

## Vodafone Qatar (VFQS)

Recommendation	MARKET PERFORM	Risk Rating	R-4
Share Price	QR8.25	Current Target Price	QR8.50
Implied Upside	3.0%		

### Modest 3Q2018 Miss; Stay Market Perform

*VFQS reported a moderately lower-than-expected 3Q2018; no major changes to our model and we maintain our rating/PT of Market Perform/QR8.50 given expensive valuation. We continue to like the company's momentum in postpaid (3Q2018 revenue up 36% YoY driven by subs increasing 24% and ARPU growing 8%) fueled 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. Moreover, we continue to forecast resumption in dividends in 2018 after an almost 4-year hiatus; indeed our 2018 DPS forecast of QR0.10 a share could prove to be conservative. Despite these positive moves, profitability metrics remain subdued with ROIC to remain below WACC until at least CY2023. VFQS trades at 10.4x and 8.7x CY2019 and CY2020 EV/EBITDA, respectively, which is markedly more expensive than peers.*

#### Highlights

- **VFQS reports QR26.7mn net profit in 3Q2018, missing our estimate of QR32.1mn.** The company had reported a net loss of QR96.4mn in 3Q2017 and earnings of QR31.2mn (2Q2018).
- **Revenue/EBITDA of QR483.6m/QR141.8mn more in-line with our estimates.** VFQS's 3Q2018 top-line (+13% QoQ/-7% QoQ) was around 6% short of our estimate of QR514.0mn; the 23% reduction in local MTRs from July 1 onward took off QR3.4mn contributing to 11% of the divergence relative to our estimate. EBITDA of QR141.8mn (+45% YoY/-5% YoY; margin: 29.3%) was 6% below QNB FS estimate of QR151.4mn (margin: 29.5%). EBITDA margins improved from 22.8% in 3Q2017 and 28.7% in 2Q2018.
- **Postpaid revenue overtakes prepaid revenue for the first time ever.** Total service revenue was up 11% YoY due to postpaid; but, weakness in primarily prepaid, seasonality and local MTR cuts drove a 5% QoQ decline in service revenue. Postpaid continues its traction despite some softening in ARPUs sequentially with revenue up 36% YoY to QR208mn (subs up 24%/ARPU up 8%). Prepaid remains challenging with top-line down almost 7% YoY to QR202mn (subs down 7%/flattish ARPU) due to postpaid migration, reduction of local MTRs and slowing market trends. While the company noted competitive promotions abated by late September, management is not calling the bottom on the prepaid market yet. Total subs & ARPU were 1,380k (-9k subs YoY, -10k subs QoQ) and QR103 (+ QR12 YoY, -QR5 QoQ), respectively.
- **EBITDA margin came in at 29.3% (QNB FS estimate: 29.5%) but excluding equipment/one-offs EBITDA margins topped 30% for the first time ever at 30.4%.** Reported EBITDA margins were lower at 22.8% in 3Q2017 and 28.7% in 2Q2018. Besides growth in service revenue, recovery from network outage faced last year and costs optimization helped EBITDA margins. Depreciation and amortization for 3Q2018 at QR104.3mn was also 3% lower than our estimate of QR107.1mn; D&A was QR105.9mn in 2Q2018 and QR186.6mn in 3Q2017. 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 QR84mn ensuring sustained bottom-line profitability going forward.
- **We project revenue/EBITDA/net income of QR2.1bn/QR582mn/QR114mn for 2018.** Our forecasts are in-line with management guidance. Our previous estimates were QR2.1bn/QR599m/QR124mn. Our estimate changes basically factor in reported 3Q2018 figures, along with some model tweaks. Beyond 2018, our new forecasts have slight changes.

#### 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 in the 40s range (In 2Q2018, ORDS reported 53% EBITDA margins at a QR2bn quarterly revenue run-rate).

#### Recommendation, Valuation and Risks

- **Recommendation and valuation: We rate VFQS a Market Perform with a PT of QR8.50.** VFQS trades at 10.4x and 8.7x CY2019 and CY2018 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	2,076	2,271	2,464
EPS (QR)	(0.30)	0.14	0.26	0.40
EV/EBITDA	14.1x	12.9x	10.4x	8.7x
Dividend Yield		1.2%	3.0%	4.2%

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)	541.3
Mkt. Cap. (\$ bn/QR bn)	1.9/7.0
EV (\$ bn/QR bn)	2.0/7.5
Shares Outstanding (mn)	845.4
FO Limit* (%)	49.0
Current FO* (%)	6.1
1-Year Total Return (%)	17.4
Fiscal Year End	December 31

Source: Bloomberg (as of October 30, 2018), \*Qatar Exchange (as of October 29, 2018); Note: FO is foreign ownership

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## 3Q2018 Results Show Momentum in Postpaid and Costs Optimization Despite Seasonal Weakness

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- **EBITDA margin came in at 29.3% (QNB FS estimate: 29.5%) but excluding equipment/one-offs EBITDA margins topped 30% for the first time ever at 30.4%.** Reported EBITDA margins were lower at 22.8% in 3Q2017 and 28.7% in 2Q2018. Besides growth in service revenue, recovery from network outage faced last year and costs optimization helped EBITDA margins. Depreciation and amortization for 3Q2018 at QR104.3mn was also 3% lower than our estimate of QR107.1mn; D&A was QR105.9mn in 2Q2018 and QR186.6mn in 3Q2017. 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 QR84mn ensuring sustained bottom-line profitability going forward.

