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THE SMARTPHONE NETWORK

tnm
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MALAWI TELECOMS REVIEW

CEDAR CAPITAL

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It all started in 1995, became green vs red in 1999...

Introduction

The Malawian mobile telecommunications market is a duopoly, with Telecom Networks Malawi (TNM) and Airtel Malawi (Airtel) as the two players. These hold 56% and 44% of registered sim cards for Airtel and TNM respectively.

TNM started operations in 1995 and offers standard GSM products such as voice, SMS, mobile data, and mobile money. Airtel came into the market in 1999 and offers similar products, with the exception that mobile money services are offered to the public on behalf of Airtel Mobile Commerce Limited. The MSE listed Airtel does not include the mobile money business. The products and services of the two companies are thus not differentiated but essentially commoditised.

We estimate Malawi to have approximately 10 million sim cards in the market, which is roughly 52% of the Malawian population. However, the "person penetration" rate is estimated at 8 million individuals, which is a less 42% penetration rate. The difference between the number of sim cards in the market and unique "person subscribers" would suggest that there is a lot of multi-simming with most of the subscribers having both Airtel and TNM sim cards.

According to the GSMA, Malawi is a relatively advanced market in terms of 3G penetration rates having experienced strong growth in the recent past. 4G subscriptions, although growing, remain minimal. However, the evolution of the connectivity landscape since 2G suggests that data-driven 4G subscriptions will continue to increase as smartphone ownership rises.

When it comes to the internet, it is estimated that only 16.4% (3.45 million Malawians) have access to the internet. As such, there is plenty of runway and room for growth as internet becomes a human right. It has been observed that internet subscribers are growing faster than other segments.

AIRTEL			
REVENUES	**Jun-21**	**Jun-20**	**Growth**
Voice	33 325	28 946	15%
Data	21 232	18 131	17%
Mobile Money			
Total	**54 557**	**47 077**	**16%**
Subscribers	5 756	4 417	30%

TNM			
REVENUES	**Jun-21**	**Jun-20**	**Growth**
Voice	22 906	23 683	(3%)
Data	15 599	13 662	14%
Mobile Money	5 016	3 261	54%
Total	**43 521**	**40 606**	**7%**
Subscribers	4 500	3 571	26%

Revenues

The revenue composition of the two companies is slightly different as Airtel does not have mobile money fees. Also, in HY21, there is a huge contrast, with Airtel enjoying a 15% growth in voice revenues to MWK33bln, while TNM suffered a 3% decline to MWK23bln. Airtel attributed the expansion in revenues to a 30% year-on-year growth in subscribers to 5.8mln. TNM's decline in revenues was notwithstanding a 26% increase in subscribers to 4.5mln. These subscriber numbers would suggest that Airtel is leading in market share with 56% of subscribers and 59% of the value share.

TNM attributes the drop in voice revenues to the aggressive competition which had forced the operator to reduce effective tariffs by as much as 30% in 2020.

In terms of data revenues, whilst TNM is lagging in absolute numbers with MWK16bln against MWK21bln for Airtel, it enjoyed a comparable year-on-year growth of 14% against 17% for Airtel. At the end of the half, Airtel had grown total operational revenues by 16% to MWK55bln, compared with 7% to MWK44bln for TNM.

EBITDA…

AIRTEL			
	Jun-21	Jun-20	Growth
EBITDA	23 250	19 751	18%
EBITDA Margin	43%	42%	2%

	TNM		
	Jun-21	Jun-20	Growth
EBITDA	17 082	15 117	13%
EBITDA Margin	39%	37%	5%

Given its lacklustre growth in revenues, TNM appears to have done much better at EBITDA level, growing the line by 13% to MWK17bln. Airtel, on the other hand, grew EBITDA by 18% to MWK23bln. The relevant margins are 43% for Airtel and 39% for TNM, with the latter showing a much stronger expansion of 200bps.

Profit after tax…

AIRTEL			
	Jun-21	Jun-20	Growth
PAT	11 346	11 414	(1%)
Tax rates	30%	30%	
ROE	38%	53%	

	TNM		
	Jun-21	Jun-20	Growth
PAT	4 511	3 780	19%
Tax rates	32%	37%	
ROE	20%	18%	

The picture at the bottom line was vastly different:

- Airtel, because of its debt levels of around MWK32bln, which is predominantly US$ denominated, incurred financing costs of MWK5.2bln, with MWK4bln being exchange losses. This was a growth of 353% year-on-year. The result was the 100bps decline in PAT for the half.
- For TNM, the strong EBITDA performance filtered to the bottom line, helped by a 7% growth in the depreciation charge, a 39% rise in the interest costs to MWK2.8bln, and a lower tax rate of 32%, compared with the 37% of June 2020. Hence the PAT grew 19% to MWK4.5bln.

