Vodafone Qatar (VFQS)

Recommendation	**MARKET PERFORM**	**Risk Rating**	**R-4**
Share Price	**QR8.68**	**New Target Price**	**QR9.36**
Implied Upside	**7.8%**	**Old Target Price**	**QR9.48**

FY2013 Guidance and Pricing Pressure Prompts Model Revisions; Maintain Market Perform Rating

Lower-than-expected profitability in the September quarter (2QFY2013); changing estimates to lower-end of management guidance. VFQS reported a strong 6.6% sequential growth in its subscriber base. However, this growth came at a price with the company posting a weaker-than-anticipated ARPU along with higher costs and subdued EBITDA. While 2QFY2013 revenue was impacted by seasonality and lower handset sales, net loss and distributable profit was affected by increased depreciation charges due to the cumulative impact of significant network capex. Our questions during the earnings conference call revealed: (1) Promotional activity has increased post Ramadan, which has negative connotations for ARPU but should be somewhat offset by increased traction in the postpaid segment and (2) VFQS could remain in the red in terms of distributable profit for FY2013. While VFQS turned profitable on a distributable basis in October, management does not expect 2HFY2013 to offset the distributable loss posted in 1H. As expected, management finally issued guidance for FY2013 and we are adjusting our estimates. Given our concerns about pricing pressure due to increasing promotional activity, we are reducing our estimates to the lower-end of management guidance. We maintain our Market Perform rating on the stock with a new target price of QR9.36.

Financial Results and Key Takeaways

- **Impressive subscriber growth comes at the expense of sequentially lower ARPUs and higher costs.** VFQS continues to sacrifice ARPUs to gain market share and did not receive much benefit from its higher-value postpaid customers (postpaid launched on June 19) during the September quarter given their small contribution to the overall base. (1) On a sequential basis, total subscriber base increased by 6.6% to 936,300 from 878,200 in June. (2) However, mobile ARPUs declined by 5.1% to come in at QR115 vs. QR122 in the June quarter. (3) Revenue declined 1.4% QoQ to QR345.4mn and was slightly lower than our estimate of QR355.5mn. (4) EBITDA also declined 1.1% sequentially to QR50.9mn due to higher direct costs. (5) Overall, VFQS reported a 2QFY2013 net loss of QR121.7mn, which increased from QR118.3mn posted in June and was worse than our expectation of QR99.5mn. (6) Distributable loss increased to QR21.0mn vs. QR17.6mn in 1QFY2013. Higher depreciation costs impacted net loss and distributable profit.
- **As expected, VFQS extends management contract with Vodafone Group for another five years at a lower fee of a maximum of 3.5% of mobile/fixed service revenue.** The original agreement was inked back in June 2008 with Vodafone Group (22.95% shareholder in VFQS) for a total annual fee of 5% of mobile service revenue. Under the new agreement, which lasts until end-2018, the fee payable to the group has been reduced to reflect the increased scale of business and the transition to fixed and mobile operations.
- **Revising estimates and target price to reflect newly issued guidance; ARPU progression should be watched closely, however.** Moreover, unlicensed VoIP providers continue to eat the company's (and QTEL's) cake, which is a risk we mentioned in our initiation report. Our model changes lead to our new estimates and target price (more details on page 2).

2QFY2013, Actual vs. Estimates

QR mn	2QFY2013	QoQ	YoY	2QFY2013e	A vs. E
Revenue	345.4	-1.4%	15.3%	355.5	-2.8%
EBITDA	50.9	-1.1%	48.6%	67.5	-24.6%
Net Profit	(121.7)	2.9%	5.8%	(99.5)	22.3%

Source: Company data, QNBFS estimates

Key Data:

Bloomberg Ticker	VFQS QD
ADR/GDR Ticker	N/A
Reuters Ticker	VFQS.QA
ISIN	QA000A0Q5NE9
Sector*	Telecoms
52wk High/52wk Low (QR)	9.98/7.20
3-m Average Volume	299,634
Mkt. Cap. ($ bn/QR bn)	2.0/7.3
Shares Outstanding (mn)	845.4
FO Limit* (%)	No Limit
Current FO* (%)	3.8
1-Year Total Return (%)	15.1
Fiscal Year End	March 31

Source: Bloomberg (as of November 18, 2012), *Qatar Exchange (as of November 18, 2012); Note: FO is foreign ownership

Broker Recommendations

Recommendation	Number
Buy	1
Hold	3
Sell	2

Source: Bloomberg

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Revising Estimates and Target Price

Management guidance for FY2013 is generally in line with our previous estimates. VFQS management provided guidance for FY2013. The company expects QR1.45-QR1.50bn in FY2013 revenue, implying YoY growth in the range of 19%-23%. On the EBITDA front, VFQS expects to post around QR240-QR280mn, up by 67%-94% YoY. This implies an EBITDA margin within 16.6%-18.7% vs. 11.8% in FY2012. On the capex front, the company projects to spend around 25% of revenue vs. 33% in FY2012.

However, we move to the lower end of guidance given our cautious outlook on ARPUs. We are now projecting QR1.45bn in revenue and QR252mn in EBITDA (17.3% EBITDA margin in FY2013). We are concerned about the increase in promotional activity seen since Ramadan. Management mentioned during the call that QTEL's "double credit" promotion for its Hala customers affected ARPUs in September although these promotions supposedly did not have an impact in October and November. VFQS is already offering 30% lifetime discounts on postpaid plans before December 31, 2012, which will also lower post-paid ARPUs in the near-term. Also, the increase seen in unlicensed VoIP providers has crimped international voice revenue and forced VFQS to lower rates to India to QR0.20 a minute from QR0.55 a minute previously (besides appealing for ictQATAR's intervention). Moreover, MNP has been delayed into end-January 2013 (from November), which pushes off any short-term benefit that VFQS could have enjoyed. While increased traction into postpaid (business segment soft launch is underway) and contribution from fixed line (backbone network 80% complete, with Barwa City customers being connected) should help, we choose to remain cautious.

Estimates

QR mn	New		Previous		Change	
	FY2013e	FY2014e	FY2013e	FY2014e	FY2013e	FY2014e
Revenue	**1,454.9**	**1,807.5**	1,541.9	1,849.1	-5.6%	-2.3%
EBITDA	**252.4**	**397.6**	287.9	425.3	-12.4%	-6.5%
Net Profit	**(438.4)**	**(291.7)**	(392.8)	(267.7)	11.6%	9.0%

Source: QNBFS estimates

September 2012 Quarter Review

Revenue declined 1.4% QoQ (up 15.3% YoY) to QR345.4mn. The reported top-line was slightly lower than our estimate of QR355.5mn. Revenue, on a sequential basis, was driven by seasonality and lower handset sales. Increasing use of illegal VoIP for international voice access also impacted the company's revenue. Relative to 2QFY2012, revenue growth was driven by customer growth and increased ARPU (strong data contribution); 2QFY2012 also benefited from around QR25mn in Star number sales and YoY top-line growth was around 25% excluding this item. The company grew its mobile customer market share to 30.5% (up 2.5 percentage points) for 1HFY2013, while mobile revenue market share also increased to 25.4%, up 1.4pp.

(1) **Continued strength in customer additions with total subscriber base up by 6.6% QoQ (15.0% YoY) to 936,300.** The company added 58,000 customers on a sequential basis, almost 3x QTEL's net adds. Besides population growth (up 7.1% QoQ according to the Qatar Statistics Authority), management pointed to a successful start of consumer postpaid and increasing brand appeal among Qataris.

(2) **Sequential decline of 5.1% but yearly growth of 9.3% in ARPUs.** VFQS continues to sacrifice ARPUs to gain market share and did not receive much benefit from its higher-value postpaid customers (postpaid launched on June 19) during the September quarter given their small contribution to the overall base. Seasonal promotions also affected the ARPU on a quarterly basis. Versus last year, ARPUs benefited given less aggressive promotional activity and strong data contribution with data now making up more than 10% of service revenue.

EBITDA also declined slightly by 1.1% sequentially to QR50.9mn due to higher direct costs. EBITDA gained significantly relative to last year, up 48.6%; excluding QR25mn in impact from Star number sales, EBITDA was up more than four fold. EBITDA margin was flattish sequentially at 14.7% and gained around 12pp on an underlying basis. EBITDA was impacted by seasonality versus the June quarter. On a YoY basis, EBITDA benefited from less aggressive seasonal promotions, improved sales mix (postpaid vs. prepaid; online vs. retail) and continued economics of scale.

