29 June 2012 | 19 pages

Vodacom Group Limited (VODJ.J)

Losing Its Voice

- Company Update
- Target Price Change
- Estimate Change

- **Seeds for the early bird** — In The Early Bird Catches The Worm - Sell, we argued that VOD, could come under pressure on consumer and competition challenges in SA; Cell C's recent voice tariff cuts (Figure 2) offer evidence of the latter. While the share (-15% since Apr) has started to reflect this, we think there could be further downside.
- **What can happen when competition heats up** — Israeli telco's provide a recent example of the potential destruction when competition rises. In 1H11, the regulator cut MTR's by 74%, reduced contract cancellation fees and issued new 2 MNO licenses (see p4). As operators slashed prices, the aftermath reads as follows: ARPU's and service rev's, -30%; EBITDA margin, -10ppts (qly) and share prices, -77%. All this in the space of the past 18 months, and even before the new MNO's launched in May-12.
- **So what about SA?** — It is unlikely to be as severe for Vodacom as the Israeli developments were particularly aggressive. We have already started factoring stronger price erosion in voice, but look at some scenarios using estimated billed outgoing minutes for Vodacom SA where our base case assumes a price decline of 20% on this basis for FY13. Roughly, the downside to our base-case EBITDA for Vodacom SA could be as much as 25% if we factored in the full extent (-45%) of Cell C's cuts to headline tariffs (Figure 8). This is before making any market share assumptions, where a 5% loss could on its own result in c5% downside to our SA EBITDA (Figure 9).
- **Earnings** — We cut our earnings estimates by an average of 5%, forecasting +10% in FY13E, and -7% in '14E. Our HEPS are c15% below consensus.
- **Don't wait** — European telco share prices started falling before the impact of competition was felt, and despite high DY's (Figure 15). The yield argument in favour of VOD may thus be insufficient to support the share, and we expect further downside as the impact of competition is reflected in results over the coming year. For the "early bird", however, the lessons from Europe suggest that it does not pay to wait for this.
- **Remain Sellers** — We reiterate our Sell rating on VOD and cut our DCF-TP to R80 from R85, implying an EV/EBITDA of 5.8x (FY13E). VOD currently remains expensive relative to peers: its CY12E EV/EBITDA of 6.2x compares to the CEEMEA avg of 3.8x, and PE of 12.1x is against 7.4x.

Sell	3
Price (28 Jun 12)	R93.75
Target price	R80.00
from R85.00	
Expected share price return	-14.7%
Expected dividend yield	7.6%
Expected total return	**-7.1%**
Market Cap	R139,496M
	US$16,524M

Price Performance (RIC: VODJ.J, BB: VOD SJ)

Vodacom Group Limited (ZAR)

Year to 31 Mar	2011A	2012A	2013E	2014E	2015E
Sales (RM)	61,197.0	66,929.0	65,315.1	65,741.9	68,914.3
Net Income (RM)	9,626.0	10,374.0	11,847.1	11,049.0	11,405.0
Diluted EPS (¢)	656	709	810	755	780
Diluted EPS (Old) (¢)	656	719	804	794	na
PE (x)	14.3	13.2	11.6	12.4	12.0
EV/EBITDA (x)	7.3	6.4	6.1	6.3	6.1
DPS (¢)	460	710	710	710	710
Net Div Yield (%)	4.9	7.6	7.6	7.6	7.6

Thato Motlanthe
+27-11-944-0834
thato.motlanthe@citi.com

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

VODJ.J: Fiscal year end 31-Mar — Price: R93.75; TP: R80.00; Market Cap: R139,496m; Recomm: Sell

Profit & Loss (Rm)	2011	2012	2013E	2014E	2015E
Sales revenue	61,197	66,929	65,315	65,742	68,914
Cost of sales	-27,600	-30,368	-29,989	-30,537	-32,376
Gross profit	33,597	36,561	35,326	35,205	36,538
Gross Margin (%)	54.9	54.6	54.1	53.6	53.0
EBITDA	**20,594**	**22,838**	**24,080**	**23,487**	**24,257**
EBITDA Margin (%)	33.7	34.1	36.9	35.7	35.2
Depreciation	-4,515	-5,022	-5,372	-5,742	-5,944
Amortisation	-840	-935	-1,000	-1,069	-1,106
EBIT	**15,239**	**16,881**	**17,708**	**16,677**	**17,207**
EBIT Margin (%)	24.9	25.2	27.1	25.4	25.0
Net interest	-755	-639	-277	-392	-387
Associates	0	0	0	0	0
Non-op/Except	-1,846	-309	0	0	0
Pre-tax profit	**12,638**	**15,933**	**17,431**	**16,286**	**16,820**
Tax	-4,659	-5,730	-5,526	-5,163	-5,332
Extraord./Min.Int./Pref.div.	266	-47	-58	-74	-83
Reported net profit	**8,245**	**10,156**	**11,847**	**11,049**	**11,405**
Net Margin (%)	13.5	15.2	18.1	16.8	16.5
Core NPAT	9,626	10,374	11,847	11,049	11,405
Per share data	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Reported EPS (¢)	562	694	810	755	780
Core EPS (¢)	656	709	810	755	780
DPS (¢)	460	710	710	710	710
CFPS (¢)	1,140	1,333	1,280	1,313	1,335
FCFPS (¢)	694	816	658	732	750
BVPS (¢)	1,064	1,267	1,354	1,387	1,445
Wtd avg ord shares (m)	1,468	1,463	1,463	1,463	1,463
Wtd avg diluted shares (m)	1,468	1,463	1,463	1,463	1,463
Growth rates	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Sales revenue (%)	4.5	9.4	-2.4	0.7	4.8
EBIT (%)	4.3	10.8	4.9	-5.8	3.2
Core NPAT (%)	27.3	7.8	14.2	-6.7	3.2
Core EPS (%)	28.9	8.1	14.2	-6.7	3.2
Balance Sheet (Rm)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Cash & cash equiv.	870	3,781	1,922	1,891	1,891
Accounts receivables	10,773	11,379	10,923	10,812	11,334
Inventory	799	832	812	817	857
Net fixed & other tangibles	22,271	24,907	27,608	29,307	30,828
Goodwill & intangibles	5,215	5,123	5,123	5,123	5,123
Financial & other assets	1,507	2,208	2,201	2,195	2,188
Total assets	**41,435**	**48,230**	**48,590**	**50,145**	**52,220**
Accounts payable	10,292	12,438	11,603	11,890	12,566
Short-term debt	3,114	2,413	1,663	4,663	1,663
Long-term debt	7,280	9,012	7,758	4,758	7,522
Provisions & other liab	4,569	5,437	7,295	8,005	8,717
Total liabilities	**25,255**	**29,300**	**28,319**	**29,316**	**30,468**
Shareholders' equity	15,622	18,530	19,812	20,296	21,137
Minority interests	558	400	458	532	615
Total equity	**16,180**	**18,930**	**20,270**	**20,829**	**21,752**
Net debt	**9,524**	**7,644**	**7,499**	**7,530**	**7,294**
Net debt to equity (%)	58.9	40.4	37.0	36.2	33.5

Valuation ratios	2011	2012	2013E	2014E	2015E
PE (x)	14.3	13.2	11.6	12.4	12.0
PB (x)	8.8	7.4	6.9	6.8	6.5
EV/EBITDA (x)	7.3	6.4	6.1	6.3	6.1
FCF yield (%)	7.4	8.7	7.0	7.8	8.0
Dividend yield (%)	4.9	7.6	7.6	7.6	7.6
Payout ratio (%)	70	100	88	94	91
ROE (%)	56.2	59.5	61.8	55.1	55.1
Cashflow (Rm)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
EBITDA	20,594	22,838	24,080	23,487	24,257
Working capital	475	1,423	-354	404	110
Other	-4,338	-4,756	-5,007	-4,678	-4,831
Operating cashflow	**16,731**	**19,505**	**18,720**	**19,213**	**19,536**
Capex	-6,548	-7,568	-9,088	-8,504	-8,559
Net acq/disposals	-24	-23	0	0	0
Other	-9	-411	-176	-176	-176
Investing cashflow	**-6,581**	**-8,002**	**-9,264**	**-8,679**	**-8,735**
Dividends paid	-5,283	-7,947	-10,565	-10,565	-10,565
Financing cashflow	**-10,119**	**-8,556**	**-11,315**	**-10,565**	**-13,565**
Net change in cash	**-84**	**2,947**	**-1,859**	**-31**	**-2,764**
Free cashflow to s/holders	**10,183**	**11,937**	**9,631**	**10,709**	**10,977**

For further data queries on Citi's full coverage universe please contact CIRA Data Services Europe at CIRADataServicesEMEA@citi.com or +44-207-986-4050
For definitions of the items in this table, please click here.

Powered by: dataCentral

In our view, the main supports to Vodacom's valuation have been (a) doubts about a meaningful increase in (especially voice) competition and therefore the expectation of earnings stability, and (b) its dividend yield. Recent developments suggest that *(a)* no longer holds, and past experiences have shown that *(b)* is not enough in the absence of *(a)*. Vodacom's share price has started to reflect this (-15% in the past three months), but we think there could be further downside. Sell, R80 TP (from R85).

