Conference Call Transcript

20 May 2013

ANNUAL RESULTS

Operator

Good day, ladies and gentlemen, and welcome to the Vodacom Group Ltd annual results conference call for year ended 31st March 2013. Vodacom Group CEO, Shameel Joosub, will host this conference call. I will read the forward-looking disclaimer before handing over to Shameel Joosub.

This announcement which sets out the annual results for Vodacom Group Ltd for the year ended 31st March 2013 contains forward-looking statements which have not been reviewed or reported on by the group's auditors with respect to the group's financial position, 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, expenses, revenues, financial positions, 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 announcement and presentation is available on the investor relations website at www.vodacom.com. If you should need assistance during the conference then please signal an operator by pressing star and then zero. Please note that this conference is being recorded. I would now like to turn the conference over to Shameel Joosub. Please go ahead.

Shameel Joosub

Thank you. Good morning to those dialling in from the US and good afternoon to our South African, UK and European investors. Thank you for joining us to discuss our annual results. Joining me here today is Ivan Dittrich, our CFO, and Belinda Williams from our Investor Relations team. I am also joined by Richard Boorman from our media team.

To summarise, this was a really good year for Vodacom. We gained 3.8 million customers and now we have 51.7 million customers across the group. Overall revenue grew by 4.5% to just shy of R70 billion. More importantly, EBITDA grew 11%, which is a great achievement given the economic environment. And headline earnings per share rose 23% to 872 cents per share. If we exclude the change in dividend withholding tax or STC our underlying earnings per share grew 14%.

The key feature of our results is a great performance from our International business with revenue from this segment up 22%. Data is still growing with revenue also up 22%. South Africa has also been more positive than our numbers suggest with reasonable underlying growth masked by a number of actions we took to improve profitability and also by the final cut in MTR.

We also continue to invest in our network to maintain our competitive advantage, spending R9.5 billion and adding over 1,700 3G base stations and 1,400 2G base stations this year. In the last 12 months we carried more than 40 billion minutes of outbound calls and approaching 50 billion of SMSes and MMSes.

Our board has approved a final dividend of 430 cents per share, bringing the total dividend to 785 cents, up 10.6% on the prior year.

Looking at the South African segment and delving a little bit more into the results, South Africa was definitely impacted by the low-end consumer being under pressure with electricity, fuel and food inflation being the key pressure points. The higher income segment appeared to be a bit more resilient.

We took a number of actions to improve profitability and made year on year comparisons of customer numbers and revenue a bit tricky. These include cutting out calling cards, reducing LCR services and substantially increasing handset financing. All of these negatively impacted revenue but boosted EBITDA, supporting the 5% growth. The final MTR cut on 1st March also impacted year on year comparisons.

Stripping these items out there was some negative impact from the slower economy, but the market is still seeing reasonable growth and we have not seen deterioration into the fourth quarter.

If we specifically look at the South African voice revenue, Q4 voice revenue declined 3.8%, but if you add back the R140 million for the leap year or Easter Friday impact Q4 was down 1.8%, which is better than the decline in Q3 of 2.3%. We expect further improvement into the next quarter.

Despite the inflationary pressures we were able to keep operating costs flat with savings in network running costs more than offsetting increased publicity spend.

On the commercial side we revamped both our prepaid and contract offerings in the second half of the year. So far the Smart an Red contract plans that we have launched are doing well and are having a positive impact on ARPU. Our new prepaid plans are increasing gross connections and lower price point is driving increased usage, which is also helping to protect revenue.

Our blended price per minute is down 7.4% to R1. The prepaid rate is down 11.1% to 72 cents. This includes the impact of Night Shift.

If we look at the number of smartphones that are on our network it increased 26% to six million phones. The average amount of data used by each smartphone grew 43.4% to 139 MB. We have dropped data prices across the board and the effective rate has come down 18% for the year.

Vodacom Business, which makes up 15% of South African service revenue, delivered better revenue growth than the consumer business with converged services in particular doing well and growing 24%. We are now geared up to launch the successful Vodafone OneNet product in the coming weeks.

We have also maintained a high level of capital expenditure, spending R7 billion in South Africa and adding just under 1,000 3G base stations. Two-thirds of our network is now connected to our own high-speed, high-capacity transmission and 77% of the network is on single RAN, which is the equipment which basically makes us LTE ready. We still lead the speed tests and were the first operator to launch LTE, with 600 sites now live and 165,000 LTE devices on the network.

If we move on to our international segment this business has delivered excellent results. Service revenue grew 22%, supported by a 13% increase in the customer base and a very strong voice usage growth of 51%. Yes, there were competitive pressures. The competitive pressure in the international markets was intense. But we countered this by introducing new integrated offers and daily and weekly pricing options and were able to offset the lower prices with higher usage.

