

Conference call transcript

16 May 2011

ANNUAL RESULTS

Disclaimer

Operator

Welcome to the Vodacom Group Limited annual results conference call for the year ended 31 March 2011.

Vodacom Group CEO, Pieter Uys will host the conference call.

I will read the forward-looking disclaimer before handing over to Pieter Uys.

This announcement which sets out the annual results for Vodacom Group Limited for the year ended 31 March 2011 contains 'forward-looking statements' 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, revenue, financial positions, dividend policy, and future prospects; business and management strategies relating to the expansion and growth of the Group; the effects of regulation of the Group's businesses by governments in the countries in which it operates; the Group's expectations as to the launch and roll out dates for 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 and presentation it is available on the investor relations website on www.vodacom.com

Pieter Uys

Thank you, Leroy. Good afternoon to everybody and good morning to those in the US. With me I've got our CFO, Rob Shuter. Hi, Rob.

Rob Shuter

Hi, Peter.

Pieter Uys

And also Belinda Williams from our Investor Relations. And then I am going to take you through a summary and then at the end we will have time for some questions. I want to start with our two key initiatives. Firstly it is a good set of results. We delivered growth on all our key measures, and that is more or less in line with the guidance we communicated a year ago. Our mobile data business remains the engine of growth but we have also started focusing a lot on

the customer experience and we delivered on the cost efficiency programme that we announced last year. So we're pretty pleased with where we ended the financial year.

Secondly, we've refreshed our brand. The new red Vodacom is definitely not the same as the old blue Vodacom. A lot of change is happening behind the colour. Firstly we've refocused our strategy into five key priorities, integrated our core business strategies also with our stakeholders dealing with all the issues under one umbrella. We've also reorganised ourselves to make the business simpler and faster. We are removing barriers to performance. And then lastly the refresh of the brand is underpinned by initiatives to deliver on the brand promise. A better network, a better customer experience and service and better value to our customers.

If I look at some of the highlights, firstly we are very pleased with the performance over the last year. Group customers up 9%, 43.5 million. Group service revenue growth, 5.5% in constant currency, strongly supported by group data revenue growth of 35.5%. Group EBITDA in constant currency up 5.8% to R20.6 billion. The strong operational performance and reduced interest rates reported headline earnings per share growth of 28.6% to 656c per share. Strong free cash flow increased 22.4% to R8.8 billion, and that delivered a 60% increase in the final dividend to 280c with the total dividend for the year sitting at 460c per share. That is a payout ratio for the year of 70% of headline earnings per share.

Those were the highlights. Let me now look into our two reporting segments. Firstly, South Africa. South Africa had a robust financial performance. Service revenue grew at 4.7%, but particularly the last quarter Q4 growing at 5.6%. EBITDA growth, 7% if I exclude foreign exchange differences. And the EBITDA margin stable at 36.8%. Capex up to R5.1 billion, up 11.5%. The economy is showing signs of recovering but it is still fragile because of increasing fuel and food costs. But we do see increased consumer spend on the back of lower inflation and lower interest rates.

Competition is definitely more intense in South Africa on the competitive front. We saw 8ta launch in the third quarter last year. Also Cell C has relaunched themselves with the new data network. If I look at the competitive environment the year has been categorised by lots of promotional pricing offers, driving down the effective price per minute and also effective price per megabyte.

The customer base is growing again after RICA. We had the 3.3 million subscribers deleted in April last year. That was a once-off. We have largely overcome RICA. The gross connections have returned to pre-RICA levels, ending the year on 11.6 million. South Africa customer base grew year on year to 26.5 million. The net additions in Q4 were strong, 1.2 million. Q3 was also strong, 1.4 million. Churn continues to improve, probably on the back of subscriber registration, making it more difficult to get a new connection. Q4 churn was down to 28.5 from 32.7 in Q3. Contract customer growth remains strong, 14% up, totalling 5.1 million. A lot of that growth comes from the lower end, lower use customers.

Then I've mentioned the competitive environment stimulating a lot of promotional activity. A lot of this has pushed up the outgoing voice traffic, almost 18% up for the year driven mostly by off-peak on net promotions, reducing the effective price per minute by 11.5% for the year.

I will now spend a few minutes on data services. The demand for data remains strong. We added almost 1,000 new 3G base stations in South Africa, increasing our data base stations by a third with population coverage sitting at around 75% at the moment. We've also recently launched our 43MB per second network. Not only does it give customers a faster experience but it also inherently puts more capacity into the network so that we can give more customers a better experience. We now have 4,300 3G base stations. All of them are 14.4 enabled. All of them are 21MB per second or HSPA+. And then around 1,500 would be dual carrier 43MB per second technology.