Traditionally, Airtel being an asset light player as it does not own but leases its towers has had a higher ROE of around 38%, whilst TNM at 20% is nearly half of that.

Debt vs cash…

AIRTEL			
	Jun-21	Dec-20	Growth
Borrowings	32 332	31 486	3%
Cash	28 238	17 418	62%
Interest Cover	4,18		
Net debt/EBITDA (x)	0,18		

	TNM		
	Jun-21	Dec-20	Growth
Borrowings	41 504	30 862	34%
Cash	13 539	14 677	(8%)
Interest Cover	3,40		
Net debt/EBITDA (x)	1,64		

Both companies are leveraged, however, the net debt/EBITDA multiple appears to be better for Airtel, although the US$ nature presents a higher risk. Although, TNM has a mix of local and US$ debt and its net debt/EBITDA multiple is worse than that of Airtel, it is by no means onerous. Looking at it the other way, interest coverage ratios are healthy at 4.18x and 3.40x for Airtel and TNM respectively.

Looking into the future …

As operators continue to add subscribers to the network, they typically reach out to harder to reach areas or segments and often either poorer subscribers or multi-SIM owners. Incremental subscribers often spend much less than more affluent early adopters of mobile services.

Revenue-dilutive Incremental Subscribers

Drivers of future Subscriber Growth

Subscriber growth is likely to continue being driven by (a) lower call prices and (b) the lower overall cost of ownership for handsets, thus, allowing penetration into lower income segments.

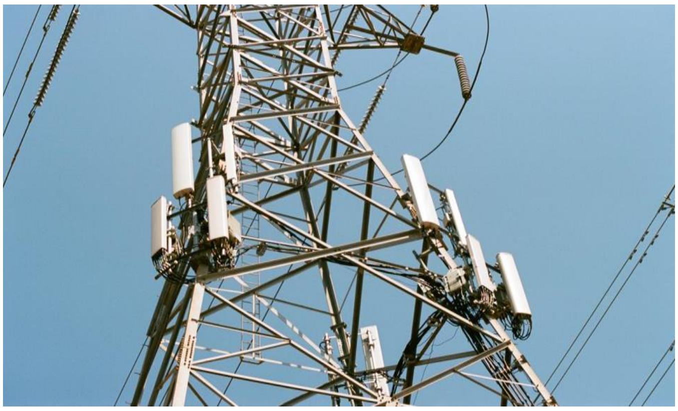
Declining ARPUs

It is expected that the acceleration in the decline of voice ARPU will continue through lower bundled tariffs, rise in lower income segments, and increased competition.

Tariff Innovation

Tariff Innovation is usually a tactical strategy geared towards maintaining market share, securing fixed spend, stimulating demand, and nudging customers towards data. Because voice remains the main profit contributor and because elasticity is critically high, tariff innovation must be managed very carefully. Typical pitfalls of tariff innovation include (i) making tariffs available and attractive to too many users at once; and (ii) not anticipating the reaction and retaliation of the competition. Price wars can lead to lose-lose situations and pyrrhic victories.

Monetisation of Passive Assets



The mobile industry is evolving and as such management teams at network operators are being forced to make changes. One of the major changes the networks are making is the hiving off and subsequently selling off what is known in the industry as passive infrastructure or towers. This has seen the emergence of dedicated tower owning and operating companies or REITs. As such, the traditional operator model of owning and operating towers (vertical integration) is changing.

Several deals have been stuck recently, with the one closer to home being the sale by Airtel Africa of its tower business in Malawi to Helios Towers for US$56 million - an equivalent of US$76 190 per unit. The installation of each tower requires an investment of between USD40 000 to USD60 000. *This forms the base value of towers or most of the basic passive infrastructure.*

Digital learning and Remote working

Digital learning and remote working have become popular topics of discussion as the COVID-19 pandemic has accelerated the move from learning and working in physical buildings to online, and telco operators have and will play a crucial role in this as an enabler.

Partnerships and diversified ecosystems

The future of the mobile networks industry thus entails partnerships, mergers, and acquisitions with other service providers. This will enable operators to differentiate themselves from the competition, build new and enhanced service offerings, and create new business models that aim to provide customers with value-added services as opposed to basic services.

