

MTN Group Limited (MTNJ.J)

Nigeria – Good Outweighs The Bad

- **Buy, R195 TP** — We trim our earnings for MTN (-2.5% on average) incorporating tweaks across the board and the currency impact in Iran. Our forecasts see HEPS up 13.5% in FY 12, and 10.7% pa in the subsequent two years. We believe that the stock's valuation remains justified by its growth outlook and 5.5% DY despite its recent re-rating, and maintain a Buy recommendation. We raise our TP to R195, from R170, which factors in a weaker ZAR and rolling forward of our valuation (p6).
- **Nigeria focus** — As a 40% contributor to group EBITDA, it is worth recapping on where Nigeria stands and our view on the operations. In brief, we highlight the short-term pressures on the underlying business which have been sharper than expected. However, we believe that the business' mid to longer-term outlook should outweigh concerns around current pressures (p5).
 - **The bad** — The underlying business in Nigeria remains under pressure and we expect this to be reflected in MTN's near-term performance there. We expect -2.3% reversal in local currency (LC) EBITDA in FY 12, followed by a further -1.5% decline in '13. This reflects a drop in EBITDA margin to 59.4% in FY 12, (from 61% in '11), falling further potentially to 56.1% in '13 on persistent slower revenue growth and upward cost pressures.
 - **The good** — There are, however, two things to be a little more cheerful about. (i) The LC decline mentioned above is more than offset by reporting currency weakness resulting in EBITDA growth of c10% in FY 12 and '13 in ZAR. (ii) We expect a recovery in even the underlying performance from FY 14 (+9.6% EBITDA in LC) on the basis of increased network capacity, more stable pricing and some margin uplift (slightly up to 56.8% in '14).
- **Valuation** — MTN's recent strength means that its CY 13E EV/EBITDA of 6x (EM 5.7x, Vodacom 7.1x) now sits toward the upper end of valuation comps. However, the company's overall growth picture in the medium-term (+11% pa, FY 12-14E), along with DY as mentioned, underpins MTN's valuation in our view. We would thus view weakness on short-term disappointments as an attractive opportunity to buy the stock.

- Company Update
- Target Price Change
- Estimate Change

Buy	1
Price (15 Feb 13)	R178.48
Target price	R195.00
	from R170.00
Expected share price return	9.3%
Expected dividend yield	5.6%
Expected total return	14.8%
Market Cap	R336,164M
	US\$38,255M

Price Performance (RIC: MTNJ.J, BB: MTN SJ)



MTN Group Limited (ZAR)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (RM)	114,684.0	121,884.0	134,662.0	147,043.1	157,903.0
Net Income (RM)	13,761.0	19,836.0	22,327.4	25,196.1	27,227.1
Diluted EPS (R)	7.47	10.70	12.14	13.76	14.87
Diluted EPS (Old) (R)	7.47	10.70	12.40	14.59	14.97
PE (x)	23.9	16.7	14.7	13.0	12.0
EV/EBITDA (x)	8.1	7.1	6.4	6.0	5.6
DPS (R)	5.00	7.49	8.74	9.90	10.70
Net Div Yield (%)	2.8	4.2	4.9	5.5	6.0