Figure 1. CEEMEA Valuation Comp Table, CY

Company	Country	PE (x)			EV/EBITDA (x)		
		2011	2012	2013	2011	2012	2013
Bezeq	Israel	4.6	5.7	6.1	3.3	3.8	4.1
Cellcom Israel	Israel	2.6	4.1	5.2	2.6	3.4	3.7
Partner Comm	Israel	4.8	4.3	5.7	3.3	3.4	3.7
Telefonica O2 Czech	Czech Rep	10.3	10.2	9.5	4.5	4.6	4.4
Mobinil	Egypt	7.5	7.1	6.1	3.5	3.2	2.9
Orascom Telco	Egypt	3.5	2.6	4.7	3.9	3.3	2.5
Magyar Telekom	Hungary	9.7	8.9	7.5	3.5	3.5	3.7
Wataniya Telco	Kuwait	10.6	10.4	8.6	3.7	3.5	3.0
Telekom Polska	Poland	10.1	9.7	17.3	3.6	3.6	4.3
QTEL	Qatar	7.5	6.4	7.1	4.9	4.1	4.1
Mobile Telesystems	Russia	11.5	10.1	9.6	4.5	4.3	4.2
VimpelCom	Russia	6.7	6.9	5.2	3.6	3.5	3.3
Turk Telekomunik	Turkey	11.0	9.4	9.2	4.9	5.1	5.0
Turkcell	Turkey	14.0	10.6	9.0	5.6	5.0	4.6
CEEMEA AVERAGE		**7.8**	**7.4**	**7.7**	**3.9**	**3.8**	**3.8**
EM AVERAGE		**14.4**	**12.9**	**11.1**	**5.6**	**5.3**	**5.0**
DVPD EUROPE AVERAGE		**10.0**	**9.6**	**9.1**	**4.6**	**4.9**	**4.9**
MTN Grp Ltd	SA	11.1	11.2	10.3	5.0	4.8	4.2
Vodacom Grp	SA	13.6	12.1	12.3	6.7	6.2	6.3

Source: CIRA Estimates

The game's begun, with Cell C dishing out the Aces

Competition happening sooner than expected

In The Early Bird Catches The Worm – Sell (16/04/12), we stressed our concerns around Vodacom's outlook given (i) a tough consumer environment, (ii) a maturing sector, and (iii) rising competition, with Cell C as the wildcard. With Cell C's recent raft of voice tariff cuts — we touched on in our notes from 18-May and 21-May — point (iii) is playing out sooner than expected, and in earnest, with Cell C introducing material reductions in headline tariffs in the voice space for just about the first time in the industry's history. This introduces a fresh threat to Vodacom's voice revenues which make up c60% of SA service revenues.

Figure 2. Cell C Moving, Shaking…

16May - Introduces new per sec, flat-rate, all-net, anytime tariffs in prepaid at 99c/min. Implied cut of as much as 65% on peak cross-net rates
29May - Announces per sec, flat-rate, anytime international non-VoIP call rates at 99c/min. Implied cut is upward of 75% to normal rates.
6Jun - Plans new per sec flat-rate, all-net, anytime postpaid tariffs at 99c/min (packages incl 'free' SMS' and data bundles. Implies at least 40% discounts vs prevailing voice cross-net peak rates
22Jun - Follows 8ta in introducing special tariff plan for Blackberry users. Plans start at R27/mo for reduced BIS services incl access to social n/works and internet. Normal package at R59/mo
All the above in addition to ongoing data price cuts and promotions

Source: CIRA

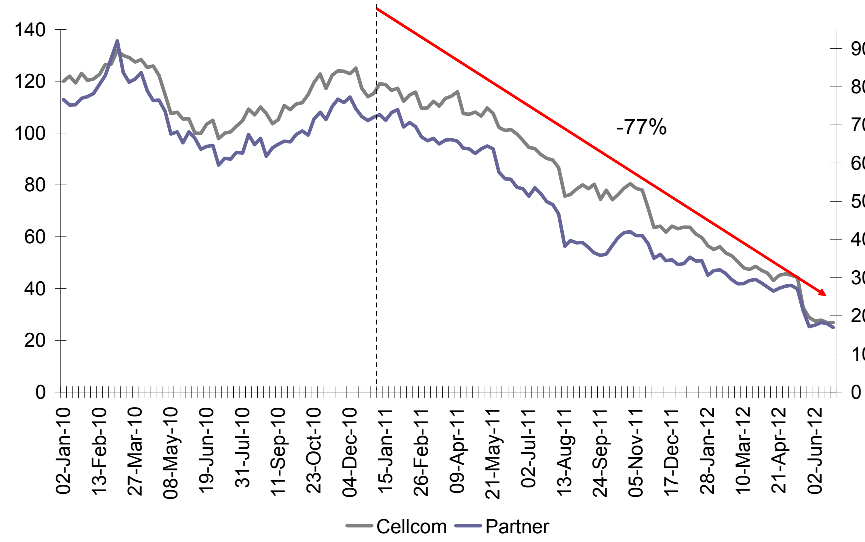
Pricing environment promises to get more competitive, with government also potentially playing a role

Ominously for Vodacom, Cell C's commentary suggests that this may only be the start of things to come over the next year or two and that the company (Cell C) will lobby for further MTR reductions over the next few years to help bring prices down further. As if that weren't enough, the Communications Ministry has also weighed in and urged telco's in SA to further cut voice and data prices with a warning that it would otherwise look at having the regulator force these down.

We expect Vodacom and MTN to follow Cell C's lead at some point, if not necessarily exactly match the price cuts suggesting that the leading incumbents' path ahead could feature both price and market share erosion. This has in fact been the experience in various European markets when the competitive ante has been upped.

Following Israel's footsteps

Figure 3. Share Price Performance of Israeli Telco's, Cellcom and Partner (NIS)



Source: Powered by dataCentral.

Israel offers an extreme example of what can happen when competition heats up

Israel offers a contemporary example of what can happen in a telecom market when competition increases. We have borrowed from some of the analysis in a 7-July-2011 report on Israeli telecoms, where our analyst highlighted the plight of telcos in that market given a sharp rise in competition. Figure 4 summarises some of the similarities we see between the SA and Israeli telecom markets, where the latter is probably ahead by around 12 months in terms of the impact on telcos.

Figure 4. Telecom Market Dynamics – South Africa's Parallels With Israel

	Israel	South Africa
No/weak competition	Pre-2010 competition was weak, market share of Partner (#3 telco) flat at 32% for eight years, service rev grew 10% pa, ARPU only declining 5% in the 5 years to 2010, EBITDA margin from 31-39% betw '05-10.	VOD service revs +8.5% p.a '07-10; EBITDA margin up from 34.4% to 37.3%
Regulatory/competitive intervention	Regulator steps in slashing MTR by 74% in Jan-11; cancels early contract exit fees; 2 MVNOs to launch in H211; prospect of 2 new MNOs for 2012.	2010 regulator legislates glide path that will see MTR fall 55% by 2013. Cell C hires Alan Knott-Craig as new CEO (2012) - not quite a new competitor, but may as well be. Interventions and changes not quite as aggressive as Israel, but quite significant for SA.
Operator behaviour	Incumbent operators slashed prices even before new competitors arrive; trend to unlimited fixed-price voice, SMS and data plans - lines between data and voice blurred, MOU and APPM become less relevant.	Lagging Israel by about a year; no real response initially but competition has heated up in the past 12-18months (promo's etc); now more aggressive in H112 as Cell C launches various 'game changing' per second billing 99c/min flat call rate products across its prepaid, contract and international offerings - slashing headline voice tariffs by upward of 45%; VOD introduces similar promo's in prepaid (not per sec); first time market sees aggressive cuts to headline voice tariffs; also change in packaging (flat rate, all-net, anytime, eliminates out of bundle rates etc), a step in the "Israel direction
Impact	ARPUs have dropped more than 30% in the past year; service revenues -30%; EBITDA margin -10ppts. Share prices….-77%!	VOD SA ARPU was already softening -17% in 12m to Q112 (R144), partly on lower MTR; -15% excl interconnect revs; we think the worst is yet to be seen in '13-14 as new voice pricing developments take effect.

Source: CIRA

Israel's developments have been much more severe than SA

The intensifying of competition in Israel has resulted in quarterly ARPU's and service revenue falling by more than 30% over the course of the past year; EBITDA margin has also somewhat collapsed, falling in the region of c10ppts since Q4 10. It is important to note that the measures and developments seen in Israel happened more quickly and aggressively than in SA, as described in Figure 4 comparisons (eg immediate 74% cut in MTR, scrapping of contract cancellation fees and unlimited use fixed-price offerings).

… But offers a glimpse of what could lie in store for SA telco's

Another difference is that MOUs in Israel were already toppish (in excess of 300 minutes) whereas SA (Vodacom, 114 minutes) still has some upside, which could help cushion ARPU erosion. Nevertheless, the Israel example offers a glimpse of what could lie in store for SA telco's, at least to some extent, over the next couple years, in our view. We had already factored in some decline in voice pricing for Vodacom over the medium-term, but Cell C's moves suggest that it could be sharper (and quicker) for Vodacom than even we anticipated.

Market may be optimistic on earnings

Our HEPS are up to 15% below consensus

In light of the above, we believe that consensus earnings forecasts for Vodacom may be optimistic. The revisions we make in this report, and laid out in Figure 5, put our medium-term forecasts as much as c15% below consensus after FY 13.

