Conference Call Transcript

13 May 2019

2019 ANNUAL RESULTS

Operator

Good day ladies and gentlemen and welcome to the Vodacom Group Ltd results conference call for the year ended 31 March 2019. Vodacom Group CEO, Shameel Joosub, will host the conference call. I will read the forward-looking disclaimer before handing over to Shameel.

This announcement which sets out the annual results for Vodacom Group Ltd for the year ended 31 March 2019 contains forward looking statements. These statements have not been reviewed or reported on by the group's auditors with respect to the group's financial condition, results of operations and businesses and certain of the group's plans and objectives. In particular such forward-looking statements include statements relating to the group's future performance, future capital expenditures, acquisitions, divestitures, revenues, expenses, financial conditions, dividend policy and future prospects, business and management strategies relating to the expansion and growth of the group, the effects of regulation on the group's businesses by governments in the countries in which it operates, the group's expectations as to the launch and rollout dates of products, services or technologies, expectations regarding the operating environment and market conditions, growth in customers and usage and the rate of dividend growth by the group.

If you do not have a copy of the results announcement it is available on the investor relations website on www.vodacom.com. All participants will currently in listen-only mode and there will be an opportunity for you to ask questions later during the conference. If you should need assistance during the call please signal an operator by pressing star and then zero. Please note that this call is being recorded. I would now like to turn the conference over to Mr Shameel Joosub. Please go ahead, sir.

Shameel Joosub

Good afternoon everyone, and good morning to those joining the call in the US. I'm joined by Till Streichert, our CFO, and Sean van Biljon, our Head of Investor Relations. You will have already seen the numbers and we've taken you through most of it at the results presentation. For this call I will take you through some of the key take-outs for the year. I'm pleased with our results. In September we concluded the largest broad-based BEE transaction in the South African telecoms industry. This gave significant value to our black shareholders while also affording them the opportunity to be part of our next R16.4 billion deal.

Our investment in Safaricom continues to perform well. Safaricom contributed R2.8 billion in after-tax profit and we received a dividend of R2 billion in December. They continue to deliver solid results, growing their net profit by 14.7% this year and declaring a special dividend on top of their normal dividend distribution. The board intends to pass this special dividend on to shareholders.

We are making good progress on our strategic growth areas. We announced some new and exciting partnerships and acquisitions this morning which will help us to accelerate growth in a number of these businesses. We have formed a strategic collaboration partnership with Amazon Web Services which will help us accelerate our enterprise growth strategy by offering more integrated solutions to our enterprise customers. We announced that we are in the process of acquiring IoT.nxt. Our acquisition of IoT.nxt would be a unique technology and tech agnostic platform that plays a significant role in solving the challenges of legacy systems as they have limitations of integration, and will position Vodacom extremely well in being the digitisation partner of choice for customers beyond pure connectivity.

Our content business is making good progress in enabling new data platforms such as Video Play, our new video streaming platform, My Muze, offering music services, which launched in the fourth quarter, and our gaming platform which we will be launching soon. We ended the year with just over 869,000 active users on Video Play in South Africa and My Muze is already at 400,000 downloads in just a few short months.

I'm very excited about the financial services opportunity across all our markets. We have almost 46 million customers from our financial services business in South Africa and M-PESA in Safaricom and in the international operations. We are putting a lot of focus in the space and we are expanding our service offering across all markets, integrating more payment options, enabling merchant payment solutions, extending insurance and bringing loans and savings opportunities to our customers. Our M-PESA business continues to deliver solid growth and we now process $149 billion in value. That is over R2 trillion.

We continue to build our digital telco capability by introducing new ways of using big data and machine learning. We now use this technology to drive intelligent decision-making including optimising capex investments, greater sophistication in financial services and constantly improving our personalised product offers to customers. For example, in South Africa using robotic process automation we automated 86 processes and introduced ChatBot technology in the call centre which has aided in reducing call volumes by 25%.

