MTN: a play on African growth - Kagiso Asset Management Equity Analyst Aslam Dalvi

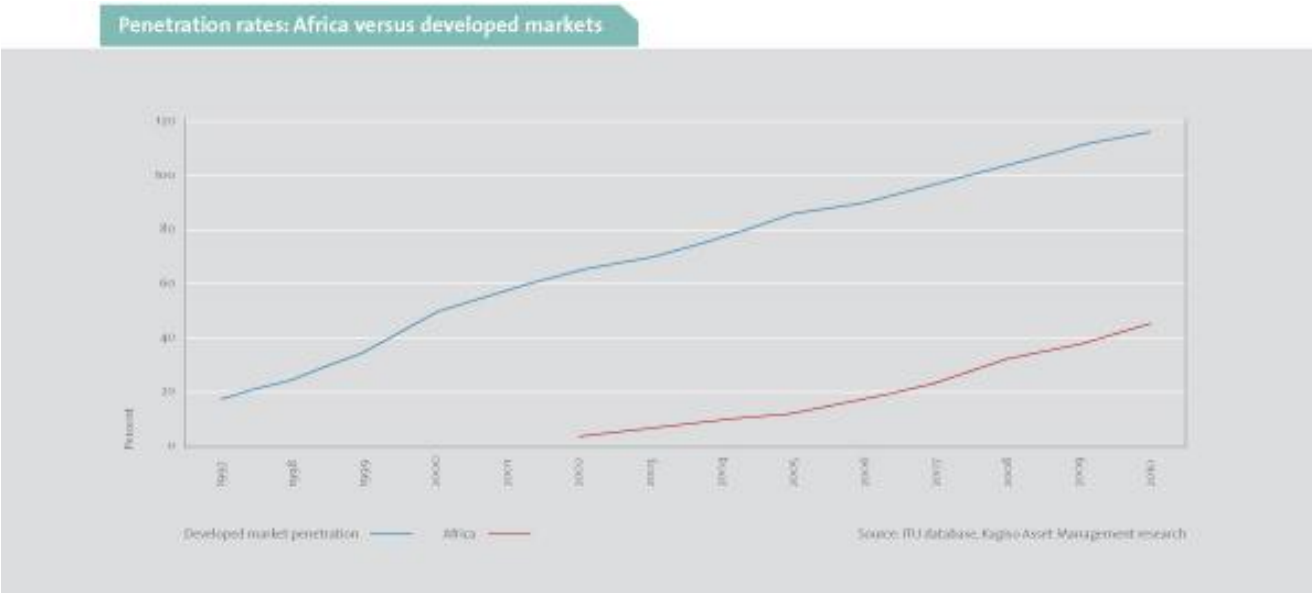
It is no surprise that investors are currently clamouring for access to emerging market growth. With the debt and fiscal problems in developed economies, investors have looked to emerging markets, where growth continues to be robust.

Despite key challenges - political instability, poor infrastructure and high income disparities - Africa has several fundamental strengths. Attractive demographics, high urbanisation rates and access to a large and untapped wealth of natural resources will see the continent continue to grow and eventually emerge as a key player in the global economy.

Africa continues to remain an attractive market for mobile telecommunications operators and the sector is likely to be a key beneficiary of African growth. Relatively low mobile penetration, favourable demographics, growing household incomes and a large population size provide a favourable market for these operators.

MTN, as a dominant player in Africa, provides investors with an indirect way to participate in African growth. Despite growing competition within mobile telecommunications, MTN remains well positioned to participate in this growth.

Penetration as a driver of mobile revenues
African penetration rates, which reflect the number of mobile subscribers as a percentage of the population, remain low when compared to other emerging and developed markets (see graph below).



Focusing on key mobile markets in Africa, we estimate that mobile penetration in Nigeria is at around 53%, Ghana at 72% and Sudan at 45%. Using data from the International Telecommunication Union (ITU), we estimate that penetration across Africa is in the region of 45%.

In addition, ‘true’ penetration rates across Africa are probably lower than reported for unique structural reasons. After one accounts for multiple SIM cards per subscriber, actual penetration is significantly lower. In Nigeria for example, multiple SIM cards represent approximately 30% of the market. As a result, ‘true’ population penetration in Nigeria is only around 37%.

A comparison of penetration rates between emerging and more mature markets, where penetration ultimately ends off above 100%, suggests that the future growth potential in African subscribers is significant.

Demographics and population growth
While the penetration argument is compelling, it looks at current market sizes only and ignores demographics. Demographics and population growth are key long-term drivers that add to the mobile growth outlook.

