MTN UGANDA IPO Note

Wednesday, October 27th, 2021

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Investment Summary

We are **NEUTRAL** on MTN Uganda. Our target price of UGX 212.73 represents an upside potential of 6.4% from the offer price of UGX 200.00.

We see the company as better placed (in part due to its investments in expanding network coverage and its market leadership position) to capture any emerging growth opportunities. However there are some risks that we see in the company such as slowdown of the legacy business segments (voice), its dominant position that may attract more regulatory scrutiny and the risk that Uganda's projected growth may not translate to economic development.

Key Ratios and Multiples

Trailing P/E Multiple(x)	13.92
Trailing EV/EBITDA Multiple (x)	5.78
EBITDA Margin	49.5%
Return on Equity	50.1%
Return on Assets	12.9%
Dividend Yield	3.4%

Background and History

MTN Uganda is a public limited company that was incorporated in Uganda in 1998. The company is a subsidiary of MTN Group, a mobile operator that has a presence in 20 markets in Africa and Middle East. MTN's core business is the provision of telecommunication services which include network services such as voice, data and messaging services, digital and financial technology services, sale of mobile devices and mobile money services.

The Offer

According to the company, the objective of the offer and subsequent listing is to comply with the NTO license terms that require the company to list a portion of its shares. This will also broaden Ugandan shareholding in MTN and provide investors an opportunity to participate in future growth of the company.

The key features of the offer and the key dates are listed in the tables below.

Key Offer Data

Offer Data	Amount
Par Value of each share (UGX)	1
Offer price per share (UGX)	200
Number of shares on offer	4,477,808,848
Total number of Issued shares	22,389,044,239

Source: MTN IPO Prospectus

Key Offer Events and Timelines

Activity	Date	Time
Offer opens	October 11, 2021	10.00 a.m
Offer closes	November 22, 2021	4.00 p.m
Announcement of Allocation	December 3, 2021	4.00 p.m
Crediting of offer shares to SCD Accounts of successful Applicants	December 3, 2021	4.00 p.m
Dispatch of SCD Account statements to successful applicants	December 3, 2021	4.00 p.m
Refund of excess Application funds in the event of Oversubscription	December 3, 2021	4.00 p.m
Listing and commencement of trading on the USE	December 6, 2021	9.30 a.m

Source: MTN IPO Prospectus

Shareholding Structure

MTN Uganda shareholding structure before and after the offer (assuming full subscription) is as follows:

	Before the Offer		After the Offer	
Shareholder	Shares	Shares %	Remaining shares	Shares %
MTN International	21,496,813,464	96.01%	17,019,004,616	76.01%
Charles Mbire	892,230,775	3.99%	892,230,775	3.99%
Public shareholders	-	-	4,477,808,848	20.00%
Total	22,389,044,239	100.00%	22,389,044,239	100.00%

Source: MTN IPO Prospectus

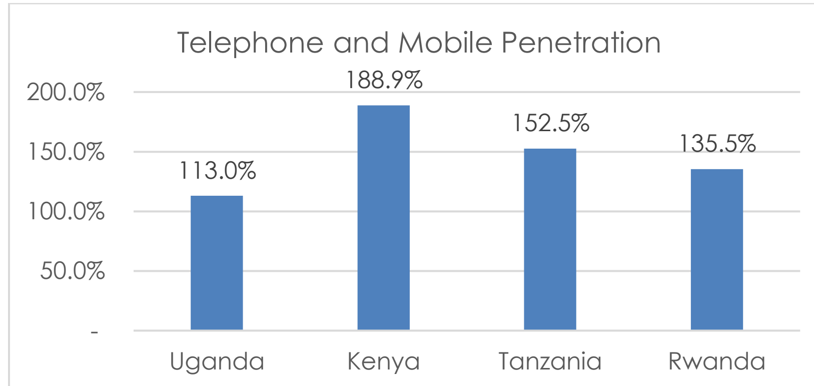
Note that there are no new shares being issued. MTN International is selling down its stake in the company (equivalent to a 20.0% stake in the company) to public shareholders. The proceeds of this sale go to MTN International and not the company (similar to Kenya government selling a stake in Safaricom).

