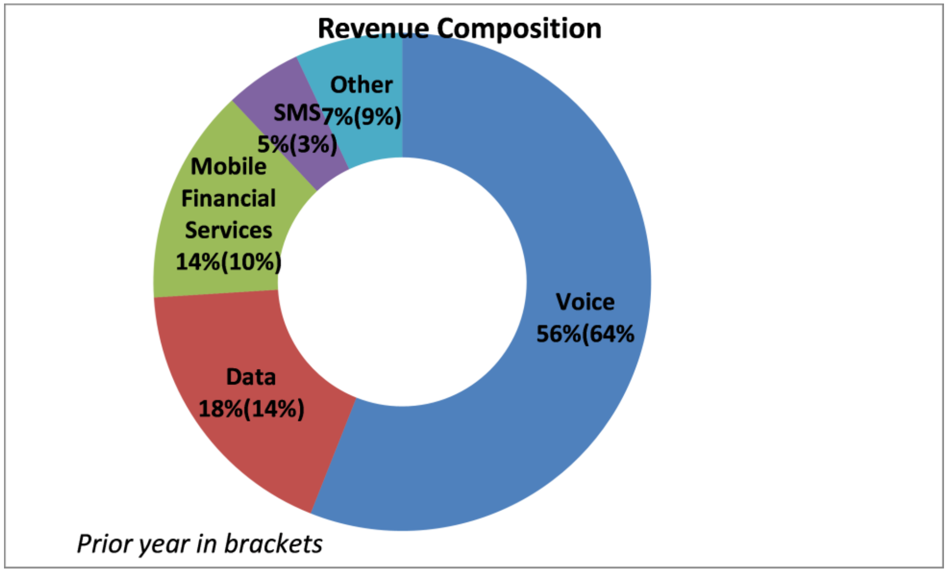
Econet Financial Year Ended 29 February 2016 Analysis

Market Data			
Current Share Price(Usc)			23
Shares in Issue			1,640,021,430.00
Market cap(US$)			377,204,928.90
YOY high(Usc)			44
YOY Low(Usc)			16.01
YTD			8.96%
YOY			-48.93%
EPS			2.60
P/E			8.85
Income Statement	**FY 2016 '000'**	**FY2015 '000'**	**% Change**
Revenue	640,989.00	746,183.00	-14.1%
Operating profit	101,864.00	159,356.00	-36.1%
Profit After tax	40,200.00	70,209.00	-42.7%
Operating margin	15.9%	21.4%	-25.6%
Net Profit margin	6.3%	9.4%	-33.3%
Financial Position			
Total Assets	1,196,904.00	1,256,492.00	-4.7%
Total Liabilites	535,007.00	591,196.00	-9.5%
Attributable Equity	657,535.00	660,771.00	-0.5%
Cashflows and Ratios			
CFs from Operations	219,115.00	175,541.00	24.8%
CFs from Investing	(91,833.00)	(143,116.00)	-35.8%
CFs from Financing	(122,806.00)	(8,517.00)	1341.9%
ROE	6.1%	10.6%	-42.3%
Revenue/user/mnth	6.84	8.14	-16.0%
Total asset turnover	0.54	0.59	-9.8%
Debt to Equity	31%	36%	-13.9%