Figure 5. Vodacom HEPS Forecasts

	FY 12	FY 13E		FY 14E		FY 15E	
R/sh		New	Prev	New	Prev	New	Prev
Citi HEPS	**7.09**	**8.10**	**8.04**	**7.55**	**7.94**	**7.80**	**-**
% Change, y-y		14.2%		-6.7%		3.2%	
Consensus HEPS	**7.09**	**8.26**	**8.03**	**8.76**	**8.81**	**9.28**	**-**
% Change, y-y		16.5%		6.1%		5.9%	
Citi DPS	**7.10**	**7.10**	**6.91**	**7.10**	**7.05**	**7.10**	**-**
% change, y-y		0.0%		0.0%		0.0%	
Consensus DPS	**7.10**	**7.68**	**6.62**	**8.27**	**7.14**	**8.67**	**-**
% change, y-y		8.2%		7.7%		4.8%	

Source: CIRA Estimates, I-Net Consensus. *As at 16-Apr*

We continue to forecast a reversal in earnings in FY 14

Our FY 13E HEPS now sits at R8.10/sh, a slight increase of 1% on our previous estimate, and reflecting growth of 14.2% y-y. Remember that this is boosted by the change in accounting for STC to a dividend withholding tax regime, as well as a reduction in finance costs on our estimates. We expect earnings growth at the EBITDA level to be slower at +6% in FY 13. We have cut FY 14E by 5% and now forecast a 6.7% y-y drop in HEPS, following which growth may turn positive, albeit subdued, again in FY 15 (+3.2%, y-y). See page 11 for more detail on our forecasts

Flat DPS at R7.10/sh as FCF comes under pressure; implies rising p/o ratio

We have upped our DPS forecasts for Vodacom to reflect the company's new policy of paying out at least 90% of earnings. Our forecasts hold DPS flat at R7.10/sh over the medium-term, as we expect free cash flow to come under pressure. This actually implies that Vodacom's dividend payout will rise towards 100% in FY 14 and FY 15 on the assumption that the company will at least look to maintain its dividend despite pressure on cash flows (on our expectations). We elaborate on this a little more on page 9.

Reasons to worry

It could be worse

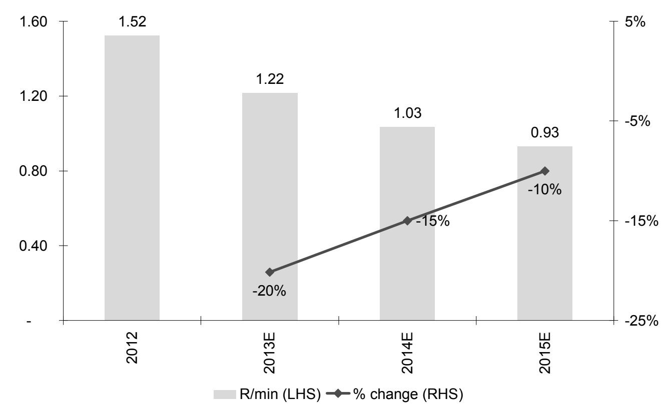
It could be even worse for Vodacom as our inputs around voice pricing are arguably quite benign in light of what we have seen from Cell C; even more so if one starts to factor in unfavourable assumptions around market share. We have used FY 14 to run some scenarios around the possible impact on Vodacom's EBITDA when flexing key inputs like voice prices and market share (South Africa specifically).

Voice prices: Competition fears are materialising

Our forecasts do not factor in the full extent of Cell C's cuts

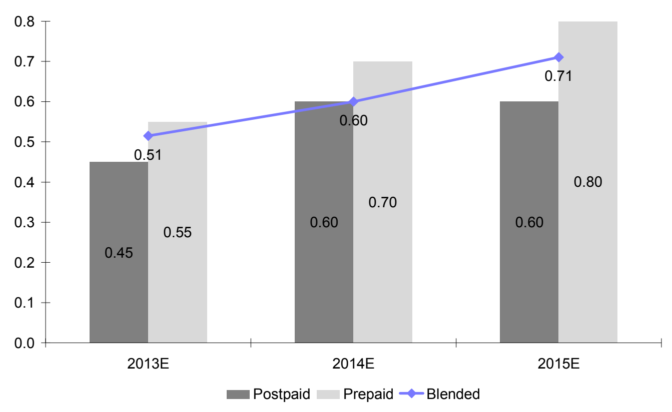
Cell C's 99c/min flat rate tariff plans across its voice product offerings in SA calculate to a reduction of more than 70% depending on bases of comparison. The potential impact on Vodacom is not straightforward as it can be affected by factors like free minutes, out-of-bundle rates and the extent to which Vodacom follows (or not) Cell C's price cuts, for instance. The contractual nature of the postpaid market is also a consideration, which could result in lags where price cuts may not be fully felt on a "linear" basis.

Figure 6. Vodacom SA, Outgoing Voice P/min



Source: CIRA Estimates. CIRA Estimates. *Based on billed outgoing minutes*

Figure 7. Our Elasticity Assumptions



Source: CIRA Estimates

We try to assess the impact of price reductions using billed outgoing minutes estimates

To try simplifying things, our approach uses *billed* outgoing minutes (i.e. excluding free minutes) to evaluate the effects of voice price movements on Vodacom's SA EBITDA. As a starting point, we estimate that Vodacom's tariff on this basis was Vodacom realised cR1.52/min in FY 12. On this basis, factoring in Cell C's new tariffs would infer a c35% cut to Vodacom's average price for outgoing minutes.

Our base case forecasts assume milder voice price cuts than those implemented by Cell C

Our base-case forecasts factor in a 20% cut in FY 13 to this average voice price for Vodacom (Figure 6), followed by 15% in FY 14 — in other words, much milder reductions, and spread over a couple years, than those immediately implemented by Cell C. This is potentially a benign assumption given Cell C's cuts, although the feed-through to effective pricing is not straightforward, as mentioned.

We think elasticity could be low for now, given a poor economic and consumer outlook

We factor in an implied elasticity of c0.5, which reflects (i) our concerns around the consumer's ability to increase usage even with price reductions, and (ii) new lower usage subscribers coming on to the network.

Figure 8. Vodacom SA – EBITDA Sensitivity, Voice Price and Elasticity Scenarios

		Elasticity			
		0.45	**0.50***	**0.70**	**1.00**
y-y % change Voice price	**-15%**	3.0%	3.9%	6.3%	10.2%
	***-20%**	-1.2%	0.0%	2.8%	7.7%
	-30%	-10.5%	-9.1%	0.4%	0.9%
	-45%	-26.5%	-25.0%	-20.8%	-13.8%

Source: CIRA Estimates. **Base case on FY 13e.*

The potential downside to Vodacom SA's EBITDA could be as much as c25% vs current FY 13 estimates if full extent of price reductions is factored in

Figure 8 shows the potential impact on our FY 14E EBITDA for Vodacom's SA operations under different voice price movements. On our scenarios, Vodacom's SA EBITDA could be as much as 25% lower than our current forecast if we factored in a more aggressive price decline of say c45% in voice prices.

Recall from our earlier discussion on the more severe case of Israeli telcos (Figure 4) that operators saw EBITDA margins fall by as much as c10ppts, which resulted in average downside of nearly c20% in EBITDA over the course of a year.

An increase in elasticity as the economy improves could provide some offset

We have included elasticity scenarios in our analysis and Figure 8 shows that there is some offset under higher elasticity scenarios. To be fair, elasticity is likely to improve as and when economic and consumer conditions improve, which could provide some offset. Our underlying elasticity assumptions are captured in Figure 7.

Potential market share losses

We have assumed a stable market share for Vodacom, but what if Cell C achieves its market share targets?

We have made what are probably favourable market share assumptions for Vodacom. On our estimates, Vodacom may have gained about a percent of market share in FY 12 on a total subs basis, which we assume will be given back in FY 13 (back to 50%) and held steady over the medium-term horizon. In reality, Cell C is clearly being aggressive in its pursuit of market share — targets a 10% gain in the next 3-4 years — which would impact negatively on Vodacom. Let's see what the impact on Vodacom could be if it lost market share (Figure 9).

Figure 9. Vodacom SA EBITDA Sensitivity to Market Share Assumptions

	Market share				
	45.0%	**47.5%**	***50.0%**	**52.5%**	**55.0%**
EBITDA (Rbn)	21.0	21.5	22.1	22.6	23.1
% from base case	-4.8%	-2.4%	-	2.4%	4.8%

Source: CIRA Estimates. **Base case on FY 14e*

5% market share loss could result in a 4.8% hit to SA EBITDA

Cell C is not quite a new operator, but is a rejuvenated one, which could amount to the same thing, in our view. If Cell C achieves its target of 10% market share increase — and assuming it erodes equally from Vodacom and MTN — our scenario analysis in Figure 9 suggests that this could knock Vodacom's SA EBITDA by c4.8% on our base-case forecasts.

…This would be worse if combined with price erosion beyond our forecasts

Bear in mind that this is even before factoring in further price erosion, per our analysis in Figure 8. The experience in some European precedents was that new MNO's managed to gain an average of 6% market share by the end of the third year after launch, see Figure 10.