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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MTNJ.J: Fiscal year end 31-Dec						Price: R178.48; TP: R195.00; Market Cap: R336,164m; Recomm: Buy					
Profit & Loss (Rm)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	114,684	121,884	134,662	147,043	157,903	PE (x)	23.9	16.7	14.7	13.0	12.0
Cost of sales	-57,591	-62,581	-68,856	-75,526	-81,127	PB (x)	4.7	3.8	3.6	3.4	3.1
Gross profit	57,093	59,303	65,806	71,517	76,776	EV/EBITDA (x)	8.1	7.1	6.4	6.0	5.6
Gross Margin (%)	49.8	48.7	48.9	48.6	48.6	FCF yield (%)	3.4	2.4	3.2	6.2	7.5
EBITDA (Adj)	41,932	45,790	50,794	53,678	57,496	Dividend yield (%)	2.8	4.2	4.9	5.5	6.0
EBITDA Margin (Adj) (%)	36.6	37.6	37.7	36.5	36.4	Payout ratio (%)	67	70	72	72	72
Depreciation	-13,248	-13,296	-14,470	-16,161	-17,347	ROE (%)	19.8	24.6	24.0	25.5	26.2
Amortisation	-2,152	-2,194	-2,194	-2,194	-2,194	Cashflow (Rm)					
EBIT (Adj)	35,110	38,076	42,817	44,890	48,294	EBITDA	50,510	53,566	59,480	63,245	67,835
EBIT Margin (Adj) (%)	30.6	31.2	31.8	30.5	30.6	Working capital	666	-4,835	-2,478	35	95
Net interest	-4,094	-1,582	-2,850	-1,525	-1,115	Other	-23,421	-16,534	-22,884	-19,553	-19,362
Associates	52	-38	-186	-186	-186	Operating cashflow					
Non-op/Except	-2,973	1,185	547	0	0	Capex	-16,578	-24,099	-23,557	-23,426	-23,981
Pre-tax profit	28,095	37,640	40,328	43,179	46,993	Net acq/disposals	877	3,483	0	0	0
Tax	-11,268	-13,853	-14,848	-14,792	-15,831	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	-2,816	-3,976	-3,452	-3,524	-3,935	Investing cashflow					
Reported net profit	14,011	19,811	22,028	24,864	27,227	Dividends paid	-2,196	-2,647	-2,647	-2,647	-2,647
Net Margin (%)	12.2	16.3	16.4	16.9	17.2	Financing cashflow					
Core NPAT	13,761	19,836	22,327	25,196	27,227	Net change in cash	6,288	3,629	6,736	16,476	20,762
Per share data						Free cashflow to s/holders					
Reported EPS (R)	7.61	10.69	11.98	13.58	14.87		11,177	8,098	10,561	20,301	24,587
Core EPS (R)	7.47	10.70	12.14	13.76	14.87						
DPS (R)	5.00	7.49	8.74	9.90	10.70						
CFPS (R)	15.07	17.37	18.55	23.87	26.52						
FCFPS (R)	6.07	4.37	5.74	11.08	13.42						
BVPS (R)	38.13	47.17	50.06	53.27	56.92						
Wtd avg ord shares (m)	1,842	1,854	1,839	1,832	1,832						
Wtd avg diluted shares (m)	1,842	1,854	1,839	1,832	1,832						
Growth rates											
Sales revenue (%)	2.4	6.3	10.5	9.2	7.4						
EBIT (Adj) (%)	11.1	8.4	12.5	4.8	7.6						
Core NPAT (%)	-1.4	44.1	12.6	12.8	8.1						
Core EPS (%)	-1.0	43.2	13.5	13.3	8.1						
Balance Sheet (Rm)											
Cash & cash equiv.	35,947	45,286	47,571	51,863	58,007						
Accounts receivables	15,692	17,916	19,794	21,614	23,211						
Inventory	1,589	2,629	2,892	3,181	3,499						
Net fixed & other tangibles	63,361	71,610	78,504	83,575	88,016						
Goodwill & intangibles	30,266	34,540	34,720	34,885	35,112						
Financial & other assets	7,931	9,427	6,190	6,381	6,596						
Total assets	154,786	181,408	189,670	201,499	214,440						
Accounts payable	15,774	25,054	24,717	26,861	28,871						
Short-term debt	10,471	10,462	10,462	10,462	10,462						
Long-term debt	24,857	23,554	23,554	23,554	23,554						
Provisions & other liab	29,610	29,639	29,639	29,639	29,639						
Total liabilities	80,712	88,709	88,372	90,516	92,526						
Shareholders' equity	71,855	88,897	94,438	100,599	107,595						
Minority interests	2,219	3,802	6,860	10,384	14,319						
Total equity	74,074	92,699	101,298	110,983	121,914						
Net debt	-619	-11,270	-13,555	-17,847	-23,991						
Net debt to equity (%)	-0.8	-12.2	-13.4	-16.1	-19.7						

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For definitions of the items in this table, please click [here](#).

Earnings revisions

Figure 1. MTN HEPS Forecasts

R/sh	FY 11	FY 12E		FY 13E		FY 14E	
		New	Prev	New	Prev	New	Prev
Citi HEPS	10.70	12.14	12.40	13.76	14.59	14.87	14.97
% change		13.5%		13.3%		8.1%	
Consensus HEPS	10.70	12.10	12.35	13.79	13.83	14.92	14.90
% change		13.1%		14.0%		8.2%	
Citi DPS	7.49	8.74	8.93	9.90	10.50	10.70	10.78
% change		16.7%		13.4%		8.0%	
Consensus DPS	7.49	8.71	8.95	9.93	9.99	10.95	11.13
% change		16.3%		14.0%		10.3%	

Source: I-Net Consensus, Citi Research Estimates

We have trimmed our medium-term forecasts for MTN by c2.5% on average. This includes tweaks across the board but mainly driven by downgrades to Iran on currency devaluation and concerns around the growth outlook there; a weaker ZAR provides some offset more generally.

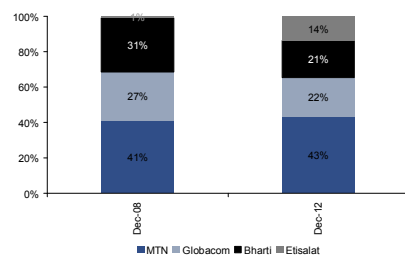
Our total DPS forecast of R8.74 for FY 12 implies a payout of 72% as guided by the company, and final dividend of R5.53/sh. MTN's FY12 (Dec) results are due on 6-Mar-13.

Mulling Nigeria – Near-term could disappoint

Nigeria is key market for MTN contributing c30% of group revenue, c40% to EBITDA and free cash flow (on our estimates). The environment in the country has become more difficult in the past year, with intensifying competition having been compounded by political and other upheavals. Against this backdrop, it is worth re-looking at Nigeria given its importance in investment case for MTN.

We refer to the [report on Indian telco Bharti](#) from 11-Dec-12, which included an in-depth look at the telecom environment in various African countries including Nigeria. We borrow from that report here, and highlight some of the main findings and what it could mean for MTN. Most of these factors speak to the pricing environment in Nigeria which is likely to remain quite difficult for now.

Figure 2. Market Share In Nigeria



Source: Nigerian Communications Commission

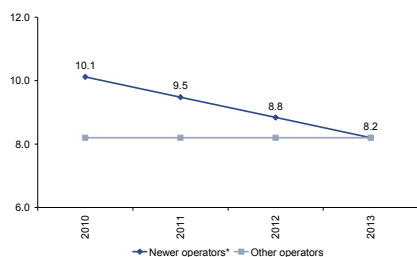
Market share – dominance double-edged sword

MTN, as the market leader in Nigeria with a 44% share (Nigeria Communications Commission), has more to lose to aggressive operators aiming to grab share. Etisalat has been the principal aggressor and enjoyed good momentum in market share gains with Bharti faring the worst in the four years to Dec-12 (Figure 2). MTN has actually gained market share overall, however, demonstrating the positive side of being market leader.

- **For MTN:** While Bharti has struggled in Nigeria MTN has managed to hold its own. A benefit of being the largest player is the ability to push on-net traffic which helps both market share retention and profitability. MTN has done this well with the on-net strategy; though, at more than 80%, this lever may have largely been exhausted.
- **Strapline:** MTN will need to compete more “directly” with other operators to defend its market share meaning a fuller extent of the pricing pressures will be felt. Despite having defended its market share in the past, the company's topline

has been affected by the aggressive price cuts (lower on-net tariffs mainly for MTN) of the past 12-18 months. Indeed MTN had to cut its tariffs by more than 25% during last year to better align its off-net offering with competitors and stem market share losses; this has been reflected in off-net traffic starting to increase. It means pricing pressure will continue for the time being

Figure 3. Nigeria MTR, NGN



Source: Citi Research

Interconnect – now a more level playing field

The current interconnect regime (since Dec-09) had newer operators, those operating for less than four years, receive higher MTR than more established ones. MTR asymmetry has thus made it a little easier for newer operators such as Etisalat, the beneficiary in chief, to gain market share. The final cut in the asymmetric MTR glide path happened in Dec-12, resulting in a more level playing field for all the operators on this front. There is a possibility of further changes to the MTR environment, though this remains uncertain at this stage.

- **For MTN:** As indicated earlier MTN relied on aggressive on-net pricing to bolster on-net traffic, managing to defend its market share (and profitability) to a better extent than its competitors. As the efficacy of this tool has started to somewhat subside, MTN is at least now better positioned to compete on off-net pricing as well. The price cuts last year, as mentioned, form part of this. A reversal in traffic patterns (in favour of off-net) does, however, have a negative effect on profitability.
- **Strap-line:** A positive for MTN in terms of the pricing environment. It reduces the scope of beneficiaries of asymmetry to cut prices more aggressively than more established players like MTN, which supports the argument for pricing stability.

Pricing could be stabilising

MTN has admitted that prices have dropped more rapidly than expected over the past two years; the company has generally been relatively slow in its response to changes in the pricing environment. As noted, however, MTN cut tariffs by around 25% midway through 2012 which has brought pricing more in line with peers.

The pace and severity of price decline – for instance, MTN's effective price per minute is down more than 45% since 2010 – could also see the pricing environment start to stabilise. This notion is given credence by the strain of network capacity generally in Nigeria (see the next section), which makes it difficult to cut prices further and stimulate more traffic.

- **For MTN:** Network capacity pressure is a bigger problem for MTN than its peers. This means that the company is unable to cut prices much more anyway without further undermining network quality. The regulator has actually thrown MTN a lifeline by banning promotional activity by all the operators in Nigeria towards the end of 2012. This has given the company some breathing space to address its network capacity issue. We may thus see some stability in the pricing environment.
- **Strap-line:** Last year's tariff cuts should still weigh on H2 12 and H1 13 but the benefit of volume growth (subscribers and traffic) should be more magnified in MTN's performance going forward.

Regulatory heat = continued capex

The Nigerian regulator has been vocal and active in intervening when network quality has not been up to scratch. In the past 12 months, operators were fined for not meeting quality KPI's and nearly banned from connecting new SIM's. As mentioned, operators are presently prohibited from promotional activities until network quality has improved.

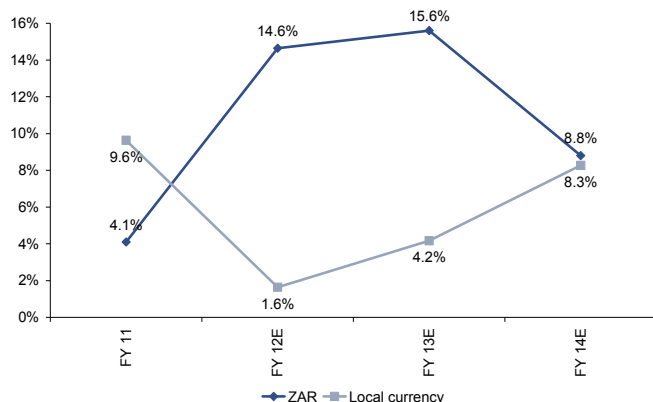
- **For MTN:** As mentioned, MTN is further behind the curve in terms of network capacity relative to other operators in Nigeria. The current state of affairs (all players being sanctioned) thus suits MTN best. If network quality does not improve, however, then MTN could face a higher risk of censure.
- **Strap-line:** MTN's capex in Nigeria will continue. We factor in R10.6bn (\$1.2bn) for FY 12 and expect a similar level of spend in FY 13. Management is confident of having caught up by mid-2013 which will be important in the company preserving its competitive position.

But what's the good news?

Our research over the past year has sounded some caution over near-term prospects in Nigeria due to some of the factors discussed above, compounded by difficult consumer conditions and unrest in the country. The dip may be actually happening a little sooner than anticipated.

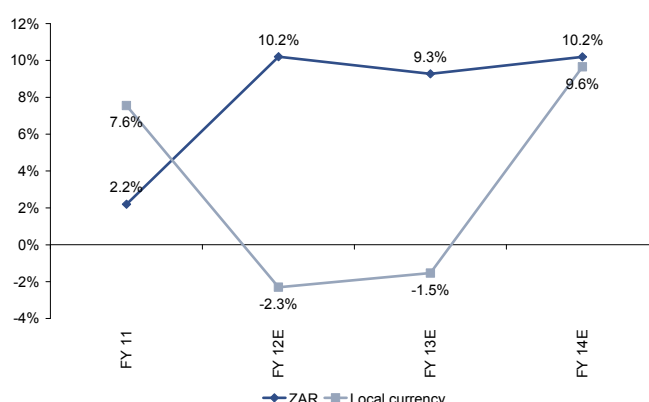
MTN, however, can point to few saving graces that should enable the company to sustain its growth over the medium to longer-term. These include: (i) relatively low penetration in Nigeria of c55%, which underpins the growth outlook, particularly in a more stable pricing environment; (ii) ZAR depreciation which, on our forecasts, offsets Nigeria's current weak underlying performance and could provide a boost in future years if/when there is an underlying recovery; (iii) prospects of a more favourable macro and consumer environment over the longer-term.

Figure 4. MTN Nigeria Revenue Growth Trends, ZAR vs Local Currency



Source: Company Data, Citi Research Estimates

Figure 5. MTN Nigeria EBITDA Growth Trends, ZAR vs Local Currency

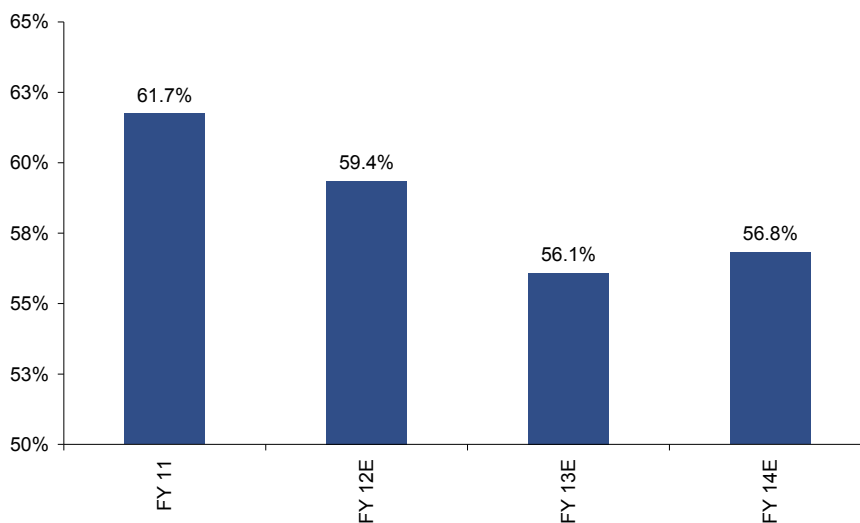


Source: Company Data, Citi Research Estimates

Figure 4 illustrates MTN Nigeria's y-y revenue growth in ZAR and local currency. As shown, we expect local currency growth to slow to +1.6% in FY 12 (implies reversal in H2) in local currency but factor in growth of 14.6% in ZAR boosted by an estimated 12.5% depreciation of the ZAR against the Naira. Underlying growth may start picking up again in FY 13 (+4.2%) on more stable pricing and increased network capacity and accelerate into FY 14. The ZAR trend in Figure 4 shows the additional boost from currency on current Citi forecasts.

Figure 5 shows local currency and ZAR trends for MTN Nigeria's EBITDA growth. Note that we expect EBITDA to decline in FY 12 and '13 in local currency, which is more than offset by ZAR weakness on translation. We think EBITDA growth could potentially rebound (+9.6%) in FY 14 on a local currency basis, boosted by some margin recovery.

Figure 6. MTN Nigeria EBITDA Margin Profile



Source: Company Data, Citi Research Estimates

In addition to a slower topline, Nigeria margins are also being squeezed by cost pressures and shifts in traffic trends (increased off-net). We thus expect EBITDA margin to dip below the 60% mark for FY 12 and slip further to 56.1% in FY 13 before possibly climbing again in FY 14. Our FY 12 assumption infers a margin of 58.3% in H2.

To recap, therefore, we caution that Nigeria's near-term performance (underlying) is likely to be softer; particularly the implied second half of FY 12 and H1 13. The upside, however, is that ZAR weakness should help rescue the reported performance in the period and that the underlying performance should ultimately recover in our view.

Valuation

We raise our target price for MTN to R195/sh (rounded), from R170, and retain a Buy rating on the share. The increase stems mainly from rolling forward of our valuation (including currency, a key factor) and streamlining of our DCF resulting in an aggregate WACC of 12.2%, down from c13%. The latter involved factoring in more standardised assumptions in our SOTP DCF. SA inputs now form the basis of our assumptions (as the head office and reporting country) for each of the other markets with the main difference being in the equity risk premium.

Figure 7. MTN DCF Valuation

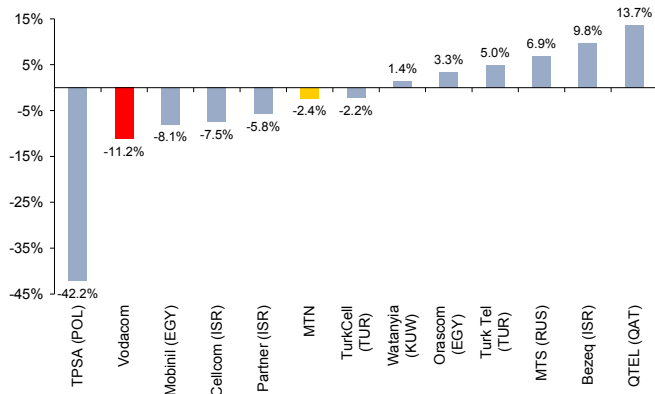
	WACC	Terminal Growth	Propn Valn, Rm	Valn % of total	EV/EBITDA '13E	EV/EBITDA '14E
South Africa	10.8%	2.0%	100,749	29%	6.6	6.4
Nigeria	12.5%	3.0%	131,618	38%	6.4	5.8
Ghana	13.2%	3.0%	18,202	5%	5.9	5.5
Iran	13.2%	3.0%	18,536	5%	6.1	5.8
Syria	13.2%	3.0%	4,964	1%	5.2	5.5
Other	12.5%	3.1%	68,166	20%	6.2	5.7
TOTAL			342,234		6.4	6.0
Consolidated net (debt)/cash			17,847			
Valuation - equity (Rm)			360,082			
Per share (R/sh)			190.88			

Source: Citi Research Estimates

The nearly 10% run in the MTN share price since early Dec-12 means that the stock's valuation sits slightly higher in the peer group comps. For instance the stock's CY 13E EV/EBITDA of 6x is a slight premium to the overall EM aggregate, and sits at the higher end of CEEMEA comps.

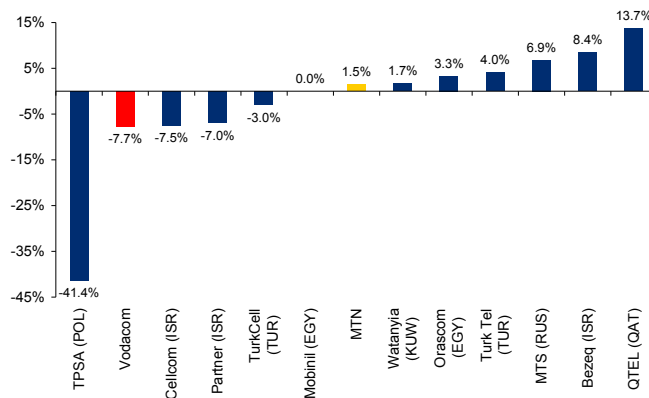
In our view, however, this is substantiated by the stock's superior growth outlook coupled with an attractive DY of 5.5%. The upcoming results could potentially contain elements the market might perceive as disappointing (along the lines of our earlier discussions). We would look to any consequent potential share weakness as stronger motivation to Buy the stock.