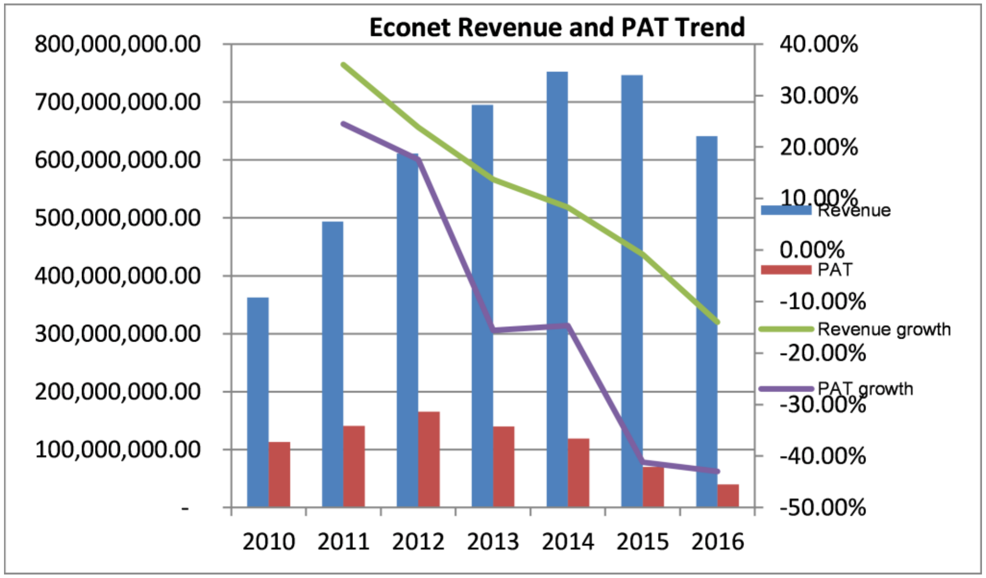
Econet Revenues Down 14%

Revenue was down 14% due to regulatory price reductions, an increase in levies and a decline in voice revenues due to a tough operating environment and the rise in the newer, cheaper alternative ways of voice calling using data. In particular, regulatory obligations have been tenacious on the company topline. POTRAZ reduced inter connection rates from 5cents to 4cents whilst the Universal Services Levy was increased from 0.5% to 1.5% resulting in a revenue decline of $4.5 million. Excise duty of 5% on airtime was being levied on the Company for the greater part of the financial year. This position was however regularized on 1 Jan 2016 to be charged on customers but however resulted in a revenue reduction of $30 million. The chart below indicates how revenue was composed among the various Econet products.



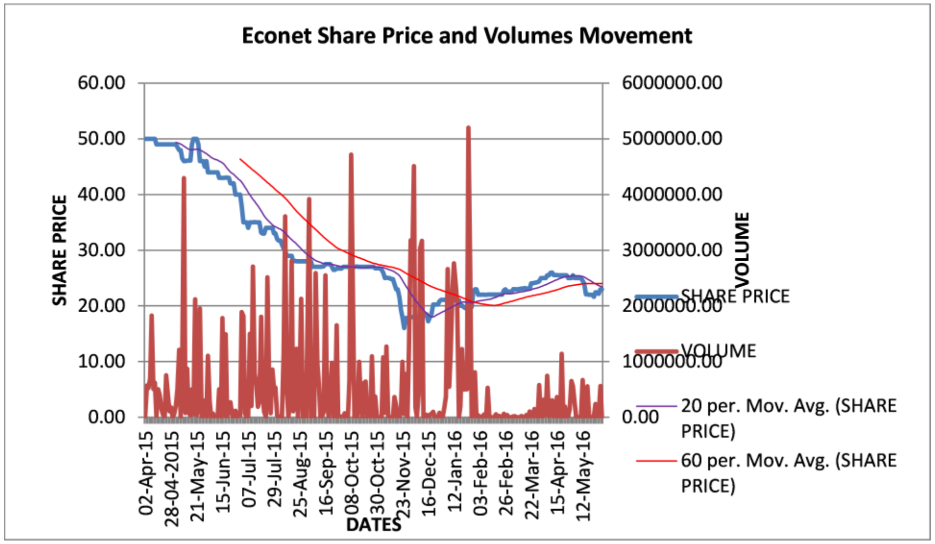
It can be observed that the importance of product diversification to Mobiles Financial Services such as Ecocash and Broadband cannot be underestimated given the reduced contribution of voice to revenues.

There was a 34% increase in data subscribers to 7.12 million from the previous year whilst Ecocash subscribers rose by 38% to 5.8million and the number of agents went up by 48%. As such 98% of mobile money transfers are conducted on the Ecocash platform. Although costs remain quite high, they were down by 12% to $420 million due to various cost optimization measures leading to a 16.5% reduction in EBITDA and 42.7% reduction in Profit After Tax. Earnings per share was down 73% to 2.6c. Debt to equity ratio was down by 14% to 31% as the company continues to reduce its gearing levels. A dividend of 0.9c was declared giving a dividend yield of 4% and a payout ratio of 35%.