Data adoption is a tremendous opportunity in the international markets with data revenue, 60% of which comes from M-Peaa, growing at 107%. Over half of our customers in Tanzania use M-Pesa for money transfer, airtime purchases and third party payments. M-pesa customers are now generating additional ARPU of $1.50. We recently launched M-Pesa in the DRC and will be extending it to our other markets this year.

Our data customers in the international operations are up 41% to over 4 million customers. These operations have also reached the critical mass, with scale benefits helping to increase the EBITDA margin by almost 10%.

We substantially increased capital expenditure in our international portfolio to capture further growth in these markets, increasing coverage and building on our network leadership.

If we look forward, we plan to maintain our service revenue guidance at low single-digit growth as we believe the international portfolio will continue to support good growth. We also expect the South African performance to improve. We still believe there is room for a steady incremental increase in the EBITDA margin and we are expecting mid- to high-single-digit EBITDA growth.

We maintain our 11% to 13% capex intensity guidance and we currently expect to continue spending at the upper end of this range. Thank you. That concludes my comments and we are now ready to take any questions you may have.

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

JP Davids
Thank you and good afternoon. Two questions to start, please. They are both on South Africa. The first one. During your presentation earlier today you mentioned that the independent service providers were struggling because of least cost routing being switched off. Is there also an element of them struggling because of the tariff adjustment you've made, specifically moving to things like your Smart tariffs and your Red tariffs? Are you recapturing this weakness that they are seeing through your direct channel? The second question is on a comment you made on the third quarter results where you talked about the tariff adjustments in February addressing competitive and government pressures. You already cited the improvement in market share. I was just wondering if you feel that the tariff adjustments have helped address any government pressures you may have been facing to lower telecom costs in the country. Thank you.

Shameel Joosub
JP, just to answer your question, the service providers account for 10% of our revenue. What we've seen is a 15% decline in their performance this year. If we remove the impact of the service providers then we actually had positive revenue growth in South Africa of at least 1%. I think the reason for the under-performance of the service provider is the exposure they had to least cost routing. Most of the least cost routing was being done by the independent service providers. So they had to basically remove a lot of that business. A lot of that business has now gone over the point of

interconnect. So it has not been lost. It has shifted from the service providers into the point of interconnect at a lower margin or at a lower rate. So that's the first part.

What we have done on the service providers to improve their performance... just to add, they haven't been impacted by the new pricing plans because actually on the new pricing plans we are seeing a positive impact on ARPU. So I think the big reason for them has really been the LCR. What we have done to address the service providers is we've changed the way our agreements get structured, so they get paid a higher percentage based on revenue growth going forward. And we've reduced the underlying base that we pay them. So if they don't perform at a consistent growth rate they actually will land up earning significantly less than what they did in the prior year.

If we look at your second question in terms of pricing pressures I think the big concern for us was that if we look at our effective rates from prepaid and also overall then one of the issues was that we were giving the value but the published prices were high. And all comparisons being done are being done at published prices, which no one explains. So what we decided to do was actually introduce new pricing that gave the value that we were giving to customers. in any case And so we brought the high level pricing down. I think that will help to alleviate a lot of pressure in terms of high level pricing. There is a big difference when you say you're paying R2.85 per minute versus the packages we've launched now which is 2 cents per second or R1.20 per minute. So that takes a lot of pressure off.

JP Davids
That's very helpful. Just one quick follow-up. On your integrated tariff, it is very encouraging that the ARPU is improving there. What sort of penetration rate have you had on the integrated tariff? What percentage of your base is now on these tariffs?

Shameel Joosub
We've launched two integrated tariffs, one in August last year and another now. Basically what we're seeing is that on the two combined we have 500,000 customers already on the new integrated plan. And it is constituting 80% of our new contract connections.

Operator
Mr Davids, this is the operator. Have all your questions been answered?

JP Davids
Yes, for the moment. I will jump back in the queue.

Operator
Thank you very much, sir. Our next question comes from Richard Barker of Credit Suisse. Please go ahead.

Richard Barker
Thank you very much. I've got a question please guys on your international businesses. I'm looking at the sequential local currency ARPU development in the fourth quarter of the year. There looks to have been quite a drop-off in Tanzania, the DRC as well and also Lesotho. Is that just seasonality or is there more at work there? Have there been any regulatory or competitive changes in the environment that would explain that?

Ivan Dittrich

That would be mainly as a result of the revenue adjustments that we've referred to in our presentation where there were some adjustments to revenue of about R200 million in Q4 that was deferred as we aligned our international OpCo's revenue recognition policies with the group after review process. And there has also been higher customer growth.

Richard Barker
So do you have a feel for what a normalised level of ARPU would be without those kinds of adjustments in there? Is it materially larger than what you have reported?

