

## VODACOM GROUP

TELECOMMUNICATIONS

STUDENT: CATARINA FERNANDES

## COMPANY REPORT

6 JANUARY 2014

## A success story turns expensive

## Too many challenges in South Africa

- We recommend selling Vodacom Group given our price target of R121.21 per share, which corresponds to a downside potential of 8% comparing with the current market price.
- Vodacom has shown consistent good performance. Special emphasis goes to solid execution demonstrated in the results from 1H14, as well as proved ability for cost control.
- Positive economic prospects make the International segment an attractive opportunity to seek a larger customer base and higher data penetration. Current International data revenue is 4x higher than two years ago.
- Challenges remain mostly in South Africa, which accounts for 82% of Group's revenue. Macroeconomic environment is not appealing, given estimate of 2% for real GDP growth in 2013. The relatively mature sector, characterized by four resilient players, is passing through a business focus and pricing transformation towards more accessible data and equipment to customers.
- Enforcement of important regulatory measures is to happen until March 2014. The impact on Vodacom's revenues is significant, should ICASA officially approve the draft MTR path. Contingent on this regulatory outcome is Vodacom's intentions to increase capex which come in the sequence of Vodafone's Project Spring investment plan.
- Regulatory approval is also on hold for the Neotel acquisition by Vodacom.

## Company Description

Vodacom operates in five African countries as a mobile operator: South Africa, Tanzania, Mozambique, DRC and Lesotho. In terms of market share, it occupies the first or second places in every market it operates. Its main shareholder is Vodafone Group.

**Recommendation:** SELL

Vs Previous Recommendation HOLD

**Price Target FY15:** R121.21

Vs Previous Price Target R123.16

**Price (as of 6-Jan-14)** R131.30

Bloomberg: VOD:SJ

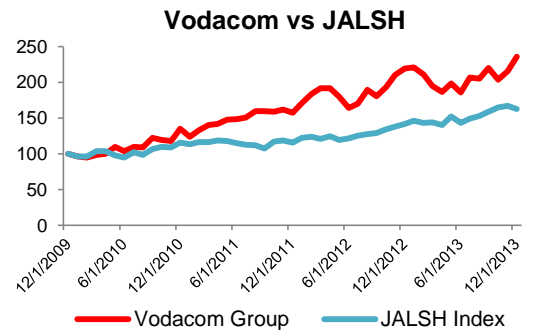
52-week range (ZAR) 100.66-134.33

Market Cap (mZAR) 196,409.93

Outstanding Shares (m) 1,487.954

Dividend indicated Gross Yield 6.25%

Source: Bloomberg



| (Values in ZAR millions) | 2013   | 2014E  | 2015F  |
|--------------------------|--------|--------|--------|
| Revenues                 | 69,917 | 74,014 | 78,247 |
| EBITDA                   | 25,253 | 27,267 | 28,478 |
| EBITDA growth            | 11%    | 8%     | 4%     |
| EBITDA margin            | 36%    | 37%    | 36%    |
| EBIT                     | 18,897 | 20,018 | 20,287 |
| Net profit               | 13,224 | 13,468 | 13,424 |
| EPS (cents)              | 887    | 904    | 901    |
| DPS                      | 805    | 819    | 812    |
| P/E                      | 11.6   | 12.6   | 16.2   |
| EV/EBITDA                | 6.7    | 6.9    | 7.6    |
| EV/Sales                 | 2.4    | 2.5    | 3.1    |
| Net Debt to EBITDA       | 0.3    | 0.5    | 0.6    |
| Net Debt to Equity       | 37.3%  | 54.4%  | 66.2%  |
| Dividend Yield           | 7.4%   | 6.6%   | 6.5%   |
| ROE                      | 69.9%  | 63.5%  | 59.3%  |
| ROIC                     | 52.4%  | 51.4%  | 43.3%  |

Source: Company's reports, Analyst's estimates

THIS REPORT WAS PREPARED BY CATARINA FERNANDES, A MASTERS IN FINANCE STUDENT OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS, EXCLUSIVELY FOR ACADEMIC PURPOSES. THIS REPORT WAS SUPERVISED BY ROSÁRIO ANDRÉ WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL. (SEE DISCLOSURES AND DISCLAIMERS AT END OF DOCUMENT)

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## Executive Summary

Vodacom is a leading mobile operator with current operations in South Africa and other four African countries. The most relevant market is South Africa, being responsible for 89% of the Group's EBITDA. As of 2013, the total revenue of the company was R70 billion.

The macroeconomic environment in South Africa is concerning, especially taking into account the company's exposure. According to international estimates, real GDP growth will not go beyond 3.5% in the medium-term, while the inflation rate will maintain approximately around 5%.

The mobile telecom market is characterized by high penetration rates (over 140%) in a 50 million universe of South Africans. It is also defined by fierce competition with currently 4 players. Prices have been showing declining trends, resulting in voice revenue deterioration, which constitutes the bulk of service revenue. Recent results on data and equipment revenue are encouraging (joy 21% and 41% growth rates for the semester ending in September 2013) but poor economic outlook, hurdles posed by competition and regulatory risk on the MTR outcome limit their upside potential.

The International markets are exciting, both due to macroeconomic growth prospects, as well as because they are in the beginning of the process of data penetration. We expect two-digit growth in the foreseeable future.

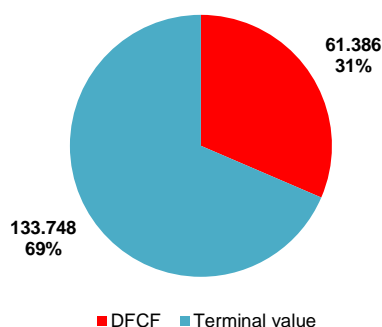
The change in business focus from traditional revenue streams such as voice and messaging to data and equipment revenue imply new challenges in terms of capital expenditures and net working capital. The provision of qualified data services is directly related to long-term success. We believe capex intensity will increase in line with the 14%-17% medium-term guidance of management, and together with more investment in working capital, will put pressure on cash flows and ROIC.

In this context, we believe debt will increase accordingly. This should not be worrying given Vodacom's strong financial position with a current market debt-to-equity ratio of 8%. The cost of capital is around 10% for the Group.

Good performance until now is making the company expensive, while undervaluing some of the risks inherent to the business. Therefore we deliver a recommendation to SELL and a target price of R121.61.

## Valuation

**Exhibit 1: Sum of Group's (DFCF) and respective Terminal value - value (mZAR) and proportion (%)**



This valuation was performed based on nominal values and is denominated in rands for all business segments, thus implicitly considering South Africa's inflation rate. The explicit period is until 2020.

Vodacom Group was evaluated through the sum of the parts (SOTP) of each geographical operation. The constituents are South Africa (SA), Tanzania, Democratic Republic of Congo (DRC), Mozambique, Lesotho, Gateway, Corporate and Eliminations<sup>1</sup> and Vodacom Business Africa. Each segment except the latter was valued through the Free Cash Flow to the Firm - Discounted Cash Flow model. Vodacom Business Africa was evaluated through EV/EBITDA multiple<sup>2</sup>. Tanzania, DRC, Mozambique, Lesotho and Gateway comprise the International segment for forecasting purposes.

The Free Cash Flows (FCF) were discounted to March 2014 and then their future values were computed so that the price target referred to the date one year from now (this is December 2014). The same principle applies to terminal values.

**Exhibit 2: Terminal as percentage of total value for each part**

|                       |      |
|-----------------------|------|
| South Africa          | 66%  |
| Tanzania              | 104% |
| DRC                   | 114% |
| Mozambique            | 105% |
| Lesotho               | 94%  |
| Gateway               | 0%   |
| Corporate             | 50%  |
| Tax Adjustment        | 56%  |
| Non-Operational Value | 50%  |

While the sum of the Group's discounted free cash flows (DFCF) represent about 30% of total enterprise value (R201.6 bn), Group's terminal value represents approximately 70% (**Exhibit 1**). Terminal value representation in each segment's total value is depicted in **Exhibit 2**. The South African terminal value is not so representative when compared to the ones in the International. The latter's representation is over 100% in the majority of countries because the sum of DFCF is actually negative<sup>3</sup>.

South Africa's terminal value is naturally the largest contributor to the Group's long-term value (85%), while Lesotho, Corporate and non-operational value represent minor sources. Gateway is assumed to have no terminal value<sup>4</sup>. Its decomposition by segment can be seen in **Exhibit 3**.

For every part related to the operations of a specific country<sup>5</sup> we discounted the cash flows and terminal values at its respective WACC<sup>6</sup>. For Group-related cash flows such as the tax adjustment or non-operational net assets, we discounted at

<sup>1</sup> Corporate comprises of the holding companies of the Group which do not relate to specific segments.

<sup>2</sup> The company considers Vodacom Business Africa within the International segment but no revenue segmentation is performed. Because of that, we do not include this business in our forecast and we rather perform a separate multiple valuation.

<sup>3</sup> This is mainly due to high capital expenditures (capex) needs.

<sup>4</sup> Gateway Telecommunications was bought in 2008 and sold in 2012. Its DFCF corresponds to residual figures thus not impacting the long-term forecast dimension of our valuation.

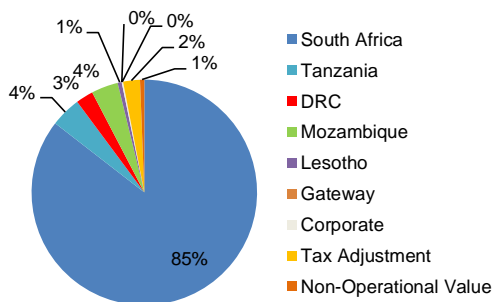
<sup>5</sup> For Gateway, given its diversified presence, we chose to discount its cash flows at South Africa's WACC.

<sup>6</sup> Weighted Average Cost of Capital

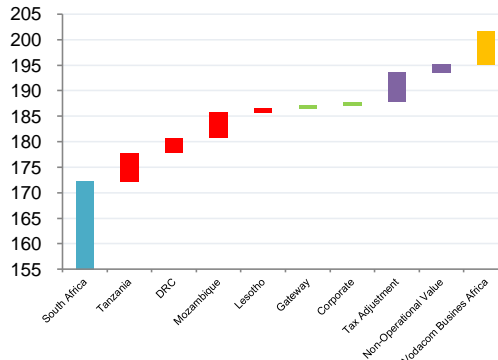
a Group's WACC<sup>7</sup>. Value contribution to total enterprise value can be seen in **Exhibit 4**.

The debt considered to compute the equity value is the book value of debt, including interest bearing debt and provisions<sup>8</sup>. The company has 1,487,954,000 shares which imply a price target for the next 12 months of R121.21<sup>9</sup>, representing a downside potential of 8%.

**Exhibit 3: Each part's terminal value percentual contribution to Group's terminal value**



**Exhibit 4: Each part contribution to enterprise value (bnZAR)**



<sup>7</sup> This WACC is an average weighted by the value from operations of each part.

<sup>8</sup> The company does not have publicly traded debt. Hence we considered book value of debt as a proxy for its market value. We believe this a fair approximation given the floating nature of the majority of Vodacom's debt, and assuming default risk will remain stable in the future.

<sup>9</sup> If we include dividend remuneration for the financial year 2014 it is 128.27, still corresponding to a "sell" recommendation.

In **Exhibit 5** we summarize the financial data regarding the valuation.

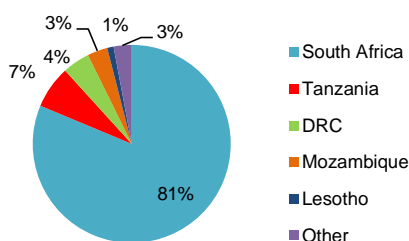
**Exhibit 5: Valuation SOTP for December 2014**

| mZAR                           | DFCF          | Terminal value | Total          |
|--------------------------------|---------------|----------------|----------------|
| <b>Operational Value</b>       |               |                |                |
| South Africa                   | 57 889        | 114 351        | 172 240        |
| Tanzania                       | (205)         | 5 819          | 5 614          |
| DRC                            | (419)         | 3 347          | 2 928          |
| Mozambique                     | (236)         | 5 136          | 4 900          |
| Lesotho                        | 51            | 778            | 829            |
| Gateway                        | 688           | 0              | 688            |
| Corporate                      | 278           | 275            | 553            |
| <b>Total</b>                   | <b>58 046</b> | <b>129 706</b> | <b>187 752</b> |
| <b>Tax Adjustment</b>          | 2 518         | 3 228          | 5 747          |
| <b>Non-Operational Value</b>   | 821           | 814            | 1 635          |
| <b>Value from operations</b>   | <b>61 386</b> | <b>133 748</b> | <b>195 134</b> |
| <b>Vodacom Business Africa</b> |               |                | <b>6 480</b>   |
| <b>TOTAL ENTERPRISE VALUE</b>  |               |                | <b>201 614</b> |
| <b>Interest Bearing Debt</b>   |               |                | 21 258         |
| <b>Equity Value</b>            |               |                | 180 356        |
| <b>PRICE PER SHARE</b>         |               |                | <b>121,21</b>  |
| Price @ 6-Jan-2014             |               |                | 132            |
| Return potential               |               |                | -8,2%          |

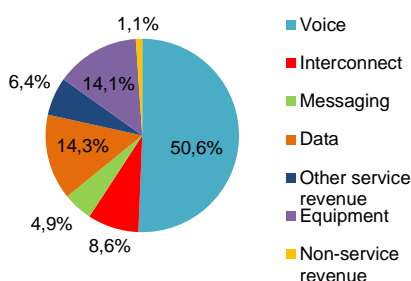
# Company overview

## Description

**Exhibit 6: Service revenue decomposition by country (FY2013)**



**Exhibit 7: Revenue decomposition by service/product (FY2013)**



Vodacom Group Ltd is the leading mobile operator in South Africa. Although the big bulk of revenue comes from this country, the company has tried to diversify its operations, with a current presence in other African markets such as Tanzania, the Democratic Republic of Congo, Mozambique and Lesotho. **Exhibit 6** shows the service revenue decomposition by country, where South Africa has a clear representation accounting for 81% of revenues, followed by Tanzania with only 7%.

The company’s core services are voice, messaging and data, which are all available on either contract, prepaid or top up<sup>10</sup>. Together with Interconnect<sup>11</sup>, these services represent 78% of the Group’s total revenue. Vodacom also offers financial services such as M-Pesa, allowing customers to transfer money. Other service revenue is constituted mainly by enterprise converged services<sup>12</sup> (in South Africa, Vodacom Business provides them). An important (non-service) revenue stream is the sale of equipment such as mobile cell phones, dongles or tablets which have been gaining increased importance due to smartphone diffusion. Other non-service revenue includes for example the sale of prepaid starter packs and contract SIM cards. **Exhibit 9** quantifies this information as percentage of total revenue.

It is important to refer that in financial year 2010, Gateway was restructured and divided into Business and non-Business services. Vodacom Business Africa was then formed as a spin-off from the Gateway acquisition by incorporating Gateway Business. In August 2012, the carrier services were sold but Vodacom Business Africa was kept as a strategic bridge to countries where Vodacom’s core business is not present. Business Africa is the International counterpart of Vodacom Business in SA and is currently present in 8 countries, including high-growth potential countries such as Nigeria and Zambia.

## Shareholder structure

Vodafone Group Plc controls Vodacom Group and owns 65% of the issued shares through Vodafone Holdings SA (Pty) Limited and Vodafone Investments

<sup>10</sup> Top up is a hybrid between contract and prepaid options which allows a contract customer to buy additional airtime when the one included in the package for which she assigned for runs out. Topping up is done through any Vodacom Prepaid recharge voucher.

<sup>11</sup> Revenue that comes from the tariff paid by other operators when a call is terminated in Vodacom’s network.

<sup>12</sup> Converged services is the trend for different technologies to evolve towards performing similar tasks, where mobile and fixed voice, messaging, data and video are aggregated to share resources and functions. Examples of converged services are VoIP, IPTV, Mobile TV, Smart TV, etc.

SA (Pty) Limited. Vodafone Group Plc is incorporated and domiciled in the United Kingdom. The government of South Africa owns 13.9% of Vodacom Group's while the Public Investment Corporation (PIC)<sup>13</sup>, owns 3,16% of shares. The remaining shares (18%) are on free float.

The last divestment occurred in late-2008 when Vodafone Group agreed to increase its stake from 50% to 65% upon Telkom's<sup>14</sup> decision to sell its investment in Vodacom Group (with the remain of the shares becoming listed on the Johannesburg Stock Exchange). It is our belief that the current shareholder structure suggests no further modification for the foreseeable future. Government's direct and indirect position in Vodacom may represent a strategic standpoint to achieve the goals included in the National Broadband Policy (NBP)<sup>15</sup>, but not as direct as in Telkom. Nevertheless, we believe its minor stake does not have the power to overlap Vodafone's influence, in case there is conflict of shareholders' interest.

Vodacom Group has different shareholdings due to its international presence. It owns 93.75% of Vodacom South Africa Pty Ltd, 82.2% of Vodacom Tanzania Ltd<sup>16</sup>, 51% of Vodacom Congo, 85% of Vodacom Mozambique and 88% of Vodacom Lesotho Pty Ltd<sup>17</sup>.

In regards to Vodacom SA, the remaining 6.25% shareholding comes from a Broad-Based Black Economic Empowerment (BBBEE) transaction performed in 2008, in order to comply with the Codes of Good Practice on BBBEE. The broad-based BEE exists to empower the historically disadvantaged black South Africans at all levels of the South African economy, including companies' ownership. A company named YeboYethu was created for this purpose to allow black people, black controlled groups and Vodacom's black business partners (collectively known as "Black Public"), as well as all Vodacom SA's staff (through YeboYethu Employees' Stock Option Plan) to have a participation in Vodacom SA. YeboYethu owns 3.44% of Vodacom SA's shares and together with Thebe<sup>18</sup> and Royal Bafokeng<sup>19</sup> they own 6.25%. The whole structure is summarized in **Annex 1**.

<sup>13</sup> PIC is wholly owned by the South African government and invests funds on the behalf of public sector identities

<sup>14</sup> Main fixed-line services provider in South Africa. It was the first national operator.

<sup>15</sup> Main objective is to provide universal broadband access by 2020. It is a top Department of Communications' priority with expected implementation next year and temporal horizon for 2020.

<sup>16</sup> On past November 26, Vodacom Group agreed to increase its stake in Vodacom Tanzania from 65% to 82.2%. The shares were bought from Cavalry Holdings, a private investment company and indirect shareholder of Tanzania, for ZAR 2.46 billion in cash. It remains with a 17.8% stake through Mirambo Ltd.

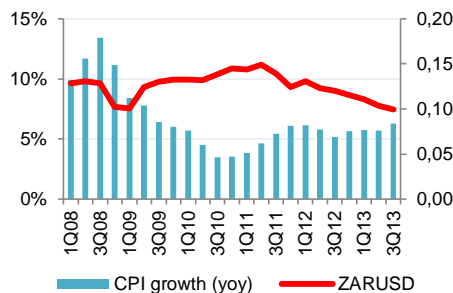
<sup>17</sup> Minor shareholders are described as follows: Cavalry (17.8%) in Tanzania; Congolese Wireless Networks (49%) in DRC; Emotel (2%), Intelec Holdings (6.5%) and Whatana Investments (6.5%) in Mozambique; and Sekha-Metsi Consortium (12%) in Lesotho.

<sup>18</sup> Thebe Investment Corporation which is a black-owned company

<sup>19</sup> An investment company that manages the assets of a 150,000 community of black South Africans

Exhibit 8: CPI growth and ZAR/USD

# Macroeconomic Overview

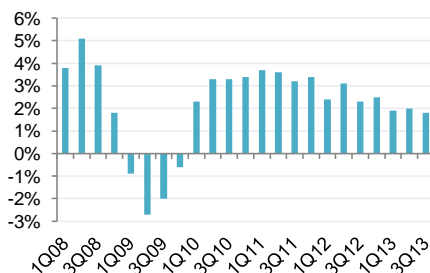


Source: Government of South Africa, Bloomberg

The South African economy over the last quarters has been characterized by a weak rand, significant inflation and the slowdown of economic growth.

The rand is a currency that typically follows the performance of the global economy and global investors' appetite, similarly to other emerging market commodity currencies. In the year ending in September 2013, the currency devalued almost 18% against the dollar. A weaker rand translates in more expensive imported goods which entices inflationary pressures. This dynamic can be observed in **Exhibit 8**, where generally periods of rand appreciation correspond to lower CPI growth and vice versa.

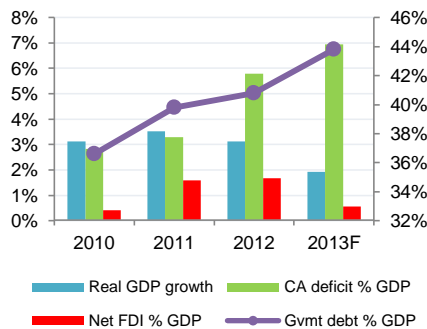
Exhibit 9: Quaterly real GDP growth (yoy)



Source: Government of South Africa

With commodity prices progressively coming down since the Fed announcement on the monetary tapering in past March, and with the South African current account deficit widening since 2010 (6.8% for the 3Q of 2013, the widest gap in more than five years), the currency becomes even more pressured. The South African Reserve Bank (SACB) wants to drain liquidity from the money market but the great amount of foreign reserves necessary to appreciate the rand and the poor economic performance (2% expected for 2013) constrain the action of the central bank. In **Exhibit 9** we can see the quarterly year-over-year (yoy) real GDP growth.

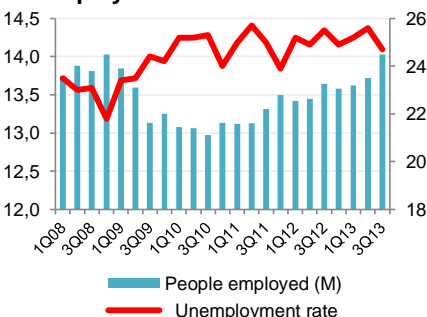
Exhibit 10: Macroeconomic indicators



Source: IMF

In addition to the impact of a weaker rand on imports, the lost exports due to strikes<sup>20</sup> (mainly in mining and automotive companies which constitute the main export sectors) and a perceived lower global demand, especially from the China and Europe, are the main causes for current account balance deterioration<sup>21</sup>. The fact that 50% of South Africa's exports is constituted by metals<sup>22</sup> makes it an essential player in global markets but also very exposed to global demand, especially China.

Exhibit 11: Employment and unemployment rate



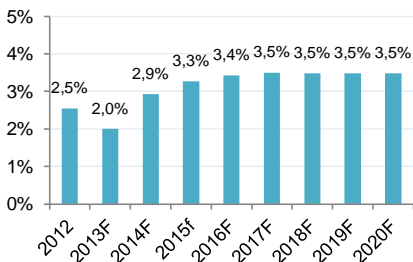
Source: Government of South Africa

The financing of external imbalances will continue to be dependent on foreign inflows into SA's bond and stock market. FDI is still an important economic factor but its evolution is somewhat uncertain. About 70% of SA's FDI is absorbed by the mining sector, which faces significant challenges in terms of labour relations and rising electricity prices. **Exhibit 10** compares GDP growth, Net FDI and Current Account balance as percentage of GDP, as well as government debt.

Inflation also poses challenges to South African companies, which struggle not only with a poor economic environment and shrinking demand, but also with

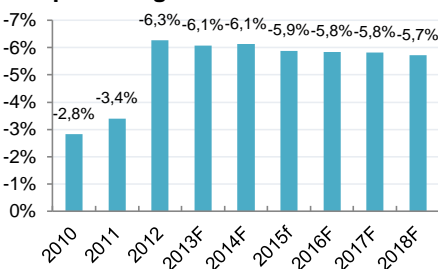
<sup>20</sup> During the last decade, 3.9 million man-days were lost per year due to strikes.  
<sup>21</sup> South African main exports are precious metals and stones, mineral ores, vehicles and machinery.  
<sup>22</sup> South Africa has the largest known reserves of platinum and chrome, it is responsible by 80% of world's platinum production and it is the 5<sup>th</sup> largest producer of gold.

**Exhibit 12: Real GDP growth forecast**



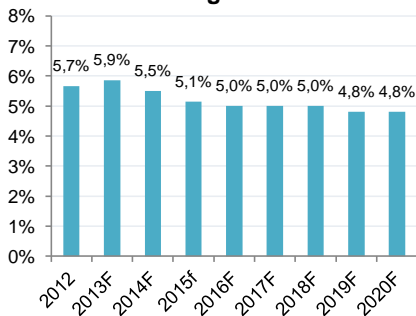
Source: IMF

**Exhibit 13: Current account balance as percentage of GDP forecast**



Source: IMF

**Exhibit 14: Average CPI forecast**



Source: IMF

rising labour costs, inflexible labour legislation and a government that is criticized to be over protector when it comes to employees' interests. During last years, the unemployment rate has maintained its very high levels (24.7% in 3Q13 versus 23.1% in 3Q08 as shown in **Exhibit 11**). People employed in social services currently represent 22.4% of the total people employed in Community and Social Services, only closely followed by Trade with 22.1%<sup>23</sup>.

On the social sphere, there are significant improvements but still some challenges. Positive facts are the enlargement of the black middle class, which has grown from 1.7M in 2004 to 4.2M people in 2012, and the decline in the share of population with no education from 19.1% in 1996 to 8.6% in 2011. Negative facts include social inequality, which is one of the highest in the world<sup>24</sup> and corruption<sup>25</sup>.

Notwithstanding, South Africa still remains the African country that is institutionally most developed compared with the majority of African countries. It has advanced financial and banking institutions and the most liquid stock exchange<sup>26</sup>. In fact South Africa ranks 3<sup>rd</sup> among 148 countries on the financial market development metric<sup>27</sup>. These conditions appeal to common foreign investors. Economic forecasts show a slight improvement of the situation as economic growth is expected to increase (**Exhibit 12**), thus improving the Current Account balance as percentage of GDP (**Exhibit 13**), and as inflation is expected to slow down (**Exhibit 14**).

<sup>23</sup> Data referring to the third quarter of 2013. Source: Government of South Africa

<sup>24</sup> The Gini Coefficient (last available value) for South Africa is 63.1 (2009), higher than Tanzania (37.6, 2007), DRC (44.4, 2006), Mozambique (45.7, 2008), Lesotho (52.5, 2003), UK (30, 1999) or United States (40.8, 2000). Source: World Bank

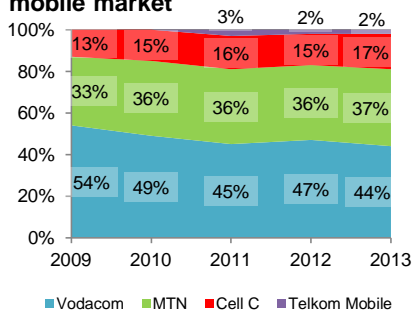
<sup>25</sup> South Africa's perceived corruption continues to increase. The Corruption Perceptions Index by Transparency International classified South Africa as 72<sup>nd</sup> in a ranking of 177 countries, versus 69<sup>th</sup> in 2012. The value of the index is 42 in a range of 0-100 (where 0 means the public sector is totally corrupt).

<sup>26</sup> South African GDP structure is leaned towards services, where banking activity is included. It represents 67.9% of GDP, while industry represents 29.7% and Agriculture 2.4%.

<sup>27</sup> World Economic Forum's Global Competitive Index 2013-2014.

## The Telecom Mobile Sector

**Exhibit 15: South African telecom mobile market**



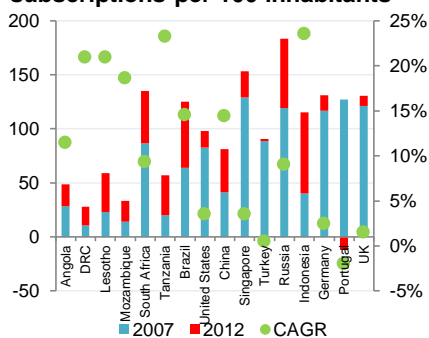
The South African telecom market is composed by four major players: Vodacom, MTN, Cell C and Telkom Mobile<sup>28</sup>. In **Exhibit 15** we can see how they are positioned in terms of subscriber market share, with Vodacom occupying the leading position (44%), followed by MTN with 37%, then Cell C which has 17% and Telkom Mobile with a very small position. Vodacom and MTN are listed companies, as well as Telkom.

The mobile communications began in 1993 when the government granted MTN and Vodacom spectrum licenses. By the time, Vodacom was a partnership between Vodafone, the British mobile operator, and Telkom, the main fixed operator in South Africa. In 2009 Telkom sold its investment in Vodacom to start investing in its own 3G network. In mid-2010 it launched 8ta, the brand associated with Telkom Mobile services and with a current market share of 2%.

Cell C is the third player which came into telecom business in late 2001. Cell C had a 50% stake in Virgin Mobile South Africa, which is a mobile virtual network operator (MVNO). MVNO are characterized by not owning a wireless network infrastructure and usually they enter into agreements with mobile network operators (MNO). In 2011 Cell C sold its stake in Virgin Mobile to the UK parent Virgin Group but remained Virgin Mobile's network partner. Taking advantage of no regulation in the MVNO market, Cell C announced in June 2013 its plans to set up an MVNE (Mobile Virtual Network Enabler) to help companies that are interested in launching MVNO services in SA. In August, the French telecom Orange has also announced its plans to enter the SA mobile market as an MVNO.

The other MVNO in SA is Red Bull Mobile, which also uses Cell C's network. At end of June 2013, Red Bull Mobile and Virgin Mobile South Africa reported 120,000 and 4000,000 customers respectively.

**Exhibit 16: Mobile-cellular subscriptions per 100 inhabitants**

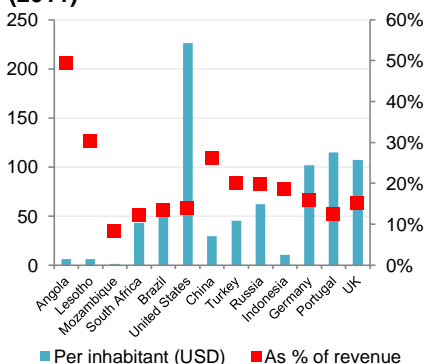


The market is regarded as very mature with a mobile penetration rate of 135% and a total mobile subscriber base of 69 million as of 2013. **Exhibit 16** shows penetration rates of various countries as of 2008 and 2012, which demonstrates South Africa placed amongst the countries with the highest values, being directly comparable to developed markets such as the UK (131%), Germany (131%) or Singapore (153%). The telecom sector is considered to be one of the most innovative and rapidly growing. This perception is mainly due to the operators' ability to target audiences, as well as marketing power next to masses. This

Source: ITU World Telecommunications/ICT Indicators Database

<sup>28</sup> Cell C's shareholders are Oger Telecom SA (60%), Lanun Securities SA (15%) and CellSAF Ltd (25%). Major MTN shareholders are Nedcor Bank (21%), Standard Bank (33%), First National (16%) and Absa (9%).

**Exhibit 17: Telecommunications investment - fixed and mobile (2011)**



Source: ITU World Telecommunications/ICT Indicators Database

contrasts with high churn levels within the sector, mainly because of the prepaid nature of the market. Vodacom has a churn rate of 50%, Cell C of 66% and MTN around 60%. Reducing these high figures are key in order to lock up revenue and decrease the cost and disruption of churn.

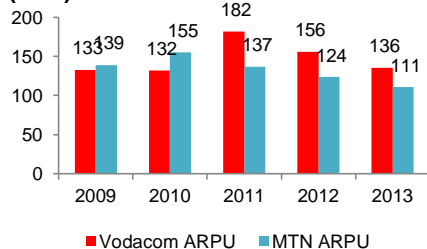
In terms of investment, South Africa employs amounts that are still quite below developed countries but above most of emerging markets as it is shown in **Exhibit 17**. For instance in 2011 the SA telecom sector invested \$43 per inhabitant while China invested only \$29, Turkey \$45 and Indonesia \$10, which may reflect more and of higher quality investment, as a response to improved technologic market needs (such as more speed or wider coverage).

Nevertheless it has one of the lowest investments in terms of revenue when compared with other markets, indicating that in order to take advantage of the business potential, the telecom players in South Africa will have to increase their investment. The weak investment as percentage of revenues is also a reflection of Telekom’s historical insufficient capex, which constituted one of the reasons for the uprise of mobile operators.

Exogenous factors such as the evolution of demographics, GDP growth and the regulatory framework are important when analysing growth prospects for the telecom sector. But it is in the intrinsic value of the products offered and in the level of investment in infrastructure that relies the long-term success of each company. In South Africa, key factors of competitiveness are related to customer retention, mostly through handset subsidization as well as contract bundles, and extraction of more value from each consumer, by boosting data usage and selling higher-end handsets.

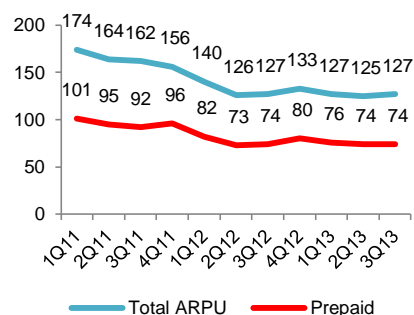
## The South African Segment

**Exhibit 18: Vodacom vs MTN ARPU (ZAR)**



The mobile services have been developing a relevant role in South Africa for contextual factors. The insufficient service quality provided by the main fixed line operator, Telkom<sup>29</sup>, led to a relatively fast emancipation of mobile operators.

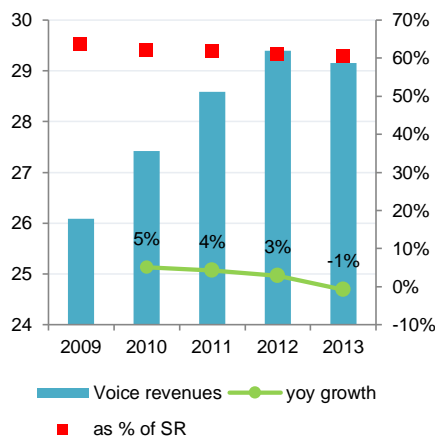
**Exhibit 19: ARPU (ZAR)**



In line with a maturing process felt in the mobile market, Vodacom's average revenue per user (ARPU) has a tendency to become flat or even decrease as depicted in **Exhibits 18 and 19**, while usage has a tendency to increase. In a context of intensifying competition, the current challenge for mobile telecoms in terms of ARPU is to compensate the decreasing proportion of Voice in the overall ARPU composition while trying to extract more value through data penetration in current voice-only customers.

However, deducting pricing conclusions from the ARPU is not straightforward because it ignores different product trends – the revenue streams coming from Voice, SMS, Data or Equipment present different behaviors and different prospective evolutions. ARPU can actually increase even with price decreases, if for example there are more SIM card disconnections, if there is a higher usage across all products or even if the company decides to clean up active customer registrations, as it happened in FY11.

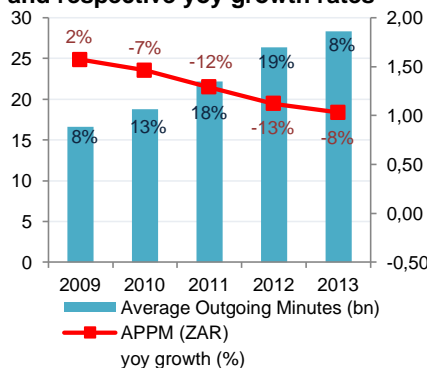
**Exhibit 20: Voice revenue (bnZAR), yoy growth rate and its representation in service revenue**



### Voice

First we take a look at the generation of voice revenues. Although accounting for approximately 60% of service revenues, voice revenues have suffered lower growth rates over last years (**Exhibit 20**). In order to understand this trend we look at the main KPIs of this revenue stream. The main drivers are the average price per minute (APPM) and the outgoing minutes which can be decomposed in Minutes of Usage (MoU<sup>30</sup>) and the number of active subscribers.

**Exhibit 21: Outgoing minutes, APPM and respective yoy growth rates**



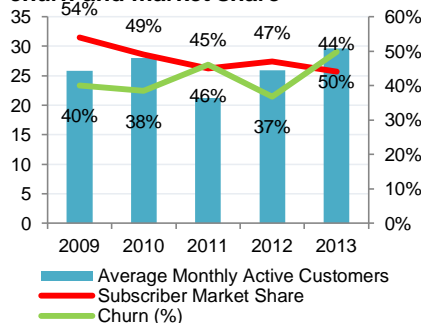
For a cumulative annual decline in the growth rate for FY09-13 of 10.1% in Vodacom's APPM, there was a corresponding 14.3% increase in outgoing minutes (**Exhibit 21**). This means that although usage growth more than offset price declines, it was not sufficient to create consistent growth for overall voice revenues (CAGR for the period is 2.8%).

The more aggressive APPM declines (2-digit negative growth rate) were from FY11 onwards, which coincided with the entrance of Telkom Mobile in the mobile market as the fourth operator in October 2010, and with the MTR cuts which

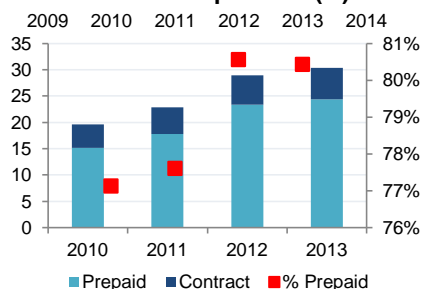
<sup>29</sup> While the number of fixed (wired)-broadband subscriptions per 100 inhabitants is 25.6 in Europe, 15.7 in the Americas and 7.0 in Asia and Pacific, in South Africa is 2.7. This is evidence of weak coverage, high prices or both. *Source: ITU*

<sup>30</sup> MoU designates total traffic (incoming and outgoing minutes) divided by the average monthly active customers.

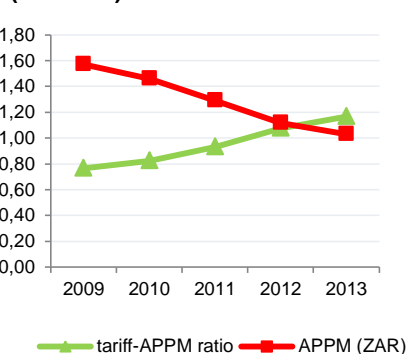
**Exhibit 22: Customer base (M), churn and market share**



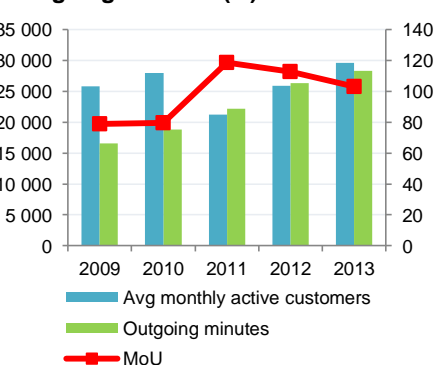
**Exhibit 23 Monthly active subscriber decomposition (M)**



**Exhibit 24: APPM and tariff-to-APPM (ZAR/min)**



**Exhibit 25: No. customers ('000), Outgoing minutes (M) and MoU**



allowed smaller players like Cell C to cut retail tariffs. Since then, the presence of more competition has put pressure on Vodacom’s market share. The company has responded with a pricing transformation which yielded positive results especially in 2012, where the most relevant price decline took place (-13%) and the market share recovered back to FY10 levels (**Exhibit 22**<sup>31</sup>). As we will see next, this recovery was mainly done by the prepaid side.

The declining APPM results in a proportionally increasing prepaid subscriber base, which is more sensitive to price variations. As we can see in **Exhibit 23**, the proportion of prepaid subscriptions relative to total monthly active subscribers increased approximately 77% in FY10 to 81% in FY12, with 9.2m prepaid net adds.

APPM is itself an average because it comprises prepaid and contract clients, as well as bundle<sup>32</sup> or non-bundle users. We can set a relationship between prepaid tariffs and APPM using a lower-end tariff such as Anytime per Second<sup>33</sup> in order to see whether prepaid tariffs represent well APPM. Dividing this tariff by the APPM for FY13 we get 1.17 versus 0.76 in FY09, which is represented in **Exhibit 24**<sup>34</sup>. This means that over the last years pre-paid tariffs have been gaining importance in the APPM and thus, in the ARPU composition.

More importantly, this is now above 1. This means that the pricing transformation crossed not only prepaid customers, but also contract and bundle subscribers. Tariffs with bundled minutes are beginning to dominate ARPU and there is a higher proportion of users in the customer base with large bundled minutes.

In regards to outgoing minutes, what we see especially in the last two financial years is the number of subscribers growing faster than total usage, resulting in a slight decrease of MoU (**Exhibit 25**). This might mean that customers that are quitting Vodacom are being replaced by new customers who albeit being more in quantitative terms, consume less airtime on an individual basis. This is in line with the high churn figures that have persisted over the last five years and have actually deteriorated in FY2013 to unprecedented levels of 50% (**Exhibit 26**). In order for MoU to increase in the future, Vodacom has to be able to retain new users and reduce churn levels.

We believe APPM will continue to decrease because competition from MNOs and MVNOs will continue to put pressure on prices, and future MTR cuts will further put smaller competitors in a privileged position. We also believe that as

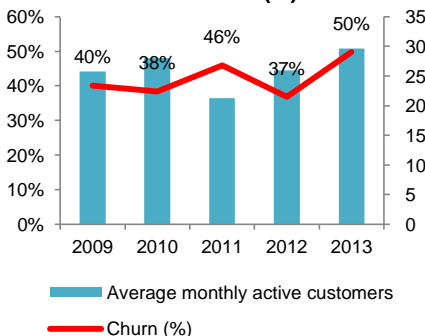
<sup>31</sup> In **Exhibit 26**, the drastic drop in the average monthly active customers was also due to a data base cleaning according to Vodacom management.

<sup>32</sup> Bundle refers to a service package that includes determined minutes of voice, messages and megabytes (MB).

<sup>33</sup> This is a plain tariff that charges R1.2 per minute (billed at second) for all networks

<sup>34</sup> In the limit, if the ratio was equal to 1 APPM is entirely represented by pre-paid tariffs and thus they are a main driver for ARPU.

**Exhibit 26: Churn rates and number of customers (M)**

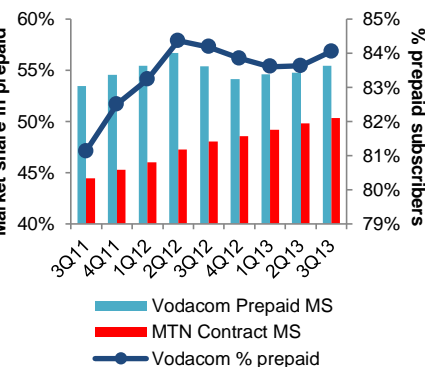


business focus leans towards data and as voice becomes a more saturated market, price wars are likely to concentrate in the data segment.

We consider that in the medium term Minutes of Usage (MoU) will be comparable to the parent Vodafone’s figure, as South African prospective IT penetration and social preferences converge to the figures of more developed countries in the forthcoming years. Customer base growth will be in line with population growth, the stabilization of SA’s penetration rates and a progressive compression of Vodacom’s market share.

We identify two main downside risks in this trend: the extent to which prices will continue to decrease presents unlimited potential due to the competitive environment felt in SA, while the airtime usage demanded by each customer may become more elastic, especially in the prepaid segment. Also, more exposure to prepaid customers may pose more challenges. While camouflaging short-term market share problems by taking advantage of price sensitivity, customer retention may be compromised, in what concerns both the number of subscribers (which so far is not a concern since it has been actually increasing) and the usage per customer (MoU), which may see trouble to improve if customers keep being constantly renewed.

**Exhibit 27: Subscriber market share**

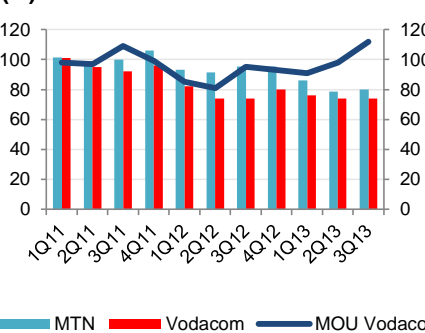


Prepaid:

In this section we analyse the prepaid and contract segments in a more detailed temporal perspective. Vodacom has been gaining market share in the prepaid segment, as well as changing its customer base mix for the last quarters as a result of the aforementioned pricing transformation.

In **Exhibit 27**<sup>35</sup>, we can see a growing prepaid market share reaching 55% in the third quarter of 2013 and a growing prepaid proportion within Vodacom’s customer base, reaching 82% in the same quarter. This means that Vodacom has not been able to make the contract segment accompany the prepaid movement being directly reflected in the increase of the contract market share for MTN, Vodacom’s main competitor.

**Exhibit 28 Prepaid ARPU and MoU (M)**

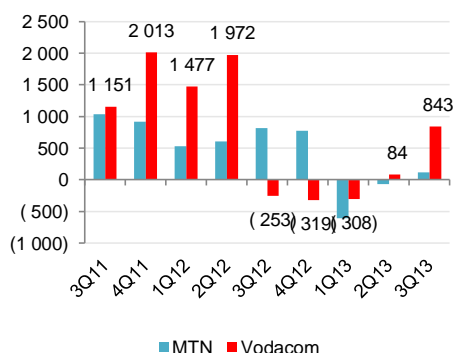


In the last quarters we deduce that Vodacom’s APPM for the prepaid segment has considerably declined. We do not have access to the prepaid APPM because prepaid outgoing minutes are not disclosed (only MoU) but if we look at prepaid ARPU and prepaid MoU for the last six quarters (**Exhibit 28**), we observe a stabilization of the first figure and an increase of the last one, meaning that the increased usage has been able to compensate for the price declines. In fact, the results presentation for the semester ending in September 30 disclosed an

<sup>35</sup> This graphic is not totally accurate given the lack information disclosed in regards to Cell C and Telkom Mobile customers. It uses the sum of Vodacom and MTN subscribers. Still it is useful to get a sense of the trends Vodacom is facing.

Effective Price per Minute (EPM) reduction of 16,9% (yoy) to R0.59 and a MoU increase of 17,9% (yoy).

**Exhibit 29: Prepaid Net Adds**

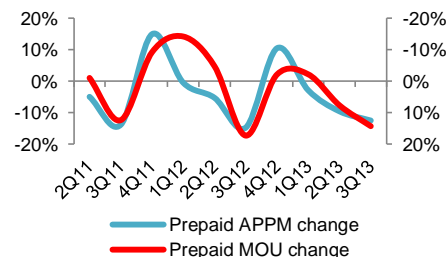


The prepaid net adds demonstrated in **Exhibit 29** materialize these numbers, where we see two consecutive increases in the net number of new prepaid customers for the quarters ending in September.

We also observe that for both operators, ARPU has decreased more than 20% in just 2,5 years with the gap between the two showing signs of progressive closing. Again this is evidence of intensifying competition.

The key factor influencing prepaid customers' behavior is demand elasticity, which has been supporting price movements. Vodacom has showed substantial drive to continue exploiting elasticity through price reductions and we expect it to do so in the future. Even though overall APPM does not directly reflect price reductions in the prepaid segment<sup>36</sup>, the cumulative APPM decrease of approximately 35% in the last 5 years was accompanied by a 73% increase in prepaid MoU.

**Exhibit 30: Sequential growth in APPM and MoU**



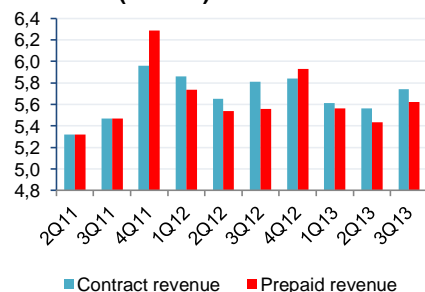
In **Exhibit 30**<sup>37</sup>, we see APPM falling by less than the growth in MoU so we observe positive elasticity. However, continuing to exploit this effect may pose a challenge because in some point elasticity will start to become more rigid, meaning that further price decreases may not lead to a more than proportional increase in voice usage (diminishing marginal utility).

Other important factor in this segment is the type of products offered. More recently Vodacom has developed time based bundles expiring in one hour precisely to capture punctual demand from the price sensitive customers. Also prepaid bundles (bundles lasting 7 days or more) have been the most successful source of revenue registering a growth rate of 22.1% yoy in the semester ended in September 2013 and 34.6% yoy in the quarter ended in June for the same year<sup>38</sup>.

Contract:

In the contract segment the evolution is less appealing taking into consideration that this market is relatively mature. In **Exhibit 31** we find the contract and

**Exhibit 31: Contract and prepaid revenue (bnZAR)**



<sup>36</sup> APPM also incorporates because it also incorporates contract prices (APPM reductions are naturally more drastic in the prepaid segment)

<sup>37</sup> APPM is calculated in this case through dividing ARPU by MOU which is only illustrative for elasticity understanding. In order to see this effect more accurately APPM would have to be calculated through voice ARPU (and not overall ARPU which includes SMS, data and other service revenue) and Outgoing minutes per user rather than MOU (which comprises Outgoing and Incoming minutes per user)

<sup>38</sup> The company decided to disclose revenue information differently since June 2013 (1<sup>st</sup> quarter results presentation), making a division between prepaid and contract, bundle and out of bundle. So all information relative to bundle revenue is only available since that date.

prepaid revenue<sup>39</sup> both showing evidence of some cyclical, with the second half of the year being stronger than the first halves.

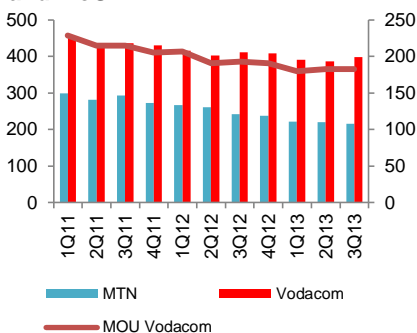
In **Exhibit 32**, a slight negative trend in MOU and ARPU over the last quarters was verified, coinciding with an increasing market share by MTN in this segment. Despite the existing opportunity of exploring data penetration in contract plans, the high saturation presents a challenge for an uptake in this segment.

In terms of new customers, we see in **Exhibit 33** that net contract additions for Vodacom have been shy in the last quarters, especially comparing with MTN, which according to the analysis performed ahead actually practices higher prices. This may be a source of concern because, although contract customers represent only 16% of Vodacom's customer base, it represents roughly half of total service revenues<sup>40</sup>.

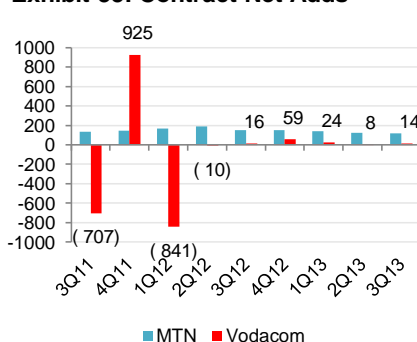
In terms of existing customers, there are currently 64% of Vodacom's contract revenue that comes from bundles<sup>41</sup> which demonstrates upside for migration from non-integrated to integrated plans. This is important to prompt data usage amongst contract users. In fact, Vodacom's last results presentation announced a 41.8% of contracts changing to Red or Smart, which are the most popular contract bundles.

In **Exhibit 34**, we see the monthly tariff for the Red plan with roughly the same characteristics<sup>42</sup> across different countries where Vodafone is present. The table shows that Vodacom has the highest monthly fee from this universe (roughly 73eur per month). Although ignoring inflation and purchasing power parity among these countries, the illustration of this comparison leads one to believe there is also room for price decreases in South Africa, especially considering that Red Advantage is the most accessible plan within the Red plans.

**Exhibit 32: Contract ARPU (ZAR) and MoU**



**Exhibit 33: Contract Net Adds**



<sup>39</sup> These figures are proxies as they are the product of given KPIs such as ARPU and number of customers (the company did not disclose this kind of information until June 2013, when it changed the disclosure framework).

<sup>40</sup> Based on numbers disclosed in September 2013.

<sup>41</sup> Contract revenue is a figure that was only revealed from June 2013 onwards, in line with the new disclosure by the company.

<sup>42</sup> We prioritized the subplans within Red that included 1G of data and a device included, generally iPhone 4S; for those with no device included it is because that option is not available

**Exhibit 34: Vodafone Red Tariff**

| Vodafone UK        | Vodafone Australia | Vodafone Portugal | Vodafone Egypt | Vodafone Turkey | Vodacom SA           |
|--------------------|--------------------|-------------------|----------------|-----------------|----------------------|
| Red                | \$65 Red           | Red +             | Red Basic      | Red Classic     | <b>Red Advantage</b> |
| ∞ min              | ∞ min              | ∞ min             | 2000 min to    | 1000 min        | <b>700 min</b>       |
| ∞ SMS              | ∞ SMS              | ∞ SMS             | Vodafone +     | 1000 SMS        | <b>∞ SMS</b>         |
| <b>1G data</b>     | 3G data            | 1G data           | 300 to any     | 1G data         | <b>1G data</b>       |
| <b>With device</b> | With device        | Without device    | number         | With device     | <b>With device</b>   |
|                    |                    | device            | 1000 SMS       |                 |                      |
|                    |                    |                   | 1G             |                 |                      |
|                    |                    |                   | Without device |                 |                      |
| <b>EUR 39</b>      | <b>EUR 65</b>      | <b>EUR 40</b>     | <b>EUR 16</b>  | <b>EUR 64</b>   | <b>EUR 73</b>        |

In order to have a sense of the in-bundle value offered by each South African operator, we built the table demonstrated in **Exhibit 35** which gathers similar contract plans from the different players, including and not including a phone.

**Exhibit 35: Comparing packages amongst SA operators**

| Equipment included in the contract |                 |                       |                | No equipment included |                 |                       |                       |
|------------------------------------|-----------------|-----------------------|----------------|-----------------------|-----------------|-----------------------|-----------------------|
| Vodacom                            | Cell C          | MTN                   | Telkom Mobile  | Vodacom               | Cell C          | MTN                   | Telkom Mobile         |
| <b>Smart S</b>                     | Straight Up 200 | Anytime 200           | SmartPlan 100  | <b>Smart XL</b>       | Straight Up 800 | Anytime 750           | SmartShare 750MB      |
| <b>75 min</b>                      |                 | 90 min                |                | <b>400 min</b>        |                 | 750 min               | 300 min               |
| <b>200 SMS</b>                     | 200 min         | 200 SMS               | 100 min        | <b>800 SMS</b>        |                 | 750 SMS               | Unlimited SMS         |
| <b>200MB data</b>                  | 200 SMS         | 200MB                 | 50 SMS         | <b>800 MB</b>         | 800 min         | 750 MB                | 750 MB                |
| <b>Samsung</b>                     | 200+200MB       | Samsung               | 150 MB         | <u>Out-of-bundle:</u> | 800 SMS         | <u>Out-of-bundle:</u> | <u>Out-of-bundle:</u> |
| <b>Galaxy S4 Mini</b>              | Samsung         | Galaxy S4 Mini        | Samsung        | <b>R1.50/min</b>      | 800 MB          | R1.75/min             | R1.50/min             |
| <u>Out-of-bundle:</u>              | Galaxy S4 Mini  | <u>Out-of-bundle:</u> | Galaxy S4 Mini | <b>R0.35/SMS</b>      | R0.99/min       | R0.75/SMS             | R1/MB                 |
| <b>R1.75/min</b>                   | ZAR0.99/min     | R2.85/min             |                | <b>R1/MB</b>          | R0.50/SMS       | R2/MB                 | R0.50/SMS             |
| <b>R0.30/SMS</b>                   | R0.50/SMS       | R0.75/SMS             |                |                       |                 |                       |                       |
| <b>R1/MB</b>                       |                 | R2/MB                 |                |                       |                 |                       |                       |
| <b>ZAR 299</b>                     | ZAR 369         | ZAR 399               | ZAR 269        | <b>ZAR 699</b>        | ZAR 800         | ZAR 750               | ZAR 349               |

We observe that for relatively accessible plans that include the same equipment<sup>43</sup>, Cell C offers more value for a lower price (ZAR 369). MTN charges a higher monthly fee (ZAR 399) and practices higher prices for out-of-bundle minutes. Regarding Vodacom, its Smart S plan offers less airtime and less data and in order to match Cell C’s bundle airtime, a Smart S subscriber would have to pay around ZAR218 (at a bundle rate of R1.75) to have additional 125 voice minutes. Telkom mobile lags behind in terms of packaged value because it does not offer many options for higher-end contract plans. However, for the SmartPlan 100 it also offers unlimited calls between Telkom Mobile operators for the first 12 months.

If we compare contract plans that do not include an equipment, Telkom Mobile plan seems to be the most attractive. Despite low airtime minutes, it provides

<sup>43</sup> We assumed Samsung Galaxy S4 Mini as default because is one of the most popular cellphones while not being as expensive as Apple’s iPhone. The contract length was assumed to be 24 months for every operator.

increased value in data usage while maintaining a very low price. Even paying an extra ZAR333 at a out-of-bundle rate of R1.50 to match Cell C’s bundle it still is the most attractive offer. In this type of bundle Vodacom does not offer much airtime minutes as the other operators and it does not have a low out-of-bundle rate, making this plan relatively less attractive.

Vodacom has more variety in the products offered with a lot of TopUp possibilities, but it holds back when compared to Cell C, which practices lower prices with more straightforward and better terms, such as the 99c per minute per second billing for any network, at any time, in or out of bundle.

Integrated bundles with a contract are a way to address sensitivity to economic pressure, and the consequent negative impact on ARPU. Including a device in the contract that is cheaper comparing with an equivalent option on prepaid is a way not only to give incentive to data consumption but also to raise loyalty next to operators. Albeit saturated, we believe the contract market is key to make revenue more solid, especially at the current moment where smartphone penetration is gaining momentum.

We believe there is still potential to be further explored in terms of price declines, variety of products offered and contract terms. The present risk for Vodacom is to let the existent opportunities in the contract segment be overshadowed by the increasing exposure to the prepaid market.

## Interconnect

The interconnect charges in South Africa are a prominent issue considering Vodacom’s large market share. Over the last years, the South African regulator has made an effort in order to decrease asymmetry within the mobile telecommunications market, by reducing Mobile Termination Rates (MTR) and thus, prompting competition. In **Exhibits 36** and **37** we can observe the evolution of the peak and off-peak MTR, as well as the draft rates released by ICASA<sup>44</sup> this year to be applicable in the beginning of 2014.

Exhibit 36: MTR (ZAR/min) in SA

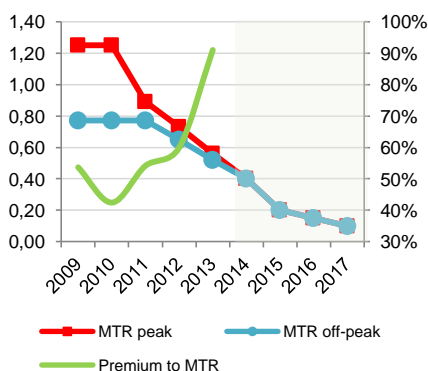


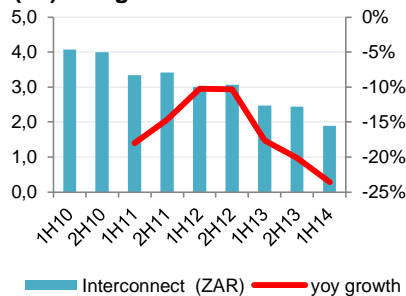
Exhibit 37: MTR path

| Market share | Company                    | March 2013 | March 2014 | March 2015 | March 2016 | March 2017 | March 2018 | March 2019 |
|--------------|----------------------------|------------|------------|------------|------------|------------|------------|------------|
| >20%         | Vodacom<br>MTN             | 40c/min    | 20c/min    | 15c/min    | 10c/min    | 10c/min    | 10c/min    | 10c/min    |
| <20%         | Cell C<br>Telkom<br>Mobile | 44c/min    | 39c/min    | 33c/min    | 26c/min    | 20c/min    | 14c/min    | 10c/min    |

Source: ICASA

<sup>44</sup> Independent Communications Authority of South Africa

**Exhibit 38: Interconnect revenue (bn) and growth rate**



So far, interconnect revenue has suffered considerably: it has been decreasing since 2010 (when MTR cuts start taking place) and annual negative growth rates are above -10% in the last three financial years (Exhibit 38). A direct result was the declining representativeness of Interconnect in overall service revenues from 19% in FY2009 to 10% in FY2013. Actually the company has been able to compensate for lost revenue through the enhancement of other revenue streams such as data while delivering service revenue growth.

**Exhibit 39: MTR lost revenue (bnZAR) and impact on SR (%)**

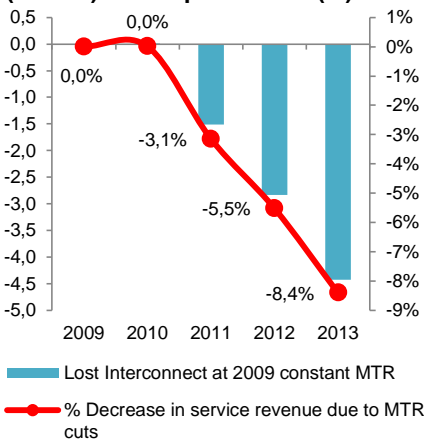


Exhibit 39 provides a sense of the lost revenue in Interconnect for a 2009 constant termination rate. We can observe that the cumulative lost revenue amounts to over R8 billion and that the service revenue (SR) percentage decrease due to lost interconnect revenue reaches 8.4% in 2013.

**Exhibit 40: MTR and the level of asymmetry**

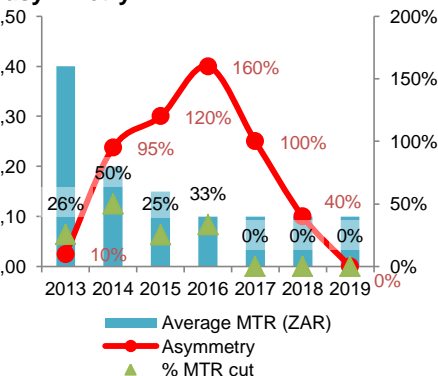
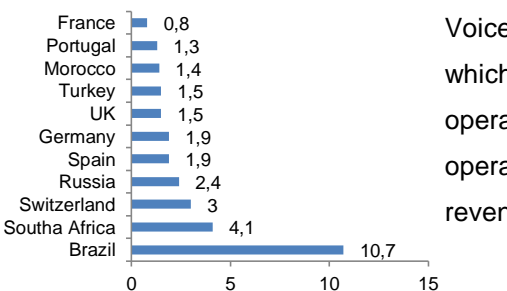


Exhibit 36 also reveals the Premium to MTR, represented by the percentage of how much the APPM is above the weighted average MTR (weighted by a 50/50 peak and off-peak proportion) over the last five years. Despite the decrease in APPM, this premium is becoming increasingly more evident, which is manifested by a current 90% level versus only 54% in 2009.

Other aspect to take into account is the regulator's proposal for the level of asymmetry<sup>45</sup> between large operators, such as Vodacom or MTN, and small operators as Cell C or Telkom, which will start from a current 10% level to one as high as 160% in 2016. This means that not only Vodacom will see termination rates suffering drastic cuts but also these cuts will be asymmetric in relation to competition. The key implied outcome is that small competitors gain margin to make more aggressive pricing strategies. We can see this dynamics in Exhibit 40.

According to Vodacom, a reasonable value of asymmetry for which they could accommodate is around 20%-25%. If the glide path proposal is approved, this might compromise future capital expenditure and operating expenses<sup>46</sup>. Currently the MTR in South Africa are among the highest in several world countries (Exhibit 41).

**Exhibit 41: MTR in Euros by country**



The decrease in MTR is also important in terms of the effect it can cause on Voice revenues, as already mentioned: lower MTRs lead to more competition, which is translated into tariff adjustments that are generally initiated by small operators because they have additional flexibility. This in turn forces larger operators to accompany price reductions which may lead to lower voice revenues. The impact will be a function of the interplay between changes in retail

<sup>45</sup> Asymmetry is measured by the percentage increase between how much large operators and small operators pay for MTR.

<sup>46</sup> This is a source of concern for Vodacom's management, constituting the reason why it is attempting to negotiate the glide path.

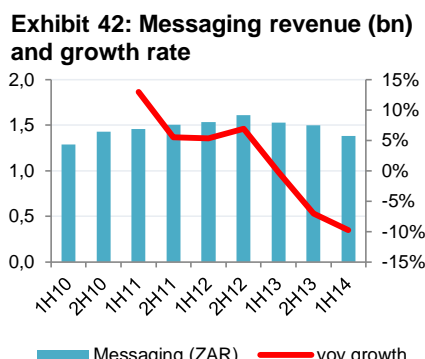
tariffs (the way small and large operators react to others' tariff adjustments), changes in on-net/off-net traffic mix, price elasticity and shifts in market share enter in the equation as well.

The quantification of MTR net impact is therefore quite complex and unclear. In addition to this voice impact, it influences not only Interconnect revenue but also interconnect costs. In FY13 Vodacom's net interconnect in SA was +R1.3bn, representing 5% of Group's EBITDA. In spite of MTRs reduction by 23% from FY12 to FY13 and the lost revenue mentioned, Vodacom SA's net interconnect actually increased by 18% yoy. This highlights the complexity of trying to predict the ultimate impact of lower termination rates.

Although management is attempting to smooth this path we believe it will be enforced and thus, we incorporate the MTR proposal as it is in our forecasts.

### SMS

In terms of messaging revenue, Vodacom does not present much exposure to it. It has always been approximately 6% of service revenues for the past five years and in last year the growth rate was actually negative. Messaging prices are likely to maintain because there is a very low elasticity potential to take advantage of in this segment and messages in general will tend to decline. We believe this revenue will be further eroded mainly due to increasing propagation of smartphones and use of instant messaging applications. In **Exhibit 42** messaging revenue and yoy growth rates are shown.



### Data

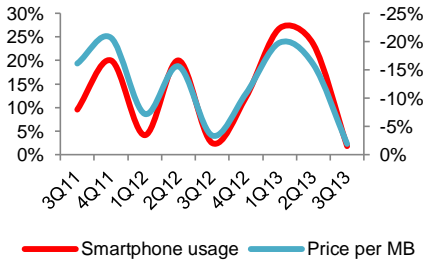
The data growth is a relatively recent phenomenon. As we can see in **Exhibit 43** the average smartphone data usage was only 38MB per month in less than three years ago. Currently it is 220MB, which is more than 5 times higher. The price per MB follows the same trend with a corresponding percentage decrease of 84% for the last 30 months.

**Exhibit 43: Price per MB and smartphone usage**

|              | 1Q11 | 2Q11 | 3Q11 | 4Q11 | 1Q12 | 2Q12 | 3Q12 | 4Q12 | 1Q13 | 2Q13 | 3Q13 |
|--------------|------|------|------|------|------|------|------|------|------|------|------|
| <b>MB</b>    | 38   | 73   | 80   | 96   | 100  | 120  | 123  | 138  | 175  | 216  | 220  |
| <b>Price</b> | 1.65 | 0.88 | 0.74 | 0.59 | 0.54 | 0.46 | 0.44 | 0.40 | 0.32 | 0.27 | 0.26 |

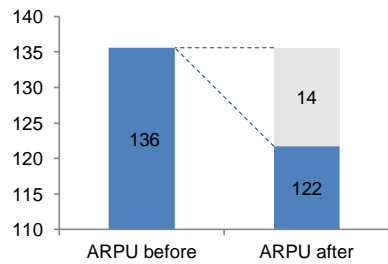
Source: Analyst's estimates

**Exhibit 44: Sequential growth in price per MB and smartphone usage**



In **Exhibit 44**, we performed a similar analysis as we did in the Voice section. We observe that growth in price per MB moves together with average smartphone usage per month, indicating that elasticity is close to one. For extreme sequential movements we also see that growth in smartphone usage tends to surpass the growth of price per MB, which shows more than proportional sensibility of data users when prices go drastically down or drastically up. Since prices have already come down substantially and taking into account the small elasticity effect, we do not expect big cuts. What is definitely expected is an increase in usage and penetration, driving the representativeness of data revenue in service revenue up from 18% to approximately 30% in 2020.

**Exhibit 45: Impact on ARPU (ZAR)**

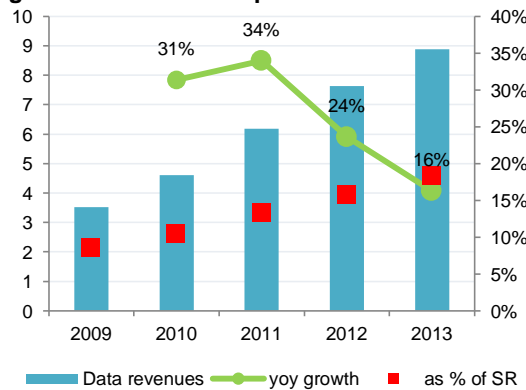


An important risk we should bear in mind has to do with the gap between data and voice pricing. If it becomes too large, meaning that using data becomes cheaper than voice, ARPU is likely to reduce as voice calls are substituted by VoIP (Voice over Internet Protocol) software such as Viber or Skype. In order to understand this effect we simulate the impact of 20% of voice minutes being substituted by data. **Exhibit 45** summarizes this effect showing its great impact on ARPU.

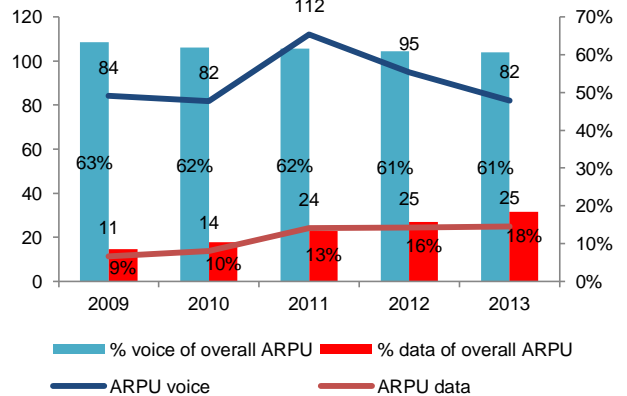
| Assumptions         |           |
|---------------------|-----------|
| % minutes replaced  | 20%       |
| Total minutes       | 5 670     |
| 1h = x MB           | 30        |
| Total MB            | 2835      |
| Price per MB        | ZAR 0,32  |
| Voice Rev Lost (M)  | ZAR 5 830 |
| Data Rev Gained (M) | ZAR 900   |
| Impact on ARPU      | -10%      |

In **Exhibit 46** we see that data has registering considerable revenue, despite a declining growth dimension, leading to a higher representation in service revenue. Comparing the ARPU for voice and for data, we see that there is a discrepancy, probably because data is not diffused and consumed in enough quantities for it to surpass voice. Nevertheless, data ARPU in terms of overall ARPU is increasing while voice ARPU is decreasing. Detailed values are demonstrated in **Exhibit 47**.

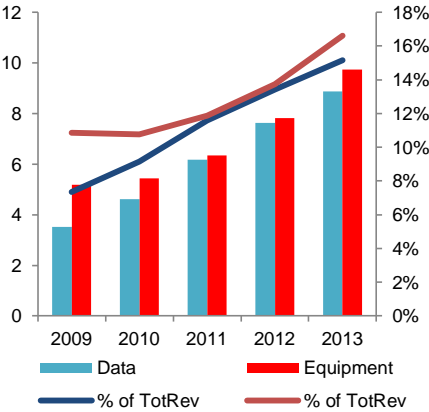
**Exhibit 46: Data revenue (bnZAR), yoy growth rate and its representation in service**



**Exhibit 47: ARPU (ZAR) for voice and data and as % of overall ARPU**



**Exhibit 48: Data and equipment revenue (bnZAR) and as % of total SA revenue**

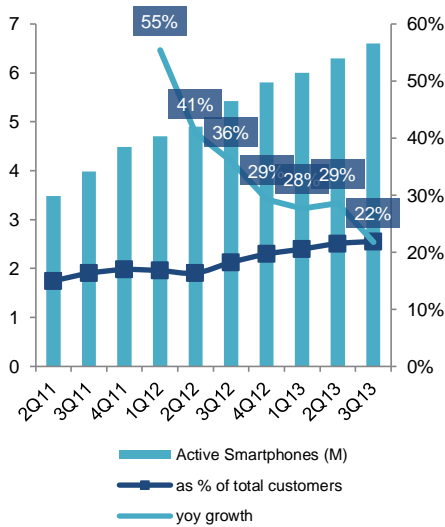


## Equipment

Boosting data usage among customers has been Vodacom's strategic priority. The approach to attain that is to make people buy more and better smartphones. That is why data and equipment revenue have been following the same trend (**Exhibit 48**).

The company has presented some remarkable results in regards to increasing active smartphones and active data users. Growth rates on a yoy basis have been consistently 2-digit in both figures. **Exhibit 49** and **50** show the path for the number of active smartphones and data users, as well as those figures as percentage of total active customers. Roughly half of total subscriber base uses data and only 22% of Vodacom's subscribers holds a smartphone, leaving a lot of room for improvement of data usage.

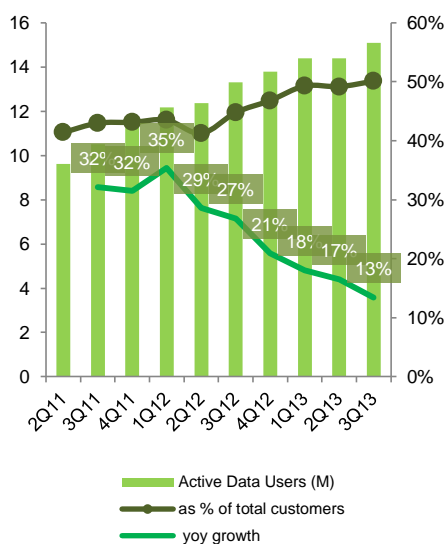
**Exhibit 49: Smartphones in SA**



The evolution of smartphone penetration is impressive for the considered temporal horizon but the majority of devices in place are of lower-end type (approximately 50% are still Blackberry), translated in high-growing but still small average data consumption. Regarding the first half results presentation, while Vodacom in South Africa presents an average smartphone usage of 220MB/month, in Europe, Vodafone presents an average of 400MB.

Therefore, substituting low-end smartphones of existing customers by high-end ones is key in order to fully explore the data momentum. Handset financing plays a crucial role in this context, where we have still high priced devices. In the year ending in September, 24% of new smartphones sold were through this financing facility.

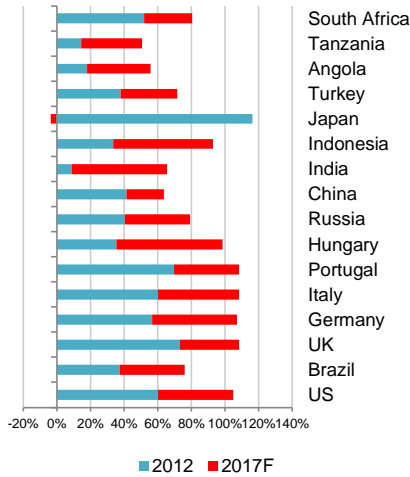
**Exhibit 50: Data users in SA**



If we segregate the smartphone penetration in contract and prepaid segments, the numbers are 50% in the first segment and 17% in the last one. In contract, the figure is higher because handset financing is only available for contracts. On prepaid, we see low penetration and low-end smartphones, revealing potential for migration to contract.

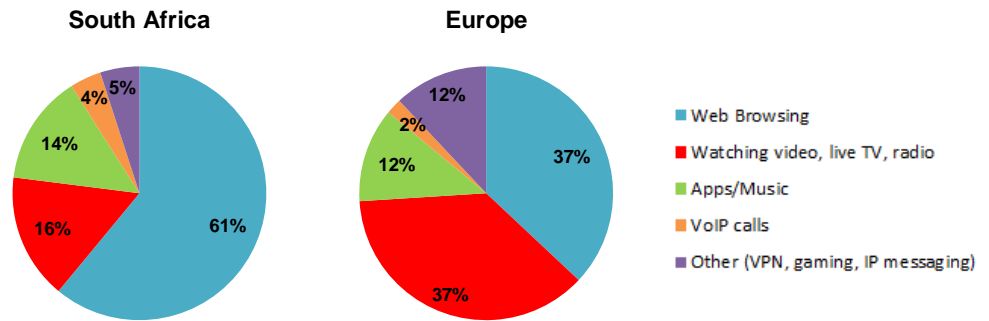
Also in **Exhibit 48**, we can get a sense of the transformation in Vodacom's revenue mix, with data and equipment revenue gaining increasing importance within total revenue, in contrast with voice, SMS or interconnect in accordance with what we saw earlier. This trend will intensify as smartphone penetration is expected to increase in South Africa (**Exhibit 51**), as well as the data traffic mix itself leans towards more data intensive (thus more expensive) activities such as video/TV/radio (**Exhibit 52**).

**Exhibit 51: Smartphone penetration as % of population**



Source: Ovum

**Exhibit 52: Data traffic mix**



Source: Vodacom disclosure

## Cost containment

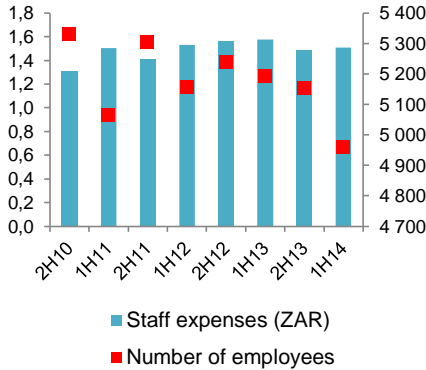
The change in revenue composition, especially towards sales of equipment, poses some challenges given the low margins associated with handset sales. For instance, in the first half of Vodacom's FY2014, the company was able to keep EBITDA margin flat, despite a 40% in equipment revenue, due to diverse cost saving initiatives.

In **Exhibit 53**, it is showed the evolution of staff expenses and the number of employees through the semesters from 2010 onwards. We see that for second semesters the number of employees is decreasing while staff expenses increase except for the second half of FY2013 (ending in March 2013). This reflects a positive growth of expenses per employee except for the 2H13, where the growth rate was -3% yoy.

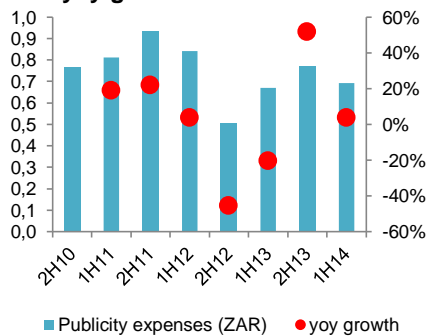
In what concern first semesters, we see an opposite trend in the number of employees until 1H13 (September 2012). From that point Vodacom decided to lay-off employees, amounting to 4957 as of September 2013 (this corresponds to less 233 employees and a 4,5% decrease yoy). The trend of expense per employee for the first half semesters remains stable during the period in consideration, including for the last one.

The cut of R 6M yoy last semester (1H14) in staff costs is impressive despite an inflationary environment. Part of staff layoffs for the semester was related to a decrease in customer care calls by 11,7% (equivalent to 10 million less calls) and 25% in 1H13. New online and self-help products contributed to reduce call volumes and thus reducing call centres costs.

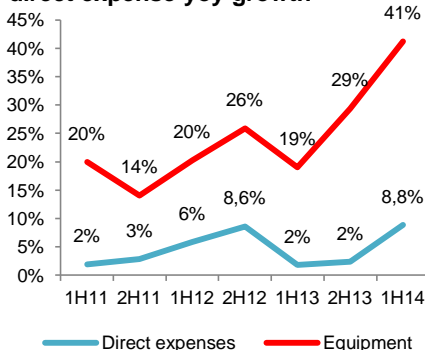
**Exhibit 53: Staff expense (bn) and number of employees**



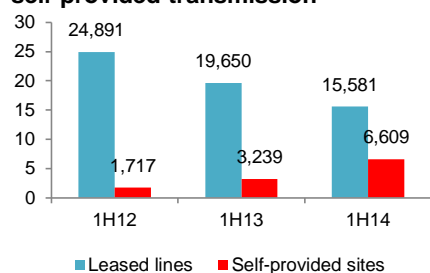
**Exhibit 54: Publicity expenses (bn) and yoy growth**



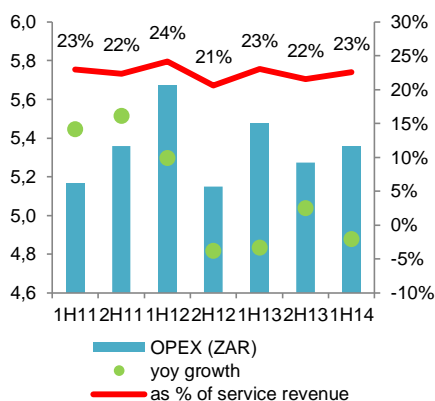
**Exhibit 55: Equipment revenue and direct expense yoy growth**



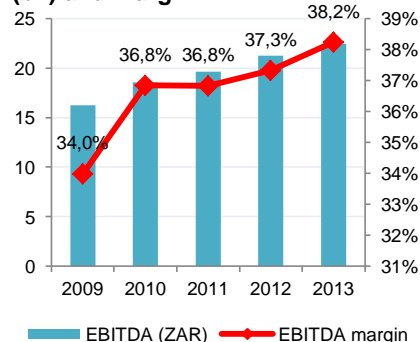
**Exhibit 56: Leased lines ('000) and self-provided transmission**



**Exhibit 57: Operational expenditure (bn)**



**Exhibit 58: South Africa EBITDA (bn) and margin**



Other expenses have been suffering reductions as cost savings between September 2011 and 2013 amount to ZAR 144M. Costs with publicity have been behaving with considerable volatility as we can see in **Exhibit 54**. It is worth to note the growth in the last two semesters of 52% in 2H13 (+R 252m) and 4% in 1H14 (+R 24m), after very negative growth rates of -46% on 2H12 (-R 426m) and -21% on 1H13 (-R 173M).

Direct expenses have continuously increased because of more handsets being sold, following approximately the trend in the growth rate of equipment revenues (**Exhibit 55**). The growth in direct costs is softened by the reduction in other components such as interconnect costs, which came down due to MTR cuts, and leased lines expenses.

The number of leased lines decreased from 24 891 in September 2012 to 15 581 2 years after as it is observed in **Exhibit 56** (about a 40% decrease, mostly from Telkom) with the leased lines expense coming down 13.6%. It is likely that these numbers will come further down given Vodacom's self-provisioning efforts, which allows the company to have more control over network quality while decreasing lease expenses. We can expect these expenses to decrease more than proportionally than a reduction in the number of leased links, as Vodacom's ability to build out its own links represents more bargaining power to negotiate the lease prices with other operators. Overall direct costs increased 9% yoy by +R 1.1bn last semester, being the semester with the highest increase among the period in consideration.

Opex (which includes staff expenses, publicity and other operating costs) as percentage of service revenues has been flat for the third year on a yoy basis and stable around 23% on a sequential basis (**Exhibit 57**). According to management, opex will grow for the next years albeit at very low single digit.

## Margins

In contrast to what should be naturally expected, Vodacom has been able to improve margins (**Exhibit 58**) despite the competitive environment and the increase of equipment representation in overall service revenues (sale of equipment has smaller margins comparing with voice or data). We attribute this improvement to the boost of data revenue and the ability to contain costs, which in our belief is an evidence of the quality of management.

If we compare EBITDA margins between Vodacom and comparable companies, we see a margin of 38% is quite attractive. The domestic competitor MTN South Africa has an EBITDA margin of 35% for the year-end in 2012 and Telkom (considering also the fixed operations because Telkom Mobile individually does

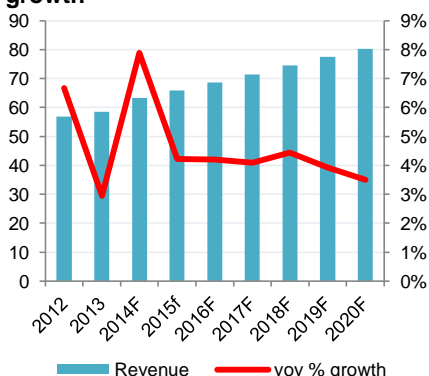
not disclose this information) has a margin of 23.7% for the same year. Other African telcos such as Milicom and Safaricom have margins of 39.9% (year-end March 2013) and 35.6% (December 2012) respectively. If we look at Vodafone in other countries we find a lot of asymmetry. EBITDA margins for the year-end March 2013 are around 15.6% in Turkey, 24% in UK, 36% in Germany, 41.8% in Portugal, 43.7% in Egypt and 44% in Italy.

We believe the current environment in South Africa will eventually cause margins to shrink, taking into account the inflation in the foreseeable future and competition from other operators. Evidence that make us believe so is the high unsustainable value of Return on Invested Capital (ROIC). Vodacom in SA has currently a ROIC of 55% which is way above its cost of capital of 10.18%.

On the revenue side, prices are expected to go down despite inflation but on the cost side, these are likely to increase with inflation, especially staff costs. There are some cost mitigating factors such as the proven management ability to cut costs and the company's intention to progressively convert leases into self-provided transmission.

Overall revenue is expected to increase at a slow pace given the considerations developed until now. Projected revenue is represented in **Exhibit 59**.

**Exhibit 59: Projected reveue for South Africa (bnZAR) and yoy growth**



## Investment in Invested Capital

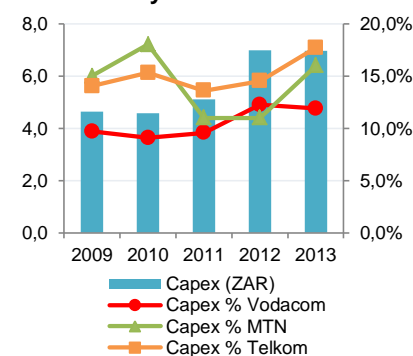
### Capital Expenditure

Investment is critical for mobile operators because as affordability of smartphones and data consumption increase, the network capacity is required to increase as well. This is even more important in emerging markets since there are fewer competitive infrastructures to deliver data services.

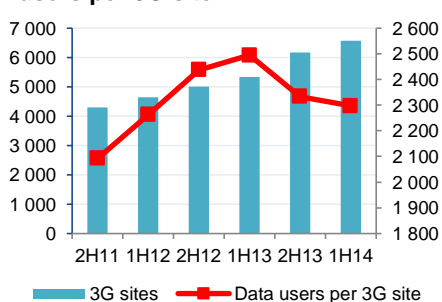
In **Exhibit 70** we can find the evolution of capital expenditure for Vodacom in South Africa and respective capital intensity<sup>47</sup>. It is currently around R7 billion per year and it represents about 12% of revenue. In absolute terms it might be a large figure but comparing with MTN South Africa and Telkom<sup>48</sup>, it has been lagging behind for the past five years except in 2012 (in relation to MTN). For 2013, MTN and Telkom had capital intensities of 16% and 18% respectively.

For the past five years Vodacom has concentrated capital expenditure mainly on transmission. This involves improving its speed, the radio access renewal (RAN) program and expanding coverage by adding new base stations.

**Exhibit 70: Capital expenditure (bn) and intensity**



**Exhibit 71: Number of 3G base stations and number of active data users per 3G site**



<sup>47</sup> Capital expenditure as percentage of total revenues.

<sup>48</sup> Vodacom's figures as well as Telkom's are relative to the year ending in March and MTN's to the year ending in December immediately before. Telkom refers to Telkom Group, including the fixed and mobile segment, South Africa and International (although International operations only account for 1% of Telkom revenue)

In South Africa over two thirds of Vodacom's base stations have high capacity transmission, either fibre or IP microwave. Vodacom has currently 9586 2G base stations, 6574 3G base stations and 727 LTE sites. EDGE<sup>49</sup> covers 96% of the South African population (as of March 2013) and 3G covers 89%. (September 2013). In **Exhibit 71** we can see the evolution in the number of 3G base stations. In line with a data penetration strategy, investment in infrastructure that supports 3G has been at focus, registering a 50% increase since March 2011. Data users per 3G site have been increasing until March 2013, when it dropped close to 2300.

More recently, LTE technology has also gained importance for Vodacom, which was the first to launch LTE in South Africa on 10 October 2012. As we will see next, access to spectrum is crucial to roll out LTE optimally.

The RAN renewal program across the Group is expected to be completed over the next financial year. In South Africa 77% of the base stations were already converted. This renewal allows to accommodate 2G, 3G and LTE in the same network and to reduce in operational and energy costs.

In the semester ending in September 2013, Vodacom has increased the Group's medium-term guidelines for capital expenditure from 11%-13% to 14%-17%. To this guideline upgrade contributes Vodafone's upcoming cash from the sale of Verizon<sup>50</sup> and the consequent £7 billion allocation to Project Spring. This investment program is to take place in the next three financial years and it accrues directly to network quality improvement and customer services in the various countries where Vodafone is present. The bulk of the windfall will be handed to shareholders and repay Vodafone's debt.

Nevertheless, Vodacom's management was clear in the fact that this guideline is conditional on the MTR outcome and level of asymmetry. For the CEO, a 25% annual MTR cut along with 15% asymmetry would be compatible with those capex guidelines. However the draft MTR points at a cut close to 50%, and asymmetries of more than 100%, which makes us believe capex intensity will lean towards the lower limit of 14%.

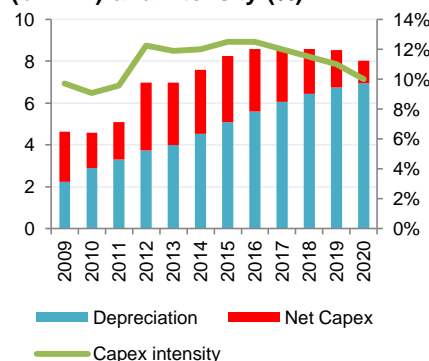
We believe more capital expenditure will be used to continue to improve, transmission as well as converged services, which involves Fibre-to-the-Premises (FTTP)<sup>51</sup> and LTE. In **Exhibit 72** we find forecasts for capex in South Africa as well as its decomposition into depreciation and net capex. We estimate capex intensity for South Africa so that values for the overall group for the next

<sup>49</sup> Technology classified as 2.75G which is an evolution from 2.5G, known as GPRS.

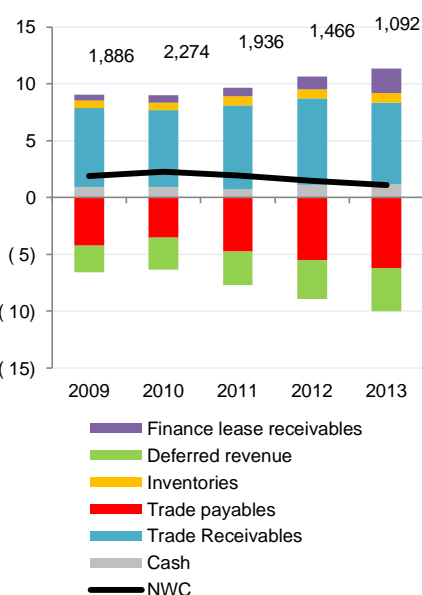
<sup>50</sup> Vodafone confirmed the sale of its 45% stake in Verizon Wireless on September 2013 for \$130 billion.

<sup>51</sup> FTTP encompasses both FTTH and FTTB

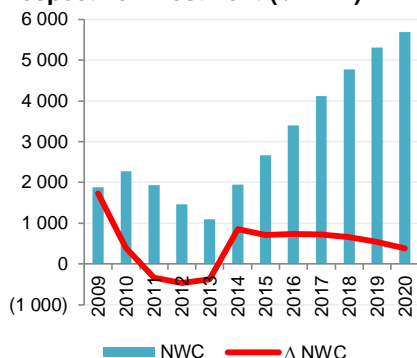
**Exhibit 72: Capex decomposition (bnZAR) and intensity (%)**



**Exhibit 73: Net working capital components (bnZAR)**



**Exhibit 74: Net working capital and respective investment (bnZAR)**



three years lie over the 14%-15% range. We believe that for the remaining explicit period, capex intensity will begin to decrease in South Africa, and depreciation will consume a larger part of capex. This has mostly to do with a mature 3G coverage network, a RAN conversion plan almost completed, LTE constraints on the spectrum side and the likely trend of other operators to accompany Vodacom’s increased capex.

### Net Working Capital

Telecoms’ working capital is specific to the sector because revenue is usually recognised as services are performed. In Vodacom’s case, trade receivables are related to revenue billed by service providers and dealers (agents) on the behalf of Vodacom<sup>52</sup>, either in South Africa or in the International segment. In South Africa, the company’s main customers are Telkom (as of 2011 it represented 18.5% of receivables), MTN, Cell C and Vo-Call Cellular (Vodacom’s largest dealer). Trade payables apply the inverse way. Both have been increasing over the last years, being a direct result from revenue growth, and both represent roughly the same in SA’s overall revenue (11% for payables and 12% for receivables as of March 2013).

Other important component in working capital is deferred revenue, which corresponds to revenue from the sale of prepaid credit vouchers used in the top up service alternative<sup>53</sup>. It has been increasing because top ups are becoming more popular, a trend that we expect to continue according to revenue growth.

Inventories and finance lease receivables are related mostly to equipment sales. As more devices are sold and as equipment revenue grows in proportion to overall revenue, inventories and the amount of financing provided to customers who buy devices included in a contract<sup>54</sup> also increase.

In **Exhibit 73**, we can see how these components behaved during the last five years and in **Exhibit 74** the aggregate movements of net working capital as well as the forecasted figures.

### Operational Free Cash Flow

In **Exhibit 75** is the operational free cash flow decomposition for 2013 and in **Exhibit 76** is the respective projections. Main items are represented by taxes and capex, and expected growth is expected to be higher as we move further on

<sup>52</sup> The company within its contractual arrangements with its agents pays them administrative fees; it receives in cash the net amount equal to the gross revenue earned less the fees.

<sup>53</sup> The revenue is deferred until such time as the customer uses the airtime or the credit expires.

<sup>54</sup> These are leasing contracts that usually last 12 or 24 months.

the explicit period. Large negative growth is due to higher investment in net working capital and higher capex.

## Other Issues

### Spectrum

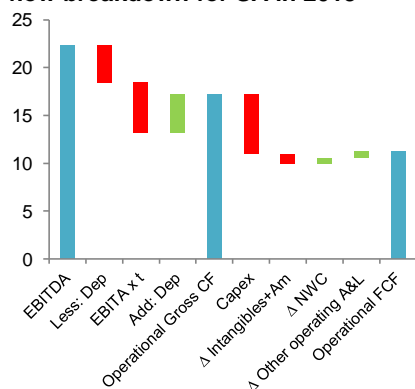
On October 2012, Vodacom launched South Africa's first LTE network, counting with 727 sites by September 2013. Vodacom has to leverage existing LTE opportunities in order to fully exploit this data phenomenon. They comprise offloading traffic from the 3G network, achieving higher volumes as devices get faster, as well as the creation of a DSL-like LTE service. This means providing sufficient LTE coverage in a way that it becomes an alternative to DSL. However these opportunities require spectrum, whose delayed allocation by ICASA has been stalling operators' ability to expand services and to continue network rollout.

Currently Vodacom and MTN use the 1800MHz band to provide LTE services while Telkom uses the 2.3GHz band and Cell C the 2.1GHz one. In March 2013 66% of Vodacom's network was ready to support LTE technology.

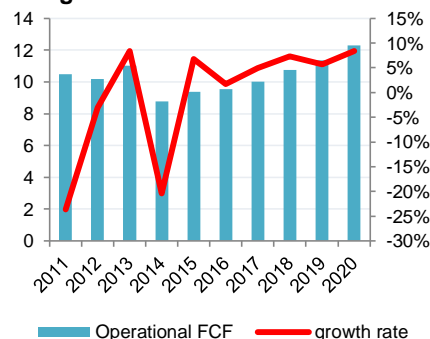
ICASA postponed the auction to allocate spectrum in the 800MHz and 2.6GHz bands which was supposed to be completed in April 2012 in a "beauty contest" framework (factors to take into consideration include business plan, technical plan, market innovation and network rollout in opposition to a traditional auction procedure). The postponement was justified by the need to "ensure that the minister's policy direction in high demand spectrum was taken into consideration". In September the government announced its plans to finalize the spectrum policy by March 2014. Vodacom's management appears to be confident that the allocation of the 2.6GHz band will take place during the last quarter of the year, hoping to start using it during the first quarter of 2014. Regarding the 800MHz band, it will not be auctioned unless the migration of analogue broadcast TV (whose first policy document was released in 2008) to digital terrestrial television (DTT) is completed.

The band frequency of the spectrum to be allocated is crucial since it comprises a tradeoff between coverage and traffic. The higher the band frequency, the lower the coverage provided by the radio cell in the base station but the higher the associated traffic capacity. For instance, a 2.6GHz band is adequate for high populated cities because it is preferable to invest in many base stations with smaller coverage each than manage traffic collisions, clashing signals and interference. The opposite is true for frequency bands like 800MHz which are more suitable for rural areas.

**Exhibit 75: Operational free cash flow breakdown for SA in 2013**



**Exhibit 76: Operational FCF (bnZAR) and growth rate**



On top of the risk inherent to the spectrum allocation, Neotel's acquisition by Vodacom puts more uncertainty on the table. The terms in which the acquisition should go through, especially regarding Neotel's spectrum are not clarified yet and are currently subject to approval by the Competition Committee and ICASA.

## M&A – The Neotel Acquisition

In late September 2013, Vodacom announced that it is in exclusive negotiations to buy 100% of Neotel SA<sup>55</sup>. Neotel shareholder structure is constituted by Tata Communications (68.5%), Nexus Connection (19%) and Communitel (12.5%). The Indian-based Tata Communications is one of the main tier 1 telecommunications company at global scale. Currently Neotel represents 12% of the overall group revenue.

If the deal gets past ICASA and the Competition Commission, we believe there will be relevant synergies for Vodacom. The main benefits are related to spectrum and infrastructure. Given the current spectrum constraints Vodacom is facing, the acquisition would allow Vodacom to improve spectrum employment and put it to work on the LTE network (especially in the 1800 MHz range). As for infrastructure, Vodacom would benefit from 15,000km of fibre which is considerable for a company whose core operations concentrate on mobile services. Currently Vodacom has fibre in all major metropolitan areas and is working in cooperation with other parties to deploy long-distance fibre nationally to connect all areas. This represents an opportunity for the company to scale up Vodacom Business and accelerate the mentioned process of delivering fibre-to-the-business and fibre-to-the-home. While enhancing the fixed line market Vodacom also saves a lot in capex.

Challenges of the deal include the spectrum itself from a competitive point of view, which may cause competition authorities to hamper the transaction. Should regulatory impediments arise in what spectrum is concerned, Vodacom will likely abandon the deal. Furthermore, as usual in M&A activity, there is risk associated with proper implementation of the business, culture clash between employees as well as brand management.

Other aspect to point out is the price of the transaction. After the announcement, Bloomberg cited a price of R5bn, which in case the transaction was to occur in the present financial year and funded entirely with debt, Vodacom's net debt-to-EBITDA would only increase by 0.1pp to 0.6 (this price represents 1/5 of Vodacom Group's EBITDA as of March 2013). Since the bulk of the upside potential remains on spectrum and infrastructure and not in operations, we

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<sup>55</sup> Neotel is the second fixed line operator after Telkom and was set up precisely as the second national operator (SNO) in 2005-2006. Its business units are Managed Services, Network Services, NeoVoice and NeoInternet/NeoBroadband.

believe the price range is not very wide. On the other hand Vodacom's rationale of the transaction may be an argument for ending up overpaying.

**Exhibit 77: Selected information on Neotel**

**FY ending in March**

| mZAR                       | 2012    | 2013    |
|----------------------------|---------|---------|
| <b>Revenue</b>             | 2 841   | 3 182   |
| <b>growth</b>              | 25%     | 12%     |
| <b>Operational expense</b> | (1 561) | (1 382) |
| <b>Employee expense</b>    | ( 463)  | ( 460)  |
| <b>Other</b>               | ( 809)  | ( 872)  |
| <b>EBITDA</b>              | 9       | 467     |
| <b>margin</b>              | 0%      | 15%     |
| <b>D&amp;A expense</b>     | ( 438)  | ( 413)  |
| <b>EBIT</b>                | ( 404)  | 54      |
| <b>Fin. Costs</b>          | ( 811)  | ( 569)  |
| <b>Fin. Income</b>         | 39      | 51      |
| <b>EBT</b>                 | (1 176) | ( 464)  |
| <b>Assets</b>              | 5 493   | 6 808   |
| <b>Net debt</b>            |         | 5 219   |
| <b>Customers ('000)</b>    |         |         |
| <b>Business</b>            | 2.4     | 3.0     |
| <b>growth</b>              | 92%     | 25%     |
| <b>Retail</b>              | 100     | 152     |
| <b>growth</b>              | 100%    | 52%     |
| <b>No. employees</b>       |         | 1 000   |

Source: Tata Communications reports

Neotel has presented consistent revenue growth in the last two years and has become profitable at the operating (EBIT) level in the financial year ending in March 2013. Despite its short customer base, its growth has been impressive with the business segment growing 25% in 2013 (2012: 92%) and the retail segment improving 52% (2012: 100%). A summary of Neotel financials are presented in **Exhibit XXX**. Albeit encouraging, Neotel's activity still lags behind Telkom in terms of size<sup>56</sup>.

Geographical expansion is also an option but is constrained by Vodafone's presence in three African countries<sup>57</sup> and by the fact that attractive markets are already crowded. Ethiopia is an example of an interesting market to enter, where Vodacom inclusively has already opened offices, but, according to Vodacom's CFO Ivan Dittrich, is a market where diverse operators want to enter as well. This emphasizes the importance of M&A potential in the countries where Vodacom is present.

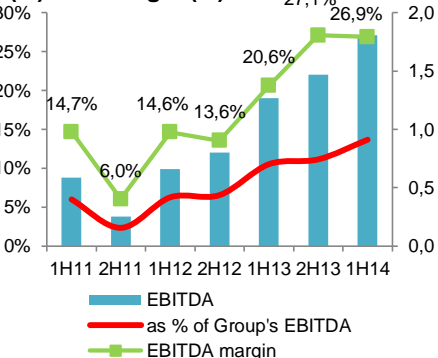
We also want to highlight that Vodacom's high ROIC<sup>58</sup> makes value creation through margins more difficult and value creation through growth more likely, evidencing again the importance of M&A and high-ROIC growth opportunities.

<sup>56</sup> Telkom, as of March 2013 presented revenue of R 32.5bn, EBITDA of R 7.1bn, 870.5 thousand ADSL subscribers, 3.3M fixed line subscribers (versus 5.5m in 2000), 22,000 employees and 147,000 km of fibre.

<sup>57</sup> Ghana, Egypt and Kenya (through Safaricom).

<sup>58</sup> For a more detailed analysis on ROIC refer to the section ROIC and growth framework.

**Exhibit 78: International EBITDA (bnZAR), proportion to Group (%) and margin (%)**



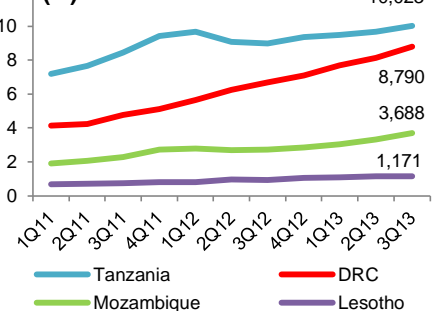
# The International Segment

## International KPI's for each market

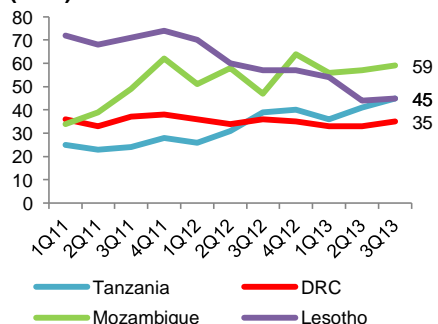
International operations are becoming increasingly important. As of September 2013 International representation in terms of Group service revenue and EBITDA was 22% and 14% versus 16% and 6% three years ago (**Exhibit 78**). The margins are also improving as Vodacom reaches more subscribers. M-pesa is one the highlights in the International performance.

Firstly, if we take a look at subscriber numbers we see that Tanzania and DRC have the largest customer base as well as the highest cumulative growth for the past three years (**Exhibit 79**). If we analyse subscribers yoy growth rates in the semester ending in September 2013, DRC and Mozambique were the best performing countries with 31% and 35% growth rates respectively, versus 12% and 24% for Tanzania and Lesotho. Estimated mobile penetration rates for 2013 are 55%, 28%, 32% and 65% for Tanzania, DRC, Mozambique and Lesotho respectively, which, still being far from SA's 144% level, constitutes an opportunity to further explore the market.

**Exhibit 79: International customers (M)**

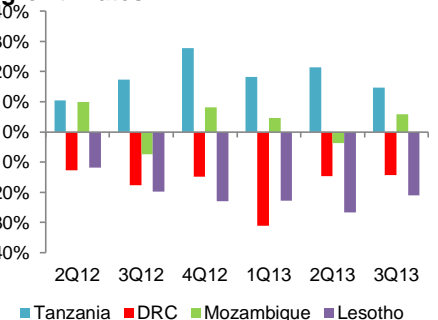


**Exhibit 80: International ARPU (ZAR)**



In terms of ARPU measured in ZAR (**Exhibit 80**), Mozambique is on the lead, followed by Tanzania and Lesotho and at last, DRC. Analysing last semester results, we see that ARPU growth rates in local currency terms are most appealing in Tanzania and Mozambique with 15% and 6% increases, while DRC and Lesotho registered 14% and 22% declines, respectively. **Exhibit 81** shows the yoy growth rate evolution of this figure in the past two years. Special highlight goes to high-performing Tanzania<sup>59</sup>, mainly due to M-pesa success, and to DRC, whose low purchasing power pushes ARPU down, evidencing constantly negative growth rates. Despite Mozambique's volatility, management has informed it had a 30% growth in service revenue (local currency) in the semester ending in September 2013, which led the operation to its first-ever net profit.

**Exhibit 81: Local currency ARPU growth rates**

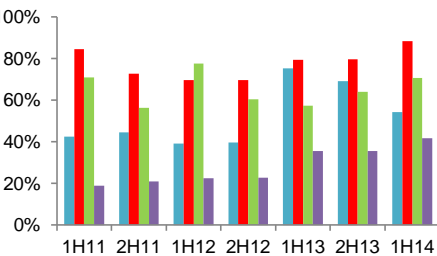


Regarding churn rates<sup>60</sup>, they remain very high and above the ones verified for South Africa (except Lesotho). In the semester ending in September 2013, churn rates were 54%, 88%, 71% and 42% for Tanzania, DRC, Mozambique and Lesotho. The most concerning rates are from DRC and Mozambique which have been increasing for the past year. **Exhibit 82** shows that evolution.

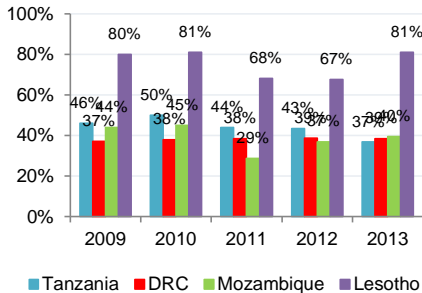
<sup>59</sup> A regulatory issue that is currently at stake in Tanzania is the recent SIM taxes. While the effect of these taxes on business growth is not certain, the impact in terms of ARPU is R6, which is more than a 10% impact considering ARPU values as of September 2013. Vodacom together with the other operators filed an application against this measure and is in current negotiations with the government to solve this issue.

<sup>60</sup> Churn is calculated by dividing the annualized number of disconnections during the period by the average monthly customers during the period.

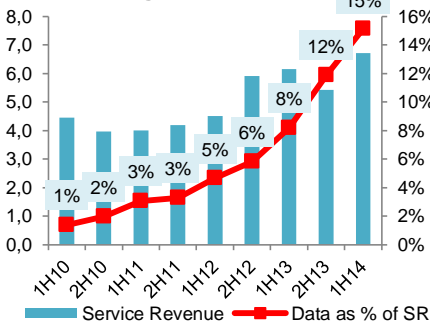
**Exhibit 82: Churn rates (%) in the International segment**



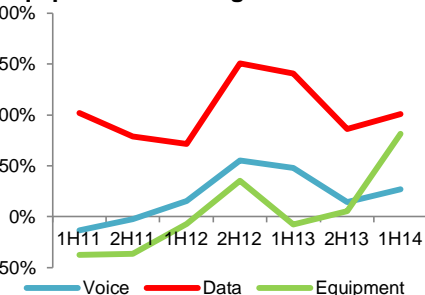
**Exhibit 83: Historic mobile market share by country**



**Exhibit 84: International service revenues (bnZAR) and data revenue as percentage of International SR**



**Exhibit 85: Voice, data and equipment revenue growth**



Finally, market shares in the different countries are shown in **Exhibit 83**. Last financial year we saw market shares narrowing in Tanzania, stabilizing in DRC and expanding in Mozambique and Lesotho. Mobile competitors in each market are presented in **Annex 2**.

## International revenue – performance

The main driver of service revenue growth in the International segment has been more data usage. Data revenue currently represents 15% of International service revenue compared to only 1% four years ago (**Exhibit 84**). Data customers were up 42% yoy in September 2013, now representing 26% of total International customers.

In **Exhibit 85** we can see the growth rate evolution for voice, data and equipment revenue streams. Growth rates have been mostly positive in the past two years. More importantly, last semester, voice revenue registered a growth rate of 27% yoy and equipment an impressive 82% (although representing only 2% of International revenue versus 20% in South Africa).

In terms of EBITDA, growth has been equally impressive with yoy rates reaching 42% in the semester ending in September 2013 and 83% the semester before (ending in March 2013). Not only revenue growth contributed to this improvement, but also the ability to cut in costs was crucial. International revenue currently represents 14% of Group’s EBITDA compared to 6% two years ago. **Exhibit 86** demonstrates this information.

## M-Pesa

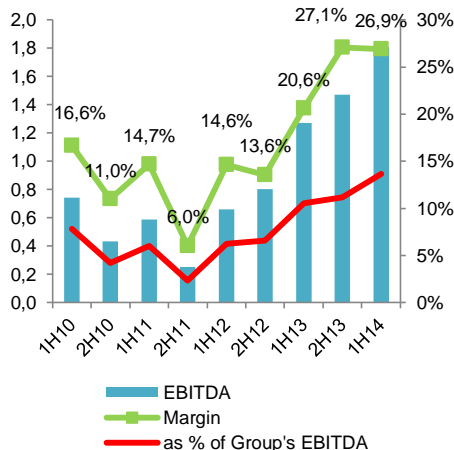
M-Pesa is a financial mobile payment system that allows users to transfer money<sup>61</sup>. It exists in Tanzania since 2008, in South Africa since 2010<sup>62</sup>, in DRC since the end of 2012 and in Mozambique and Lesotho it was recently launched. This service has more expression in Tanzania, where its customers represent half of the total 5.6 million M-Pesa users in all markets. In Tanzania 50% of Vodacom’s subscribers use this financial service.

As it is considered a data service, the increase in International data customers also comes from penetration of M-Pesa. According to the company’s management, M-Pesa contributed 18,7% to Tanzania service revenue (versus 12,6% one year ago) with nearly 20% of all airtime being bought through this

<sup>61</sup> An M-Pesa user can transfer money to any mobile user (either Vodacom or other), can buy airtime for any Vodacom customer, pay bills and withdraw or deposit money from a bank account (in case the customer decides to associate the M-Pesa account with her existing banking account, though it is not mandatory to have a bank account).

<sup>62</sup> When M-Pesa was launched in South Africa, it turned out to have weak implementation mainly due tight banking regulations. In the last results presentation, the CEO informed that the management team “(...) now has the formula to expand the M-Pesa rate”.

**Exhibit 86: International EBITDA (bnZAR), its margin (%) and as percentage of Group's EBITDA**



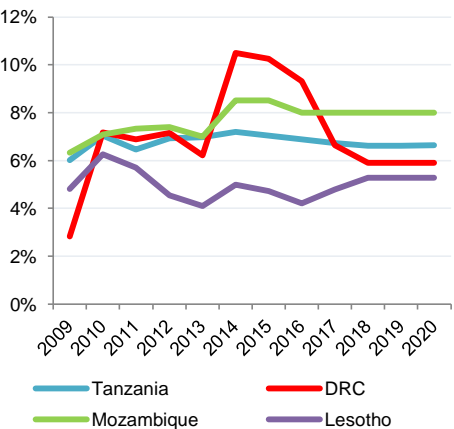
service (versus 8% one year ago). The trend for M-Pesa is to become increasingly associated with banks and the government<sup>63</sup>. We believe there is high upside potential in M-Pesa as its distribution gains scale.

### International revenue – our forecast

In order to forecast International revenues, we decided that each country's economic performance would give better estimates for future revenue patterns<sup>64</sup>.

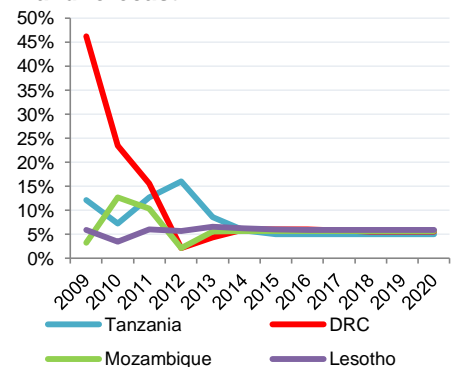
In **Exhibit 87** we find the expected real GDP growth for the explicit period and in **Exhibit 88** the expected inflation rates<sup>65</sup>. Population growth estimates from 2012 onwards are around 3% for Tanzania and DRC, 2% for Mozambique and 1% for Lesotho, according to the World Bank. As of 2012, these countries had populations of 47.7M, 70M, 24.5M and 2.2M people respectively. Investment and the current account balance as percentage of GDP can be seen in **Annex 3**.

**Exhibit 87: Real GDP growth for International countries - historic and forecast**

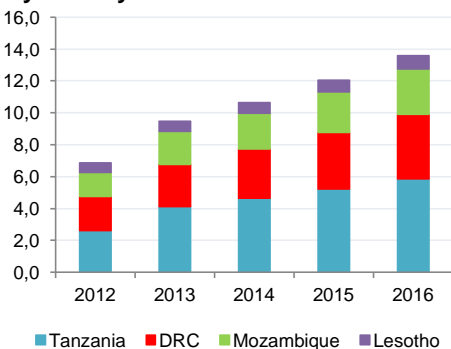


Given the growth potential in each on these markets and assuming economic progress will necessarily lead to more technologic demands, we believe International revenue will become more representative in the Group's revenue, becoming approximately 28% by financial year 2020 versus 19% in 2013. In **Exhibit 89a and b**, we show how representation will change in relation to the International segment, in terms of service revenue and revenue.

**Exhibit 88: Inflation rate for International countries - historic and forecast**



**Exhibit 89a: Service revenue (mZAR) by country**



**Exhibit 89b: Country revenues as % of International revenue**

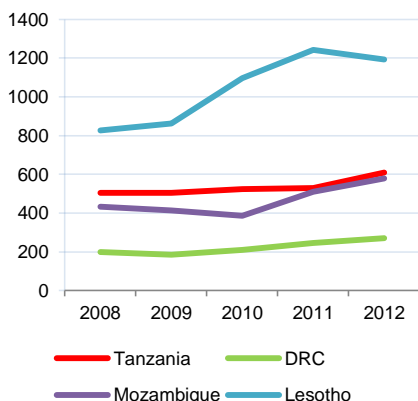
|                   | 2009 | 2013 | 2020F |
|-------------------|------|------|-------|
| <b>Tanzania</b>   | 38%  | 39%  | 43%   |
| <b>DRC</b>        | 37%  | 25%  | 29%   |
| <b>Mozambique</b> | 10%  | 18%  | 22%   |
| <b>Lesotho</b>    | 5%   | 6%   | 6%    |
| <b>Gateway</b>    | 11%  | 12%  | 0%    |

<sup>63</sup> In Tanzania, the service works with six banks which allows M-Pesa users to integrate their accounts with their banking accounts. In the DRC, nurses and soldiers are being paid by M-Pesa.

<sup>64</sup> Information disclosed by the company regarding the International segment for forecasting purposes includes either the aggregate figures of each revenue stream (voice, messaging, data, equipment, etc.) or the KPIs per country such as number of customers, ARPU, penetration rates etc. In our model we use the latter to forecast revenue.

<sup>65</sup> Since our model is based on nominal values expressed in rands, the nominal growth used in our estimates includes the South African inflation rate.

Exhibit 90: GDP per capita (USD)



## Investment in Invested Capital

### Capital Expenditure

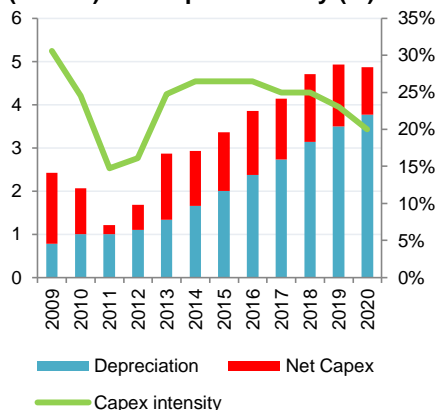
While in developed countries mobile subscribers have broad access to data services (mobile, fixed, cable and satellite) there are fewer competitive infrastructures to deliver data service in the International markets where Vodacom operates (generally mobile, sometimes fixed). This represents an opportunity for growth but at the same time it is a challenge because more capital must be employed.

