

Vodafone Qatar (VFQS)

Recommendation	MARKET PERFORM	Risk Rating	R-4
Share Price	QR8.10	Current Target Price	QR8.50
Implied Upside	4.9%		

Recent Positive Moves Already Priced In; Stay Market Perform

We maintain our target price of QR8.50 and our Market Perform rating on VFQS. 1Q2018 was VFQS' first ever profitable quarter, almost 10 years since June 2008 when the company was granted Qatar's 2nd cellular license. With its license extended for another 40 years (50 remaining in total), we expect annual license amortization to drop from QR403mn to QR85mn ensuring sustained bottom-line profitability going forward. Moreover, with majority control moving to Qatar Foundation (50% owner), we expect traction in the post-paid segment to continue, along with a renewed push into fixed-line services. We update our model and forecast resumption in dividends after an almost 4-year hiatus. Despite these positive moves, profitability metrics remain subdued with ROIC to remain below WACC until at least CY2023. We maintain our Market Perform and QR8.50 price target on VFQS.

Highlights

- **VFQS reports QR17.5mn net profit in 1Q2018 vs losses of QR28.6mn/QR74.2mn in December/March 2017 quarters. Amortization** dropped 65% YoY/QoQ to QR43.7mn. **Normalized EBITDA margins** (excluding handsets/one-offs) improved to 27.5% vs. 25.4% in 4QCY2017 and 26.9% in 1Q2017. **Total subs** grew sequentially to 1.41mn vs. 1.39mn in the December 2017 and 1.501 in March 2017. The YoY decline in subs is primarily due to the pre-paid segment, which saw ~50k customer loss due to the network disruption faced in July, along with seasonality; pre-paid subs declined from 1.229mn in March 2017 to 1.07mn in March 2018 and were flat QoQ. Strong traction continued in post-paid, which saw subs grow to 340k vs. 319k in December 2017 and 272k in March 2017. At QR105, **ARPU**s were flat sequentially and up QR3 YoY; the YoY declines in pre-/post-paid ARPU was more than made up by the gain in post-paid subs and increased mix of post-paid subs in the overall base; we estimate QR211/QR72 in post-/pre-paid ARPU in March 2018 (ORDS reported QR268/QR64).
- **We project top-line to increase from QR2bn in CY2017 to QR2.1bn and QR2.3bn in CY2018 and CY2019, respectively.** This translates to yearly growth rates of 6.5% and 8.9%. Growth is driven mostly by the post-paid segment, with **blended ARPU**s expected to grow from QR99.8 in CY2017 to QR103.9 in 2018 and QR105.7 in 2019; **total subs** are expected to grow from 1.39mn to 1.505mn and 1.562mn in 2018 and 2019, respectively. We also expect **reported EBITDA margins** to move from 26.9% in CY2017 to 26.7% in 2018 and expand to 30.4% in 2019. 2018 should also be the first year of profits with net income moving from a loss of QR256mn in CY2017 to QR92mn in 2018 and QR215mn in 2019. **Capital intensity** should increase from 18.4% in CY2017 to 18.7% and 20.4% in 2018 and 2019, respectively, as VFQS spends on 5G and fixed. Finally, we expect VFQS to **resume paying dividends** after a break of almost four years and declare dividends of QR0.10 for CY2018 and QR0.25 in CY2019 (detailed estimates start on Page 3).

Catalysts

- **With QF assuming majority ownership of VFQS, we expect increased traction in higher-value mobile segments and fixed broadband.** However, this effect is hard to quantify. Moreover, we are not convinced if VFQS could ever reach the scale to sport EBITDA margins beyond mid-30s to 40% range (In 1Q2018, ORDS reported 48% EBITDA margins at a QR2bn quarterly revenue run-rate). In the medium-term, mobile network enhancements and growth in data, along with focus on higher-value segments like post-paid, enterprise and nationwide fixed-line, could drive the next leg of growth.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We rate VFQS a Market Perform with a PT of QR8.50.** VFQS trades at 13.0x and 10.2x CY2018 and CY2019 EV/EBITDA, respectively, which is significantly more expensive than its regional peers.
- **Risks: 1) Increased competition** leading to ARPU erosion and/or market share loss; 2) **Weakening of post-paid and fixed-line traction/stickiness** and 3) **Fall in population/industry growth rates.**

Key Financial Data and Estimates

	CY2017	CY2018e	CY2019e	CY2020e
Revenue (QR mn)	1,998	2,129	2,317	2,485
EPS (QR)	(0.30)	0.11	0.25	0.36
EV/EBITDA	13.9x	13.0x	10.2x	8.8x
Dividend Yield		1.2%	3.1%	4.3%

