

Vodafone Qatar (VFQS)

Recommendation	MARKET PERFORM	Risk Rating	R-4
Share Price	QR9.16	Current Target Price	QR8.50
Implied Upside	(7.2)%		

Updating Model to Reflect 2Q2018; Market Perform

VFQS reported a generally in-line 2nd quarter and provided guidance for 2018; we adjust our model and maintain rating/PT of Market Perform/QR8.50. We continue to like the company's traction in postpaid with segment subs up 22% YoY and segment revenue growing 19% YoY driven by traction in Flex, Red and enterprise plans. With majority control moving to Qatar Foundation (50% owner), we expect traction in the postpaid segment to continue, along with a renewed push into fixed-line services. We continue to forecast resumption in dividends in 2018 after an almost 4-year hiatus. Despite these positive moves, profitability metrics remain subdued with ROIC to remain below WACC until at least CY2023. VFQS trades at 13.9x and 11.5x CY2018 and CY2019 EV/EBITDA, respectively, which is significantly more expensive than peers. We maintain our Market Perform rating and QR8.50 target.

Highlights

- **VFQS posts adj. 2Q2018 net profit of QR17.2mn vs. QNB FS estimate of QR13.5mn.** Reported NI of QR31.2mn included a one-time ~QR14mn fall in opex due to a reversal in provisions and compared to a net loss of QR57.1mn in 2Q2017 and a net profit of QR17.5mn (1Q2018).
- **Revenue/adjusted EBITDA came in-line with our estimate (+1%/+2% delta).** 2Q2018 revenue of QR519.3mn (in-line with QNBFS est. of QR513.0mn) was up 1% YoY but down 2% QoQ. EBITDA, ex. the reversal, was QR135.0mn (-3% YoY, 0% QoQ) vs. our model of QR131.9mn.
- **Another strong performance on the ARPU front but lower-than-expected subs kept 2Q2018 revenue broadly in-line with our model.** While we were expecting sequentially flattish subs at 1.41mn, VFQS reported 1.39mn customers, with a decline of 1% compared to March 2018, due to the holiday period; the company posted 1.464mn customers in June 2017. Postpaid customers grew 22% YoY given continued traction with several plans. We were expecting ~21% YoY growth in postpaid subs and believe the increased mix of higher-value postpaid customers partly contributed to ARPU being up QR7 YoY to QR108 vs. our estimate of QR102.
- **Better-than-anticipated cost management helped gross margins expand to 63.3% vs. our model of 61.0%; gross margins were 64.7%/60.7% in 2Q2017/1Q2018.** Adjusted for the aforementioned reversal, EBITDA margin came in at 26.0% (QNB FS estimate: 25.7%). Depreciation and amortization for 2Q2018 at QR105.9mn was also 4% lower than our estimate of QR110.5mn; D&A was QR109.0mn in 1Q2018 and QR188.3mn in 2Q2017. As previously disclosed, the significant YoY reduction in amortization stems from VFQS' license extension for an additional 40 years until 2068, which helps reduce annual license amortization costs from QR403mn to QR85mn ensuring sustained bottom-line profitability going forward.
- **We project revenue/EBITDA/net income of QR2.1bn/QR599mn/QR124mn for 2018.** Our forecasts are at the higher end of management guidance. Our previous estimates were QR2.1bn/QR568m/QR92mn. We expect better margins in the 2nd half of this year to keep up with company guidance of 27%-28% EBITDA margins in 2018; driving our higher EBITDA/net income projections for 2018. We expect 22.1% capex intensity in 2018, in-line with management guidance, as VFQS spends on 5G upgrades and fixed line expansion.