Capital expenditure in the International segment is concentrated on the RAN renewal program, similarly to South Africa, and network improvement for more basic technologies. Given the relatively low penetration rates and the population's income (refer to **Exhibit 90**) the priority is to provide 2G and 3G technologies rather than for instance LTE.

On March 2013 the rate of conversion of the RAN renewal program (conversion base stations to single RAN technology) was 100% in Mozambique and Lesotho, 81% in Tanzania and 84% in the DRC. It is expected to be completed by March 2014.

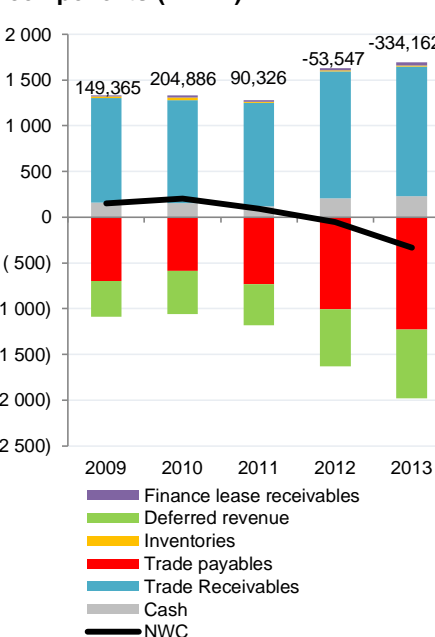
The lack of infrastructure is especially true in the DRC, where telecoms have to rely on costly satellite transmission. In order to change this, Vodacom established connection to the West Africa Cable System (WACS) sea cable and the SEACOM (which lands in East Africa East coast of DRC).

Exhibit 91: Capex decomposition (bnZAR) and capex intensity (%)



In **Exhibit 91** we see that capex enhancement is clearly part of the international strategy<sup>66</sup>. In the last year capex intensity evolved from 16% to close to 25% and we believe this trend will persist during the next years, in line with the medium-term investment guideline.

Exhibit 92: Net working capital components (mZAR)



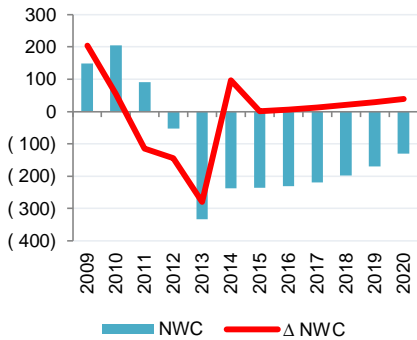
### Net Working Capital

The net working capital behaviour is similar to the one in South Africa<sup>67</sup>, evidencing a declining trend throughout the last five years, and inclusively being negative in 2013. The main differences are mainly related to a small, albeit growing, equipment revenue which leads to low finance lease receivables and low inventory needs.

<sup>66</sup> In fact comparing capex-to-revenue between Vodacom (March 2012) and MTN South Africa and MTN Nigeria (December 2012) the figures are 13%, 16% and 36% respectively.

<sup>67</sup> Net working capital for the International segment is allocated in terms of the revenue representation these operations have in the Group.

**Exhibit 93: Net working capital and respective investment (bnZAR)**

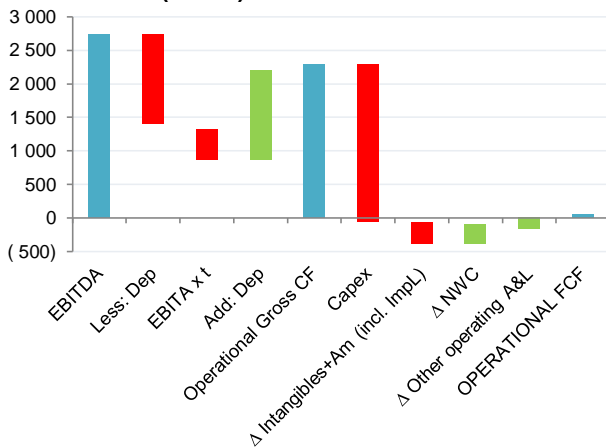


We believe this trend will reverse in the following years since investment in net working capital will be needed to prompt mostly equipment revenue. Handset financing will be a crucial strategy, especially in these markets where the payment of a smartphone upfront is not accessible for customers. **Exhibits 92 and 93** show net working capital composition and forecast.

## Operational Free Cash Flow

In **Exhibits 94a and 94b** we can find operational cash flow decomposition as of 2013, as well as our forecast until 2020. Cash flow is negative in the first years mainly because of higher capex intensity.

**Exhibit 94a: Operational cash flow breakdown for International (mZAR)**



**Exhibit 94b: Operational FCF (mZAR)**

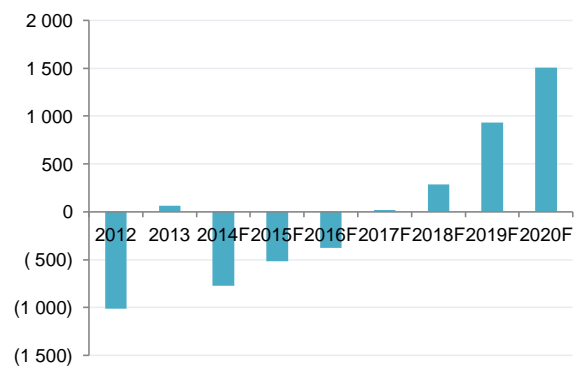
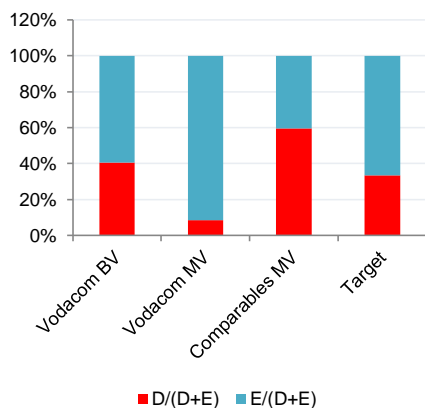


Exhibit 95: Financial Structure



## Financial Structure

Vodacom has a financial structure that, albeit typical for telecoms in general, is low geared when comparing to its peers. For financial year 2013, the debt-to-equity ratio in book values was 68% against a median of comparables of 111%. This corresponds roughly to 40% debt and 60% equity for Vodacom. When we analyse it in market values (using book value of debt as a proxy of market value of debt) this low-gearred financial structure becomes even clearer. Vodacom has an incredibly low 8% debt-to-equity ratio against a median of 147% for comparable companies, which represents approximately 8% of debt versus 60% for comparables. **Exhibit 95** shows this information.

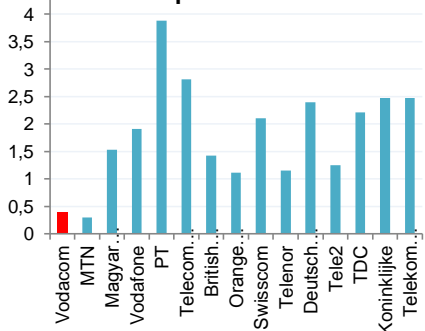
Exhibit 96: Share price variations for different debt-to-equity ratios

| D/E         | D/(D+E)    | Share Price   |
|-------------|------------|---------------|
| 0,18        | 15%        | 140,82        |
| 0,25        | 20%        | 134,87        |
| 0,33        | 25%        | 129,40        |
| <b>0,50</b> | <b>33%</b> | <b>121,21</b> |
| 0,54        | 35%        | 119,70        |
| 0,67        | 40%        | 115,37        |
| 0,82        | 45%        | 111,34        |

In terms of the target debt-to-equity, one could argue that the emerging market nature of Vodacom's operations may not give incentive to leverage up its financial position. We believe this is not totally true for two reasons: Vodacom may take advantage of the financial safety its parent Vodafone can provide (in fact, a great part of Vodacom's loans are obtained from Vodafone – **Annex 4**); and in case Vodacom wants to incur/increase domestic loans, we do not see that as a constraint given that South Africa's banking system is very mature<sup>68</sup>. Thus, we believe this target will converge to the average of its comparables (**Annex 5**) and we opted by the use of a 0.5 ratio<sup>69</sup>. **Exhibit 96** shows the sensitivity of the share price to the debt-equity ratio considered.

During the financial year of 2012, Vodacom incurred in a three-year loan of R3 billion received from Vodafone Investments Luxemburg s.a.r.l.<sup>70</sup>. In September 2013 Vodacom obtained another two loans from Vodafone in a total amount of R4.5 billion. The loans received from Vodafone are detailed in **Annex 4a**.

Exhibit 97: Net debt to EBITDA of Vodacom comparables as of 2013



On August 2011 Vodacom established a R10 billion domestic medium-term note programme (DMTN) and has rolled R750 million each three months ever since. The details on this programme are described in **Annex 4b**.

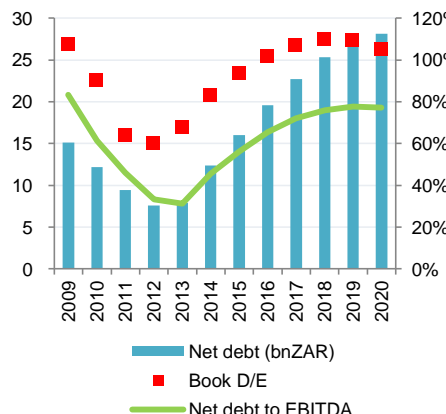
Net debt over the past years is in line with a low geared financial structure. According to our estimates, net debt decreased from R15bn in 2008 to R8bn in 2013, which corresponds to a net debt to EBITDA ratio evolution from 0.8 to 0.3. If we compare with a peer group it has the lowest net debt to EBITDA (**Exhibit 97**). The debt incurred is mainly to finance short-term debt, finance leases, capex and NWC requirements. We believe this declining trend will invert in the future as

<sup>68</sup> Domestic credit provided by the private sector as percentage of GDP is amongst the highest globally (187% of GDP in 2012). United States have 229%, UK 207%, Italy 170%, Tanzania 25%, DRC 11.1%, Mozambique 29.1%, Lesotho 3.2%. Source: World Bank

<sup>69</sup> This in line with a weighted average of the current debt-to-equity ratios of the sector (w=0.7) and the company (w=0.3) equal to 0.5. If the company increased its net debt to EBITDA to 2, the implicit D/E (adjusted by adding up cash) would also be 0.5.

<sup>70</sup> Société Anonyme à Responsabilité Limitée

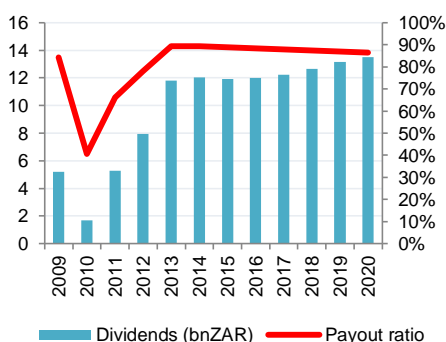
**Exhibit 98: Vodacom net debt, book value of debt-to-equity, net debt to EBITDA - historic and forecast**



capex increase as well as net working capital requirements due to more importance of handset sales. We expect that debt-to-equity and net debt to EBITDA will increase in the future to similar values of 2009<sup>71</sup>. This process yields a debt-to-equity at market values of 28.5%<sup>72</sup> in 2020 versus close to 8% in 2013, which puts Vodacom in the path to achieve the debt-to-equity target of 0.5. **Exhibit 98** summarizes this information.

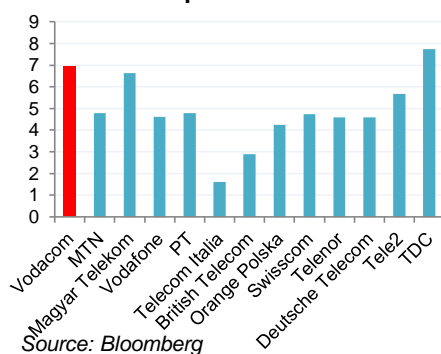
In terms of dividends, Vodacom has been able to deliver a very attractive dividend to its shareholders with consistently high payout ratios without incurring in more debt. Last year, dividend payout was close to 90%. In the future we expect payouts to slightly decrease as capex increases. We believe that is strategically preferable to cut dividends rather than capex because of the irreversible consequences related to service quality and competitiveness loss. With the growth rates assumed for each country where Vodacom operates and the estimated ROIC for the explicit period we triangulate payout for the values to be consistent. In **Exhibit 99** we can find historic and forecasted dividends.

**Exhibit 99: Dividends and payout ratio - historic and forecast**

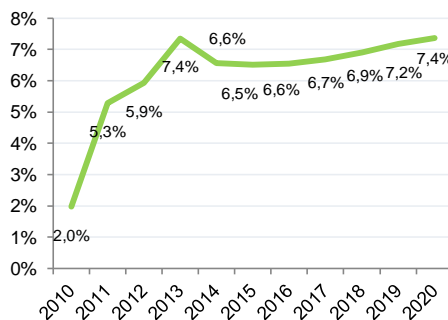


Historic dividend yield has also been attractive especially in relation to comparable companies. In **Exhibit 100** we see that Vodacom has the second highest dividend yield for 2013 (7%), only surpassed by the Danish telecom TDC (8.5%). This dividend yield is also above the average dividend yields for telecoms in CEEMEA<sup>73</sup> (5.3%), Latin America (1.6%) or Europe (4.7%)<sup>74</sup>. We expect this dividend yield to continue increasing but at a much slower pace than the years before. In **Exhibit 101** we find historic and forecast<sup>75</sup> dividend yields.

**Exhibit 100: Dividend yield (%) of Vodacom comparables as 2013**



**Exhibit 101: Dividend yield - historic and forecast**



<sup>71</sup> Management in the interim presentation for FY2014 said it was willing to increase net debt to EBITDA to 2 in order to face possible capital expenditures of 17% of revenue. As explained before we are not convinced capex is going to be as high and therefore, not ignoring the possibility of net debt to EBITDA being equal to two in the future (it is in fact a likely outcome considering a debt-to-equity target of 0.5), we believe that for the explicit period this value will not surpass the 0.8 threshold.

<sup>72</sup> This ratio was computed as the future value of the equity value obtained from the valuation of the company as of December 2014. The discount rate used was a Group average WACC weighted by the value from operations of each segment. Although this assumes a constant segment representation for the future, this gives a sense of the behavior of the company in terms of capital structure.

<sup>73</sup> Central and Eastern Europe, Middle East and Africa.

<sup>74</sup> These values were sourced by Absa Capital and include 19 companies in the first group, 5 in the second and 14 the third.

<sup>75</sup> Note that dividend yield for the years 2010-2013 is computed with the market share price, whereas for 2014-2020 period is with our own estimates. Also the dividend per share used for the period 2010-2013 is the one disclosed in the company annual reports.

## Cost of Capital

For the computation of cost of capital, a more careful approach must be conducted given the emerging market nature of Vodacom's operations. The Weighted Average Cost of Capital (WACC) approach was adopted.

In order to compute the cost of equity we used the CAPM in order to get a proxy of this value. We calculated the cost of equity in US dollar terms and then translate it into rands the inflation rate estimates..

The first step was to calculate the levered betas for comparable companies. The criteria to chose them were similar services provided (either fixed or mobile) and relatively diversified operations in South Africa or other emerging market economies. In **Annex 5** there are the comparables used for the cost of capital<sup>76</sup>.

Prices for the 10 comparables were withdrawn and then converted into USD in order to regress the respective returns against the MSCI World Index. Levered betas were obtained, being then unlevered using proxies of debt-to-equity ratios (market cap and net debt, as a proxy to market value of debt) and the local corporate taxes. The median of the unlevered betas yielded an industry beta of 0.50<sup>77</sup>. This beta was relevered to incorporate Vodacom's target capital structure.

We assume that a global investor who has a fully diversified portfolio should take into account the systematic risk inherent to an emerging market like South Africa. Hence we computed a country risk premium (CRP) based on SA's default spread adjusted by the volatilities of SA equities and bond markets<sup>78</sup>. The spread was calculated based on the difference between a 10-year dollar denominated South African bond and an equivalent US bond, which corresponds to a value of 2.29%.

For DRC and Mozambique, whose long-term debt is currently rated by Moody's B3 and B1 (foreign and domestic), we derived default spreads of 6% and 4%, respectively<sup>79</sup>. For Tanzania and Lesotho, because they do not have credit ratings, we used the highest default spread among South Africa, DRC and Mozambique in a conservative perspective.

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<sup>76</sup> We preferred to choose this criteria rather than cash flow related KPIs such as ROIC and long-term growth because the highly uncommon ROIC figure for Vodacom narrows considerably the comparable pallet.

<sup>77</sup> This may be a low value compared with 0.91, which is the average unlevered beta for Telecom services used by Aswath Damodaran. Differences may be due to the use of Net Debt as a proxy for market value of debt or to the fact that companies with diversified operations are less cyclical, thus having lower betas.

<sup>78</sup> We first regressed the Johannesburg Index (JALSH Index) against the MSCI Index to obtain a country beta. However the result was a beta inferior to one, which multiplied by the levered beta of 0.69 led to an even lower value. We abandoned this approach to measure the country risk premium and adopted one consistent with Aswath Damodaran in "Investment Valuation", 2<sup>nd</sup> edition, named Default Spreads + Relative Standard Deviations.

<sup>79</sup> With the ratings from Moody's, we used Damodaran Country Default Spreads and Risk Premiums data base (updated on January 2013) to compare countries with similar ratings (given that DRC and Mozambique are not included) and derived the correspondent spreads.

We then computed the volatility of the Johannesburg Index and the prices of a 10-year SA bond, we divided the first by the latter and obtained a coefficient of 1.75. This coefficient is multiplied by the default spread previously obtained to originate the country risk premium. We used the same coefficient for the other countries because of inexistence/lack of liquidity in their stock exchanges.

Since we assume that a company's exposure to country risk should be proportional to its exposure to market risk (beta) we add the CRP to the market risk premium (MRP) of 5.5% and allow it to be multiplied by beta. We get CRP as high as 10.5% for DRC, Tanzania and Lesotho, 7% for Mozambique and 4% for South Africa. A risk-free rate on a 10-year US treasury bond was used, which corresponds to an yield of 3.03%.

In the end of the cost of equity computation, the currency translation was performed, using the SA inflation rates estimate given by the IMF. Rand-denominated costs of equity range between 12.95% and 17.55%.

For the cost of debt computation, an indirect method was used because the company does not have publicly traded debt<sup>80</sup>. We assume that the maximum rate of return investors would require if the company does not default is equivalent to the one associated with the Republic of South Africa. The long-term issuer rating (domestic and foreign) for the Republic of South Africa according to Moody's is Baa1 (affirmed on 17 July 2013), to which corresponds a probability of default for 10 years of 2.006% and a recovery rate of 64% using the Present Value Ratio of Cash Flows method<sup>81</sup>. With the yield of a 10-year generic South African government bond of 7.55%, the cost of debt becomes 6.677%.

One note we have to make to the cost of debt is that the required return by investors may be lower if one considers the possibility of Vodacom's rating to be above the republic. This may happen if we assume that Vodafone Group will not allow one of its subsidiaries to default, and considering that Vodafone's rating is in fact above South Africa's according to Moody's (A3 vs Baa1).

Finally, the WACC was calculated, with the given local tax rates for each country and the target debt-to-equity ratio of 0.5<sup>82</sup>.

The values obtained were 10.18%, 13.15%, 12.93%, 11.48% and 13.26% for South Africa, Tanzania, DRC, Mozambique and Lesotho, respectively. The WACC computation and inputs are summarized in **Annex 6**.

<sup>80</sup> We found a Local Long-term rating of AA+ for Vodacom on Standard & Poor's that corresponds to the medium-term note program. However we could not find it on Bloomberg; we only found first lien and unsecured loans with maturity below 2015. Also on Moody's there is no rating for Vodacom.

<sup>81</sup> Issuer-Weighted Cumulative Default Rates (1983-2012H1) and Recovery Rates on Defaulted Sovereign Bond Issuers in Moody's Investor Service, July 2012, "Special Comment – Sovereign Default and Recovery Rates 1983-2012H1"

<sup>82</sup> Refer to section Financial Structure for more information on this ratio.

In order to have a sense of the impact of WACC on our valuation we performed a two-variable sensitivity analysis to Vodacom’s share price with the cost of capital of the two most important units in terms of revenue and value representation, which are South Africa and Tanzania<sup>83</sup>.

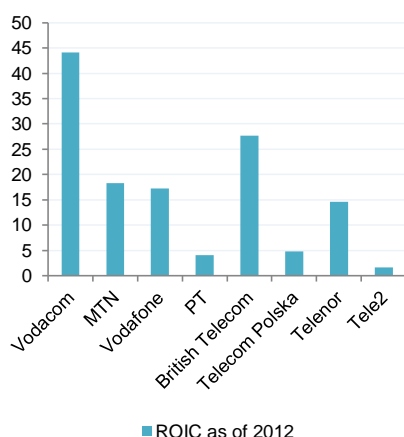
In **Exhibit 102** the results for the different WACC combinations are summarized. We see that for a worst scenario of 13% and 16% of WACC values for South Africa and Tanzania respectively, the share price decreases about 28% relatively to our share price estimation to R88.10. In the case of an upside scenario, and for a 7% and 10% WACC values, the share price increases 87.4% to R229.89. Although the upside scenario is relatively better (in inverse terms) than the worst scenario, it is also less likely, given Vodacom’s emerging market nature and the difficulty to correctly estimate the country risk premium.

**Exhibit 102: Share price for different WACCs in SA and Tanzania**

|               |        | WACC South Africa |        |        |        |        |        |       |     |
|---------------|--------|-------------------|--------|--------|--------|--------|--------|-------|-----|
|               |        | 121,21            | 7%     | 8%     | 9%     | 10,18% | 11%    | 12%   | 13% |
| WACC Tanzania | 10%    | 228,69            | 180,62 | 150,20 | 126,15 | 113,84 | 102,11 | 92,87 |     |
|               | 11%    | 226,35            | 178,27 | 147,85 | 123,80 | 111,49 | 99,77  | 90,52 |     |
|               | 12%    | 224,88            | 176,81 | 146,38 | 122,34 | 110,03 | 98,30  | 89,06 |     |
|               | 13,15% | 223,75            | 175,68 | 145,26 | 121,21 | 108,90 | 97,17  | 87,93 |     |
|               | 14%    | 223,15            | 175,08 | 144,65 | 120,61 | 108,30 | 96,57  | 87,33 |     |
|               | 15%    | 222,60            | 174,53 | 144,10 | 120,06 | 107,75 | 96,02  | 86,78 |     |
|               | 16%    | 222,17            | 174,10 | 143,68 | 119,63 | 107,32 | 95,60  | 86,35 |     |

## ROIC and Growth Framework

**Exhibit 103: ROIC of comparables**

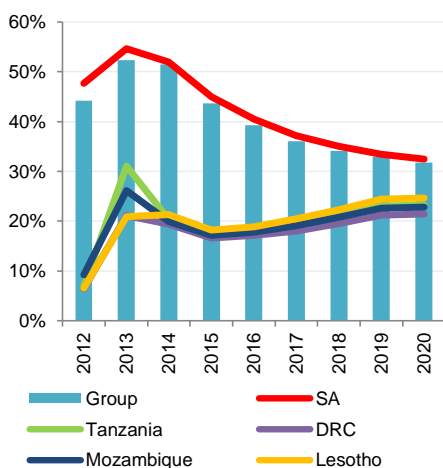


One important consideration to take into account is the reasonability of our projections in accordance with consistent values for the return on invested capital (ROIC), the long-term growth rate and the reinvestment rate.