Source: Company data, QNBFS estimates; Note: All data based on current number of shares

Key Data

Bloomberg Ticker	VFQS QD
ADR/GDR Ticker	N/A
Reuters Ticker	VFQS.QA
ISIN	QA000A0Q5NE9
Sector	Telecoms
52wk High/52wk Low (QR)	9.76/6.03
3-m Avg. Volume ('000)	2,099.0
Mkt. Cap. (\$ bn/QR bn)	1.9/6.8
EV (\$ bn/QR bn)	2.0/7.5
Shares Outstanding (mn)	845.4
FO Limit* (%)	No Limit
Current FO* (%)	5.5
1-Year Total Return (%)	(6.9)
Fiscal Year End	December 31

Source: Bloomberg (as of May 30, 2018), *Qatar Exchange (as of May 30, 2018); Note: FO is foreign ownership

Saugata Sarkar, CFA, CAIA
 +974 4476 6534
 saugata.sarkar@qnbfs.com.qa

Recent Events: License Extension Ushers in Immediate Profitability; QF Deal a LT Positive

In February, Vodafone Qatar instituted a number of important changes that bode well longer term:

- **Qatar Foundation bought out Vodafone Europe's 22.95% stake in VFQS and became a 50% shareholder.** This deal was closed a month after as per Vodafone's announcement on March 29. QF agreed to pay a total of QR1.35bn or QR6.96 a share, representing a 3% discount to the 30 trading day VWAP as at February 25. *We believe this deal will allow Vodafone Qatar to benefit longer-term from an influential shareholder and allow for further traction in fixed-line, enterprise and post-paid segments.*
- **Vodafone Group extended its technical support agreement with Vodafone Qatar for 5 years.** This five-year Partner Market agreement will ensure that Vodafone Qatar continues to use the Vodafone brand and benefits from the expertise and assets of Vodafone Group. There is a 50% discount to the fees associated with this agreement over the first two years. On the flip-side, VFQS did have to break its \$330mn debt agreement (Wakala contract) with Vodafone Finance at \$223mn. *This amount is due for repayment as a bullet payment in November 2019; however, VFQS recently signed a QR911mn, six-year facility with Barwa Bank to help refinance this obligation as it comes due in November of next year.*
- **VFQS' cellular license was extended at no additional cost for another 40 years until 2068, allowing VFQS to report its first ever profitable quarter.** *With its license extended for another 40 years (50 remaining in total), we expect annual license amortization to drop from QR403mn to QR85mn ensuring sustained bottom-line profitability going forward.* As a reminder, Vodafone Qatar paid \$2.1bn for the license, which was originally awarded in June 2008 and has already amortized around \$1bn since then.
- **New leadership has been put in place to drive growth.** Following the company's Annual General Assembly on March 19, H.E. Sheikh Hamad bin Abdullah Al-Thani took over the position of VFQS CEO from Ian Grey who has retired; Sheikh Hamad was most recently VFQS' Chief Operating Officer. Under his leadership, Vodafone Qatar's enterprise market share grew substantially as did its position as an ICT and mega projects service provider. *Besides his mandate to drive growth, Sheikh Hamad adds much needed stability to Vodafone Qatar's top ranks which has seen four different previous CEOs over the last 7 ½ years.* Moreover, Rashid Al Naimi was elected as Managing Director. As the CEO of Qatar Foundation Endowment, Rashid Fahad Al-Naimi is responsible for QF's investment portfolios. He is also the residing Chairman of MEEZA and Mazaya Qatar, and a Board Member of VFQS.
- **Pending regulatory approvals, VFQS will halve its share capital and the par value of shares; this move has no economic impact but cleans up accumulated losses in the balance sheet.** VFQS intends to reduce its share capital from QR8.454bn to QR4.227bn by halving the par value of its shares from QR10 to QR5. This will be offset by extinguishing accumulated losses, which stood at QR4.272 as of December 2017; these accumulated losses have been largely driven by previous amortization charges. Moreover, any further remaining losses up to a maximum of QR 45mn will be netted-off against VFQS' distributable reserves. *These moves do not lead to any changes in the size of the balance sheet and have no economic impact but serve to clean up the balance sheet so the stock screens better for potential new investors.*