Focussing on this year's results a bit more specifically, from a group perspective we have seen strong customer growth, gaining almost 4 million customers. Safaricom added 2.3 million customers and together we now have 110 million customers. A reminder that as we transition into the new IFRS 15 standard my commentary today is based on IAS 18 results. Group revenue was up 4.3% with strong growth in our international operations which helped to offset some of the growth pressures in the South African segment. EBTIDA grew 2.4% with excellent improvement in our international operations where we have seen strong margin expansion. EBITDA has been impacted by the BEE transaction costs and our roaming agreement with Rain.

Headline earnings per share were down 6.6%. if we adjust our M&A activities which include the BEE transaction this year and the Safaricom acquisition in the prior year we see headline earnings per share growth of 2.6% reflecting good underlying performance in the business. We have spent R13 billion on expanding and improving all our networks. We are now 4G live in all markets and 5G available in Lesotho. And finally, the board declared a dividend of 400 cents per share in line with policy. This brings the total dividend to 795 cents. This is translated into a yield of just over 7.2% on Friday's closing share price.

Let's look at the segments in more detail. In March we implemented the end user and subscriber service charter regulations in South Africa relating mainly to out of bundle usage and reducing out of bundle rates by 50%. This now allows customers a virtually worry-free experience. In South Africa service revenue grew 2.1%, a good result if you consider the backdrop of delivered price transformation, new data regulations and a low economic growth environment. In the contract space we've gained 475,000 customers with both the enterprise and consumer segments delivering strong growth. Overall contract customers were up 8.9% from the prior year. In the prepaid segment we added 1.1 million prepaid customers in the year.

Customers find resonance with our highly discounted bundle offers with short-term validity period such as daily or weekly and personalised value offers through Just 4 You. In fact, over 80% of prepaid bundles bought are validity periods of less than 30 days, showing the massive demand there is for such offerings. Data revenue was up 3.9%. The effective price per MB has now reduced by 37% following the implementation of the ICASA regulations in March. We went a step further and cut out of bundle rates by almost 50%. For the most of it the new regulation solves the out of bundle issue and is a good outcome for customers. Usage growth remained strong at 35% which gives me confidence that elasticity will help offset these price declines. Other data metrics remain encouraging with over 19.9 million smart devices on the network, of which 10 million are 4G users. Our platform strategy, designed to stimulate reasons to consume data, is gaining momentum. Take up of the video play service is encouraging with 869 000 active users on the platform. Our music platform, MyMuze, is steadily gaining customers, and our gaming platform Playinc. is launching soon.

The financial service space has been amazing, contributing R1 billion of profit before tax. Customers have accessed R8.1 million or over a third of airtime sold through our Airtime Advance platform. It now boasts close to 10 million customers using this convenient service. It advances you airtime which is payable on your next recharge. The insurance business is doing very well, growing double digits with over 1.3 million policies, a 30% growth. EBITDA declined 1.3% with margins contracting due to the roaming agreement with Rain. Excluding this EBITDA margin declined by 0.5% mainly from the slow growth in top line growth. Our cost containment measures are delivering results which offset the increased cost of maintaining a higher number of sites in our network and cost inflation.

I'm extremely pleased with the performance in our international operations. Improved trends were driven by strong growth in the DRC and Mozambique, improvements in Tanzania despite the tough competitive environment, and continued growth in Lesotho. Service revenue increased 15.6% and EBITDA grew exceptionally well at 26.8% to over R6 billion. In March 2019 Mozambique was affected by cyclone Idai. We mobilised efforts to restore communication services as soon as possible to ensure that customers get in contact with affected family members and to aid relief efforts. To assist this crisis we zero-rated calling from the 21st March to the 1st April and we have also donated $1 million to aid in the restoration of roofs on schools to get back into the classrooms as soon as possible.