Key Investment Considerations

1. **Industry Consideration**

Uganda Lags peers in Mobile Penetration

According to the Uganda Communications commission (UCC) fixed and mobile subscriptions stood at 29.0 million connections at the end of June 2021. This represents a CAGR (2Q2015 – 2Q2021) of only 4.5% which is lower than that of Kenya's (CAGR: 27.2%), Tanzania (CAGR: 7.6%) and Rwanda (CAGR: 5.0%) over the same period. The telephone penetration rate was estimated at about 68.0%. This is also lower compared to some of the regional peers: Kenya (132.2%), Tanzania (89%), and Rwanda (84.3%). It's worth noting that Uganda has historically had a higher proportion (47%) of children (0-14 years) that may not have access to telephone lines compared to the rest of countries (Kenya: 42%, Tanzania: 45%, Rwanda: 40%). This could partly explain the lower penetration level. However, even when we take the addressable population (15+ years), Uganda's penetration is still lower compared to its regional peers, as shown below.



Source: UN Population estimates, Respective regulators, Faida calculations

The lower penetration level offers more headroom for growth in subscriptions compared to other countries. We expect this growth to be underpinned by population growth. According to the World Bank, Uganda's population is expected to grow at a CAGR (2020-2030) of 2.5% to 59 million people by 2030 from an estimated 46 million people in 2020. More importantly, the working age group (15 to 64 years) - the group that would be expected to own a telephone line - is expected to rise faster (by 10 million to 34 million) compared to the children age group (3 million to 24 million) over the same period.

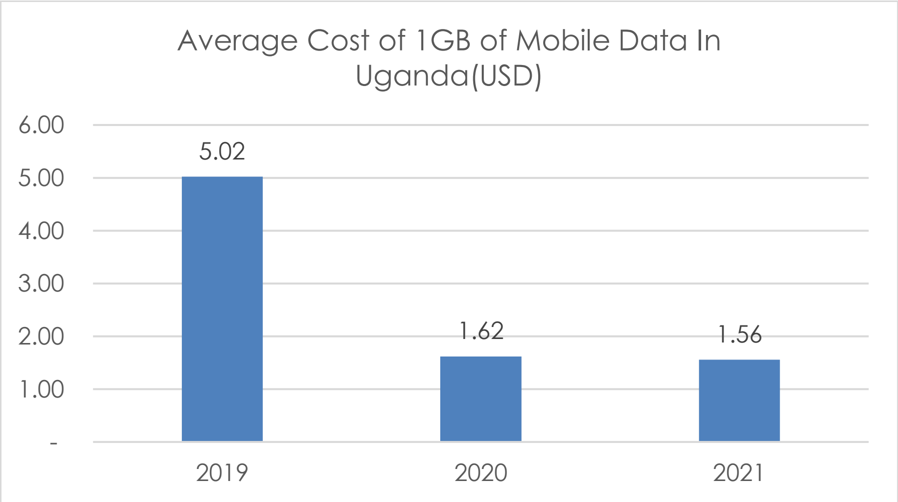
However, growth in subscriptions does not necessarily lead to proportional growth in revenues. This has been the case for the Sub-Saharan region despite it having the highest growth in subscriptions. Read more on this here. This due to the lower average revenue per user (ARPU) of these subscriptions compared to other regions. These economies generally have lower disposable incomes which contributes to lower spending, hence the lower ARPUs. This leads to lower revenue growth. Therefore, the growth of subscriptions is only one part of the story. We also need to look at how demographic changes impact economic growth.

Uganda is projected to grow by at least 6.0% over the medium term. We expect this to lead to increase in disposable incomes and improvement in spending.

Mobile Data

Internet subscriptions – fixed and mobile – have grown at a much higher CAGR (2Q2015 – 2Q2021) of 27.2% to 21.9 million subscriptions. Internet penetration over the same period has increased from 37.3% to about 50.0%. Internet access in Uganda, like in many SSA countries, is predominantly through mobile phones (99.3% of the internet subscriptions are mobile subscriptions)