### 3Q2018 Comparisons

In QR mn	3QCY18	3QCY18e	3QCY17	2QCY18	A vs. E	YoY	QoQ
Subscribers (000)	1,381	1,374	1,389	1,390	1%	-1%	-1%
ARPU (QR)	103	109	91	108	-5%	13%	-5%
Revenue	483.6	514.0	429.4	519.3	-6%	13%	-7%
Gross Profit (Loss)	313.3	331.3	263.2	328.6	-5%	19%	-5%
EBITDA	141.8	151.4	97.8	149.0	-6%	45%	-5%
Operating Profit (Loss) - EBIT	37.5	44.4	(88.9)	43.2	-16%	N/M	-13%
Net Profit (Loss)	26.7	32.1	(96.4)	31.2	-17%	N/M	-14%
Gross Margin	64.8%	64.5%	61.3%	63.3%			
EBITDA Margin	29.3%	29.5%	22.8%	28.7%			
EBIT Margin	7.8%	8.6%	-20.7%	8.3%			
Net Margin	5.5%	6.3%	-22.5%	6.0%			
Depreciation and Amortization	(104.3)	(107.1)	(186.6)	(105.9)	-3%	-44%	-1%

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%	3.9%	9.4%	8.5%	4.4%	2.9%	2.2%
Gross Profit	11.4%	1.3%	2.2%	12.0%	11.0%	6.0%	4.4%	3.0%
EBIT	41.4%	33.5%	N/M	83.1%	45.1%	20.9%	13.1%	8.5%
EBITDA	33.8%	16.0%	8.1%	21.5%	18.5%	10.5%	7.2%	4.9%
Net Income	42.2%	31.6%	N/M	95.9%	50.0%	23.4%	16.0%	11.7%
DPS				150.0%	40.0%	14.3%	12.5%	11.1%
CFPS	39.0%	29.6%	12.8%	34.4%	9.9%	10.0%	4.7%	3.4%
FCPS	165.9%	158.8%	-16.3%	163.3%	26.9%	29.2%	22.8%	9.4%
Operating Ratios								
Gross Margin	64.1%	64.0%	63.0%	64.5%	66.0%	67.0%	68.0%	68.5%
EBIT Margin	(11.8%)	(11.2%)	7.6%	12.8%	17.1%	19.8%	21.7%	23.1%
EBITDA Margin	26.1%	26.9%	28.0%	31.1%	34.0%	36.0%	37.5%	38.5%
Net Margin	(13.1%)	(12.8%)	5.5%	9.9%	13.6%	16.1%	18.1%	19.8%
Capex Intensity	15.1%	18.4%	22.0%	20.8%	19.2%	17.6%	14.8%	13.7%
Finance Ratios								
Debt - Equity Ratio	20.3%	18.3%	18.0%	15.0%	14.6%	14.3%	9.4%	3.1%
Net Debt - Equity Ratio	16.7%	13.9%	11.9%	8.4%	6.2%	3.8%	0.2%	(3.8%)
Net Debt-to-Capital	14.3%	12.2%	10.7%	7.8%	5.9%	3.7%	0.2%	(3.9%)
Cash Interest Coverage	19.0x	18.1x	16.8x	17.6x	19.6x	21.7x	27.9x	54.2x
Ave. Effective Borrowing rate %	3.0%	3.6%	4.2%	5.7%	6.0%	6.0%	7.5%	11.8%
Return Ratios								
ROIC	(4.3%)	(4.2%)	2.7%	4.8%	6.7%	8.0%	9.1%	10.2%
ROE	(5.8%)	(5.7%)	2.5%	4.7%	6.9%	8.4%	9.5%	10.3%
ROA	(4.1%)	(4.1%)	1.8%	3.4%	5.0%	6.1%	7.1%	8.1%
Dividend Payout %			74.0%	94.5%	88.2%	81.7%	79.2%	78.8%
Valuation								
EV/Sales	3.8x	3.8x	3.6x	3.2x	3.0x	2.8x	2.6x	2.5x
EV/EBITDA	14.4x	14.1x	12.9x	10.4x	8.7x	7.7x	7.0x	6.5x
EV/EBIT	N/M	N/M	47.5x	25.4x	17.3x	14.1x	12.1x	10.9x
P/E	N/M	N/M	61.1x	31.2x	20.8x	16.8x	14.5x	13.0x
P/BV	1.5x	1.6x	1.5x	1.5x	1.4x	1.4x	1.4x	1.3x
Dividend Yield	0.0%	0.0%	1.2%	3.0%	4.2%	4.8%	5.5%	6.1%
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	0.9x	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
<b>Revenue</b>	<b>2,119</b>	<b>2,059</b>	<b>1,998</b>	<b>2,076</b>	<b>2,271</b>	<b>2,464</b>	<b>2,572</b>	<b>2,647</b>
Direct Costs	(935)	(740)	(719)	(768)	(806)	(838)	(849)	(847)
<b>Gross Profit</b>	<b>1,184</b>	<b>1,319</b>	<b>1,279</b>	<b>1,308</b>	<b>1,465</b>	<b>1,626</b>	<b>1,723</b>	<b>1,800</b>
Other Expenses, Excluding D&A	(784)	(782)	(741)	(726)	(758)	(789)	(797)	(807)
<b>EBITDA</b>	<b>401</b>	<b>537</b>	<b>538</b>	<b>582</b>	<b>707</b>	<b>838</b>	<b>926</b>	<b>993</b>
Depreciation & Amortization	(816)	(780)	(762)	(423)	(417)	(417)	(417)	(417)
<b>EBIT</b>	<b>(415)</b>	<b>(243)</b>	<b>(224)</b>	<b>158</b>	<b>290</b>	<b>421</b>	<b>509</b>	<b>575</b>
Interest Income	0	2	2	5	6	5	7	9
Interest Expense	(19)	(28)	(30)	(35)	(40)	(43)	(43)	(36)
Other Income/Expense	(32)	(0)	(4)	(14)	(32)	(48)	(59)	(69)
<b>Profit Before Tax</b>	<b>(466)</b>	<b>(269)</b>	<b>(256)</b>	<b>114</b>	<b>224</b>	<b>336</b>	<b>414</b>	<b>480</b>
Income Tax Expense								
<b>Profit for Shareholders</b>	<b>(466)</b>	<b>(269)</b>	<b>(256)</b>	<b>114</b>	<b>224</b>	<b>336</b>	<b>414</b>	<b>480</b>
<b>EPS (QR)</b>	<b>(0.55)</b>	<b>(0.32)</b>	<b>(0.30)</b>	<b>0.14</b>	<b>0.26</b>	<b>0.40</b>	<b>0.49</b>	<b>0.57</b>
<b>DPS (QR)</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.10</b>	<b>0.25</b>	<b>0.35</b>	<b>0.40</b>	<b>0.45</b>