Our focus on growing data and M-PESA in international markets is delivering results. Data revenue delivered strong growth of 25.8%. We added 1.1 million customers during the year to reach almost 18 million data customers, up 6.6%. We have started rolling out our content services in all operations and all our markets now offer 4G services. Demand for our mobile finical services through the M-PESA platform remains strong in all our international markets. Active M-PESA customers increased by 14.8% to 13.5 million. M-PESA revenue grew 32.2%, representing 15.8% of service revenue as we processed $2.8 billion in transactions on a monthly basis in the international operations alone.

We are seeing good progress across the portfolio of profitability with EBITDA margins expanding strongly by 3.1% to 31.3%. This was as a result of strong revenue growth and continued focus on cost containment through our fit for growth programme. Safaricom announced their results a week ago. Performance was solid with service revenue increasing 7% and EBIT increasing 13.1%, underpinned by strong growth in the customer base and M-PESA revenue growth.

We are pleased with their performance which is tracking in line with our expectations. We have included profits of R2.8 billion after deducting the amortisation of fair value assets and received a cash dividend of R2.0 billion in December from Safaricom. Safaricom proposed both a normal dividend of TSh 50.08 billion and a special dividend of TSh 24.84 billion, our share of which equates to R2.3 billion and R1.1 billion respectively. The board intends to pass the special dividend on to shareholders.

Let's move on to some of the more topical items to update you on. On the regulatory front naturally spectrum remains a major focus for us in South Africa. The Minister withdrew the ECA Amendment Bill in February and has indicated an intent to incorporate legislation and policy that will advance the transition to the fourth industrial revolution. We will be cooperating and will provide input at an appropriate time to help shape policy to the benefit of all South Africans.

On spectrum specifically the Minister is set to issue a policy directive after consultation with the newly-formed cabinet after which ICASA can start the process for licensing high-demand spectrum. The most significant obstacle to reducing input costs and by extension data prices is the fact that no new spectrum has been allocated in South Africa in the last 14 years. Delays in completing the digital migration and allocating 4G spectrum has curbed the pace at which data prices could have fallen.

Finally, let me move on to our medium-term targets. We are positioning ourselves as part of our Vision 2020 to become a leading digital company. To this end we are changing the way we operate to be more agile and utilise data machine learning in a bigger way across the businesses. We are updating our medium-term targets to reflect these opportunities and the benefits of our Safaricom acquisition and now expect a high to mid-single-digit growth rate in group operating profit. As this target is based on operating profit instead of EBIT we will also capture Vodacom's share of the growing associate profits generated by Safaricom.

Group service revenue remains unchanged at mid-single-digit growth with a slight change to capex intensity with capex at 13% to 14.5% of group revenue to reflect the change in revenue reporting. The 0.5% increase is entirely due to the revenue impact from the adoption of IFRS 15. That brings me to the end of my comments and I now open the floor. Till and I are ready to take questions.

Operator
Thank you very much, sir. Ladies and gentlemen, at this time if you wish to ask a question please press star and then one on your touchtone phone. If you decide to withdraw your question please press star and then two to remove yourself from the queue. Again if you wish to ask a question please press star and then one now. Our first question is from JP Davids of JP Morgan. Please go ahead.

JP Davids
Hi. Good afternoon. Thanks for the opportunity. Two questions to get us going. Firstly on the fixed line side, that business looks to be scaling quite nicely at the moment, going from strength to strength. Can you talk a little bit about the economics you're seeing in that business? Is the profitability scaling along with the revenue trends? And maybe also bring in the AWS partnership into that discussion just around what AWS is going to bring to the party here and maybe a little bit of the dynamics around that partnership.

And then switching gear to M-PESA. I think, Shameel, this morning you mentioned that there is a potential deal with Vodafone Group around the M-PESA brand, on-shoring that to Africa. Just in terms of how we think about that, outside of the marginal uplift that that could support what are the other benefits? And also can you just frame the size of that transaction very broadly for us if possible? Thank you.