Figure 10. European Examples, Market Share Impact

Country	New entrant	Launch	New entrant mkt share gain (+3yrs)	Approach
UK	"3"	2003	5.5%	Quickly gained mkt share via subsidised handsets and discounting
Italy	"3"	2003	8.5%	Quickly gained mkt share via subsidised handsets and discounting
Poland	P4	2006	7.0%	Benefitted from steep and asymmetric MTR cuts, easier migration between operators (regulator) and cheaper costs
Spain	Yoigo	2006	2.5%	Less appetite for initial losses, but high prices made mkt susceptible to discounting strategy, Yoigo reduced and simplified tariff plans and gradually started gaining mkt share

Source: CIRA

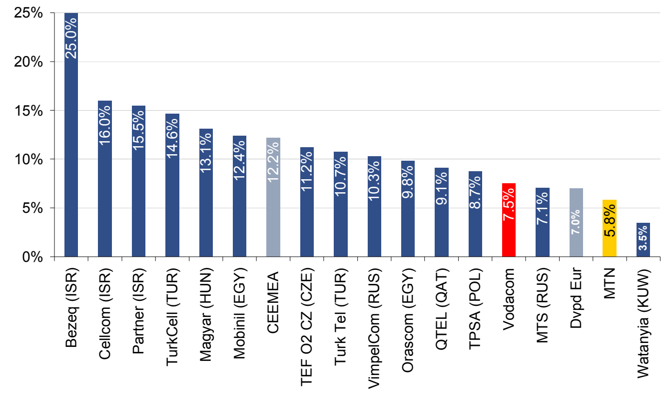
The yield is not enough

Vodacom's DY is attractive, but still light in CEEMEA context

Vodacom's DY has increased to 7.5% on share weakness, but still quite low vs CEEMEA peers (12.2%)

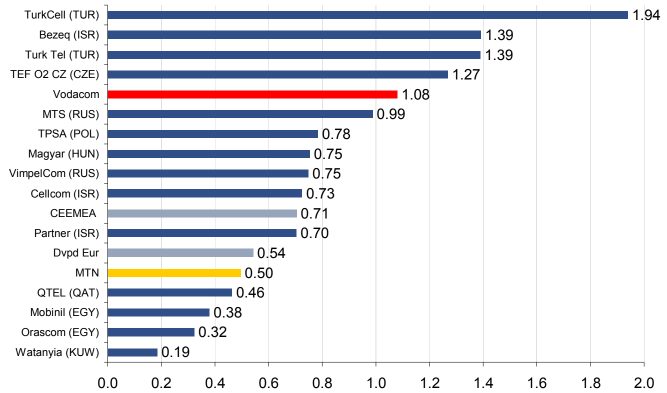
With the recent weakness in Vodacom's share price, its implied CY 13 dividend yield has risen to 7.5%. Although this measures favourably in a South African context — and in line with Developed European telco's (simple average of 7%) — Vodacom's yield remains lightweight when compared to CEEMEA names, which average c12.2% (Figure 11).

Figure 11. Peer Group DY Comparisons, CY 12 (%)



Source: CIRA Estimates

Figure 12. Yield Ratio: Dividend to Free Cash Flow, CY 12



Source: CIRA Estimates

Vodacom already paying out all of its free cash; what if this comes under pressure?

Furthermore, Vodacom has arguably shown its hand in that our forecast payout for the company means that it is already paying out all of its free cash. Figure 12 shows that Vodacom's dividend-to-FCF yield ratio is around 1.08, placing it amongst the highest in the universe and sitting above the majority of its CEEMEA peers.

Debt for dividends and the risk to free cash

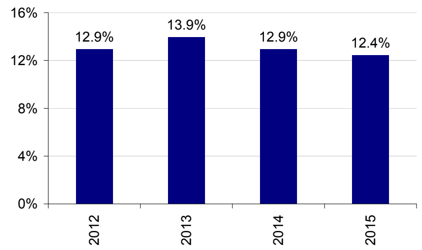
In other words, Vodacom's flexibility in maintaining its DY is reduced in the event that free cash flow comes under pressure. In fact, looking at our free cash flow forecasts for Vodacom, this could happen sooner rather than later.

Figure 13. Vodacom Free Cash Flow Forecasts

Rm	2012	2013E	% change	2014E	% change	2015E	% change
EBITDA	22,994	24,116	4.9%	23,524	-2.5%	24,295	3.3%
less Capex	-7,568	-9,088		-8,504		-8,559	
Working Capital	1,508	-360		393		115	
OpFCF	**16,934**	**14,668**	-13.4%	**15,413**	5.1%	**15,851**	2.8%
Less tax	-5,192	-5,526		-5,163		-5,332	
Less Finance Costs	-771	-277		-392		-387	
EFCF	**10,971**	**8,866**	-19.2%	**9,859**	11.2%	**10,132**	2.8%
ECFC Yield		6.3%		7.0%		7.2%	
DY to FCF-Y		1.19		1.07		1.04	

Source: Company Data, CIRA

Figure 14. Vodacom Capex to Sales Ratio



Source: CIRA Estimates

On our estimates, Vodacom's free cash flow yield could actually deteriorate over the medium-term on earnings pressure and magnified in the event that capex remains elevated. In addition to ongoing capacity and quality upgrades, Vodacom will also need to invest in new technology over time. Capex intensity could, therefore, skew towards or (as we forecast) even exceed the top-end of Vodacom's indicated range (11-13%); especially if revenues stall as we expect. Our earlier scenario analysis highlights the risk to free cash flow if earnings deteriorate more than we expect.

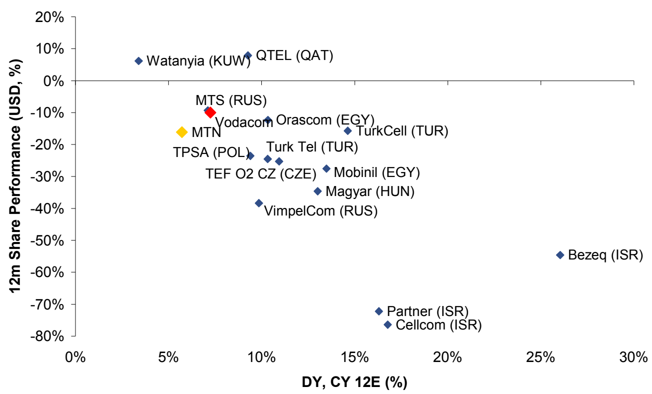
We assume that Vodacom's group capex-to-sales ratio will average c13.1% over the medium-term horizon, though there could be upside to this in our view. In this light, we believe that Vodacom's cash flow yield could remain below 7.5%, resulting in a DY/FCFY of over 1 for the stock. In other words, Vodacom would effectively need to borrow to in order to fund dividends if the current level is to be maintained.

Dividend yield could rise further, but on share weakness

Poor earnings outlook = poor share price performance; regardless of yield

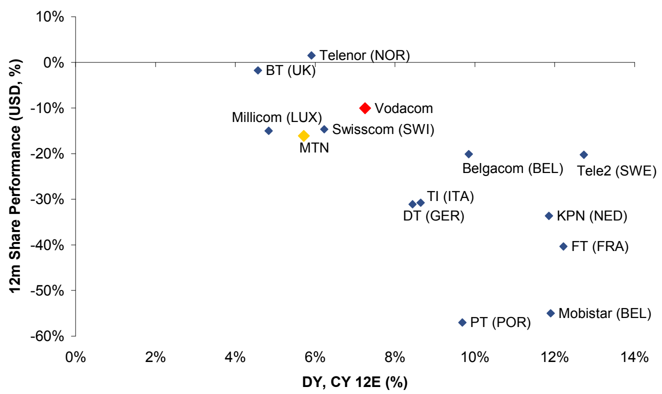
Coming back to our case study again, Europe offers up several examples of share prices falling despite attractive dividend yields being offered; the main reason being a poor outlook for earnings — and lack of visibility on a bottoming out — in those markets. Just the past 12 months have demonstrated this dynamic where Figure 15 and Figure 16 show that even stocks with relatively high dividend yields in CEEMEA and developed Europe, respectively, have performed poorly.

Figure 15. CEEMEA – Share Performance vs CY 12 DY (USD)



Source: CIRA

Figure 16. Developed Europe – Share Performance vs CY 12 DY (USD)



Source: CIRA

We thus believe that the "yield argument" in favour of Vodacom is not strong enough to prevent further downside in the share price as risks to the company's earnings remain high, in our view.

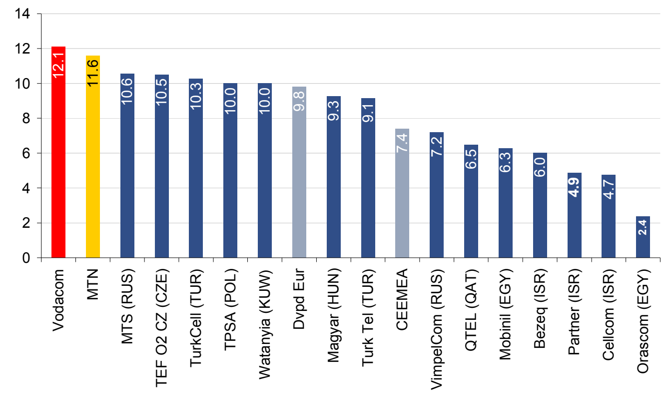
Valuation

Still at a premium

Vodacom's premium valuation unjustified, in our view

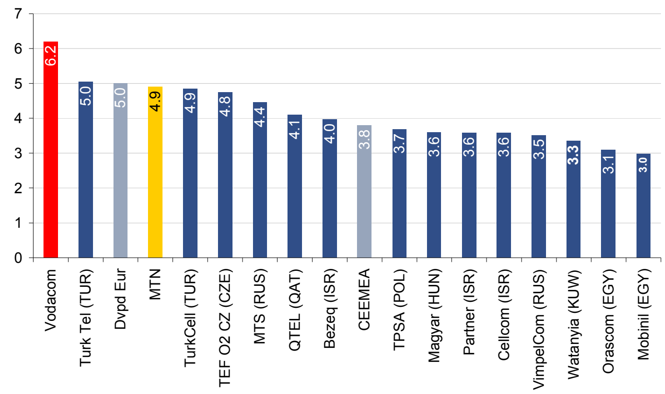
Despite the share's recent underperformance, therefore, we believe that Vodacom warrants a further de-rating given its valuation. Vodacom remains expensive relative to its CEEMEA and European peers. On a PE basis, Vodacom's CY 12E multiple of 12.1x is a premium of c60% compared to the CEEMEA average and c30% versus developed European telcos. Vodacom's EV/EBITDA of 6.2x (Figure 18) also remains at the top-end of the peer group comparison.