So all of that driving data revenue up almost 34% in South Africa for the year. Data customers are up 34.6%, now totalling 9 million. 2.6 million of those are buying data bundles on a regular basis. Data cards PC connectivity devices went up 48% and are now sitting at 1.1 million. The big growth area for us in the data story is smartphones, up 84%. We now have 3.6 million smartphones on the network. 23% of those smartphones have a data bundle attached to it. So that is the South African segment. I will move on to the international part of the business now.

Overall if you look at the international performance it is impacted by the stronger rand translation. If I take away Gateway, looking at the pure mobile business, customers growth was strong, up 24% to 17 million. We're also pleased with the elasticity that we've experienced as tariffs have come down. Usage on average is up 20.5% on the back of the reduced prices. Service revenue increased 11.6% in constant currency. We have improved revenue growth in most of our operations. EBITDA declined by 20.7% in constant currency, the EBITDA margin falling to 10.2%. Most of that is because of Gateway. If I take Gateway out of the equation and look at it in constant currency the mobile operations EBITDA margin expanded from 17.7% to 19.5%. Capex in constant currency reduced by about 30% following a big investment that we had last year in Tanzania building out the network there. And then we had to make a further impairment to the Gateway business of another R1.5 billion.

So our medium-term targets remain mostly unchanged. We intend on maintaining or improving our market positions in our business. We still expect the group service revenue to grow in low single digits as we make our way through the declining interconnect revenue. While we've completed our R500 million cost efficiency programme that we announced last year, one of our strategic priorities going forward is operational excellence. We continue to look at ways to make it simpler, faster and easier to deal with our customers, so we also expect to see more savings coming through. So we are hoping to at least maintain our margin and possibly see more improvements in the margin.

The Group capital budget for the current financial year is up from R6.3 billion last year to R7.7 billion going forward. These numbers exclude the non-cash accounting for the RAN swap that we're doing. So of this R7.7 billion for the Group capex we've allocated R6.3 billion for South Africa excluding the RAN swap. A lot of the investment will go into making the data network and the transmission wider, faster and smarter.

So let's look at our medium-term targets. In summary I can say we had a great year. We're starting to benefit from the improved economy but also from our efforts to improve the customer experience and deliveries we've had on our cost programme. We've refocused our strategy. There is now a firm target to make sure that we delivery on all stakeholder expectations. The mobile broadband strategy remains the key driver for growth going forward and the demand for

data services remains high in South Africa and also the other territories. We are making great strides in improving the network and also the service to support the data business.

Finally to conclude then we are pleased that we delivered good shareholder returns for the year with total shareholder returns of 51%. So that concludes things from my side. I will hand back to Leroy to open the call for questions and answers.

Operator

Ladies and gentlemen, at this point if you would like to ask a question please press star then one to join the question queue. If you decide to withdraw your question you can press star then two to remove yourself from the list. I will repeat, if you would like to ask a question please press star then one. Our first question comes from JP Davids from Barclays Capital.

JP Davids

Good afternoon, guys. You've provided some very useful dividend guidance, talking about a dividend payout of over 70% for the medium term. But at the same time the net debt to EBITDA is starting to get closer to a net neutral position. At what point in the absence of M&A do you decide to do a special dividend or something like that? Is there a magic number in terms of net debt to EBITDA that you think is optimal for the group? Thank you.

Pieter Uys

Thanks for the question. Rob, can I ask you to unpack that a bit?

Rob Shuter

Ja. I think I will tackle it in a few steps. We do view ourselves as structurally under-g geared. You have seen our net debt to EBITDA ratio come down from over 1 times to about 0.5. Ideally we would like to restore some gearing if and when the opportunity arises. In the medium term the view was let's up the payout ratio because at least that will help preserve the gearing we've got. The uncertainties going forward are around potentially share repurchase of the government stake. We've been engaging with them on that. We think it could be a really good transaction for Vodacom. But it is very difficult to assess the timing of that. The other possibility is around M&A. We remain committed to expanding the portfolio, but only for decent priced acquisitions in our geographies and in our core market. And that is also difficult to read. So we've tried to leave ourselves the flexibility to cater for those uncertainties. And we will see how that plays out over the next year or two, and if we need to revisit we will revisit. But there is no special dividend on the cards and there is no particular metric that will bring that onto the cards.

JP Davids

Thanks, Rob. If I could follow up with a separate question. On your contribution margin there was a very nice ramp-up during the year on the back of lower commissions etc. Is that rate of improvement something that you would expect into FY12 or is that a medium-term level that you've reached for the contribution margin in the domestic business? Thank you.

Rob Shuter

I think that we remain committed to improving the EBITDA margin over time through operational efficiencies. We've signalled it is going to be more modest going forward. It is going to require an improvement in the contribution margin because the other cost lines are much more difficult to manage below the kind of service revenue growth we're expecting over the next couple of

years. We've got wage inflation affecting the staff cost line. You've got expansion of the network and more traffic affecting areas like network opex. So we will target improvements in the contribution margin. Some will get eaten back in some of the other areas. That should drive more modest improvements going forward. And the kinds of areas we're looking at are around acquisition costs, so cost of acquisition in the post paid space. We think there is work we can do there. Some work in the prepaid cost of acquisition, although that is a much smaller number. And we are going to look for further efficiencies in the upfront commissions in the distribution space.