Source: Company data, QNBFS estimates

## Detailed Financial Statements

Balance Sheet (In QR mn)	FY2016	FY2017	CY2017	CY2018e	CY2019e	CY2020e	CY2021e	CY2022e
<b>Non-Current Assets</b>								
Property, Plant and Equipment	1,249	1,233	1,202	1,331	1,481	1,631	1,761	1,831
Intangible Assets	5,235	4,782	4,461	4,366	4,270	4,175	4,079	3,984
Trade and Other Receivables	34	25	25	30	34	37	38	39
<b>Total Non-Current Assets</b>	<b>6,518</b>	<b>6,040</b>	<b>5,688</b>	<b>5,726</b>	<b>5,785</b>	<b>5,842</b>	<b>5,879</b>	<b>5,855</b>
<b>Current Assets</b>								
Inventory	13	13	36	15	17	17	18	19
Trade and Other Receivables	330	357	302	336	377	393	418	434
Cash and Cash Equivalents	130	169	199	280	311	406	518	464
<b>Total Current Assets</b>	<b>474</b>	<b>539</b>	<b>536</b>	<b>631</b>	<b>705</b>	<b>817</b>	<b>955</b>	<b>917</b>
<b>Total Assets</b>	<b>6,992</b>	<b>6,579</b>	<b>6,225</b>	<b>6,357</b>	<b>6,490</b>	<b>6,659</b>	<b>6,834</b>	<b>6,772</b>
<b>Equity</b>								
<b>Total Equity</b>	<b>4,923</b>	<b>4,654</b>	<b>4,472</b>	<b>4,586</b>	<b>4,719</b>	<b>4,835</b>	<b>4,943</b>	<b>5,073</b>
<b>Non-Current Liabilities</b>								
Trade and Other Payables	48	50	52	60	68	74	77	79
Provisions	62	114	105	108	123	134	139	143
Long-Term Borrowings	1,023	946	818	827	708	708	708	474
<b>Total Non-Current Liabilities</b>	<b>1,132</b>	<b>1,110</b>	<b>976</b>	<b>995</b>	<b>899</b>	<b>915</b>	<b>924</b>	<b>697</b>
<b>Current Liabilities</b>								
Trade and Other Payables	937	816	777	776	872	909	967	1,002
Short-Term Borrowings	0	0	0	0	0	0	0	0
<b>Total Current Liabilities</b>	<b>937</b>	<b>816</b>	<b>777</b>	<b>776</b>	<b>872</b>	<b>909</b>	<b>967</b>	<b>1,002</b>
<b>Total Liabilities</b>	<b>2,069</b>	<b>1,925</b>	<b>1,753</b>	<b>1,771</b>	<b>1,770</b>	<b>1,824</b>	<b>1,891</b>	<b>1,699</b>
<b>Equity and Liabilities</b>	<b>6,992</b>	<b>6,579</b>	<b>6,225</b>	<b>6,357</b>	<b>6,490</b>	<b>6,659</b>	<b>6,834</b>	<b>6,772</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

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