Figure 17. PE Comparisons (CY 12)



Source: CIRA Estimates

Figure 18. EV/EBITDA Comparisons (CY 12)



Source: CIRA Estimates

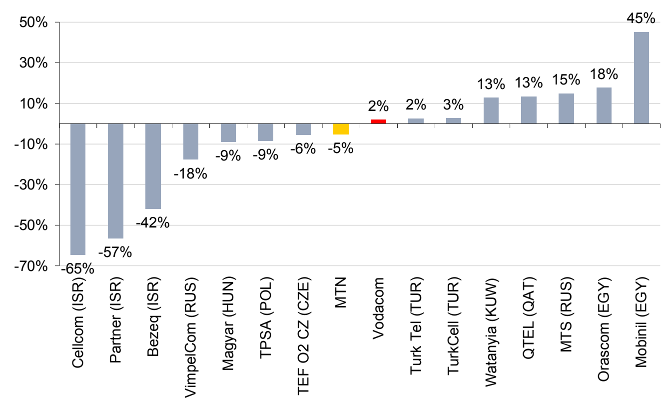
Downgrade target price, maintain Sell rating

New TP R80, Sell maintained

We cut our SOTP-DCF price target for Vodacom to R80, from R85, and reiterate our Sell rating on the stock. As mentioned, we believe that the share price warrants a further de-rating. Our new target price points to downside of 15%, which computes to an expected total return (ETR) of -7.5% when our forecast DY is added.

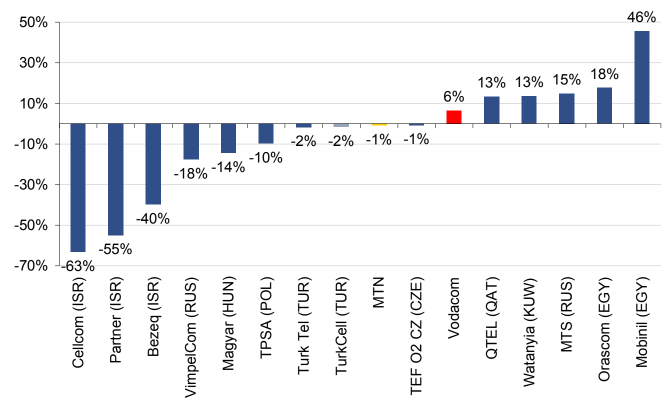
On our FY 13 forecasts, our target price implies a dividend yield of 8.9% which is closer to, but still below, the CEEMEA average of 12.2%. Our target price further implies a PE (on FY 13) of 9.9x and EV/EBITDA of c5.8x.

Figure 19. CEEMEA Telecoms YTD Share Performance (USD)



Source: CIRA

Figure 20. CEEMEA Telecoms YTD Share Performance (local currency)



Source: CIRA

Forecasts

Income statement

Finance costs to drop further in FY 13, but could rise again in FY 14 on higher gearing:

- Earnings pressure
- Ongoing capex
- Sustaining dividend

Figure 21. Vodacom P&L Summary

Rm	2012	2013E	% change	2014E	% change	2015E	% change
Revenue	66,929	65,315	-2.4%	65,742	0.7%	68,914	4.8%
Op Profit	16,617	17,708	6.6%	16,677	-5.8%	17,207	3.2%
Op Margin %	*24.8%*	27.1%		25.4%		25.0%	
Net finance costs	-684	-277		-392		-387	
PBT	15,933	17,431		16,286		16,820	
Tax	-5,730	-5,526		-5,163		-5,332	
Tax rate	*36.0%*	31.7%		31.7%		31.7%	
Minority	-47	-58		-74		-83	
Net Profit	10,156	11,847	16.7%	11,049	-6.7%	11,405	3.2%
Headline Earnings	10,374	11,847	14.2%	11,049	-6.7%	11,405	3.2%
Headline EPS	7.09	8.10	14.2%	7.55	-6.7%	7.80	3.2%
DPS	7.10	7.10	0.0%	7.10	0.0%	7.10	0.0%

Source: Company Data, CIRA estimates

Operating summary

Impact of Gateway disposal: knock to International revenue growth, boost to EBITDA

Figure 22. Vodacom Operating Forecast Summary

Rm	2012	2013E	% change	2014E	% change	2015E	% change
Revenue	**66,929**	**65,315**	**-2.4%**	**65,742**	**0.7%**	**68,914**	**4.8%**
SA	56,932	57,742	1.4%	57,356	-0.7%	59,731	4.1%
International	10,426	7,982	-23.4%	8,796	10.2%	9,610	9.2%
Corporate	-429	-409		-410		-427	
EBITDA	**22,763**	**24,116**	**5.9%**	**23,524**	**-2.5%**	**24,295**	**3.3%**
SA	21,254	22,055	3.8%	20,919	-5.2%	21,379	2.2%
International	1,461	2,017	38.1%	2,565	27.2%	2,879	12.2%
Corporate	48	44		40		36	
EBITDA margin %	**34.0%**	**36.9%**		**35.8%**		**35.3%**	
SA	37.3%	38.2%		36.5%		35.8%	
International	14.0%	25.3%		29.2%		30.0%	
Corporate	-	-		-		-	

Source: Company Data, CIRA estimates

South Africa

Voice – pricing pressure to take its toll

Data – we expect price competition to mitigate volume growth, dampens overall growth

Equipment – '13 growth to reverse given ultra-low cost handset (ULCH) "blitz" in the '12 base

Margin could hold up for now – mainly boosted by ULCH reversal; but -ve impact from slower topline over the medium-term

Figure 23. Vodacom SA Operational Forecast Summary

Rm	2012	2013E	% change	2014E	% change	2015E	% change
Voice	29,395	30,652	4.3%	30,105	-1.8%	30,655	1.8%
Interconnect	6,062	5,400	-10.9%	4,478	-17.1%	5,021	12.1%
Messaging	3,143	3,304	5.1%	3,310	0.2%	3,401	2.7%
Data	7,639	8,624	12.9%	9,343	8.3%	10,193	9.1%
Other Service Rev	2,188	2,399	9.7%	2,554	6.4%	2,631	3.0%
Service Revenue	**48,427**	**50,379**	**4.0%**	**49,790**	**-1.2%**	**51,901**	**4.2%**
Equipment sales	7,817	6,674	-14.6%	6,878	3.0%	7,143	3.9%
Non-service revenue	688	688	0.0%	688	0.0%	688	0.0%
Total Revenue	**56,932**	**57,742**	**1.4%**	**57,356**	**-0.7%**	**59,731**	**4.1%**
EBITDA	**21,254**	**22,055**	**3.8%**	**20,919**	**-5.2%**	**21,379**	**2.2%**
EBITDA Margin %	37.3%	38.2%		36.5%		35.8%	

Source: Company Data, CIRA

We strip Gateway out of our forecasts, following its disposal

Ex-Gateway revenue +15.6%; EBITDA +23.8%

International

Figure 24. International Revenue and EBITDA Forecasts

Rm	2012	2013E	% change	2014E	% change	2015E	% change
International Revenue	**10,426**	**7,982**	**-23.4%**	**8,796**	**10.2%**	**9,610**	**9.2%**
Tanzania	2,653	3,139	18.3%	3,452	10.0%	3,751	8.7%
DRC	2,201	2,478	12.6%	2,830	14.2%	3,201	13.1%
Mozambique	1,411	1,646	16.6%	1,722	4.6%	1,806	4.9%
Lesotho	640	720	12.6%	793	10.1%	852	7.4%
Gateway	3,522	-	-	-	-	-	-
EBITDA	**1,461**	**2,056**	40.8%	**2,608**	26.8%	**2,939**	12.7%
EBITDA Margin %	14.0%	25.8%		29.6%		30.6%	

Source: Company Data, CIRA estimates

SOTP DCF

Figure 25. Vodacom DCF Valuation

Country	WACC	Term growth	100% Valn, Rm	Ownership, %	Prop Valn, Rm	Valn % of Total	EV/EBIDTA 13E
SA	10.1%	2.0%	126,774	94%	118,851	94%	5.7
Tanzania	12.4%	3.5%	5,993	65%	3,896	3%	6.4
DRC	17.0%	3.0%	2,495	51%	1,273	1%	5.6
Lesotho	14.3%	3.0%	2,017	80%	1,613	1%	6.2
Mozambique	12.4%	5.0%	1,293	85%	1,099	1%	4.1
TOTAL					**126,732**		**5.8**
Net debt			(7,499)	FY13F			
Valuation - equity			119,232				
			15,792	USD m			
Per share (R)			**81.22**				

Source: CIRA Estimates

- We set a new TP of R80/sh (rounded)
- Gateway sold and now excluded (we previously valued this at zero anyway)

Companies mentioned

Figure 26. Companies Mentioned

Company	Code	Share P	Rating	Company	Code	Share P	Rating
Bezeq	BEZQ.TA	4.15	Neutral	Wataniya Telco	NMTC.KW	2.20	Buy
Cellcom Israel	CEL.TA	23.53	Sell	Telekom Polska	TPSA.WA	15.63	Buy
Partner Comm	PTNR.TA	15.65	Sell	QTEL	QTEL.QA	107.00	Buy
Telefonica O2 Czech	SPTTsp.PR	384.50	Buy	MTS	MBT.N	17.08	Buy
Mobinil	EMOB.CA	122.43	Buy	VimpelCom	VIP.N	8.01	Buy
Orascom Telco	ORTEq.L	2.40	Buy	Turk Telekomunik	TTKOM.IS	7.00	Neutral
Magyar Telekom	MTEL.BU	435.00	Buy	Turkcell	TCELL.IS	8.98	Buy
Vodacom Grp	VODJ.J	94.30	Sell	MTN Grp Ltd	MTNJ.J	142.49	Buy

Source: CIRA

Vodacom Group Limited

Company description

Vodacom is the leading cellular operator in South Africa, with 54% of the market and over 28m subscribers in South Africa. Vodacom is also a leading operator in Tanzania, DRC, Lesotho and quickly gaining share in Mozambique. It's subscriber base stood at 41.3m at the end of June 09. Vodacom operations also include Gateway, African satellite network operator, acquired in Dec 08.