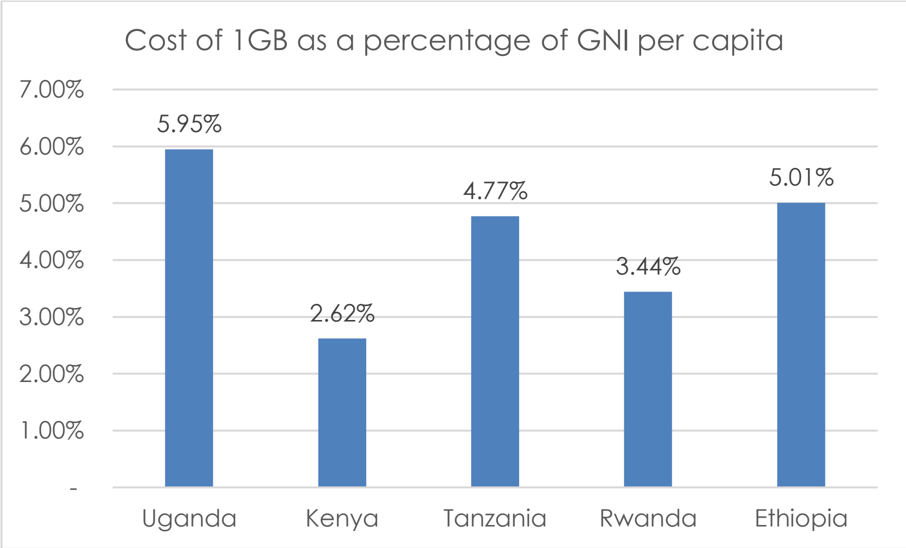
The growth in mobile data has been fueled by lower cost of smartphone ownership (lower mobile data costs and cheaper devices) and access to high-speed networks (3G & 4G).



Source: Cable.co.uk

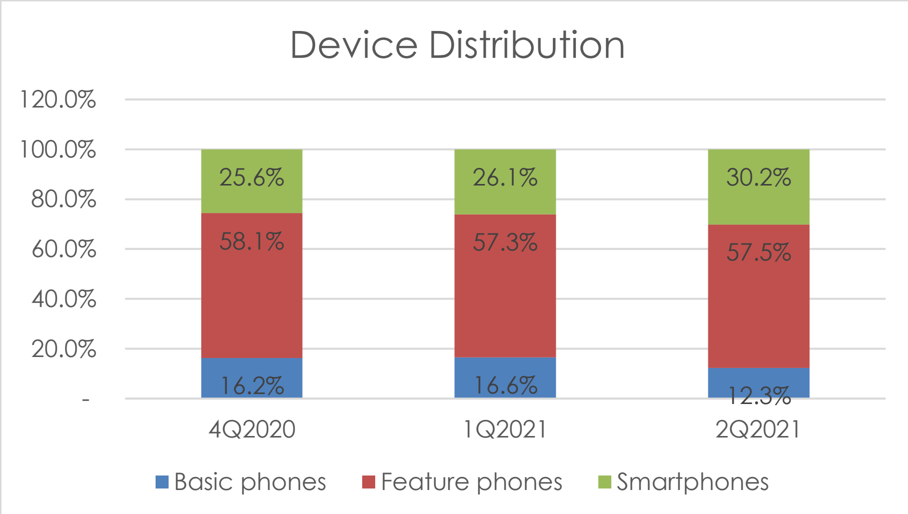
In the 2Q2021, the sector recorded total internet traffic of 69.4 billion megabytes (MBs), a 17.0% y/y growth (2Q2020: 59.2 billion MBs). This, according to the UCC, translates to average usage of 803 MBs per user per month. This is lower than the SSA average is 2.2 GBs per user per month (Average usage on Safaricom is about 1.5GBs per month).

Although the cost of data is more affordable, Uganda remains the least affordable among its regional peers, as the chart below shows. Addressing this could further increase uptake of mobile data.



Source: ai4a; GNI = Gross National Income

Increasing the proportion of smart devices on the networks will also have a positive impact on mobile data traffic. Smart devices generally have more capabilities and having more smart devices on a network can lead to potentially more data consumption compared to feature phones. At the end of the 2Q2021, the sector had about 9.7 million smart devices on all networks, representing about 30.2% of all terminals connected. This represents a smartphone adoption (number of devices as a percentage of total subscriptions) rate of about 34.0%, which is lower than the East African average of 42.0%.

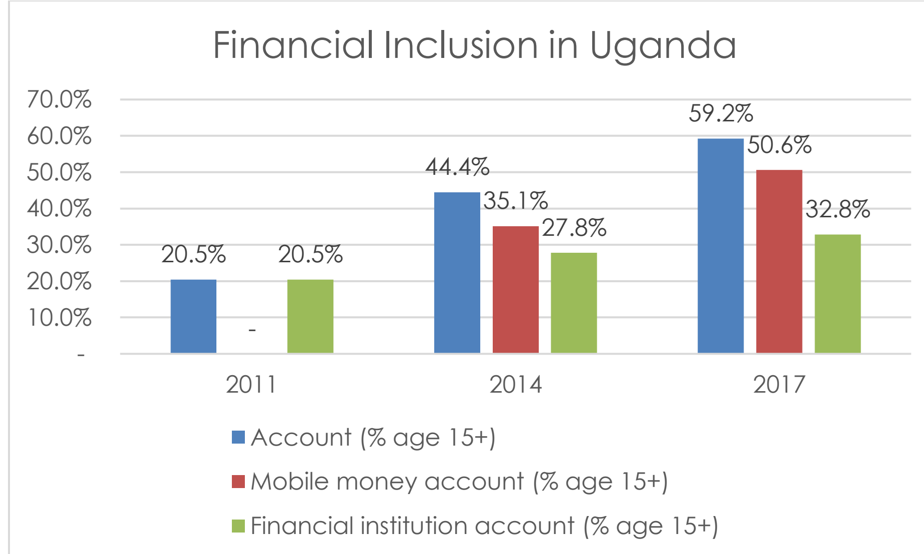


Source: UCC

Mobile Money

Due to the relatively high unbanked population in the SSA region, mobile money services have found a place in the region in driving overall financial inclusion. According to GSMA, the region accounted for 64% of all mobile money value transacted globally in 2020, reaching USD 490.0 billion (23.0% y/y). It is also worth noting that East Africa accounts for 55.0% (USD 273.0 billion) of the USD 490.0 billion. The services have evolved from just domestic peer to peer money transfers to include international money transfers, bill payments, loans, and savings platforms.

Uganda has not been left behind. As the chart below shows, the percentage of the population holding accounts has seen growth largely due to higher mobile money account ownership.



Source: World Bank Findex (2017)

According to the UCC, as at the end of June 2021, Uganda had about 31.3 million mobile money accounts, translating to a penetration rate of 75.0%. The proportion of active accounts is about 66.0%, which is higher than the EAC average of 28.0% and Kenya's 50.2%. It should be noted, however, that the average monthly transaction size per active user in Kenya is four times larger (KES 62.8K in Kenya vs KES 14.5K in Uganda) than that of an active user in Uganda. This may be due to Kenya's larger mobile ecosystem and economy.

2. Company Considerations

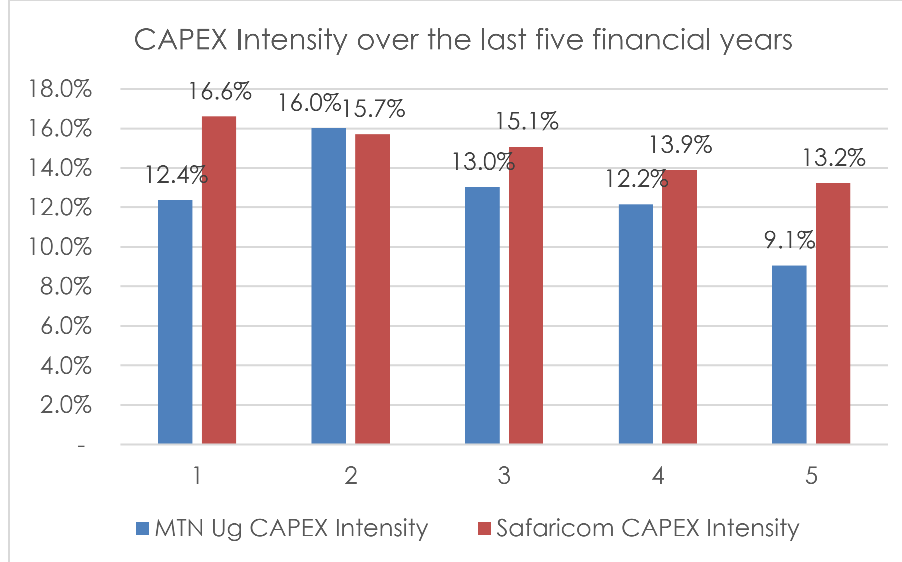
MTN Uganda's Competitive Positioning

The Uganda mobile sector has historically been overcrowded. Before 2018, there were over 5 active mobile operators. It's generally difficult to run financially viable operations with such a high number of players and two dominant players (It's estimated that MTN and Airtel control 90.0% of the mobile subscribers). As such a number of operators have closed shop or merged (Warid, Afrimax/Vodafone, Smart, K2 have all exited the market). The key mobile operators include MTN, Airtel, Africell (had announced plans to exit by October 7th, 2021), Lycamobile, Smile and Uganda Telecom. There have been concerns that with fewer players, competition may also be lower to the detriment of consumers.

MTN Uganda maintains overall market leadership in mobile subscriptions with a market share of about 50.0% and an estimated market share of 43.0% (based on active mobile money users) in the mobile money segment. According to the company, it also controls a significant market in the mobile data segment.

We opine that this market leadership position is partly due to investments made in expanding the network coverage. As of 30 June 2021, MTN's countrywide 2G, 3G and 4G LTE population coverage stood at 96.1%, 89.1%, and 52.4% respectively. The company matches Safaricom in 2G coverage but lags in 3G (96% vs 89%) and 4G (94% vs 52.4%) coverage. The significant lag in 4G coverage may partly be due to lack of sub 1Ghz bands (currently only uses the 1800Mhz and 2600Mhz) which would allow the company to extend coverage more cost effectively particularly in rural settings. If these bands are availed, the company expects to increase 4G LTE coverage to 74.3% by 2023.

In terms of capital expenditures (excluding intangible assets), the company has invested on average about UGX 195.0 billion (KES 6.0 billion) over the last five years. The average capex intensity (Capital expenditures – excluding intangibles as a percentage of total revenues) over this period is about 12.5 % (Safaricom's average CAPEX intensity over the last five years is about 14.9%, which 18.9% higher than MTN's).



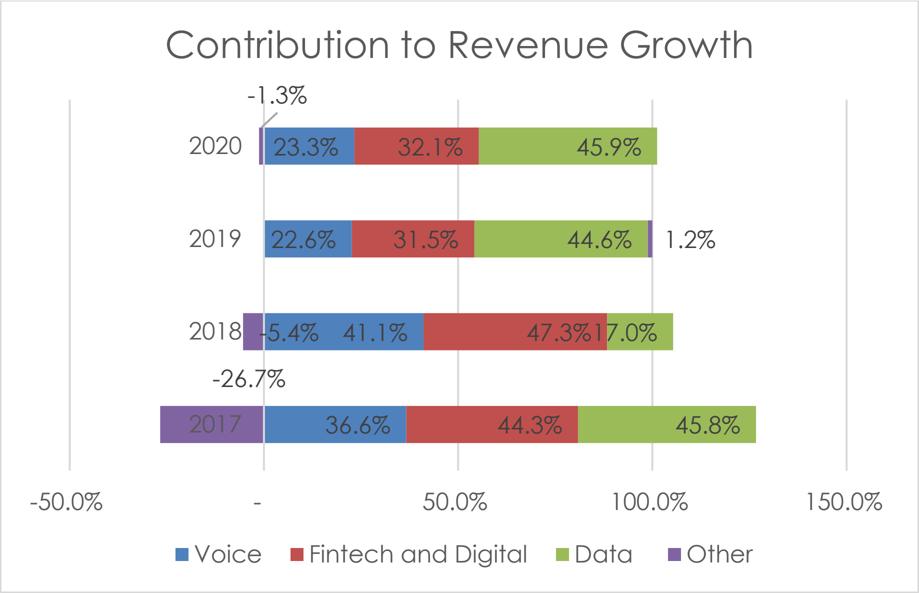
Source: Company financials, Faida calculations

In 2021, the company expects to invest about 403.0 billion (KES 12.6 billion, CAPEX intensity of about 19.5%). This amount includes expenditure on projects that had been delayed due to COVID-19 measures. We also note that company will likely pursue a more capital light infrastructure program (particularly on passive infrastructure like the telecommunications towers/masts) in line with MTN Group's strategy.

We expect that these investments will help MTN capture growth opportunities arising in the sector.

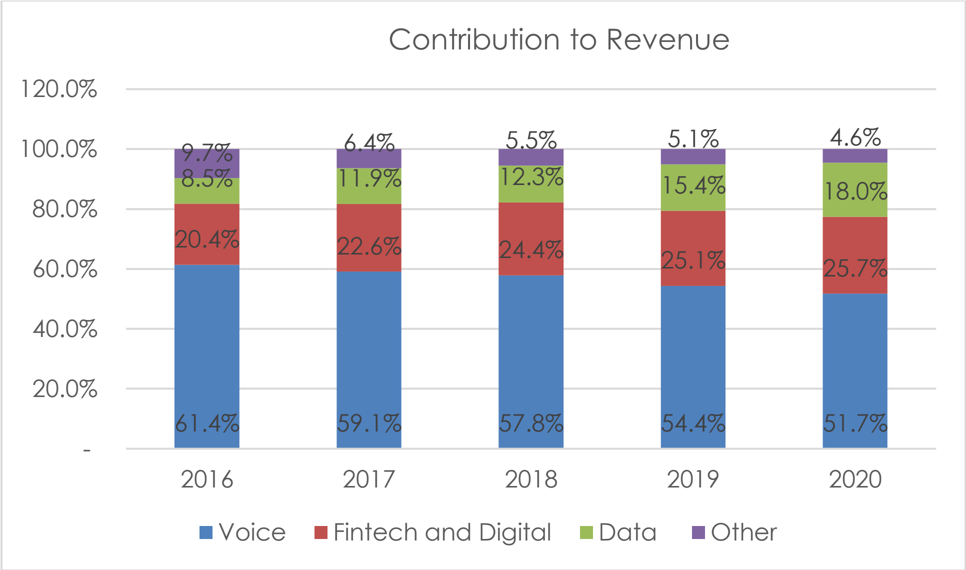
Financial Performance

Revenues: MTN's revenues have grown at a CAGR of 9.5% over the last five financial years. As the chart below shows, data and fintech and digital services have been the major contributors in the company's revenue growth.



Source: MTN Uganda, Faida calculations

Due to the higher growth in data and fintech/digital services, the company's revenue composition has also shifted. The contribution of voice services to total revenues has been declining while contribution from data services, fintech and digital growing over the last five years.



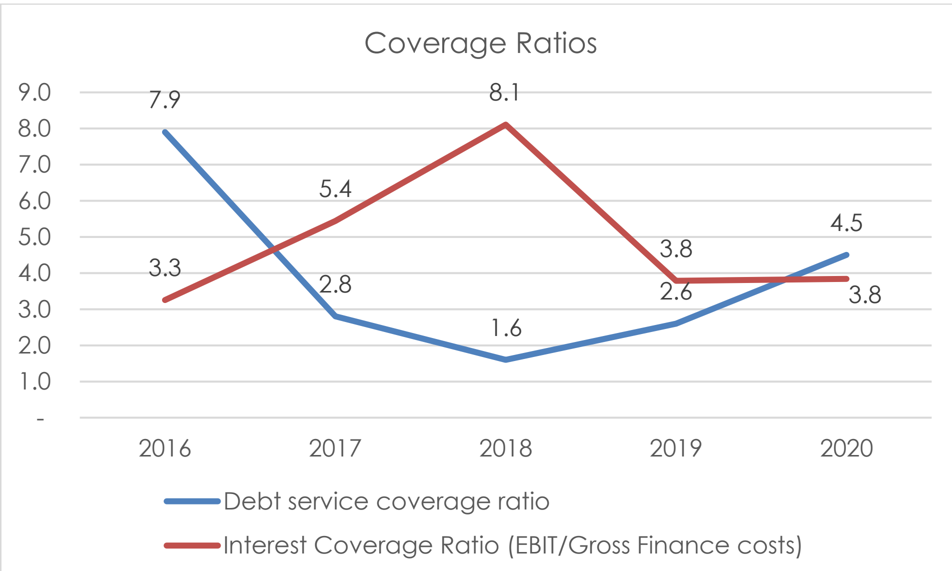
Source: MTN Uganda

This is in line with trends from other regional peers (though the contribution of voice services to revenue and revenue growth is still on the higher side compared to some regional players like Safaricom). The company expects voice revenues to continue growing at a slower pace (0.8% - 2.7% over the medium term) compared to data and digital services (12-15% over the medium term). As a result, the contribution from voice services to overall revenues is expected to continue declining.

Total Costs: The company has managed to keep growth in total costs (CAGR: 0.7% to 482.3 billion) below the growth in revenues. The largest decline is on cost of sales which have registered a growth of -2.6% to 187.8 billion. This was on the back of lower network costs (CAGR: -3.1% to UGX 119.0 billion), cost of handsets and accessories and interconnect and roaming costs (CAGR: -5.6% to UGX 33.4 billion). Total operational expenditures have grown at a CAGR of 3.2% to UGX 294.5 billion. Due to the lower growth in total costs compared to revenues, the total cost intensity declined from 70.5% in 2016 to 50.5% in 2020.

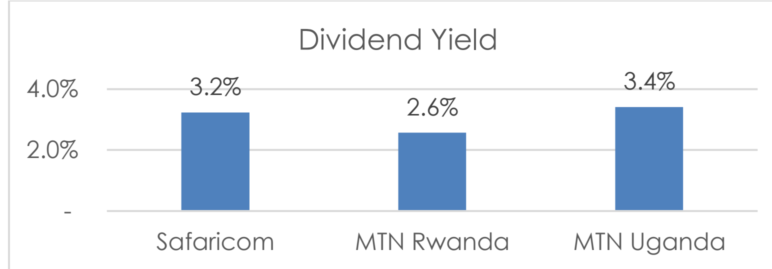
EBITDA and EBITDA margins: The company's EBITDA has grown at a CAGR of 24.5% to UGX 512.0 billion. Over the same period its EBITDA margin has grown from 29.5% to 49.5%. This growth in EBITDA and EBITDA margin is due to revenue growth and prudent cost management.

Leverage: As of June 2021, the company's total debt stood at UGX 1.0 trillion with majority (65.4%) being lease liabilities and rest (34.6%) being bank borrowings. The company's gross debt and net debt to equity ratios stood at 1.4x and 1.2x respectively. Although the coverage ratios have deteriorated, we opine that they are sufficient.



Source: MTN Uganda

Dividends: MTN's current dividend policy is to pay at least 60.0% of the after-tax profits. Over the last four years, the company's payout ratio has ranged between 48.0% (2020) and 67.0(2017). This is lower than Safaricom's payout (80.0%). However, its dividend yield ranks among the highest.



Key Risks

Slowdown in the Legacy business: The slowdown in voice, which is typically a high margin business, will see the company's revenues being dominated by lower margin business lines. This may impact negatively overall company margins.

Economic growth may not translate to lower poverty levels: If economic growth projected in Uganda is not broad based and the mechanisms for wealth distribution are not effective, economic growth may not necessarily lead to lower poverty levels. The World Bank also notes that for demographic changes such as those projected in Uganda (a higher proportion of working age group that is relatively young and a higher proportion of the population living in the urban areas) to lead to demographic dividends, countries must make the necessary social investments such as in education and healthcare. If these investments are not made, labour productivity may not improve leading to lower economic growth.

Dominance: As mentioned earlier, MTN and Airtel control close to 90.0% of the market. The high concentration may draw the attention of regulators who may try to impose policies that either prevent abuse of dominance or increase effective competition. This has been the case in Kenya where Safaricom maintains a dominant position. The proposed policies tend to be harsh on the dominant players.

Peer Analysis

MTN Uganda ranks favourably in most metrics in our peer analysis. The high return on equity is due to the company's high financial leverage.

Company	EBITDA Margin	Profit Margin	ROE	ROA	Return on Capital
Sonatel	43.5%	14.0%	26.0%	8.9%	18.6%
MTN Nigeria	51.3%	15.2%	126.6%	11.8%	24.7%
MTN Rwanda	49.8%	13.4%	48.1%	7.9%	22.7%
Safaricom	50.8%	26.0%	48.9%	31.0%	42.6%
Vodacom SA	39.9%	16.9%	19.4%	9.2%	13.9%
MTN Uganda	**49.5%**	**17.1%**	**50.1%**	**12.9%**	**20.6%**
MTN Uganda's rank	**4**	**2**	**2**	**2**	**4**

Source: Bloomberg, Faida analysis

Recommendation

We are **NEUTRAL** on MTN Uganda. We used the EV/EBITDA (trading comparable) and the P/E (trading comparable) to arrive at our target price.

P/E Comparable Method

Trading Comparable - median P/E	14.8
Forecasted Earnings – UGX	324,662,000,000
Forecasted Market Cap- UGX	4,820,955,104,337
No of issued shares	22,389,044,239
Target Price - UGX	215.33
Offer price - UGX	200.00
Upside/(Downside) potential	7.66%

EV/EBITDA Trading Comparable Method

Comparable median EV/EBITDA	5.34
Forecasted EBITDA – UGX '000	1,048,010,000
Forecasted EV – UGX '000	5,599,719,753
Less: Debt – UGX '000	1,032,062,120
Less: Minority Interest	-
Add: cash & cash equivalents – UGX '000	137,066,567
Estimated Market Cap – UGX '000	4,704,724,200
Number of shares	22,389,044,239
Value per share – UGX	210.14
Offer price – UGX	200
Upside/(Downside) potential	5.07%

To arrive at our final target price, we equally weight the target prices from both methods. Our weighted target is UGX 212.73, representing an upside potential of 6.4%.

Valuation method	Target Price	Weight	Weighted Target Price
EV/EBITDA	210.14	0.5	105.07
P/E	215.33	0.5	107.66
Final Weighted Target Price – UGX			212.73
Offer price – UGX			200.00
Upside/(Downside) potential			6.4%

Summary Income Statement

Amount "UGX 000	2016	2017	2018	2019	2020	1H2021	5 Year CAGR
Revenue from contracts with customers	1,307,539,739	1,437,195,411	1,550,767,490	1,717,574,282	1,877,799,208	994,306,081	9.5%
Total Cost of sales	(418,554,846)	(411,480,283)	(441,514,628)	(378,121,518)	(377,259,136)	(187,810,411)	-2.6%
Cost of sales Intensity	32.0%	28.6%	28.5%	22.0%	20.1%	18.9%	-
Gross Profit	888,984,893	1,025,715,128	1,109,252,862	1,339,452,764	1,500,540,072	806,495,670	14.0%
Total Operating expenses	(503,647,362)	(522,374,651)	(552,231,022)	(530,806,273)	(571,130,757)	(294,495,105)	3.2%
OPEX intensity	38.5%	36.3%	35.6%	30.9%	30.4%	29.6%	-
EBITDA	**385,337,531**	**503,340,477**	**557,021,840**	**808,646,491**	**929,409,315**	**512,000,565**	**24.6%**
EBITDA %	29.5%	35.0%	35.9%	47.1%	49.5%	51.5%	-
Profit/(loss) from operations	191,948,706	274,301,537	335,388,454	506,980,908	598,942,522	282,818,703	32.9%
Profit after tax	96,331,173	152,664,352	219,526,926	269,250,048	321,682,153	130,698,165	35.2%
Net Profit Margin	7.4%	10.6%	14.2%	15.7%	17.1%	13.1%	

Summary Statement of Financial Position

Amounts "UGX 000	2016	2017	2018	2019	2020	1H2021
Property, plant and equipment	662,106,894	680,270,049	701,779,576	713,879,887	727,131,137	772,728,205
Non-current assets	**817,644,114**	**856,656,344**	**869,866,630**	**1,503,595,115**	**1,873,219,245**	**1,932,605,531**
Trade and other receivables	305,748,010	204,178,304	213,947,720	173,130,974	157,548,573	205,913,105
Mobile money deposits	308,031,866	315,087,526	407,945,136	450,355,234	655,351,841	680,564,789
Current Assets	**691,438,471**	**595,909,993**	**719,776,788**	**737,504,891**	**886,804,785**	**1,049,178,227**
Total assets	**1,509,082,585**	**1,452,566,337**	**1,589,643,418**	**2,241,100,006**	**2,760,024,030**	**2,981,783,758**
Total equity and liabilities	**1,509,082,585**	**1,452,566,337**	**1,589,643,418**	**2,241,100,006**	**2,760,024,030**	**2,981,783,758**

Recommendations Guide

LONG-TERM BUY: The Company has strong fundamentals. However, there are certain investments or strategies that would require an investor to have a long-term view of the company to allow for capital appreciation. Also, the company may be facing head wings which we view as short term

BUY: Strong fundamentals. Minimal risks to the catalysts/growth drivers

NEUTRAL: This is where the positives and negatives in a company almost balance out. You can accumulate for the long term.

SELL: Deteriorating fundamentals. Risks outweigh the catalyst/growth driver

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