JP Davids

Thanks very much.

Operator

Just a reminder to participants, if you would like to ask a question please press star then one. Our next question comes from Craig Hackney from Religare Capital Markets.

Craig Hackney

Good afternoon. I have two questions. Firstly, in South Africa your equipment revenue growth was very strong this year. If you could just speak about the reasons for that and whether you see it continuing in the new year. Secondly on Gateway. Could you give a revenue split between the carrier services and the business services segment please?

Pieter Uys

On the back of the strong rand we had very strong equipment sales, perhaps the sales in numbers went up by 30% plus. That was just on the back of good promotions and on the back of the strong rand, handset prices coming down. It is difficult to predict what is going to happen going forward. Gateway, Rob, I don't know if you can untangle that too?

Rob Shuter

We don't normally go down to that level, but suffice to say that Gateway Carrier had much higher revenues than VBA, \$300 million to \$400 million a year, depending which year you're in. Vodacom Business Africa is in the \$80 million to \$100 million range. Carrier is three to four times the revenue of Vodacom Business Africa.

Craig Hackney

Thank you very much.

Operator

Our next question comes from Herve Drouet from HSBC.

Herve Drouet

Good afternoon. My first question is regarding the competitive environment. You mentioned there was increasing promotion, particularly on the off-peak on net. Do you see that changing over the year? Are you starting to see some change, either higher competition or on the contrary an easing of the promotions? My second question is one of your competitors had some problems in renewing the distributions in South Africa. I was wondering if you think that may have an impact in terms of commissions being paid to the agents for the distribution of mobile services from your point of view. Thank you.

Pieter Uys

If you look at the competition in South Africa there is competition in the voice space, there is competition in the data space. In the voice space over the last couple of years and also on the back of interconnect coming down we've not just seen headline tariffs come down. Yes, tariffs are very complicated and some of those have come down. But a lot of activity has happened around promotions that are done for a couple of months. So at the moment there are not a lot of voice promotions hitting the market. Competition is more or less stable on the voice side. On the data side, on the other hand, it is much more aggressive. Cell C, 8ta, they were never in the data space. Cell C launched their new network. 8ta is a new network. At the moment there are very aggressive data promotions in the market. It started with Cell C. We followed recently with a promotion. MTN also followed. On the headline tariffs the tariff ranges from where we are down to 25% below us on some of the offers. So there will probably be some movement in the headline tariff as well. But the promotions come and go, and we will see how it goes. So voice is pretty stable at the moment. But on the data side we have to compete at the moment. The second question, Rob was speaking to some of the cost side of the equation and cost benefits that we had last year from the distribution side. So what exactly happened with one of the competitors I'm not sure. At the moment we have a very good partnership with our distribution.

Herve Drouet

Okay. So you don't feel any change from commissions or pressure on commissions in any way? It is business as usual with distribution for you?

Pieter Uys

We will continue to focus on the distribution costs because it is one of those big pots where you have to focus to make a difference on the cost efficiency side. Last year we took on a percent of the upfront prepaid commissions, and we will probably do a similar number going forward. But it is not something that will completely disrupt the market.

Herve Drouet

Thank you very much.

Operator

Just a reminder to participants, if you would like to ask a question please press star then one. Our next question comes from Nick Kershaw from the Deutsche Bank.

Nick Kershaw

Good afternoon. Just two quick questions. Can you tell us how many data bundles you had in South Africa at the end of March? And also you disclosed your data traffic in the interim period. Can you give us an indication of what that was for the second half period?

Pieter Uys

The data bundles or data cards at the end of the period were 1.1 million. And then in terabytes I think it was 7 076 terabytes. That is 7 petabytes for the year.

Nick Kershaw

Great. Thanks very much.

Operator

Mr Uys, it appears we have no further questions from the conference. Would you to make any closing comments?

Pieter Uys

Thank you, Leroy. We had a good year. We delivered high shareholder returns of 51%. In the company we've done a real good look at how we do business. We have refocused our strategy, aligning the different strategies with stakeholder strategies. And we have come out with a clear way going forward. We have split it up into five priority areas. We have also reorganised ourselves to deliver on for example the customer promise, which is one of the key priorities. And then the refresh of the brand is underpinned by better delivery on the network. As you see from the capex we continue to invest in the network. Service delivery, we are working hard to improve the customer experience and the value. There is a lot of value offers in the market at the moment and we will continue to be competitive. So thank you for joining us on the call and I look forward to speaking to you again soon. Bye, bye.