March 2018 Results Show a Return to Profitability

VFQS reports QR17.5mn net profit in 1Q2018 vs losses of QR28.6mn/QR74.2mn in December/March 2017 quarters. Amortization dropped 65% YoY/QoQ to QR43.7mn. **Normalized EBITDA margins** (excluding handsets/one-offs) improved to 27.5% vs. 25.4% in 4QCY2017 and 26.9% in 1Q2017. **Total subs** grew sequentially to 1.41mn vs. 1.39mn in the December 2017 and 1.501 in March 2017. The YoY decline in subs is primarily due to the pre-paid segment, which saw ~50k customer loss due to the network disruption faced in July, along with seasonality; pre-paid subs declined from 1.229mn in March 2017 to 1.07mn in March 2018 and were flat QoQ. Strong traction continued in post-paid, which saw subs grow to 340k vs. 319k in December 2017 and 272k in March 2017. At QR105, **ARPU**s were flat sequentially and up QR3 YoY; the YoY declines in pre-/post-paid ARPU was more than made up by the gain in post-paid subs and increased mix of post-paid subs in the overall base; we estimate QR211/QR72 in post-/pre-paid ARPU in March 2018 (ORDS reported QR268/QR64).

Financial Forecasts

We project top-line to increase from QR2bn in CY2017 to QR2.1bn and QR2.3bn in CY2018 and CY2019, respectively. This translates to yearly growth rates of 6.5% and 8.9%.

- **Growth is driven mostly by the post-paid segment**, with blended ARPUs expected to grow from QR99.8 in CY2017 to QR103.9 in 2018 and QR105.7 in 2019; total subs are expected to grow from 1.39mn to 1.505mn and 1.562mn in 2018 and 2019, respectively.
- **We also expect reported EBITDA margins to move from 26.9% in CY2017 to 26.7% in 2018 and expand to 30.4% in 2019.**
- **2018 should also be the first year of profits** with net income moving from a loss of QR256mn in CY2017 to QR92mn in 2018 and QR215mn in 2019.
- **Capital intensity should increase from 18.4% in CY2017 to 18.7% and 20.4% in 2018 and 2019, respectively**, as VFQS spends on 5G and fixed.
- **We expect VFQS to resume paying dividends after a break of almost four years** and declare dividends of QR0.10 for CY2018 and QR0.25 in CY2019.

Fundamental Drivers	CY2017	CY2018e	CY2019e	CY2020e
Mobile Subscribers (in 000s)				
Pre-Paid Subs	1,071	1,150	1,190	1,244
YoY Growth	(11.9%)	7.4%	3.5%	4.5%
Post-Paid Subs	319	355	372	398
YoY Growth	24.6%	11.3%	4.8%	7.0%
Total Mobile Subs	1,390	1,505	1,562	1,642
YoY Growth	(5.6%)	8.3%	3.8%	5.1%
Mobile ARPU (in QR)				
Pre-Paid ARPU	73	70	70	71
YoY Growth	(12.0%)	(4.0%)	0.3%	1.4%
Post-Paid ARPU	210	212	220	228
YoY Growth	1.3%	0.7%	4.0%	3.5%
Blended Mobile ARPU	100	104	106	109
YoY Growth	(2.8%)	4.1%	1.7%	2.9%
Mobile Service Revenue (in QR mn)				
Pre-Paid Service Revenue	976	901	978	1,037
YoY Growth	(18.9%)	(7.6%)	8.5%	6.1%
Post-Paid Service Revenue	692	864	958	1,053
YoY Growth	19.8%	24.8%	10.9%	10.0%
Total Mobile Service Revenue	1,668	1,765	1,935	2,090
YoY Growth	(6.4%)	5.8%	9.6%	8.0%
Other Service Revenue (Incl. Fixed)	184	201	227	240
Other Revenue (Incl. Handsets)	146	163	155	155
Total Revenue (in QR mn)	1,998	2,129	2,317	2,485
YoY Growth	(2.9%)	6.5%	8.9%	7.2%
EBITDA (in QR mn)				
EBITDA	538	568	704	808
EBITDA Margin	26.9%	26.7%	30.4%	32.5%
YoY Growth	16.0%	5.5%	24.1%	14.7%
Capex (in QR mn)				
Capex	368	398	472	472
Capex Intensity	18.4%	18.7%	20.4%	19.0%
YoY Growth	10.9%	8.2%	18.5%	0.0%