Catalysts

- **With QF assuming majority ownership of VFQS, we expect increased traction in higher-value mobile segments and fixed broadband.** However, this effect is hard to quantify. Moreover, we are not convinced if VFQS could ever reach the scale to sport EBITDA margins beyond mid-30s to 40% range (In 1Q2018, ORDS reported 53% EBITDA margins at a QR2bn quarterly revenue run-rate). In the medium-term, mobile network enhancements and growth in data, along with focus on higher-value segments like postpaid, enterprise and nationwide fixed-line, could drive the next leg of growth.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We rate VFQS a Market Perform with a PT of QR8.50.** VFQS trades at 13.9x and 11.5x CY2018 and CY2019 EV/EBITDA, respectively, which is significantly more expensive than its regional peers.
- **Risks: 1) Increased competition** leading to ARPU erosion and/or market share loss; **2) Weakening of postpaid and fixed-line traction/stickiness** and **3) Fall in population/industry growth rates.**

Key Financial Data and Estimates

	CY2017	CY2018e	CY2019e	CY2020e
Revenue (QR mn)	1,998	2,134	2,293	2,451
EPS (QR)	(0.30)	0.15	0.26	0.38
EV/EBITDA	15.5x	13.9x	11.5x	9.8x
Dividend Yield		1.1%	2.7%	3.8%

Source: Company data, QNBFS estimates; Note: All data based on current number of shares

Key Data

Bloomberg Ticker	VFQS QD
ADR/GDR Ticker	N/A
Reuters Ticker	VFQS.QA
ISIN	QA000A0Q5NE9
Sector	Telecoms
52wk High/52wk Low (QR)	9.76/6.03
3-m Avg. Volume ('000)	1,708.7
Mkt. Cap. (\$ bn/QR bn)	2.1/7.7
EV (\$ bn/QR bn)	2.3/8.3
Shares Outstanding (mn)	845.4
FO Limit* (%)	49.0
Current FO* (%)	5.7
1-Year Total Return (%)	1.8
Fiscal Year End	December 31

Source: Bloomberg (as of August 6, 2018), *Qatar Exchange (as of August 6, 2018); Note: FO is foreign ownership

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June 2018 Results Show Continued Progress in Postpaid and Costs Reduction

VFQS posts adjusted 2Q2018 net profit of QR17.2mn vs. QNB FS estimate of QR13.5mn. Reported NI of QR31.2mn included a one-time ~QR14mn fall in opex due to a reversal in provisions and compared to a net loss of QR57.1mn in 2Q2017 and a net profit of QR17.5mn (1Q2018).

- **Revenue/adjusted EBITDA came in-line with our estimate (+1%/+2% delta).** 2Q2018 revenue of QR519.3mn (in-line with QNBFS est. of QR513.0mn) was up 1% YoY but down 2% QoQ. EBITDA, ex. the reversal, was QR135.0mn (-3% YoY, 0% QoQ) vs. our model of QR131.9mn.
- **Another strong performance on the ARPU front but lower-than-expected subs kept 2Q2018 revenue broadly in-line with our model.** While we were expecting sequentially flattish subs at 1.41mn, VFQS reported 1.39mn customers, with a decline of 1% compared to March 2018, due to the holiday period; the company posted 1.464mn customers in June 2017. Postpaid customers grew 22% YoY given continued traction with several plans. We were expecting ~21% YoY growth in postpaid subs and believe the increased mix of higher-value postpaid customers partly contributed to ARPU being up QR7 YoY to QR108 vs. our estimate of QR102.
- **Better-than-anticipated cost management helped gross margins expand to 63.3% vs. our model of 61.0%; gross margins were 64.7%/60.7% in 2Q2017/1Q2018.** Adjusted for the aforementioned reversal, EBITDA margin came in at 26.0% (QNB FS estimate: 25.7%). Depreciation and amortization for 2Q2018 at QR105.9mn was also 4% lower than our estimate of QR110.5mn; D&A was QR109.0mn in 1Q2018 and QR188.3mn in 2Q2017. As previously disclosed, the significant YoY reduction in amortization stems from VFQS' license extension for an additional 40 years until 2068, which helps reduce annual license amortization costs from QR403mn to QR85mn ensuring sustained bottom-line profitability going forward.

