

# VFQS Alert – 2Q2023 Beat Aided by Managed Services Revenue/D&A; Maintain Estimates; Accumulate

- **VFQS' 2Q2023 net profit of QR126.5mn grew 16.1% YoY but declined 5.2% sequentially and exceeded our QR117.6mn forecast by 7.5%.** The beat this quarter primarily came from non-mobile service revenue, which include managed services/fixed services & other (mainly visitors' roaming) revenue. Cash margins, however, were a bit softer-than-expected but lower D&A expenses also helped in delivering the bottom-line beat. We had expected continued growth on a yearly basis and a decline vs. 1Q2023 (given population decline during the summer) – reported results were somewhat in-line with our expectations but we were positively surprised by the company's ability to hold the line and even grow its mobile subs (overall up 4.1% YoY/0.2% QoQ to 2.099mn) vs. Qatar's population of 2.656mn (flat YoY, -11.6% QoQ) as of June 2023.
- **Sub growth helps mobile service revenue despite ARPU weakness, especially in prepaid; non-mobile service revenue provides a significant boost.** Quarterly revenue of QR774.9mn (9.9% YoY, -0.1% QoQ) came in 4.1% ahead of our top-line forecast of QR744.2mn. We note that prepaid revenue declined roughly 10% YoY after falling by ~9% YoY in 1Q2023 driven by ARPU decline. During the conference call, management pointed to a declining prepaid market in 1H2023 post the World Cup as certain sectors, mainly construction, came under pressure, along with persistent competitive pricing pressure. However, the company remains positive for 2H2023 as VFQS expects project activity (especially related to O&G and the North Field, along with projects that were put on hold because of the World Cup) and population to bounce back helping boost the mobility segment, especially on the prepaid front. The non-mobile service segment continues to benefit from traction in managed services from projects that commenced in 4Q2022, along with growth in wholesale, fixed and roaming revenue. *For more details on revenue segments, subs and ARPUs, please see table on page 2.*
- **Focus on costs optimization remains evident with VFQS reporting a healthy 2Q2023 EBITDA margin of 40.5% vs. 41.0% in 2Q2022 and 41.3% in 1Q2023.** We were modeling an EBITDA margin of 41.8%. EBITDA of QR314.2mn grew 8.6% YoY but declined 1.9% QoQ and was in-line with our estimate of QR311.1mn (1.0% divergence).
- **Management guidance remains mostly intact for 2023 except a slight moderation in EBITDA margin (a growth of 1-1.5 ppts vs. >1.5 ppts disclosed in January 2023); we maintain our estimates.** Our 2023 earnings estimate of QR536.1mn implies a 6.3% growth to QR276.2mn in 2H2023 net income vs. QR259.8mn in 1H2023.
- **VFQS continues to deliver on its growth metrics; we reiterate our Accumulate rating/price target of QR2.070.** Longer-term, postpaid (~72% of 2Q23 mobile service revenue), 5G, managed services, fixed, broadband, enterprise and bundled ICT solutions should boost growth. While capex levels were elevated due to 5G and WC-related coverage/capacity expansion, dividend and FCF yields should improve in the future.
- **As we had expected in our [report](#), the stock has broken out of its trading range (up 22% YTD) as its dividend yield has finally become compelling – VFQS approved QR0.10 in DPS for 2022 (DY: 5.2%) – and we expect DPS to climb 20% YoY to QR0.12 (DY: 6.2%) this year.** The company's longer-term growth prospects as a 2nd operator in a market of Qatar's size and dynamics (population size of 2.7mn in June 2023, along with a mobile penetration of 171% as of March 2023; VFQS already has revenue market share of 28.5% and subscriber market share of 40.7% as of 1Q2023, with postpaid and prepaid market shares of 41.3% and 40.5%, respectively) is more of an open question. We continue to believe there is some room for improvement (as of 1Q2023, VFQS has an EBITDA margin of 41.3% vs. ORDS' 50.7%, an ARPU of QR74 vs. ORDS' QR93.4, along with 573K high-ARPU/margin postpaid customers relative to Ooredoo's 813K postpaid subscribers). Going forward, as VFQS demonstrates progress in closing some of this gap beyond our modeled expectations, the stock could have more room to run. With FCF yields increasing from 4.3% in 2022 to 11.4% in 2027, we believe there could be upside to DPS, which could also act as a catalyst for the stock.

