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Headwinds in South Africa: Vodacom shareholders should be aware (including Vodafone)

July 5, 2019 by Alastair Jones

We've been writing extensively about the future role of 5G and how 3.5GHz spectrum feeds into that role. Unfortunately for some operators, 5G is just a pipe dream – particularly in a place like South Africa. Here, the government has not issued or auctioned off any spectrum for the last 14 years. In fact, South Africa has one of the lowest spectrum allocations of all markets globally. This should mean that the market has one of the lowest returns of all, as the operators all struggle to provide capacity for consumers. But this is where it gets interesting – the opposite has happened. The operators have merely kept data pricing at the highest level possible to limit capacity issues. Now the blame game begins. Whilst the government and the industry try blame each other, investors in Vodacom are likely to suffer the most (LINK). Vodafone, being the majority shareholder, should take note. In fact, we think Vodafone should consider whether spinning off Vodacom to its shareholders may make sense to give them the choice as to whether they should continue owning the asset.

South Africa has the highest data pricing across 30 markets that we cover. To give an example: An iPhone XR package with 1.2GB of data costs $120/month on Vodacom. The same phone, with 15GB of data (and unlimited voice/SMS) in the UK costs US$67/month on Vodafone's network. Given wealth differentials between the two markets, this is not sustainable.

By keeping prices high, the operators can manage network stress, instead of having to invest more aggressively to increase capacity. We estimate that Vodacom's network is less constrained than the global average which is why it has not invested significantly to offset spectrum shortages and therefore been able to report super-normal returns. For investors this has been a great situation over the last decade. But there are two issues which makes us more cautious going forward:

- **Regulatory/government action heating up**: Fuelled by a consumer campaign (#datamustfall), the regulator has instigated a review of data prices. The Competition Commission recently published its findings which were damning for the industry (HERE). And finally, the President has been highlighting data tariffs as a key barrier to economic growth and is looking to issue spectrum in the next few months. All these issues suggest Vodacom (and MTN) will have to act to show willing, otherwise repercussions will intensify; and
- **Competition is now starting to get its act together**: One of the reasons tariffs have remained high is that there hasn't been a well-funded operator to challenge the dominance of MTN and Vodacom. Enter Telkom with prices 80% lower than Vodacom which is beginning to gain traction. Although Vodacom has >4x the number of subscribers, Telkom carries more traffic. Vodacom is having to react.

High returns are a good thing, if they can be sustained. Unfortunately for Vodacom we don't think they will be. With regulation and competition beginning to bite, Vodacom is being pushed into a corner. It's forced them to launch aggressive promotions which were costly (HERE). As the pressure intensifies, expect them to make more mistakes. It's a journey we wouldn't recommend being part of. If you want access to African growth potential at reasonable multiples, MTN has great assets across Sub-Saharan Africa (HERE), along with Airtel

Africa (HERE). But for Vodacom whose value is predominantly exposed to a deteriorating market outlook in SA, we would stay away.
