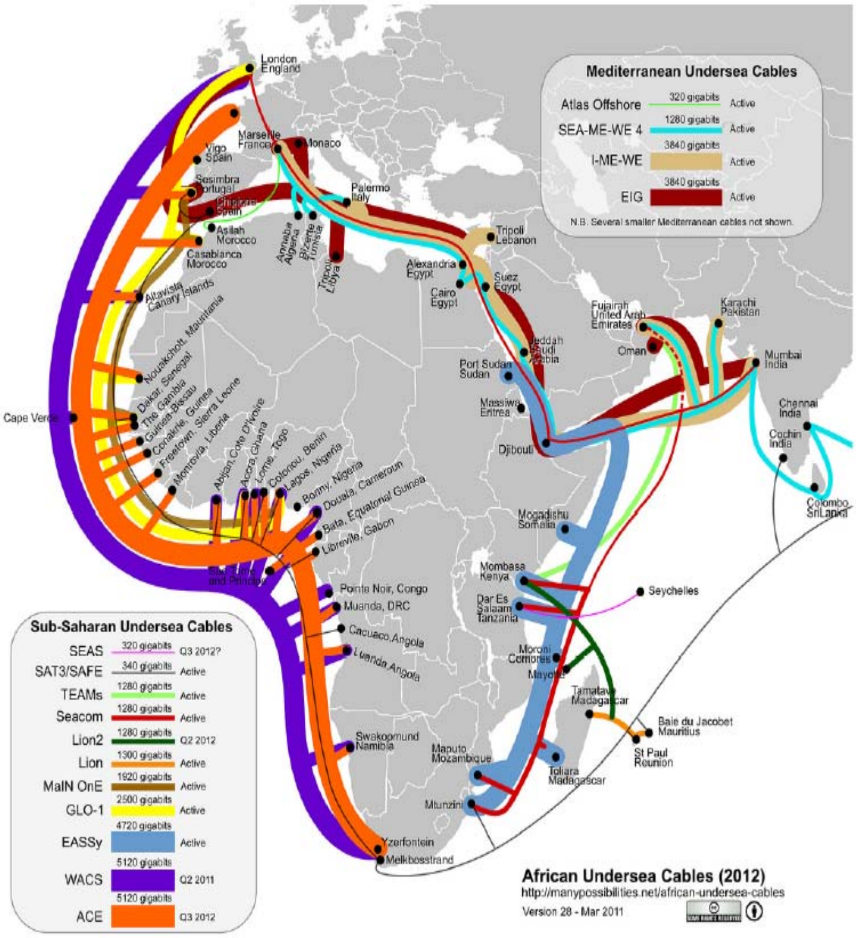

### Southern Africa

**Econet Wireless** - Is the largest GSM mobile operator in Zimbabwe with a market share of about 69% and more than 5.0m subscribers and 1,400 base stations. The company offers a unique blend of branded subscriber and pre-paid mobile phone services.
**Market Cap: USD 0.68bn**
**Total Subscribers: Approx.5.6m**

**MTN Group**- Incorporated in 1994, MTN Group Limited is a multi-national telecommunications group offering voice and data communications products and services to individuals and businesses. MTN has GSM licences in 21 countries and internet service provider businesses in 13 countries, spanning three continents.
**Market Cap: USD 35.2bn**
**Total Subscribers: Approx. 153.0m**

**Vodacom Group** - Is a communications group providing mobile communications. Its mobile network covers a total population of approximately 179.0m people across five countries: South Africa, Tanzania, the DRC, Lesotho and Mozambique.
**Market Cap: USD 18.3bn**
**Total Subscribers: Approx. 45.0m**

## Undersea Cables across Africa




Large parts of Africa have gained access to international fibre bandwidth via submarine cables (as shown by the map). Fibre optics as a transmission medium has a comparatively unlimited bandwidth, particularly in undersea applications.

The development of sub marine cables is likely to see Africa's internet and broadband sector benefiting in the long term. East Africa, for example is already benefiting noticeably from Seacom, TEAMS and EASSy.

WACS (planned) also forms part of a myriad of submarine cables telecommunications providers have invested in, in an attempt to bring the much-needed broadband capacity to the continent. This is expected to bolster Africa's efforts to achieve the United Nations Millennium Development Goals to bridge the digital divide and provide millions of subscribers in Africa with the capacity and ability to use smart solutions.

## INTRODUCTION

### Global Telephony Industry

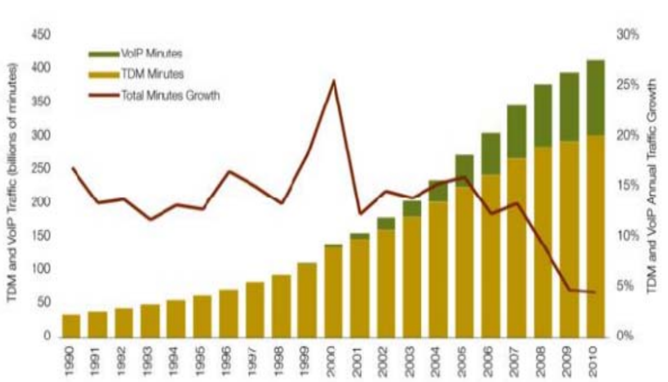
"Mr Watson come here, I want you." With these historic words Alexander Graham Bell called to his assistant Thomas Augustus Watson over the so-called telephone on 10 March 1876 in Boston, Massachusetts, and from there an industry was born. Interestingly, the cost of the first call between New York and Chicago was around USD 9.0 for five minutes, which translates to US 3c/sec versus today's mobile tariffs of US 0.8c/sec for a call between Zimbabwe and the US.

By definition, telecommunication is the transmission of signals over long distance, such as by telegraph, radio, or television. It encompasses the electrical communication at a distance of voice, data, and image information. It is therefore important to mention that the subject of telecommunications is not only limited to voice telephony but is much wider as it includes data and images.

Of course, from a global perspective, we know that voice telephony is big business. In fact, TeleGeography estimates that international call volumes have grown at a CAGR of about 13% over the past 20 years. As depicted in Fig 1, traffic growth surged in the late 1990s, peaking at 25% in 2000, before returning to levels in line with historical patterns.

With the growth in call volumes (both fixed and mobile) across the globe, it cannot be doubted therefore that a cell phone has become arguably the most ubiquitous gadget in the world as it is used for just about everything from making calls, surfing the internet, banking and transacting, and even organising revolutions (as was the case in the MENA region).

**Fig 1: International Call Volumes**




### Africa Telecoms Sector

Arguably Africa's greatest success story to date in telecommunications is the remarkable spread of mobile telephony throughout the continent. We also note that positive economic reforms, particularly in countries such as Ghana, Kenya, Rwanda, Zambia and Liberia have greatly improved the operating environment for African telecoms. These economic benefits have also been enhanced by regional economic blocs (COMESA, EAC) that have set the tone for an integration of economies. The improved growth momentum has to a large extent improved incomes and accelerated urbanisation (infrastructural development).

In SSA for example, Nigeria is one of the fastest-growing telecoms markets, fuelled by several new entrants, the launch of mobile value-added services (VAS) and broadband. Telecom industry liberalisation has also pushed market penetration of telecom services in Nigeria from just 1.2% in 2002 to an estimated 50% in 2010.

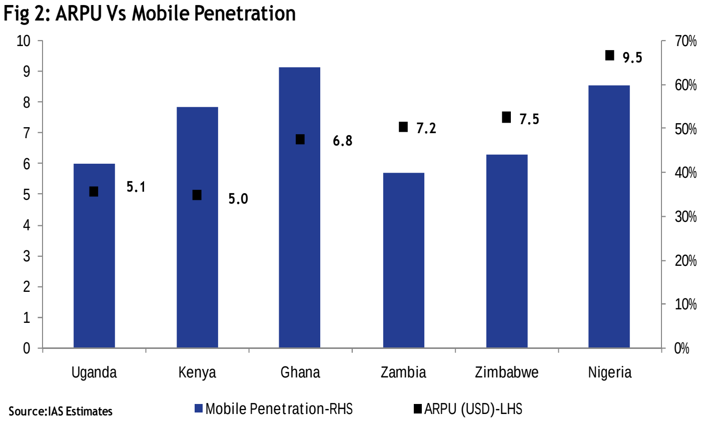
Growth in Africa's ICT sector has also accelerated in recent years owing to improvements in infrastructure, the arrival of wireless access technologies and lower tariffs.

## TRENDS IN THE SSA TELECOMS SECTOR

### Declining Voice ARPUs as operators reach voice maturity…

One of the most common trends that is not only common to SSA telcos but naturally occurs as a telecoms company reaches its maturity stage in terms of subscriber numbers is that the ARPU levels tend to decline. An analysis of a sample of telecoms companies on the African space including Mobinil (Egypt), Safaricom (Kenya) and Econet (Zimbabwe) reveals declining trends in ARPUs over the past years. Other underlying determinants include pressures to lower prices by regulating authorities in various jurisdictions as well as local competition. Moreover, new initiatives such as servicing the non-urban population (as in the case of Safaricom in Kenya) have an effect of diluting ARPUs. Targeting lower value subscribers such as the rural market in Africa will naturally exert downward pressure on ARPUs. The main constraint therefore is that telcos still have to contain costs and grow in relatively saturated voice markets that are often characterised by new competition.

**Fig 2: ARPU Vs Mobile Penetration**




### Voice competition intensifying across various jurisdictions…

Within an SSA context, Kenya remains an exciting case-study with regards to voice competition. The East African country remains one of the most competitive markets as we have witnessed price wars amongst the main operators.

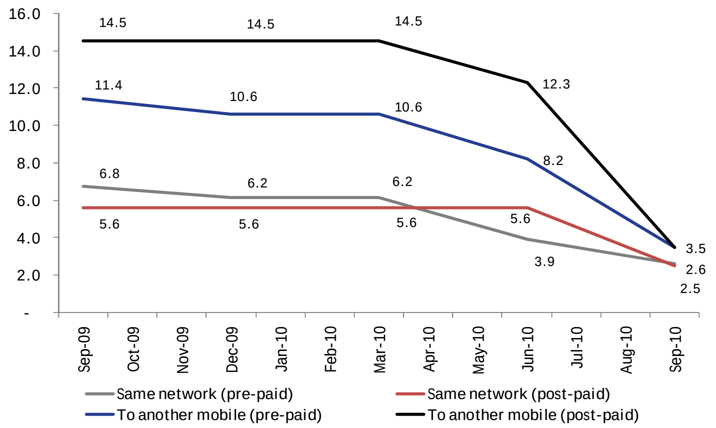
Safaricom is East Africa's biggest mobile phone company, controlling c67% of the market in Kenya, and it has struggled to maintain its market share due to stiff competition from Airtel Kenya and its price based market share accumulation strategy.

Bharti Airtel, the parent company which is also India's top cellular carrier, has largely implemented a low-cost, high-volume Indian model in Africa which involves outsourcing network, IT and back office operations in order to reduce costs. Airtel, for example, cut its tariffs by more than 50% in August 2010 leading to voice rates tumbling to as little as KES 1.0 per minute from KES 3.5 per minute.

An analysis of mobile tariffs in Kenya since September 2009 shows a drastic decline in pre-paid and post paid tariffs across networks. The tariff declines were also a result of an interconnection determination by the CCK that saw a reduction in mobile termination rates. More recently, the Government of Kenya intervened when Kenya's president, Mwai Kibaki "ordered' an end to further cuts in mobile phone termination charges, thereby giving telecom operators a reprieve from a looming renewal of tariff wars. Operators in Kenya such as Safaricom and Essar Telekom had been lobbying to have the MTR frozen to prevent a price war escalating.

On a more positive note however, Kenyan mobile phones subscriber numbers have risen from about 17.9m in 2009 to 25.0m on the back of the cheaper calling rates, which is a direct benefit of competition (for consumers).

**Fig 3:Average Mobile Tariffs per Minute (KES)**




Source:CCK

Another positive development that has come as result of competition is that operators such as Safaricom and Telkom Kenya are planning joint projects so as to cut operating costs. The projects include amongst other things, sharing costs of setting up telecommunication towers. The project is expected to be modelled along the lines of international tower companies like India's Indus Towers, a consortium of telecoms operators in that country.

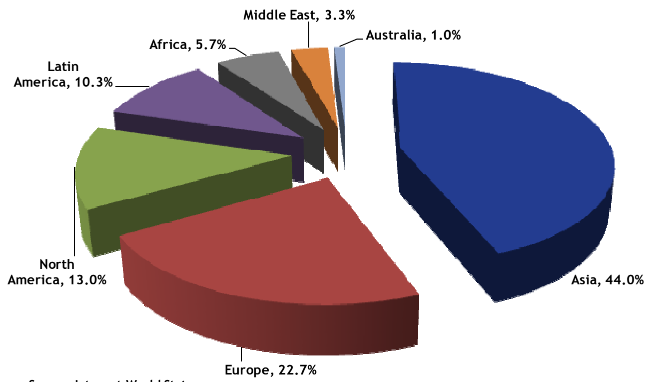
### The Data Revolution…

As discussed earlier, voice penetration levels in Africa have increased and in some cases reached maturity. The main predicament however, is that telcos continue to face the daunting task of staying "relevant" beyond their existing business models of just being airtime factories. Therefore, the next big question is, 'What is the next growth avenue?' The answer to the question seems to lie in data as opposed to voice.

### Low internet penetration levels in SSA point to massive growth prospects…

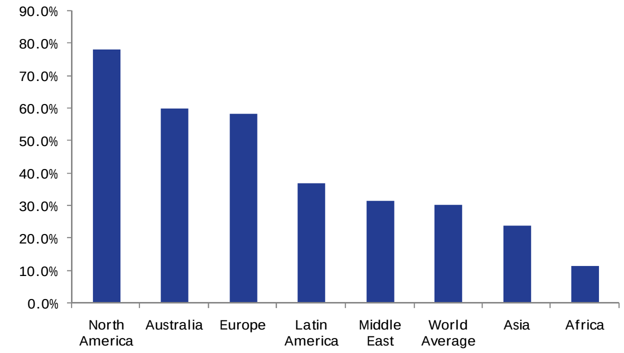
Generally, internet penetration levels of 10.9% for Africa are well below developed world standards. Most countries in SSA for example have penetration levels below 10%, with the likes of Uganda at 9.6%, Zambia 6.8%, Botswana 5.9%, Kenya 10%, Malawi 4.6% and Tanzania 1.6%. In fact, broad band subscriptions in Africa are expected to reach 265.0m by 2015. In addition, services such as cloud computing, next generation analytics, virtualisation and hosted services are positioned to become critical elements to making such growth a reality.

**Fig 4: Percentage of Internet Users**



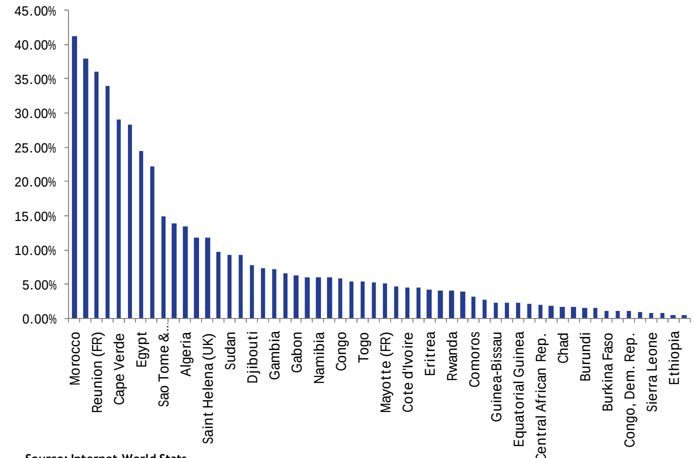

Source: Internet World Stats

**Fig 5: Global Analysis of Internet Penetration Levels**




Source: Internet World Stats

**Fig 6: SSA Internet Penetration**




Source: Internet World Stats

### Mobile broad band growing faster than fixed broad band…

Generally, we are predicting a boom in Africa's data market over the next five years, propelled by an "igniting" mobile broadband market.

The underlying fact is that fixed broadband services in emerging markets are far more expensive than in mature markets and beyond the reach of the majority of consumers. In South Africa, for example prices range from USD 600/year for entry level DSL services to USD 1,500/year for the high end options and in Nigeria, entry level broadband services cost about USD 1,200/year. In fact, a close analysis reveals that in some emerging markets, broadband pricing is double or triple the price of an equivalent service in a more developed market.

An important highlight is that most African countries, particularly in SSA excluding South Africa, are often characterised by limited fixed line infrastructure, which has created enormous opportunities for wireless and mobile communications solutions. Mobile broadband is generally the cheapest option for data-hungry consumers in emerging markets, although the performance limitations make for a compromise on customer experience.

### Increased Mobile broadband across Africa…

According to a June 2011 Opera Report, entitled, "*State of the Mobile Web,* the Opera Mini browser saw increases in all three categories of growth: unique users, pages viewed and data consumed in June 2011. Overall, a total of 115.0m people used the Opera Mini browser in June 2011. While global numbers appear to be on the up, above-average growth rates are mostly common in Africa.

The top 10 countries by usage of the Opera Mini browser in Africa were Nigeria, South Africa, Kenya, Ghana, Sudan, Zimbabwe, Tanzania, Ethiopia, Zambia and Morocco.

From June 2010 to June 2011, page views in the top 10 countries of Africa increased by 187%, unique users increased by 184% and data transferred increased by 199%. Zimbabwe and Morocco led the top 10 countries of the region in terms of page view growth (4,965% and 1,598%, respectively). The two countries also led the top 10 countries of the region in the growth of data transferred (3,449.7% and 1,385.9%, respectively). In addition, Zimbabwe and Ethiopia were in the top spot in terms of the growth of unique users (4,483.3% and 989.5%, respectively). Zimbabwe was also leader in the region in terms of the page views per user, with each user browsing 713 pages on average each month. Generally, Zimbabwe is credited for its relatively high internet penetration levels of 11.8% versus 4.5% for countries such as Malawi as a result of high literacy rates.

We believe the growth statistics are reflective of the underlying growth prospects in mobile broad band across the African continent.

**Fig 7: Mobile Web Statistics**

| | Nigeria | South Africa | Kenya | Ghana | Sudan | Zimbabwe | Tanzania | Ethiopia | Zambia | Morocco | USA |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Page-view growth* | 465% | 93% | 41% | 211% | 343% | 4965% | 448% | 1042% | 523% | 1598% | 94% |
| Unique-user growth* | 437% | 68% | 73% | 200% | 294% | 4483% | 195% | 990% | 540% | 787% | 5% |
| Data transfer growth* | 425% | 87% | 91% | 252% | 221% | 3450% | 455% | 889% | 616% | 1386% | 81% |
| Page views per user/month | 338 | 454 | 522 | 509 | 567 | 713 | 672 | 418 | 515 | 427 | 510 |
| Data transferred per user (MB) | 4 | 5 | 7 | 7 | 8 | 7 | 8 | 8 | 6 | 9 | 12 |
| Data transferred per page view (KB) | 13 | 12 | 14 | 13 | 14 | 10 | 12 | 19 | 11 | 23 | 23 |

* growth since June 2010

Source:Opera Software

### Web-based applications also driving data growth...

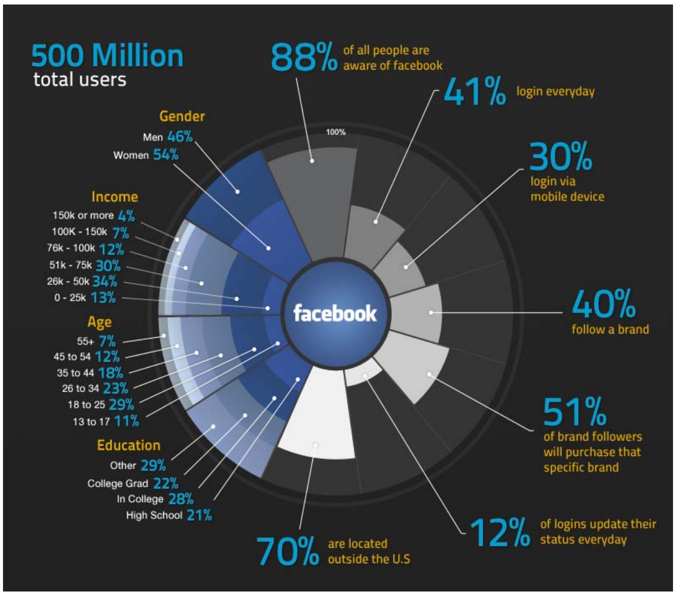
Messaging applications such as Google, Facebook and Twitter have been one of the most important drivers of data growth. As shown in Fig 7a, c88% of all people in world are aware of Facebook. In fact, Africa is Facebook's fastest growing market, promising robust growth. Another important trend worth mentioning is that Facebook is not only driving mobile data consumption, but MVNOs have identified it as a value-add content platform to drive ARPUs. The fastest growing African countries in 2010 were Nigeria (1.4m new users), Egypt (1.6m new users), and South Africa (750,000 new users).

### A focus on Data as opposed to Voice...

A common trend amongst SSA telcos, as alluded to earlier, given falling ARPUs, is a shift in focus towards data services. For companies such as Safaricom in Kenya, data (including VAS) contributes approximately 20% to total revenues.

However, in more developed markets such Japan, data contributes about 80%. Of course, the issue of competition within the data space cannot be completely ruled out. In Kenya, Safaricom has the country's sole third-generation (3G) licence but Airtel is also planning to roll out its 3G service. In Zimbabwe, Econet's contenders such as TelOne and NetOne have indicated plans to rollout broadband internet. The key set back, however is that internet access, data and devices are still expensive for most African users.

**Fig 7a: Facebook 2010 Social Demographics**




**Source:** *Facebook*

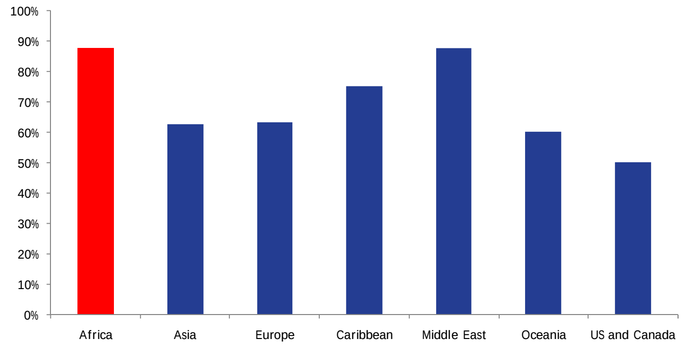
However, low-cost Android handsets are "doing the trick". Overall, Africa remains largely a prepaid market and the winning solution is to offer mobile data bundles as prepaid top-ups. Safaricom in Kenya and Econet in Zimbabwe are already seeing the benefit of such pricing strategies.

## The Role of Undersea Cables...

Large parts of Africa have gained access to international fibre bandwidth via submarine cables. The underlying rationale is that fibre optics as a transmission medium has a comparatively unlimited bandwidth. A major advantage fibre has when compared with coaxial cable is that no equalisation is necessary. All transoceanic cables currently being installed and planned for the future are based on fibre optics. It is the favoured transmission medium for very wideband terrestrial links, including undersea applications.

The development of sub marine cables is likely to see Africa's internet and broadband sector benefiting in the long term. As indicated in Fig 8, between 2006 and 2010, international bandwidth usage increased nearly seven-fold in Africa.

**Fig 8: Used International Bandwidth: CAGR (2006-2010)**




Source:IAS/Telegeography

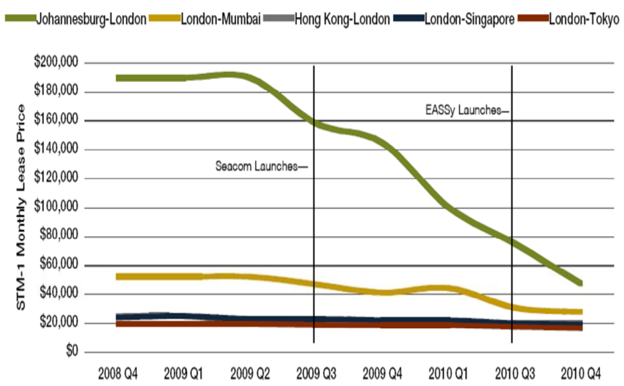
International submarine fibre optic cables have indeed reached several African countries for the first time in 2009 and 2010, with more cables expected to go online in 2011 and 2012. In East Africa, for example Seacom fibre-optic link started operating in July 2009, while the East African Marine System (*Teams*), a cable linking 20 African countries started in October 2009. As a result, Kenya's internet users more than doubled over the past year. The country now has approximately 7.5m internet users compared to about 3.0m in 2010.

Seacom also plans to extend the cable into Somalia, Burundi and Southern Sudan through various partners as a result of the growing demand for internet services. Seacom currently has fibre-optic links in Rwanda, Uganda, Tanzania, Ethiopia, Djibouti and Kenya.

Generally, we expect wholesale prices for internet bandwidth to come down from previous levels. The wholesale prices on international fibre optic cables have come down to USD 400 from previous charges of as high as USD 4,500.

Furthermore, as the cost of international bandwidth comes down, we should see more operators rolling out national fibre backbone networks to take bandwidth beyond the capital cities as is the case in Kenya. Indications are that the government is set to lay fibre optic cable in Kenya's 47 counties at a cost of KES 5.6bn in an effort to boost access and lower the cost of internet. The government is also keen to take internet access to rural Kenya to allow it to offer services such as registration of births and deaths, passport issuance and tax collection under the e-Government plan. This, in our view, should further boost the rate of the country's economic development.

