INTUITION
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Vodacom: Connecting Cape to Cairo

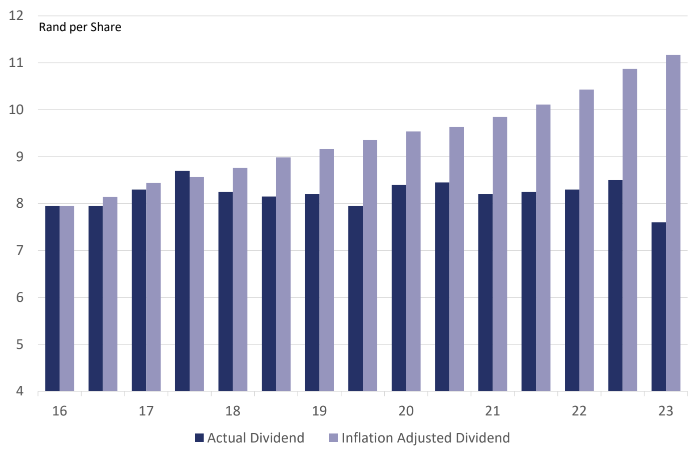
Vodacom is Africa's largest mobile telecomms firm by revenue and is majority owned by UK-listed Vodafone Plc (65.1%). Over the 2020-2022 Covid period, as lockdowns forced people across Sub-Saharan Africa to work from home and rely heavily on the internet via their cell phones, the share price reacted accordingly, rising 30%. Whilst banks and property companies were forced to slash or cancel dividends during the pandemic, Vodacom's dividend proved resilient. However, looking back over 10 years, distributions have not kept pace with inflation and the share has since drifted back to the same price it was 10 years ago (excl. dividends). After much introspection and pressure from shareholders, CEO Shameel Joosub announced a new growth initiative, namely to: 1) enter the Egyptian market; 2) Expand M-Pesa; and 3) accelerate its 'Beyond Mobile' strategy to de-risk and grow its revenue from new sources like financial and digital services, internet (IoT) and increased fibre roll-out via a joint venture with Remgro. This article will look at the progress, opportunities and challenges the company is facing today as it evolves from a telecommunications to a technology company in the face of rampant inflation in Egypt and load-shedding costs in its largest market.

Nick Rogers

At the outset, it is worth noting that to fund its future growth, Vodacom needed to free up much-needed cash flow for various investments that have multi-year horizons. The first step was to announce a change to its 10-year dividend policy of paying shareholders 90% of its adjusted headline earnings, to one of paying out 'at least' 75%. Since investments of this magnitude can take years to digest, especially given the regulatory hurdles one needs to jump through across Africa, we decided in 2022 to err on the side of caution and reduce our exposure across portfolios.

Valued at R43.6 billion, the 55% stake in Vodacom Egypt was the largest acquisition in Vodacom's history. To pay for

VODACOM: DIVIDEND GROWTH REL TO INFLATION



Unfortunately, Vodacom's dividends have not kept pace with inflation over the past six years.

SPEED READ

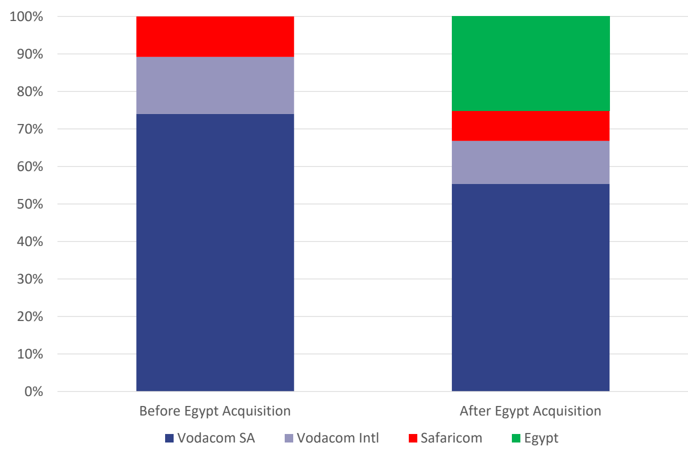
- **Valued at R43.6 billion, the 55% stake in Vodacom Egypt was the largest acquisition in Vodacom's history.**
- **To fund growth, Vodacom has reduced its dividend payout policy from 90% to 75% of adjusted HEPS. Consequently, its 2023 dividend fell to R6.70 from R8.50.**
- **M-Pesa (M for mobile, Pesa is Swahili for money) remains Africa's largest mobile money platform by total transaction value at $364.8 billion – Vodacom owns 33.4% of M-Pesa.**
- **Since 2020, Vodacom SA has spent over R4.3 billion on batteries, generators, diesel, security and maintenance across its 15,000 low-voltage sites around the country.**
- **Vodacom SA has 10,000 data points on each customer, which offers some fascinating insights. For example, people who wake up before 5am are less likely to default on loans.**

it, Vodacom issued new shares to Vodafone (worth R32.8 billion) and paid R10.8 billion in cash. Why Egypt? Firstly, it is already the number one telecomms brand in Egypt, enjoying a 44% mobile revenue market share. However, there are other long-term structural tailwinds which include:

1. Egypt's youthful population (52% under 24 years of age) implies a more tech-savvy demographic. For example, data usage in Egypt is twice that of SA.
2. A skilled workforce, thanks to a literacy rate of 73%, leads to higher disposable income and expenditure on mobile services.
3. A US$300 billion opportunity in providing banking services to the 72% of the population who are unbanked, especially given Vodacom's M-Pesa platform.
4. Egypt boasts the 2nd-largest economy in Africa (33rd globally) along with a very respectable GDP growth rate of 6.6%.
5. Adding this geography expands Vodacom's population reach to over 500 million people across the continent.

How is it going? Albeit early days, Vodacom has just reported record quarterly revenues of R35.7 billion (+36.9%) in Q1 2024, owing to the inclusion of Vodafone Egypt in its numbers for the first time. Excluding Egypt, group revenue increased by 9.7%, a solid start to the year. However, headline earnings per share (HEPS) will decline due to the higher number of shares in issue. With the goal being diversification to reduce country risk, especially given SA's anaemic GDP growth, SA's share of operating profit has dropped from 73% to 59% whilst Egypt's contribution was 19%, making it Vodacom's second-largest market. Importantly, Vodafone Egypt generates a return on capital employed (ROCE) in excess of 30%, which should arrest the recent decline in the Group's ROCE to 28.9%.

CONTRIBUTION TO PROFITS



The 55% stake in Vodacom Egypt will further diversify the Group's profits across different geographies, thereby reducing risk across the Group, especially to a weak SA economy.

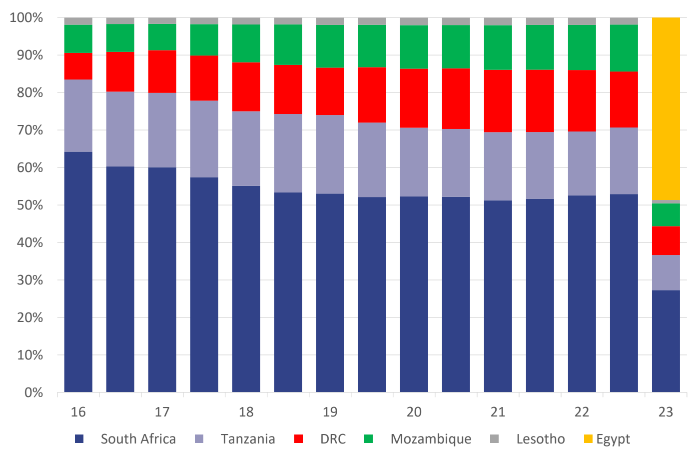
Unfortunately, it didn't take long for short-term risks to become apparent. Due to Egypt's reliance on wheat and other commodities from Ukraine and Russia, the country has experienced severe inflation – the latest reading for June was almost 36%! To combat this, interest rates have risen to 18.25% - from 8% in 2021. In addition, Egypt has devalued its currency twice since the deal was announced, in return for support from the IMF to help with soaring import costs. This implies that in the short term, Vodacom overpaid for its Egyptian investment, but it does not alter the long-term growth appeal of the country. A further risk is the overhang in the share price due to the concern that embattled Vodafone may sell down its 65.1% stake in Vodacom despite recently denying it has any intentions to do so. Time will tell. Nonetheless, with 12% of world trade passing through the Suez Canal, Egypt being the 2nd-largest natural gas producer in Africa and their government's 2030 focus on digitization, Egypt is well-placed to contribute meaningfully to Vodacom's growth strategy.

"M-Pesa remains Africa's largest mobile money platform by total transaction value, recording transactions worth $364.8 billion over the past year."

M-Pesa remains Africa's largest mobile money platform by total transaction value, recording transactions worth $364.8 billion over the past year. Post the expansion into Ethiopia last October, M-Pesa now operates across seven countries and its 51.7 million customers transact 61 million times a day! M-Pesa allows users to deposit, withdraw, transfer money, pay for goods and services, access credit, insurance, and savings, all using a mobile device. M-Pesa is fully reliant on merchants to sell its services in urban and rural areas. In this regard, Vodacom has more than doubled its merchants to 196,000 which bodes well for sales in 2024. Vodacom holds a 34.4% interest in M-Pesa through its joint venture with Safaricom in Kenya and the growth trajectory remains fully intact over the long-term.