Vodacom is 65% owned and controlled by Vodafone, which acquired control in May 2009. Telkom simultaneous agreed to unbundled its shares to its shareholders, thus bring about a listing of Vodacom on the JSE on the 19th of May 2009.

Investment strategy

We rate the stock Sell with an R80 price target. The South African market has started to mature and offers fewer growth opportunities. The medium-term consumer landscape has also gotten tougher, which we believe could impact on telecom spending. Importantly, against this backdrop, we expect a rise in competition to put further pressure on Vodacom's prospective ARPU and growth. Although growth could hold up for now, we believe the risks have increased and expect earnings to go backwards in FY 14.

Vodacom's stock looks expensive on valuation and we believe that the share should de-rate to reflect its increased risk profile.

Valuation

Our DCF valuation R80 per share. Our valuation incorporates WACC of 12.8% and a terminal growth rate of 2% for South African operators and 14%/3.5% for its other operations.

94% of our DCF is driven by South African operations. At our target price, Vodacom would trade at an implied 2013e EV/EBITDA of 5.8x, which is towards the upper ranges of our valuation benchmarks for Vodacom's emerging market peers.

Risks

We see the following as the main risks to the share price falling to our target price:

An improvement in the economic and consumer landscape, improved dividends and potential special dividends, strong cost and margin management and a continued benign competitive environment.

More generally, we highlight the following risks:

Not being able to recover the loss of revenue from interconnection. As seen in markets like Egypt, it can take a one or two quarters to make up for loss in revenue from tariffs as prices are cut.

Cell-C has become more aggressive. Cell-C has not been able to make inroads into the South African market, and has seen its market share remain low since 2007. Cell-C is in a strong position to cut tariffs, which may put pressure on Vodacom as it targets an increase in market share to 25% from c13-14% currently.

Expansion may reduce returns. Vodacom has a patchy record in pursuing acquisitions and expanding outside of South Africa. It has had to impair Mozambique in the past, as well as the recent Gateway acquisition. We see a risk to dividends and cashflow if further acquisitions are made and believe Vodacom would benefit more from increasing its dividend and returning cash to shareholders.

Increasing regulatory noise - ICASA has had a limited impact on the South African market so far. But it has become more vocal (along with the government) in wanting to reduce pricing on mobile. A more hostile regulator may change the favourable dynamic operators have enjoyed since mobile started in 1993/4.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Vodacom Group Limited (VODJ.J)

Ratings and Target Price History

Fundamental Research

Analyst: Thato Motlanthe

Covered since October 9 2011

Date	Rating	Target Price	Closing Price
1 4-Nov-09	*1M	*75.00	51.56
2 30-Sep-11	*2M	*90.00	90.36
3 7-Oct-11	Stock rating system changed		
4 7-Oct-11	*2	90.00	88.25
5 16-Apr-12	*3	*85.00	107.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Vodacom Group Limited (VODJ.J)

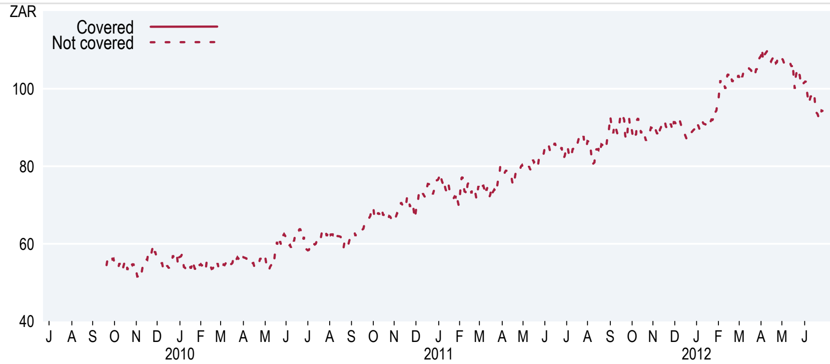
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Thato Motlanthe

Covered since October 9 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

DMBH is a market maker in the publicly traded equity securities of Telekomunikacja Polska SA. DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th March 2012 is as follows: Buy (1) representing 54% of the DMBH coverage 0% of which are IB clients,Hold (2) representing 33% of the DMBH coverage 0% of which are IB clients,Sell (3) representing 13% of the DMBH coverage 0% of which are IB clients.

Citigroup Global Markets Inc. or its affiliates beneficially owns 1% or more of any class of common equity securities of Bezeq. This position reflects information available as of the prior business day.

Within the past 12 months, Citigroup Global Markets Inc. or its affiliates has acted as manager or co-manager of an offering of securities of Magyar Telekom, Turkcell.

Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from Vodacom Group Limited, Cellcom Israel Ltd., Mobinil, Mobile Telesystems OJSC, Magyar Telekom, Wataniya Telecom, Orascom Telecom, Qatar Telecom, Telefonica O2 Czech Republic, Telekomunikacja Polska SA, Türk Telekomünikasyon AS, VimpelCom.

Citigroup Global Markets Inc. or its affiliates expects to receive or intends to seek, within the next three months, compensation for investment banking services from Cellcom Israel Ltd., MTN Group Limited, Orascom Telecom, Telefonica O2 Czech Republic, VimpelCom.

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Vodacom Group Limited, Cellcom Israel Ltd., Mobinil, Mobile Telesystems OJSC, Magyar Telekom, MTN Group Limited, Wataniya Telecom, Orascom Telecom, Partner Communications Co Ltd, Qatar Telecom, Telefonica O2 Czech Republic, Turkcell, Telekomunikacja Polska SA, Türk Telekomünikasyon AS, VimpelCom in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as investment banking client(s): Vodacom Group Limited, Cellcom Israel Ltd., Mobinil, Mobile Telesystems OJSC, Magyar Telekom, MTN Group Limited, Wataniya Telecom, Orascom Telecom, Qatar Telecom, Telefonica O2 Czech Republic, Telekomunikacja Polska SA, Türk Telekomünikasyon AS, VimpelCom.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: Vodacom Group Limited, Cellcom Israel Ltd., Mobinil, Mobile Telesystems OJSC, Magyar Telekom, MTN Group Limited, Wataniya Telecom, Orascom Telecom, Qatar Telecom, Telefonica O2 Czech Republic, Turkcell, Telekomunikacja Polska SA, Türk Telekomünikasyon AS, VimpelCom.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: Vodacom Group Limited, Cellcom Israel Ltd., Mobinil, Mobile Telesystems OJSC, Magyar Telekom, MTN Group Limited, Wataniya Telecom, Orascom Telecom, Partner Communications Co Ltd, Qatar Telecom, Telefonica O2 Czech Republic, Turkcell, Telekomunikacja Polska SA, Türk Telekomünikasyon AS, VimpelCom.

Analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Citigroup Global Markets Inc. and its affiliates ("the Firm"). Like all Firm employees, analysts receive compensation that is impacted by overall firm profitability which includes investment banking revenues.

The Firm is a market maker in the publicly traded equity securities of MTN Group Limited, Partner Communications Co Ltd, Turkcell.

For important disclosures (including copies of historical disclosures) regarding the companies that are the subject of this Citi Investment Research & Analysis product ("the Product"), please contact Citi Investment Research & Analysis, 388 Greenwich Street, 28th Floor, New York, NY, 10013, Attention: Legal/Compliance [E6WYB6412478]. In addition, the same important disclosures, with the exception of the Valuation and Risk assessments and historical disclosures, are contained on the Firm's disclosure website at https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures. Valuation and Risk assessments can be found in the text of the most recent research note/report regarding the subject company. Historical disclosures (for up to the past three years) will be provided upon request.

Citi Investment Research & Analysis Ratings Distribution

	12 Month Rating			*Relative Rating*		
Data current as of 31 Mar 2012	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	52%	37%	11%	10%	79%	10%
% of companies in each rating category that are investment banking clients	44%	42%	40%	47%	42%	43%

Guide to Citi Investment Research & Analysis (CIRA) Fundamental Research Investment Ratings:

CIRA's stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.

Risk rating takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.

Investment Ratings: CIRA's investment ratings are Buy, Neutral and Sell. Our ratings are a function of analyst expectations of expected total return ("ETR") and risk. ETR is the sum of the forecast price appreciation (or depreciation) plus the dividend yield for a stock within the next 12 months. The Investment rating definitions are: Buy (1) ETR of 15% or more or 25% or more for High risk stocks; and Sell (3) for negative ETR. Any covered stock not assigned a Buy or a Sell is a Neutral (2). For stocks rated Neutral (2), if an analyst believes that there are insufficient valuation drivers and/or investment catalysts to derive a positive or negative investment view, they may elect with the approval of CIRA management not to assign a target price and, thus, not derive an ETR. Analysts may place covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and / or trading in the company's securities (e.g. trading suspension). As soon as practically possible, the analyst will publish a note re-establishing a rating and investment thesis. To satisfy regulatory requirements, we correspond Under Review and Neutral to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

Relative three-month ratings: CIRA may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is

considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

Prior to October 8, 2011, the firm's stock recommendation system included a risk rating and an investment rating. **Risk ratings,** which took into account both price volatility and fundamental criteria, were: Low (L), Medium (M), High (H), and Speculative (S). **Investment Ratings** of Buy, Hold and Sell were a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating. Additionally, analysts could have placed covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and/or trading in the company's securities (e.g. trading suspension). Stocks placed "Under Review" were monitored daily by management and as practically possible, the analyst published a note re-establishing a rating and investment thesis. For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings were:Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return). For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings were:Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

NON-US RESEARCH ANALYST DISCLOSURES

Non-US research analysts who have prepared this report (i.e., all research analysts listed below other than those identified as employed by Citigroup Global Markets Inc.) are not registered/qualified as research analysts with FINRA. Such research analysts may not be associated persons of the member organization and therefore may not be subject to the NYSE Rule 472 and NASD Rule 2711 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account. The legal entities employing the authors of this report are listed below:

Citigroup Global Markets (Pty) Ltd	Thato Motlanthe
Citigroup Global Markets Ltd	Dalibor Vavruska
Citibank NA	Michael Klahr

OTHER DISCLOSURES

The subject company's share price set out on the front page of this Product is quoted as at 28 June 2012 01:18 PM on the issuer's primary market.