Shameel Joosub

Okay. So firstly on the fixed line part, obviously strong growth in fixed line, enterprise fixed line specifically at 17.2% growth. We've seen good EBITDA margins. Obviously the business has been going for many years now, so we have been achieving EBITDA margins in the fixed business very similar to what we achieved in our mobile business today. That's been really strong for us. And if we continue to grow… SD-WAN for example is one of the latest products that we've introduced and we've seen very good uptake on SD-WAN. Also what is encouraging is IPDCN services and so on. So as an example, we won Shoprite this year to provide the big IPDCN services for Shoprite. And we just won Standard Bank as well. So I think continuous growth there has been really good for us in the enterprise part. In terms of FTTH and FTTB, which is also fixed line which doesn't show up in these numbers and gets reported more in the consumer segment, we have also seen growth there with 80,000 homes and businesses now passed with fibre to the home and fibre to the business. It is still early days but we're seeing margins get better all the time.

Till Streichert

Just adding perhaps to the margin question before we go to the next point, in the fixed line category actually this is also why the AWS deal is quite importantly as Shameel has explained. Cloud and hosting margins are pretty high. You can think about it as about 60%or 70% margin. IPDCN is also in the range of 50% to 60% margin. And typically what you look at obviously also with regards to partners is at a revenue share, and equally our core data revenue which is supported by that. So that's in the fixed line category. We do have in the fixed line category one item which is sizeable. That's the transit revenue. That is opposite to the cloud hosting IP VPN of lower margin nature. You rather look at the margin between 5% and 10% for the transit revenue that is coming through there. So you do have a mix. Pretty high margin and basically one category, transit, which is low margin. But overall it is a business that at the rate it is growing is contributing quite nicely to EBITDA and EBIT margin.

Shameel Joosub

Okay. Then in terms of the question around M-PESA, essentially it is a big strategic move from our part that M-PESA is essentially now owned jointly by Safaricom and Vodacom, or will be in the coming days and weeks. Essentially what we're going to do with it is capitalise it properly and make sure that we're building the platform for M-PESA and financial services through this entity going forward. So it's what we're calling M-PESA 2.0. And it is basically what does M-PESA look like two years' from now, three years' from now and so on. We are very encouraged by what we see especially in the East in terms of all the different sue cases. And we're also cognisant of the fact that we have more cash in/cash out, merchant capability and so on. So we can build a strong platform and open up the platform to more developments. I think that's going to be quite an exciting part for us. So we're going to be putting a lot of focus on M-PESA and financial services in the years to come as it's becoming a very material part of our business. And I think the way we think of ourselves now is both a telco and a financial service house.

JP Davids

Thanks. And just to follow up there, my understanding is that Vodafone did charge some branding fees etc. to the OpCo's. Would that agreement be bought out, so there would be some financial compensation to Vodafone for that?

Shameel Joosub

To be honest it's a token part in terms of the bigger picture. It's a small number. It's more I think Vodafone is convinced that it being in the hands of us and Safaricom will give it the right focus and make sure that we can drive it even further. So we're going to capitalise it further and make sure that we can get the requisite success, including making sure that we don't duplicate assets in different countries.

JP Davids
Thank you.

Operator
Thank you very much. Our next question is from John Kim of UBS. Please go ahead.

John Kim
Hi. Afternoon. Two questions please. First, can we talk a little bit about cost controls? You spoke a bit about automation of process and controlling costs. Can you help us quantify that a bit in terms of forward-going cost increases, and how is that tracking against the plan internally? A second question on the financial services. Can you unpack the growth there as well? How much is driven by additional products and services versus just higher transactional volume from the core? Thanks.

Till Streichert
Okay. Let me take the first question just on cost management. So all in all you've seen us doing pretty well on cost management, both in South Africa if you adjust for the cost that is moving above EBITDA with the Rain roaming capacity deal, and equally the BEE transaction cost, and in the international market actually a significant part of the margin expansion that you are seeing coming through, the 3.1%, is driven by good cost control and fit for growth management. Going forward there are four key areas that we are driving up further. And you could see that on the slide that I've shown to you earlier today.

And on the one side are the digital sales. So that is everything around online sales and app penetration. And we've called out a target of getting that up to 25% over the next few years from about 8% now. And that obviously directly helps you to save commissions, resources. Digital self-service. We are planning to reduce our calls by another 50% over the next few years. Just in the last financial year we have reduced our calls by 25% year over year. And one of the key drivers for that reduction was basically the deployment of our ChatBot, Toby. So you can see already that a substantial part of our calls are handled actually by Toby. That's the ChatBot and it does work quite well.

The third area is what I call robotic process automation, smart operations. And we've identified a number of processes across the business where we deploy actually tools and we automate processes. I will just give you a simple example. It sounds overly simplistic, but in the end that is what it is about. On an annual basis last year we had about 66,000 energy invoices in our fine preparations team relating to our sites that we get and the energy consumption. Those 66,000 energy invoices come basically in various formats and layouts. And without this RPA module which we have put in place, which includes intelligent optical character recognition, those invoices would have needed to be handled manually. Now you scan them and they basically get consolidated and those values get read out and put into our payment system automatically, which is a significant source of efficiency. So on a full year basis we have identified for the next coming 12 to 18 months about 300,000 man-hours related to processes that we believe we can make more efficient.

And the fourth pillar is basically capex, what we call smart capex deployment. And it is very much about upgrading and including more data sources into our models where and how to deploy capex, very much focussed on radio equipment and fixed line, and optimise the deployment with the objective that literally every piece of equipment that we are putting out into our network is immediately utilised to its maximum extent. So that's the story on fit for growth and cost management going forward for all our companies.

John Kim
Okay. And on to the financial services question please.

Shameel Joosub
So on the financial services side let me separate it into the three different segments. Firstly, in South Africa R1.0 billion profit before tax, 102.8% growth. I would say it has come from two parts mainly. The insurance book grew 30% over the last year, so that was quite strong. And then in the Airtime Advance product we saw massive scale with over 10 million customers now using the service. So it was very much scaling up on that. We have launched some new products, but those are still in their infancy like our payment gateways and so on. So a lot of it is now coming from scaling up the number of active users using the product.

Then in the international, firstly M-PESA grew 32.2% in the international OpCo's. it grew 19.2% in Safaricom, so an average growth rate of just over 25% between the two categories underpinned by a strong growth in customers, 12% across the different markets. So it is generated by 12% customer growth. It is generated by more usage per customer, and then also coming from new products that we're introducing. An example would be in Safaricom we introduced a new produced called Fuliza which is an overdraft product. And the overdraft product is now running for just under three months and has already done 4.2 billion of transactions. So we keep increasing the number of use cases, but we also continue to scale all the markets as well to try and get them all to the same level of sophistication that we have in Safaricom.

John Kim
Okay. Very helpful. On the expansion path can you unpack the AWS relationship a little bit more? Do you have any size for this opportunity in terms of available markets or served markets?

Shameel Joosub
Okay, so for AWS really it's twofold. One is that they've become our primary cloud provider, so moving a lot of stuff into the cloud to give us scale, but also to help us to be able to analyse and utilise some of the functionality in the AWS platform once the data is sitting there. So VI, AI and so on. So that's the one part. And also to give us where we are very much based on GPS those services will have the ability to scale. So that's the one part. The second part is transformation of our IP into the cloud. And then we're also busy with some projects to look at transforming more of the network services into the cloud as well. And we're doing that and looking at with Vodafone. Then the third part is as a reseller/integrator partner of AWS. So we will sell AWS services throughout Africa with obviously a bigger set-up in Africa and also in Kenya.