AIRTEL MALAWI

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Price (MWK)	38.29
P/E (x)	19.13
P/B (x)	11.88
Year to Date Gain/Loss	36.85%
Market Cap (MWK mln)	421 190
Recommendation	HOLD

MWK000's	Jun-21	Jun-20	YoY
Voice Revenue	33 325	28 946	15%
Data Revenue	21 232	18 131	17%
Other Revenue	4 772	3 931	21%
Total Revenue	**59 329**	**51 008**	16%
Other Income	742	413	80%
Expenses	(31 307)	(27 327)	15%
EBITDA	**28 764**	**24 094**	**19%**
Depreciation	(7 313)	(6 761)	8%
Operating Profits	**21 451**	**17 333**	**24%**
Finance costs	(5 129)	(1 085)	373%
PBT	**16 322**	**16 248**	**0%**
Tax	(4 976)	(4 834)	3%
PAT	**11 346**	**11 414**	**(1%)**
Inventories	9	266	(97%)
Receivables	19 496	21 717	(10%)
Cash	28 238	11 483	146%
Current Assets	**57 264**	**38 338**	49%
PPE	62 475	68 638	(9%)
Total Assets	**137 749**	**114 391**	20%
Payables	38 281	44 723	(14%)
Current liabilities	**89 220**	**54 759**	**63%**
Borrowings	32 332	37	
Capital/NAV	35 439	27 166	30%
Capex	7 313	16 249	(55%)

Technical Data		
Voice Subscribers	*5 756*	*4 417*
Data Subscribers	*1 980*	*1 403*
ARPU (MWK)	*1 862*	*2 075*
Capex/Revenue (%)	12,33	31,86
EBIDTA Margin (%)	48,48	47,24
ROE (%)	36,25	

Growth all round ….

Airtel Malawi's HY21 reflected the strong top line performances. Voice revenues grew 15% to MWK33bln, on the back of a 14% growth in subscribers in 6 months. However, the ARPU declined 10% to MWK1 862, showing the dilutionary impact of the rapid growth in SIM cards.

Data revenues were up 17% to MWK21bln while "other revenues – mostly interest income" rose 21% to MWK5bln.

Aggregating these revenue streams, total turnover rose 16% year on year to MWK59bln.

Margins remain robust …

The growth in revenues did not compromise margins, with EBITDA margins expanding by 125bps points to 48.5%. Hence EBITDA increased by 19% to MWK29bln.

Kwacha depreciation felt…

Financing costs galloped 373% to MWK5bln, attributed mainly to exchange losses of around MWK4bln. Actual interest costs were the same as last year at circa MWK1bln. Airtel Malawi has US$-denominated debt of US$40mln owed to an international bank. The loan is due in September 2023.

The exchange losses meant the PAT declined by 1% year-on-year to MWK11bln.

Debt burden is not onerous …

At face value, the debt-to-equity ratio of 92% might appear excessive, but the interest payments are 6.6x covered by operating profits and the net debt to EBIDTA ratio is a comfortable 0.14x. It is worth noting that Airtel had a cash balance of MWK28bln at the close of the period, giving a net debt of just MWK4bln.

Minor regulatory headwinds…

On 30 September it was reported that Airtel had been fined MWK2.1bln by the Competition and Fair Trade Commission over forfeited bonuses on the Khethekhethe bundle promotion.

Watch out for exchange losses…

At an operational level, Airtel is growing revenues, and more commendable is the double-digit growth in voice revenues. Other operators in the region are recording voice revenue declines. The company's cash flow generation is strong. The risk for Airtel going forward is the negative effect of exchange losses on the PAT. At these levels of a P/E of roughly 20x, we think the company is fairly valued. **HOLD**

TELEKOM NETWORKS MALAWI

Price (MWK)	22.98
P/E (x)	27.20
P/B (x)	4.77
Year to Date Gain/Loss	14.50%
Market Cap (MWK mln)	230 729
Recommendation	BUY

MWK million's	Jun-21	Jun-20	YoY
Voice Revenue	22 906	23 683	(3%)
Data Revenue	15 599	13 662	14%
Mobile Money	5 016	3 261	54%
Total Revenue	**43 521**	**40 606**	7%
Cost of Sales	(10 331)	(9 042)	14%
Gross Profit	**33 190**	**31 564**	5%
Other Income	2 017	1 637	23%
Expenses	(18 125)	(18 057)	0%
EBITDA	**17 082**	**15 144**	13%
Depreciation	(7 648)	(7 149)	7%
Operating Profits	**9 434**	**7 995**	18%
Finance costs	(2 773)	(1 996)	39%
PBT	**6 661**	**5 999**	11%
Tax	(2 150)	(2 219)	(3%)
PAT	**4 511**	**3 780**	19%
Inventories	2 146	1 682	28%
Receivables	20 949	14 644	43%
Cash	13 539	16 081	(16%)
Current Assets	**37 738**	**33 528**	13%
PPE	73 975	56 458	31%
Total Assets	**133 325**	**110 806**	20%
Payables	27 407	16 582	65%
Current liabilities	**52 682**	**52 014**	1%
Borrowings	41 504	45 682	(9%)
Capital/NAV	**48 417**	**42 970**	13%
Capex	14 882	11 661	28%

Technical Data	Jun-21	Jun-20	YoY
Voice Subscribers	*4 500*	*3 571*	26%
EBIDTA Margin (%)	*39,25*	*37,29*	
Return on Equity (%)	19,54	17,86	

Voice underperforming but turning around ….

TNM's performance was once again hampered by a 3% decline in voice revenues to MWK23bln, attributed to a competition induced decline in effective tariffs. The decline in voice revenues occurred despite a 26% year-on-year growth in subscribers to 4.5mln. On the other hand, data and mobile money revenues grew by 14% and 54% to MWK16bln and 5bln respectively. In the 6 months, total revenues increased by 7% to MWK44bln.

Playing the margin game …

Cost of sales growth was 14%; while operating expenses growth was flat, resulting in the EBITDA advancing 13% to MWK17bln. The corresponding EBITDA margins rose 200bps to 39.25%. Operating expenses included a provision of MWK936mln in respect of the unresolved VAT issue. Total provisions on this matter were MWK7bln by the close of the half.

Borrowings increased 34% to MWK42bln when compared with the December 2020 amount of MWK30bln. Hence, financing costs rose 39% to MWK2.8bln, which was 3.4x covered by operating profits. A muted 3% growth in the tax provision resulted in a healthier 19% rise in the PAT to MWK4.5bln.

Turnaround and undervalued play …

TNM appears to have arrested the decline in voice revenues, while mobile money growth remains buoyant. Operationally, TNM's turnaround seems to be on track. The tax provision could potentially be written back should the matter be resolved in favour of TNM, providing another catalyst going forward.

Undervalued demerger play …

Given the latest trends of splitting the mobile network business into three components by (a) monetising the passive assets (towers) through sale and leaseback, (b) unbundling of mobile money services, and (c) retaining the pure play voice and data businesses. Using recent strike prices of tower deals, we valued TNM's 812 towers. We also valued the mobile money business using strike prices and applied the P/E, EV/EBITDA, and P/EBITDA multiples to value the voice and data business. We got a value per share of **MWK31.95. BUY.**

MWK mlns	
Mobile Service Operations	209 586,45
Towers	72 378,08
Mobile Money	38 818,27
TNM Valuation	**320 782,80**
TNM value per share	**31,95**

American Towers & Helios Towers Transactions in SSA …

Company/Transaction	# of towers	Valuation (USD) mlns	Valuation/Tower
			USD 000's
Nigeria - Airtel	1 211	1 060	875,31
Uganda - MTN	962	89	92,78
Ghana	1 836	219	119,01
Cell C - South Africa	1 400	200	142,86
Free Senegal (Helios)	1 220	210	172,13
Airtel Malawi (Helios)	735	56	76,19
Airtel Madagascar (Helios)	494	52	105,26
Airtel Tanzania	1 400	175	125,00
Zantel	185	7	36,22
Airtel DRC	967	165	170,63
Vodacom - Tanzania	1 149	75	65,27
Tigo - Tanzania	1 020	81	79,41
Tigo - DRC	729	42	56,93
Tigo - Ghana	750	54	72,00
Airtel - Zambia	949	150	158,06
MTN - Nigeria	8 850	984	111,19
Etilisat - Nigeria	2 136	485	227,06
MTN - Rwanda	550	48	87,27
MTN - Zambia	748	57	76,20
MTN - Ivory Coast	911	141	154,77
MTN - Cameron	820	143	174,39
Visafone - Nigeria	800	67	83,75
Average			**156,41**

Competing on price …

Winner takes all price wars

- Tuesday 28 July 2020 | 12:02 CET | News - Malawi's internet users have criticised mobile operator TNM for announcing a cut in prepaid data rates but not reducing the cost of data bundles, MaraviPost reported. TNM has said it cut internet rates 70 percent in the campaign 'Data price must fall'. However, the reduction only applies to pay-as-you-go and not bundles. The current charge per MB is around MWK 25. The 70 percent reduction would mean the price is about MWK 6,000 per GB, which is still higher than the cost of a 1GB bundle. Furthermore, there are few people who use internet under pay-as-you-go rates, they noted. TNM made the reduction on 24 July. Minister of Information Gospel Kadzako was cautious, saying he would comment after listening to reactions of the users themselves.
- Monday 3 August 2020 | 09:59 CET | News - Airtel Malawi has reduced its Pay As You Go tariffs from MWK 15 per megabyte of data to MWK 5 per 1 MB and has increased the benefits with eight popular bundles with effect from 03 August. Airtel Malawi MD Charles Kamoto said the company has "listened carefully to feedback from customers". Minister of Information Gospel Kazako said the decision by Airtel is in line with the Tonse Alliance philosophy of improving the welfare of the public regardless of their social status.

Sell the masts…

- 10 Dec 2020 - MTN Group is looking to sell and lease back part of its South African tower portfolio, Bloomberg reports, citing an interview with a new CEO Ralph Mupita. The group’s South African network is understood to comprise around 13,000 cell towers.