Citigroup Global Markets Inc. and/or its affiliates has a significant financial interest in relation to MTN Group Limited, Qatar Telecom, VimpelCom. (For an explanation of the determination of significant financial interest, please refer to the policy for managing conflicts of interest which can be found at www.citiVelocity.com.)

For securities recommended in the Product in which the Firm is not a market maker, the Firm is a liquidity provider in the issuers' financial instruments and may act as principal in connection with such transactions. The Firm is a regular issuer of traded financial instruments linked to securities that may have been recommended in the Product. The Firm regularly trades in the securities of the issuer(s) discussed in the Product. The Firm may engage in securities transactions in a manner inconsistent with the Product and, with respect to securities covered by the Product, will buy or sell from customers on a principal basis.

Securities recommended, offered, or sold by the Firm: (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including Citibank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested. Although information has been obtained from and is based upon sources that the Firm believes to be reliable, we do not guarantee its accuracy and it may be incomplete and condensed. Note, however, that the Firm has taken all reasonable steps to determine the accuracy and completeness of the disclosures made in the Important Disclosures section of the Product. The Firm's research department has received assistance from the subject company(ies) referred to in this Product including, but not limited to, discussions with management of the subject company(ies). Firm policy prohibits research analysts from sending draft research to subject companies. However, it should be presumed that the author of the Product has had discussions with the subject company to ensure factual accuracy prior to publication. All opinions, projections and estimates constitute the judgment of the author as of the date of the Product and these, plus any other information contained in the Product, are subject to change without notice. Prices and availability of financial instruments also are subject to change without notice. Notwithstanding other departments within the Firm advising the companies discussed in this Product, information obtained in such role is not used in the preparation of the Product. Although Citi Investment Research & Analysis (CIRA) does not set a predetermined frequency for publication, if the Product is a fundamental research report, it is the intention of CIRA to provide research coverage of the/those issuer(s) mentioned therein, including in response to news affecting this issuer, subject to applicable quiet periods and capacity constraints. The Product is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in the Product must take into account existing public information on such security or any registered prospectus.

Investing in non-U.S. securities, including ADRs, may entail certain risks. The securities of non-U.S. issuers may not be registered with, nor be subject to the reporting requirements of the U.S. Securities and Exchange Commission. There may be limited information available on foreign securities. Foreign companies are generally not subject to uniform audit and reporting standards, practices and requirements comparable to those in the U.S. Securities of some foreign companies may be less liquid and their prices more volatile than securities of comparable U.S. companies. In addition, exchange rate movements may have an adverse effect on the value of an investment in a foreign stock and its corresponding dividend payment for U.S. investors. Net dividends to ADR investors are estimated, using withholding tax rates conventions, deemed accurate, but investors are urged to consult their tax advisor for exact dividend computations. Investors who have received the Product from the Firm may be prohibited in certain states or other jurisdictions from

purchasing securities mentioned in the Product from the Firm. Please ask your Financial Consultant for additional details. Citigroup Global Markets Inc. takes responsibility for the Product in the United States. Any orders by US investors resulting from the information contained in the Product may be placed only through Citigroup Global Markets Inc.

Important Disclosures for Morgan Stanley Smith Barney LLC Customers: Morgan Stanley & Co. LLC (Morgan Stanley) research reports may be available about the companies that are the subject of this Citi Investment Research & Analysis (CIRA) research report. Ask your Financial Advisor or use smithbarney.com to view any available Morgan Stanley research reports in addition to CIRA research reports.
Important disclosure regarding the relationship between the companies that are the subject of this CIRA research report and Morgan Stanley Smith Barney LLC and its affiliates are available at the Morgan Stanley Smith Barney disclosure website at www.morganstanleysmithbarney.com/researchdisclosures.
For Morgan Stanley and Citigroup Global Markets, Inc. specific disclosures, you may refer to www.morganstanley.com/researchdisclosures and https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures.
This CIRA research report has been reviewed and approved on behalf of Morgan Stanley Smith Barney LLC. This review and approval was conducted by the same person who reviewed this research report on behalf of CIRA. This could create a conflict of interest.

The Citigroup legal entity that takes responsibility for the production of the Product is the legal entity which the first named author is employed by. The Product is made available in **Australia** through Citigroup Global Markets Australia Pty Ltd. (ABN 64 003 114 832 and AFSL No. 240992), participant of the ASX Group and regulated by the Australian Securities & Investments Commission. Citigroup Centre, 2 Park Street, Sydney, NSW 2000. The Product is made available in Australia to Private Banking wholesale clients through Citigroup Pty Limited (ABN 88 004 325 080 and AFSL 238098). Citigroup Pty Limited provides all financial product advice to Australian Private Banking wholesale clients through bankers and relationship managers. If there is any doubt about the suitability of investments held in Citigroup Private Bank accounts, investors should contact the Citigroup Private Bank in Australia. Citigroup companies may compensate affiliates and their representatives for providing products and services to clients. The Product is made available in **Brazil** by Citigroup Global Markets Brasil - CCTVM SA, which is regulated by CVM - Comissão de Valores Mobiliários, BACEN - Brazilian Central Bank, APIMEC - Associação dos Analistas e Profissionais de Investimento do Mercado de Capitais and ANBID - Associação Nacional dos Bancos de Investimento. Av. Paulista, 1111 - 11º andar - CEP. 01311920 - São Paulo - SP. If the Product is being made available in certain provinces of **Canada** by Citigroup Global Markets (Canada) Inc. ("CGM Canada"), CGM Canada has approved the Product. Citigroup Place, 123 Front Street West, Suite 1100, Toronto, Ontario M5J 2M3. This product is available in **Chile** through Banchile Corredores de Bolsa S.A., an indirect subsidiary of Citigroup Inc., which is regulated by the Superintendencia de Valores y Seguros. Agustinas 975, piso 2, Santiago, Chile. The Product is made available in **France** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. 1-5 Rue Paul Cézanne, 8ème, Paris, France. The Product is distributed in **Germany** by Citigroup Global Markets Deutschland AG ("CGMD"), which is regulated by Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin). CGMD, Reuterweg 16, 60323 Frankfurt am Main. Research which relates to "securities" (as defined in the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong)) is issued in **Hong Kong** by, or on behalf of, Citigroup Global Markets Asia Limited which takes full responsibility for its content. Citigroup Global Markets Asia Ltd. is regulated by Hong Kong Securities and Futures Commission. If the Research is made available through Citibank, N.A., Hong Kong Branch, for its clients in Citi Private Bank, it is made available by Citibank N.A., Citibank Tower, Citibank Plaza, 3 Garden Road, Hong Kong. Citibank N.A. is regulated by the Hong Kong Monetary Authority. Please contact your Private Banker in Citibank N.A., Hong Kong, Branch if you have any queries on or any matters arising from or in connection with this document. The Product is made available in **India** by Citigroup Global Markets India Private Limited, which is regulated by Securities and Exchange Board of India. Bakhtawar, Nariman Point, Mumbai 400-021. The Product is made available in **Indonesia** through PT Citigroup Securities Indonesia. 5/F, Citibank Tower, Bapindo Plaza, Jl. Jend. Sudirman Kav. 54-55, Jakarta 12190. Neither this Product nor any copy hereof may be distributed in Indonesia or to any Indonesian citizens wherever they are domiciled or to Indonesian residents except in compliance with applicable capital market laws and regulations. This Product is not an offer of securities in Indonesia. The securities referred to in this Product have not been registered with the Capital Market and Financial Institutions Supervisory Agency (BAPEPAM-LK) pursuant to relevant capital market laws and regulations, and may not be offered or sold within the territory of the Republic of Indonesia or to Indonesian citizens through a public offering or in circumstances which constitute an offer within the meaning of the Indonesian capital market laws and regulations. The Product is made available in **Israel** through Citibank NA, regulated by the Bank of Israel and the Israeli Securities Authority. Citibank, N.A, Platinum Building, 21 Ha'arba'ah St, Tel Aviv, Israel. The Product is made available in **Italy** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. Via dei Mercanti, 12, Milan, 20121, Italy. The Product is made available in **Japan** by Citigroup Global Markets Japan Inc. ("CGMJ"), which is regulated by Financial Services Agency, Securities and Exchange Surveillance Commission, Japan Securities Dealers Association, Tokyo Stock Exchange and Osaka Securities Exchange. Shin-Marunouchi Building, 1-5-1 Marunouchi, Chiyoda-ku, Tokyo 100-6520 Japan. If the Product was distributed by SMBC Nikko Securities Inc. it is being so distributed under license. In the event that an error is found in an CGMJ research report, a revised version will be posted on the Firm's Citi Velocity website. If you have questions regarding Citi Velocity, please call (81 3) 6270-3019 for help. The Product is made available in **Korea** by Citigroup Global Markets Korea Securities Ltd., which is regulated by the Financial Services Commission, the Financial Supervisory Service and the Korea Financial Investment Association (KOFIA). Citibank Building, 39 Da-dong, Jung-gu, Seoul 110-180, Korea. KOFIA makes available registration information of research analysts on its website. Please visit the following website if you wish to find KOFIA registration information on research analysts of Citigroup Global Markets Korea Securities Ltd. http://dis.kofia.or.kr/fs/dis2/fundMgr/DISFundMgrAnalystPop.jsp?companyCd2=A03030&pageDiv=02. The Product is made available in **Malaysia** by Citigroup Global Markets Malaysia Sdn Bhd (Company No. 460819-D) ("CGMM") to its clients and CGMM takes responsibility for its contents. CGMM is regulated by the Securities Commission of Malaysia. Please contact CGMM at Level 43 Menara Citibank, 165 Jalan Ampang, 50450 Kuala Lumpur, Malaysia in respect of any matters arising from, or in connection with, the Product. The Product is made available in **Mexico** by Acciones y Valores Banamex, S.A. De C. V., Casa de Bolsa, Integrante del Grupo Financiero Banamex ("Accival") which is a wholly owned subsidiary of Citigroup Inc. and is regulated by Comision Nacional Bancaria y de Valores. Reforma 398, Col. Juarez, 06600 Mexico, D.F. In **New Zealand** the Product is made available to 'wholesale clients' only as defined by s5C(1) of the Financial Advisers Act 2008 ('FAA') through Citigroup Global Markets Australia Pty Ltd (ABN 64 003 114 832 and AFSL No. 240992), an overseas financial adviser as defined by the FAA, participant of the ASX Group and regulated by the Australian Securities & Investments Commission. Citigroup Centre, 2 Park Street, Sydney, NSW 2000. The Product is made available in **Pakistan** by Citibank N.A. Pakistan branch, which is regulated by the State Bank of Pakistan and Securities Exchange Commission, Pakistan. AWT Plaza, 1.1. Chundrigar Road, P.O. Box 4889, Karachi-74200. The Product is made available in the **Philippines** through Citicorp Financial Services and Insurance Brokerage Philippines, Inc., which is regulated by the Philippines Securities and Exchange Commission. 20th Floor Citibank Square Bldg. The Product is made available in the Philippines through Citibank NA Philippines branch, Citibank Tower, 8741 Paseo De Roxas, Makati City, Manila. Citibank NA Philippines NA is regulated by