2Q2018 Comparisons

In QR mn	2QCY18	2QCY18e	2QCY17	1QCY18	A vs. E	YoY	QoQ
Subscribers (000)	1,390	1,410	1,464	1,410	-1%	-5%	-1%
ARPU (QR)	108	102	101	108	5%	7%	0%
Revenue	519.3	513.0	515.8	531.9	1%	1%	-2%
Gross Profit (Loss)	328.6	313.0	333.5	322.7	5%	-1%	2%
EBITDA	149.0	131.9	138.7	134.6	13%	7%	11%
Adjusted EBITDA	135.0	131.9	138.7	134.6	2%	-3%	0%
Operating Profit (Loss) - EBIT	43.2	21.4	(49.6)	25.6	101%	N/M	68%
Adjusted Operating Profit (Loss) - EBIT	29.2	21.4	(49.6)	25.6	36%	N/M	14%
Net Profit (Loss)	31.2	13.5	(57.1)	17.5	132%	N/M	79%
Adjusted Net Profit (Loss)	17.2	13.5	(57.1)	17.5	28%	N/M	-1%
Gross Margin	63.3%	61.0%	64.7%	60.7%			
Adjusted EBITDA Margin	26.0%	25.7%	26.9%	25.3%			
Adjusted EBIT Margin	6.0%	2.6%	-11.1%	3.3%			
Adjusted Net Margin	3.3%	2.6%	-11.1%	3.3%			

Source: Company data, QNBFS estimates

Key Ratios and Valuation Metrics

Growth Rates	FY2017	CY2017	CY2018E	CY2019E	CY2020E	CY2021E	CY2022E	CY2023E
Revenue	-2.9%	-2.9%	6.8%	7.5%	6.9%	5.0%	3.3%	3.0%
Gross Profit	11.4%	1.3%	5.2%	9.9%	9.4%	6.5%	4.8%	3.7%
EBIT	41.4%	33.5%	N/M	67.8%	41.8%	22.9%	14.1%	10.1%
EBITDA	33.8%	16.0%	11.3%	19.2%	16.7%	11.1%	7.6%	5.7%
Net Income	42.2%	31.6%	N/M	77.7%	46.2%	25.7%	17.3%	13.4%
DPS				150.0%	40.0%	14.3%	12.5%	11.1%
CFPS	39.0%	29.6%	3.8%	42.3%	11.0%	11.0%	5.8%	4.4%
FCPS	165.9%	158.8%	-65.0%	486.7%	31.3%	32.4%	25.2%	11.0%
Operating Ratios								
Gross Margin	64.1%	64.0%	63.1%	64.5%	66.0%	67.0%	68.0%	68.5%
EBIT Margin	(11.8%)	(11.2%)	8.0%	12.5%	16.5%	19.4%	21.4%	22.9%
EBITDA Margin	26.1%	26.9%	28.1%	31.1%	34.0%	36.0%	37.5%	38.5%
Net Margin	(13.1%)	(12.8%)	5.8%	9.6%	13.1%	15.7%	17.9%	19.7%
Capex Intensity	15.1%	18.4%	22.1%	20.6%	19.3%	17.6%	14.8%	13.6%
Finance Ratios								
Debt - Equity Ratio	20.3%	18.3%	17.8%	14.8%	14.5%	14.2%	9.2%	3.0%
Net Debt - Equity Ratio	16.7%	13.9%	13.2%	10.1%	8.1%	5.8%	2.0%	(2.3%)
Net Debt-to-Capital	14.3%	12.2%	11.7%	9.2%	7.5%	5.5%	2.0%	(2.3%)
Cash Interest Coverage	19.0x	18.1x	17.3x	18.0x	19.7x	21.9x	28.3x	56.2x
Ave. Effective Borrowing rate %	3.0%	3.6%	4.2%	5.7%	6.0%	6.0%	7.5%	12.1%
Return Ratios								
ROIC	(4.3%)	(4.2%)	2.8%	4.7%	6.5%	7.8%	9.1%	10.3%
ROE	(5.8%)	(5.7%)	2.7%	4.7%	6.7%	8.2%	9.4%	10.4%
ROA	(4.1%)	(4.1%)	2.0%	3.4%	4.9%	6.1%	7.2%	8.3%
Dividend Payout %			68.2%	96.0%	91.9%	83.5%	80.1%	78.6%
Valuation								
EV/Sales	4.1x	4.2x	3.9x	3.6x	3.3x	3.1x	3.0x	2.8x
EV/EBITDA	15.9x	15.5x	13.9x	11.5x	9.8x	8.7x	7.9x	7.2x
EV/EBIT	N/M	N/M	49.0x	28.8x	20.1x	16.1x	13.8x	12.2x
P/E	N/M	N/M	62.5x	35.2x	24.0x	19.1x	16.3x	14.4x
P/BV	1.7x	1.7x	1.7x	1.6x	1.6x	1.6x	1.5x	1.5x
Dividend Yield	0.0%	0.0%	1.1%	2.7%	3.8%	4.4%	4.9%	5.5%
Liquidity Ratios								
Current Ratio	0.7x	0.7x	0.8x	0.8x	0.9x	1.0x	0.9x	0.8x
Quick Ratio	0.6x	0.6x	0.8x	0.8x	0.8x	1.0x	0.9x	0.8x