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	2Q2022	1Q2023	2Q2023	2Q2023e	A Vs. E
<b>Mobile Subscribers (000s)</b>					
Pre-Paid Subs	1,459.0	1,522.0	1,529.0	1,362.2	12.2%
YoY Growth	16.7%	4.0%	4.8%	(6.6%)	
QoQ Growth	(0.3%)	(1.0%)	0.5%	(10.5%)	
Post-Paid Subs	557.0	573.0	570.0	574.7	(0.8%)
YoY Growth	20.2%	4.6%	2.3%	3.2%	
QoQ Growth	1.6%	0.7%	(0.5%)	0.3%	
<b>Total Mobile Subs</b>	<b>2,016.0</b>	<b>2,095.0</b>	<b>2,099.0</b>	<b>1,937.0</b>	<b>8.4%</b>
YoY Growth	17.6%	4.1%	4.1%	(3.9%)	
QoQ Growth	0.2%	(0.5%)	0.2%	(7.5%)	
<b>Mobile ARPU (QR)</b>					
Pre-Paid ARPU	32	29	28	28	0.5%
YoY Growth	(9.2%)	(14.7%)	(11.2%)	(11.6%)	
QoQ Growth	(5.9%)	(12.1%)	(2.1%)	(2.5%)	
Post-Paid ARPU	195	191	190	188	1.1%
YoY Growth	(5.4%)	(2.6%)	(2.8%)	(3.8%)	
QoQ Growth	(0.5%)	(2.1%)	(0.7%)	(1.8%)	
<b>Blended Mobile ARPU</b>	<b>77</b>	<b>74</b>	<b>72</b>	<b>74</b>	<b>(2.7%)</b>
YoY Growth	(4.9%)	(5.1%)	(7.0%)	(4.4%)	
QoQ Growth	(1.3%)	(3.9%)	(3.2%)	(0.5%)	
<b>Mobile Service Revenue (QR mn)</b>					
Pre-Paid Service Revenue	142.4	134.0	128.4	122.3	5.0%
YoY Growth	8.2%	(8.8%)	(9.8%)	(14.1%)	
QoQ Growth	(3.1%)	(17.3%)	(4.2%)	(8.7%)	
Post-Paid Service Revenue	322.7	327.0	326.0	322.9	1.0%
YoY Growth	13.2%	3.2%	1.0%	0.1%	
QoQ Growth	1.8%	(3.0%)	(0.3%)	(1.3%)	
<b>Total Mobile Service Revenue</b>	<b>465.1</b>	<b>461.0</b>	<b>454.4</b>	<b>445.2</b>	<b>2.1%</b>
YoY Growth	11.6%	(0.6%)	(2.3%)	(4.3%)	
QoQ Growth	0.2%	(7.6%)	(1.4%)	(3.4%)	
<b>Other Service Revenue (Managed Services, Broadband, Roaming, Wholesale &amp; Others)</b>					
	<b>153.9</b>	<b>226.0</b>	<b>233.6</b>	<b>218.1</b>	<b>7.1%</b>
YoY Growth	20.8%	53.7%	51.7%	41.7%	
QoQ Growth	4.7%	(11.7%)	3.3%	(3.5%)	
<b>Total Service Revenue (QR mn)</b>					
	<b>619.0</b>	<b>687.0</b>	<b>688.0</b>	<b>663.3</b>	<b>3.7%</b>
YoY Growth	13.8%	12.4%	11.1%	7.2%	
QoQ Growth	1.3%	(9.0%)	0.1%	(3.4%)	
<b>Other Revenue (Incl. Handsets &amp; Hardware Portion of Projects Revenue)</b>					
	<b>86.3</b>	<b>88.9</b>	<b>86.9</b>	<b>80.9</b>	<b>7.4%</b>
YoY Growth	157.0%	(25.7%)	0.7%	(6.3%)	
QoQ Growth	(27.8%)	(34.1%)	(2.2%)	(9.0%)	
<b>Total Revenue (QR mn)</b>					
	<b>705.3</b>	<b>775.9</b>	<b>774.9</b>	<b>744.2</b>	<b>4.1%</b>
YoY Growth	22.1%	6.2%	9.9%	5.5%	
QoQ Growth	(3.5%)	(12.8%)	(0.1%)	(4.1%)	