The graph indicates that Revenue and PAT trend has been negative since 2012 with PAT declining much faster than revenues due to the significant cost structures of the business. In the financial year ended, the company engaged in cost cutting initiatives which included a 20% cut in gross salaries, retrenchment of over 150 employees and negotiations with suppliers to achieve a 15% reduction in costs.

Technical Analysis



The graph exhibits a general decline in the Econet share price since 2015 due to negative investor sentiment and increased selling pressure particular from foreign investors. The counter has however witnessed a slight recovery in the share price since the beginning of 2016 as has been indicated by the short term moving average which has been trending above the long term average until recently where we observe it cutting the long term average from above which is an indication of emerging downtrend. We do not however expect that trend to persist as the counter is deemed to be currently over punished by the market.

Investment case

- It is a highly liquid counter.
- The company remains a market leader in the telecommunications industry. It commands 70% of total value share in this market, its subscriber base currently stands 10 million and 98% of the mobile money value is transacted on the Ecocash platform.
- The Company has positioned itself well for the deterioration of its traditional revenue streams through wide growth of overlay services such as Ecocash and Broadband. It has currently laid out more than 10 000km of fibre and has agents all around the country that ensure steady growth of its Mobile Financial Services. These two services now jointly contribute 32% to total revenues from 24% in 2015.
- The company is able to make material capital investments in a way that its competitors are unable to which allows it to offer a quality and scale of service that is unrivalled.
- Strong relationships with its vendor partners, both for equipment and broadband, as well as its diaspora remittance business via EcoCash mean that the group is very well placed to deal with the challenges of cash shortages and outgoing payments for its imports.
- The company continues to enjoy strong cash flows and has made substantial progress in paying down its debt and reducing its gearing.

Investment Concerns

- The outlook for voice revenue (contributes over 50% to total revenue) remains negative as over the top (OTT) services like Whatsapp continue to disrupt demand for voice and whilst at the same time the voice space is subject to a vicious price war among the networks
- Regulatory pressures have taken a serious toll on the company's revenues and will continue to do so given the POTRAZ order to reduce inter connection fees from 5c to 4c and the increase from 0.5% to 1.5% of Universal Services Fund levy.
- Despite being the number one mobile operator in the country, Econet has been far from being immune to the economic woes of the country. It has established a very wide coverage of fibre and yet the full benefits are yet to be realized given the low disposable incomes.
- The decline in net earnings of the business remains a serious cause for concern given that with each coming year Econet is becomes more reliant on lower margin products.

Valuation and Recommendation

Going forward we anticipate a reversal in revenue growth in the coming year as the previously mentioned 5% duty on airtime will now be levied on customers. This duty resulted in a $30 million reduction in the 2016 revenues. This is expected to support the reducing contribution from voice revenues which are also expected to be supported by the massive promotions that are being undertaken to promote the use of voice services. Sizeable growth from data use is expected given the increasing use of social networks and internet by the general populace despite the depressed economic conditions. Mobile Financial Services are also anticipated to exhibit further positive momentum given the wider outreach into the Diaspora and the fact that this kind of service is already very popular locally. As such a 10% growth in revenues is expected in 2017. EBITDA margins are expected to slightly taper off to 36% due to increasing importance of lower margin products. As the company is now dedicated towards reducing its borrowings, finance costs are expected to reduce further leading to a Profit After tax growth of 18% at $47.5 million. In our valuation we used the P/E multiple which indicates a historical average of 7.6x against a current P/E of 8.8x. We also used the EV/EBITDA approach which indicates a historical average of 4.4x against a current EBITDA of 3.4x. In forecasting future earnings for the business we used the Maintainable Earnings approach which gave us a fairvalue of 38c per share. A combination of all these methods gave an estimated fairvalue of 41c thus giving an upside potential of 78% from the current price of 23c per share. We therefore give a **BUY** recommendation as we have a firm belief that Econet will continue to be the dominant telecoms player in the market for the foreseeable future and will enjoy significant upside with any improvement in the macro-economic conditions.