LOOKING BACK: Vodafone

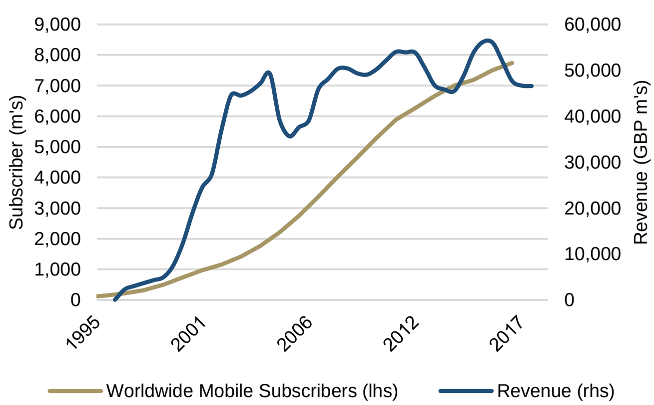
Vodafone is a household name and one of the largest mobile telecommunications providers in the world. The company operates in 49 markets and serves 530 million customers. The scale and magnitude of Vodafone's numbers are truly impressive, especially considering that the mobile phone industry did not exist 25 years ago. This quarter, we look at Vodafone's past, present, and potential implications for local players in the telecoms space.

Vodafone has its roots in a company called Rascal, that sought to commercialise military radio equipment in the early 1980s. The international GSM specifications were developed with partners during the following years and the first mobile calls were made in the early 90's, followed by SMS services in the mid-1990s.

Within a decade the consumer would have access to data services. Another decade would bring with it access to 4G services, and data speeds that would have been unimaginable when the industry started.

Vodafone had exceptional subscriber and revenue growth until around 2002. Mobile service providers such as Vodafone had pricing power, and customers were willing to pay for the convenience of not being tied to fixed lines.

Chart 1: Vodafone's Subscribers & Revenue



Source: Bloomberg

In figure 1, we can see the total worldwide growth of mobile subscribers. Demand and subscriber growth is strong, but Vodafone has lost pricing power and in real terms, the customer is continuously paying less, while getting more.

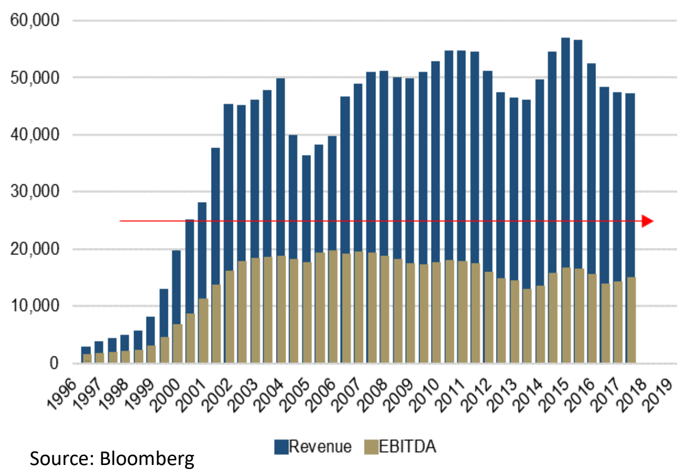
In most regions there are multiple mobile operators, and telecom deregulation and competition authorities prevent any player from becoming too dominant.

The telecoms industry also has very high capital expenditure requirements and companies are continuously forced to invest in newer technology to satisfy customers' demands, as the need for data increases.

These big capital investments necessitate that telco's operate at scale – and scale requires customers. To retain and attract customers, pricing needs to be lowered, while at the same time competitors are doing the same.

Telco's (and therefore Vodafone) are in the unfortunate position of having exponentially growing demand for their products, yet operational costs are increasing, and large capital investments are needed to remain relevant. The customers are the winners while industry profitability and returns, are the apparent losers.

Figure 2: Vodafone's Revenue & EBITDA



Source: Bloomberg

As in figure 2, we can see that with stagnant revenues and profits for almost 20 years, investors saw little benefit in holding the stock. In fact, since January 1999, investors would have lost an annualised 4.7% in USD. This resulted in a 17% underperformance vs. the MSCI World Index. When taking dividends in account, the company has only produced an annual 1.0% for investors.

Vodafone might provide some insight into what future returns might look like when an industry or company becomes "ex-growth". Ex-growth does not necessarily need to imply lack of growth on metrics such as number of subscribers or the amount of data sold, but rather a lack of revenue and earnings growth.

It's possible that Vodacom has a similar problem locally in South Africa to Vodafone's experiences in other regions. Vodacom has found it difficult to grow earnings, resulting in a possible permanent derating due to lack of growth opportunities.