Further growth is expected from the proposed joint venture with Remgro, which is rolling out fibre across SA. Currently, there are delays due to regulatory approvals. However, Vodacom intends to take an initial stake of 30% in MAZIV, the company that will house Dark Fibre Africa (DFA) and Vumatel, owned by Remgro in return for injecting its own fibre assets into the company. DFA specialises in long-distance fibre infrastructure and has total fibre assets spanning 13,600km whilst Vumatel specialises in fibre-to-the-home networks, with its fibre assets spanning 31,000km. MAZIV aims to democratize the internet across SA by rolling out fibre to townships and lower-income areas and in so doing, reduce the technology 'demographic divide' between the 'haves' and the 'have nots.' Vodacom also has its sights set on rolling out fibre in Tanzania, DRC, Mozambique and Lesotho. Vodacom is thus increasing its bet on the continent's fast-growing and tech-savvy youth to turn to their smartphones to access a wide range of services from entertainment and online shopping to personal loans and insurance. It will be capital intensive and there are always execution risks with projects of this size, yet the reward is substantial for those who are successful.

VODACOM DATA REVENUES

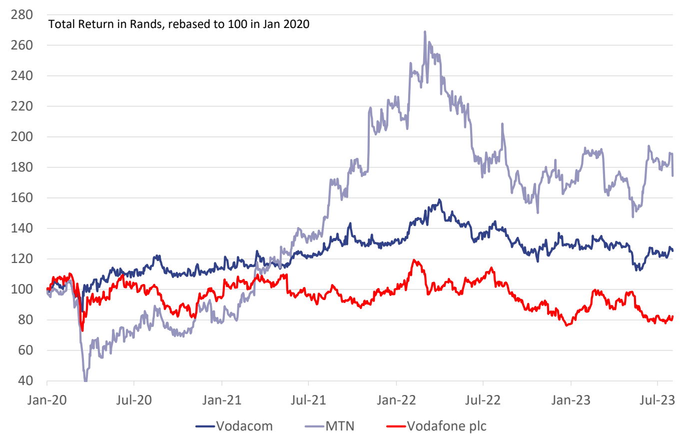


Vodacom Egypt's tech-savvy population uses 2x the amount of data as SA customers.

Key to Vodacom's growth prospects is the continued adoption of smartphones since most new services can only run on the latest technology. But affordability has always been an issue, until now. In June, I chatted to Vodacom's investor relations manager, J.P. Davids, about how they intend to increase smartphone ownership in SA, given that less than 50% of the population owns one. Vodacom now has a local assembly capability which removes the usual 30% import duty and reduces the cost of the SA-made handset to just $40. To bring this to fruition, Vodacom is working on handset financing with Android which is helping to install a function that can lock the phone if you do not pay. At a very affordable price of R5/day, including basic data & airtime, the handset is paid off within a year. Furthermore, Vodacom is seeking a partnership with WhatsApp where Vodacom receives $5/handset to ensure that WhatsApp is the default application, further reducing the cost. This is a great example of the entrepreneurial and innovative capability of the current management team and the need to adapt to conditions on the ground in sub-Saharan Africa.

Having invested R5 billion in SA infrastructure since 2018, Vodacom has pledged a further investment of R60 billion

TOTAL RETURN FOR SELECTED COMPANIES



Total returns (capital growth and dividends) for Vodacom and MTN rose during the Pandemic as lockdowns forced people to rely on their mobile devices. This highlights the latent potential and growth available in Africa, in contrast to the saturated markets of Europe where Vodafone plc operates.

over the next 5 years in line with their vision to connect everyone in South Africa, regardless of location. As it stands, Vodacom has helped improve coverage to 95.8% of the rural population as well as extending 4G coverage to 98% of its network. 4G offers 1 gigabyte/second download speed, which is generally required to be able to use streaming services such as Netflix. This brings us to their biggest challenge in their largest market, Loadshedding! Since 2020, Vodacom SA has spent cR4.0 billion on backup power solutions including R1.7 billion on batteries alone in the past 2 years. Despite the deep frustrations, Vodacom has been ahead of peer MTN in this regard, resulting in industry-leading network availability during elevated levels of power outages. Vodacom is in discussions with NERSA to purchase R16 billion worth of energy from independent power producers (IPP) which will pay off over the long run. The only positive is that when the power goes off, people tend to use more data, and the quickest and most convenient source is their cellphones. Data growth accelerated from 30% in April '22 to 45% in March'23.

In conclusion, Vodacom is experiencing renewed growing pains yet we are happy to increase our exposure once we feel that growth has returned and risks reduced. What is pleasing to see is that the revenue derived from financial and digital services, and IoT, now accounts for almost one-fifth of the Group's total revenue and is well on track to reach the target contribution of 25% to 30% over the medium term. Low single-digit growth in SA looks set to continue given the load-shedding burden whilst inflation will remain an issue in most territories for the rest of this year. Nonetheless, the wheels of growth have been set in motion after a pedestrian decade and we look forward to watching the story unfold.

Topic:	**TBC**
Natal Midlands	
Date:	21st of September 2023
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	19th of September
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	n/a
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

Our next Insight seminar will take place in September in Howick and Johannesburg. The topic will be announced in due course.

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