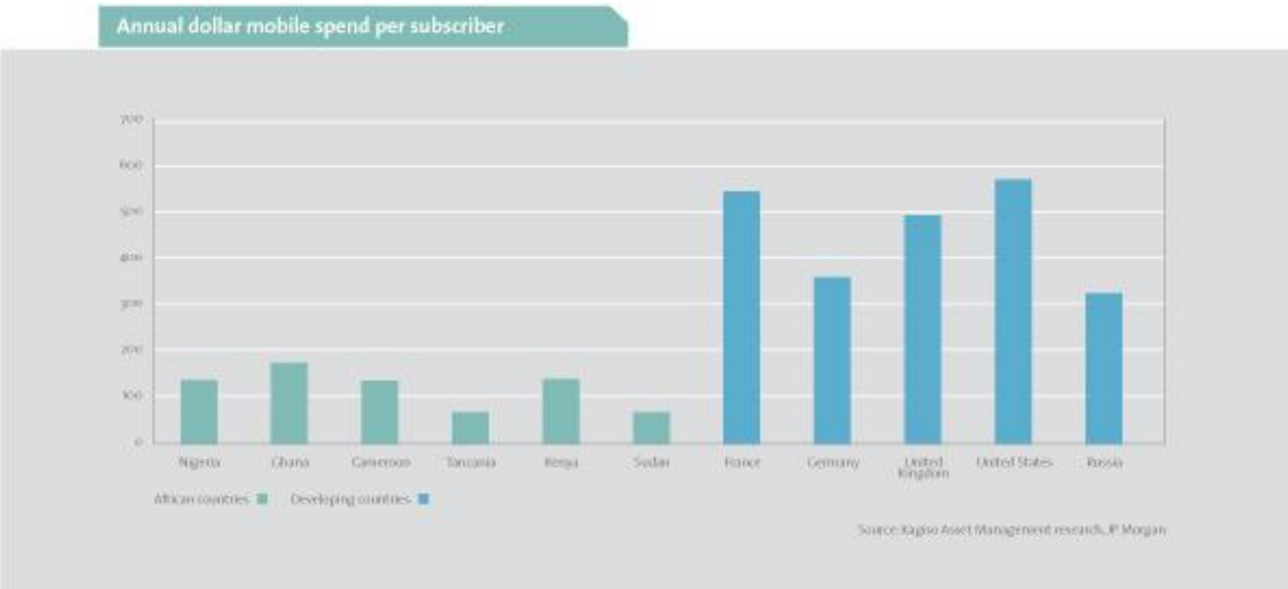
One of the most attractive features of Africa is the relatively young age of the population. The median age of the African population across key regions is approximately 20 years and compares very favourably with developed markets, where the median age is closer to 41 years.

One of the benefits of such a young population is that there is a strong correlation between economic output and population age. The argument is that output per citizen will grow as the youth start working and more actively contribute to the economy. This economic growth will ultimately see a strong rise in consumption and per capita income over time.

A high comparative population growth rate is another key long-term driver for mobile operators in Africa. Our estimates suggest that African population growth rates are in the region of 2.5% per annum, which compares very favourably with developed and eastern emerging markets, where rates average around 0.5%. Over time, this provides a strong tailwind for mobile operators as their subscriber markets continue to grow organically.

The combination of favourable demographics and strong population growth supports our view that the demand outlook for mobile services in Africa remains sound.

Rising per capita spend
In comparison to developed markets, Africa lags considerably with regards to mobile spend (see chart below). We estimate total mobile spend per subscriber in Africa averages around US120 dollars per year compared to developed markets, where average spend is closer to US460 dollars per year.



With good fundamentals supporting long-term economic growth in the region, it is inevitable that per capita mobile spend will rise in Africa. While spend is unlikely to match developed markets in the medium term, there is significant room for growth from current levels. The combination of rising spends and a growing pool of subscribers will see the mobile revenue pool in Africa continue to expand.

Growth avenues
In addition to strong underlying drivers in Africa, there are opportunities for additional growth in areas such as data, financial services and business solutions. We see the data opportunity in Africa as a key growth sector going forward.

Scope for African data growth
Global data usage growth in the last decade has been very high. It is astounding that in 1995 the world had only 16 million internet users and today there are in excess of two billion users. The growth in data traffic has been even more pronounced over this period.

There have been three very important enablers for this growth: increasing access via devices, increasing broadband speeds and a shift to more bandwidth intensive data types such as video. These drivers are not unique to developed markets and should support data demand in Africa.

Internet penetration, which measures the number of internet users across all platforms as a percent of the population, for developed markets is between 50% and 70%. In contrast, penetration in Africa is around 11% - once again highlighting significant room for growth.

Key internet infrastructure providers such as Cisco highlight strong underlying fundamentals in demand for mobile data services. Estimates from their 2011 white paper on mobile data indicate that the mobile data market in Africa will more than double each year over the next five years. A large part of this growth will come from an increase in mobile internet users, which Cisco estimates will increase significantly over this period.

With limited competition from traditional fixed line incumbents, mobile operators are well positioned to capitalise on this opportunity.

Playing in Africa
MTN is arguably the largest player in Africa with 16 African operations in total. Excluding South Africa, we estimate that these operations currently account for 55% of group revenue and close to 63% of group profits. The largest of the African operations are Nigeria and Ghana, which account for roughly 42% and 5% of group profits, respectively.

MTN is the dominant player in most of its markets, generally holding a number one or number two market position. This places the company in a strong position to benefit from continued growth in mobile markets, while still enjoying the benefits to profitability of significant scale.

Africa is however not without its challenges. While political issues and poor infrastructure are always on the agenda, more recently, rising competition has become a key risk. As a result of competition, we expect mobile tariffs to decline and we see operators like MTN losing some share and margin over the medium term.

Despite increasing competition, Africa remains attractive from a mobile revenue point of view. In line with general strong economic growth, we see the market for mobile services expanding and MTN remains well positioned to participate in this growth.

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