And the idea is that if you think about it we have the connectivity layer, which is mobile and fixed. The intent is if we can put cloud on top of that. Now, remember we have our own data centres as well. But if we couple our data centres with the AWS cloud you've got the public cloud and the private cloud or what we would today call a hybrid cloud. Essentially that gives you the ability to provide customers with a number of different services. So what we will do is have a whole team in place, solutions architects, integrators and those types of people that will go out and sign up people, get them to move to the cloud and so on.

Then we will offer services to those clients over and above them just being hosted in the cloud. So AI as a service, VI as a service, ChatBot as a service and so on. And why it's a game changer for us is it takes us beyond connectivity. But two, it allows us to be able to build products and services in the AWS cloud which then helps us to get faster to market.

John Kim
Okay. Very helpful. Thank you.

Shameel Joosub
And we'll be targeting obviously different segments. The SME segment is obviously a big focus area, but also public sector on the one side and corporates by industry segment if you like.

John Kim
Okay. Helpful. Thank you.

Operator
Thank you very much. Ladies and gentlemen, again if you wish to ask a question please press star and then one. Our next question is from Ziyad Joosub of HSBC.

Ziyad Joosub
Hi everyone. Thanks very much for taking my questions. The first question is just on the Telkom roaming agreement. It was mentioned at the presentation that that will start filtering into enterprise or wholesale revenue by July. Will that be in July? Will the Telkom roaming revenues start bleeding in, or by July will we see the full quantum of what the total potential revenue could be come through into Vodacom's revenue? The second question is on data. I was wondering if you could maybe provide a bit more colour before the out of bundle regulations came through on the 1st March. You've obviously seen a nice recovery in your data conversions and your elasticity relative to Q3. How was January and February data growth relative to March when the out of bundle regulations kicked in? And then just a last question on voice revenue, outgoing voice in South Africa. The last four quarters you've sequentially seen improvements and I think in Q4 if I'm not mistaken it looks like voice revenue was growing positive. Maybe if you could give us an idea of how we should look at that or model that going forward. Thank you.

Shameel Joosub
So on Telkom roaming, firstly the Telkom roaming started to migrate from December but will scale up basically with all the traffic being on by the end of June. So from July effectively we should have all the traffic on board, or at least the traffic that amounts to the floor. Obviously they can control the traffic over and above that. But I would say they would have cut over from MTN by the end of June.

Ziyad Joosub
Okay. Thank you.

Shameel Joosub
In terms of data out of bundle, effectively the underlying trend… So January was still impacted by the Christmas promotion so we still had the promo running through most of January. February was a much better month in terms of underlying growth, more in terms of what we were seeing last year or the first half of the year. So strong growth, high single digit I would say. But then March came and that all went away in terms of the out of bundle rate decline. So I would say underlying we're quite pleased with the data growth. And we are starting to see some of the price transformations that we have done have started to lap. But the issue still is that you've got to deal with the out of bundle issue.

Till Streichert
Let me take the question on voice. So you are right, Ziyad. This year we have seen actually throughout the year a bit of stabilisation of the decline in voice revenue. If you look at it half one we

were on -1.3% year over year, in half two -0.9%. Look, going forward I think there is stabilisation so you can probably look at that as a probably flattish voice revenue contribution to our total service revenue or year over year growth. But let me also emphasise what is more important than actually the split between voice, SMS and data is really the overall service revenue trajectory. And going forward we will be talking a lot more on the drivers of our total service revenue and less about the individual components of voice, data and SMS. But again going forward I think voice being flat is a good indicator or a good target.

Ziyad Joosub
Thank you very much. That's very clear. Thanks a lot.

Operator
Thank you very much. Ladies and gentlemen, a final reminder, if you wish to ask a question please press star and then one now. Sir, it would appear that we have no questions in the queue at the moment.

Shameel Joosub
Okay. Thank you for joining us for today's call. If there are any other questions that you might have please reach out to the Vodacom investor relations team. Enjoy the rest of your day. Thank you.

Operator
Thank you very much. Ladies and gentlemen, that concludes this conference call and you may now disconnect your lines.

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