

Conference call transcript

7 November 2011

INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2011

Operator

Good day and welcome to the Vodacom Group Ltd interim results conference call for the six months ended 30 September 2011. Please note that all participants are in listen-only mode and there will be an opportunity for you to ask questions after today's presentation. Please also note that this conference is being recorded. Vodacom Group CEO, Pieter Uys, will host the conference call. I will now read the forward-looking statement before handing over to Pieter Uys. The announcement which sets out the interim results for Vodacom Group Ltd for the six months ended 30 September 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 relating to the group's future performance, future capital expenditures, acquisitions, divestitures, expenses, revenue, financial positions, dividend policy and future projects, business and management strategies relating to the expansion and growth of the group, the effective regulation of the group's businesses by governments in the countries in which it operates, the group's expectations as to the launch and rollout dates for products, services or technologies, implications 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 it is available on the investor relations website on www.vodacom.com. I would now like to turn the conference over to Pieter Uys. Please go ahead, sir.

Pieter Uys

Good afternoon to everybody, and morning to those who are still in the morning. I've also got Rob Shuter with me and Belinda as well. Before going to the details I'd just like to summarise a little bit, and then get into some of the highlights. Strong market performance across all the operations has driven customer numbers in the group up 22%, now sitting at 48 million. During these six months we added 4.4 million customers in the group, 2 million of them coming out of non-SA. Data revenue continued to be a big driver for us, growing at 31%, with active data customers up 38%. We are now at 12.5 million active data customers on the network. And we are also very pleased to say that the positive momentum that we have built up in the international operations is continuing and they posted a really encouraging performance with their constant currency revenue growth of 20%.

That was some introductory comments. Let's look at the highlights. Good service revenue growth, 6%, that's the reported number. That is above our guidance of earlier in the year where we said we would grow in the low single digits. EBITDA growth, 7.6% reported year on year. If I look at it in constant currency, 10%. Group EBITDA margin for the half year, 33.2%, more or less stable on last year. If I exclude

the impact of foreign exchange movements, trading in foreign exchange, the EBITDA margin actually expanded by half a percentage point, taking it to 33.7%. Group capex, we invested more. Last year we had a slow year. The World Cup rules dictated last year that for about a quarter we couldn't invest into the network in South Africa. R3.5 billion in capex going into the network in the group.

Operating free cash flow growth despite the significant increase that we've made in the capex invested, group operating capital was up 5.6% to R6.9 billion. That's also due to positive operating free cash flow generation from the international portfolio for the six months. Headline earnings per share growth, 6.9% to 324 cents. I'm very pleased to announce the 44.4% increase in the interim dividend to R2.60 per share.

Okay, so let's now look at our two reporting segments. I will spend some time on South Africa and also cover the rest of the portfolio. In South Africa we had robust financial performance. Profitability growth is ahead of the service revenue. Service revenue growth was 4.7%. If I strip out the impact of MTRs 7% service revenue growth. EBITDA growth was 6.6% with the margin flat at 35.9%. Again if I exclude the trading foreign exchange the EBITDA grew at 8.7% and the margin expanded to 36.5%. This was also as a result of improving our contribution margins, and we've also capitalised in line with Vodafone's employee costs related to building the base stations.

If I look at the economic outlook the global economy is weakening. The Rand is weakening against key currencies. There is continuous pressure on consumers with rising petrol and food prices. And then in the environment around us competition is definitely more intense in South Africa, the data market specifically. We introduced drastic tariff reductions in August for contract and prepaid in September, reducing the headline prices by 22%. Competition in the voice market remains relatively benign. In the enterprise space competition has heated up. We saw Telkom finally launch their mobile converged fixed offerings, and they have come to market with very aggressive offers.

Since our rebrand in April we've come to market in South Africa with a lot of value promotions. That has pushed up the outgoing traffic up 34%. A lot of it is also off-peak promotions driving the on-net traffic up to 70%. This has resulted in the effective price per minute in South Africa coming down 24% year on year. We also saw good customer growth, 21% up in South Africa year on year to just short of 29 million. That was driven by net additions for the six months of 2.4 million, most of it coming from the prepaid segment.

Data demand in South Africa has remained strong with data revenue up 29.4% year on year. This was driven by more and more active data customers, a 32% increase in data customers. We are now sitting on 10.5 million in South Africa. Of the 10.5 million, 3.5 million are actively on a regular basis buying data bundles. That number is up 90% year on year. Data in South Africa represents almost 16% of service revenue. Smartphones are also a big driver behind the data growth. We added almost 900,000 smartphones in the last year in South Africa. Smartphones in South Africa are now totalling 4.1 million. Although the traditional mobile broadband still

accounts for the majority of the data traffic on the network, the growth rate from smartphone data traffic is ten times higher than that for dongles and other modems. The average use per smartphone has increased to 80MB per month.

To support this growth in the data space we have increased our capex investment to R3 billion in South Africa. Also making good progress against our plan of self-providing transmissions we have 3,700 base stations connected now with our own transmissions. Transmission is either microwave or fibre. We also expanded our 3G network. Today we're sitting at 4,700 3G base stations. 70% of those have been upgraded and now support 21 mbps per second or HSPA+ technology. Half of these total number of 3G base stations also have a dual carrier. In other words they can support up to 43 mbps.