Source: Company data, QNBFS estimates

Growth Rates	FY2017	CY2017	CY2018E	CY2019E	CY2020E	CY2021E	CY2022E	CY2023E
Revenue	-2.9%	-2.9%	6.5%	8.9%	7.2%	5.4%	3.6%	3.3%
Gross Profit	11.4%	1.3%	3.3%	11.8%	9.3%	7.0%	5.1%	4.1%
EBIT	41.4%	33.5%	N/M	106.2%	39.5%	22.7%	16.2%	11.5%
EBITDA	33.8%	16.0%	5.5%	24.1%	14.7%	10.3%	8.1%	6.2%
Net Income	42.2%	31.6%	N/M	133.7%	42.5%	24.9%	18.7%	14.4%
DPS				150.0%	40.0%	14.3%	12.5%	11.1%
CFPS	39.0%	29.6%	9.3%	36.2%	9.1%	10.6%	6.2%	5.0%
FCPS	165.9%	158.8%	14.4%	83.3%	25.5%	32.0%	26.4%	12.2%
Operating Ratios								
Gross Margin	64.1%	64.0%	62.1%	63.8%	65.0%	66.0%	67.0%	67.5%
EBIT Margin	(11.8%)	(11.2%)	6.0%	11.3%	14.7%	17.1%	19.2%	20.7%
EBITDA Margin	26.1%	26.9%	26.7%	30.4%	32.5%	34.0%	35.5%	36.5%
Net Margin	(13.1%)	(12.8%)	4.3%	9.3%	12.3%	14.6%	16.7%	18.5%
Capex Intensity	15.1%	18.4%	18.7%	20.4%	19.0%	17.3%	14.4%	13.3%
Finance Ratios								
Debt - Equity Ratio	20.3%	18.3%	18.1%	14.9%	14.7%	14.4%	9.4%	3.1%
Net Debt - Equity Ratio	16.7%	13.9%	11.1%	7.6%	5.7%	3.4%	(0.3%)	(4.7%)
Net Debt-to-Capital	14.3%	12.2%	10.0%	7.1%	5.4%	3.3%	(0.3%)	(4.9%)
Cash Interest Coverage	19.0x	18.1x	19.7x	23.3x	25.4x	28.0x	36.4x	72.4x
Ave. Effective Borrowing rate %	3.0%	3.6%	3.5%	4.3%	4.5%	4.5%	5.7%	9.1%
Return Ratios								
ROIC	(4.3%)	(4.2%)	2.2%	4.5%	6.1%	7.4%	8.8%	10.1%
ROE	(5.8%)	(5.7%)	2.0%	4.6%	6.4%	7.9%	9.2%	10.2%
ROA	(4.1%)	(4.1%)	1.5%	3.4%	4.7%	5.8%	6.9%	8.1%
Dividend Payout %			91.8%	98.2%	96.5%	88.4%	83.7%	81.3%
Valuation								
EV/Sales	3.7x	3.7x	3.5x	3.1x	2.9x	2.7x	2.5x	2.4x
EV/EBITDA	14.2x	13.9x	13.0x	10.2x	8.8x	7.9x	7.1x	6.5x
EV/EBIT	N/M	N/M	57.8x	27.5x	19.5x	15.6x	13.1x	11.4x
P/E	N/M	N/M	74.4x	31.8x	22.3x	17.9x	15.1x	13.2x
P/BV	1.5x	1.5x	1.5x	1.5x	1.4x	1.4x	1.4x	1.3x
Dividend Yield	0.0%	0.0%	1.2%	3.1%	4.3%	4.9%	5.6%	6.2%
Liquidity Ratios								
Current Ratio	0.7x	0.7x	0.9x	0.9x	1.0x	1.0x	1.0x	0.9x
Quick Ratio	0.6x	0.6x	0.9x	0.8x	0.9x	1.0x	0.9x	0.8x

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement (In QR mn)	FY2016	FY2017	CY2017	CY2018e	CY2019e	CY2020e	CY2021e	CY2022e
Revenue	2,119	2,059	1,998	2,129	2,317	2,485	2,620	2,713
Direct Costs	(935)	(740)	(719)	(807)	(840)	(870)	(891)	(895)
Gross Profit	1,184	1,319	1,279	1,321	1,478	1,615	1,729	1,818
Other Expenses, Excluding D&A	(784)	(782)	(741)	(754)	(773)	(808)	(838)	(855)
EBITDA	401	537	538	568	704	808	891	963
Depreciation & Amortization	(816)	(780)	(762)	(440)	(442)	(442)	(442)	(442)
EBIT	(415)	(243)	(224)	127	262	366	449	521
Interest Income	0	2	2	2	3	3	4	5
Interest Expense	(19)	(28)	(30)	(29)	(30)	(32)	(32)	(26)
Other Income/Expense	(32)	(0)	(4)	(8)	(20)	(30)	(38)	(45)
Profit Before Tax	(466)	(269)	(256)	92	215	307	383	454
Income Tax Expense								
Profit for Shareholders	(466)	(269)	(256)	92	215	307	383	454
EPS (QR)	(0.55)	(0.32)	(0.30)	0.11	0.25	0.36	0.45	0.54
DPS (QR)	0.00	0.00	0.00	0.10	0.25	0.35	0.40	0.45