Figure 8. CEEMEA Share Price Performances, YTD USD



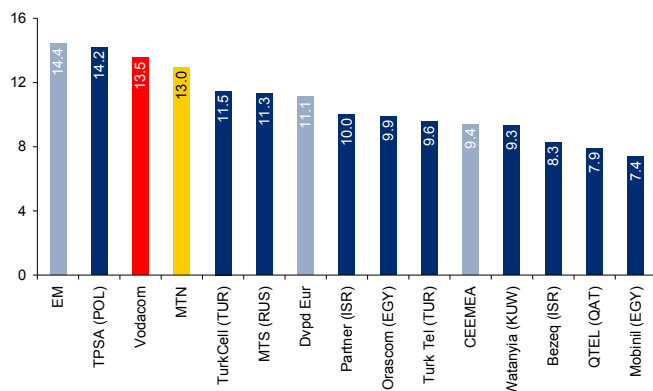
Source: dataCentral, Citi Research

Figure 9. CEEMEA Share Price Performances, YTD Local Currency



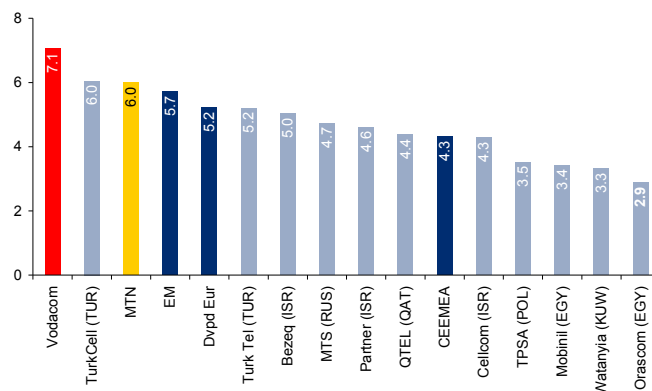
Source: dataCentral, Citi Research

Figure 10. CEEMEA PE Comparisons, CY 13E



Source: dataCentral, Citi Research

Figure 11. CEEMEA EV/EBITDA Comparisons, CY 13E



Source: dataCentral, Citi Research

Companies Mentioned: Bezeq (BEZQ.TA; NIS4.63; 1); Cellcom Israel Ltd. (CEL.TA; NIS28.21; 3); Mobinil (EMOB.CA; E£139.01; 1); Mobile Telesystems OJSC (MBT.N; US\$20.06; 1); Wataniya Telecom (NMTC.KW; KWKD2.380; 1H); Orascom Telecom (ORTEq.L; US\$3.23; 1H); Partner Communications Co Ltd (PTNR.TA; NIS20.85; 3); Qatar Telecom (QTEL.QA; QR118.20; 1); Turkcell (TCELL.IS; TL11.20; 1); Telekomunikacja Polska SA (TPSA.WA; ZL7.10; 3); Türk Telekomünikasyon AS (TTKOM.IS; TL7.14; 2); Vodacom Group Limited (VODJ.J; R113.49; 3)

MTN Group Limited

Company description

MTN is the No2 cellular operator in South Africa, with 35% of the market and 16.4 million subscribers in South Africa. The total number of subscribers spread over Nigeria, and other sub-Saharan African and Middle East countries has reached over 108m. MTN has a 77% free float, making it a highly liquid share. MTN South Africa is generating significant cash flow, which is allowing the group to pursue expansion options throughout the Middle East and Africa.

Investment strategy

We rate MTN Group Buy. MTN has been a strong operator, and on an operational basis despite facing tough competition in its various markets. MTN faces increasingly maturing markets, which means having to work harder to generate growth; Nigeria remains key and still offers some impetus on subscriber growth over the medium-term albeit under some pressure at the moment. Some of MTN's other markets are also rebounding from a difficult spell of aggressive competition and could aid medium-term growth.

MTN is a strong cash generator and should be able to at least maintain and potentially increase its dividend payout and/or continue with share buybacks. Overall, the stock offers an appealing package of above average growth and dividend.

Valuation

Mobile telecommunication companies are generally strong operational cash generators. In our valuation approach, we use discounted cash flow analysis to arrive at the valuation of MTN. In the forecast of cash flows, provision is made for ongoing or maintenance capital expenditure, which we believe is a necessary cost of ongoing operations. While in its growth phase, depreciation is seldom as high as the maintenance capex charge when the network is fully rolled out. This is true in MTN's case, as South African operations will require significant maintenance capex even when the network reaches its capacity. Our target price of R195 is based on the sum-of-the-parts valuation of each of MTN's geographic operations on a DCF basis.

Risks

We would highlight the market risk associated with extensive investment in operations outside of South Africa, and the high forecast risk of operations in markets with little third-party knowledge on which to base our assumptions. If the impact of these risks is greater than we anticipate, then the share price might not reach our target price. On the other hand, we believe that MTN might continue to post strong earnings growth and that the market continues to value the stock as a momentum play, rather than on its free cash flow and risk fundamentals. This could cause the share price to rise above our target price. Furthermore, the high risk that we anticipate may manifest itself in a one-off event, either positive or negative. In particular, MTN faces litigation risk in some of its markets including Iran and Nigeria, which may or may not result in cash outflows.

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