The most important characteristic is the high-level ROIC we observe for Vodacom. We find this situation unsustainable because as the markets where Vodacom operates evolve into a more mature stage, competition becomes tighter, prices tend to go down and investment tends to increase as an attempt to develop a competitive advantage. We adjust revenue and margins so that ROIC becomes progressively lower in the long-run. In **Exhibit 103** ROIC is shown for different comparable telecoms and in **Exhibit 104** its evolution is depicted.

<sup>83</sup> As of 2013 they represent together 90% of Group’s revenue and 85.5% of the enterprise value.

**Exhibit 104: ROIC forecast for the group and each unit**



The growth rates for terminal values computed in each country where Vodacom operates correspond to the real growth estimates given by the IMF. We do so because we believe that in the long-run the value of Vodacom operations is directly related with each country’s production growth, as well as the available income for each person or customer. The underlying assumption is that telecommunications representation in each country’s GDP composition will remain constant<sup>84</sup>. We do not add inflation to this growth rate for two reasons: in the long-run price increases will have low marginal impact on ARPU, given that prices tend actually to decrease<sup>85</sup>; including inflation can overstate terminal values and provide less accuracy by enhancing the its representation in the final enterprise value. In **Exhibit 105** we show the growth rates considered.

Since the growth rate is an important component of the terminal value (accounting for 64% of the enterprise value) we performed a sensitivity analysis to the growth rates of South Africa and Tanzania for the same reasons as for the WACC analysis. We see that the share price is naturally more responsive to South Africa growth rate swings comparative to Tanzania. Notwithstanding, the optimistic scenario, where South Africa and Tanzania grow at 5% and 9.5% respectively in the long-term presents an upside potential of 23% in the share price while the downside scenario registers a -14% price loss. **Exhibit 106** shows the different combinations.

**Exhibit 105: Growth rates**

|              |      |
|--------------|------|
| South Africa | 3,5% |
| Tanzania     | 6,6% |
| DRC          | 5,9% |
| Mozambique   | 8,0% |
| Lesotho      | 5,3% |

**Exhibit 106: Share price for different WACCs in SA and Tanzania**

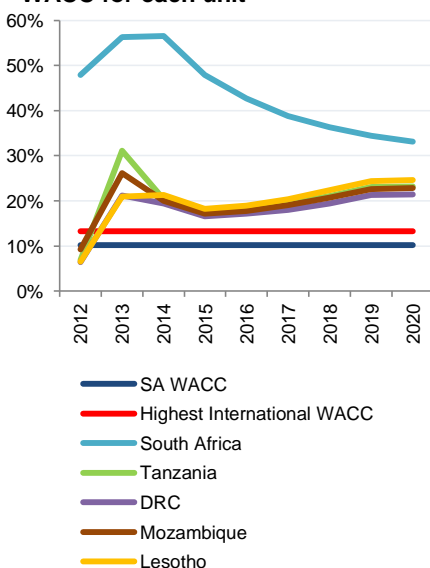
|            |      | g South Africa |        |        |               |        |        |        |
|------------|------|----------------|--------|--------|---------------|--------|--------|--------|
|            |      | 2,0%           | 2,5%   | 3,0%   | 3,5%          | 4,0%   | 4,5%   | 5,0%   |
| g Tanzania | 3,5% | 104,02         | 108,52 | 113,65 | 119,29        | 126,39 | 134,44 | 144,03 |
|            | 4,5% | 104,53         | 109,04 | 114,18 | 119,83        | 126,93 | 134,99 | 144,59 |
|            | 5,5% | 105,11         | 109,63 | 114,77 | 120,42        | 127,54 | 135,60 | 145,22 |
|            | 6,6% | 105,88         | 110,40 | 115,55 | <b>121,21</b> | 128,34 | 136,41 | 146,05 |
|            | 7,5% | 106,60         | 111,12 | 116,27 | 121,94        | 129,08 | 137,16 | 146,81 |
|            | 8,5% | 107,64         | 112,17 | 117,33 | 123,01        | 130,15 | 138,25 | 147,91 |
|            | 9,5% | 109,11         | 113,65 | 118,82 | 124,50        | 131,65 | 139,76 | 149,44 |

With estimated ROIC and growth values at the end of the explicit period, we allowed reinvestment rates (RR) to adjust, leading to a slight decrease in the

<sup>84</sup> Our estimate of telecommunication revenue in South Africa is about 4% of GDP for 2011. According to the ITU (International Telecommunications Union) database the corresponding figure is 9.9% in Kenya, 3.9% in Mozambique, an average of 5.2% in Africa, 3% in the Arab States, 2.8% in Europe, 2.7% in Asia&Pacific. According to KPMG in “Tanzania 2013 - Budget Brief”, communications accounted for 22% of the GDP growth in 2012,

<sup>85</sup> This is a phenomenon already mentioned in the Cost Containment section: while prices tend to decrease because of competitive intensification, costs tend to accompany inflation.

**Exhibit 107: Forecast of ROIC vs WACC for each unit**



Group’s payout ratio from 89.3% in 2013 to 86.4% in 2020<sup>86</sup>. Although forecasted dividend for 2015 will be lower than for 2014 (mostly due to higher depreciation charges in relation to revenue increase), from that year on dividends will keep increasing, without putting in jeopardy shareholders’ dividend gains. We believe this is the most likely scenario given shrinking margins, higher capex plans and the company’s commitment to its shareholders.

The last analysis that should be performed is related with value creation. Comparing WACC with ROIC for each unit gives us an idea whether value is being created or destroyed. For the years under analysis we used WACC calculations from the section Cost of Capital.

In the case of South Africa, there is substantial value being created given that as of FY2013, ROIC was 56.3% versus a WACC of 10.2%. We forecast that from 2014 onwards less value will be created in line with the mentioned shrinking margins and higher capital expenditures. For 2020, we estimate a ROIC of 33.1%.

For the International segment, we compare the respective ROIC with the highest WACC amongst the international countries<sup>87</sup> (for graphic simplification). The International segment was destroying value in 2012 but this trend was inverted in 2013. For the next two years we estimate reductions in ROIC in line with more intensive capital expenditure. For the remaining years we expect more value to be created as service revenue boost due to larger installed network capacity and economic growth. **Exhibit 107** summarizes ROIC-WACC relationship.

**Exhibit 108: Sensitivity analysis to the multiple used to evaluate Vodacom Business Africa**

| EBITDA multiple | Share price (ZAR) |
|-----------------|-------------------|
| 15              | 120,12            |
| 16              | 120,34            |
| 17              | 120,56            |
| 18              | 120,77            |
| 19              | 120,99            |
| <b>20</b>       | <b>121,21</b>     |
| 21              | 121,43            |
| 22              | 121,65            |
| 23              | 121,86            |
| 24              | 122,08            |
| 25              | 122,30            |

## Final remarks

We would like to make some final notes on the valuation performed as well as do a sum up of our conclusions.

In regards to the valuation of Vodacom Business Africa, concerns around the multiple used are likely to arise given that the multiple used was given by Vodacom management<sup>88</sup>. Therefore, in order to measure the impact of that uncertainty, sensitivity analysis to the value of the multiple was performed. We find that the share price is practically irresponsive (less than 1%) for extreme variations in the multiple. **Exhibit 108** shows the results of that analysis.

<sup>86</sup> The Group’s payout ratio for 2020 is calculated as an average of (1-RR) for each country unit weighted by EBIT, because it is the last income statement item that is immediately before net income and that is available for each unit (financial revenue and costs are only available for the Group as a whole). The reinvestment rate for each unit is computed dividing the ROIC by the growth rate as of the end of the explicit period. For the remaining years we make the payout ratio of 2013 converge to the one in 2020.

<sup>87</sup> This WACC of 13.3% corresponds to Lesotho.

<sup>88</sup> We opted by the use of this multiple because of lack of disclosure regarding this segment and the complexity/time-consumption of segregating telecom services that are applicable only for businesses in comparable companies.

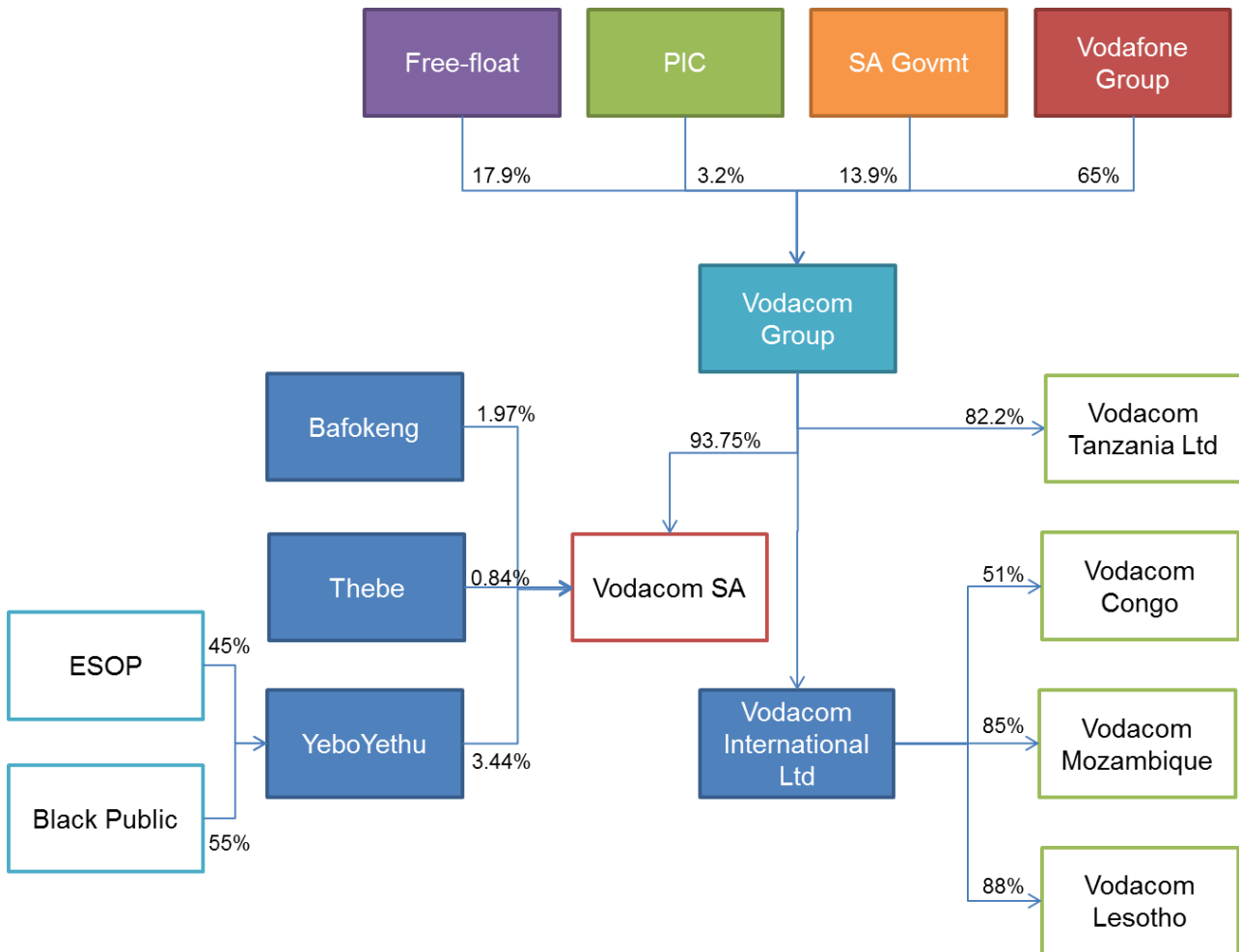
Concerning multiples valuation, we calculated the EV/EBITDA and P/E multiple of the comparables group and concluded that our share price estimate lies within the range. While for an EV/EBITDA valuation we obtained a share price of R90.29 for 2014, for P/E we obtained a corresponding value of R133.23. **Exhibit 109** summarizes these results.

**Exhibit 109: Vodacom share price computed through multiples**

| bnZAR                   | P/E    | Analyst | EV/EBITDA |
|-------------------------|--------|---------|-----------|
| <b>Enterprise value</b> | 220.8  | 201.4   | 156.9     |
| <b>Debt</b>             | 0      | 21.26   | 18.9      |
| <b>Equity Value</b>     | 220.8  | 180.36  | 138.0     |
| <b>Price per share</b>  | 148,40 | 121,21  | 92,77     |
| <b>Difference</b>       | 21%    | 0%      | -24%      |

# Appendix

## Annex 1: Shareholder structure

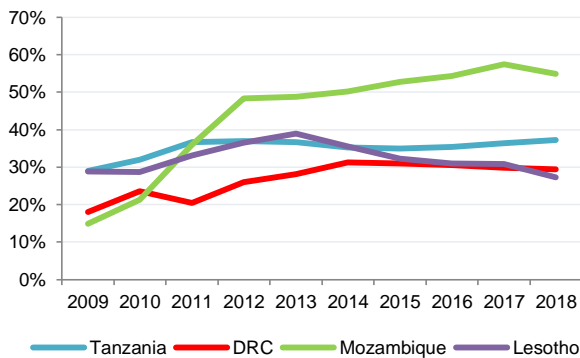


**Annex 2: Market players by country and market shares (for Tanzania only):**

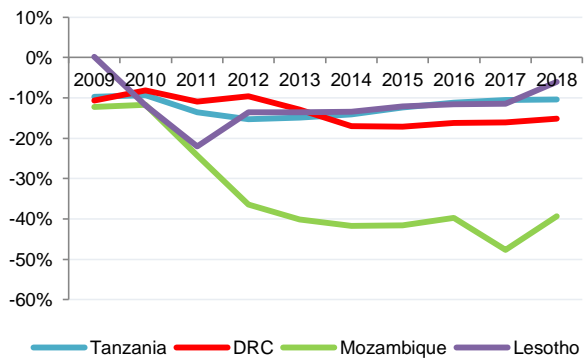
| Tanzania              | DRC                               | Mozambique | Lesotho |
|-----------------------|-----------------------------------|------------|---------|
| Vodacom (36%)         | Vodacom                           | Vodacom    | Vodacom |
| Airtel Tanzania (32%) | Airtel DRC                        | Mcel       | Econet  |
| Tigo (24%)            | Tigo Congo                        | Movitel    |         |
| Zantel (8%)           | Congo Chine Telecom <sup>89</sup> |            |         |
|                       | Supercell                         |            |         |

**Annex 3: International economic data**

**Investment as % of GDP - historic and forecast**



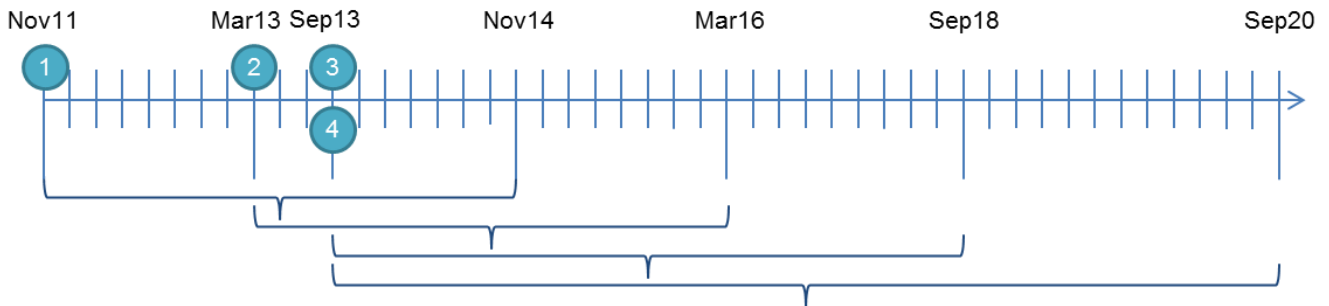
**Current account balance as % of GDP - historic and forecast**



<sup>89</sup> Acquired by Orange (France Telecom mobile arm) in late 2011.

**Annex 4: Debt structure**

**2a) Loans received by Vodafone**



- 1 Amount R3bn; quarterly interest @ 3m JIBAR + 1.45%; unsecured; 3y maturity
- 2 Amount R3bn; quarterly interest @ 3m JIBAR + 1.15%; unsecured; 3y maturity
- 3 Amount R3bn; quarterly interest @ 3m JIBAR + 1.15%; unsecured; 5y maturity
- 4 Amount R1.5bn; quarterly interest @ 3m JIBAR + 1.35%; unsecured; 7y maturity

**2b) DMTN programme**

This programme was registered on the interest rate market of JSE Limited under which notes, including commercial paper, may be issued by the company from time to time. Up to now, Vodacom has rolled R750 million (nominal value) on a three-month basis, bearing interest at 3-month JIBAR+0.1%. The maximum aggregate amount of all notes outstanding may not exceed R10 billion and this is a senior unsecured type of debt. As of October 2012, this instrument was rated by Standard and Poor's as AA+.

## Annex 5: List of comparable companies

| Company                | Listing           | Geographic operations   |
|------------------------|-------------------|---|
| <b>MTN Group</b>       | Johannesburg, SA  | Main markets: South Africa, Nigeria, Iran, Ghana, Cameroon, Ivory Coast, Uganda, Syria, Sudan. Others: Guinea Bissau, Guinea Conakry, Liberia, Benin, Cyprus, Dubai, Afghanistan, Yemen, South Sudan, Rwanda, Congo, Zambia, Botswana, Swaziland                  |
| <b>Vodafone Group</b>  | London, UK        | Subsidiaries: Albania, Czech Republic, Germany, Greece, Hungary, Ireland, Malta, Netherlands, Portugal, Romania, Spain, Turkey, UK, Egypt, Ghana, India, New Zealand, Qatar, Vodacom Group. Joint-ventures: Australia, Italy, Fiji. Associates: Safaricom (Kenya) |
| <b>PT</b>              | Lisbon, Portugal  | Main markets: Portugal, Brazil. Others: Angola, Namibia, Cape Verde, S. Tomé e Príncipe, Macau and Timor-Leste  |
| <b>Telecom Italia</b>  | Milan, Italy      | Main markets: Italy, Brazil, Argentina. Others: Europe, Asia and South America.   |
| <b>British Telecom</b> | London, UK        | Operations in over 170 countries  |
| <b>Orange Polska</b>   | Warsaw, Poland    | Main markets: France, Spain, Poland. Others: Belgium, Luxembourg, Dominican Republic, Slovakia, Romania, Moldova, Armenia and presence in Africa and Middle East.   |
| <b>Telenor</b>         | Oslo, Norway      | Main markets: Norway, Sweden, Denmark, Hungary, Serbia, Montenegro, Thailand, Bangladesh, India, Malaysia, Pakistan   |
| <b>Tele2</b>           | Stockholm, Sweden | Main markets: Sweden, Norway, Netherlands, Lithuania, Russia, Kazakhstan,   |
| <b>Telekom Austria</b> | Vienna, Austria   | Austria, Bulgaria, Croatia. Others: Belarus, Slovenia, Serbia, Macedonia, Liechtenstein   |

## Annex 6: WACC computation

|  | South Africa  | Tanzania      | DRC           | Mozambique    | Lesotho       |
|--|---------------|---------------|---------------|---------------|---------------|
| <b>10y US Treasury bond risk-free rate</b>   | 3,03%         | 3,03%         | 3,03%         | 3,03%         | 3,03%         |
|  | 6,22%         | 6,35%         | 6,93%         | 7,03%         | 7,33%         |
| <b>Industry <math>\beta</math> unlevered</b> | 0,50          | 0,50          | 0,50          | 0,50          | 0,51          |
| <b>Tax rate</b>                              | 28%           | 30%           | 40%           | 32%           | 25%           |
| <b>Target D/E</b>                            | 0,50          | 50%           | 50%           | 50%           | 50%           |
| <b><math>\beta</math> levered</b>            | 0,69          | 0,69          | 0,69          | 0,69          | 0,69          |
| <b>SA 10y WB</b>                             | 5,046%        |               |               |               |               |
| <b>US 10y WB</b>                             | 2,754%        |               |               |               |               |
| <b>Default spread</b>                        | 2,29%         | 6,00%         | 6,00%         | 4,00%         | 6,00%         |
| <b><math>\sigma</math> SA equities</b>       | 17,8%         | 17,8%         | 17,8%         | 17,8%         | 17,8%         |
| <b><math>\sigma</math> SA bond</b>           | 10,2%         | 10,2%         | 10,2%         | 10,2%         | 10,2%         |
| <b>coeff</b>                                 | 1,747         | 1,747         | 1,747         | 1,747         | 1,747         |
| <b>CRP</b>                                   | 4,0%          | 10,5%         | 10,5%         | 7,0%          | 10,5%         |
| <b>MRP</b>                                   | 5,50%         | 5,50%         | 5,50%         | 5,50%         | 5,50%         |
| <b>CPI country</b>                           | 4,8%          | 4,93%         | 5,50%         | 5,60%         | 5,90%         |
| <b>CPI US</b>                                | 1,66%         | 1,66%         | 1,66%         | 1,66%         | 1,66%         |
| <b>differential</b>                          | 1,0309        | 1,032         | 1,038         | 1,039         | 1,042         |
| <b>COST OF EQUITY</b>                        | 12,86%        | 17,39%        | 17,39%        | 14,95%        | 17,39%        |
| <b>COST OF DEBT</b>                          | 6,68%         | 6,68%         | 6,68%         | 6,68%         | 6,68%         |
| <b>WACC</b>                                  | <b>10,18%</b> | <b>13,15%</b> | <b>12,93%</b> | <b>11,48%</b> | <b>13,26%</b> |

## Summary Tables and Financial Statements

### Summary of historic quarterly revenue for the Group

| FY March<br>mZAR           | Mar-11<br>4Q11 | Jun-11<br>1Q12 | Sep-11<br>2Q12 | Dec-11<br>3Q12 | Mar-12<br>4Q12 | Jun-12<br>1Q13 | Sep-12<br>2Q13 | Dec-12<br>3Q13 | Mar-13<br>4Q13 | Jun-13<br>1Q14 | Sep-13<br>2Q14 |
|----------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>South Africa</b>        |                |                |                |                |                |                |                |                |                |                |                |
| Voice                      | 7 246          | 7 028          | 7 258          | 7 753          | 7 356          | 7 136          | 7 364          | 7 573          | 7 078          | 6 956          | 7 166          |
| Interconnect               | 1 637          | 1 469          | 1 530          | 1 611          | 1 452          | 1 215          | 1 256          | 1 317          | 1 128          | 930            | 958            |
| Data<br>Service<br>Revenue | 1 689          | 1 856          | 1 864          | 1 929          | 1 990          | 2 044          | 2 180          | 2 261          | 2 397          | 2 489          | 2 607          |
| <b>Revenue</b>             | <b>11 863</b>  | <b>11 558</b>  | <b>11 891</b>  | <b>12 755</b>  | <b>12 223</b>  | <b>11 769</b>  | <b>11 988</b>  | <b>12 532</b>  | <b>11 945</b>  | <b>11 678</b>  | <b>12 059</b>  |
| Equipment<br>Revenue       | 1 504          | 1 819          | 1 777          | 2 208          | 2 013          | 2 021          | 2 258          | 2 808          | 2 653          | 2 703          | 3 340          |
| <b>Revenue</b>             | <b>13 602</b>  | <b>13 537</b>  | <b>13 881</b>  | <b>15 135</b>  | <b>14 379</b>  | <b>14 007</b>  | <b>14 426</b>  | <b>15 475</b>  | <b>14 699</b>  | <b>14 549</b>  | <b>15 575</b>  |
| <b>International</b>       |                |                |                |                |                |                |                |                |                |                |                |
| Voice                      | 906            | 942            | 1 126          | 1 440          | 1 362          | 1 490          | 1 564          | 1 719          | 1 486          | 1 805          | 2 078          |
| Interconnect               | 174            | 157            | 190            | 213            | 216            | 231            | 276            | 311            | 249            | 300            | 393            |
| Data<br>Service<br>Revenue | 69             | 90             | 114            | 153            | 183            | 225            | 266            | 306            | 320            | 421            | 564            |
| <b>Revenue</b>             | <b>2 080</b>   | <b>2 064</b>   | <b>2 326</b>   | <b>2 905</b>   | <b>2 848</b>   | <b>3 028</b>   | <b>2 964</b>   | <b>2 786</b>   | <b>2 480</b>   | <b>2 981</b>   | <b>3 535</b>   |
| Equipment<br>Revenue       | 26             | 30             | 35             | 39             | 34             | 27             | 33             | 41             | 36             | 43             | 66             |
| <b>Revenue</b>             | <b>2 138</b>   | <b>2 119</b>   | <b>2 394</b>   | <b>2 983</b>   | <b>2 930</b>   | <b>3 097</b>   | <b>3 058</b>   | <b>2 875</b>   | <b>2 553</b>   | <b>3 065</b>   | <b>3 655</b>   |
| <b>Group</b>               |                |                |                |                |                |                |                |                |                |                |                |
| <b>Service<br/>Revenue</b> | <b>13 856</b>  | <b>13 552</b>  | <b>14 144</b>  | <b>15 567</b>  | <b>14 982</b>  | <b>14 736</b>  | <b>14 896</b>  | <b>15 298</b>  | <b>14 406</b>  | <b>14 639</b>  | <b>15 564</b>  |
| <b>Revenue</b>             | <b>15 618</b>  | <b>15 569</b>  | <b>16 178</b>  | <b>17 997</b>  | <b>17 185</b>  | <b>17 024</b>  | <b>17 402</b>  | <b>18 294</b>  | <b>17 197</b>  | <b>17 536</b>  | <b>19 143</b>  |

### Summary of Income Statement historic data and forecasts

| mZAR                 | 2009   | 2010   | 2011   | 2012   | 2013   | 2014F  | 2015F  | 2016F  | 2017F  | 2018F  | 2019F  | 2020F   | CAGR       | as % of Group |      |
|----------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|------------|---------------|------|
|                      |        |        |        |        |        |        |        |        |        |        |        |         | 2013-2020F | 2013          | 2020 |
| <b>South Africa</b>  |        |        |        |        |        |        |        |        |        |        |        |         |            |               |      |
| Service revenue      | 41 182 | 44 324 | 46 392 | 48 427 | 48 234 | 50 479 | 50 584 | 50 702 | 50 902 | 51 680 | 52 583 | 53 816  | 2%         | 81%           | 72%  |
| yoy % growth         | 11%    | 8%     | 5%     | 4%     | 0%     | 5%     | 0%     | 0%     | 0%     | 2%     | 2%     | 2%      |            |               |      |
| Equipment            | 5 190  | 5 432  | 6 343  | 7 817  | 9 740  | 12 086 | 14 635 | 17 282 | 19 889 | 22 293 | 24 317 | 25 796  | 15%        | 99%           | 94%  |
| yoy % growth         | 5%     | 5%     | 17%    | 23%    | 25%    | 24%    | 21%    | 18%    | 15%    | 12%    | 9%     | 6%      |            |               |      |
| Revenue              | 47 733 | 50 431 | 53 371 | 56 932 | 58 607 | 63 227 | 65 900 | 68 664 | 71 471 | 74 652 | 77 578 | 80 295  | 5%         | 84%           | 78%  |
| yoy % growth         | 13%    | 6%     | 6%     | 7%     | 3%     | 8%     | 4%     | 4%     | 4%     | 4%     | 4%     | 4%      |            |               |      |
| EBITDA               | 16 222 | 18 578 | 19 653 | 21 254 | 22 408 | 24 174 | 24 713 | 25 406 | 26 087 | 26 875 | 27 540 | 28 103  | 3%         | 89%           | 77%  |
| yoy % growth         | 10%    | 15%    | 6%     | 8%     | 5%     | 8%     | 2%     | 3%     | 3%     | 3%     | 2%     | 2%      |            |               |      |
| <b>International</b> |        |        |        |        |        |        |        |        |        |        |        |         |            |               |      |
| Service revenue      | 7 570  | 8 071  | 7 957  | 10 143 | 11 258 | 10 639 | 12 052 | 13 578 | 15 187 | 16 952 | 18 889 | 21 048  | 9%         | 19%           | 28%  |
| yoy % growth         | 47%    | 7%     | -1%    | 27%    | 11%    | -5%    | 13%    | 13%    | 12%    | 12%    | 11%    | 11%     |            |               |      |
| Equipment            | 128    | 197    | 124    | 138    | 137    | 233    | 380    | 560    | 773    | 1 028  | 1 328  | 1 684   | 43%        | 1%            | 6%   |
| yoy % growth         | 19%    | 54%    | -37%   | 11%    | -1%    | 70%    | 63%    | 47%    | 38%    | 33%    | 29%    | 27%     |            |               |      |
| Revenue              | 7 902  | 8 420  | 8 196  | 10 426 | 11 583 | 11 060 | 12 620 | 14 326 | 16 148 | 18 167 | 20 405 | 22 920  | 10%        | 17%           | 22%  |
| yoy % growth         | 26%    | 7%     | -3%    | 27%    | 11%    | -5%    | 14%    | 14%    | 13%    | 13%    | 12%    | 12%     |            |               |      |
| EBITDA               | 1935   | 1176   | 840    | 1461   | 2739   | 2986   | 3660   | 4441   | 5329   | 6359   | 7502   | 8251    | 17%        | 11%           | 23%  |
| yoy % growth         | -69%   | -39%   | -29%   | 74%    | 87%    | 9%     | 23%    | 21%    | 20%    | 19%    | 18%    | 10%     |            |               |      |
| <b>Group</b>         |        |        |        |        |        |        |        |        |        |        |        |         |            |               |      |
| Service revenue      | 48 671 | 52 184 | 54 052 | 58 245 | 59 336 | 61 119 | 62 636 | 64 280 | 66 089 | 68 632 | 71 471 | 74 864  | 3%         |               |      |
| yoy % growth         | 15%    | 7%     | 4%     | 8%     | 2%     | 3%     | 2%     | 3%     | 3%     | 4%     | 4%     | 5%      |            |               |      |
| Equipment            | 5 300  | 5 591  | 6 440  | 7 915  | 9 832  | 12 319 | 15 016 | 17 842 | 20 663 | 23 320 | 25 645 | 27 480  | 16%        |               |      |
| yoy % growth         | 5%     | 5%     | 15%    | 23%    | 24%    | 25%    | 22%    | 19%    | 16%    | 13%    | 10%    | 7%      |            |               |      |
| Revenue              | 55 442 | 58 535 | 61 197 | 66 929 | 69 917 | 74 014 | 78 247 | 82 717 | 87 347 | 92 546 | 97 710 | 102 942 | 6%         |               |      |
| yoy % growth         | 15%    | 6%     | 5%     | 9%     | 4%     | 6%     | 6%     | 6%     | 6%     | 6%     | 6%     | 5%      |            |               |      |
| EBITDA               | 18 196 | 19 782 | 20 594 | 22 763 | 25 253 | 27 267 | 28 478 | 29 953 | 31 522 | 33 339 | 35 148 | 36 460  | 5%         |               |      |
| yoy % growth         | 11%    | 9%     | 4%     | 11%    | 11%    | 8%     | 4%     | 5%     | 5%     | 6%     | 5%     | 4%      |            |               |      |

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### Consolidated Income Statement

| mZAR   | 2012          | 2013          | 2014F         | 2015F         | 2016F         | 2017F         | 2018F         | 2019F         | 2020F          |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|
| <b>Total revenue</b>   | <b>66 929</b> | <b>69 917</b> | <b>74 014</b> | <b>78 247</b> | <b>82 717</b> | <b>87 347</b> | <b>92 546</b> | <b>97 710</b> | <b>102 942</b> |
| <b>EBITDA</b>  | <b>22 763</b> | <b>25 253</b> | <b>27 267</b> | <b>28 478</b> | <b>29 953</b> | <b>31 522</b> | <b>33 339</b> | <b>35 148</b> | <b>36 460</b>  |
| Depreciation   | (4 860)       | (5 338)       | (6 174)       | (7 047)       | (7 907)       | (8 667)       | (9 386)       | (10 006)      | (10 427)       |
| Amortisation   | (1 022)       | (1 026)       | (1 075)       | (1 144)       | (1 218)       | (1 295)       | (1 381)       | (1 469)       | (1 560)        |
| Impairment losses  | ( 199)        | ( 14)         | 0             | 0             | 0             | 0             | 0             | 0             | 0              |
| BBBEEC   | 0             | 0             | 0             | 0             | 0             | 0             | 0             | 0             | 0              |
| <b>Operating profit</b>  | <b>16 617</b> | <b>18 897</b> | <b>20 018</b> | <b>20 287</b> | <b>20 827</b> | <b>21 560</b> | <b>22 571</b> | <b>23 673</b> | <b>24 473</b>  |
| Profit on subsidiary   | 0             | 224           | 0             | 0             | 0             | 0             | 0             | 0             | 0              |
| Finance income   | 109           | 117           | 117           | 117           | 117           | 117           | 117           | 117           | 117            |
| Finance costs<br>(Loss)/Gain on<br>remeasurement and<br>disposal of financial<br>instruments | ( 45)         | 123           | 0             | 0             | 0             | 0             | 0             | 0             | 0              |
| Loss from associate  | 0             | 0             | 0             | 0             | 0             | 0             | 0             | 0             | 0              |
| <b>Profit before tax</b>   | <b>15 933</b> | <b>18 434</b> | <b>18 775</b> | <b>18 713</b> | <b>18 952</b> | <b>19 405</b> | <b>20 175</b> | <b>21 081</b> | <b>21 760</b>  |
| Taxation   | (5 730)       | (5 210)       | (5 306)       | (5 289)       | (5 356)       | (5 485)       | (5 702)       | (5 958)       | (6 150)        |
| <b>Net profit</b>  | <b>10 203</b> | <b>13 224</b> | <b>13 468</b> | <b>13 424</b> | <b>13 596</b> | <b>13 921</b> | <b>14 473</b> | <b>15 123</b> | <b>15 610</b>  |
| - Owners of the parent   | 10 156        | 12 991        | 13 231        | 13 187        | 13 356        | 13 676        | 14 218        | 14 856        | 15 335         |
| - Non-controlling interests  | 47            | 233           | 237           | 237           | 240           | 245           | 255           | 266           | 275            |

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### Consolidated Income Statement

| mZAR   | 2012          | 2013          | 2014F         | 2015F         | 2016F         | 2017F         | 2018F         | 2019F         | 2020F         |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| <b>Non-current assets</b>                          | <b>30 678</b> | <b>34 434</b> | <b>39 546</b> | <b>44 644</b> | <b>49 709</b> | <b>54 261</b> | <b>58 644</b> | <b>62 479</b> | <b>65 250</b> |
| Property, plant and equipment                      | 24 367        | 27 741        | 32 085        | 36 621        | 41 093        | 45 040        | 48 781        | 52 001        | 54 188        |
| Intangible assets                                  | 5 123         | 5 332         | 5 644         | 5 967         | 6 308         | 6 661         | 7 058         | 7 452         | 7 851         |
| Financial assets                                   | 201           | 198           | 198           | 198           | 198           | 198           | 198           | 198           | 198           |
| Trade and other receivables                        | 227           | 196           | 211           | 223           | 235           | 248           | 263           | 278           | 292           |
| Finance lease receivables                          | 447           | 726           | 910           | 1 109         | 1 317         | 1 526         | 1 722         | 1 894         | 2 029         |
| Deferred tax                                       | 313           | 241           | 498           | 526           | 556           | 587           | 622           | 657           | 692           |
| <b>Current assets</b>                              | <b>17 552</b> | <b>21 157</b> | <b>22 588</b> | <b>23 980</b> | <b>25 446</b> | <b>26 939</b> | <b>28 496</b> | <b>29 969</b> | <b>31 340</b> |
| Financial assets                                   | 695           | 1 170         | 1 170         | 1 170         | 1 170         | 1 170         | 1 170         | 1 170         | 1 170         |
| Inventory  | 832           | 861           | 1 079         | 1 315         | 1 562         | 1 809         | 2 042         | 2 246         | 2 406         |
| Trade and other receivables                        | 11 379        | 10 971        | 11 791        | 12 461        | 13 168        | 13 901        | 14 723        | 15 540        | 16 368        |
| Finance lease receivables                          | 691           | 1 437         | 1 800         | 2 195         | 2 608         | 3 020         | 3 408         | 3 748         | 4 016         |
| Tax receivable                                     | 174           | 190           | 252           | 266           | 281           | 297           | 315           | 332           | 350           |
| Cash and cash equivalents                          | 3 781         | 6 528         | 6 495         | 6 573         | 6 656         | 6 741         | 6 837         | 6 932         | 7 029         |
| <b>TOTAL ASSETS</b>                                | <b>48 230</b> | <b>55 591</b> | <b>62 134</b> | <b>68 624</b> | <b>75 155</b> | <b>81 200</b> | <b>87 140</b> | <b>92 448</b> | <b>96 590</b> |
| Treasury shares                                    | (1 530)       | (1 389)       | (1 389)       | (1 389)       | (1 389)       | (1 389)       | (1 389)       | (1 389)       | (1 389)       |
| Retained earnings                                  | 20 121        | 21 342        | 22 586        | 23 890        | 25 278        | 26 767        | 28 385        | 30 150        | 32 048        |
| Other reserves                                     | ( 61)         | 847           | 847           | 847           | 847           | 847           | 847           | 847           | 847           |
| <b>Equity attributable to owners of the parent</b> | <b>18 530</b> | <b>20 800</b> | <b>22 044</b> | <b>23 348</b> | <b>24 736</b> | <b>26 225</b> | <b>27 843</b> | <b>29 608</b> | <b>31 506</b> |
| Non-controlling interests                          | 400           | 416           | 612           | 807           | 1 005         | 1 207         | 1 418         | 1 639         | 1 868         |
| <b>Total equity</b>                                | <b>18 930</b> | <b>21 216</b> | <b>22 655</b> | <b>24 155</b> | <b>25 741</b> | <b>27 432</b> | <b>29 262</b> | <b>31 248</b> | <b>33 373</b> |
| <b>Non-current liabilities</b>                     | <b>10 932</b> | <b>9 620</b>  | <b>12 554</b> | <b>14 726</b> | <b>16 886</b> | <b>18 781</b> | <b>20 441</b> | <b>21 725</b> | <b>22 379</b> |
| LT Borrowings                                      | 9 012         | 7 881         | 10 534        | 12 589        | 14 626        | 16 397        | 17 915        | 19 061        | 19 576        |
| Deferred tax                                       | 1 017         | 981           | 1 230         | 1 300         | 1 375         | 1 451         | 1 538         | 1 624         | 1 711         |
| Trade and other payables                           | 352           | 222           | 224           | 238           | 252           | 265           | 280           | 293           | 304           |
| Provisions   | 551           | 536           | 566           | 599           | 633           | 668           | 708           | 748           | 788           |
| <b>Current liabilities</b>                         | <b>18 368</b> | <b>24 755</b> | <b>26 925</b> | <b>29 743</b> | <b>32 528</b> | <b>34 986</b> | <b>37 437</b> | <b>39 475</b> | <b>40 838</b> |
| ST Borrowings                                      | 2 004         | 6 290         | 8 407         | 10 047        | 11 674        | 13 087        | 14 298        | 15 213        | 15 624        |
| Trade and other payables                           | 15 406        | 17 780        | 17 912        | 19 056        | 20 179        | 21 187        | 22 385        | 23 468        | 24 378        |
| Provisions   | 355           | 283           | 323           | 341           | 361           | 381           | 404           | 426           | 449           |
| Tax payable  | 172           | 46            | 267           | 282           | 298           | 315           | 334           | 352           | 371           |
| Dividends payable                                  | 22            | 16            | 16            | 16            | 16            | 16            | 16            | 16            | 16            |
| Bank overdrafts                                    | 409           | 340           | 0             | 0             | 0             | 0             | 0             | 0             | 0             |
| <b>Total liabilities</b>                           | <b>29 300</b> | <b>34 375</b> | <b>39 479</b> | <b>44 469</b> | <b>49 414</b> | <b>53 767</b> | <b>57 878</b> | <b>61 200</b> | <b>63 216</b> |
| <b>TOTAL EQUITY AND LIABILITIES</b>                | <b>48 230</b> | <b>55 591</b> | <b>62 134</b> | <b>68 624</b> | <b>75 154</b> | <b>81 200</b> | <b>87 140</b> | <b>92 448</b> | <b>96 590</b> |

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### Consolidated Cash Flow Map

|  | 2012           | 2013                        | 2014F           | 2015F           | 2016F           | 2017F           | 2018F           | 2019F           | 2020F           |
|--|----------------|-----------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| mZAR                                   |                |                             |                 |                 |                 |                 |                 |                 |                 |
| EBITDA                                 | 22 763         | 25 253                      | 27 267          | 28 478          | 29 953          | 31 522          | 33 339          | 35 148          | 36 460          |
| Less: Dep                              | (4 860)        | (5 338)                     | (6 174)         | (7 047)         | (7 907)         | (8 667)         | (9 386)         | (10 006)        | (10 427)        |
| EBITA                                  | 17 838         | 19 937                      | 21 093          | 21 432          | 22 046          | 22 855          | 23 953          | 25 142          | 26 033          |
| Tax Adjustment                         | 440            | 348                         | 345             | 374             | 408             | 446             | 490             | 539             | 579             |
| Taxes                                  | (6 416)        | (5 690)                     | (6 005)         | (6 112)         | (6 300)         | (6 548)         | (6 880)         | (7 243)         | (7 512)         |
| NOPLAT                                 | 11 862         | 14 595                      | 15 432          | 15 694          | 16 153          | 16 753          | 17 562          | 18 437          | 19 101          |
| Add: Dep                               | 4 860          | 5 338                       | 6 174           | 7 047           | 7 907           | 8 667           | 9 386           | 10 006          | 10 427          |
| <b>Operational Gross CF</b>            | <b>16 722</b>  | <b>19 933</b>               | <b>21 606</b>   | <b>22 740</b>   | <b>24 060</b>   | <b>25 420</b>   | <b>26 949</b>   | <b>28 443</b>   | <b>29 527</b>   |
| Capex                                  | (7 650)        | (8 712)                     | (10 518)        | (11 582)        | (12 380)        | (12 614)        | (13 127)        | (13 227)        | (12 614)        |
| Δ Intangibles+Am (incl. ImpL)          | (1 129)        | (1 249)                     | (1 387)         | (1 467)         | (1 559)         | (1 648)         | (1 778)         | (1 863)         | (1 959)         |
| Δ NWC                                  | 611            | 653                         | (968)           | (711)           | (744)           | (738)           | (672)           | (571)           | (418)           |
| Δ Other operating assets & liabilities | 1 071          | 804                         | (314)           | 323             | 255             | 107             | 187             | 77              | (111)           |
| <b>Operational Investing CF</b>        | <b>(7 097)</b> | <b>(8 504)</b>              | <b>(13 188)</b> | <b>(13 437)</b> | <b>(14 428)</b> | <b>(14 893)</b> | <b>(15 390)</b> | <b>(15 583)</b> | <b>(15 102)</b> |
| <b>OPERATIONAL FCF</b>                 | <b>9 625</b>   | <b>11 429</b>               | <b>8 419</b>    | <b>9 303</b>    | <b>9 632</b>    | <b>10 527</b>   | <b>11 559</b>   | <b>12 860</b>   | <b>14 426</b>   |
| Financial Revenues                     | 64             | 464                         | 117             | 117             | 117             | 117             | 117             | 117             | 117             |
| Taxes paid                             | (23)           | (132)                       | (33)            | (33)            | (33)            | (34)            | (34)            | (34)            | (34)            |
| <b>Non-operating gross CF</b>          | <b>41</b>      | <b>332</b>                  | <b>84</b>       | <b>84</b>       | <b>84</b>       | <b>83</b>       | <b>83</b>       | <b>83</b>       | <b>83</b>       |
| <b>Non-operating investing CF</b>      | <b>(2 778)</b> | <b>(3 246)<sup>90</sup></b> | <b>70</b>       | <b>51</b>       | <b>54</b>       | <b>56</b>       | <b>62</b>       | <b>62</b>       | <b>63</b>       |
| <b>NON-OPERATIONAL FCF</b>             | <b>(2 737)</b> | <b>(2 915)</b>              | <b>154</b>      | <b>134</b>      | <b>137</b>      | <b>139</b>      | <b>146</b>      | <b>145</b>      | <b>146</b>      |
|  | <b>6 888</b>   | <b>8 514</b>                | <b>8 573</b>    | <b>9 438</b>    | <b>9 769</b>    | <b>10 667</b>   | <b>11 705</b>   | <b>13 005</b>   | <b>14 572</b>   |
| <b>FCF</b>                             |                |                             |                 |                 |                 |                 |                 |                 |                 |
| Δ Debt                                 | 1 031          | 3 086                       | 4 430           | 3 696           | 3 664           | 3 184           | 2 730           | 2 060           | 926             |
| Δ Other financial A&L <sup>91</sup>    | (1)            | 6                           | 0               | 0               | 0               | 0               | 0               | 0               | 0               |
| Δ Equity                               | (7 453)        | (10 938)                    | (12 029)        | (11 924)        | (12 010)        | (12 229)        | (12 644)        | (13 137)        | (13 484)        |
| Interests paid                         | (748)          | (927)                       | (1 360)         | (1 692)         | (1 992)         | (2 272)         | (2 513)         | (2 708)         | (2 830)         |
| ITS                                    | 269            | 265                         | 387             | 483             | 569             | 651             | 722             | 780             | 817             |
| Δ Dividends payable                    | 14             | (6)                         | 0               | 0               | 0               | 0               | 0               | 0               | 0               |
| <b>CF from Financing</b>               | <b>(6 888)</b> | <b>(8 514)</b>              | <b>(8 572)</b>  | <b>(9 438)</b>  | <b>(9 769)</b>  | <b>(10 667)</b> | <b>(11 705)</b> | <b>(13 005)</b> | <b>(14 572)</b> |

Notes to designations in the CF map:

- Δ Stands for annual change or variation
- A&L stands for assets net of liabilities
- ITS stands for interest tax shield

<sup>90</sup> The large amount of investment in Non-operating investing cash flow for 2013, as well as the year before, comes from increases in excess cash, which believe to become stable in the future.

<sup>91</sup> Other financial assets and liabilities refer to net derivative financial instruments that are not considered interest bearing debt.

## Disclosures and Disclaimer

### Research Recommendations

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|             |  |
|-------------|--|
| <b>Buy</b>  | Expected total return (including dividends) of more than 15% over a 12-month period.   |
| <b>Hold</b> | Expected total return (including dividends) between 0% and 15% over a 12-month period. |
| <b>Sell</b> | Expected negative total return (including dividends) over a 12-month period.           |

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