That's South Africa in a nutshell. If I now look at the international business, the positive momentum that we started seeing last time is continuing in the international business. There was strong customer growth supported by service revenue growth of 20% if I look at it in constant currency. The customer numbers have grown to 19 million in the international portfolio. In the six months we added 2 million, growing 22.5% the total number of subscribers. A lot of the subscriber growth has been fuelled by smarter price offerings in the market, and that has really positioned us well relative to our competitors in the market.

Data revenue in the international market was up 71%. Data customers in the international market were 82% up. We now have 1.9 million active data users outside of South Africa. Then if I look at M-Pesa in Tanzania it's a good story, 2.2 million active customers now. In the last month I think there was \$350 million coming through the M-Pesa system in Tanzania.

EBITDA in constant currency in the international businesses was up almost 15%. EBITDA margins were relatively stable at 14.6% despite cost pressures coming from fuel and other foreign denominated operational costs. All the operations reported positive EBITDA growth except for Gateway. If I exclude Gateway and look at the international mobile operations in constant currency the EBITDA margin actually expanded by 1.9%. It is now sitting at 22.2%, just the mobile operations. In Gateway we had an impairment charge of R318 million. That is mostly where we've seen increased price competition or competitive markets and also poorer trading conditions. So that's the international part.

I would like to now open it up for discussions, questions, interactions. Rob Shuter is also here. Back to you, Mr Operator.

Operator

Thank you very much, sir. Ladies and gentlemen, at this time if you'd like to ask a question please press star and then one on your phone. If you then decide to withdraw your question please press star and then two. Our first question comes from David Lerche of Avior Research. Please go ahead.

David Lerche

Good afternoon everyone. Pieter, we see data in South Africa is only making up around 16% of revenue but certainly by my numbers somewhere around 60% to 70% of the traffic on the network. How do you manage to balance this out and keep things sustainable?

Pieter Uys

The investment that we've put into the network more recently is all to do with that. So the big bottleneck in the network is the transmission. We found that the high capacity sites, 3,700 of them now have our own transmission where we can control the capacity. More importantly, it's a fixed cost capacity. So we don't have to pay incremental costs to somebody else. So, on the transmission side we're in a good space. On the network side we've upgraded all the main high-capacity areas with the latest technology. It comes with more efficiency. We also continue to add more transceivers. We also see very good growth coming from 2G data, EDGE. A lot of the equipment, the old equipment couldn't do EDGE. So for now we're in a good space. Through further investment we can support the growth. In the longer term we would definitely want additional spectrum to sustain the growth into the longer term.

David Lerche

Thank you very much.

Operator

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

JP Davids

Good afternoon, gentlemen. In your intro you mentioned, Pieter, that Telkom had gotten more aggressive in the enterprise space on pricing. How have you reacted to that? Have you had to get more aggressive yourself on pricing, or is it bundling that you try to compete with or a service offering? And then looking at the consumer market, fair enough to say it was benign in the first half of the year. As you look into the second half of the year do you envisage remaining focused on promotional type activity rather than tariff cutting across the base? Thank you.

Pieter Uys

In the enterprise space over the last two years we've built up a portfolio of products exactly for this reason, for when Telkom is launched into the converged fixed and mobile space. So if I look at the top end of the enterprise market, the big corporates, we are very competitive and we are maintaining and holding our own in the business. We have good products, good offers, also converged, integrated solutions to the corporates. However, there is an opportunity to also grow that business further. There is a big segment of SMMEs in the country where we can certainly offer more of these converged enterprise services. Fortunately we started investing early. We have the product sets and the network to support a converged offering ourselves. If I look at the consumer space, like I mentioned before most of the tariff competition has come through on the data side of the business. On the voice side it has been more through promotions, mostly on-net promotions driving down the effective price per minute and driving up the on-net traffic. Into the second half we are cautious. We are not seeing big, dramatic tariff cuts. We're certainly not planning

on any of those ourselves. The promotions will continue. In the data space we're also going through a period of the year's trading where we have attractive offers to our customers. This is the festive December period where we have a summer promotion running at the moment. We launched one on the data side yesterday and there will be more to extend to all our customers to keep them loyal towards Vodacom.

JP Davids

Super. Thanks very much, Pieter.

Pieter Uys

Thanks, JP.

Operator

Our next question comes from Johan Snyman of Renaissance Capital. Please go ahead.

Johan Snyman

Thank you. Good afternoon, Pieter. Just a few quick ones. Number one, what is the current thinking around Gateway? Does it make sense strategically to keep that investment? And then secondly, I just want to get a sense if I look at the effective pricing, have we seen any non-billable minutes on the network in the last two quarters or so?

Pieter Uys

Gateway is made up of the two parts. There is the carrier voice business. If you don't have scale in the carrier voice business you really can't compete out there. That's the part of the business that is definitely not in our interests to keep. We will be looking at finding ways to exit out of that part. The other part is really the business and the enterprise part of the equation, the converged side. In South Africa as competition also heats up, where it's important – and also if I look globally at Vodafone with their Vodacom global enterprise offering – you need to be able to offer a product set going into the continent. So, on the business side of Gateway we have not given up. What we are doing, however, is integrating Gateway business with the rest of our Vodacom business offerings so that we have an integrated product set and not run it separately. For instance, if there are customers of Vodafone that want a connection or service into Africa instead of handing it over to another business we are integrating the product set. That would be our strategy for the two.

Then the next question is the effective prices. If I look at Nightshift, which is still running, and then the R29 voucher where if you recharge on that day we gave you an hour free calls, that has definitely driven a lot of non-billable minutes in the last two quarters. If I take all minutes, price per minute is down 24%. If I exclude the free minutes the price per minute is down 8%.

Johan Snyman

Thank you.

Operator

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

Craig Hackney

Thank you. With Telkom being more aggressive on the enterprise space, I was just wondering, in terms of your self-provision how strong the business case still is of self-providing versus leasing from Telkom. Does it still make a lot of sense to be very aggressive on your own self-provision?

Pieter Uys

The self-providing is driven by our own need to support the data business. If you don't get to a situation where you have unlimited capacity in your data network you can only do that if you have your own transmission, big optic fibre pipes. But with it comes the benefit of having this big pot of bandwidth in the centre that you can then also use for enterprise businesses. Certainly we're not building network for the enterprises. It is a by-product that comes from our investment into supporting the data business.

Craig Hackney

If you have a look at the leasing from Telkom versus self-provision is there still a strong business case for self-providing from a cost point of view?

Pieter Uys

Definitely. As the traffic increases the fees increase. On the one side you pay a variable cost per megabit, and on the other side you have a fixed cost that you pay off very quickly and then you have the benefit of the sunk transmission investments.

Craig Hackney

Okay. Thank you.

Operator

Ladies and gentlemen, a reminder that if you would like to ask a question please press star and then one. We have a follow-up question from Craig Hackney of Religare Capital. Please go ahead, sir.

Craig Hackney

I just wanted to look a bit at the international operations. If I look at Tanzania and the DRC you had very good subscriber growth there, between 11% and 12% quarter on quarter. Then local currency ARPU was up 6% quarter on quarter. Could you speak a bit about the dynamics in those markets? And then on the other side in Mozambique the quarterly subscribers are down 9% and ARPU is up 15% and churn at 112%. Could you give a bit more detail on what's going on there?

Pieter Uys

Let me start with Tanzania and the DRC. Firstly we've seen a more stable competitive environment in those two markets. In Tanzania, for example, recently we've seen a tariff increase from most of the market from the days when tariffs went

one way, down to very low levels. I think for now that's behind us. If I look at the DRC also tariffs crashed previously and went down to a level where it was almost impossible to make a call on any of the networks. The regulator intervened and put a floor price linked to interconnect. That has definitely stabilised the DRC business, and it also allowed us to take a smart tariffing to the market to make sure that we are competitive in the market. On Mozambique, firstly, on their subscriber numbers, there was an error in their system at one point and they disconnected around 400,000 customers. That's coming through as churn. They also changed their tariff modelling in Mozambique. Previously they had very big buckets of free minutes. You pay X per month and you get almost unlimited minutes. That was also not sustainable. So they have also done away with that and come to market with smarter tariffing, headline pricing lower. And it is gaining traction in the market. That's the story in Mozambique.

Craig Hackney

Thanks. Just on DRC and Tanzania again, if you look at the good subscriber growth there do you see that as a function of the overall market growth or churn?

Pieter Uys

The market there is still overall growing. It's difficult to see because the penetration is still low. So there is churn, but a lot of it is still new connections getting into the market as the economy also stabilises. There are very competitive offers from everybody. So the whole market is very positive at the moment in those two markets.

Craig Hackney

Thank you very much.

Operator

Gentlemen, we have no further questions. Would you like to make some closing comments?

Pieter Uys

Thank you. In conclusion let me first say when we started the year we said that we would have group service revenue growth in the low single digits. In the first half we've outperformed that. If I look into the second half we will have now our data tariff reductions into the second half, and we still stick to our original guidance of low single digit growth. However, if I look at the EBITDA margin in the group that is a much more positive story. We have put a lot of effort into maintaining costs, cost management in the business. And again we are sticking with our original guidance of marginal improvement for the full year. So EBITDA is a very positive story still to look forward to in the second half. Capital expenditure. We are stepping up investment to support more growth, a better network. We guided that we will invest R7.7 billion. That guidance also remains unchanged.

So then in summary, we had the rebrand in April. A good start to the year. We put a lot of value propositions into the market. We had some network issues and are investing to work around those. It is definitely a better network now. And the customer service is also improving. All of this is paying off and we are seeing it come



through in good customer numbers. Our mobile broadband strategy also remains a key driver to our growth in South Africa, but also more and more in the rest of the continent. And despite the increased competition the growth is good, demand is high and we're continuing to invest and deliver on our promise of a better network, better experience, better service and great value. Thank you for joining us this afternoon. Till next time, cheers.

Operator

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

END OF TRANSCRIPT