Ivan Dittrich
I think it was probably more in line with what we had in Q3.

Richard Barker
Okay. Thanks very much.

Operator
Our next question comes from Ziyad Joosub of JP Morgan. Please go ahead.

Ziyad Joosub
Thank you very much. Firstly on the deferred revenue international. Is the deferred revenue coming out of voice or is it spread across the revenue lines?

Shameel Joosub
It is predominantly voice.

Ziyad Joosub
It's predominantly voice. And also the 10% of revenue that is ISP. Was it only 15% down in quarter four or was it also down in quarter three? Is it only a quarter four issue as we stand now?

Shameel Joosub
No, it's a full year issue.

Ziyad Joosub
And do you book the ISP revenue from LCR into mobile voice or mobile interconnect?

Shameel Joosub
It's in mobile voice. And just to be clear it was worse in Q4. There was a bigger decline in Q4 because of new pricing on LCR. And with the new MTR cut coming in in the month of March there was obviously preparation for that beforehand.

Ziyad Joosub
Thank you very much.

Operator
Ladies and gentlemen, a reminder that if you'd like to ask a question please press star and then one now. Our next question comes from Craig Hackney of Noah Capital. Please go ahead.

Craig Hackney
Thank you. I just want to look at your South Africa prepaid churn in the fourth quarter of 68% annualised. Could you give us a sense of how much of that is being driven by the clean up of the

base and how much is true underlying churn, and what we should expect into the first quarter of FY14 if possible please.

Shameel Joosub
I think obviously one of the big impacts has been the calling card behaviour. And the 68% should come down to 44% or 45% going forward.

Craig Hackney
Okay. Thank you very much.

Operator
Our next question comes from JP Davids of Barclays. Please go ahead, sir.

JP Davids
Hi again, guys. Two more questions please. The first one is just in terms of your broad-based black economic empowerment credentials. That's all very good. It does look like ownership though still remains an area of opportunity for you guys. Would Vodafone support this by selling down their stake? Are you able to comment on that? And then the second one. In your slide pack on enterprise you talk about a Pan African network expanding. Can you just clarify that? I get a little nervous when you see that sort of taking on Africa as a whole type of statement. Thank you.

Shameel Joosub
Okay. So maybe just to comment on the BEE. Firstly we are level three. We had the DTI code and then we had the ICT charter. The ICT charter was a lot more stringent. There was some concern that we would fall back to a level four. But we took strong measures in the latter part of the year and made sure that we maintained our level three status by introducing these new measures and making sure that we comply with the ICT level three, which is a lot more stringent than the DTI level three.

Having said that we have clear ambitions to become a level two provider. And to that end we continue to look at how we can optimise the current BEE deal. Remember the ICT charter has a R7.5 billion cap, which we comply with. But we look to optimise that deal on the one side. Once the licensing regime is thought out for new spectrum if need be then we would be willing to do another BEE deal. That would purely be based on the fact that there is a harmonisation of ICT charter to the Electronic Communication Act that needs to still happen.

On the second question in terms of the Pan African network, when we acquired Gateway we basically acquired presence in a number of countries and then expanded that by having points of presence in different countries. And that has allowed us to capitalise on opportunities such as signing up the DHL account for Africa, doing Barclays for Africa and so on. That doesn't require a lot of infrastructure investment. These infrastructure investments have already been made. But it definitely provides customers with a level of confidence. Our Vodacom Business Africa business is now R900 million of revenue. Most of our presence is based in Nigeria and in Zambia where we have more staff. The other countries, the other five or six countries, we have three or four people in each country.

JP Davids
Thanks. That's very clear. If I could be cheeky and just ask another third question while I'm on the line. Going back to South Africa, in your slide pack you talk about a resurgence of retail stores that's ongoing. Do you have plans for ramping up more stores in the country? Could you give us an idea

of where you are in the direct channel in terms of how many stores you have in the country? Thank you.

Shameel Joosub
We have close to 300 stores using two different franchise channels and then a number of branded dealers who have exclusive relationships with us. We obviously fund the fittings and so on for the different stores. So we have a very strong presence. We continue to look to enhance that presence as new shopping centres open, but it's not unusual in a big shopping centre to find at least 20 points from which we sell our products because we are making extensive use of retail channels. Where we are looking to expand our distribution is into the rural areas, but more from the perspective of engaging with the kiosks and street vendors, making sure that our presence in that market is a lot more prevalent so that we don't lose any share or capture more of the share in those markets.

JP Davids
Really appreciate that. Thank you.

Operator
Our next question comes from Richard Barker of Credit Suisse. Please go ahead.

