

## Vodafone Qatar (VFQS)

Recommendation	UNDERPERFORM	Risk Rating	R-4
Share Price	QR10.28	Current Target Price	QR7.30
Implied Upside	(29.0%)	Old Target Price	QR8.10

### Sep. Q Beats on Lower Costs; LT Outlook Murky; Underperform

*We retain our Underperform rating and lower our price target to QR7.30. While VFQS posted a lower-than-expected loss for the Sep. 2016 quarter due to direct costs reduction, fundamentals stay challenging and the stock remains expensive. We need to see evidence of a sustained recovery to become more constructive on the name.*

#### Highlights

- **VFQS reported a lower net loss of QR64mn in 2QFY2017, an improvement versus a loss of almost QR100mn in 1QFY2017.** Reported net loss was ahead of our estimate of a loss of QR82mn (Bloomberg consensus: -QR83mn). The company's **revenue** of QR499mn dropped below the QR500mn level for the first time since September 2013. Our revenue estimate for the quarter was QR513mn, implying a divergence of -3%. Overall top-line was impacted by completion of a one-off clean-up of subs (85k removed 60/40 over the first two quarters of FY2017), management de-emphasis of low-margin handset business and reduction in MTR. **EBITDA** increased by 37% on a QoQ basis to QR137mn in 2QFY2017 aided by better pricing and a higher data mix. The beat vs. our model was primarily due to lower direct costs (leased lines, etc.), which was 12% lower than our estimate. *See pages 2 & 3 for a detailed breakdown of results versus our estimates.*
- **ARPU improved marginally, while customer base came in flattish.** On a blended basis, VFQS's mobile quarterly **ARPU** of QR105 grew 4% from QR101 in June 2016 and QR99 in March 2016, still around 20% below levels reached in June 2014 despite an increasing mix of postpay in the business. Mobile ARPU remains well below Ooredoo's QR127. Continued competitive pressure could lead to further ARPU erosion with VFQS' prepaid ARPU more than 20% higher than ORDS; but on the positive side, the closing of the postpay gap could boost ARPU/profitability as VFQS's postpaid ARPU remains almost 50% below ORDS. **Mobile subs** were flattish sequentially at 1.457mn vs. 1.458mn in 1QFY2017 driven by the aforementioned prepaid base clean-up while postpaid was up 3% driven by connect plans. Prepaid is around 83% of the overall mobile base.
- **Revising estimates to match guidance reflecting 2H2017 growth over 1H.** Management provided guidance for FY2017; we are adjusting our estimates to the upper end of guidance ranges: revenue (QR2.03-2.07bn; down 4-2% YoY), service revenue (QR1.94-1.98bn; down 1% to up 1% YoY), EBITDA margin of 24.5%-25% vs. 18.9% in FY2016 and capex intensity of 12.7% (18.7% in FY2016). VFQS also projects QR90-110mn in FCF vs. QR134mn in FY16 outflows.

#### Catalysts

- **Uptick in KPIs are potential catalysts.** Mobile network enhancements and growth in data, along with focus on higher-value segments like postpaid, enterprise and eventually nationwide fixed-line, could drive the next leg of growth. Impact of the 10% workforce cut and reduction in allowances for some staff could also help costs. However, profitability may remain elusive until FY20/21.

#### Recommendation, Valuation and Risks

- **Recommendation and valuation: We rate VFQS an Underperform with a price target of QR7.30.** The stock is trading at 15.2x FY2018e EV/EBITDA.
- **Risks: Subdued oil prices continue to suppress investor appetite.** Specific risks to VFQS include: 1) market share loss to ORDS (seen recently during Sep. 2014 to June 2015 and again in June and Sep. 2016); 2) ARPU pressure; 3) Lack of postpay traction/stickiness; 4) Decline in population/industry growth rates and 4) Continued lack of clarity on nationwide fixed line.

#### Key Financial Data and Estimates

	FY2015	FY2016	FY2017e	FY2018e
Revenue (QR mn)	2,307	2,119	2,074	2,233
Revenue Growth	16.4%	-8.1%	-2.1%	7.7%
EPS (QR)	(0.26)	(0.55)	(0.33)	(0.23)
EV/EBITDA (x)	16.7	23.9	18.1	15.2
DPS (QR)	0.21	-	0.14	0.24
Dividend Yield	2.0%	0.0%	1.3%	2.3%

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)	13.15/9.70
3-m Avg. Volume ('000)	1,196.5
Mkt. Cap. (\$ bn/QR bn)	2.4/8.7
Shares Outstanding (mn)	845.4
FO Limit* (%)	No Limit
Current FO* (%)	7.5
1-Year Total Return (%)	(18.5)
Fiscal Year End	March 31

Source: Bloomberg (as November 13, 2016), \*Qatar Exchange (as of November 13, 2016); Note: FO is foreign ownership

Saugata Sarkar

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

## Valuation

We derive our price target using a five-year DCF model on Vodafone Qatar. We use a cost of equity of 12.9%, a cost of debt of 2.5% and a WACC of 11.9%. Our terminal growth rate assumption is 3.5%. Each 5% variation in our terminal subscribers or terminal ARPU assumptions changes VFQS' fair value by 1.4%.

### DCF Valuation

	Fair Value (QR mn)	Fair Value per Share (QR)
Cumulative PV of FCFF	2,070	2.45
PV of Terminal Value	4,955	5.86
PV of Cash Flows	7,025	8.31
Add:		
Cash Balances (September 2016)	184	0.22
Less: Debt Balances (September 2016)	1,035	1.22
<b>Fair Value of Equity</b>	<b>6,175</b>	<b>7.30</b>

Source: Company data, QNBFS estimates

### Sensitivity Analysis

		Terminal Growth Rate						
		2.0%	2.5%	3.0%	3.5%	4.0%	4.5%	5.0%
WACC	8.9%	9.80	10.50	11.30	12.20	13.40	14.80	16.50
	9.9%	8.40	8.90	9.40	10.10	10.80	11.70	12.80
	10.9%	7.20	7.60	8.00	8.50	9.00	9.70	10.40
	11.9%	6.30	6.60	6.90	7.30	7.70	8.20	8.70
	12.9%	5.60	5.80	6.10	6.40	6.70	7.00	7.40
	13.9%	5.00	5.20	5.40	5.60	5.80	6.10	6.40
	14.9%	4.50	4.70	4.80	5.00	5.20	5.40	5.60

Source: Company data, QNBFS estimates

## Fundamental Drivers: Actual vs. Estimates and Comparisons

Drivers	Q2FY16 A	Q1FY17 A	Q2FY17 A	Q2FY17 E	A v E	QoQ	YoY
Population ('000)	2,347.269	2,477.113	2,553.393	2,499.841	2%	3%	9%
Penetration	195.9%	181.1%	176.5%	183.6%			
Revenue - Mobile (QR mn)	453.571	449.000	447.679	453.984	-1%	0%	-1%
YoY Growth (%)	-6.0%	-0.2%	-1.3%	0.2%			
Subscribers ('000)	1,486.000	1,458.000	1,457.000	1,509.217	-3%	0%	-2%
YoY Growth (%)	8.3%	2.7%	-2.0%	1.6%			
QoQ growth (%)	4.6%	-5.8%	-0.1%	3.5%			
Subscribers ('000) - Total Market	4,598.019	4,485.419	4,507.793	4,589.943	-2%	0%	-2%
VFQS Market Share	32.3%	32.5%	32.3%	32.9%	-2%	-1%	0%
Blended ARPU (QR)	111.000	101.000	105.000	102.000	3%	4%	-5%
YoY Growth (%)	-10.5%	-9.0%	-5.4%	-8.1%			
QoQ growth (%)	0.0%	2.0%	4.0%	1.0%			

Source: Company data, QNBFS estimates

## Income Statement: Actual vs. Estimates and Comparisons

Income Statement (In QR mn)	Q2FY16 A	Q1FY17 A	Q2FY17 A	Q2FY17 E	A v E	QoQ	YoY
<b>Revenue</b>	<b>528.098</b>	<b>500.512</b>	<b>499.359</b>	<b>513.496</b>	<b>-3%</b>	<b>0%</b>	<b>-5%</b>
Direct Costs	(238.002)	(190.506)	(181.378)	(205.398)	-12%	-5%	-24%
<b>Gross Profit</b>	<b>290.096</b>	<b>310.006</b>	<b>317.981</b>	<b>308.098</b>	<b>3%</b>	<b>3%</b>	<b>10%</b>
Gross Margin (%)	54.9%	61.9%	63.7%	60.0%			
Other Expenses, Excluding D&A	(189.417)	(209.927)	(181.204)	(184.859)	-2%	-14%	-4%
<b>EBITDA</b>	<b>100.679</b>	<b>100.079</b>	<b>136.777</b>	<b>123.239</b>	<b>11%</b>	<b>37%</b>	<b>36%</b>
EBITDA Margin (%)	19.1%	20.0%	27.4%	24.0%			
<b>Depreciation &amp; Amortization</b>	<b>(199.730)</b>	<b>(193.395)</b>	<b>(194.686)</b>	<b>(198.960)</b>	<b>-2%</b>	<b>1%</b>	<b>-3%</b>
Total Operating Expenses	(389.147)	(403.322)	(375.890)	(383.819)	-2%	-7%	-3%
<b>EBIT</b>	<b>(99.051)</b>	<b>(93.316)</b>	<b>(57.909)</b>	<b>(75.721)</b>	<b>-24%</b>	<b>-38%</b>	<b>-42%</b>
EBIT Margin (%)	-18.8%	-18.6%	-11.6%	-14.7%			
Interest Income	0.021	0.306	0.553	0.282	96%	81%	2533%
Interest Expense	(4.615)	(6.574)	(6.554)	(6.593)	-1%	0%	42%
Other Income/Expense	(9.996)		(0.051)	-			-99%
Profit Before Tax	(113.641)	(99.584)	(63.961)	(82.032)	-22%	-36%	-44%
Income Tax Expense							
<b>Profit for Shareholders</b>	<b>(113.641)</b>	<b>(99.584)</b>	<b>(63.961)</b>	<b>(82.032)</b>	<b>-22%</b>	<b>-36%</b>	<b>-44%</b>
Net Margin	-21.5%	-19.9%	-12.8%	-16.0%			

Source: Company data, QNBFS estimates

## Detailed Financial Statements

Income Statement (In QR mn)	FY2015	FY2016	FY2017e	FY2018e	FY2019e	FY2020e	FY2021e	FY2022e
<b>Revenue</b>	<b>2,307</b>	<b>2,119</b>	<b>2,074</b>	<b>2,233</b>	<b>2,432</b>	<b>2,659</b>	<b>2,862</b>	<b>3,029</b>
Direct Costs	(1,060)	(935)	(801)	(849)	(912)	(984)	(1,044)	(1,091)
<b>Gross Profit</b>	<b>1,247</b>	<b>1,184</b>	<b>1,272</b>	<b>1,385</b>	<b>1,520</b>	<b>1,675</b>	<b>1,817</b>	<b>1,939</b>
Other Expenses, Excluding D&A	(680)	(784)	(754)	(782)	(803)	(851)	(887)	(909)
<b>EBITDA</b>	<b>567</b>	<b>401</b>	<b>519</b>	<b>603</b>	<b>718</b>	<b>824</b>	<b>930</b>	<b>1,030</b>
Depreciation & Amortization	(752)	(816)	(778)	(771)	(795)	(821)	(845)	(864)
<b>EBIT</b>	<b>(186)</b>	<b>(415)</b>	<b>(259)</b>	<b>(168)</b>	<b>(77)</b>	<b>3</b>	<b>85</b>	<b>166</b>
Interest Income	0	0	3	4	6	6	5	8
Interest Expense	(19)	(19)	(26)	(26)	(22)	(13)	(9)	(9)
Other Income/Expense	(12)	(32)	0	0	0	0	0	0
Profit Before Tax	(216)	(466)	(283)	(191)	(93)	(4)	82	165
Income Tax Expense								
<b>Profit for Shareholders</b>	<b>(216)</b>	<b>(466)</b>	<b>(283)</b>	<b>(191)</b>	<b>(93)</b>	<b>(4)</b>	<b>82</b>	<b>165</b>
<b>EPS (QR)</b>	<b>(0.26)</b>	<b>(0.55)</b>	<b>(0.33)</b>	<b>(0.23)</b>	<b>(0.11)</b>	<b>(0.00)</b>	<b>0.10</b>	<b>0.20</b>
<b>DPS (QR)</b>	<b>0.21</b>	<b>-</b>	<b>0.14</b>	<b>0.24</b>	<b>0.35</b>	<b>0.45</b>	<b>0.54</b>	<b>0.64</b>

Source: Company data, QNBFS estimates

## Detailed Financial Statements

Balance Sheet (In QR mn)	FY2015	FY2016	FY2017e	FY2018e	FY2019e	FY2020e	FY2021e	FY2022e
<b>Non-Current Assets</b>								
Property, Plant and Equipment	1,322	1,249	1,222	1,197	1,169	1,138	1,105	1,070
Intangible Assets	5,709	5,235	4,747	4,261	3,775	3,288	2,802	2,316
Trade and Other Receivables	21	34	33	35	38	42	45	48
<b>Total Non-Current Assets</b>	<b>7,052</b>	<b>6,518</b>	<b>6,002</b>	<b>5,493</b>	<b>4,982</b>	<b>4,468</b>	<b>3,952</b>	<b>3,434</b>
<b>Current Assets</b>								
Inventory	27	13	9	9	10	11	12	13
Trade and Other Receivables	214	330	364	378	410	447	485	518
Cash and Cash Equivalents	151	130	327	561	486	419	705	986
<b>Total Current Assets</b>	<b>392</b>	<b>474</b>	<b>701</b>	<b>949</b>	<b>906</b>	<b>877</b>	<b>1,202</b>	<b>1,516</b>
<b>Total Assets</b>	<b>7,444</b>	<b>6,992</b>	<b>6,703</b>	<b>6,442</b>	<b>5,888</b>	<b>5,346</b>	<b>5,154</b>	<b>4,950</b>
<b>Equity</b>								
<b>Total Equity</b>	<b>5,566</b>	<b>4,923</b>	<b>4,640</b>	<b>4,335</b>	<b>4,042</b>	<b>3,743</b>	<b>3,446</b>	<b>3,151</b>
<b>Non-Current Liabilities</b>								
Trade and Other Payables	40	48	54	58	63	69	75	79
Provisions	43	62	65	70	76	83	89	95
Long-Term Borrowings	909	1,023	1,035	685	335	335	335	335
<b>Total Non-Current Liabilities</b>	<b>993</b>	<b>1,132</b>	<b>1,153</b>	<b>813</b>	<b>474</b>	<b>487</b>	<b>499</b>	<b>508</b>
<b>Current Liabilities</b>								
Trade and Other Payables	885	937	909	944	1,023	1,116	1,210	1,291
Short-Term Borrowings	0	0	0	350	350	0	0	0
<b>Total Current Liabilities</b>	<b>885</b>	<b>937</b>	<b>909</b>	<b>1,294</b>	<b>1,373</b>	<b>1,116</b>	<b>1,210</b>	<b>1,291</b>
<b>Total Liabilities</b>	<b>1,878</b>	<b>2,069</b>	<b>2,062</b>	<b>2,106</b>	<b>1,846</b>	<b>1,603</b>	<b>1,709</b>	<b>1,799</b>
<b>Equity and Liabilities</b>	<b>7,444</b>	<b>6,992</b>	<b>6,703</b>	<b>6,442</b>	<b>5,888</b>	<b>5,346</b>	<b>5,154</b>	<b>4,950</b>

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*

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

### Risk Ratings

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

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

### Contacts

#### Saugata Sarkar

Head of Research

Tel: (+974) 4476 6534

[saugata.sarkar@qnbfs.com.qa](mailto:saugata.sarkar@qnbfs.com.qa)

#### Shahan Keushgerian

Senior Research Analyst

Tel: (+974) 4476 6509

[shahan.keushgerian@qnbfs.com.qa](mailto:shahan.keushgerian@qnbfs.com.qa)

#### Zaid al-Nafoosi, CMT, CFTe

Senior Research Analyst

Tel: (+974) 4476 6535

[zaid.alnafoosi@qnbfs.com.qa](mailto:zaid.alnafoosi@qnbfs.com.qa)

#### QNB Financial Services Co. WLL One Person Company

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

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