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INCOME STATEMENT	2QCY22 A	1QCY23 A	2QCY23 A	2Q2023 E	A Vs. E	YoY	QoQ
<i>(In QR mn Unless Specified)</i>							
<b>Revenue</b>	<b>705.329</b>	<b>775.878</b>	<b>774.883</b>	<b>744.199</b>	<b>4.1%</b>	<b>9.9%</b>	<b>-0.1%</b>
<i>YoY Growth (%)</i>	<i>22.1%</i>	<i>6.2%</i>	<i>9.9%</i>	<i>5.5%</i>			
Direct Costs (Interconnection & Other Opex)	(231.248)	(268.365)	(267.706)	(248.563)	7.7%	15.8%	-0.2%
<i>as a % of Total Revenue (%)</i>	<i>32.8%</i>	<i>34.6%</i>	<i>34.5%</i>	<i>33.4%</i>			
<b>Gross Profit (Loss)</b>	<b>474.081</b>	<b>507.513</b>	<b>507.177</b>	<b>495.637</b>	<b>2.3%</b>	<b>7.0%</b>	<b>-0.1%</b>
<i>Gross Margin (%)</i>	<i>67.2%</i>	<i>65.4%</i>	<i>65.5%</i>	<i>66.6%</i>			
Other Expenses (Employee and Other Expenses)	(184.718)	(187.294)	(193.011)	(184.561)	4.6%	4.5%	3.1%
<i>as a % of Total Revenue (%)</i>	<i>26.2%</i>	<i>24.1%</i>	<i>24.9%</i>	<i>24.8%</i>			
Depreciation and Amortization	(157.093)	(158.927)	(157.322)	(163.088)	-3.5%	0.1%	-1.0%
<b>Total Operating Expenses</b>	<b>(341.811)</b>	<b>(346.221)</b>	<b>(350.333)</b>	<b>(347.650)</b>	<b>0.8%</b>	<b>2.5%</b>	<b>1.2%</b>
<b>EBITDA</b>	<b>289.363</b>	<b>320.219</b>	<b>314.166</b>	<b>311.075</b>	<b>1.0%</b>	<b>8.6%</b>	<b>-1.9%</b>
<i>EBITDA Margin (%)</i>	<i>41.0%</i>	<i>41.3%</i>	<i>40.5%</i>	<i>41.8%</i>			
<b>Operating Profit (Loss) - EBIT</b>	<b>132.270</b>	<b>161.292</b>	<b>156.844</b>	<b>147.987</b>	<b>6.0%</b>	<b>18.6%</b>	<b>-2.8%</b>
<i>EBIT Margin (%)</i>	<i>18.8%</i>	<i>20.8%</i>	<i>20.2%</i>	<i>19.9%</i>			
Interest Income	1.704	3.113	2.665	1.946	37.0%	56.4%	-14.4%
Interest Expense/Lease Interest Expense	(11.960)	(17.579)	(20.653)	(19.637)	5.2%	72.7%	17.5%
Other Income/Expense	(13.054)	(13.435)	(12.405)	(12.669)	-2.1%	-5.0%	-7.7%
<b>Profit (Loss) Before Tax</b>	<b>108.960</b>	<b>133.391</b>	<b>126.451</b>	<b>117.627</b>	<b>7.5%</b>	<b>16.1%</b>	<b>-5.2%</b>
<b>Net Profit (loss) - Adjusted</b>	<b>108.960</b>	<b>133.391</b>	<b>126.451</b>	<b>117.627</b>	<b>7.5%</b>	<b>16.1%</b>	<b>-5.2%</b>
<i>Net Margin (%)</i>	<i>15.4%</i>	<i>17.2%</i>	<i>16.3%</i>	<i>15.8%</i>			
<i>Net Profit YoY Growth</i>	<i>60.1%</i>	<i>24.2%</i>	<i>16.1%</i>	<i>8.0%</i>			
<b>EPS (QR)</b>	<b>0.03</b>	<b>0.03</b>	<b>0.03</b>	<b>0.03</b>	<b>7.5%</b>	<b>16.1%</b>	<b>-5.2%</b>

Recommendations		Risk Ratings	
<i>Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price</i>		<i>Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals</i>	
<b>OUTPERFORM</b>	Greater than +20%	<b>R-1</b>	Significantly lower than average
<b>ACCUMULATE</b>	Between +10% to +20%	<b>R-2</b>	Lower than average
<b>MARKET PERFORM</b>	Between -10% to +10%	<b>R-3</b>	Medium / In-line with the average
<b>REDUCE</b>	Between -10% to -20%	<b>R-4</b>	Above average
<b>UNDERPERFORM</b>	Lower than -20%	<b>R-5</b>	Significantly above average

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