Net loss and distributable profit was affected by higher costs and increased depreciation charges due to the cumulative impact of significant network capex. Overall, VFQS reported a 2QFY2013 net loss of QR121.7mn, which increased from QR118.3mn posted in June and was worse than our expectation of QR99.5mn; the company posted a net loss of QR115.0mn in September 2011. Distributable loss increased to QR21.0mn vs. QR17.6mn in 1QFY2013 and QR14.0mn in 2QFY2012. Higher depreciation costs impacted net loss and distributable profit and yearly comparisons were distorted by the previously mentioned Star number recognition.

Capital expenditure in the six months to September 30 rose around 20% to QR146mn ahead of the launch of fixed line services. VFQS spent around QR83mn in capex in 2QFY2013, including QR31mn on its fixed line rollout. On the mobile side, the company added a further 16 sites during the quarter.

Detailed Financial Statements

Income Statement

(In QR mn)	FY2012	FY2013e	FY2014e	FY2015e	FY2016e
Revenue	**1,222**	**1,455**	**1,807**	**2,099**	**2,354**
Direct Costs	(561)	(627)	(741)	(850)	(941)
Gross Profit	**661**	**828**	**1,066**	**1,249**	**1,412**
Other Expenses, Excluding D&A	(517)	(576)	(669)	(693)	(706)
EBITDA	**144**	**252**	**398**	**556**	**706**
Depreciation & Amortization	(600)	(665)	(668)	(669)	(678)
EBIT	**(456)**	**(412)**	**(270)**	**(113)**	**28**
Interest Income	1	2	6	7	8
Interest Expense	(30)	(28)	(27)	(22)	(15)
Profit before Tax	**(486)**	**(438)**	**(292)**	**(128)**	**21**
Income Tax Expense	0	0	0	0	0
Profit for Shareholders	**(486)**	**(438)**	**(292)**	**(128)**	**21**
EPS (QR)	**(0.57)**	**(0.52)**	**(0.34)**	**(0.15)**	**0.02**

Source: Company data, QNBFS estimates

Balance Sheet

(In QR mn)	FY2012	FY2013e	FY2014e	FY2015e	FY2016e
Non-Current Assets					
Property, Plant and Equipment	1,364	1,445	1,452	1,439	1,400
Intangible Assets	6,550	6,167	5,763	5,359	4,956
Trade and Other Receivables	7	11	11	11	11
Total Non-Current Assets	**7,921**	**7,622**	**7,226**	**6,809**	**6,366**
Current Assets					
Inventory	12	15	16	20	22
Trade and Other Receivables	171	182	196	234	378
Cash and Cash Equivalents	100	113	137	164	282
Total Current Assets	**284**	**311**	**349**	**418**	**683**
TOTAL ASSETS	**8,205**	**7,933**	**7,575**	**7,227**	**7,049**
Equity					
Share Capital	8,454	8,454	8,454	8,454	8,454
Legal Reserve	11	11	11	11	11
Hedging Reserve	1	5	5	5	5
Accumulated Deficit	(1,893)	(2,331)	(2,625)	(2,775)	(2,823)
Total Equity	**6,574**	**6,139**	**5,846**	**5,696**	**5,648**
Non-Current Liabilities					
End of Service Benefits	8	10	10	10	10
Provisions	11	12	12	12	12
Long-Term Borrowings	1,037	1,089	989	689	489
Total Non-Current Liabilities	**1,056**	**1,111**	**1,011**	**711**	**511**
Current Liabilities					
Trade and Other Payables	575	683	718	820	890
Short-Term Borrowings	0	0	0	0	0
Total Current Liabilities	**575**	**683**	**718**	**820**	**890**
Total Liabilities	**1,631**	**1,794**	**1,728**	**1,531**	**1,401**
EQUITY AND LIABILITIES	**8,205**	**7,933**	**7,575**	**7,227**	**7,049**

Source: Company data, QNBFS estimates

Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*	
OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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