**Fig 9: Falling Bandwidth Prices**




### Submarine Cables in Africa

**SAT-3/WASC (In Service)**
- Abidjan, Côte d'Ivoire
- Accra, Ghana
- Alta Vista, Canary Islands, Spain
- Cacuaco, Angola
- Cotonou, Benin
- Dakar, Senegal
- Douala, Cameroon
- Lagos, Nigeria
- Libreville, Gabon
- Melkbosstrand, South Africa
- Sesimbra, Portugal

**Africa Coast to Europe (ACE)** (Planned)
- Abidjan, Côte d'Ivoire
- Accra, Ghana
- Banjul, Gambia
- Bata, Equatorial Guinea
- Cape Town, South Africa
- Conakry, Guinea
- Cotonou, Benin
- Dakar, Senegal
- Freetown, Sierra Leone
- Kribi, Cameroon
- Lagos, Nigeria
- Libreville, Gabon
- Lisbon, Portugal
- Luanda, Angola
- Monrovia, Liberia
- Muanda, Congo, Dem. Rep.
- Nouakchott, Mauritania
- Penmarch, France
- Santana, Sao Tome and Principe
- Swakopmund, Namibia
- Tenerife, Canary Islands, Spain

**West African Cable System (WACS)** (Planned)
- Abidjan, Côte d'Ivoire
- Accra, Ghana
- Alta Vista, Canary Islands, Spain
- Highbridge, United Kingdom
- Lagos, Nigeria
- Limbe, Cameroon
- Lome, Togo
- Luanda, Angola
- Muanda, Congo, Dem. Rep.
- Point Noire, Congo, Rep.
- Praia, Cape Verde
- Seixal, Portugal
- Swakopmund, Namibia
- Yzerfontein, South Africa

**SEACOM/Tata TGN-Eurasia** (In Service)
- Dar Es Salaam, Tanzania
- Djibouti City, Djibouti
- Maputo, Mozambique
- Mombasa, Kenya
- Mtunzini, South Africa
- Mumbai, India
- Zafarana, Egypt

**Eastern Africa Submarine System (EASSy)** (In Service)
- Dar Es Salaam, Tanzania
- Djibouti City, Djibouti
- Maputo, Mozambique
- Mombasa, Kenya
- Moroni, Comoros
- Mtunzini, South Africa
- Port Sudan, Sudan
- Toliary, Madagascar

**SAT-2 (In Service)**
- El Médano, Canary Islands, Spain
- Funchal, Portugal
- Melkbosstrand, South Africa

**The East African Marine System (TEAMS)** (In Service)
- Fujairah, United Arab Emirates
- Mombasa, Kenya

Source: TeleGeography

**Fig 10: Submarine Cable Capacity in East Africa**

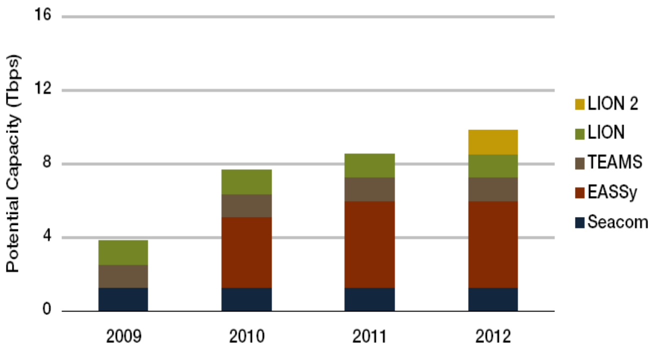
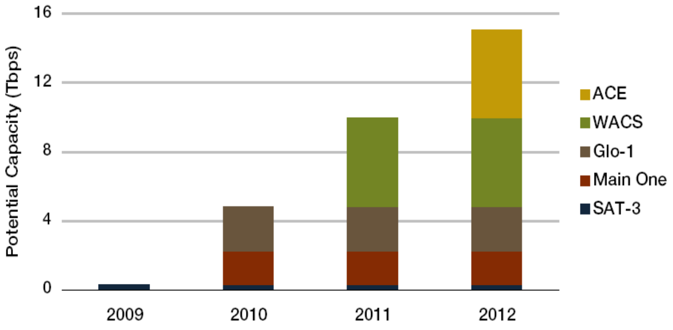



**Fig 11: Submarine Cable Capacity in West Africa**




## A focus on Value Added Services (VAS)

Most Telcos in SSA are now focussing more on Value Added Services (VAS), not only as a strategy of diversifying income streams but also as a way of ensuring the stickiness of subscribers. Examples include services such mobile money and insurance.

Specific examples would include the M-PESA payment system. Safaricom first launched M-PESA in Kenya in 2007. M-PESA has since been taken up by Vodafone to other markets. As at March 2011, Vodafone claimed 10.0m users in Kenya and 7.0m in Tanzania. Since launching in SA in 2010, Vodacom has signed up about 100,000 customers. On the other hand, MTN initially launched Mobile Money in SA in partnership with Standard Bank in 2005 (1.8m customers by December 2010) and started rolling-out internationally in 2009. As at 31 March 2011, MTN claimed a total of 4.6m users across 12 countries. Mobile Money generated about USD 10.0m in revenue to December 2010, and it now contributes over 3.5% of quarterly revenue in Uganda.

Other operators in East Africa such as Telkom Kenya and Essar Telecoms have also introduced mobile money services such as *ZAP* and *Yu-cash*. In Francophone West Africa, Sonatel has also introduced *Orange Money*. While Zimbabwe's Econet Wireless has made limited progress with its *Eco-Cash* offering, it has introduced other VAS such as *Ecolife* and *Econet mail* so as to maintain a leadership position.

However, we expect competition to intensify across the continent in the next few years. MCommerce providers will in the future include MVNOs, banks, retailers, social networks and other independent providers.

## The Convergence of voice and data…

Comparing telcos in SSA with other mature data market operators such as Japan's NTT Docomo shows that Africa is lagging far behind. NTT Docomo's data and voice ARPUs have now converged, implying that NTT's average subscriber now spends as much on data as on voice services. In developed markets such as Japan and the UK, the abundant use of mobile media has been the main contributor to data revenues whereas the lack of adequate data speeds and high latencies has stifled mobile video usage in SSA. However, the general trend is that telcos in SSA are moving towards voice and data ARPU convergence, though it is likely to occur in the long term.

## VoIP also contributing to the convergence …

Voice over Internet Protocol (VoIP) has been largely made possible through new technologies such as multiplexing. This makes is possible to transmit a plurality of information channels over a single transmission medium. For example, an information channel may be a telephone voice channel, data channel, or a channel carrying image information. Some applications of VoIP are *Click to talk* web sites for e-commerce, Digital whiteboard conferencing, broadcast audio and video, unified messaging and Fax over IP. This effectively means that voice is a form of data and therefore ICT companies such as Neotel in South Africa, Africom in Zimbabwe and Access Kenya in East Africa can compete with traditional telcos in the respective markets by making use of VoIP. The fact that voice can be compressed up to 4 to 8 kbps means that silence periods can be removed. In addition, billing can be made independent of distance and advanced telephony features are also possible.

## Increased Multinational Interest in SSA…

Multinational interest across the telecoms sector in SSA is a clear indication of the investment case that lies in African telcos. Generally, investors into Africa have largely been attracted by the sector's high profit margins, low penetration and bottom-heavy demographic population profile which guarantee a massive pool of consumers.

## India- remains a bullish investor in SSA

Generally, India is taking a lead in Africa telco investments. Bharti Airtel, India's biggest mobile phone company, for example is planning to invest about USD 1.0bn this year in order to expand its network across the continent. The group has already invested USD 11.0bn in Africa. Essar, on the other hand, a company that owns 33% of Vodafone's Indian operation is also planning to invest USD 2.0bn in up to seven African mobile businesses. Essar is already a significant investor in telecoms operations in Africa through a number of relationships with other companies. The company also owns a majority stake in Dhabi Group's Warid Telecom operations in Uganda and Congo.

State-run Mahanagar Telephone Nigam Limited (MTNL) has reportedly been eyeing a 51% stake in Zimbabwe's state-owned landline operator, TelOne. MTNL provides basic phone, internet and cellular mobile telephony services in Delhi and Mumbai. The company already operates on the African continent through its Mauritius arm, Mahanagar Telephone Mauritius Ltd (MTML).

### Libya, losing its grip…

Quite clearly, the UN-backed economic sanctions that came through in the wake of the political unrest in Libya largely caused the Libyan government to lose its grip on the Africa telecoms market. The Libyan government primarily invested in the telecoms sector through its investment arm, known as the LAP Green network. It is worth noting that its investments in Zambia, South Africa, Uganda and Rwanda have remained frozen. The Zambian government, for example froze Libya's 75% stake in Zamtel. In Uganda and Rwanda, however, the governments have not only frozen Libya's assets but taken over the management of the telecom companies. Over the past few years, however, LAP Green network had pushed to invest in the African telecom market. Two years ago, it signed a USD 300.0m financing agreement with the Industrial and Commercial Bank of China to fuel its expansion program in Africa through the acquisition of financially distressed operators.

However, it is interesting to see what will happen now with the new transitional council in place.

### China, broadly focusing more on ICT…

Broadly speaking, China has stepped up its investment drive across the African continent. China is also pushing into sectors such as telecoms and firms such as Huawei and ZTE Technologies have been gaining steam in the infrastructure arena and are now establishing a foothold in the retail segment with low cost mobile phones and internet modems. As a result, they are gaining market share in the retail segment that has traditionally been the domain of European based brands such as Nokia, Motorola and Samsung. China's interest in telecoms also stretches out to Zimbabwe, where Econet has partnered with ZTE Technologies. The Chinese company is supplying technical equipment for commissioning various switches across the country. The switches are earmarked at boosting network capacity. In addition, Econet has also been working with Huawei in the implementation of a fibre optic network project that will also boost its capacity.

### South Africa, taking a lead in tapping into Africa's fast growing Telecomms Industry…

Multinational group MTN has positioned itself as Africa's biggest wireless operator, active in 21 countries across Africa and the Middle East. MTN is also consolidating its position to take advantage of other opportunities that lie in Africa's telecoms sector.

We believe that the company has competitive aspirations in most African countries that it does not have a presence in such as Zimbabwe, for example. Early this year, the company was in talks with state- owned mobile operator NetOne (Zimbabwe) about buying a 49% stake. NetOne is the smallest mobile operator by subscribers in Zimbabwe (market share of 12%), lagging behind Econet Wireless and Telecel (owned by Orascom Telecom). Indications were that NetOne has been valued at between USD 500.0m and USD 800.0m.

South African communications group Telkom is also considering Africa as its next growth region and is looking at acquisitions after two to three years. According to management, the recent sale of its struggling Nigerian business Multi-Links to Visafone Communications for USD 52.0m was not a complete pullout from Africa's most populous country.

### Canada and the USA

Organisations such as Research in Motion (RIM) and Google (USA) are looking to Africa for new growth opportunities. Africa is a strategic priority for RIM and the company is moving aggressively into the market to make the BlackBerry solution (smart phones, tablets and services such as the BlackBerry Internet Service) available to consumers. BlackBerry devices are now available in over 35 African countries in partnership with over 80 mobile operators.

Interestingly, Africa has also seen an evolution in mobile media. In addition, mobile internet continues to see strong growth across Africa. AdMob, the mobile advertising company that is owned by Google, reported that is had seen an 81% growth in traffic in Africa in 2010 alone, with three countries – Nigeria (21%), South Africa (21%) and Egypt (12%) – accounting for more than 50% of AdMob's ad requests from Africa in December 2010. This growth has also been driven by low cost Android smart phones entering the market, such as the *Ideos* from Huawei which retails at about USD 100 in Kenya, DRC, Uganda, and other countries.

According to Google, Africa has only one web domain for every 10,000 people, versus a global average of 94 domains for every 10,000 people. As a result, Google has stepped up its efforts to create and enable more African content online by providing Google products in many African languages, including Swahili, Shona, Ndebele, Zulu and Afrikaans.

### France, also stepping up its investments...

France Telecom, which is the world's fifth largest mobile operator by subscribers has been on the continent for over 20 years and is a converged communications player in Africa through mobile subsidiaries, fixed line businesses, internet service providers, and an investment in the Africa Coast to Europe (ACE) fibre optic cable that stretches from France, runs along Africa's western boundaries and extends from South Africa to the East African coast through the LION and LION2 cables. France Telecom is currently the biggest international investor in Africa's bandwidth backbone as it has contributed towards EASSy, SAT3WS, TEAMS, ACE, LION 1 and LION 2.

France Telecom has set a target to earn EUR 7.0bn revenue from its emerging markets (Africa, the Middle East, and Asia) by 2015. The company has also earmarked SSA as one of its priority prospect markets. It has also invested in Telkom Kenya and has managed to modernise and streamline the business into a converged ICT services provider.

# SSA TELECOMS COMPARATIVE ANALYSIS

| Company Name | Country | Market Cap (USDm) | PER | PER (T+1) | PBV | EV/EBITDA | Div Yield | ROE | PBT Margin | Net Margin | EV/Sub(USD) | ARPU (USD) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Econet Wireless | Zimbabwe | 677.7 | 4.8 | 4.2 | 3.2 | 2.8 | 3.0% | 62.4% | 39.8% | 28.5% | 124.6 | 7.5 |
| MTN Group | South Africa | 35,224.5 | 17.9 | 12.9 | 3.6 | 5.5 | 2.5% | 19.9% | 24.5% | 12.5% | 248.1 | 9.1 |
| TNM Malawi | Malawi | 115.2 | 17.9 | 13.4 | 2.6 | 5.7 | 2.8% | 15.0% | 16.2% | 10.7% | 221.2 | 6.0 |
| Safaricom Limited | Kenya | 1,351.6 | 9.7 | 8.7 | 1.9 | 3.9 | 6.3% | 20.3% | 19.4% | 13.9% | 84.7 | 4.9 |
| Onatel | Burkina Faso | 319.4 | 13.7 | 13.6 | 2.0 | 3.2 | 5.8% | 16.0% | 19.1% | 10.9% | 146.6 | 7.0 |
| Sonatel | Senegal | 2,546.7 | 7.6 | 7.7 | 2.3 | 3.7 | 11.5% | 31.2% | 35.5% | 25.7% | 218.8 | 9.6 |
| Vodacom Group Limited | South Africa | 18,343.3 | 16.3 | 14.2 | 8.6 | 7.6 | 3.9% | 56.2% | 20.7% | 13.5% | 451.2 | 15.8 |
| **SSA Average** | | | **12.6** | **10.7** | **3.5** | **4.6** | **5.1%** | **31.6%** | **25.0%** | **16.5%** | **213.6** | 8.5 |

**MENA**

| Company Name | Country | Market Cap (USDm) | PER | PER (T+1) | PBV | EV/EBITDA | Div Yield | ROE | PBT Margin | Net Margin |
|---|---|---|---|---|---|---|---|---|---|---|
| Etisalat | UAE | 24,666 | 9.7 | 9.2 | 2.3 | 7.2 | 5.3% | 22.1% | 24.1% | 24.9% |
| Mobinil | Egypt | 1,751 | 8.6 | 29.1 | 2.5 | 4.0 | 11.8% | 29.1% | 15.0% | 11.6% |
| Orascom Telecom Holding S.A.E | Egypt | 3,890 | 11.6 | 4.1 | 2.0 | 4.1 | 0.0% | 26.0% | 23.1% | 5.4% |
| Pakistan Telecomms | Pakistan | 1,156 | 8.4 | 8.1 | 0.9 | 5.8 | 8.9% | 9.9% | 16.5% | 11.1% |
| Qatar Telecom | Qatar | 7,198 | 9.4 | 8.6 | 1.5 | 4.6 | 1.8% | 19.4% | 21.5% | 10.8% |
| Saudi Telecom Company | Saudi Arabia | 22,718 | 7.8 | 7.8 | 1.9 | 5.3 | 7.1% | 24.9% | 20.6% | 19.7% |
| Telecom Egypt | Egypt | 5,316 | 9.6 | 9.9 | 1.1 | 6.0 | 0.0% | 11.6% | 20.8% | 32.0% |
| **MENA Average** | | | **9.3** | **11.0** | **1.7** | **5.3** | **5.0%** | **20.4%** | **20.2%** | **16.5%** |

**Emerging Markets**

| Company Name | Country | Market Cap (USDm) | PER | PER (T+1) | PBV | EV/EBITDA | Div Yield | ROE | PBT Margin | Net Margin |
|---|---|---|---|---|---|---|---|---|---|---|
| Bahrain Telecomss Company | Bahrain | 1,948 | 7.0 | 7.8 | 1.5 | 4.5 | 10.1% | 19.5% | 31.5% | 26.4% |
| Bharti Airtel Ltd | India | 30,488 | 15.0 | 14.9 | 3.0 | 12.5 | 0.6% | 23.6% | 20.3% | 16.7% |
| Telekom Malaysia Bhd | Malaysia | 4,064 | 21.7 | 19.0 | 1.7 | 5.7 | 5.5% | 16.1% | 12.0% | 11.2% |
| Maroc Telecom S.A. | Morocco | 15,799 | 13.2 | 13.9 | 10.2 | 7.4 | 6.4% | 60.0% | 44.7% | 29.6% |
| Mobile Telesystems | Russia | 15,545 | 11.3 | 9.6 | 2.9 | 2.0 | 6.6% | 28.3% | 18.3% | 12.2% |
| Taiwan Mobile Co | Taiwan | 6,236 | 14.4 | 15.1 | 4.1 | 7.3 | 7.7% | 29.9% | 28.1% | 20.5% |
| Total Access Communications | Thailand | 3,297 | 17.8 | 14.6 | 2.5 | 6.6 | 5.2% | 15.8% | 19.8% | 15.1% |
| SK Telecom | Korea | 11,627 | 10.2 | 6.3 | 1.8 | 1.6 | 5.4% | 11.5% | 16.3% | 11.3% |
| **Emerging Markets Average** | | | **13.8** | **12.7** | **3.4** | **6.0** | **6.0%** | **25.6%** | **23.8%** | **17.9%** |

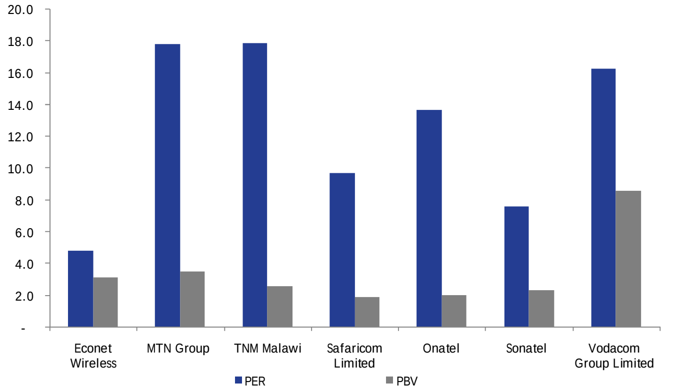
**Developed Markets**

| Company Name | Country | Market Cap (USDm) | PER | PER (T+1) | EV/EBITDA |
|---|---|---|---|---|---|
| Deutsche Telecom | Germany | 60,195 | 13.1 | 12.7 | 4.6 |
| France Telecom | France | 58,807 | 8.6 | 9.1 | 4.8 |
| Swisscom | Switzerland | 21,460 | 11.2 | 10.8 | 6.4 |
| Telecom Italia | Italia | 26,576 | 8.6 | 8.1 | 4.7 |
| Telefonica | Spain | 120,453 | 10.6 | 10.1 | 6.0 |
| NTT DoComo | Japan | 72,614 | 13.7 | 11.9 | 4.2 |
| Vodaphone | UK | 134,828 | 11.0 | 10.2 | 8.7 |
| Millicom | Sweden | 10,731 | 16.8 | 14.6 | 6.8 |
| **Developed Markets Average** | | | **11.7** | **10.9** | **5.8** |
| **Mean** | | | **11.8** | **11.3** | **5.4** |

Source: Bloomberg/URAL SIB Report/IAS Estimates/Reuters

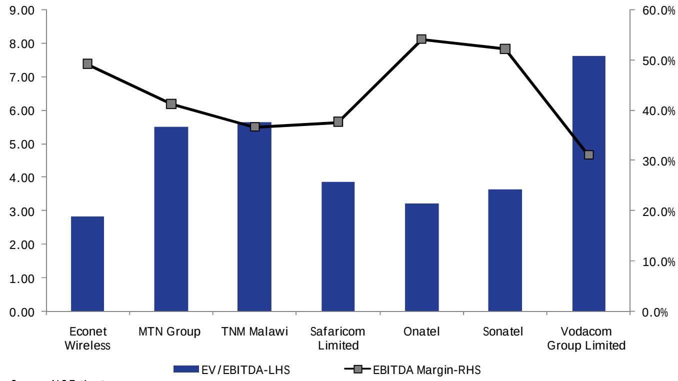
## SSA Telecoms- Comparative Graphs

**Fig 12: PER & PBV Multiples**



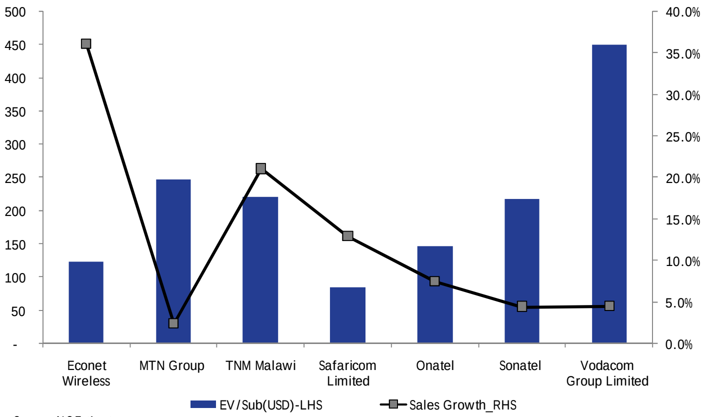

Source: IAS Estimates

**Fig 13: EV/EBITDA vs EBITDA Margin**



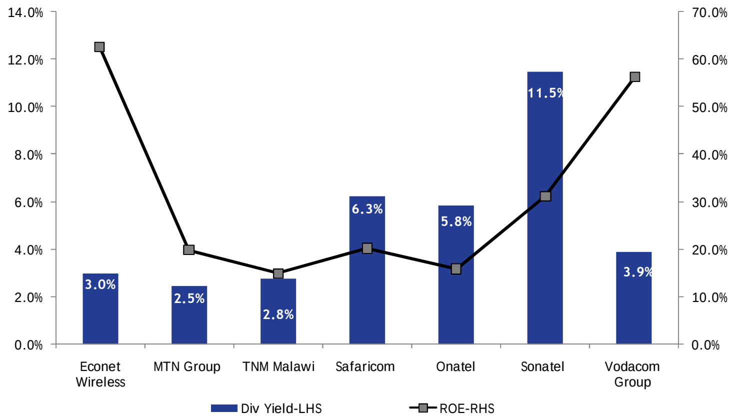

Source: IAS Estimates

**Fig 14: EV/Subscriber Vs Sales Growth**




Source: IAS Estimates

**Fig 15: ROE Vs Dividend Yield**




Source: IAS Estimates

### Methodology

Our research covers seven Sub Saharan African telcos ; Econet Wireless Zimbabwe, MTN Group (SA), Onatel (BRVM), Safaricom (Kenya), Sonatel (BRVM), TNM (Malawi) and Vodacom Group (SA). We have included MTN Group (SA) and Vodacom Group (SA) in the report. Since the two do not fall under our coverage universe they have been included for comparison purposes. Financial forecasts for the two companies are based on Analyst consensus estimates compiled by Thomson Reuters. We valued the companies through a comparative valuation technique based on multiples such as PER, PBV, EV/Sub (USD) and EV/EBITDA given the similar nature of company operations. However, we have complemented this with Discounted Cash Flow (DCF) valuations, applying different assumptions on the companies depending on the company specific issues and geographical location.

### Recommendation and Conclusion

Broadly speaking, the phenomenal growth in Africa's ICT sector has to a large extent driven GDP growth across the continent. It is interesting to note that in 2008, the World Bank conducted an econometric analysis across 120 countries to investigate the impact of higher penetration of broadband and other ICTs on economic growth (the average growth rate of per capita GDP). The study concluded that impacts were somewhat greater in developing countries than in developed countries. For developing countries, every 10 percentage point increase in the penetration of broadband services was associated with an increase in per capita GDP of 1.38 percentage points; Internet and mobile phone penetration were associated with a 1.12 and 0.81 percentage point increase, respectively.