Richard Barker
Thanks. Just a couple of housekeeping questions really. Firstly, you talked a little bit in the text about the impact of termination rate cuts on the revenue line. I just wondered if you could say anything about what the net impact was on EBITDA and what your net interconnect revenue was and how it has changed year on year. A bit of information on the cost side is what I'm getting at. And secondly, I was wondering if you could talk about the South African enterprise business in terms of revenue and EBITDA. You just said R900 million odd of revenue. What's the progress like on the EBITDA there? That has been EBITDA negative up till now.

Shameel Joosub
Let me start off with that one. So basically on the Vodacom Business side what we're seeing now is EBITDA starting to improve. So now we are achieving positive EBITDA and we've cleaned up a lot of the bad debt and those types of things in our operations, specifically Nigeria. And we are confident that we can achieve at least... this year the EBITDA has improved, but next year we see EBITDA multiples in the 20s.

Ivan Dittrich
Then just on the MTR. That impact was about R550 million to R570 million negative on EBITDA. The net interconnect was up about 14% to R1.3 billion.

Richard Barker
Is that at the group level or just at the South African level?

Ivan Dittrich
This is at the South African level.

Richard Barker
Okay. Thank you.

Operator
Our next question comes from Chris Grundberg of UBS. Please go ahead.

Chris Grundberg
Thanks. Just a quick one. I just wondered if you would give us the number of subscribers you have taking the LTE so far in South Africa by dongles and smartphones. Thanks.

Shameel Joosub
There are 165,000 customers using LTE currently. I will give you the split now between smartphones and dongles. Can I come back to you on that one?

Chris Grundberg
Thanks. Can you also send out the MB usage for that as well? I'm assuming it is higher than the average.

Shameel Joosub
Sure.

Operator
Our next question comes from Craig Hackney of Noah Capital. Please go ahead.

Craig Hackney
Thank you. Just looking in South Africa again at voice, in my calculations with regards to outgoing minutes of use per subscriber and then your average outgoing rate per minute I get the average rate per minute down 8% year on year and outgoing MOU down 9% year on year. Assuming there is zero price elasticity in that market is that what you're seeing, or am I doing something wrong on my calculations?

Shameel Joosub
I think one of the big impacts has obviously been in PPM. It was down 7.5% to R1. And MOU was down just on 10%. But the big part has obviously come from the LCR impact in contract and out of bundle in contract. That is where we've had the biggest impact. So contract decreased more. In prepaid we have seen much better elasticity. How we have dealt with the contract issue is by launching the new integrated plans. We are ensuring that we secure the out of bundle spend if you look. So where a customer was previously spending R300 as part of that six monthly subscription and then ad hoc data, ad hoc SMS and out of bundle voice. We are now taking that spend and migrating this to a new plan where we hold on to that spend using that activity system but giving the customer a lot more value for the same spend.

Craig Hackney
Okay. So going forward you will see a more favourable relationship between that outgoing average rate and minutes of use in FY14.

Shameel Joosub
Very much so. That's why the whole context has been really pushing the transformation of pricing if you like, both in prepaid and contract, which we believe will create a lot more elasticity.

Craig Hackney
Okay. Thank you.

Operator
Our next question comes from David Lerche of Avior. Please go ahead.

David Lerche

Hi. Good afternoon everyone. Just a quick one on the capex. You said you should likely be towards the upper end of your 11% to 13% guidance for the group. Are you able to give us some sort of split between South Africa versus the international operations? Just a little bit more detail there please.

Ivan Dittrich
If you look at the year that has just gone by we ended up at 13.5%. South Africa was in the 10% range and I think international was around 24%. As we said we expect to be at the upper end of the range, with South Africa at similar levels and international slightly lower.

David Lerche
Thank you very much.

Belinda Williams
Just to come back to you on smartphone on LTE the smartphone usage is more than double, in fact almost three times that of the average smartphone usage.

Operator
Thank you very much. Ladies and gentlemen, a final reminder that if you would like to ask a question please press star and then one now. Our next question comes from Ziyad Joosub of JP Morgan. Please go ahead.

Ziyad Joosub
Hi. Thank you. In quarter three you guys gave us some guidance that if you stripped out the effect of terminating the calling card subs total service revenue growth wouldn’t have been negative 1.7% but zero percent. Just bashing those numbers out it implies that terminating the calling card subs had a 2.5% to 3% impact on mobile voice. Would you be comfortable with that figure? Do you think it still held in Q4?

Shameel Joosub
No, the impact in Q4 was much less.

Ziyad Joosub
Much less. Okay.

Shameel Joosub
And Q4 obviously was impacted by LCR and specifically the fact that with the new rate cut coming in meant that more customers moved off.

Ziyad Joosub
Okay. Thank you.

Operator
Gentlemen, we have no further questions. Do you have any closing comments?

Shameel Joosub
No, thank you. Thanks for your time.

Operator

Thank you very much. On behalf of Vodacom Group Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT