Some of the Vodafone parts starting to bear fruit

By James Ratzer | July 27, 2019

For most analysts, a sum-of-the-parts valuation can be something to drive you crazy. The spreadsheet tells you the value is there, but the Bloomberg screen tells you it is not. Waiting for sum-of-the-parts discounts to close can sometimes be like watching paint dry, and then blink and you miss it.

Past investors in Vodafone will remember what seemed like an endless discount to the sum-of-the-parts persisting before the sale of Verizon Wireless. Then all of a sudden, not only did the discount close, the stock moved to a premium as talk of an AT&T takeover emerged. Similar stocks today like Softbank and Naspers also look attractive on this basis today – and hopefully at some points those discounts to net asset value will close.

Today though, we re-examine whether a perceived discount in Vodafone sum-of-the-parts might be on the cusp of closing again, as operational trends improve and Vodafone has announced more active steps to unlock “hidden” value in its tower assets. On Friday we published a detailed review on their proposed intentions (HERE), and the announcements saw Vodafone’s share price rally 11% in the day. Almost unheard of in the European telecoms sector.

We had been cautious on the Vodafone share price since the Verizon Wireless disposal, as Vodafone was exposed to pan-European sector deflationary trends and we never could make the valuation look compelling. However at the turn of the year, we upgraded Vodafone and the European telecoms sector to overweight (see HERE). We thought inflecting revenue trends combined with an attractive double-digit EFCF yield was compelling. With the benefit of hindsight we were a few months early, but Vodafone has finally delivered inflecting service revenue trends and set out an optimistic tone for the next few quarters. We think Vodafone should be able to take service revenue growth back to over 1% growth by year-end, and the last time Vodafone was doing this, the shares were nearer 190p – 30% higher than the current price. The new consolidation of Unity will also help to further support organic growth rates.

However, the rocket fuel that might help to bring in new investors, is Vodafone's clearer intention to monetise their tower portfolio more aggressively through a partial IPO at the very least, which marks a noticeable shift in strategy. As global interest rates have declined since the beginning of the year, the wall of money looking for yield assets has pushed up the value of infrastructure assets significantly – and Vodafone is now looking to cash in. When Cellnex is up 65% YTD, but Vodafone is down 4% YTD, who can blame them, otherwise activist investors might start to make themselves more vocal.

But Vodafone is being smarter than just selling to cash in on the multiple. They are also looking to unlock operational synergies from 5G RAN sharing first before handing over the value to a third party. This has clearly been borne out by the terms of the merger of their tower asset in Italy into Inwit. Their patience and the creation of operational synergies is allowing them to cash out the asset at 24x EV/ EBITDA, more than 2 ½ times higher than the equity value when TI cashed out back at the IPO in 2015. We think this transaction alone has created 4% value accretion for Vodafone, and they should be able to more than match that in Germany if they can deliver a tower sharing deal with either DT or Telefonica Deutschland. We don't yet include the potential upside from this in our valuation.

The new management team isn't yet celebrating its first birthday, but they are already trying to reinvigorate the equity story, which can be tough to do when your industry is still struggling to deliver sustainable revenue growth. While towers are clearly top of the agenda right now, this isn't the end of the road for unlocking value. Vodafone would like to unlock the value in its Indian tower stake (albeit this might end up being used to fund ongoing losses at Vodafone Idea – see HERE for more details), but more value transparency might come over time from its EM assets – either a Vodacom spin-out or even a spin-out of the entire set of EM assets.

Sum-of-the-parts discounts tend not to just close of their own accord. Management, which is incentivised to get the stock price moving, often needs to take action – and this is what we are now clearly seeing. A very welcome step in the right direction.

Full 12-month historical recommendation changes are available on request

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