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement (In QR mn)	FY2016	FY2017	CY2017	CY2018e	CY2019e	CY2020e	CY2021e	CY2022e
Revenue	2,119	2,059	1,998	2,134	2,293	2,451	2,573	2,658
Direct Costs	(935)	(740)	(719)	(788)	(814)	(833)	(849)	(850)
Gross Profit	1,184	1,319	1,279	1,345	1,479	1,618	1,724	1,807
Other Expenses, Excluding D&A	(784)	(782)	(741)	(746)	(765)	(784)	(798)	(811)
EBITDA	401	537	538	599	714	833	926	997
Depreciation & Amortization	(816)	(780)	(762)	(429)	(428)	(428)	(428)	(428)
EBIT	(415)	(243)	(224)	170	286	405	498	568
Interest Income	0	2	2	5	6	5	7	9
Interest Expense	(19)	(28)	(30)	(35)	(40)	(42)	(42)	(35)
Other Income/Expense	(32)	(0)	(4)	(16)	(31)	(46)	(58)	(68)
Profit Before Tax	(466)	(269)	(256)	124	220	322	405	475
Income Tax Expense								
Profit for Shareholders	(466)	(269)	(256)	124	220	322	405	475
EPS (QR)	(0.55)	(0.32)	(0.30)	0.15	0.26	0.38	0.48	0.56
DPS (QR)	0.00	0.00	0.00	0.10	0.25	0.35	0.40	0.45

Source: Company data, QNBFS estimates

Detailed Financial Statements

Balance Sheet (In QR mn)	FY2016	FY2017	CY2017	CY2018e	CY2019e	CY2020e	CY2021e	CY2022e
Non-Current Assets								
Property, Plant and Equipment	1,249	1,233	1,202	1,355	1,495	1,635	1,755	1,815
Intangible Assets	5,235	4,782	4,461	4,351	4,254	4,158	4,062	3,966
Trade and Other Receivables	34	25	25	26	28	30	31	32
Total Non-Current Assets	6,518	6,040	5,688	5,731	5,777	5,823	5,848	5,813
Current Assets								
Inventory	13	13	36	12	13	14	14	15
Trade and Other Receivables	330	357	302	343	375	388	411	428
Cash and Cash Equivalents	130	169	199	212	224	307	414	365
Total Current Assets	474	539	536	567	612	708	839	808
Total Assets	6,992	6,579	6,225	6,298	6,389	6,531	6,687	6,621
Equity								
Total Equity	4,923	4,654	4,472	4,595	4,725	4,828	4,927	5,052
Non-Current Liabilities								
Trade and Other Payables	48	50	52	57	62	66	70	72
Provisions	62	114	105	102	111	118	124	128
Long-Term Borrowings	1,023	946	818	820	700	700	700	467
Total Non-Current Liabilities	1,132	1,110	976	979	873	885	894	667
Current Liabilities								
Trade and Other Payables	937	816	777	723	791	818	866	902
Short-Term Borrowings	0	0	0	0	0	0	0	0
Total Current Liabilities	937	816	777	723	791	818	866	902
Total Liabilities	2,069	1,925	1,753	1,702	1,664	1,703	1,760	1,569
Equity and Liabilities	6,992	6,579	6,225	6,298	6,389	6,531	6,687	6,621

Source: Company data, QNBFS estimates

Recommendations

Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price

OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings

Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals

R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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