Our findings are that SSA telcos exhibit a strong investment case. While voice has reached saturation levels in various jurisdictions, data appears to be the next growth avenue for SSA telcos. On the back of the data potential and strong macro-economic improvements, the development of under-sea cables, liberalisation of the telecoms sector and infrastructural developments, we think exposure in this space is indeed a potent source of alpha. We would recommend investors to play this growth theme through Econet Wireless in Zimbabwe and Sonatel (BRVM) from a long-term perspective, given their operational scale and market dominance. However, we think there are still competitive and regulatory pressures in Kenya and Burkina Faso. Therefore, we assign a **HOLD** recommendation on Safaricom and Onatel. We see a speculative opportunity in Malawi's TNM given the reports that it could be in talks with South Africa's Vodacom Group.

| BLOOMBERG: ECWH:ZH | | BUY |
|---|---|---|
| Current price (USc) | | 405.0 |
| Target price (USc) | | 610.0 |
| Upside/Downside | | 51% |
| **Liquidity** | | |
| Market Cap (USDm) | | 677.7 |
| Shares (m) | | 167.3 |
| Free float (%) | | 27.0 |
| Ave. daily vol ('000) | | 175.0 |
| **Share price performance** | | |
| 6 Months (%) | 481 | -15.8% |
| Relative change (%)* | | -7.6% |
| 12 Months (%) | 471 | -14.0% |
| Relative change (%)* | | -16.4% |

**Relative to MSCI Index*

| Financials (USDm) - FY 28 Feb | 2011 | 2012F | 2013F |
|---|---|---|---|
| Turnover | 493.5 | 589.7 | 693.2 |
| EBITDA | 242.7 | 277.8 | 306.8 |
| Net finance income | (7.2) | (18.1) | (10.7) |
| Attributable earnings | 140.4 | 162.8 | 187.7 |
| EPS (USc) | 83.9 | 97.3 | 112.2 |
| NAV/share (USc) | 127.7 | 225.0 | 304.7 |
| DPS (USc) | 12.2 | 32.4 | 37.4 |
| **Valuation Ratios** | **2011** | **2012F** | **2013F** |
| Subscribers' 000 | 5,510.0 | 5,789.9 | 6,034.6 |
| PER (x) | 4.8 | 4.2 | 3.6 |
| PBV (x) | 3.2 | 1.8 | 1.3 |
| EV/EBITDA (x) | 2.8 | 2.5 | 2.2 |
| Gross ARPU (USD) | 7.5 | 8.5 | 9.6 |
| EV/Subscriber (USD) | 124.6 | 118.6 | 113.8 |
| EBITDA Margin (%) | 49% | 47% | 44% |
| Earnings Yield (%) | 21% | 24% | 28% |
| Dividend Yield (%) | 3.0% | 8.0% | 9.2% |
| Gearing (%) | 71.9% | 34.8% | 10.4% |
| RoaA (%) | 27.3% | 23.9% | 24.6% |
| RoaE (%) | 62.4% | 46.4% | 38.9% |

## ECONET WIRELESS ZIMBABWE LIMITED

*Catch it when you can...*

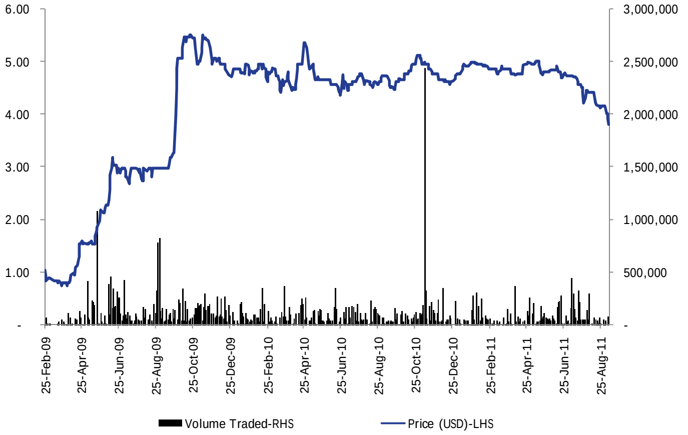
**Econet remains the undisputed leader in Zimbabwe's domestic telecoms sector, commanding c70% of the mobile telecoms market, with a subscriber base of 5.6m. A key highlight is that competitors in the market such as Telecel and NetOne tend to lack the operational and financial strength to contend with Econet on an equal footing. This, in our view places Econet in a strong position.**

- **Leading the pack in terms of innovation.** Econet has maintained its position as a leader in terms of innovation having already rolled out 3G/EDGE. We expect the introduction of new products to attract even more revenues for the company as well as increase its subscriber base. The company has also introduced loyalty programmes such as *Ecolife* and *Eco-Cash* (the company's mobile money transfer service which is similar to Safaricom's M-PESA).

- **Broadband presents a new opportunity.** We believe data presents significant opportunities for the company given that it has a head start over other players, in terms of penetration. Broad band penetration in Zimbabwe is still low and demand for Econet's 3G services is likely to increase.

- **Compelling valuation.** On a mark to market basis Econet remains the cheapest SSA telco on a standout 4.2x PER 2012. We are surprised market players are still hesitant. H1 2012 results show a solid growth in subscriber numbers and robust growth on the bottom line. We believe now is an opportune moment to gain exposure. **BUY**

**Econet: Price Vs Volume**




| STRENGTHS | WEAKNESSES |
|---|---|
| Strong brand name and market leader<br>First mover advantage eg Ecolife/Ecocash<br>Strong management team<br>Economies of scale advantages<br>3G Network in place | Associated with litigation issues and intercompany conflicts that may present a negative image<br>Demand for data services may be constrained by a lack of corporate demand<br>Gearing remains high<br>Energy disruptions ie ZESA power cuts |
| **OPPORTUNITIES** | **THREATS** |
| Strong economic recovery to drive incomes<br>Increase network coverage as a result of investments in fibre optic terrestial links<br>Low broad band penetration in Zimbabwe presents a solid growth opportunity<br>New products/services | Increased competition- recap of existing players<br>Falling calling rates eg per sec billing<br>Political instability in Zimbabwe<br>Deterioration of the competitive environment<br>Reputational risks associated with external partners such as banks, insurance companies and software companies ( eg TrustCo issue) |

## Nature of Operations

Econet Wireless Zimbabwe Limited is the largest GSM mobile operator in Zimbabwe with a market share of c70% and more than 5.0m subscribers and 1,400 base stations. The company offers a unique blend of branded subscriber and pre-paid mobile phone services.

Econet owns Ecoweb (51%), one of the largest ISPs in Zimbabwe. This is supported by Econet's wireless infrastructure and earth station, which also provides direct international dial access to more than 244 countries and territories worldwide. The company also has 84.3% stake in Transaction Processing Systems, a provider of financial transaction switching, point of sale and other value added services that look to exploit the convergence of banking, IT and telecoms.

## Market Dynamics

Generally, the Zimbabwean mobile telephony market is approaching saturation with an estimated potential market of 7.0m users including fixed line subscribers (estimated total population of 13.0m people). National telephone penetration is estimated at 70% with mobile telephone penetration at 68%. Econet currently competes with two main rivals, Telecel (60% owned by Orascom) and Net-One (government owned). While the two remain relatively weaker than Econet, an aggressive network roll out by any of the competitors could potentially harm Econet's market position, sales and margins. However, Econet has over the years, embarked on wide scale expansion programs and aggressive marketing initiatives and this has given the company an edge over its competition.

## Overview of H1 2012 Financial Performance

**Attractive revenue and earnings growth.** Econet released it H1 2012 financial results, which were broadly in line with our expectations. The mobile phone operator reported a 16% growth in earnings, mainly driven by growth in subscribers to about 5.6m. Revenues jumped 24% to USD 290.9m from USD 235.5m and EBITDA increased 14% to USD 131.2m. Overall, eps rose to US 44c, up from US 38c in the same period last year. An interim dividend of US 11.8c per share was declared implying an annualised dividend yield of 6.0% and 4.0x cover.

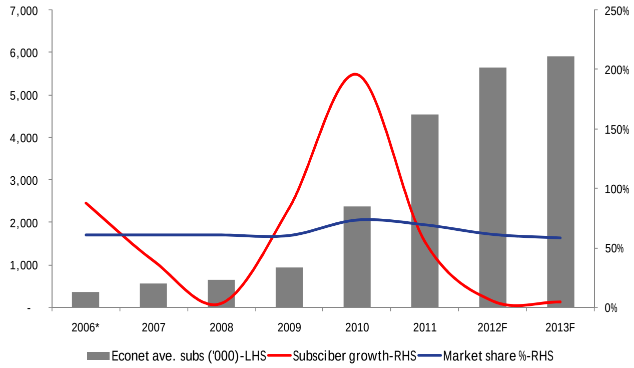
**A decline in Data & SMS contribution to revenue.** Voice contributed 75.9% to total revenue, up from 62.9% the prior period (on improved network optimisation) while data and SMS contributed 13%, down from 15%. Management attributed the decline in data contribution to the introduction of per second billing which resulted in subscribers migrating from txt to voice. A total of 1.5m subscribers were connected to broadband whilst 590,000 were on eTXT.

**A drop in margins.** EBITDA margins eased 370bps to 45%, negatively impacted fuel costs to power base stations and the increased cost of the network. Going forward, our main concerns relate to the likely squeeze on margins and ARPUs, exacerbated by the high base the company is coming from. In addition, the move to retail (of accessories) is likely to impact margins. However, management has indicated that the company will focus on maintaining the EBITDA margin at c49%.

| Shareholder Structure | % Shareholding |
|---|---|
| Econet Wireless Global | 44.18% |
| Stanbic Nominees | 9.33% |
| Baclays Zimbabwe Nominees | 7.67% |
| Old Mutual Life Assurance | 4.96% |
| Austin Eco Holdings Limited | 4.21% |
| Old Mutual Zimbabwe Limited | 2.31% |
| Free Float | 27.30% |

Source: IAS

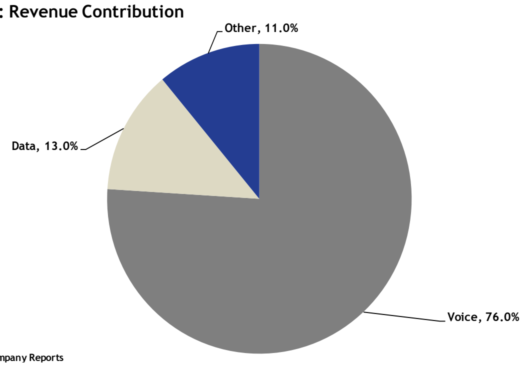
Fig 16: Subscriber Growth Vs Market Share




Source: IAS/Company Reports

| Income Statement (USDm) | H1 2011 | H1 2012 | % Δ |
|---|---|---|---|
| **Revenue** | **235.5** | **290.9** | 24% |
| **EBITDA** | 114.9 | 131.2 | 14% |
| **D&A** | **(22.5)** | **(21.2)** | -6% |
| Operating proft | 92.4 | 110.1 | 19% |
| Net finance costs | (2.3) | (11.7) | 406% |
| Profit before tax | 90.1 | 102.6 | 14% |
| Tax | (25.8) | (28.6) | 11% |
| **Profit after tax** | **64.3** | **74.0** | 15% |
| EPS (USD) | 0.38 | 0.44 | 16% |
| EBITDA Margin | 48.8% | 45.1% | |
| PBT Margin | 38.3% | 35.3% | |
| Earnings Margin | 27.3% | 25.4% | |
| **Balance Sheet** | **FY 2011** | **H1 2012** | **% Δ** |
| Total Assets | 637.51 | 667.14 | 5% |
| NAV | 287.64 | 329.22 | 14% |
| Current Assets | 101.07 | 178.18 | 76% |
| Current Liabilities | 103.00 | 164.47 | 60% |
| Current Ratio | 0.98 | 1.08 | |
| **Cash Flow Statement** | **H1 2011** | **H1 2012** | **% Δ** |
| Operating Activities | 107.05 | 127.61 | |
| Investing Activities | (127.83) | (57.15) | |
| Financing Activities | 27.60 | (31.07) | |

Fig 17: Revenue Contribution




Source: IAS/Company Reports

It is worth mentioning that the main investment attractions in Econet have been its healthy EBITDA margins. However, margins have eased from a peak of 58% (recorded in Jan to Feb 2009) largely due to network roll out and cost adjustments. Marketing costs are also likely to increase as the company revitalises its brands and opens new service centres across the country.

**Capex trending downwards but still remains a priority.** Capex for H1 2012 amounted to USD 38.7m versus USD 122.1m in H1 2011. It is likely that capex will continue trending down as the capex burden eases. Econet has already spent about USD 470.0m on network expansion since 2009, when Zimbabwe adopted a multi-currency regime.

**Declining debt levels.** Net gearing in H1 2012 improved to 68% from 86% at year end and EBITDA interest coverage was high at 11.3x, although finance charges increased 406% as the company reached peak funding. Management has indicated that future expansion shall be funded from internally generated cash flows. Cash generation remains strong with USD 127.6m being generated from operations.

## Operational Review

**Defending ARPUs.** According to management, APRUs increased to USD 10.70 from USD 10.05 in FY 2011, supported by data, broadband and VAS such as Ecolife and eTXT. Generally, Econet enjoys higher ARPUs than local peers due to the high value subscriber base, mainly corporate who are on post-paid. The high value subscribers tend to reduce the incremental cost of adding low value subscribers.

**Subscriber numbers...Still a positive trend.** In H1 2012, total subscribers increased 25% y-o-y to 5.6m, of which 99% of the subscriber base is pre-paid. While pre-paid users are naturally lower revenue users, they offer the advantage of being significantly cash generative with trade debtors limited to 1.0% of subscribers and bad debt to turnover low at approximately 6.0%.

**Cost containment strategies to ease pressure on margins.** Econet distributes circa 50% of airtime through electronic platforms, reducing costs and facilitating smoother distribution. In addition, the telco has VSAT equipment, which allows it to handle its own international traffic, further reducing cost and aiding service delivery. The company has also entered the handset retail market, offering branded handset in partnership with ZTE.

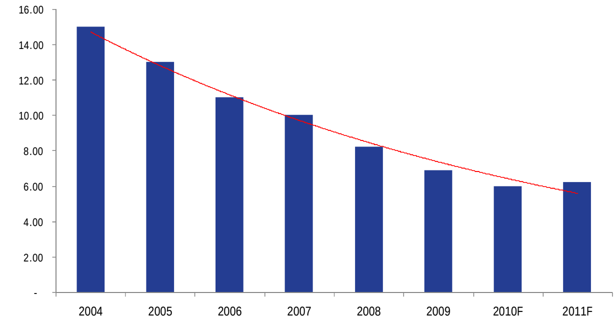
## Outlook

**A positive outlook on dividends.** As mentioned above, Econet is past its peak funding cycle, implying significant “free cash flows” that enable the telco to return values to shareholders in the form of dividends.

## Valuation and Recommendation

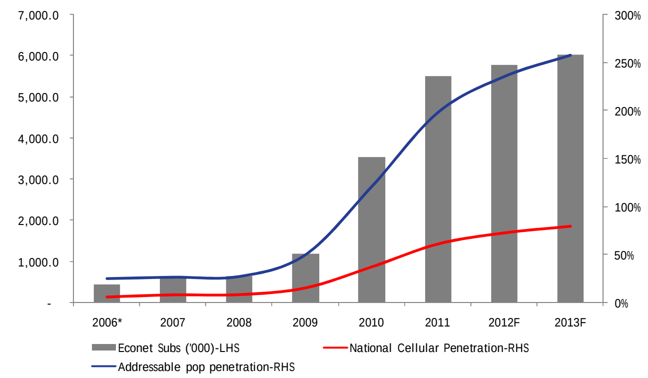
We believe that a negative corporate governance perception on Econet may have been weighing on the share price. However, we think it has been overdone. The telco is cheap at an EV/Sub of USD 125 versus an SSA average of USD 214. Our two valuation methods (EV/subscriber and DCF) yield a fair value of USD 6.10 per share, implying 51% potential upside. **BUY**

**Fig 18: Econet ARPU Trend (USD)**



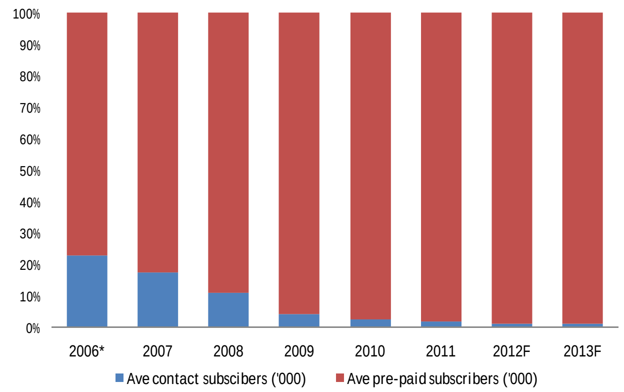

Source: IAS/Company Reports

**Fig 19: Subscribers Vs Mobile Penetration Levels**



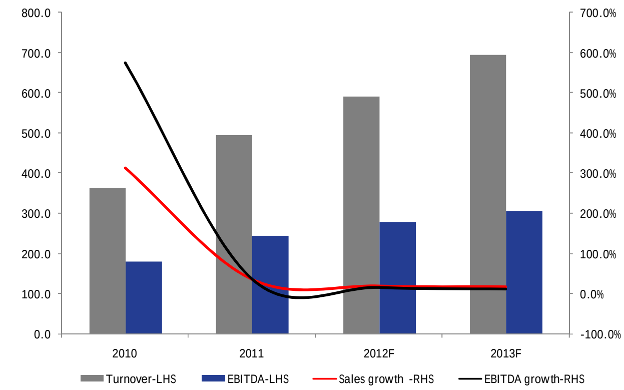

Source: IAS/Company Reports

**Fig 20: Disaggregation of Subscriber Types**




Source: IAS/Company Reports

**Fig 21: Econet Financial Analysis**




Source: IAS/Company Reports

## ECONET - 5 YEAR CGR COMPARISON

| 28 FEBRUARY (USDm) | 2006* | 2007 | 2008 | 2009 | 2010 | 2011 | 2012F | 2013F | 5yr CAGR |
|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | | | |
| Shareholders' equity | 4.1 | 49.2 | 61.3 | 81.2 | 163.2 | 286.7 | 414.5 | 549.4 | 133% |
| Minority interests | 0.0 | 0.0 | 0.2 | 5.7 | 2.3 | 2.8 | 3.4 | 4.1 | 220% |
| **Total shareholders' equity** | **4.4** | **69.7** | **81.1** | **127.2** | **201.2** | **335.1** | **463.4** | **599.1** | 138% |
| Interest Bearing Debt | 0.0 | 0.6 | 0.0 | 9.1 | 138.7 | 240.9 | 192.7 | 123.3 | |
| Trade creditors | 5.0 | 1.3 | 1.7 | 40.0 | 14.4 | 53.9 | 61.9 | 72.7 | 61% |
| Current Liabilities | 10.9 | 3.1 | 1.8 | 40.1 | 52.8 | 60.7 | 68.5 | 80.4 | 41% |
| **Total Liabilities and equity** | **15.3** | **73.4** | **82.9** | **176.4** | **392.7** | **636.6** | **724.6** | **802.8** | 111% |
| Fixed Assets | 2.8 | 54.2 | 38.5 | 134.4 | 267.5 | 498.9 | 534.9 | 574.9 | 182% |
| Investments | 1.1 | 15.7 | 42.8 | 13.3 | 0.0 | 31.1 | 31.1 | 32.6 | 94% |
| Stock - Trade net | 0.2 | 0.1 | 0.2 | 25.3 | 8.7 | 33.6 | 44.2 | 67.5 | 181% |
| Debtors | 4.8 | 1.2 | 1.2 | 0.1 | 30.5 | 0.5 | 0.8 | 1.2 | -36% |
| Cash at bank | 0.3 | 0.2 | 0.1 | 0.1 | 13.9 | 34.7 | 48.5 | 66.1 | 161% |
| Current Assets | 10.4 | 3.0 | 1.5 | 25.6 | 53.2 | 68.9 | 93.8 | 135.4 | 46% |
| **Total Assets** | **15.3** | **73.4** | **82.9** | **176.4** | **392.7** | **636.6** | **724.6** | **802.8** | 111% |
| **Income Statement** | | | | | | | | | |
| **Turnover** | **31.8** | **34.6** | **21.4** | **87.9** | **362.8** | **493.5** | **589.7** | **693.2** | 73% |
| **EBITDA** | **16.1** | **16.1** | **6.1** | **26.6** | **179.3** | **242.7** | **277.8** | **306.8** | 72% |
| Associate income | 0.5 | 2.5 | 8.4 | -1.1 | 1.9 | 0.0 | 0.0 | 0.0 | -100% |
| **Profit before tax** | **18.2** | **22.3** | **58.3** | **3.1** | **148.1** | **196.5** | **217.9** | **251.1** | 61% |
| Taxation | 5.9 | 5.9 | 11.7 | 5.1 | 34.9 | 55.5 | 54.5 | 62.8 | 57% |
| **Profit after tax** | **12.3** | **16.4** | **46.6** | **-2.1** | **113.2** | **141.0** | **163.4** | **188.4** | 63% |
| Minorities | 0.0 | 0.0 | 0.0 | 0.1 | -1.4 | 0.5 | 0.6 | 0.7 | 102% |
| **Attributable Income** | **12.3** | **16.4** | **46.6** | **-2.2** | **114.6** | **140.4** | **162.8** | **187.7** | 63% |
| **Ratios** | | | | | | | | | |
| Weighted shares (m) | | | | | | 163.8 | 163.8 | 163.8 | |
| EPS (USc) | 7.4 | 9.8 | 27.8 - | 1.3 | 68.5 | 83.9 | 97.3 | 112.2 | |
| Cash EPS (USc) | 6.7 | 10.3 | 28.1 | 9.7 | 79.3 | 107.3 | 122.3 | 139.0 | |
| DPS (USc) | 2.5 | 3.3 | 0.8 | - | 22.8 | 12.2 | 32.4 | 37.4 | |
| NAV per share (USc) | 2.5 | 1.0 | 3.0 | (1.3) | 74.9 | 127.7 | 225.0 | 304.7 | |
| **Growth Ratios** | | | | | | | | | |
| Sales growth | | 8.7% | -38.1% | 310.4% | 312.5% | 36.0% | 19.5% | 17.6% | |
| EBITDA growth | | -0.1% | -62.4% | 338.9% | 575.1% | 35.4% | 14.5% | 10.4% | |
| Earnings growth | | 32.8% | 184.5% | -104.7% | -5282.6% | 22.5% | 15.9% | 15.2% | |
| **Margins** | | | | | | | | | |
| Gross Margin | 75% | 76.6% | 84.0% | 78.6% | 80.0% | 80.0% | 80.0% | 80.0% | |
| EBITDA Margin | 50.5% | 46.5% | 28.2% | 30.2% | 49.4% | 49.2% | 47.1% | 44.3% | |
| PBT Margin | 57.3% | 64.5% | 272.0% | 3.5% | 40.8% | 39.8% | 37.0% | 36.2% | |
| Interest cover (times) | n/a | n/a | 1.2 | 9.1 | 35.7 | 28.1 | 13.1 | 24.5 | |
| Earnings Margin | 38.7% | 47.3% | 217.4% | -2.5% | 31.6% | 28.5% | 27.6% | 27.1% | |

* 8 months

***Note: Financial figures for 2006 to 2008 were derived using the Old Mutual Implied Rate (OMIR), which may not reflect a true account due to variability of exchange rates during that period.**

| EQUITY RESEARCH |
|---|
| SOUTH AFRICA |
| September 2011 |
| TELECOMS |

## MTN GROUP LIMITED

*Employing an "omnipresence" strategy in Africa...*

**MTN, which is already active across 21 countries in Africa and the Middle East, has been looking to increase its data revenue as the mobile industry matures in several of its key markets. Given fewer opportunities for acquisitions in emerging markets, we believe the company will be focusing more on increasing its pay-outs to shareholders and therefore view the company as a dividend play.**

- **Room for data and VAS growth.** MTN believes that it can leverage data service opportunities. Currently, data contributes 12.3% of total revenues. MTN's business model is evolving. Although there is still considerable untapped demand for voice services in many markets, MTN is also investing in and expanding its infrastructure to enable more use of data services. As smart phones become more accessible to more people, demand for internet services grows and so MTN's opportunity expands.

- **VAS is also being applied across various countries.** MTN Liberia, for example has formally launched a 'Mobile Money' service in the country in partnership with Ecobank-Liberia. The new service enables MTN subscribers to access money via their mobile phones. MTN is also looking to facilitate an increase in the availability of smart phones in various markets.

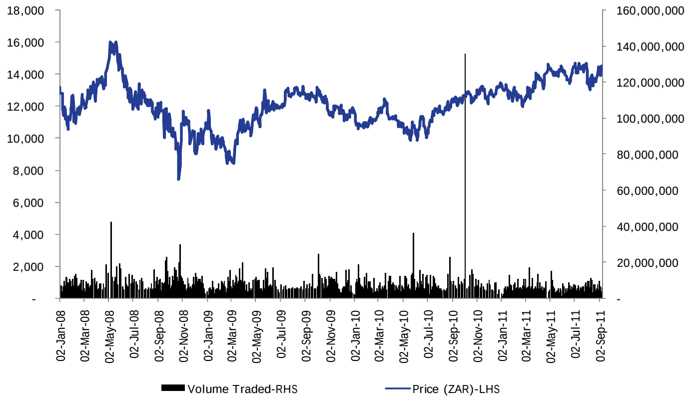
- **Ratings look demanding.** At a PER of 17.9x and EV/Subscriber of USD 248, MTN is not cheap relative to SSA and emerging market peers. However, we think that MTN's rating is pricing in its massive subscriber numbers and the attractive dividend outlook as indications are that cash will be returned to shareholders in the event that new acquisitions are not concluded.

| **BLOOMBERG: MTN:SJ** | | **NOT RATED** |
|---|---|---|
| Current price (ZAR) | | 138.6 |
| Current price (USD) | | 18.7 |
| Target price (ZAR) | | |
| Target price (USD) | | |
| Upside/Downside (%) | | |
| **Liquidity** | | |
| Market Cap (ZARm) | | 261,272.1 |
| Market Cap (USDm) | | 35,224.5 |
| Shares (m) | | 1,884.7 |
| Free float (%) | | |
| Ave. daily vol ('000) | | 6,826 |
| **Share price performance** | | |
| 6 Months (%) | 125.75 | 10.2% |
| Relative change (%)* | | 18.4% |
| 12 Months (%) | 123.2 | 12.5% |
| Relative change (%)* | | 10.1% |

**Relative to MSCI Index*

| **Financials (ZARm) - FY 31 Dec** | **2010** | **2011F** | **2012F** |
|---|---|---|---|
| Turnover | 114,684 | 119,558 | 129,600 |
| EBITDA | 47,306 | 50,413 | 56,028 |
| **Profit before tax** | 28,095 | 30,767 | 36,397 |
| **Profit after tax** | 16,827 | 23,682 | 27,475 |
| EPS (ZAR) | 7.76 | 10.74 | 12.46 |
| NAV/share (ZAR) | 39.00 | 38.46 | 38.57 |
| DPS (ZAR) | 3.43 | 6.57 | 8.49 |
| **Valuation Ratios** | **2010** | **2011F** | **2012F** |
| Subscribers' 000 | 141,600 | 153,000 | 160,000 |
| PER (x) | 17.9 | 12.9 | 11.1 |
| PBV (x) | 3.6 | 3.6 | 3.6 |
| EV/EBITDA (x) | 5.5 | 5.2 | 4.6 |
| Gross ARPU (USD) | 9.1 | 8.8 | 9.1 |
| EV/Subscriber (USD) | 248.1 | 229.6 | 219.5 |
| EBITDA Margin | 41.2% | 42.2% | 43.2% |
| Earnings Yield | 5.6% | 7.7% | 9.0% |
| Dividend Yield | 2.5% | 4.7% | 6.1% |
| Gearing | 49.1% | 50.8% | 52.9% |
| RoaA | 9.2% | 12.9% | 14.4% |
| RoaE | 19.9% | 27.9% | 32.3% |

**MTN: Price Vs Volume**




| STRENGTHS | WEAKNESSES |
|---|---|
| Strong brand name on the African continent<br>Financial strength and operational expertise enables the group to take advantage of acquisitions<br>Strategic partnerships across various sectors and regions e.g Banks, Medical Companies and Education | Exposure to high risk countries eg Ivory Coast and the MENA region<br>Exposure to currencies other than reporting currency creates translation-related risks |
| **OPPORTUNITIES** | **THREATS** |
| Low mobile penetration in SSA markets<br>Considerable scope for growth in data services<br>Further diversification of operating portfolio can reduce the concentration of risk<br>Support to local banks can foster the development of bankable strategic alliances | Increased regulations in various countries<br>Slowing revenue growth in some of the markets as a result of maturity<br>Shortages of skilled human resources |

## Nature of Operations

Incorporated in 1994, MTN is a multi-national telecoms group offering voice and data communications products and services to individuals and businesses. MTN has GSM licences in 21 countries and ISP businesses in 13 countries, spanning three continents. MTN has also made investments in fibre optic cables such as the USD 90.0m investment in the West Africa Cable System (WACS) so as to increase access to broadband capacity.

MTN operates in three regions: South and East Africa (SEA), West and Central Africa (WECA), and the Middle East and North Africa (MENA). MTN SEA is made up of GSM licences in MTN South Africa, MTN Swaziland, MTN Zambia, MTN Uganda, MTN Rwanda and Mascom Botswana and ISP businesses in South Africa, Uganda, Rwanda, Zambia, Namibia, Kenya and Botswana. MTN WECA comprises GSM licences in MTN Nigeria, MTN Ghana, MTN Cameroon, MTN Congo-Brazzaville, MTN Côte d'Ivoire, MTN Benin, MTN Guinea-Bissau, MTN Guinea Conakry and MTN Liberia and ISP businesses in Nigeria, Cameroon, Côte d'Ivoire and Ghana. MTN MENA consists of GSM licences in MTN Irancell, MTN Syria, MTN Sudan, MTN Afghanistan, MTN Yemen and MTN Cyprus and ISP businesses in Syria and Cyprus.

## Market Dynamics in South Africa

Competition in the South African mobile telecommunications industry has intensified over the last few years, most recently due to the entry of SA's fourth operator, 8ta, as well as the aggressive targeting of data services. The data space is currently experiencing aggressive price competition, a feature we expect to continue for some time as operators vie for market share.

## Overview of H1 2011 Financial Performance

**Narrow growth in revenues.** The company reported a 1.0% growth in H1 2011 revenues to ZAR 55.9bn (USD 7.9bn). The low growth was largely due to currency swings and slower growth in some of its major markets.

**Firm margins in most markets.** The good news was that the EBITDA margin was propped up by the profit on the sale of towers in Ghana. EBITDA rose by 3.9% due to increases on a local currency basis of 9.4% in SA, 16.8% in Nigeria and 30.8% in Iran.

**Hefty dividend increase.** Overall, the group closed in a net positive cash position (ZAR 2.67bn) largely due to lower capex and improved EBITDA margins. Capex was 32.4% lower at ZAR 5.71bn following delays in the rollout of certain capex projects and a ZAR 603.0m forex impact. An interim dividend of 273cps (H1 2010: 151cps) was declared, increasing the dividend payout to 65%.

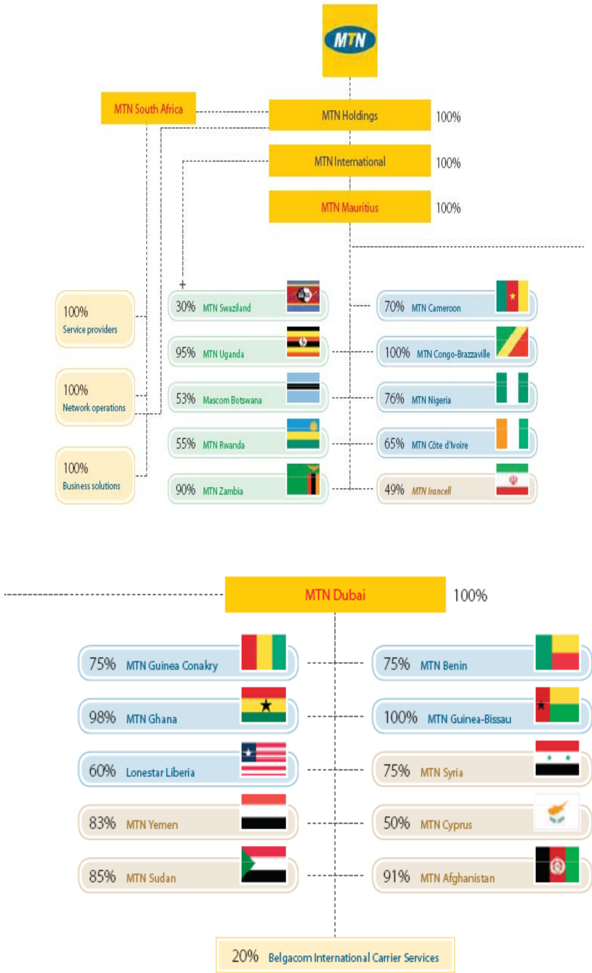
## Operational Review

**Solid subscriber growth.** Total subscribers rose by 7.5% since December 2010 to 152.3m. MTN South Africa increased its subscriber base by 5.1% to 19.8m. The rise in subscribers was mainly due to growth in the prepaid segment which increased its subscriber base by 5% to 16.2m. The group expects net additions of 16.9m subscribers in 2011, led by growth in Nigeria, Iran and South Africa.

| Shareholder Structure | % Shareholding |
|---|---|
| Public | 67.9% |
| Non-public | 32.1% |
| GEPF | 17.6% |
| Lombard Odier Darier | 9.8% |
| Empowerment entities | 4.5% |
| Directors of MTN Group | 0.2% |

Source: IAS

### Fig 22: MTN Group Structure




**Source: Company Reports**

| Income Statement (ZARm) | H1 2010 | H1 2011 | % Δ |
|---|---|---|---|
| **Revenue** | **55,989** | **56,542** | **1%** |
| **EBITDA** | **24,249** | **25,202** | 4% |
| Operating Profit | 16,906 | 17,767 | 5% |
| Net Finance costs | 2,198 | 587 | -73% |
| Profit before tax | 14,767 | 17,166 | 16% |
| **Profit after tax** | 9,337 | 10,823 | 16% |
| **Attributable profit** | **8,094** | **9,450** | **17%** |
| EBITDA Margin | 43.3% | 44.6% | 3% |
| PBT Margin | 26.4% | 30.4% | 15% |
| PAT Margin | 16.7% | 19.1% | 15% |

## KEY MARKETS

**Nigeria** grew its subscriber base by 4.8% to 40.5m. However, Nigerian ARPU declined by 6.7% to USD 9.8/user.

**Irancell** maintained its market share at 44% and recorded an 8.2% rise in subscribers to 32.2m. The third operator has not yet been launched commercially. Population and geographic coverage increased to 79% and 22%, respectively.

**MTN Ghana** had registered 90% of its subscribers. ARPUs declined by 3.9% to USD 7.0/user.

Direct network operating costs rose by 51.9% due to higher electricity and diesel costs. Data growth was still primarily driven by **South Africa**. Data revenue (excluding SMS) overtook SMS revenue for the first time and contributed 6.3% and 6% respectively to total revenue. Airtime and subscription revenue remain the key contributors to revenue comprising 66.1% of the group's total revenue despite decreasing by 2.8%. Mobile Money had been implemented in 12 countries and Nigeria is expected to introduce this product using a partnership model.

## Outlook

**Network investment and rollout remains priority.** The group will continue to upgrade and optimise networks to meet increased demand for data services and has approved capital expenditure of ZAR 22.1bn for 2011. Network quality is one of MTN's key competitive advantages.

**Acquisition opportunities on the cards.** Management has indicated that the company is looking for options to increase dividend payouts to shareholders but are also assessing an acquisition in North Africa, where MTN could buy anything worth up to USD 5.0bn in enterprise value. Political instability in countries such as Yemen and Syria has however created an exigent business environment in recent times.

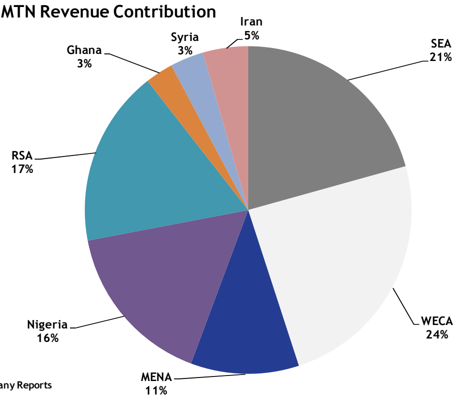
**Cost benefits expect to boost competitiveness.** MTN expects to leverage on a new structural framework that it has formed for key projects that includes cost-effective platforms for delivery of data and services; ongoing standardisation of systems and processes; increased centralisation of procurement activities and rationalisation of suppliers; and shared services and outsourcing. Rather than follow a "big bang" approach, the group plans to establish successful shared services and outsourcing models in certain markets, before extending them to other operations.

**More of a dividend play.** MTN will continue to investigate options to improve sustainable returns to shareholders now that a higher dividend payout policy has been adopted. It will also engage with authorities to sustain the social and commercial success of the telecommunications sector.

## Comment

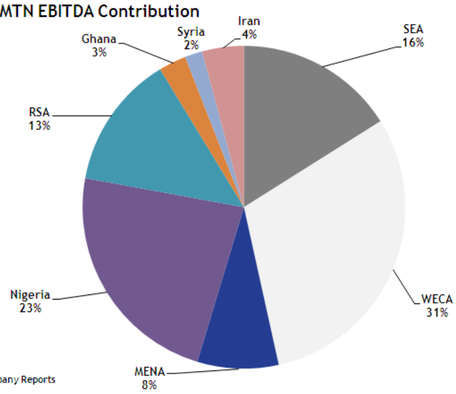
At a PER of 17.9x and EV/Subscriber of USD 248, MTN is not cheap relative to SSA and other emerging market telcos. However, we think that MTN's rating is pricing in its massive subscriber numbers and an attractive dividend outlook as indications are that cash will be returned to shareholders in the event that new acquisitions are not concluded.

**Fig 23: MTN Revenue Contribution**



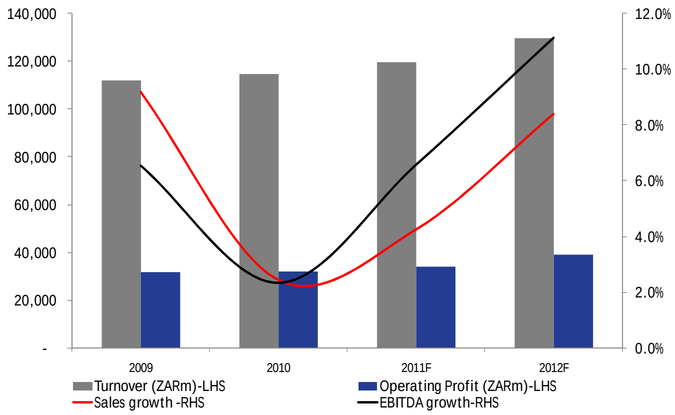

Source: IAS/Company Reports

**Fig 24: MTN EBITDA Contribution**



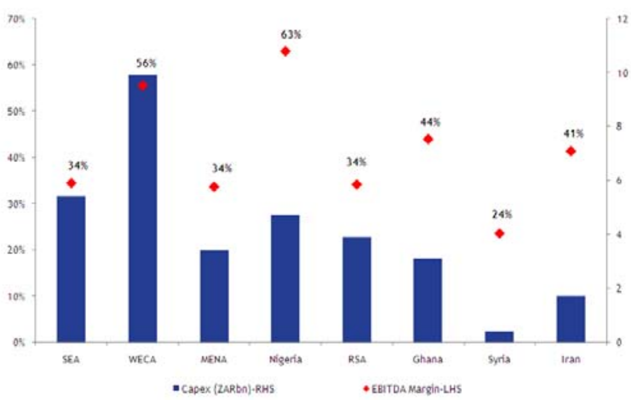

Source: IAS/Company Reports

**Fig 25: MTN Financial Analysis**




Source: IAS/Company Reports

**Fig 26: MTN Margins Vs Capex**



## MTN GROUP - 5 YEAR CGR COMPARISON

| 31 DEC (ZARm) | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011F | 2012F | 5yr CAGR |
|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | | | |
| Shareholders' equity | 19,716 | 38,696 | 47,315 | 76,386 | 70,011 | 71,855 | 72,493 | 72,689 | 30% |
| Minority interests | 3,380 | 4,033 | 4,187 | 4,156 | 2,855 | 2,219 | 2,263 | 2,309 | -8% |
| **Total shareholders' equity** | **23,096** | **42,729** | **51,502** | **80,542** | **72,866** | **74,074** | **74,756** | **74,997** | 26% |
| Current Liabilities | 11,951 | 19,985 | 34,970 | 54,591 | 54,945 | 46,717 | 49,112 | 52,883 | 31% |
| **Total Liabilities and equity** | **44,812** | **96,917** | **115,586** | **170,106** | **156,237** | **154,786** | **159,765** | **165,805** | 28% |
| PPE | 20,676 | 30,647 | 39,463 | 64,193 | 67,541 | 63,361 | 64,311 | 65,340 | 25% |
| Current Assets | 13,676 | 20,635 | 33,501 | 54,787 | 46,024 | 55,059 | 57,276 | 60,384 | 32% |
| **Total Assets** | **44,812** | **96,917** | **115,586** | **170,106** | **156,237** | **154,786** | **159,765** | **165,805** | 28% |
| **Income Statement** | | | | | | | | | |
| **Revenue** | **27,212** | **51,595** | **73,145** | **102,526** | **111,947** | **114,684** | **119,558** | **129,600** | 33% |
| Selling & distribution expenses | (4,736) | (7,949) | (9,071) | (13,274) | (14,649) | (14,741) | (15,773) | (16,877) | 25% |
| Other operating expenses | (1,490) | (2,839) | (4,592) | (7,743) | (7,837) | (10,446) | (10,885) | (11,342) | 48% |
| Impairment of PPE | - | - | (212) | (225) | (167) | 231 | (169) | (170) | |
| Depreciation of PPE | (2,497) | (5,030) | (6,774) | (9,939) | (11,807) | (13,280) | (13,944) | (14,641) | 40% |
| Amortisation of intangible assets | (256) | (1,289) | (2,199) | (2,820) | (2,668) | (2,120) | (2,226) | (2,337) | 53% |
| **Operating Profit** | **8,478** | **16,094** | **22,872** | **30,407** | **31,588** | **32,137** | **34,074** | **38,880** | 31% |
| Finance income | 422 | 1,880 | 1,780 | 6,727 | 6,420 | 2,077 | 3,116 | 4,673 | 38% |
| Finance costs | (795) | (3,307) | (4,953) | (8,644) | (12,230) | (6,171) | (6,480) | (7,218) | 51% |
| **Profit before tax** | **8,115** | **14,690** | **19,707** | **28,490** | **25,773** | **28,095** | **30,767** | **36,397** | 28% |
| Income tax expense | (1,411) | (2,591) | (7,791) | (11,355) | (8,612) | (11,268) | (7,084) | (8,922) | 52% |
| **Profit after tax** | **6,704** | **12,099** | **11,916** | **17,135** | **17,161** | **16,827** | **23,682** | **27,475** | 20% |
| **Ratios** | | | | | | | | | |
| Weighted shares (m) | 1,663.17 | 1,752.56 | 1,861.38 | 1,865.41 | 1,851.15 | 1,842.31 | 1,884.67 | 1,884.67 | |
| EPS (ZAR) | 3.53 | 6.05 | 5.70 | 8.21 | 7.91 | 7.76 | 10.74 | 12.46 | |
| DPS (ZAR) | 0.65 | 0.65 | 0.90 | 1.36 | 1.81 | 3.43 | 6.57 | 8.49 | |
| NAV/Share | 11.85 | 22.08 | 25.42 | 40.95 | 37.82 | 39.00 | 38.46 | 38.57 | |
| Dividend Cover | 5.43 | 9.31 | 6.33 | 6.04 | 4.37 | 2.26 | 1.63 | 1.47 | |
| Dividend Yield | 0.5% | 0.5% | 0.6% | 1.0% | 1.3% | 2.5% | 4.7% | 6.1% | |
| **Growth Ratios** | | | | | | | | | |
| Sales growth | | 89.6% | 41.8% | 40.2% | 9.2% | 2.4% | 4.3% | 8.4% | |
| EBITDA growth | | 99.6% | 43.0% | 35.4% | 6.5% | 2.3% | 6.6% | 11.1% | |
| Op Profit growth | | 89.8% | 42.1% | 32.9% | 3.9% | 1.7% | 6.0% | 14.1% | |
| PBT growth | | 81.0% | 34.2% | 44.6% | -9.5% | 9.0% | 9.5% | 18.3% | |
| Earnings growth | | 80.9% | 0.0% | 44.4% | -4.3% | -2.4% | 41.5% | 16.0% | |
| **Margins** | | | | | | | | | |
| EBITDA Margin | 41.3% | 43.4% | 43.8% | 42.3% | 41.3% | 41.2% | 42.2% | 43.2% | |
| OP Margin | 31.2% | 31.2% | 31.3% | 29.7% | 28.2% | 28.0% | 28.5% | 30.0% | |
| PBT Margin | 29.8% | 28.5% | 26.9% | 27.8% | 23.0% | 24.5% | 25.7% | 28.1% | |
| Earnings Margin | 21.6% | 20.6% | 14.5% | 14.9% | 13.1% | 12.5% | 16.9% | 18.1% | |
| Effective Tax Rate | 17.4% | 17.6% | 39.5% | 39.9% | 33.4% | 40.1% | 23.0% | 24.5% | |

**Note: Given that our focus is mainly on SSA Excluding South Africa this section has been compiled strictly for comparative purposes. Also note that our forecasts are based on Thompson Reuters consensus estimates.**

**EQUITY RESEARCH**

**BRVM**

**September 2011**

**TELECOMS**

## ONATEL

### Office National des Telecommunications du Burkina Faso

*Competitive forces looming in the market…*

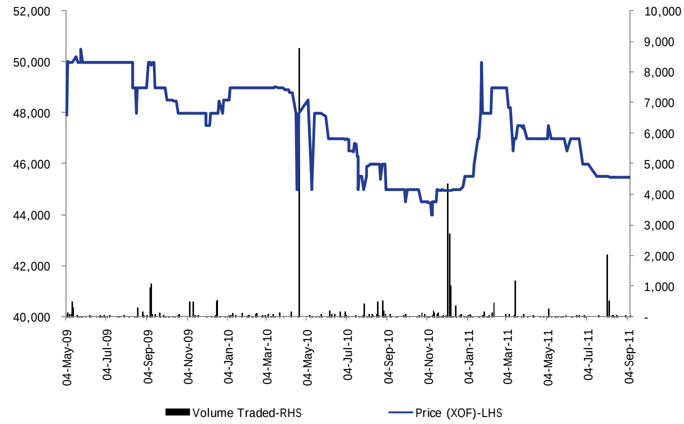
**As part of a privatisation program, the Government of Burundi appointed Projet de Development des Secteurs Financier et Prive (PDSFP), a World Bank funded project, to handle the privatisation of ONATEL. The move was largely aimed at providing government with an avenue to sell-off a stake in the operator, which was facing intense competition in its home market. The company is now 51% owned by Maroc Telecom.**

- **Competition intensifying.** The telecoms industry in Burkina Faso has been marked by competition and this has resulted in an erosion of prices. In addition, the adoption of per second billing has also slowed down revenue growth. Onatel's H1 2011 bottom-line performance was disappointing as the profit figure was significantly below our expectations. On the top-line, consolidated revenues amounted to XOF 46.8bn, representing an 11% decrease on H1 2010.

- **Comparative Valuation looks good.** On an EV/EBITDA basis, ONATEL lags its peers, with an EV/EBITDA of only 3.2x, significantly lower than the SSA and MENA averages of 4.6x and 5.3x, respectively. We believe ONATEL's point of strength in terms of valuation is that it is tightly held and downside risk is limited. While prospects for FY 2011 are not exciting given the stiff competition (with the share price having responded by de-rating from a peak of XOF 50,000), we believe the problems are fixable. We would recommend investors **HOLD** for the long term given the undemanding ratings.

| **BLOOMBERG: ONTBF:BC** | | | **HOLD** |
|---|---|---|---|
| Current price (XOF) | | | 45,000 |
| Current price (USD) | | | 93.9 |
| Target price (XOF) | | | 49,409.3 |
| Target price (USD) | | | 103.1 |
| Upside/Downside (%) | | | 10% |
| **Liquidity** | | | |
| Market Cap (XOFm) | | | 153,000 |
| Market Cap (USDm) | | | 319.4 |
| Shares (m) | | | 3.4 |
| Free float (%) | | | 20.0 |
| Ave. daily vol | | | 131.0 |
| **Share price performance** | | | |
| 6 Months (%) | | 49,000 | -8.2% |
| Relative change (%)* | | | 0.03% |
| 12 Months (%) | | 45,000 | 0.0% |
| Relative change (%)* | | | -2.4% |
| **Relative to MSCI Index* | | | |
| **Financials (XOFm) - FY 31 Dec** | **2010** | **2011F** | **2012F** |
| Turnover | 102,930 | 93,660 | 107,709 |
| EBITDA | 55,690 | 51,407 | 59,118 |
| Profit before tax | 19,690 | 17,306 | 20,043 |
| Attributable earnings | 11,176 | 11,249 | 13,028 |
| EPS (XOF) | 3,287 | 3,309 | 3,832 |
| NAV/share (XOF) | 22,151 | 24,366 | 26,803 |
| DPS (XOF) | 2,625 | 2,680 | 3,104 |
| **Valuation Ratios** | **2010** | **2011F** | **2012F** |
| Subscribers' 000 | 2,569.1 | 3,374.7 | 3,459.1 |
| PER (X) | 13.7 | 13.6 | 11.7 |
| PBV (X) | 2.0 | 1.8 | 1.7 |
| EV/EBITDA (x) | 3.2 | 3.7 | 3.3 |
| Gross ARPU (USD) | 7.0 | 4.8 | 5.4 |
| EV/Subscriber (USD) | 146.6 | 118.8 | 116.9 |
| EBITDA Margin | 54.1% | 54.9% | 54.9% |
| Earnings Yield | 7.3% | 7.4% | 8.5% |
| Dividend Yield | 5.8% | 6.0% | 6.9% |
| Gearing | 49.7% | 47.1% | 44.7% |
| RoaA | 5.1% | 4.7% | 4.9% |
| RoaE | 16.0% | 14.2% | 15.0% |

**Onatel: Price Vs Volume**




| STRENGTHS | WEAKNESSES |
|---|---|
| Strong brand name<br>Strategic relationship with Maroc Telecom ensures support in terms of technical and financial support<br>First mover advantages in Burkina Faso<br>Strong management team<br>Tightly held scrip limits downside | Demand for data services may be constrained by a lack of corporate<br>Limited float on the BRVM limits exposure |
| **OPPORTUNITIES** | **THREATS** |
| Low mobile penetration in Burkina Faso<br>Considerable scope for growth in high bandwidth applications as a result of new innovations<br>Increase network coverage<br>Increased economic activity | Increased competion in Burkina Faso<br>Economic slowdown<br>Plolitical instability in Franco phone Africa<br>Regulatory threats<br>Increased interconnnection costs |

## Nature of Operations

ONATEL SA is a telecoms operator in Burkina Faso. It is a leader in all its business segments, fixed, mobile and internet. The mobile business is operated by the subsidiary Telmob - SA. The main shareholders are Maroc Telecom (51%) and the State of Burkina Faso (26%). The company provides switched telephone service between fixed points and the telex service on these networks, mobile services and other related value-added services (VAS).

| Shareholder Structure | % Shareholding |
|---|---|
| Maroc Telecom | 51% |
| Etat Burkinabe' | 26% |
| Societe Financiere Internatinale | 3% |
| Free float | 20% |

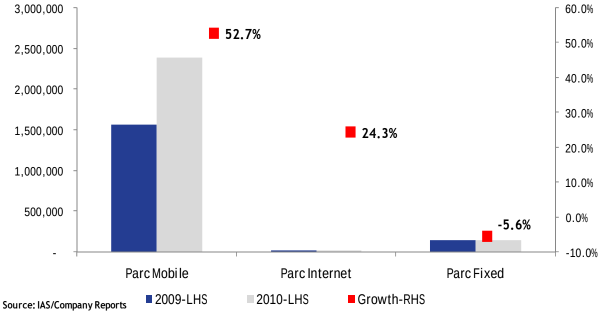
Source: IAS

## Market Dynamics in Burkina Faso

The telecoms market in Burkina Faso is divided into several sectors, namely fixed, mobile and internet. The fixed telephony sector was fully liberalised in December 2005, marking the end of the ONATEL monopoly. ONATEL however, is the only operator that offers fixed telecommunication services in the country.

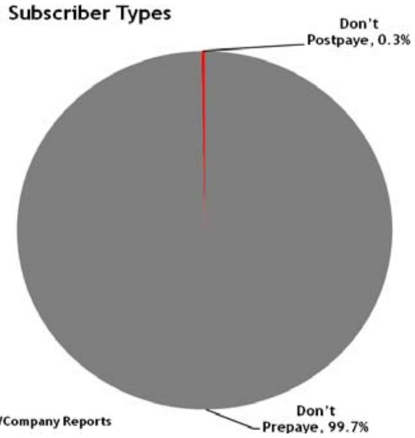
ONATEL's internet business, marketed under the brand Fasonet, occupies a dominant position in this segment. The market for mobile telephony was opened to competition in 2000 when the Burkina Faso government granted two licenses to Telecel and Celtel Burkina Faso. Since 2004, the business of Onatel Mobile was transferred to its 100% subsidiary, Telmob. Currently, three operators share the mobile telephony market in Burkina Faso. These are Telmob, Telecel and Celtel Burkina Faso. The mobile telephony market in Burkina Faso has been growing, with ONATEL having increased its client base by 44.0% on the year to approx 2.8m subscribers.

Fig 27:Subscriber Growth




Source: IAS/Company Reports

Fig 28: Subscriber Types




Source:IAS/Company Reports

## Overview of H1 2011 Financial Performance

**ONATEL's H1 2011 bottom-line performance was disappointing.** Net profit came in significantly below our expectations, due to price reductions that were precipitated by intensifying competition in the key home market. ONATEL's consolidated revenues amounted to XOF 46.8bn, representing an 11% decrease on H1 2010. The decline was largely a result of significant price reductions in the mobile segment. The fixed segment also underperformed on the back of mobile competition and vandalism of installations.

**Q1 2011 financial performance was dire.** It is worth noting that ONATEL had reported a 77.21% fall in net profit for Q1 2011 on the back of lower tariffs charged to clients compared with the same period last year. Sales were also 8.2% lower at XOF 24.0bn. The company has had to cut fixed line charges due to stiffer competition from the mobile sector.

**Margins under pressure.** H1 2011 EBIT contracted 71% to settle at XOF 4.4bn on the joint effect of lower revenues and higher interconnection costs to other carriers. The EBIT margin declined to 9.5% from 29% in H1 2010. Furthermore, net income for the period stood at XOF 2.6bn, a 67% decline, implying a net margin of 5.6% (compared with a margin of 14.9% in H1 2010).

| Operational Data | H1 2010 | H1 2011 | % Δ |
|---|---|---|---|
| **Subscribers (000)** | | | |
| Fixed | 154.0 | 142.6 | -7.4% |
| Internet | 24.6 | 29.4 | 19.5% |
| Active Mobile Park | 1,993.9 | 2,795.5 | 40.2% |
| **Income Statement (XOFm)** | **H1 2010** | **H1 2011** | **% Δ** |
| Revenue | 52,605 | 46,830 | -11% |
| EBIT | 15,226 | 4,445 | -71% |
| Net finance costs | (1,340) | (1,024) | -24% |
| Profit after tax | 7,819 | 2,609 | -67% |
| EBIT Margin | 28.9% | 9.5% | |
| Earnings Margin | 14.9% | 5.6% | |

## Operational Review

**Operational numbers showing improvements.** Total subscribers grew 40% ahead of H1 2010, reaching 2.8m active customers in H1 2011. The fixed segment, however registered a downward trend, losing 6.3% compared to H1 2010. As expected, the internet segment registered a 19.5% growth in subscriptions, with approximately 29,000 customers at the end of June 2011. Estimates from *Trading Economics* show that there is 1 internet user for every 100 people in Burkina Faso and that literacy levels are at 47%.

**Fixed segment suffering from vandalism**. Another set back for the company has been an increase in acts of violence and vandalism on the telephone network. This has led to interruptions of services thereby causing customers' discontent. In the future, Onatel SA will have to consolidate its achievements and safeguard its quality of services so as to maintain a leading position on the market.

## Outlook

**Plans earmarked at growing network coverage.** ONATEL is looking to extend its mobile coverage to the remaining cities in the country as well as relieve congestion in large urban areas by offering better network quality.

**Moving into rural areas**. ONATEL is looking at targeting lower value subscribers outside the main urban areas. However, the main set back is that this move tends to dilute ARPUs as the operator focuses on low ARPU customers.

**Defending ARPU levels**. Management has set a target of improving ARPUs through innovative offers and promotions. New products will also help to cushion against the adverse effects of price competition.

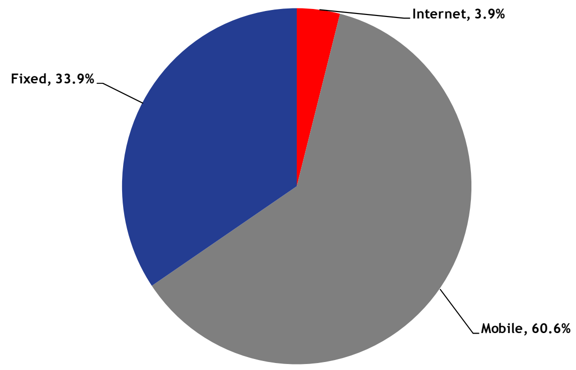
**The internet growth trajectory to continue**. Plans have also been put in place to extend internet access through ADSL and BLR networks, which are consistent with the evolution of the internet market. The target is to add 8,300 new fixed subscribers, 12,000 new internet subscribers and 785,307 new mobile customers.

**Bullish revenue target for FY 2011**. Management has set an objective to achieve a turnover of more than XOF 130.0bn for FY 2011, split into XOF 46.0bn for fixed internet and XOF 84.7bn for mobile.

## Valuation and Recommendation

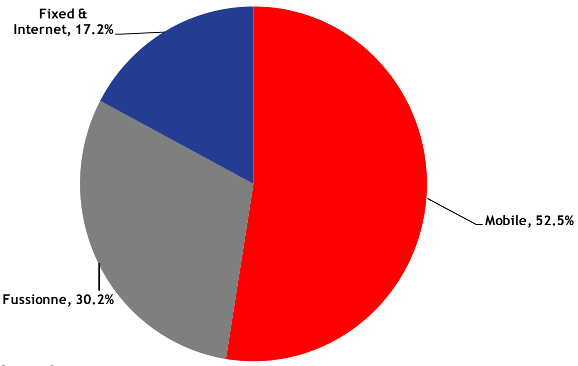
**Valuation looks good**. On an EV/EBITDA basis, ONATEL lags its peers, with an EV/EBITDA of only 3.3x, significantly lower than the SSA and MENA averages of 4.6x and 5.3x, respectively. We believe ONATEL's point of strength in terms of valuation is that it is tightly held and downside risk in limited. However, prospects for FY 2012 are not exciting given the stiff competition. We would recommend investors hold for the long term given the undemanding EV/Sub of USD 147 (SSA average of USD 214/Sub), PBV of 2.0x (SSA average of 3.5x). Our valuation methods point to a 10% potential upside. **HOLD**

**Fig 29: Revenue Contribution**



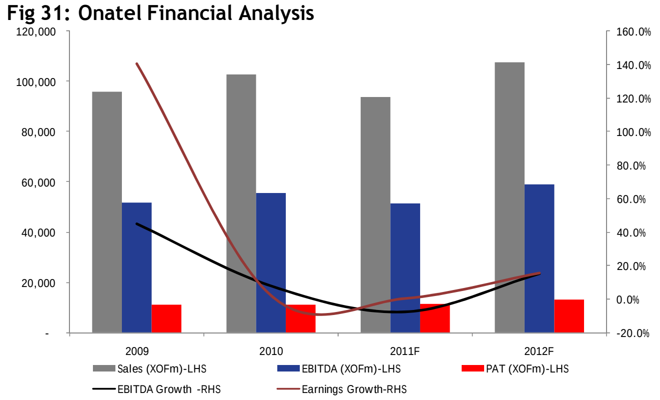

Source: IAS/Company Reports

**Fig 30: Net Profit Contribution**




Source: IAS/Company Reports

**Fig 31: Onatel Financial Analysis**




Source: IAS/Company Reports

## ONATEL - 5 YEAR CGR COMPARISON

| 31 DEC (XOFm) | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011F | 2012F | 5yr CAGR |
|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | | | |
| Shareholders' equity | 60,340 | 27,373 | 33,016 | 74,280 | 64,718 | 75,313 | 82,844 | 91,129 | 25% |
| Minority interests | - | 26,299 | 31,721 | 130 | - | 137 | 143 | 150 | -65% |
| **Total shareholders' equity** | **60,340** | **53,672** | **64,737** | **74,410** | **64,718** | **75,450** | **82,988** | **91,279** | 9% |
| Current Liabilities | 44,669 | 42,418 | 61,410 | 67,350 | 85,126 | 103,132 | 46,247 | 48,560 | 2% |
| **Total Liabilities and equity** | 152,643 | 147,321 | 178,590 | 201,340 | 205,402 | 229,182 | 254,206 | 282,244 | 12% |
| Fixed Assets | 108,760 | 104,780 | 126,825 | 136,930 | 132,353 | 150,244 | 165,268 | 181,795 | 10% |
| Current Assets | 36,785 | 36,436 | 39,792 | 52,670 | 61,312 | 68,850 | 78,489 | 89,477 | 17% |
| **Total Assets** | 152,643 | 147,321 | 178,590 | 201,340 | 205,402 | 229,045 | 254,206 | 282,244 | 12% |
| **Income Statement** | | | | | | | | | |
| **Sales** | **67,358** | **71,922** | **78,024** | **82,350** | **95,725** | **102,930** | **93,660** | **107,709** | 5% |
| Value added | 42,332 | 35,563 | 41,286 | 45,419 | 53,496 | 57,902 | 52,450 | 60,317 | 8% |
| Staff costs | **(9,710)** | **(11,128)** | **(10,436)** | **(11,565)** | **(11,831)** | **(12,103)** | **(12,381)** | **(12,666)** | 2% |
| **EBITDA** | 34,803 | 27,480 | 33,737 | 35,715 | 51,695 | 55,690 | 51,407 | 59,118 | 13% |
| Finance income | **165** | **880** | **289** | **140** | **154** | **169** | **186** | **205** | -27% |
| Finance expenses | (2,651) | (4,548) | (3,101) | (3,429) | (3,200) | (2,378) | (3,567) | (3,995) | -5% |
| **Profit before Tax** | 14,554 | 1,414 | 7,314 | 8,589 | 15,203 | 19,690 | 17,306 | 20,043 | 65% |
| Taxation | (3,994) | (173) | (349) | (229) | (4,290) | (8,514) | (6,057) | (7,015) | 104% |
| **Profit after Tax** | 10,803 | 1,334 | 6,629 | 8,890 | 10,913 | 11,176 | 11,249 | 13,028 | 53% |
| **Attributable Income** | 10,803 | 1,334 | 6,629 | 8,890 | 10,913 | 11,176 | 11,249 | 13,028 | 53% |
| **Ratios** | | | | | | | | | |
| Weighted shares (m) | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | |
| EPS (XOF) | 3,177 | 151 | 994 | 1,334 | 3,210 | 3,287 | 3,309 | 3,832 | |
| DPS (XOF) | 1,906 | 90 | 597 | 800 | 1,926 | 2,625 | 2,680 | 3,104 | |
| NAV/Share | 17,747 | 8,051 | 9,711 | 21,847 | 19,035 | 22,151 | 24,366 | 26,803 | |
| Dividend Cover | 1.67 | 1.67 | 1.67 | 1.67 | 1.67 | 1.25 | 1.23 | 1.23 | |
| Dividend Yield | 4.2% | 0.2% | 1.3% | 1.8% | 4.3% | 5.8% | 6.0% | 6.9% | |
| **Growth Ratios** | | | | | | | | | |
| Sales growth (%) | | 6.8% | 8.5% | 5.5% | 16.2% | 7.5% | -9.0% | 15.0% | |
| EBITDA growth (%) | | -21.0% | 22.8% | 5.9% | 44.7% | 7.7% | -7.7% | 15.0% | |
| Op Profit growth (%) | | -68.6% | 87.0% | 15.2% | 102.9% | 1.6% | -5.0% | 15.0% | |
| PBT growth (%) | | -90.3% | 417.3% | 17.4% | 77.0% | 29.5% | -12.1% | 15.8% | |
| Earnings growth (%) | | -95.3% | 560.4% | 34.1% | 140.7% | 2.4% | 0.7% | 15.8% | |
| **Margins** | | | | | | | | | |
| EBITDA Margin | 51.7% | 38.2% | 43.2% | 43.4% | 54.0% | 54.1% | 54.9% | 54.9% | |
| OP Margin | 24.1% | 7.1% | 12.2% | 13.4% | 23.3% | 22.0% | 23.0% | 23.0% | |
| PBT Margin | 21.6% | 2.0% | 9.4% | 10.4% | 15.9% | 19.1% | 18.5% | 18.6% | |
| Earnings Margin | 16.0% | 0.7% | 4.3% | 5.5% | 11.4% | 10.9% | 12.0% | 12.1% | |
| Effective Tax Rate | 27.4% | 12.2% | 4.8% | 2.7% | 28.2% | 43.2% | 35.0% | 35.0% | |

**EQUITY RESEARCH**

**KENYA**

**September 2011**

**TELECOMS**

## SAFARICOM

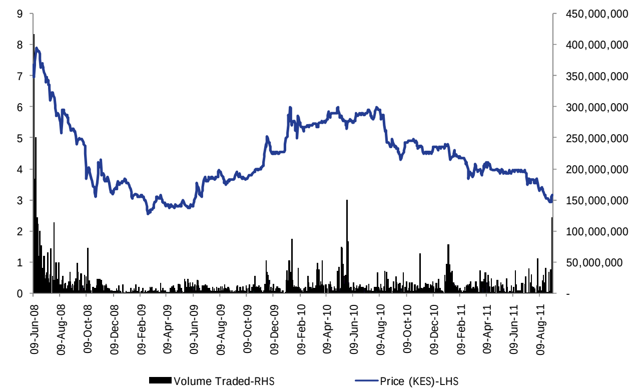
*Voice still bringing home the bacon...*

**Reports out of East Africa indicate that the Lower Indian Ocean Network 2 (LION2) submarine cable has docked in Mombasa, and is set to be connected to its sister cable, LION, in international waters ahead of testing. Safaricom has invested heavily in data which is viewed as the next frontier of growth for the industry, and already dominates the market with a 92% market share. As the most liquid and the largest capitalised counter on the NSE, the stock provides an avenue into tapping the data growth story in East Africa.**

- **Regulatory inefficiencies.** Safaricom has taken telecoms regulator the CCK to court in an effort to reclaim KES 1.4bn (USD 14.9m) in excess licence fees from the telecoms watchdog. In June 2010, the CCK slashed the cost of a 3G permit by 60% from USD 25.0m to USD 10.0m in a bid to stimulate interest, and later the same month Airtel Kenya paid the lower amount for a concession, with Telkom Kenya (Orange) going on to acquire a cut-price concession in November 2010. Following the price cut, Safaricom is seeking a rebate from the CCK as it believes that the huge disparity between the licence fees has created unfair competition in the sector, forcing it to operate at significantly higher initial costs than its rivals.

- **Threats of competition remain elevated but stock is fundamentally undervalued.** Safaricom's PER (historic) of 9.4x is at a premium to Sonatel's 7.6x PER and Econet's 4.8x, but below the SSA average of 12.6x. In addition, an EV/EBITDA of 3.9x and EV/Sub of USD 85 lags behind SSA, MENA, emerging market and developed world averages. While the company is likely to benefit from margin expansion on data and non voice income streams, competition and regulatory threats remain elevated in the market. **HOLD.**

**Safaricom: Price Vs Volume**




| **BLOOMBERG: SAFCOM:KN** | | | | **HOLD** |
|---|---|---|---|---|
| Current price (KES) | | | | 3.2 |
| Current price (USD) | | | | 0.03 |
| Target price (KES) | | | | 3.5 |
| Target price (USD) | | | | 0.04 |
| Upside/Downside (%) | | | | 9% |
| **Liquidity** | | | | |
| Market Cap (KESm) | | | | 128,000 |
| Market Cap (USDm) | | | | 1,351.6 |
| Shares (m) | | | | 40,000 |
| Free float (%) | | | | 25 |
| Ave. daily vol ('000) | | | | 11,680 |
| **Share price performance** | | | | |
| 6 Months (%) | | | 3.85 | -17% |
| Relative change (%)* | | | | -9% |
| 12 Months (%) | | | 4.95 | -35% |
| Relative change (%)* | | | | -38% |
| **Relative to MSCI Index* | | | | |
| **Financials (KESm) - FY 31 Mar** | **2011** | **2012F** | | **2013F** |
| Turnover | 94,832 | 102,419 | | 111,636 |
| EBITDA | 35,723 | 35,847 | | 37,956 |
| Profit before tax | 18,361 | 20,484 | | 23,444 |
| Profit after tax | 13,159 | 14,748 | | 16,879 |
| EPS (KES) | 0.33 | 0.37 | | 0.42 |
| NAV/share (KES) | 1.69 | 1.77 | | 1.86 |
| DPS (KES) | 0.20 | 0.30 | | 0.35 |
| **Valuation Ratios** | **2011** | **2012F** | | **2013F** |
| Subscribers' 000 | 17,183 | 18,000 | | 18,200 |
| PER (x) | 9.7 | 8.7 | | 7.6 |
| PBV (x) | 1.9 | 1.8 | | 1.7 |
| EV/EBITDA (x) | 3.9 | 3.9 | | 3.8 |
| Gross ARPU (USD) | 4.9 | 5.0 | | 5.4 |
| EV/Subscriber (USD) | 84.7 | 82.6 | | 82.9 |
| EBITDA Margin | 38% | 35% | | 34% |
| Earnings Yield | 10% | 12% | | 13% |
| Dividend Yield | 6% | 9% | | 11% |
| Gearing | 22% | 26% | | 28% |
| RoaA | 12% | 13% | | 14% |
| RoaE | 20% | 21% | | 23% |

| STRENGTHS | WEAKNESSES |
|---|---|
| Strong brand name in East Africa<br>Strategic and technical support from Vodafone<br>Good management team<br>Strategic partners in various sectors such as financial services, education & health | Demand for data services may be constrained by a lack of corporate demand<br>Declining voice and SMS ARPUs |
| **OPPORTUNITIES** | **THREATS** |
| M-PESA to drive revenue growth in future<br>Considerable scope for growth in VAS<br>High bandwidth application due to the launch of undersea cables<br>Increased 3G coverage to increase internet access | Increased competition in East Africa from the likes of Airtel Kenya<br>Economic slowdown<br>Inflationary threats<br>Strict regulatory environment eg CCK |

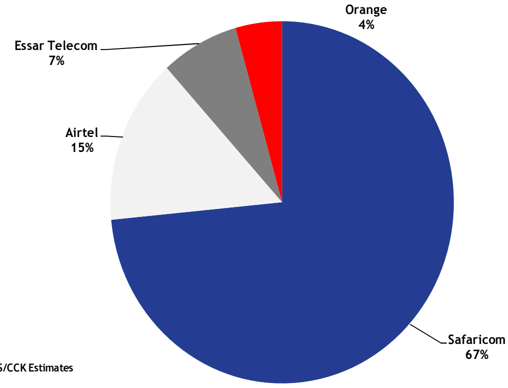
## Nature of Operations

Safaricom is a provider of converged communication solutions in Kenya. It provides a broad range of first-class products and services for telephony, broadband internet and mobile transfer services. The company was incorporated in Kenya in April 1997 as a state owned company by virtue of the 60% government ownership. The government's stake was later reduced to 35% after floating 25% of its stake to the public in 2008. The controlling interest moved to Vodafone Kenya which now holds a 40% stake in the company. Safaricom has an estimated market share of about 67%. Operating mainly as a telephony company, voice accounts for c67% of its top line. However, the highly successful M-PESA Money transfer service, launched in 2007, has attracted 13.5m users and accounts for c12% of total revenue. Data (fixed and mobile) represents 5.0% of the firm's revenue while SMS accounts for about 8.0%.

| Shareholder Structure | % Shareholding |
|---|---|
| Vodafone Kenya | 40.0% |
| Permanent Secretary-Treasury | 35.0% |
| Free Float | 25.0% |

Source: IAS

Fig 32: Market Share Statistics



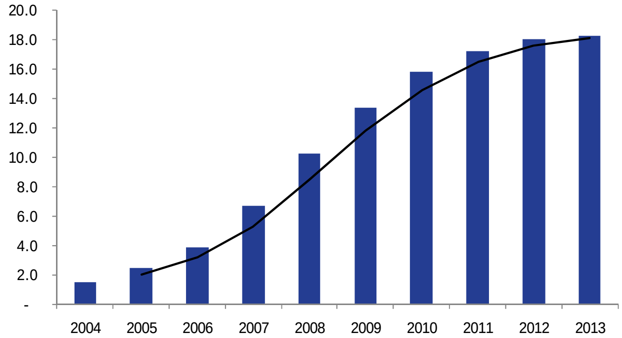

Source: IAS/CCK Estimates

## Market Dynamics in Kenya

The Kenyan market has in recent times been characterised by competition especially in the voice segment. Generally, the adoption of a low cost strategy by Airtel Kenya is believed to have ignited price wars in the voice market. To defend market share, the other operators were forced to follow suit. The reduction of interconnection rates (as regulated by CCK) by the operators also fuelled the competition.

We opine that Safaricom will maintain its dominant position, despite the stiff competition especially in the tariffs structure. Its promising prospects in the data market will give it a strong grip in the market. In addition, value-added products such as M-PESA will also significantly boost its revenues.

Fig 33: Evolution of Subscribers (Millions)




Source: IAS/Company Reports

## Overview of FY 2011 Financial Performance

**Turnover driven by data growth.** In FY 2011, revenue growth of 12.9% was higher than subscriber growth. MOU per subscriber also increased significantly from 60.6 minutes to 96.0 minutes. It appears that data revenues are providing a strong cushion against declining voice revenue. Safaricom registered a 12.9% growth in turnover to KES 94.8bn, on the back of a 57% growth in data.

**Voice revenues were only down a marginal 1.7%.** Despite the declining voice ARPUs, voice remains the biggest revenue stream with KES 63.5bn generated in FY 2011. This was largely a result of a 58% increase in minutes of use (MOU) per customer to 96 minutes. The company has managed to firm up voice revenues through a continued focus on the customer, attractive pricing, easy access through wide distribution channels, promotional activities aimed at stimulating usage and spending. In addition, the group has also invested in the network so as to guarantee quality and reach.

**Margins were lower.** EBITDA was KES 35.7bn and pretax profit declined by 12.4% to KES 18.4bn. Similarly, net profit dropped 13% to KES 13.16bn. The EBITDA margin declined from 44% in FY 2010 to 38%, whilst the PAT margin declined from 18% in FY 2010 to 13.9% in FY 2011. The increase in operating expenses was attributed to the intensifying customer acquisition initiatives and increase in the cost of licences. Selling and administrative expenses also grew in line with the company's revamped customer focus.

| Income Statement (KESbn) | FY 2010 | FY 2011 | % Δ |
|---|---|---|---|
| **Revenue** | 83.961 | 94.832 | 12.9% |
| Voice | 64.576 | 63.501 | -1.7% |
| Total Data | 15.724 | 24.696 | 57.1% |
| SMS | 5.191 | 7.544 | 45.3% |
| M-PESA | 7.556 | 11.784 | 56.0% |
| Data | 2.977 | 5.368 | 80.3% |
| **EBITDA** | **36.604** | **35.723** | **-2.4%** |
| Operating Profit | 22.611 | 19.390 | -14.2% |
| Profit before tax | 20.967 | 18.361 | -12.4% |
| **Profit after tax** | **15.148** | **13.159** | **-13.1%** |
| **Customers (m)** | **15.793** | **17.183** | **8.8%** |
| Mobile Service ARPU (KES) | 458.5 | 436.6 | -4.8% |
| EBITDA Margin | 43.6% | 37.7% | -13.6% |
| PAT Margin | 18.0% | 13.9% | -23.1% |

## Operational Review

**Maintaining its market leadership position.** Safaricom continues to lead the pack on the innovation front. M-PESA remains a key achievement by Safaricom and is expected to continue boosting its revenues significantly. The service is now being applied in other markets and will remain a key driver to the company's revenues. Its modification and upgrades to enable mobile banking and settlement of payments continues to be a major boost to the company. Another demonstration of continued innovation is the upgrading of its 3G network. As a long term project, the operator is now carrying out trials for the 4G network to make data delivery even faster.

Safaricom has "distinguished" itself in the market and has invested in a 3G network (with over 50% of the base stations 3G enabled). Currently, it is the only company with a countrywide coverage of the technology. The company has so far connected 5,000 subscribers via fixed lines making it one of the biggest providers in the segment.

**Calling rates expected to increase.** Kenyan mobile telephone operators are expected to raise calling rates for customers on the back of a weak KES against the USD and high inflation of about 16%. Generally, call rates have been falling for a year after India's Bharti Airtel, slashed prices by more than 50% in a bid to lure subscribers from the biggest operator, Safaricom. Operators will need to adjust call rates so as to recover from the shocks. It is worth noting that Safaricom is the only telco in Kenya making profits at the current subdued rates.

## Outlook

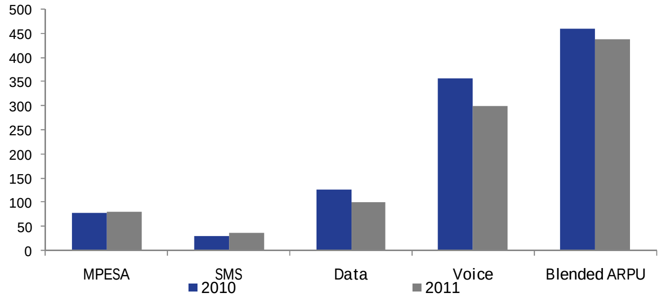
**Bundling to add flavour to a saturated market.** We foresee bundling to be the key stimulus for the Kenyan market's growth going forward, given the saturation in the mobile market and voice competition. With an EBITDA of c50% compared to voice's 38%, the data segment is highly profitable. Currently, data has a penetration of 25.1% compared to that of voice which is over 60%. This is our view demonstrates the massive growth potential within the data space.

**A focus on the corporate market.** Safaricom's outlook remains positive given its aggressive move to data. A focus on the corporate market will also boost data growth. The development of digital villages such as in Athi River and e-government initiatives n the country present exciting growth prospects for Safaricom.

## Valuation and Recommendation

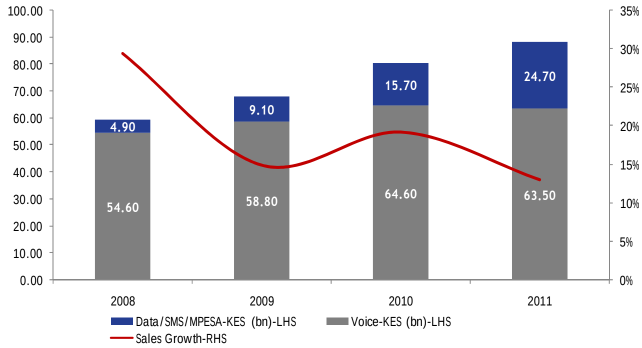
**Still looking cheap**. The significant potential in broadband and the notable opportunity that could arise from VAS and M-PESA. It worth noting however that Safaricom's PER (historic) of 9.7x is at a premium to Sonatel's 7.6x PER and Econet's 4.8x, but below the SSA average of 12.6x. In addition, an EV/EBITDA of 3.9x and EV/Sub of USD 85 lags behind SSA, MENA, emerging market and developed world averages. However, our view is that competition and regulatory threats remain elevated in the market. Our valuation points to a target price of KES 3.5, implying 9.0% potential upside. **HOLD**

**Fig 34: ARPU Analysis**



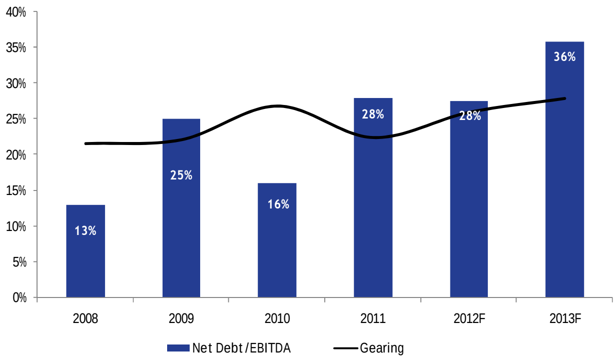

Source: IAS/Company Reports

**Fig 35: Revenue Analysis**



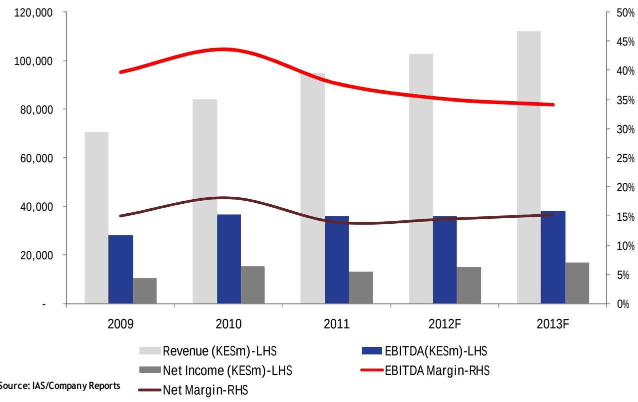

Source: IAS/Company Reports

**Fig 36: Analysis of Debt Levels**




Source: IAS/Company Reports

**Fig 37: Safaricom Financial Analysis**




Source: IAS/Company Reports

## SAFARICOM - 5 YEAR CGR COMPARISON

| 31 MAR (KESm) | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012F | 2013F | 5yr CAGR |
|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | | | |
| **Shareholders funds** | 23,771 | 32,789 | 42,643 | 51,147 | 62,295 | 67,454 | 70,827 | 74,368 | 23% |
| Bank borrowings | 5,000 | 6,200 | 6,480 | 4,775 | 7,610 | 12,105 | 13,315 | 14,913 | 19% |
| Shareholders loans | 4,235 | 4,235 | - | - | 395 | 178 | 267 | 401 | -47% |
| **Total Liabilities and equity** | 43,945 | 56,408 | 77,085 | 91,682 | 70,301 | 79,737 | 84,409 | 89,682 | 13% |
| PPE | 32,791 | 42,732 | 56,480 | 69,035 | 73,090 | 83,023 | 88,004 | 93,284 | 20% |
| Current Assets | 7,534 | 10,150 | 12,887 | 17,402 | 22,567 | 21,590 | 22,920 | 24,354 | 23% |
| **Total Assets** | 43,945 | 56,408 | 74,364 | 91,582 | 101,065 | 109,978 | 116,344 | 123,114 | |
| **Income Statement** | | | | | | | | | |
| **Total Revenues** | **34,972** | **47,447** | **61,369** | **70,480** | **83,961** | **94,832** | **102,419** | **111,636** | 22% |
| Cost of Sales | (12,916) | (18,155) | (26,066) | (32,788) | (36,554) | (45,795) | (50,185) | (53,586) | 29% |
| **Gross Profit** | 22,056 | 29,292 | 35,303 | 37,691 | 47,406 | 49,038 | 52,234 | 58,051 | 17% |
| Other operating income | 11 | 17 | 5 | 16 | 15 | 36 | 55 | 82 | 28% |
| **Total Operating Expenses** | **(9,280)** | **(11,504)** | **(16,946)** | **(21,516)** | **(24,796)** | **(29,648)** | **(31,079)** | **(32,573)** | 26% |
| **EBITDA** | 18,570 | 24,149 | 28,041 | 27,951 | 36,604 | 35,723 | 35,847 | 37,956 | 14% |
| **Profit before Tax** | 12,211 | 18,384 | 19,945 | 15,304 | 20,967 | 18,361 | 20,484 | 23,444 | 9% |
| Taxation | (3,785) | (5,182) | (5,385) | (4,767) | (5,819) | (5,202) | (5,735) | (6,564) | 7% |
| **Profit after Tax** | 8,425 | 13,202 | 14,560 | 10,537 | 15,148 | 13,159 | 14,748 | 16,879 | 9% |
| **Ratios** | | | | | | | | | |
| Weighted shares (m) | 40,000 | 40,000 | 40,000 | 40,000 | 40,000 | 40,000 | 40,000 | 40,000 | |
| EPS (KES) | 0.21 | 0.33 | 0.36 | 0.26 | 0.38 | 0.33 | 0.37 | 0.42 | |
| DPS (KES) | 0.07 | 0.10 | 0.05 | 0.10 | 0.20 | 0.20 | 0.30 | 0.35 | |
| NAV/Share | 0.59 | 0.82 | 1.07 | 1.28 | 1.56 | 1.69 | 1.77 | 1.86 | |
| Dividend Cover | 2.82 | 3.30 | 7.28 | 2.63 | 1.89 | 1.64 | 1.23 | 1.21 | |
| Dividend Yield | 2.3% | 3.1% | 1.6% | 3.1% | 6.3% | 6.3% | 9.4% | 10.9% | |
| **Growth Ratios** | | | | | | | | | |
| Sales growth (%) | | 35.7% | 29.3% | 14.8% | 19.1% | 12.9% | 8.0% | 9.0% | |
| EBITDA growth (%) | | 30.0% | 16.1% | -0.3% | 31.0% | -2.4% | 0.3% | 5.9% | |
| Op Profit growth (%) | | 39.2% | 3.2% | -11.9% | 39.8% | -14.2% | 9.1% | 20.4% | |
| PBT growth (%) | | 50.6% | 8.5% | -23.3% | 37.0% | -12.4% | 11.6% | 14.5% | |
| Earnings growth (%) | | 56.7% | 10.3% | -27.6% | 43.8% | -13.1% | 12.1% | 14.5% | |
| **Margins** | | | | | | | | | |
| Gross Margin | 63.1% | 61.7% | 57.5% | 53.5% | 56.5% | 51.7% | 51.0% | 52.0% | |
| EBITDA margin | 53.1% | 50.9% | 45.7% | 39.7% | 43.6% | 37.7% | 35.0% | 34.0% | |
| OP margin | 36.5% | 37.5% | 29.9% | 23.0% | 26.9% | 20.4% | 20.7% | 22.8% | |
| PBT margin | 34.9% | 38.7% | 32.5% | 21.7% | 25.0% | 19.4% | 20.0% | 21.0% | |
| Earnings Margin | 24.1% | 27.8% | 23.7% | 15.0% | 18.0% | 13.9% | 14.4% | 15.1% | |
| Effective Tax Rate | 31.0% | 28.2% | 27.0% | 31.2% | 27.8% | 28.3% | 28.0% | 28.0% | |

## SONATEL SA

*Winds of change dampening prospects…*

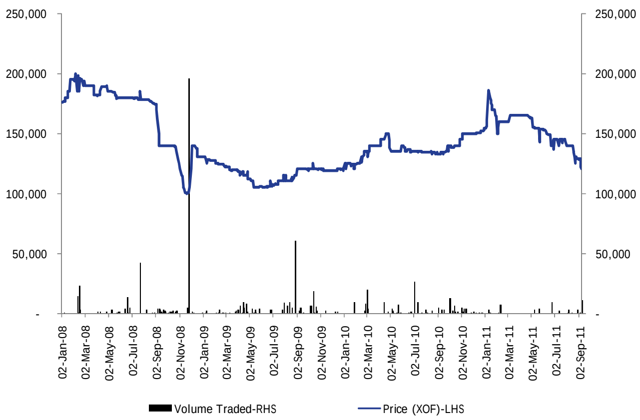
**Sonatel is now actively looking for acquisitions in West Africa, meaning that existing mobile operators in West Africa could be a potential target for Sonatel. In addition, there appears to be untapped potential in the company's core markets of Senegal, Mali and Guinea for mobile telephony and internet.**

- **Regulatory threats looming in the key market.** New regulatory charges in Senegal may affect the company's bottom line in FY 2011. The government's controversial tax on international incoming calls will likely result in a 10% decline in FY 2011 revenues. The new tax would also lead to many more Senegalese living overseas to use VoIP-based alternatives so as to circumvent paying the higher rates Sonatel will have to charge. The proposed tax adds XOF 49.20 (USD 0.10) per minute on calls made from outside the country (up 53% on the previous rate) while calls to fixed numbers impose an extra XOF 75.45 on users. Given that international calls account for more than 67% annual turnover, the development is likely to retard the company's growth momentum.

- **We expect the counter to be resilient to downside risks.** Sonatel has indicated that it consider raising fees on overseas calls to offset the impact of the new tax structure. Our **BUY** recommendation is endorsed by the relative resilience of the sector in general, the healthy dividend yield of 11.5%, and the operator's diversified revenue streams (across various geographies) underpinned further by VAS as a new revenue stream and the significant bundling opportunity that could arise in the region.

| BLOOMBERG: SNTS:BC | | | BUY |
|---|---|---|---|
| Current price (XOF) | | | 122,000 |
| Current price (USD) | | | 254.7 |
| Target price (XOF) | | | 150,901.1 |
| Target price (USD) | | | 315.0 |
| Upside/Downside (%) | | | 24% |
| **Liquidity** | | | |
| Market Cap (XOFm) | | | 1,220,000 |
| Market Cap (USDm) | | | 2,546.7 |
| Shares (m) | | | 10 |
| Free float (%) | | | 20 |
| Ave. daily vol | | | 837 |
| **Share price performance** | | | |
| 6 Months (%) | | 165,000 | -26% |
| Relative change (%)* | | | -18% |
| 12 Months (%) | | 133,000 | -8% |
| Relative change (%)* | | | -11% |
| **Relative to MSCI Index* | | | |
| **Financials (USDm) - FY 31 Dec** | **2010** | **2011F** | **2012F** |
| Turnover | 620,157 | 659,198 | 710,339 |
| EBITDA | 323,520 | 336,191 | 361,098 |
| Profit before tax | 220,178 | 230,645 | 257,568 |
| Attributable earnings | 159,631 | 158,684 | 174,992 |
| EPS (XOF) | 15,963 | 15,868 | 17,499 |
| NAV/share (XOF) | 52,450 | 55,072 | 57,826 |
| DPS (XOF) | 14,000 | 14,426 | 15,908 |
| **Valuation Ratios** | **2010** | **2011F** | **2012F** |
| Subscribers' 000 | 11,280 | 12,800 | 13,500 |
| PER (x) | 7.6 | 7.7 | 7.0 |
| PBV (x) | 2.3 | 2.2 | 2.1 |
| EV/EBITDA (x) | 3.7 | 3.8 | 3.5 |
| Gross ARPU (USD) | 9.6 | 9.0 | 9.2 |
| EV/Subscriber (USD) | 218.8 | 208.2 | 197.8 |
| EBITDA Margin | 52.2% | 51.0% | 50.8% |
| Earnings Yield | 13.1% | 13.0% | 14.3% |
| Dividend Yield | 11.5% | 11.8% | 13.0% |
| Gearing | 11.5% | 11.8% | 13.0% |
| RoaA | 16.8% | 15.6% | 17.0% |
| RoaE | 31.2% | 29.5% | 31.0% |

**Sonatel :Price Vs Volume**




| STRENGTHS | WEAKNESSES |
|---|---|
| Strong brand name<br>Experiencing growth in subsribber numbers despite competitive threats<br>Strategic relationship with France Telecom ensures support in terms of technical and financial support | Demand for data services may be constrained by a lack of corporate demand |
| **OPPORTUNITIES** | **THREATS** |
| Low mobile penetration in Mali (52%)<br>Considerable scope for growth in broadband as a result of the launch of the ACE Cable<br>Increased economic activity in Franco phone West Africa | Competion in key markets ie Senegal and Mali<br>Regualtor threats ie taxes<br>Economic slow down<br>Foreign currency shortages |

## Nature of Operations

Sonatel, which is 42.0% owned by France Telecom (one of the largest operators worldwide) is the dominant telecom firm in Senegal and Mali, and is the largest company by value on the BRVM. Operating in four countries with a population of 40.0m inhabitants, the company offers fixed, mobile, internet and TV services, serving approximately 12.8m subscribers. The company is also 28% by the Senegalese government.

France Telecom provides the technical and commercial support in order to enable the Sonatel group to remain the reference operator in the sub region. Over the years, the partnership has put an emphasis on the improvement of rural coverage in the best technical economical conditions, the launch of TV via ADSL and the implementation of the brand evolution strategy (*Orange*).

## Market Dynamics

The intense competition on the mobile market in both Senegal and Mali has, to a large extent been an additional stimulant for Sonatel to implement an efficient commercial and marketing strategy with permanent innovations. In Senegal, one of the competitors is a Sudanese firm, Sudatel. In Mali, the government is reportedly inviting bids for a third telecoms licence, as it is looking to cater for the interests of the consumers as well as maximise receipts for the public treasury. At present, there are just two telecoms operators in Mali, state-owned Societe des Telecommunications du Mali (SOTELMA), which also controls the country's largest cellco by subscribers Malitel, and Orange Mali. Both operators currently offer fixed line and mobile voice services, in addition to broadband via both ADSL and wireless in the local loop or WiMAX.

## Overview of H1 2011 Financial Performance

**Revenue trend positive despite stiff competition.** Revenues for H1 2011 maintained an upward trend growing 5.70% to XOF 312.3bn despite fiercer competition and the unfavourable XOF/Guinean franc exchange rate.

**The increase in fiscal charges was the main dampener.** Operational and fiscal charges increased significantly, resulting in a drop of 20% in net income. External services, which represent the largest part of operating expenses, also recorded an increase of 13.1%. Furthermore, the "tax break" in Mali came to an end.

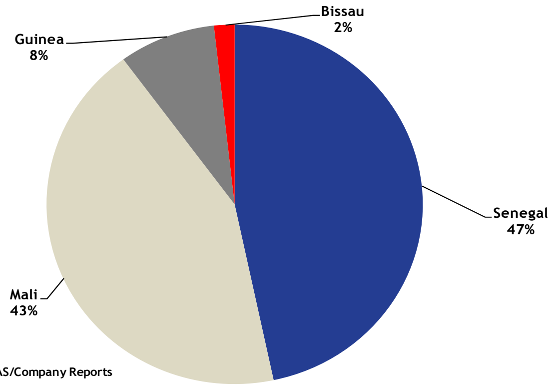
**EBITDA margins down, but still attractive.** EBITDA for H1 2011 declined 2.0% to XOF 163.8bn from XOF 167.5bn in H1 2010. Consequently, the EBITDA margin declined by 426 basis points to 52.4%. A key note however is that the group has maintained a satisfying level of profitability with EBITDA margins above 50%.

According to management, Sonatel plans to keep its EBITDA margin above 50% during FY 2012, and keep its dividend payment to shareholders at current levels, at the very least. Overall, Sonatel's net profit totalled XOF 75.4bn (USD 161.0m) for H1 2011.

| Shareholder Structure | % Shareholding |
|---|---|
| France Telecom | 42.3% |
| Government | 27.7% |
| Employee Trust | 10.0% |
| Free float | 20.0% |

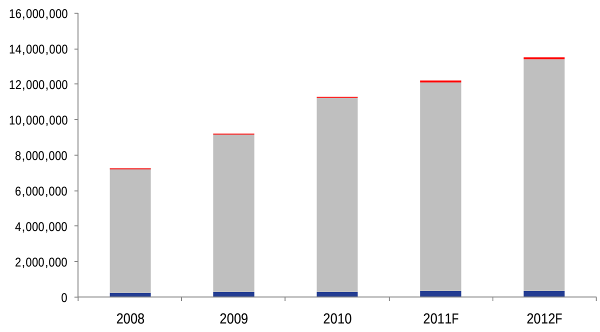
Source: IAS

**Fig 38: Disaggregation of Mobile Subscribers**




Source: IAS/Company Reports

**Fig 39: Evolution of Subscriber Numbers**




Source: IAS/Company Reports

| Operational Data | H1 2010 | H1 2011 | % Δ |
|---|---|---|---|
| **Subscribers** | | | |
| Mobile | 9,795,715 | 12,843,724 | 31.1% |
| Fixed | 269,436 | 288,479 | 7.1% |
| Internet | 72,508 | 105,337 | 45.3% |
| **Income Statement (XOFm)** | **H1 2010** | **H1 2011** | **% Δ** |
| Revenue | 295,416 | 312,254 | 6% |
| EBITDA | 167,540 | 163,774 | -2% |
| EBIT | 115,815 | 114,450 | -1% |
| Profit after tax | 94,452 | 75,358 | -20% |
| Capex | 30,000 | 37,000 | 23% |
| EBITDA Margin | 56.7% | 52.4% | |
| Earnings Margin | 32.0% | 24.1% | |

## Operational Review

**Strong growth in subscriber numbers.** Operational figures were positive as mobile subscriptions grew 31% compared to H1 2010, reaching 12.8m active customers at the end of H1 2011, mainly due to multi-equipment development and larger offerings of prepaid plans. The internet segment saw the greatest expansion with a 45.3% growth in subscriptions. Fixed subscribers grew at a single digit growth rate of 7.1% to 288,479 subscribers.

**Data revenue growth disappointing.** The group continues to lag behind its peers such as Safaricom in terms of growth in the data segment. Data subscribers only represent 2.3% of the total subscriber base versus 20% for Safaricom. In 2010, Sonatel launched a mobile money payment business and registered about 295,000 as of December 2010. Sonatel was also awarded a 3G licence in Mali and Senegal. The operator has since started deploying 3G infrastructure in the two countries.

**Capex on the increase**. Sonatel expects to increase its capex by at least 10% in FY 2011. The company plans to spend at least XOF 100.0bn (USD 211.0m) in FY 2011, compared with XOF 90.0bn in FY 2010. This will go towards reinforcing the company's voice and data capacity and expanding coverage in Mali and Guinea.

## Outlook

**ACE submarine cable expected to boost growth prospects in the long term**. The submarine cable ACE (Africa Coast to Europe) will allow the greatest number of countries in Franco-phone West Africa to access the network high-speed world. This new optic cable fibre, with a length 17,000km in its current configuration, will be put into service in the H1 2012. It will serve 23 countries, either by direct access to countries along the coast or through a connected country for countries with no access to the sea.

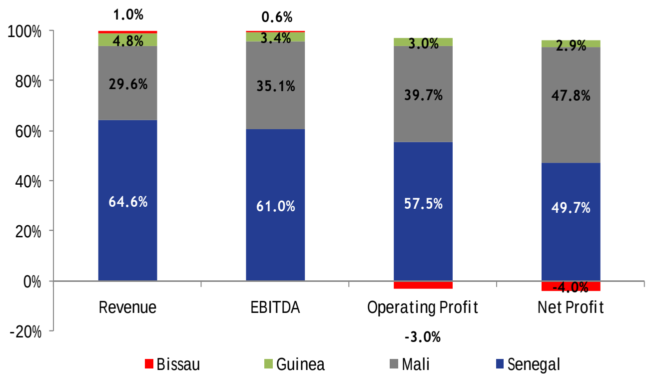
The cable construction represents an investment of about USD 690.0m for the consortium, of which about USD 180.0m should be supported by the various subsidiaries. Given its relationship with France Telecom, Sonatel is positioned to reap the rewards of the mega investment.

**Competition to remain a common phenomenon across all market.** Sonatel's markets are still characterised by increased competition. Despite efforts by the group to maintain a relatively strong position its key markets. In Senegal, there is increased competition from operators such as Millicom whereas in Mali, the company competes with Maroc Telecom's Malitel. The group's strategy is hinged on continuing its policy focused on providing a high quality technical service and commercial so as to remain competitive.

## Valuation and Recommendation

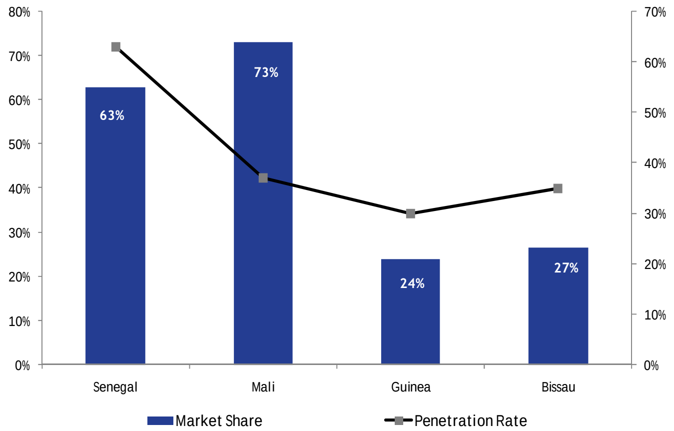
Sonatel trades currently at a discount to SSA and MENA peers, having a PER (T+1) of 7.7x, significantly lower than the SSA average of 10.7x, Our valuation points to at target price of XOF 150,901, implying 24% potential upside. **BUY**

**Fig 40: Contribution of Entities**



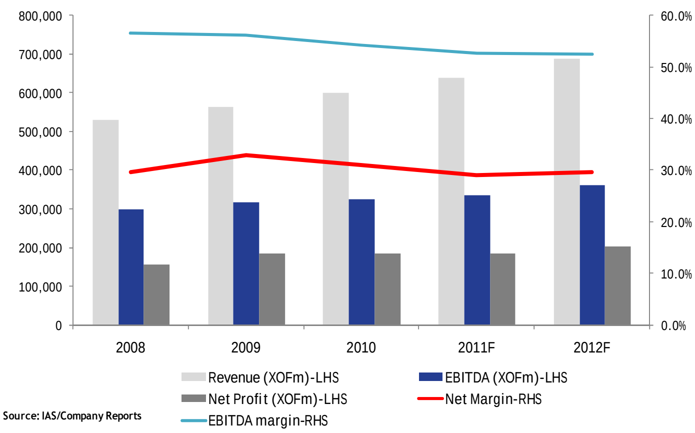

Source: IAS/Company Reports

**Fig 41: Sonatel Market Share Statistics**




Source: IAS/Company Reports

**Fig 42: Sonatel Financial Analysis**




Source: IAS/Company Reports

## SONATEL - 5 YEAR CGR COMPARISON

| 31 DEC (XOFm) | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011F | 2012F | 5yr CAGR |
|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | | | |
| Shareholders' equity | 325,788 | 386,714 | 438,937 | 465,422 | 499,955 | 524,495 | 550,720 | 578,256 | 10.0% |
| Minority interests | 21,464 | 32,620 | 47,632 | 42,510 | 56,930 | 66,919.00 | 67,588.19 | 68,264.07 | 25.5% |
| **Total shareholders' equity** | **347,252** | **419,334** | **486,569** | **507,932** | **556,885** | **591,414** | **618,308** | **646,520** | 11.2% |
| Current Liabilities | 153,506 | 166,384 | 197,951 | 235,332 | 223,175 | 288,382 | 294,150 | 300,033 | 13.4% |
| **Total Liabilities and equity** | **565,849** | **655,308** | **743,175** | **831,839** | **884,103** | **1,014,224** | **1,024,366** | **1,034,610** | 12.4% |
| Fixed Assets | 278,245 | 333,086 | 399,673 | 432,169 | 440,439 | 458,350 | 481,268 | 505,331 | 10.5% |
| Current Assets | 287,604 | 322,222 | 343,502 | 399,670 | 443,664 | 555,874 | 543,099 | 529,279 | 14.1% |
| **Total Assets** | **565,849** | **655,308** | **743,175** | **831,839** | **884,103** | **1,014,224** | **1,024,366** | **1,034,610** | 12.4% |
| **Income Statement** | | | | | | | | | |
| **Sales** | **336,100** | **409,299** | **504,668** | **546,653** | **593,754** | **620,157** | **659,198** | **710,339** | 13.0% |
| Value added | 230,418 | 281,847 | 322,494 | 343,593 | 376,623 | 382,750 | 402,111 | 449,890 | 10.7% |
| Staff costs | **37,167** | **38,227** | **45,639** | **50,496** | **57,058** | **59,230** | **65,920** | **88,792** | 9.8% |
| **EBITDA** | 193,251 | 243,620 | 276,855 | 293,097 | 319,565 | 323,520 | 336,191 | 361,098 | 10.9% |
| Finance income | **3,892** | **3,511** | **5,192** | **10,549** | **9,487** | **13,501** | **14,446** | **15,457** | 28.2% |
| Finance expenses | (2,724) | (5,476) | (10,096) | (7,479) | (8,535) | (10,656) | (17,569) | (18,271) | 31.4% |
| **Profit before Tax** | 147,346 | 182,107 | 197,308 | 193,036 | 224,728 | 220,178 | 230,645 | 257,568 | 8.4% |
| Taxation | (31,882) | (36,796) | (36,728) | (34,043) | (41,375) | (35,898) | (46,129) | (54,089) | 2.4% |
| **Profit after Tax** | 116,396 | 146,617 | 161,205 | 156,825 | 185,028 | 184,760 | 184,516 | 203,479 | 9.7% |
| **Attributable Income** | 105,548 | 130,628 | 140,967 | 136,578 | 163,603 | 159,631 | 158,684 | 174,992 | 8.6% |
| **Ratios** | | | | | | | | | |
| Weighted shares (m) | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | |
| EPS (XOF) | 10,555 | 13,063 | 14,097 | 13,658 | 16,360 | 15,963 | 15,868 | 17,499 | |
| DPS (XOF) | 6,210 | 7,947 | 9,900 | 13,000 | 13,500 | 14,000 | 14,426 | 15,908 | |
| NAV/Share | 32,579 | 38,671 | 43,894 | 46,542 | 49,996 | 52,450 | 55,072 | 57,826 | |
| Dividend Cover | 1.70 | 1.64 | 1.42 | 1.05 | 1.21 | 1.14 | 1.10 | 1.10 | |
| Dividend Yield | 5.1% | 6.5% | 8.1% | 10.7% | 11.1% | 11.5% | 11.8% | 13.0% | |
| **Growth Ratios** | | | | | | | | | |
| Sales growth (%) | | 21.8% | 23.3% | 8.3% | 8.6% | 4.4% | 6.3% | 7.8% | |
| EBITDA growth (%) | | 26.1% | 13.6% | 5.9% | 9.0% | 1.2% | 3.9% | 7.4% | |
| Op Profit growth (%) | | 29.1% | 9.9% | -4.8% | 15.3% | 1.9% | 4.9% | 10.0% | |
| PBT growth (%) | | 23.6% | 8.3% | -2.2% | 16.4% | -2.0% | 4.8% | 11.7% | |
| Earnings growth (%) | | 23.8% | 7.9% | -3.1% | 19.8% | -2.4% | -0.6% | 10.3% | |
| **Margins** | | | | | | | | | |
| EBITDA margin | 57.5% | 59.5% | 54.9% | 53.6% | 53.8% | 52.2% | 51.0% | 50.8% | |
| OP margin | 42.7% | 45.3% | 40.4% | 35.5% | 37.7% | 36.8% | 36.3% | 37.0% | |
| PBT margin | 43.8% | 44.5% | 39.1% | 35.3% | 37.8% | 35.5% | 35.0% | 36.3% | |
| Earnings Margin | 31.4% | 31.9% | 27.9% | 25.0% | 27.6% | 25.7% | 24.1% | 24.6% | |
| Effective Tax Rate | 22.3% | 20.9% | 18.9% | 16.5% | 19.2% | 16.5% | 20.0% | 21.0% | |

## Telekom Networks Malawi (TNM)

*Smart growth over the years…*

**While Telekom Networks Malawi (TNM) has indicated that it is currently in talks with a potential strategic equity partner, indications are that it could be on the table with Vodacom Group. The telco is currently owned by Malawi Telecommunications Limited (MTL, 44.44%), First Merchant Bank (12.92%), local conglomerate Press Corporation Limited (10.46%), Old Mutual (10.46%) and employees (1%), with 20.7% of shares in free float. At the end of June 2011, TNM had more than 1.2m subscribers, claiming a 36.8% share of the country's mobile market.**

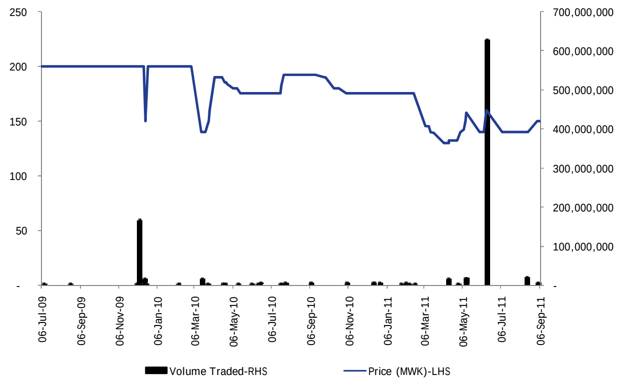
- **Strategically positioned.** It would appear that TNM is geared to be a competitive force in the mobile telecommunications sector. We have seen milestone achievements such as the construction of new base stations for wider network coverage, commissioning of a new Online Charging System (OCS) for pre-paid services, introduction of 3G services, the launch of affordable voice and data bundles and commissioning a new billing system for post-paid service.

- **Loan facility to finance capex projects.** TNM has revealed that it has secured a long-term loan facility from a syndicate of local banks to finance its on-going capital investment programs. TNM plans to upgrade and develop its infrastructure with the addition of innovative products. The group plans to expand coverage of 3.5G to more centres.

- **Lacklustre valuation metrics.** TNM trades at a demanding PER of 17.9x, relative to its SSA peers. Forward ratings are also demanding with a PER (T+1) of 13.4x. However, reports that Vodacom could be vying for a stake in the telco, present a speculative opportunity in our view. **SPEC BUY.**

| BLOOMBERG:TNM:MW | | | SPEC BUY |
|---|---|---|---|
| Current price (MWK) | | | 1.89 |
| Current price (USc) | | | 1.15 |
| Target price (MWK) | | | 2.00 |
| Target price (USc) | | | 1.21 |
| Upside/Downside (%) | | | 6% |
| **Liquidity** | | | |
| Market Cap (MWKm) | | | 18,976.5 |
| Market Cap (USDm) | | | 115.2 |
| Shares (m) | | | 10,040.5 |
| Free float (%) | | | 21.7 |
| Ave. daily vol ('000) | | | 12,950 |
| **Share price performance** | | | |
| 6 Months (%) | | 2.00 | -5.5% |
| Relative change (%)* | | | 2.7% |
| 12 Months (%) | | 1.92 | -1.6% |
| Relative change (%)* | | | -4.0% |
| **Relative to MSCI Index* | | | |
| **Financials** | **2010** | **2011F** | **2012F** |
| Turnover | 9,930.5 | 12,767.9 | 16,426.1 |
| EBITDA | 3,646.9 | 4,916.1 | 6,596.4 |
| Attributable earnings | 1,059.7 | 1,418.7 | 2,177.6 |
| EPS (t) | 10.6 | 14.1 | 21.7 |
| DPS (t) | 5.3 | 7.1 | 10.8 |
| NAV/share (t) | 72.5 | 79.5 | 90.4 |
| **Valuation Ratios** | **2010** | **2011F** | **2012F** |
| Subscribers' 000 | 1,034.4 | 1,500.0 | 1,616.5 |
| PBV (x) | 2.6 | 2.4 | 2.1 |
| PER (x) | 17.9 | 13.4 | 8.7 |
| EV/EBITDA(x) | 5.7 | 4.2 | 2.9 |
| Gross ARPU (USD) | 6.0 | 6.2 | 6.2 |
| EV/Subscriber (USD) | 221.2 | 152.5 | 141.5 |
| EBITDA Margin | 36.7% | 38.5% | 40.2% |
| Earnings Yield | 5.6% | 7.5% | 11.5% |
| Dividend Yield | 2.8% | 3.7% | 5.7% |
| Gearing | 23.0% | 17.9% | 3.3% |
| RoaA | 7.7% | 8.2% | 10.4% |
| RoaE | 15.0% | 18.6% | 25.5% |

**TNM: Price Vs Volume**




| STRENGTHS | WEAKNESSES |
|---|---|
| Strong brand name in Malawi<br>International gateway enables the provision of related services at lower rates<br>First mover advantage | With a low per capita GDP , growth prospects may be limited<br>Demand for data services may be constrained by a lack of corporate demand beyond major financial institutions. |
| **OPPORTUNITIES** | **THREATS** |
| Low mobile penetration<br>Considerable scope for growth in high bandwidth application<br>Increase network coverage<br>Increased economic activity | Increased competion<br>Falling calling rates<br>Economic slowdown<br>Foreign currency shortages and inflationary pressures<br>Political risks |

## Nature of Operations

TNM Limited is a communications and technology company and is the second largest GSM mobile operator in Malawi having been awarded a 15-year licence from 28 May 1999. The company enjoys a market share of approximately 37% of the mobile sector and has more than 1.0m subscribers with over 200 base stations covering circa 50% of the country's geographic reach.

Listed on the MSE, it was established in 1995 as a joint venture between Telekom Malaysia and the then government owned Malawi Telecommunications Limited (MTL). In April 2007, Telekom Malaysia sold its 60% majority stake in TNM.

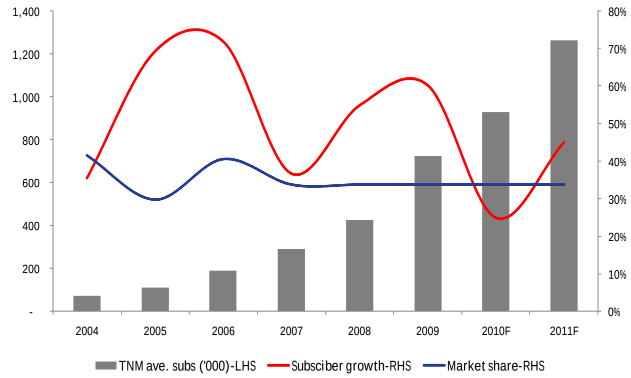
| Shareholder Structure | % Shareholding |
|---|---|
| Malawi Telecomms Limited | 44.4% |
| Livingstone Holdings Telecom | 12.9% |
| Old Mutual Life Assuarance | 10.5% |
| Press Corporation Limited | 10.5% |
| Free float | 21.7% |

Source: IAS

## Market Dynamics

Most African markets have experienced growth rates in mobile subscriber numbers in excess of 50% per annum. Malawi is a case in point, having increased its penetration rate from an estimated 7.0% in 2007 to c21%, currently. Economic growth in the country continues to underpin the telecoms sector growth. In response to significant investment by telecom operators, efficiency, quantity and quality of services is improving to meet the economic and social needs of the country.

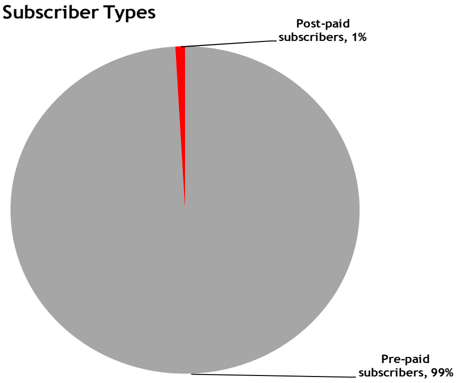
Fig 43: Subscriber Growth Vs Market Share




Source: IAS/Company Reports

The telecoms industry in Malawi has gone through a number of transformations. Fixed line operators that have traditionally focused on data and telephony started moving towards greater mobility. At the same time, the mobile phone industry ventured into data services with the launch of high speed mobile broadband data services. Growth for operators has also been driven by low-cost handsets in rural areas. Moreover, an introduction of VAS has also been another growth area.

Fig 44: Subscriber Types




In terms of market competition, TNM currently lags Bharti's Airtel Malawi. A key positive, however is that competition is only  limited to two mobile operators. The third largest mobile operator failed to roll out its network by the established deadline whilst the fourth and fifth largest operators had their licenses revoked. This leaves room for existing players to grow.

## Overview of H1 2011 Financial Performance

**Solid results.** TNM released its H1 2011 results, indicating a 23% increase in revenue to MWK 5.3bn (USD 31.3m). According to management, the growth was driven by a rise in subscriber numbers that came about as a result of new product offerings and marketing promotions.

**A slight boost in margins.** EBITDA rose 29% from MWK 1.54bn in H1 2010 to MWK 1.99bn, despite rising costs related to higher levels of network maintenance and support costs. As a result, the EBITDA margin improved slightly over the period, from 36% to 37%.  It is worth noting however that TNM has enjoyed healthy EBITDA margins of 52% for the past years but these have thinned to due to the network roll out. EBITDA margins are likely to hover around 35% compounded by the subsidy on handsets for new subscribers resulting in a higher marginal subscriber cost.

| Income Statement (MWKm) | H1 2010 | H1 2011 | % Δ |
|---|---|---|---|
| **Revenue** | **4,294.2** | **5,301.2** | **23%** |
| Direct operational costs | (1,584.3) | (1,869.4) | 18% |
| **Gross profit** | **2,709.9** | **3,431.8** | **27%** |
| **EBITDA** | **1,542.4** | **1,990.7** | **29%** |
| Operating proft | 776.3 | 983.9 | 27% |
| Net finance costs | (187.1) | (190.7) | 2% |
| Profit before tax | 589.2 | 783.2 | 33% |
| **Profit after tax** | **412.5** | **587.4** | **42%** |
| EPS (MWK) | 0.04 | 0.06 | 50% |
| DPS (MWK) | 0.02 | 0.02 | 0% |
| EBITDA Margin | 35.9% | 37.6% | 5% |
| PBT  Margin | 13.7% | 14.8% | 8% |
| Earnings Margin | 9.6% | 11.1% | 15% |

Overall, TNM recorded a profit after tax of MWK 587.0m for H1 2011, implying 42% growth over the MWK 412.0m recorded in H1 2010.

## Operational Review

**Talks with South Africa's Vodacom?** Indications are that South Africa's Vodacom is in talks to buy a stake in TNM. It also appears that TNM has streamlined some of its businesses to bring them closer in line with how Vodacom operates. Vodacom has previously announced that it is looking at expansion opportunities in Sub Saharan Africa. Vodacom is already a dominant mobile carrier in South Africa, and has operations in Tanzania, the Democratic Republic of Congo, Mozambique and Lesotho.

**Loan facility to finance capex projects.** TNM has revealed that it has secured a long-term loan facility from a syndicate of local banks to finance its on-going capital investment programs. TNM plans to upgrade and develop its infrastructure with the addition of innovative products. The group plans to expand coverage of 3.5G to more centres. Nonetheless, though the hope of new services remains high, the demand for such high-speed services remains limited. It remains unclear which applications will be able to attract average customers into paying higher bills. There is tremendous potential in the sector and competition is likely to increase.

Given the underlying industry dynamics, however, we believe TNM is perfectly positioned to capitalise on the strong projected growth that the telecoms industry is expected to experience over the next few years.

**A focus data services.** TNM became the first mobile operator to launch 3G services in 2009 and can now offer cutting edge services such as video calls, video and music streaming, high speed wireless internet access services 4-5 times faster than 2.5g and any other ISP provider on the market.

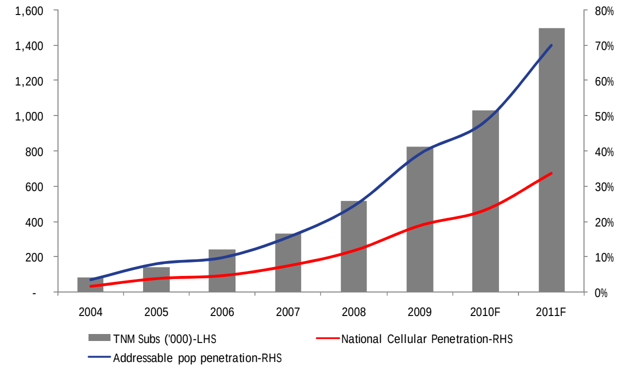
**Connectivity strengthened.** TNM has strengthened its quality and reliability through the International Satellite Gateway and now offers higher bandwidth and internet speed through its connection to the SEACOM Cable running via Mozambique. The international gateway provides interesting scope for expanding the hard currency earning side of the business.

**Leveraging on strategic partnerships.** Strategic relationships and agreements have been entered into with suppliers, banks and other network operators to boost airtime sales for all aspects of TNM's business. The internet business should support earnings growth. The demand for group products remains strong given the low mobile penetration rate in Malawi of circa 21%.

## Valuation and Recommendation

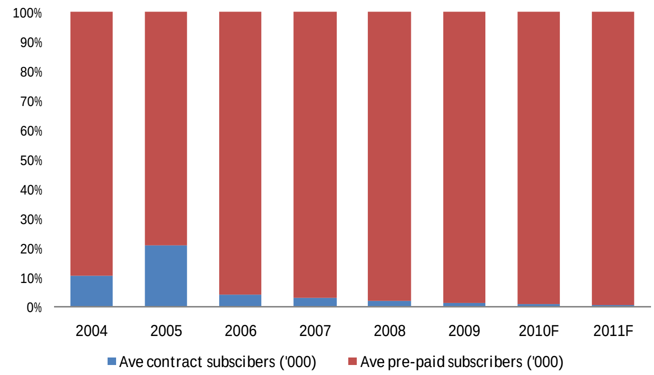
TNM trades at a demanding PER of 16.6x, relative to its SSA peers. Forward ratings are also demanding with a PER (T+1) of 13.4x. Reports that Vodacom could be vying for a stake in the telco, present a speculative opportunity in our view. We believe a group such as Vodacom has the financial strength and operational expertise to swiftly turnaround the fortunes of TNM within the Malawan market. **SPEC BUY.**

**Fig 45: Subscribers Vs Mobile Penetration Levels**



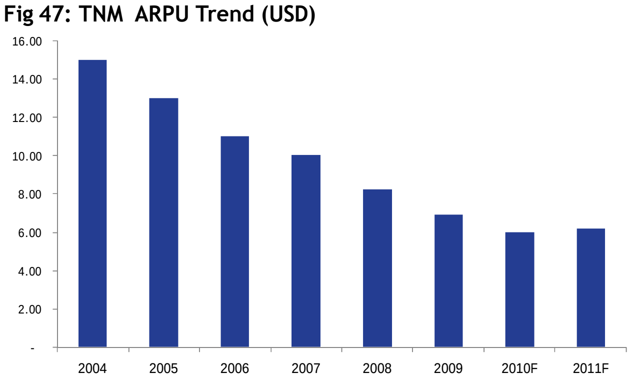

Source: IAS/Company Reports

**Fig 46: Disaggregation of Subscriber Types**



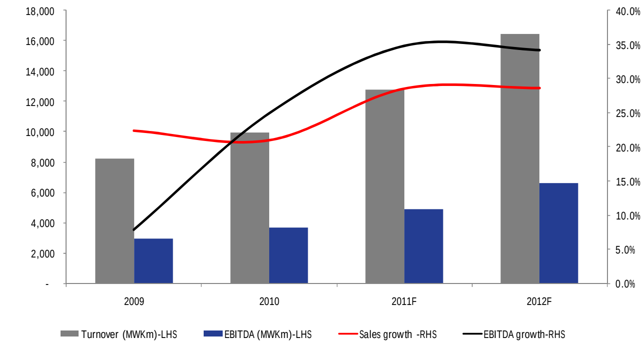

Source: IAS/Company Reports

**Fig 47: TNM ARPU Trend (USD)**




Source: IAS/Company Reports

**Fig 48: TNM Financial Analysis**




Source: IAS/Company Reports

## TNM - 5 YEAR CGR COMPARISON

| 31 DECEMBER (MWKm) | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011F | 2012F | 5yr CAGR |
|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | | | |
| Shareholders' equity | 1,256.0 | 2,525.6 | 3,158.2 | 6,205.9 | 6,818.2 | 7,275.5 | 7,984.9 | 9,073.7 | 42% |
| Minority interests | | | | | | | | | |
| **Total shareholders' equity** | **1,256.0** | **2,788.2** | **3,351.6** | **6,490.7** | **7,252.7** | **7,943.3** | **9,029.6** | **10,696.8** | 45% |
| Interest Bearing Debt | 572.4 | 178.4 | - | - | 2,145.4 | 2,523.4 | 2,392.6 | 2,342.2 | 35% |
| Trade creditors | 277.4 | 350.8 | 544.0 | 1,337.4 | 1,682.2 | 4,583.7 | 6,482.8 | 9,174.2 | 75% |
| Current Liabilities | 1,322.1 | 757.7 | 1,067.6 | 2,137.9 | 2,329.7 | 5,198.1 | 7,356.8 | 10,243.5 | 31% |
| **Total Liabilities and equity** | **3,358.4** | **3,724.3** | **4,419.2** | **8,628.6** | **11,727.8** | **15,664.8** | **18,779.0** | **23,282.5** | 36% |
| Fixed Assets | 2,050.8 | 2,594.0 | 3,092.9 | 5,798.2 | 9,231.6 | 13,207.8 | 16,123.3 | 19,447.2 | 45% |
| Investments | | | | | | | | | |
| Stock - Trade net | 27.4 | 14.9 | 108.6 | 179.2 | 182.0 | 81.8 | 89.4 | 97.8 | 24% |
| Debtors | 571.5 | 810.4 | 344.7 | 1,074.0 | 797.7 | 598.0 | 661.9 | 732.5 | 1% |
| Cash at bank | 605.9 | 202.6 | 832.1 | 1,534.4 | 642.0 | 852.8 | 963.9 | 2,043.7 | 7% |
| Current Assets | 1,307.6 | 1,130.3 | 1,285.6 | 2,794.7 | 2,397.3 | 2,269.2 | 2,439.8 | 3,587.0 | 12% |
| **Total Assets** | **3,358.4** | **3,724.3** | **4,419.2** | **8,628.6** | **11,727.8** | **15,664.8** | **18,779.0** | **23,282.5** | 36% |
| **Income Statement** | | | | | | | | | |
| **Turnover** | 2,835.1 | 4,275.2 | 5,771.3 | 6,701.9 | 8,205.0 | 9,930.5 | 12,767.9 | 16,426.1 | 28% |
| **EBITDA** | **1,376.3** | **2,228.7** | **2,638.9** | **2,708.5** | **2,920.0** | **3,646.9** | **4,916.1** | **6,596.4** | 22% |
| Net finance income | (129.1) | (146.4) | 30.0 | 38.7 | (121.7) | (423.8) | (346.2) | (228.9) | 27% |
| **Profit before Tax** | **1,031.9** | **1,819.5** | **2,201.3** | **2,222.3** | **1,757.5** | **1,611.3** | **2,602.3** | **3,994.3** | 9% |
| Taxation | (537.5) | (549.8) | (748.8) | (692.3) | (542.7) | (551.6) | (1,183.6) | (1,816.7) | 1% |
| **Profit after Tax** | **494.3** | **1,269.7** | **1,452.5** | **1,530.0** | **1,214.8** | **1,059.7** | **1,418.7** | **2,177.6** | 16% |
| Minorities | | | | | | | | | |
| **Attributable Income** | **494.3** | **1,269.7** | **1,452.5** | **1,530.0** | **1,214.8** | **1,059.7** | **1,418.7** | **2,177.6** | 16% |
| **Ratios** | | | | | | | | | |
| Shares in issue (m) | | | | | 10,040.5 | 10,040.5 | 10,040.5 | 10,040.5 | |
| EPS(t) | 4.9 | 12.6 | 14.5 | 15.2 | 12.1 | 10.6 | 14.1 | 21.7 | |
| Cash EPS(t) | 9.3 | 15.9 | 19.2 | 20.5 | 24.0 | 28.9 | 37.5 | 51.1 | |
| DPS (t) | 5.6 | - | 9.4 | 7.2 | 6.0 | 5.3 | 7.1 | 10.8 | |
| NAV per share (t) | 12.5 | 25.2 | 31.5 | 61.8 | 67.9 | 72.5 | 79.5 | 90.4 | |
| Dividend Cover | 0.9 | n/a | 1.5 | 2.1 | 2.0 | 2.0 | 2.0 | 2.0 | |
| Dividend Yield | 3.0% | 0.0% | 5.0% | 3.8% | 3.2% | 2.8% | 3.7% | 5.7% | |
| **Growth Ratios** | | | | | | | | | |
| Sales growth | | 50.8% | 35.0% | 16.1% | 22.4% | 21.0% | 28.6% | 28.7% | |
| EBITDA growth | | 61.9% | 18.4% | 2.6% | 7.8% | 24.9% | 34.8% | 34.2% | |
| PBT growth | | 76.3% | 21.0% | 1.0% | -20.9% | -8.3% | 61.5% | 53.5% | |
| Earnings growth | | 156.9% | 14.4% | 5.3% | -20.6% | -12.8% | 33.9% | 53.5% | |
| **Margins** | | | | | | | | | |
| EBITDA Margin | 48.5% | 52.1% | 45.7% | 40.4% | 35.6% | 36.7% | 38.5% | 40.2% | |
| PBT Margin | 36.4% | 42.6% | 38.1% | 33.2% | 21.4% | 16.2% | 20.4% | 24.3% | |
| Earnings Margin | 17.4% | 29.7% | 25.2% | 22.8% | 14.8% | 10.7% | 11.1% | 13.3% | |
| Interest cover (times) | 9.0 | 13.4 | n/a | n/a | 15.4 | 4.8 | 8.5 | 18.4 | |
| Effective Tax Rate | 52.1% | 30.2% | 34.0% | 31.2% | 30.9% | 34.2% | 45.5% | 45.5% | |

EQUITY RESEARCH

SOUTH AFRICA

September 2011

TELECOMS

## VODACOM GROUP LIMITED

*Also looking to Africa...but wings remain clipped*

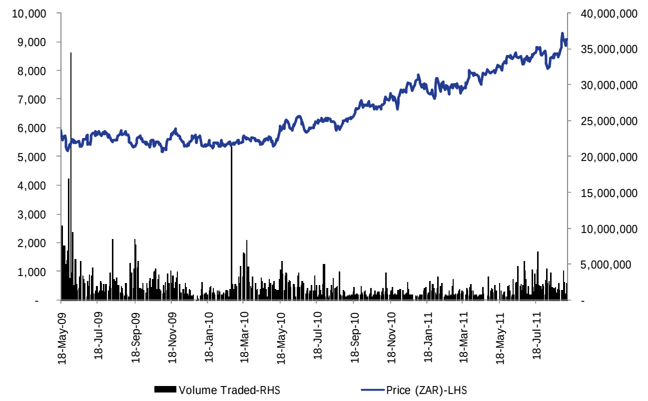
**Standard & Poor's (S&P) recently assigned its South African national scale long-term rating of zaAA and short term rating of zaA-1 to Vodacom Group for its strong financial performance. The ratings show Vodacom's capacity to meet specific financial obligations. Thanks to its resilient and strong position in South African mobile telephony, where Vodacom is the leading operator.**

- **Absa deal to boost customer numbers.** Vodacom and South Africa's largest retail bank, Absa recently announced a multi-million rand agreement, in which the two will collaborate in order to accelerate the pace of mobile innovation and expand the range of banking and mobile services on offer to consumers. We expect this to boost customer growth despite the intensifying competition and pressure on pricing.

- **Data and VAS opportunities exist.** Clearly, most of Vodacom's' SSA markets are still some years from reaching voice saturation. While, data use is still limited, there is a huge growth potential. The company has launched Vodacom M-PESA in Tanzania. The mobile money-transfer service has been a success in Tanzania where there are over 1.0m customers who generated transactions worth USD 169.0m in the month of March 2011 alone. However, take-up of Vodacom M-PESA in South Africa has been dismal with fewer than 100,000 registered customers as at 31 March 2011. The group is planning to launch Vodacom M-PESA in Lesotho and Mozambique in 2012.

- **Relative to MTN, the stock appears more attractive.** However, ratings are at a significant premium to our SSA averages.

**Vodacom: Price Vs Volume**




| BLOOMBERG: VOD:SJ | | NOT RATED |
|---|---|---|
| Current price (ZAR) | | 91.4 |
| Current price (USD) | | 12.3 |
| Target price (ZAR) | | |
| Target price (USD) | | |
| Upside/Downside (%) | | |
| **Liquidity** | | |
| Market Cap (ZARm) | | 136,058.5 |
| Market Cap (USDm) | | 18,343.3 |
| Shares (m) | | 1,488.0 |
| Free float (%) | | 16.0 |
| Ave. daily vol ('000) | | 1,431 |
| **Share price performance** | | |
| 6 Months (%) | 74.05 | 23.5% |
| Relative change (%)* | | 31.7% |
| 12 Months (%) | 62.82 | 45.6% |
| Relative change (%)* | | 43.2% |
| **Relative to MSCI Index* | | |

| Financials (ZARm) - FY 31 Mar | 2011 | 2012F | 2013F |
|---|---|---|---|
| Turnover | 61,197 | 64,563 | 69,405 |
| EBITDA | 19,051 | 20,520 | 23,160 |
| Profit before tax | 12,638 | 14,901 | 16,137 |
| Profit after tax | 7,979 | 9,373 | 9,918 |
| EPS (ZAR) | 5.62 | 6.46 | 6.81 |
| NAV/share (ZAR) | 10.64 | 10.43 | 10.37 |
| DPS (ZAR) | 3.55 | 4.07 | 4.29 |
| **Valuation Ratios** | **2011** | **2012F** | **2013F** |
| Subscribers' 000 | 43,500 | 45,000 | 47,000 |
| PER (x) | 16.28 | 14.15 | 13.43 |
| PBV (x) | 8.59 | 8.76 | 8.82 |
| EV/EBITDA (x) | 7.6 | 7.1 | 6.3 |
| Gross ARPU (USD) | 15.8 | 16.1 | 16.6 |
| EV/Subscriber (USD) | 451.2 | 436.4 | 417.5 |
| EBITDA Margin | 31.1% | 31.8% | 33.4% |
| Earnings Yield | 6.1% | 7.1% | 7.4% |
| Dividend Yield | 3.9% | 4.5% | 4.7% |
| Gearing | 66.5% | 69.9% | 73.4% |
| RoaA | 19.8% | 21.3% | 18.9% |
| RoaE | 56.2% | 61.7% | 65.5% |

| STRENGTHS | WEAKNESSES |
|---|---|
| Strong brand name onin South Africa<br>Financial strength and operational expertise enables the group to take advantage of acquisitions<br>Strategic partnerships e.g ABSA | Exposure to high risk countries<br>Exposure to currencies other than reporting currency creates translation-related risks |
| **OPPORTUNITIES** | **THREATS** |
| Low mobile penetration in SSA markets<br>Considerable scope for growth in data services<br>Further diversification of operating portfolio can reduce the concentration of risk | Increased regulations in various countries<br>Slowing revenue growth in some of the markets as a result of maturity<br>Shortages of skilled human resources |

## Nature of Operations

Vodacom is a communications group providing mobile communications and related services to approximately 43.5m customers. Its mobile network covers a total population of approximately 179.0m people across five countries; South Africa, Tanzania, the DRC, Lesotho and Mozambique. Vodacom's presence in Africa was strengthened with the acquisition of Gateway on 30 December 2008, which has customers in 40 countries in Africa, providing communications services to multi-national companies and telecommunications network operators. In addition, majority shareholder Vodafone Group has agreed to use Vodacom as its exclusive investment vehicle in Sub Saharan Africa

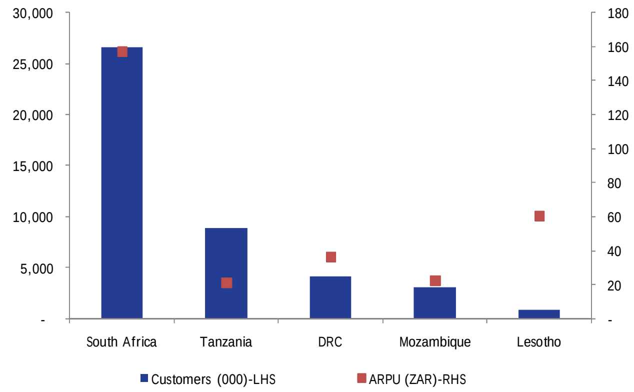
| Shareholder Structure | % Shareholding |
|---|---|
| Vodafone Group | 65.0% |
| South African Government | 13.9% |
| Government employees' pension fund | 5.4% |
| Free float | 16.0% |

Source: IAS

## Market Dynamics
## Regional Markets

Generally, the competitive environment in Sub Saharan Africa is increasingly becoming more intense. For example, price competition has been fierce in Tanzania and DRC with prices having fallen as low as USD 0.02 per minute in the former. Competitive pressure has contributed to an 18.0% a year decline in the effective price per minute across the group. New players have also entered the mobile data market. New forms of competition are also coming from handset manufacturers, internet companies and software providers, as well as systems integrators in the converged communications space.

**Fig 49: Vodacom ARPUs Vs Customer Numbers**




Source: IAS/Company Reports

## South African Market

Generally, the SA market is now mature and is displaying much more competitive behavior as compared to other SSA markets. There is also a threat of regulatory pressure over the next three years in South Africa, and continuing requirements for sizeable infrastructure investment.

The South African cellular industry is experiencing a rapid expansion in mobile broadband usage. Opportunities to grow voice revenues are diminishing as the industry nears saturation. As a result, Mobile Network Operators (MNOs) are increasingly looking to data services as the next growth frontier. Vodacom, for example, has gone as far as to cite mobile broadband as representing the future of the firm. Given Vodacom's intention to increasingly appeal to SA's mass market, we believe that Vodacom is nearing an inflection point and that the lower-margin, prepaid segment will be an increasingly dominant contributor in future

| Revenue | Q1 2010 | Q1 2012 | % Δ |
|---|---|---|---|
| South Africa | 12,567 | 13,537 | 7.7% |
| International | 1,922 | 2,119 | 10.2% |
| Corporate | (83) | (87) | 4.8% |
| **Total Revenue** | **14,406** | **15,569** | **8.1%** |
| **Service Revenue** | **Q1 2010** | **Q1 2012** | **% Δ** |
| South Africa | 11,012 | 11,558 | 5.0% |
| International | 1,859 | 2,064 | 11.0% |
| Corporate | (69) | (70) | 1.4% |
| **Total Service Revenue** | **12,802** | **13,552** | **5.9%** |
| **South Africa Indicators** | **Q1 2010** | **Q1 2012** | **% Δ** |
| Customers (m) | 23.2 | 27.7 | 19.7% |
| ARPU (ZAR) | 149 | 142 | -4.7% |
| **International Indicators** | **Q1 2010** | **Q1 2012** | **% Δ** |
| Customers (m) | 14.561 | 17.686 | 21.5% |
| ARPU (ZAR) | 36.25 | 32.5 | -10.3% |

## Overview of Q1 2012 Financial Performance

Vodacom reported an 8.1% rise in revenues for Q1 2012 to ZAR 15.6bn (USD 2.3bn), compared with ZAR 14.4bn in the previous period. Customer numbers increased 20.4% to 45.4m. Performance was largely driven by strong data growth, with group data revenue increasing 37.6% and active data customers increasing 43.3% to 10.9m.

## Operational Review
## South Africa Operations

A total of 1.2m customers were added in Q1 2012 and there was 16.3% y-o-y increase in average minutes of use. Prepaid customers closed at 22.4m adding just over 1.0m in the quarter.

Contract customer growth remained strong; up 13.9% to 5.3m. Gross connections were up 58.9% to 3.6m. Total ARPU was down 4.7% to ZAR 142, largely due to a 24.8% reduction in the effective price per minute, offset by a 16.3% increase in average minutes of use stimulated by off-peak promotional offers. Contract ARPU was down 10.2% to ZAR 369 due to strong growth of lower end contract packages and reduced out of bundle spend. Prepaid ARPUs remained flat at ZAR 79. Data revenue increased 35.4% to ZAR 1.86bn and active data customers grew 37.7% to 9.6m. PC connectivity devices increased by approximately 43,000 in the quarter to 1.1m. Active smart phones on the network increased by more than 0.4m to 3.7m.

Overall, South Africa delivered a robust performance with service revenue growing 5.0% to ZAR 11.56m mainly due to robust data growth. Revenue increased 7.7% outpacing service revenue growth, largely due to a 28.0% increase in equipment revenues. The group continued to make substantial investments in the network, to enhance quality and support the growth in data traffic, adding 107 3G base stations in the quarter.

## International Operations

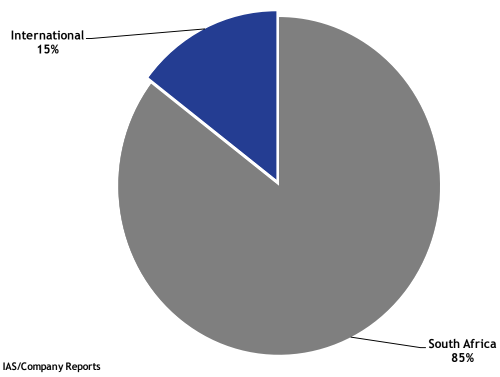
There was an improvement from the international operations. Revenue increased by 10.2% to ZAR 2.1bn. Service revenue increased by 11.0% to ZAR 2.1bn, largely due to growth in voice traffic of 10.8% offset by a decline in the effective price per minute of 2.3%. In local currencies, ARPU in Tanzania and Mozambique increased y-o-y. The International operations recorded customer growth of 21.5% to 17.7m, adding 729,000 customers in the quarter. While data revenue is only 4.4% of service revenue in the International operations, it increased by 109.3% mainly due to strong growth in M-PESA active customers to 1.6m in Tanzania, adding just over 342,000 in the quarter

## Outlook

**Service revenue to grow in “low single digits”.** Management has indicated it is likely for service revenue to grow in low single digits due to the effects of increased competition after the launch of 8ta and the ‘relaunch’ of Cell C. The group’s capex program (ZAR 7.7bn) will focus on the accelerated rollout of mobile broadband coverage which will support continued growth in demand for data services. Management said it aims to triple data users on its network to 25.0m users over the next 2 years.

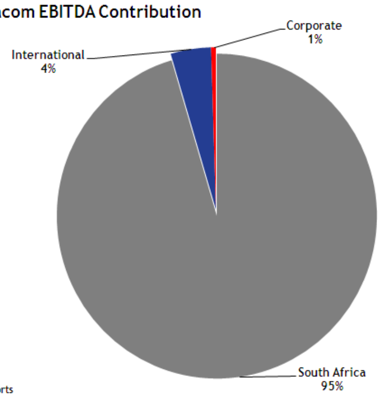
**Growth into Africa limited by Vodafone’s shareholding in the group.** Unlike MTN, Vodacom has kept its expansion drive “closer to home’, within the SADC region, given the fact that Vodafone is already invested directly in telcos such as Safaricom in Kenya. However, Vodafone has defined Vodacom as its Sub Saharan Africa investment vehicle. Growth going forward will therefore be a function of organic means, technology and service evolution, especially in data services. We also expect a spike in CAPEX in about 3 years time as LTE becomes a priority. In the absence of other opportunities, we believe that the company will likely return value to its shareholders through dividends.

Fig 50: Vodacom Revenue Contribution



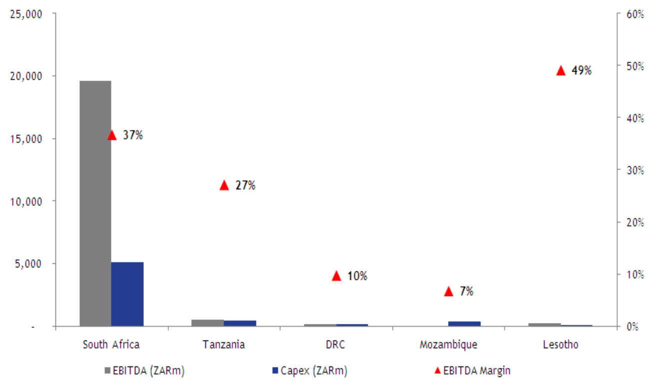

Source: IAS/Company Reports

Fig 51: Vodacom EBITDA Contribution



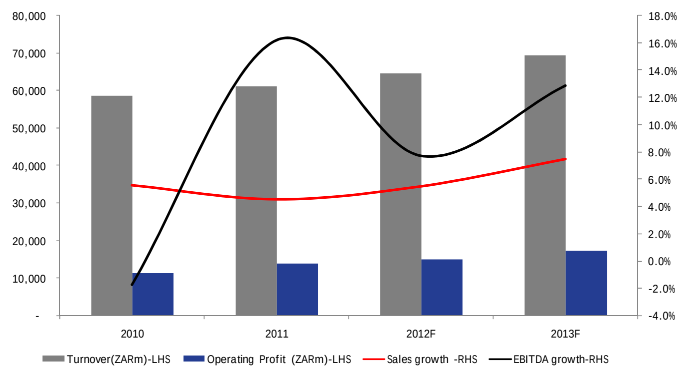

Source: IAS/Company Reports

Fig 52: Vodacom Margins and Capex




Source: IAS/Company Reports

Fig 53: Vodacom Financial Analysis




Source: IAS/Company Reports

VODACOM GROUP - 5 YEAR CGR COMPARISON

| 31 MAR (ZARm) | 2005* | 2006* | 2007* | 2008* | 2009 | 2010 | 2011 | 2012F | 2013F | 5yr CAGR |
|---|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | | | | |
| Shareholders' equity | 7,826 | 8,389 | 9,426 | 11,402 | 14,017 | 13,738 | 15,622 | 15,527 | 15,427 | 13.2% |
| Minority interests | 129 | 283 | 221 | 404 | 1,081 | 898 | 558 | 558 | 558 | 14.5% |
| **Total shareholders' equity** | **7,954** | **8,672** | **9,647** | **11,805** | **15,098** | **14,636** | **16,180** | **16,085** | **15,985** | 13.3% |
| Current Liabilities | 6,875 | 7,339 | 9,892 | 10,372 | 11,487 | 11,917 | 13,092 | 13,681 | 14,297 | 12.3% |
| **Total Liabilities and equity** | **22,566** | **24,768** | **28,470** | **34,175** | **47,359** | **41,691** | **41,435** | **48,720** | **58,784** | 10.8% |
| PPE | 12,231 | 13,387 | 17,073 | 19,120 | 21,844 | 21,383 | 21,577 | 22,526 | 23,518 | 10.0% |
| Current Assets | 8,662 | 8,689 | 7,626 | 9,707 | 12,135 | 12,560 | 13,453 | 19,507 | 28,285 | 9.1% |
| **Total Assets** | **22,566** | **24,768** | **28,470** | **34,175** | **47,359** | **41,691** | **41,435** | **48,720** | **58,784** | 10.8% |
| **Income Statement** | | | | | | | | | | |
| **Revenue** | **27,315** | **34,043** | **41,146** | **48,178** | **55,442** | **58,535** | **61,197** | **64,563** | **69,405** | 12.4% |
| Selling & distribution expenses | (767) | (977) | (1,146) | (1,264) | (1,793) | (1,728) | (2,086) | (2,180) | (2,289) | 16.4% |
| Other operating expenses | - | - | - | - | (5,624) | (5,977) | (6,928) | (7,240) | (7,602) | |
| Impairment of assets | (268) | 53 | (23) | (30) | (112) | (3,370) | (1,508) | (1,576) | (1,655) | |
| Depreciation of PPE | (2,611) | (2,652) | (2,902) | (3,366) | (4,683) | (5,157) | (5,355) | (5,596) | (5,876) | 15.1% |
| Amortisation of intangible assets | (232) | (344) | (459) | (545) | - | - | - | - | - | |
| **Operating Profit** | **6,485** | **8,866** | **10,860** | **12,491** | **12,005** | **11,238** | **13,696** | **14,924** | **17,285** | 9.1% |
| Finance income | 663 | 659 | 75 | 72 | 108 | 124 | 109 | 118 | 127 | -30.2% |
| Finance costs | (642) | (1,318) | (538) | (496) | (1,876) | (2,417) | (1,167) | (1,220) | (1,274) | -2.4% |
| **Profit before tax** | **6,506** | **8,207** | **10,396** | **12,067** | **10,237** | **8,945** | **12,638** | **14,901** | **16,137** | 9.0% |
| Income tax expense | (2,614) | (3,078) | (3,836) | (4,109) | (4,045) | (4,745) | (4,659) | (5,961) | (6,220) | 8.6% |
| **Profit after tax** | **3,892** | **5,129** | **6,560** | **7,958** | **6,192** | **4,200** | **7,979** | **9,373** | **9,918** | 9.2% |
| Ratios | | | | | | | | | | |
| Weighted shares (m) | 0.01 | 0.01 | 0.01 | 0.01 | 1,488.03 | 1,486.36 | 1,468.39 | 1,487.95 | 1,487.95 | |
| EPS (ZAR) | 38,614,000 | 50,261,000 | 63,424,000 | 78,114,000 | 4.09 | 2.82 | 5.62 | 6.46 | 6.81 | |
| DPS (ZAR) | 34,000,000 | 45,000,000 | 54,000,000 | 59,400,000 | 3.50 | 1.10 | 3.55 | 4.07 | 4.29 | |
| NAV/Share | 782,560 | 841,210 | 942,580 | 1,140,170 | 9.42 | 9.24 | 10.64 | 10.43 | 10.37 | |
| Dividend Cover | 1.14 | 1.12 | 1.17 | 1.32 | 1.17 | 2.57 | 1.58 | 1.59 | 1.59 | |
| Dividend Yield | 0.0% | 0.0% | 0.0% | 0.0% | 3.8% | 1.2% | 3.9% | 4.5% | 4.7% | |
| **Growth Ratios** | | | | | | | | | | |
| Sales growth | | 24.6% | 20.9% | 17.1% | 15.1% | 5.6% | 4.5% | 5.5% | 7.5% | |
| EBITDA growth | | 27.2% | 19.9% | 15.3% | 1.7% | -1.8% | 16.2% | 7.7% | 12.9% | |
| Op Profit growth | | 36.7% | 22.5% | 15.0% | -3.9% | -6.4% | 21.9% | 9.0% | 15.8% | |
| PBT growth | | 26.1% | 26.7% | 16.1% | -15.2% | -12.6% | 41.3% | 17.9% | 8.3% | |
| Earnings growth | | 29.8% | 26.5% | 23.2% | -22.0% | -31.1% | 96.5% | 16.6% | 5.4% | |
| **Margins** | | | | | | | | | | |
| EBITDA Margin | 34.2% | 34.8% | 34.6% | 34.0% | 30.1% | 28.0% | 31.1% | 31.8% | 33.4% | |
| OP Margin | 23.7% | 26.0% | 26.4% | 25.9% | 21.7% | 19.2% | 22.4% | 23.1% | 24.9% | |
| PBT Margin | 23.8% | 24.1% | 25.3% | 25.0% | 18.5% | 15.3% | 20.7% | 23.1% | 23.3% | |
| Earnings Margin | 14.1% | 14.7% | 15.4% | 16.2% | 11.0% | 7.2% | 13.5% | 14.9% | 14.6% | |
| Effective Tax Rate | 40.2% | 37.5% | 36.9% | 34.1% | 39.5% | 53.0% | 36.9% | 40.0% | 38.5% | |

***Note: During the period 2005 to 2008, Vodacom was not listed on the JSE and per share figures are based on 10,000 shares in issue**

**Note: Given that our focus is mainly on SSA Excluding South Africa this section has been compiled strictly for comparative purposes. Also note that our forecasts are based on Thompson Reuters consensus estimates.**

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