Source: Company data, QNBFS estimates

Detailed Financial Statements

Balance Sheet (In QR mn)	FY2016	FY2017	CY2017	CY2018e	CY2019e	CY2020e	CY2021e	CY2022e
Non-Current Assets								
Property, Plant and Equipment	1,249	1,233	1,202	1,265	1,401	1,537	1,653	1,709
Intangible Assets	5,235	4,782	4,461	4,356	4,250	4,144	4,038	3,932
Trade and Other Receivables	34	25	25	26	28	30	32	33
Total Non-Current Assets	6,518	6,040	5,688	5,647	5,679	5,711	5,723	5,674
Current Assets								
Inventory	13	13	36	23	25	26	28	29
Trade and Other Receivables	330	357	302	305	336	348	370	387
Cash and Cash Equivalents	130	169	199	320	342	427	533	483
Total Current Assets	474	539	536	648	704	802	931	899
Total Assets	6,992	6,579	6,225	6,295	6,383	6,513	6,654	6,573
Equity								
Total Equity	4,923	4,654	4,472	4,561	4,686	4,774	4,851	4,956
Non-Current Liabilities								
Trade and Other Payables	48	50	52	57	61	66	69	72
Provisions	62	114	105	118	126	135	142	147
Long-Term Borrowings	1,023	946	818	824	700	700	700	467
Total Non-Current Liabilities	1,132	1,110	976	999	887	901	911	686
Current Liabilities								
Trade and Other Payables	937	816	777	735	809	839	892	931
Short-Term Borrowings	0	0	0	0	0	0	0	0
Total Current Liabilities	937	816	777	735	809	839	892	931
Total Liabilities	2,069	1,925	1,753	1,734	1,696	1,739	1,803	1,617
Equity and Liabilities	6,992	6,579	6,225	6,295	6,383	6,513	6,654	6,573

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

Contacts

Saugata Sarkar, CFA, CAIA

Head of Research

Tel: (+974) 4476 6534

saugata.sarkar@qnbfs.com.qa

Mohamed Abo Daff

Senior Research Analyst

Tel: (+974) 4476 6589

mohd.abodaff@qnbfs.com.qa

Shahan Keushgerian

Senior Research Analyst

Tel: (+974) 4476 6509

shahan.keushgerian@qnbfs.com.qa

QNB Financial Services Co. W.L.L.

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

Zaid al-Nafoosi, CMT, CFTe

Senior Research Analyst

Tel: (+974) 4476 6535

zaid.alnafoosi@qnbfs.com.qa

Disclaimer and Copyright Notice: This publication has been prepared by QNB Financial Services Co. W.L.L. ("QNBFS") a wholly-owned subsidiary of Qatar National Bank (Q.P.S.C.). QNBFS is regulated by the Qatar Financial Markets Authority and the Qatar Exchange. Qatar National Bank (Q.P.S.C.) is regulated by the Qatar Central Bank. This publication expresses the views and opinions of QNBFS at a given time only. It is not an offer, promotion or recommendation to buy or sell securities or other investments, nor is it intended to constitute legal, tax, accounting, or financial advice. QNBFS accepts no liability whatsoever for any direct or indirect losses arising from use of this report. Any investment decision should depend on the individual circumstances of the investor and be based on specifically engaged investment advice. We therefore strongly advise potential investors to seek independent professional advice before making any investment decision. Although the information in this report has been obtained from sources that QNBFS believes to be reliable, we have not independently verified such information and it may not be accurate or complete. QNBFS does not make any representations or warranties as to the accuracy and completeness of the information it may contain, and declines any liability in that respect. For reports dealing with Technical Analysis, expressed opinions and/or recommendations may be different or contrary to the opinions/recommendations of QNBFS Fundamental Research as a result of depending solely on the historical technical data (price and volume). QNBFS reserves the right to amend the views and opinions expressed in this publication at any time. It may also express viewpoints or make investment decisions that differ significantly from, or even contradict, the views and opinions included in this report. This report may not be reproduced in whole or in part without permission from QNBFS.

COPYRIGHT: No part of this document may be reproduced without the explicit written permission of QNBFS.