The Bangko Sentral ng Pilipinas. The Product is made available in **Poland** by Dom Maklerski Banku Handlowego SA an indirect subsidiary of Citigroup Inc., which is regulated by Komisja Nadzoru Finansowego. Dom Maklerski Banku Handlowego S.A. ul.Senatorska 16, 00-923 Warszawa. The Product is made available in the **Russian Federation** through ZAO Citibank, which is licensed to carry out banking activities in the Russian Federation in accordance with the general banking license issued by the Central Bank of the Russian Federation and brokerage activities in accordance with the license issued by the Federal Service for Financial Markets. Neither the Product nor any information contained in the Product shall be considered as advertising the securities mentioned in this report within the territory of the Russian Federation or outside the Russian Federation. The Product does not constitute an appraisal within the meaning of the Federal Law of the Russian Federation of 29 July 1998 No. 135-FZ (as amended) On Appraisal Activities in the Russian Federation. 8-10 Gasheka Street, 125047 Moscow. The Product is made available in **Singapore** through Citigroup Global Markets Singapore Pte. Ltd. (“CGMSPL”), a capital markets services license holder, and regulated by Monetary Authority of Singapore. Please contact CGMSPL at 8 Marina View, 21st Floor Asia Square Tower 1, Singapore 018960, in respect of any matters arising from, or in connection with, the analysis of this document. This report is intended for recipients who are accredited, expert and institutional investors as defined under the Securities and Futures Act (Cap. 289). The Product is made available by The Citigroup Private Bank in Singapore through Citibank, N.A., Singapore Branch, a licensed bank in Singapore that is regulated by Monetary Authority of Singapore. Please contact your Private Banker in Citibank N.A., Singapore Branch if you have any queries on or any matters arising from or in connection with this document. This report is intended for recipients who are accredited, expert and institutional investors as defined under the Securities and Futures Act (Cap. 289). This report is distributed in Singapore by Citibank Singapore Ltd ("CSL") to selected Citigold/Citigold Private Clients. CSL provides no independent research or analysis of the substance or in preparation of this report. Please contact your Citigold//Citigold Private Client Relationship Manager in CSL if you have any queries on or any matters arising from or in connection with this report. This report is intended for recipients who are accredited investors as defined under the Securities and Futures Act (Cap. 289). Citigroup Global Markets (Pty) Ltd. is incorporated in the **Republic of South Africa** (company registration number 2000/025866/07) and its registered office is at 145 West Street, Sandton, 2196, Saxonwold. Citigroup Global Markets (Pty) Ltd. is regulated by JSE Securities Exchange South Africa, South African Reserve Bank and the Financial Services Board. The investments and services contained herein are not available to private customers in South Africa. The Product is made available in **Spain** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. 29 Jose Ortega Y Gasset, 4th Floor, Madrid, 28006, Spain. The Product is made available in the **Republic of China** through Citigroup Global Markets Taiwan Securities Company Ltd. ("CGMTS"), 14 and 15F, No. 1, Songzhi Road, Taipei 110, Taiwan and/or through Citibank Securities (Taiwan) Company Limited ("CSTL"), 14 and 15F, No. 1, Songzhi Road, Taipei 110, Taiwan, subject to the respective license scope of each entity and the applicable laws and regulations in the Republic of China. CGMTS and CSTL are both regulated by the Securities and Futures Bureau of the Financial Supervisory Commission of Taiwan, the Republic of China. No portion of the Product may be reproduced or quoted in the Republic of China by the press or any third parties [without the written authorization of CGMTS and CSTL]. If the Product covers securities which are not allowed to be offered or traded in the Republic of China, neither the Product nor any information contained in the Product shall be considered as advertising the securities or making recommendation of the securities in the Republic of China. The Product is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security or financial products. Any decision to purchase securities or financial products mentioned in the Product must take into account existing public information on such security or the financial products or any registered prospectus. The Product is made available in **Thailand** through Citicorp Securities (Thailand) Ltd., which is regulated by the Securities and Exchange Commission of Thailand. 18/F, 22/F and 29/F, 82 North Sathorn Road, Silom, Bangrak, Bangkok 10500, Thailand. The Product is made available in **Turkey** through Citibank AS which is regulated by Capital Markets Board. Tekfen Tower, Eski Buyukdere Caddesi # 209 Kat 2B, 23294 Levent, Istanbul, Turkey. In the **U.A.E**, these materials (the "Materials") are communicated by Citigroup Global Markets Limited, DIFC branch ("CGML"), an entity registered in the Dubai International Financial Center ("DIFC") and licensed and regulated by the Dubai Financial Services Authority ("DFSA") to Professional Clients and Market Counterparties only and should not be relied upon or distributed to Retail Clients. A distribution of the different CIRA ratings distribution, in percentage terms for Investments in each sector covered is made available on request. Financial products and/or services to which the Materials relate will only be made available to Professional Clients and Market Counterparties. The Product is made available in **United Kingdom** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. This material may relate to investments or services of a person outside of the UK or to other matters which are not regulated by the FSA and further details as to where this may be the case are available upon request in respect of this material. Citigroup Centre, Canada Square, Canary Wharf, London, E14 5LB. The Product is made available in **United States** by Citigroup Global Markets Inc, which is a member of FINRA and registered with the US Securities and Exchange Commission. 388 Greenwich Street, New York, NY 10013. Unless specified to the contrary, within EU Member States, the Product is made available by Citigroup Global Markets Limited, which is regulated by Financial Services Authority.

Pursuant to Comissão de Valores Mobiliários Rule 483, Citi is required to disclose whether a Citi related company or business has a commercial relationship with the subject company. Considering that Citi operates multiple businesses in more than 100 countries around the world, it is likely that Citi has a commercial relationship with the subject company.

Many European regulators require that a firm must establish, implement and make available a policy for managing conflicts of interest arising as a result of publication or distribution of investment research. The policy applicable to CIRA's Products can be found at https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures.

Compensation of equity research analysts is determined by equity research management and Citigroup's senior management and is not linked to specific transactions or recommendations.

The Product may have been distributed simultaneously, in multiple formats, to the Firm's worldwide institutional and retail customers. The Product is not to be construed as providing investment services in any jurisdiction where the provision of such services would not be permitted.

Subject to the nature and contents of the Product, the investments described therein are subject to fluctuations in price and/or value and investors may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Certain investments contained in the Product may have tax implications for private customers whereby levels and basis of taxation may be subject to change. If in doubt, investors should seek advice from a tax adviser. The Product does not purport to identify the nature of the specific market or other risks associated with a particular transaction. Advice in the Product is general and should not be construed as personal advice given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. Prior to acquiring any financial product, it is the client's responsibility to obtain the relevant offer document for the product and consider it before making a decision as to whether to purchase the product. With the exception of our product that is made available only to Qualified Institutional Buyers (QIBs), CIRA concurrently disseminates its research via proprietary and non-proprietary electronic distribution platforms. Periodically, individual CIRA analysts may also opt to circulate research posted on such

platforms to one or more clients by email. Such email distribution is discretionary and is done only after the research has been disseminated via the aforementioned distribution channels. CIRA simultaneously distributes product that is limited to QIBs only through email distribution.

The level and types of services provided by CIRA analysts to clients may vary depending on various factors such as the client's individual preferences as to the frequency and manner of receiving communications from analysts, the client's risk profile and investment focus and perspective (e.g. market-wide, sector specific, long term, short-term etc.), the size and scope of the overall client relationship with Citi and legal and regulatory constraints.

CIRA product may source data from dataCentral. dataCentral is a CIRA proprietary database, which includes Citi estimates, data from company reports and feeds from Reuters and Datastream.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST