Nigerian Telecommunications Sector Update.

MERISTEM

Content Highlights

Telcos and the pandemic

The pandemic impacted the telecommunications sector in a way different from many other sectors of the economy. The movement restrictions increased the use of telecommunications services (particularly data and fintech services), thereby improving the revenue of players in the sector. While the telcos revenue generation was shored up by the pandemic, there was also an increase in costs, majorly due to the exchange rate devaluation which coincided with the outbreak and other COVID-19 induced costs.

Crossing the Regulatory Hurdle

Due to the nature of services, the Nigerian telecommunications sector is heavily regulated, with checks put in place at intervals to ensure adherence by stakeholders. The most recent of all is the ongoing SIM card database audit, which commenced in December 2020. This requires linking all registered SIM cards to National Identity Numbers (NIN) and necessitated halting the sale and registration of sim cards. This subsequently led to a decline in subscriber base across operators.

Reaching a Compromise

USSD services provided by telcos to bank customers have become an important tool of providing banking services. Revenue from the services have however remained unrealized by the telecommunication companies, leading to a long-lasting dispute between banks and telcos. A resolution was reached earlier this year to charge customers NGN6.98k per USSD transaction, bringing an end to the disagreement.

The Pace of Innovation

Lately, there has been increasing conversations around 5G. The penetration and adoption levels are however still in the early stage, with only an insignificant proportion of smartphone users currently making use of the network. Like its predecessors (earlier wireless networks), the rate of deployment of the 5G network across regions have been uneven.

Banking the Unbanked

The Government's financial inclusion drive (due to the low level of traditional banking imprint and large cash economy), the size of Nigeria's population as well as the case study of the telco-led fintech model in other African countries (Ghana and Kenya) all reflects the opportunities that exists in the mobile money segment of telcos in Nigeria. Mobile Network Operators have therefore been leveraging on these possibilities to drive up their fintech business. Telcos have also engaged in acquiring the required licenses, spreading out their agent network and collaborating with other financial institutions.

MTNN

MTN Nigeria Communications Plc. is a leading provider of telecommunications services in Nigeria, the firm commenced operations in 2001. Given it's the first mover's advantage, **MTNN** has since then grown to be the leading provider of telecommunications services in the country, with 38.61% of the total market share.

AIRTELAFRI

Airtel Africa Plc is a telecommunications group, with operations in 14 countries across West and East Africa. The company provides telecommunications and mobile money services across its operating countries except Nigeria (where the firm recently got an approval in principle to operate as a payment service bank).

Introduction

The Nigerian telecommunications sector has benefitted immensely from the increased adoption of ICT across sectors. Technological progress has supported the increased significance of the ICT sector. From accounting for just 7.01% of GDP in 2012, the sector now makes up 14.20% of GDP. Particularly, the total telecoms subscriber base has increased by a CAGR of 7.04% in the space of 10 years (2011 and 2021), while tele-density is presently at 99.18% compared to 68.49% in 2011.

The sector expanded by 12.74% YoY in the third quarter of the year. The increased adoption of telecommunications services, coupled with the sector's resilience to adverse economic trends and stiff regulation forged the sector into one of the key drivers of the nation's economic rebound. The outlook of the sector therefore remains positive, given the huge potentials that exist. Of such opportunities are the exponential population growth rate, low data and smartphone penetration, shift in social trends and the large unbanked population.

Chart 1: Subscriber Base and Tele density Movement

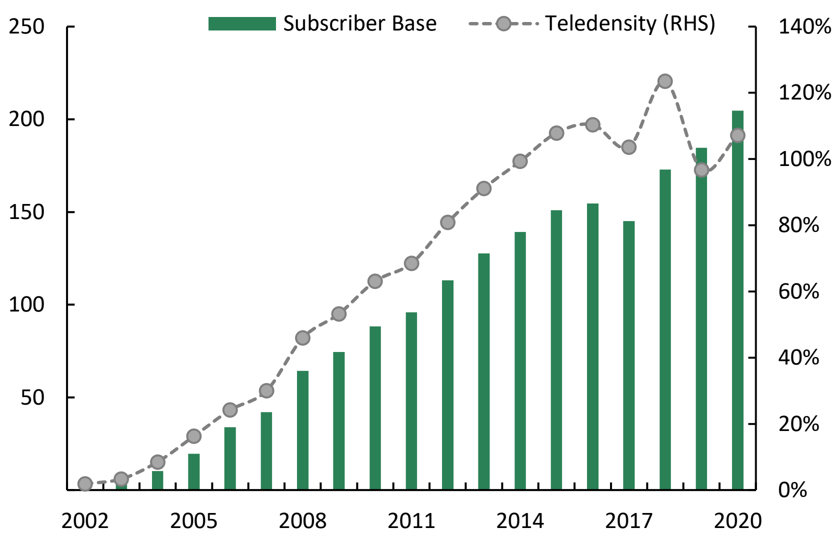
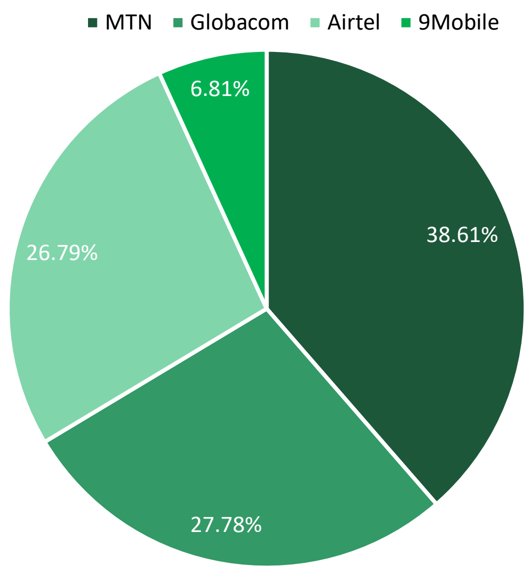


Chart 2: Market Share by Company



Source: NCC, Meristem Research

While competition has necessitated the development of different initiatives as players jostle for market share, the leadership structure of the sector has remained largely unchanged. **MTNN** has maintained its market leadership with 73.57 million subscribers (38.61% of the total market share), trailed closely by Glo with 52.93 million subscribers (27.78% of the market), while Airtel and

9mobile hold 26.79% and 6.81% of the subscriber base with 51.04 million and 12.98 million subscribers' respectively.

Telcos and the Pandemic

Unlike many sectors of the economy, the COVID-19 pandemic affected Telcos differently. Data traffic was higher during the period as teleconferencing became predominant and social media engagement intensified. Also, we witnessed increased adoption of mobile money services, aided by restrictions on bank visits.

MTNN's revenue increased by 12.55% YoY in the first half of 2020. The increase in revenue was primarily spurred by the 57.63% YoY increase in data revenue, increasing the segment's contribution to total service revenue to 24.19%, from 17.27% in the corresponding period of 2019. Revenue from voice services increased by 2.76% YoY, the contribution to total revenue however declined to 67.74%, from 74.19% in H1:2019. In its Fintech segment, revenue increased by 29.65% YoY and digital revenue increased by 121.77%.

Similarly, **AIRTELAFRI's** revenue during the review period increased by 6.91% YoY, attributable to the increase in data revenue (+ 28.01% YoY), fintech revenue (+ 19.12% YoY) and other revenue (+8.33% YoY). Voice revenue however decline by 3.20% YoY. The decline in voice revenue was due to the 11.36% YoY decline in voice revenue in Francophone Africa, as a result of the drop in interconnect charge in Niger, Madagascar and Chad. The COVID-19 pandemic and the devaluation of Nigerian Naira also impacted income generated from voice revenue.

On costs, expenses surged during the period, reflecting the impact of exchange rate devaluation on lease related expenses. For context, **MTNN**'s operating expenses increased by 17.53% YoY in the first half of 2020, driven by the 23.66% increase in direct network operating expense (lease related expenses) and 22.06% growth in other operating expense, attributable to the pandemic. Subsequently, EBITDA margin declined to 51.26% (vs. 53.33% in H1:2019) and net margin dipped to 14.85% from 17.56% in H1:2019, leading to a 4.68% YoY decline in after tax profit. The case was similar for **AIRTELAFRI**, which witnessed a 10.64% YoY increase in network operating expenses. This led to a 5.97% YoY growth in expenses. EBITDA however grew by 7.75% YoY and EBITDA margin improved to 44.07% from 43.72% in the previous year. Similarly, operating profit increased by 12.90% YoY and operating margin improved to 24.68% from 23.37%. The increase in net finance cost by 20.73% YoY (due to the impact of devaluation on foreign denominated obligations) however caused net income to dip by 56.82% YoY, leading to a decrease in net margin by 988bps to 6.70%.

Crossing the Regulatory Hurdle

In a bid to ensure that mobile network operators comply with existing requirements for SIM card registration and limit the number of SIM cards owned per customer to four, the Nigerian Communications Commission (NCC) embarked on a national database audit for registered SIM cards in Q4:2020. The outcome of the process was a temporary ban on the sale and registration of new SIM cards in order to sync existing subscriber information with the National Identity Number (NIN). Thus, all subscribers were mandated to link their SIM cards with their NINs before the end of the year 2020. The deadline was however extended severally, following a review of the progress of the exercise at each deadline. Some of the factors that have caused the extension includes difficulties in reaching remote areas, and low rate of NIN enrolment in schools and hospitals. The commission have set the latest deadline as 2021-year end.

In a move to prevent significant subscriber loss, the network operators increased subscriber awareness of the NIN enrolment exercise by setting up several enrolment centers in line with the NCC's guideline. Significant progress has since been achieved, as over 60 million unique NINs have been collected as at the beginning of July 2021. There was however still a decline in subscriber base (from 207.95 million in October 2020 to 187.03 million in June 2021). The ban on subscriber registration was lifted in April 2021 and the subscriber base continued it upward trend in June.

The impact of the suspension on the financial performance of the firms in the sector was however minimal, as the listed players continued to witness remarkable growth. The decline in subscriber base was more than offset by the increase in average revenue by active users. Average Revenue per User for the listed players **MTNN** and **AIRTELAFRI** increased by 12.82% QoQ and 10.00% QoQ respectively in the first quarter of 2021.

USSD Development: *Reaching a Compromise*

The Unstructured Supplementary Service Data (USSD) allow mobile phones communicate with their network operators. The service is available on the network, thus making it accessible even to users of feature phones. USSD has been deployed by majority of mobile financial services providers around the world as a primary means of communication between customers and their mobile payment platforms (especially low-income customers). The story in Nigeria has been no different, banks introduced the USSD service in 2015 to facilitate the ease of transaction among customers, reduce visits to their physical branches and drive the usage of banking services among customers who do not reside in close proximity to the banks. This is meant to ultimately improve the government's financial inclusion drive and banks profitability.

The increased penetration of telecommunications services in the country has translated to growth in USSD and other instant payment transactions channels (internet banking and mobile apps). Bank USSD services allow customers access a range of financial services (purchase of airtime, transfers and payment of utility bills) from their mobile phones. Given the value proposition and the ease of use of USSD, there has been an increase in usage of the service.

Thus, USSD service have become an integral channel of delivering banking services to customers. In Q4:2020, the value of transactions carried out via USSD was up to NGN1.63trn. The charges and sharing formula has however sparked loggerhead between banks and telcos where both parties failed to reach a consensus on the appropriate charge and pricing template for the service until earlier this year. In July 2019, the NCC set a pricing template for USDD services that requires implementing a per session billing model (with a session being 20 seconds). A price floor per session of USSD transactions was set at NGN1.63k and each transaction had a rice cap of NGN4.89k per transaction. The commission however noted the exclusion of zero rated USSD services (customer service, balance enquiry, purchase of airtime and data services related to telecommunications services) from the pricing template. The pricing template was to take effect from the start of September 2019, the cost was however not remitted to the mobile network operators.

Noting that the COVID-19 pandemic further increased the usage of USSD services due to the lockdown and other restrictions during the period, the USSD service charge owed to telcos accumulated to NGN42bn in 2020. In March, the CBN and NCC met to resolve the USSD dispute and reached a resolution to charge a flat rate of NGN6.98 per USSD transaction, adopting a per transaction method of billing as against the initial per session billing. The arrangement ensured that NGN5.00 of the new USSD service cost was for the new transactions initiated, while the NGN1.98 balance will go into servicing the accumulated debt of NGN42bn. The settlement of debt and subsequent remittance of the USSD charges is expected to help improve the enterprise business of the MNOs, particularly for operators with the larger subscriber base.

Update on 4G and 5G: *The Pace of Innovation*

As 5G technology is gradually making way into several markets across the globe, telecommunications equipment manufacturers, mobile network operators and regulators are playing a critical role in ensuring the speedy roll out of the network. According to the Global System for Mobile Communications Association (GSMA), 5G is expected to account for 20% of mobile connections globally by 2025. While the movement to 5G technology is imminent, (especially as a faster and more efficient network will be required to power emerging technology), the pace at which the technology is being deployed has been uneven across regions.

Chart 3: 5G Population Coverage by Region

Source: GSMA, Meristem Research

The roll out of 5G network commenced in 2019, championed by South Korea, China, United States and United Kingdom. Since 5G technology was first deployed, a number of other countries in different regions (Asia, Europe, Middle East and North Africa, America etc.) have begun the roll-out. As was the case with earlier generations of wireless network, most countries in Sub-Saharan Africa lag in the race of 5G deployment when compared to their emerging and developed market peers. The slow pace of 5G network roll out in Sub Saharan Africa is attributable to both demand and supply side factors.

On the supply side, enormous investments are still being made on the deployment of 4G in the region, as room still exists for further penetration of the network. According to GSMA, only 0.4% of subscribers in Africa use 5G, while 4G penetration was at 10% (vs global average of 43.67%) in 2020. Thus, the adoption of 4G still has a long way to go before 5G is being rolled out. On another hand there is the shortage of 5G supported devices in the region, considering the low-income of its inhabitants (for context, total smartphone adoption still accounts for less than 50% of total connections). Thus, there is still a long way ahead, before 5G adoption in Sub Saharan Africa catches up with advanced climes. GSMA has estimated that by 2025, only 27% of mobile connections in Sub-Saharan Africa would be 5G connections (vs 48% in North America, 67% in Sub Saharan Africa and 48% in Middle East and North Africa). In Africa governments and corporate organizations are expected to lead the adoption of 5G, also the growth of internet of things is expected to spur increased dependence on broadband, thereby making a case for 5G adoption.

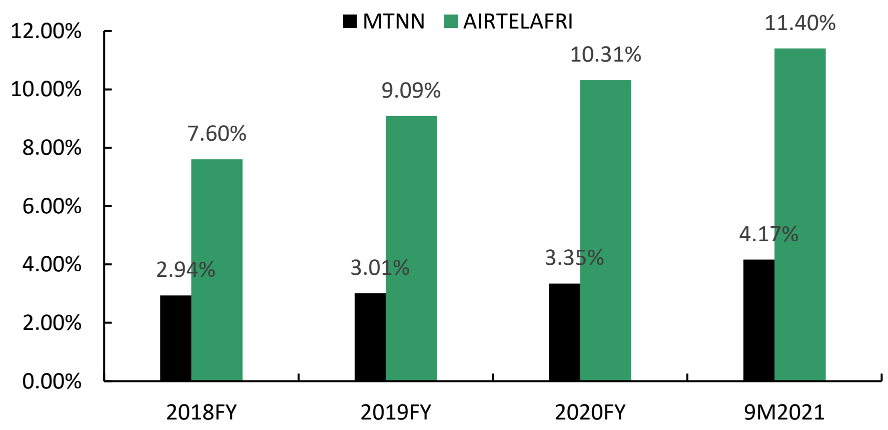
We however note the huge capital expenditure that will be required to drive the 5G coverage (mobile network operators are expected to invest up to USD900bn on their network between now and 2025, of which more than 80% will be on 5G).

Fintech Development: *Banking the Unbanked*

There has been an increasing adoption of mobile money services worldwide, in 2020 the registered mobile money accounts globally increased by 12.70% YoY (over 136 million accounts). The growth in mobile money adoption was championed by Sub Saharan Africa (sub–Saharan Africa made up 43.00% of the new mobile money accounts in 2020). The swiftness in adoption of mobile money services in Sub Saharan Africa speaks to its potentials and rides on the back of the low level of financial inclusion and traditional banking penetration in the region.

The widespread adoption of fintech services in Nigeria has shaped the fintech segment of MNOs to a more integral part of their operations. This was further deepened by the COVID-19 pandemic, which caused a shift to alternative methods of conducting financial transactions. For the listed players, **MTNN** and **AIRTELAFRI**, revenue generated from their fintech segment in the most recent financial period contributed 4.17% YoY and 11.40% to total revenue (from 3.32% and 9.97% in the comparable period of last year respectively).

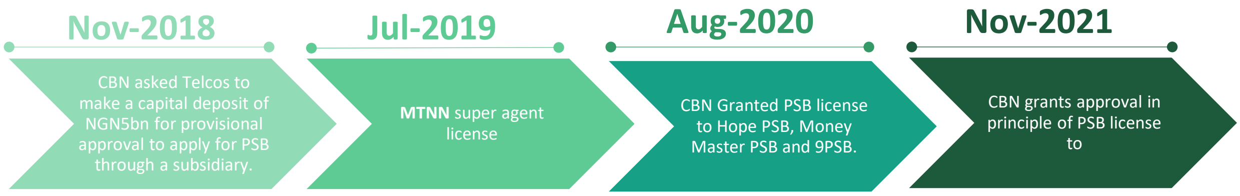
Chart 4: Fintech % of Total Revenue



Source: Company filings, Meristem Research

The opportunities that exist in the fintech space have however not been fully exploited by the Mobile Network Operators. In November 2021, the Central Bank of Nigeria granted Mobile Money (MoMo) Payment Service Bank Limited and SMARTCASH Payment Service Bank Limited (the respective subsidiaries of

MTNN and **AIRTELAFRICA**) Approval in Principle to operate a Payment Service Bank in the country. This is coming over a year after the apex bank granted the first set of PSB licenses in the country (in August 2020) and 3 years after the telecommunications giants first started the process to acquire their PSB licenses (December 2018). The license is expected to improve the scope of fintech services currently being offered by the companies.



Permissible Activities Under Fintech Licenses

	Super-Agent License	Payment Service Bank License
Eligibility	Minimum of 50 agents	Banking agents, Telecommunications companies, Retail chains, Postal service providers and courier companies,
Capital Requirement	NGN50mn	NGN5bn
Permissible Activities	Deploy agent network in rural areas	Issue debit/ prepaid cards Operate electronic wallets Invest in government securities
Non-Permissible Activities	Holding electronic money value	Granting Loans Accepting foreign currency deposits Dealing in foreign exchange Insurance underwriting.

MTN Nigeria (MTNN)

- **MTNN** is a subsidiary of the multinational telecommunications giant, **MTN Group Limited**, incorporated in Nigeria in 2000. The company provides mobile voice, data and fintech services in the country.

- **MTNN** has grown its subscriber base from 59.89 million in December 2014 to 80.76 million in December 2020, an implied annual growth rate of 5.11%, making it the largest Mobile Network Operator in Nigeria. Consequently, revenue has grown annually by 8.51% over the same period.

- The company recently launched its Ambition 2025 Strategy, which is focused on building valuable platforms, driving industry leading connectivity, creating shared values and accelerating portfolio transformation.

- As at 9M:2021, revenue was higher by 23.63% YoY to NGN1.21trn. While Voice business remains the largest source of revenue (accounting for c.60% of total revenue), the company has been strategically driving growth across other business lines.

- The firm has also maintained strong and competitive margins. Gross and EBITDA margins averaged 74.83% and 46.62% respectively between 2016FY and 2020FY. This has translated to strong shareholder returns with both return on equity and return on assets averaging 100.29% and 11.30% (vs. **AIRTELAFRI**: 28.73% and 3.00%).

- The firm has hastened the expansion of its data and fintech businesses, giving the prospects in those segments. This led to a 4G coverage of 69.20% and a mobile money agent network of 630,000.

- **MTNN** has Environmental, Social and corporate Governance (ESG) at the core of its business activities. The company prioritizes driving sustainability through eco responsibility, improving its governance, and creating economic value for all stakeholders.

Recommendation	**BUY**
Valuation	
Trailing EPS	13.82
BVPS	9.14
P/E	12.08
P/BV	20.80
Target PE	13.00
Dec-2022 Exp. EPS	15.22
Dec 2022 Target price	**197.86**
Fair value estimate	203.09
Current Price	167.00
Up/Downside Potential	18.48%
Key metrics	
ROE	151.20%
ROA	13.40%
Net margin	18.30%
Asset Turnover	0.75
Leverage	11.30
Dividend yield	3.53%
Share Price Data	
Year High	201.00
Year Low	157.00
YTD return	-1.71%
Beta	0.90
Adjusted Beta	0.92
SGR	5.00%
Long run ROE	50.00%
ERP	9.00%
Cost of Equity	21.43%
Cost of Debt	13.22%
Equity%	86.70%
Debt%	13.30%
WACC	14.31%
Shares outstanding	20.35bn
Market cap [NGN]	3,443.98bn
Financial year end	Dec
Most Recent Period (MRP)	9M:2021

NGX: MTNN | Bloomberg: MTNN NL| Reuters: MTNN LG

Introduction

MTN Nigeria Communications Plc. (**MTNN**) is a leading provider of telecommunications services in Nigeria and a subsidiary of the MTN Group Limited. The firm was incorporated in Nigeria in 2000 and commenced operations commercially in August 2001, when the MTN group acquired the GSM 900MHz and GSM 1,800 MHz licenses. Since the firm commenced its Nigerian operations, it has maintained its position as market leader. The firm has remained the biggest mobile network operator by market share, with subscriber base presently at 73.56 million, making up 38.61% of total mobile subscribers in the country. As a mobile network operator, MTN Nigeria offers a range of mobile voice, data, fintech and digital services. Voice revenue has remained the primary source of the firm's revenue, contributing 59.95% to total service revenue in Q3:2021. Data service is the firm's second largest revenue source, while it's fintech and digital services rank third and fourth respectively in their contribution to revenue.

Chart 5: MTNN Subscriber base movement

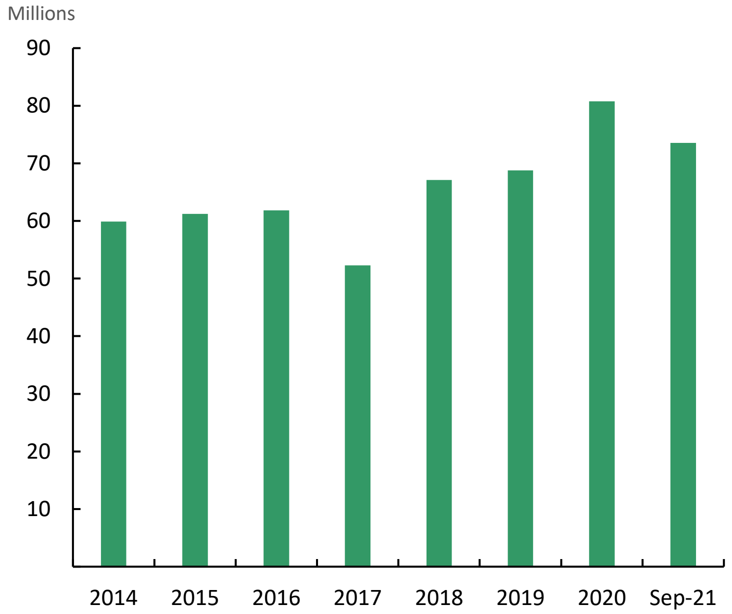
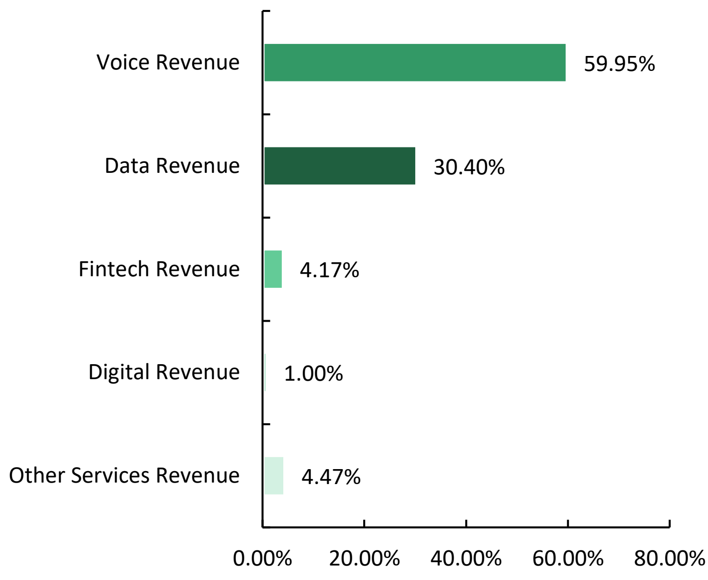


Chart 6: MTNN Revenue Mix



Source: NCC, Meristem Research

Strategy: *Maintaining Primacy*

MTNN recently launched its "Ambition 2025 strategy" which focuses on four strategic priorities: **building the largest and most valuable platforms**, **driving industry leading connectivity operations**, **creating shared values** and

accelerating portfolio transformation. The strategy is aimed at driving growth across key business segments including data services, fintech and digital services. To this end the company has focused on enhancing its network capacity to grow data traffic via expanding 4G network coverage across Nigeria. As at 9M:2021, the company had achieved 4G network coverage of 69.20%, making it the Mobile Network Operator with the highest 4G subscriber base in the industry. The company's efforts in driving growth in its data services led to a 58.20% YoY increase in its average Mega Bytes (MB) Per User and ultimately an 85.50% YoY increase in data traffic.

MTNN has also continued the expansion of its fintech business. The low traditional banking footprint, large cash economy and high unbanked population presents an opportunity for its's fintech service to support the Government's financial inclusion drive. Since **MTNN** was granted a super-agent license in July 2019, the firm has scaled up its fintech segment which now accounts for c.4.00% of total revenue as at 9M:2021 (vs 2.90% in H1:2019). Also, the recent receipt of regulatory approval-in-principle of a payment service bank license is expected to further enhance future fintech revenue.

Localization: *Driving Retail Ownership*

In order to localize ownership of **MTNN**, MTN Group made public its intention to sell off up to 14% of its stake to the Nigerian public, over the medium-term. In the first instance, the Group will conduct a public offer for sale of up to 575 million shares in MTN Nigeria at a price of NGN169.00 per share. As at December 2020, MTN group held a 76.08% stake, but upon completion of the equity offer its stake should come down to 73.25%.

Accelerating Revenue Growth Across Segments

The company has sustained revenue growth over the years with improved performance across its business lines. In the space of five years, revenue has grown by a CAGR of 10.77% to NGN1.35bn in 2020FY. The trend looks to continue as growth in revenue subsisted in the 9 months period ended September 2021, as revenue increased by 23.63% YoY. The growth in overall revenue was reflective of better performances across the voice (+10.56% YoY), data (+51.54% YoY), fintech (+ 55.20% YoY) and digital (+55.99% YoY) channels.

In its data business, **MTNN** is benefitting from the sector-wide growth in data services (due to the increasing smartphone penetration and internet usage). Also, it has continued to expand its 4G network coverage and as well enhance its network capacity to accommodate increasing data traffic. This has resulted in increased 4G network coverage to 69.20% (+9.10% Ytd) and an 85.50% data traffic growth.

The company also focused on the expansion of its fintech business. The current low rate of financial inclusion presents an opportunity for sizable future fintech revenue growth as the Government pushes for financial inclusion. Recently, the company received an approval in principle for its fintech subsidiary to operate as a payment service bank (PSB). This is expected to expand the permissible activities that can be conducted in its fintech segment and ultimately improve fintech revenue.

Foreign Exchange Volatility Pressures Costs

The majority of the firm's expenses is tied to its direct network operating costs, which makes up 57.24% of total expenses and comprises majorly of lease related expenses. Direct network operating cost increased at an annual growth rate of 19.79% between 2015 and 2020, due to the aggressive roll out of new site and exchange rate devaluation. Another significant operating expense is interconnected costs, which increased at a 5-Year CAGR of 12.79%, the growth in interconnect cost is attributable to the increase in subscriber base and voice usage. The firm has however maintained a decent cost to income ratio, averaging 53.42% in the past 5-Years. The firm's finance cost has also been a sore spot, impacted by the devaluation of exchange rate on interest expense and high borrowings. The firm however recently refinanced its floating rate obligations, in order to reduce cost of debt.

In 9M:2021, operating expense increased by 19.62% YoY, caused majorly by the growth in direct network operating costs (+30.23% YoY) and interconnect costs (+13.05% YoY). Cost to income ratio however declined to 48.98% (vs. 48.98% in 9M 2020) and remains ahead of its peer **AIRTELAFRI** at 51.98%.

EBITDA increased by 27.45% YoY, and EBITDA margin inched higher by 158bps YoY to 52.60% in 9M:2021. Profit before and after tax also increased by 51.87% YoY and 52.74% YoY respectively causing an uptick in net margin to 18.26% YoY (ahead of **AIRTELAFRICA**'s net margin of 12.54%). While the increasing voice traffic is expected to further pressure interconnect costs, a relatively stable exchange rate will bode well for lease related expenses. We also note the result of the company's refinancing efforts at bringing down cost of debt and expect it to reduce its interest expense burden.

Delivering Value

The firm has maintained an impressive Return on Equity, with ROE averaging 100.29% in the past 5 years, as at 9M:2021, ROE was 126.01%. This compares favorably to its African peer average of 27.90%. There has been an increase in Net margin (from 11.19% in 2016 to 15.24% in 2020FY, while both asset turnover and financial leverage has remained quite stable, asset turnover; from 0.78x in 2016 to 0.69x in 2020 and financial leverage; from 12.53 to 11.01 during the same period).

Valuation

In arriving at a fair value (of **NGN203.09**) for **MTNN**, we adopted a blend of Free Cash Flow to Firm, Free Cash Flow to Equity, Dividend Discount and Relative valuation Models. Our valuation was informed by the overall positive outlook of the firm as well as the risk factors facing the company. We note the growth prospects in the Data (due to the firm's 4G technology investments) and the Fintech (driven by the limited traditional banking footprint and recently granted PSB license) segments. Downside risks are however expected to emanate from the stringent (and potentially restrictive) regulatory environment and significant exposure to foreign exchange volatility as noted earlier.

Chart 7: MTNN PE vs. Peers

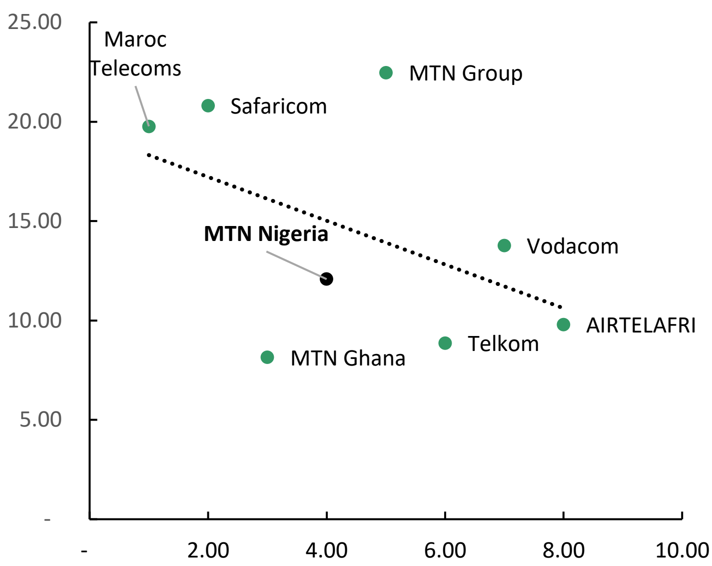
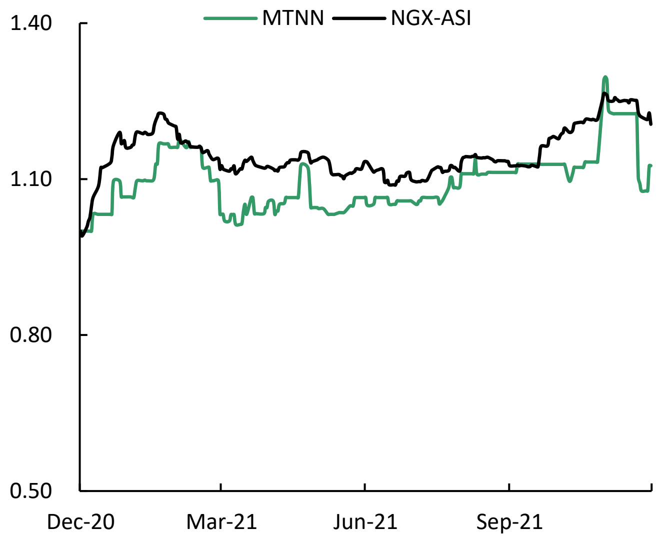


Chart 8: MTNN Share Price Movement vs Market Index



Source: Bloomberg, Meristem Research

Sensitivity Analysis

Sensitivity Analysis of Dec-2022 Target Price to key model inputs							Min	170.64
		EPS					Max	227.08
		14.22	14.72	15.22	15.72	16.22		
Target PE	12.00x	170.64	176.64	182.64	188.64	194.64		
	12.50x	177.75	184.00	190.25	196.5	202.75		
	13.00x	184.86	191.36	**197.86**	204.36	210.86		
	13.50x	191.97	198.72	205.47	212.22	218.97		
	14.00x	199.08	206.08	213.08	220.08	227.08		

FCFF VALUATION SUMMARY							
(Figures are in USD'mn)		**2021**	**2022**	**2023**	**2024**	**2025**	**Terminal Value**
EBIT		519,307	557,298	588,544	652,410	726,382	
Operating Cash Taxes		177,804	160,973	136,040	176,794	197,946	
NOPLAT		341,503	396,326	452,504	475,616	528,436	
Non-Cash Charges		275,724	300,975	339,576	351,152	358,660	
CAPEX		(241,330)	(244,708)	(262,132)	(243,356)	(250,657)	
Working Capital Investment		26,166	(25,263)	(23,708)	(19,269)	(28,183)	
FCFF		402,063	427,330	506,241	564,144	608,257	6,860,039
Valuation Parameters							
SGR	5%						
Cost of Equity	21.43%						
Cost of Debt	13.22%						
WACC	14.31%						
Discount Period		0.15	1.15	2.15	3.15	4.15	5.15
PV factor		0.98	0.86	0.75	0.66	0.57	0.50
PV of FCFF		**394,078**	**366,409**	**379,731**	**370,190**	**349,170**	**3,445,028**
Value of Operations		5,304,61					
Value of Non-operating assets		277,019					
Enterprise Value		5,581,626					
Non-Equity claims		887,742					
Equity Value		4,693,884					
Shares Outstanding		20,355					
Equity Value per Share		**230.61**					

Valuation Summary		
Method	**NGN**	**Weight**
FCFF	230.60	30%
FCFE	176.60	20%
DDM	162.58	20%
Relative Valuation	220.23	30%
Blended Valuation	**203.09**	

Financial Statement						
NGN'mn	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Revenue	**1,039,117**	**1,169,831**	**1,346,390**	**1,508,311**	**1,631,389**	**1,747,544**
Direct Network operating cost	305,519	246,604	310,248	-346,911	-375,219	-401,935
Gross Profit	**735,823**	**923,227**	**1,036,246**	**1,161,550**	**1,256,333**	**1,345,783**
Operating Expenses	301,847	298,196	350,506	-366,520	-398,059	-417,663
EBITDA	**433,976**	**625,031**	**685,740**	**795,031**	**858,274**	**928,120**
Operating Profit	266,114	393,225	426,713	519,307	557,298	588,544
Profit before taxation	221,343	291,277	298,874	411,791	448,907	475,824
Profit for the year	**145,686**	**203,283**	**205,214**	**284,136**	**309,746**	**333,077**
Total Non-Current Assets	745,884	1,239,396	1,440,725	1,565,770	1,694,285	1,762,227
Total Current Assets	195,855	262,888	522,818	429,952	397,527	458,986
Total Assets	**941,739**	**1,502,284**	**1,963,543**	**1,995,721**	**2,091,813**	**2,221,213**
Total Equity	**219,352**	**145,857**	**178,386**	**221,006**	**267,468**	**317,430**
Total Non-Current Liability	141,439	961,844	1,041,245	1,011,728	1,028,092	1,085,709
Total Current Liability	580,948	394,583	743,912	762,987	796,252	818,074
Total Liabilities	**722,387**	**1,356,427**	**1,785,157**	**1,774,715**	**1,824,344**	**1,903,783**

Ratios						
Gross Margin	70.81%	78.92%	76.96%	77.01%	77.01%	77.01%
EBITDA Margin	41.76%	53.43%	50.93%	52.71%	52.61%	53.11%
Net Margin	14.02%	17.38%	15.24%	18.84%	18.99%	19.06%
ROA	15.47%	13.53%	10.45%	14.24%	14.81%	15.00%
ROE	66.42%	139.37%	115.04%	128.56%	115.81%	104.93%
Asset Turnover	1.10x	0.78x	0.69x	0.76x	0.78x	0.79x
Leverage	4.29x	10.30x	11.01x	9.03x	7.82x	7.00x

AIRTEL AFRICA (AIRTELAFRI)

- **AIRTELAFRI** (Airtel Africa Plc.) is a multinational telecommunications company, with presence in 14 countries across West, Central and East Africa. The group has a subscriber base of 122.70 million across its operating regions, making it the second largest telecommunications operator in Africa.

- Its win with strategy is focused on increasing the profitability of the firm, while catering for all stakeholders needs, using a combination of data, mobile money, cost efficiency, its people, network and distribution.

- **AIRTELAFRI** has grown its subscriber base from 76.73 million in 2016 to 122.70 million in 2021, implying a 5-year annual growth rate of 9.84%. Subsequently, revenue has grown by 7.89% annually during the same period. Its operation across countries also partially shields it from over exposure to adverse occurrences in one of its countries of operations during any period.

- AIRTEL has a sustainability framework, focused on its business, people, community and environment. Thus, it launched its sustainability strategy, providing a medium to contribute to six of the United Nations Sustainable Development Goals.

- The company is focused on driving sustainable growth in its data and fintech segments. To drive growth in its data business, it scaled up 4G network coverage and smartphone penetration. This has translated to an greater data consumption per customer, and ultimately a higher data revenue.

- To exploit the opportunities that exists in the fintech space, **AIRTELAFRI** has entered into partnership with financial institutions such as Money gram, Standard Chartered Bank. Airtel also sold off minority stake in its Airtel money business to strategic investors like The Rise Fund, Mastercard and QIA and looks to list the business publicly within the next 3-5 years in order to fully unlock value in the segment.

Recommendation	**SELL**
Valuation	
Trailing EPS	97.26
BVPS	392.30
P/E	9.80x
P/BV	2.40x
Target EV/EBITDA	3.90x
Mar-2023 Exp. EBITDA [NGN]	912.51bn
March 2022 Target price	**687.73**
Fair value estimate	1,213.41
Current Price	955.00
Up/Downside Potential	-27.99%
Key metrics	
ROE	24.80%
ROA	8.80%
Net margin	14.70%
Asset Turnover	0.43
Leverage	2.80
Dividend yield	1.08%
Share Price Data	
Year High	955.00
Year Low	601.00
YTD return	+12.12%
Beta	0.72
Adjusted Beta	0.82
SGR	3.60%
Long run ROE	12.00%
ERP	9.00%
Cost of Equity	20.75%
Cost of Debt	10.00%
Equity%	42.08%
Debt%	57.92%
WACC	14.52%
Shares outstanding	3.76bn
Market cap [NGN]	3,758.15bn
Financial year end	Mar
Most Recent Period (MRP)	H1:2022

NGX: AIRTELAFI | Bloomberg: AIRTELAF NL| Reuters: AIRTELAF LG

Airtel Africa Plc (**AIRTELAFRI**) is one of the top providers of telecommunications and mobile money services in Africa. The group has operations in 14 African countries, found mostly in East, Central and West Africa. Of the 14 countries, Nigeria accounts for the bulk of the group's revenue (39.44%) and customer base (32.93%). The firm is the second largest telecommunication company by subscriber market share in Nigeria, trailing **MTNN**. It's strong presence in Africa gives the company the benefit of access to a large market with enormous potentials.

Chart 9: **AIRTELAFRI** Revenue by Region

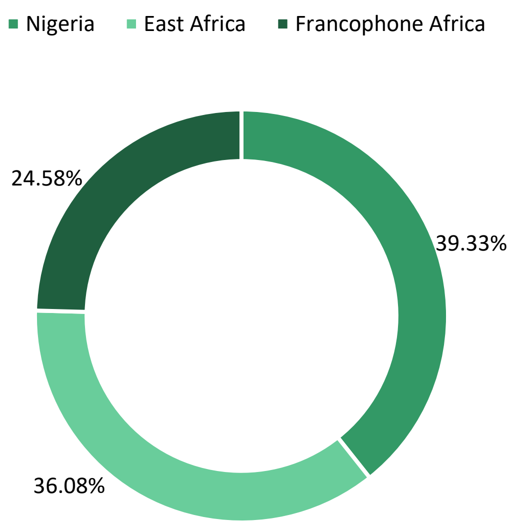
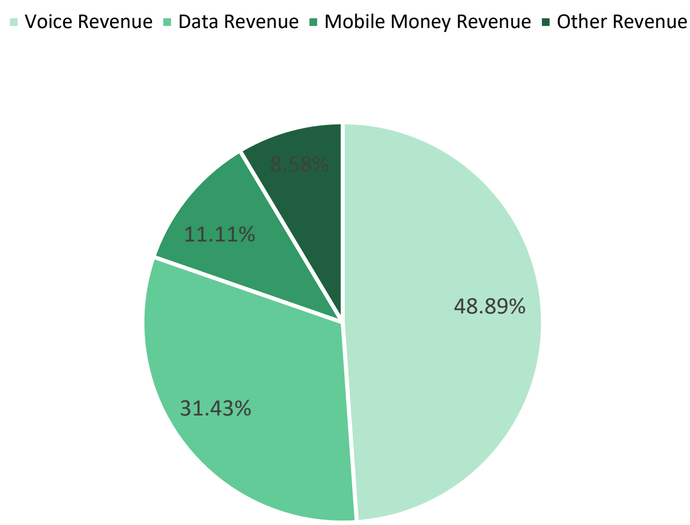


Chart 10: **AIRTELAFRI** Revenue mix



Source: Company Filling. Meristem Research

Strategy: *Leveraging on Opportunities*

The firm has a "Win with" strategy, which it aims at **driving profitable growth**, **enabling financial inclusion**, **fostering digitalization**, **supporting education** and **empowering customers**. To achieve these, Airtel is focused on winning with in six major areas: network, customers, data, mobile money, cost, and people. Particularly, the Airtel's aim is to create a leading network with the capacity to meet surging demand and improve connectivity by modernizing its network, increasing its speed and cutting down on latency and delivering voice quality. To this end, it has focused on the expansion of its 4G network, with 81.80% of its sites in Nigeria presently on 4G (making it the Telco with the highest 4G coverage in the country). To win with customers, the firm is focused on strengthening its distribution network and enhancing customer experience, through simplified Know Your Customer (KYC) process. Its Win with data places attention on maximizing value of data-based services and growing penetration. Thus, it is increasing its investment in 4G network, developing its wireless home broadband and enterprise businesses. On winning with mobile money, **AIRTELAFRI** aims to drive the adoption of its airtel money business to enhance financial inclusion to the pool of unbanked population in its operating countries. This is to be done through strengthening its distribution channel (agent network), expanding the range of its mobile money services and expanding its partnerships.

Growing Income Across the Continent

AIRTELAFRI has maintained a decent revenue growth over the years, growing topline at a 3- year average annual rate of 10.33%. This reflects the growth across the firm's business lines over the period. In H1:2022, the firm 's topline grew by 25.18% YoY, driven by growth in Average Revenue Per User by 14.81% and total customer base by 5.41% YoY. The growth was witnessed across revenue segments, with mobile money (+ 43.09% YoY) and data revenue sources (+33.s76% YoY) and voice revenue (+17.28% YoY). Also, revenue growth was spread across operating regions, Nigeria (+24.79% YoY), East Africa (+24.73% YoY) and Francophone Africa (+ 25.84% YoY).

Increasing Efficiency

The bulk of the telco giant's cost is associated with its network operating expense, (accounting for an average of 31.16% of total expenses in the past 5-years). During the same period, the network operating expense has grown at an annual growth rate of 4.95%. Cost to income has however been on a downward trend over the same time (from 71.19%in 2015 to 54.07% in 2020). The lower cost to income is attributable to the operation of a single RAN network for the spread of 4G network, reducing the operating costs due to the usage of a single base station. In H1:2022, total expenses increased by 10.58% YoY, majorly spurred by increase in network operating expense by 16.67% YoY, access charge by 6.45% YoY and license fee (+21.28% YoY). The increase in cost is attributable to increased voice traffic and sites roll out. Cost to income ratio however declined by 378bps to 51.98% (from 55.76% in the prior period). Thus, EBITDA improved by 35.22% and EBITDA margin increased by 360bps to 48.32% (vs. 44.74%), similarly, there was an uptick in operating margin to 32.22%, from 26.01%. Subsequently, after tax profit improve by 154.46% and net margin improved to 12.54% (vs. 6.17%).

Outlook and Valuation

In arriving at a fair value (of **NGN1,213.41**) for **AIRTELAFRI**, we adopted a blend of Free Cash Flow to Firm, Free Cashflow to Equity, Dividend Discount and Relative Valuation Models. We considered the prospects that exists for the firm, given the growth in the sector across its operating countries and the company specific outlook. We also note the some of the downside risks to our forecast such as the stern regulation.

Chart 11: AIRTELAFRI EV/EBITDA vs. Peers

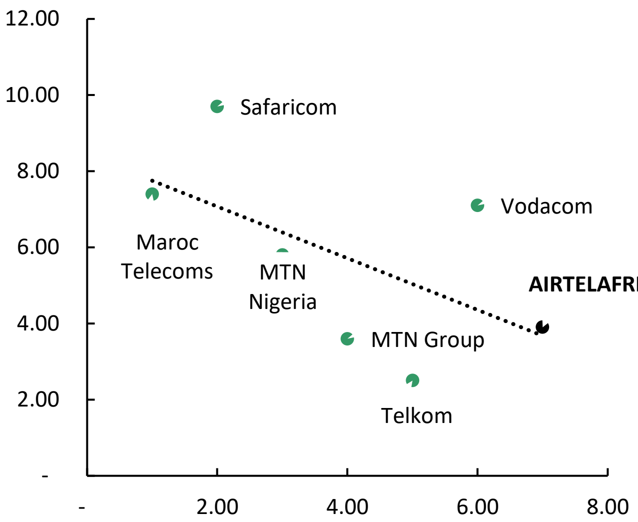
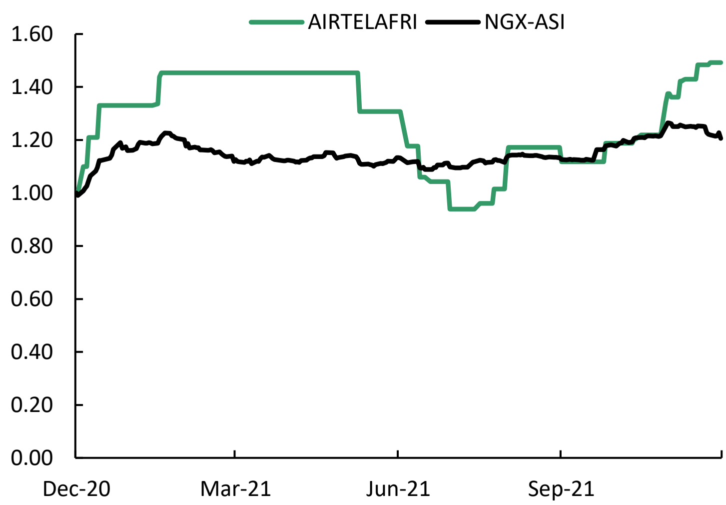


Chart 12: AIRTELAFRI Share Price Movement vs Market Index



Source: Bloomberg, Meristem Research

Sensitivity Analysis

Sensitivity Analysis of Dec-2022 Target Price to key model inputs							Min	508.49
		EBITDA/Share					Max	868.97
		175.34	**175.84**	**176.34**	**176.84**	**177.34**		
Target EV/EBITDA	**2.90x**	508.49	509.94	511.39	512.84	514.29		
	3.40x	596.16	597.86	599.56	601.26	602.96		
	3.90x	683.83	685.78	**687.73**	689.68	691.63		
	4.40x	771.50	773.70	775.90	778.10	780.30		
	4.90x	859.17	861.62	864.07	866.52	868.97		

FCFF VALUATION SUMMARY							
(Figures are in USD'mn)		2022	2023	2024	2025	2026	Terminal Value
EBIT		1,424.46	1,498.12	1,529.82	1,548.37	1,592.04	
Operating Cash Taxes		570.70	601.17	610.39	618.36	112.24	
NOPLAT		853.76	896.95	919.43	930.01	1,479.81	
Non-Cash Charges		806.62	894.30	980.57	1,061.05	1,077.34	
CAPEX		(648.03)	(644.59)	(677.08)	(646.96)	(663.20)	
Working Capital Investment		(250.02)	(161.66)	(217.14)	(154.31)	(206.79)	
FCFF		**2,757.49**	**3,084.29**	**3,145.99**	**3,356.51**	**3,391.43**	**32,175.13**
Valuation Parameters							
SGR	3.60%						
Cost of Equity	20.75%						
Cost of Debt	10.00%						
WACC	14.52%						
Discount Period		0.15	1.15	2.15	3.15	4.15	5.15
Discount Factor		0.98	0.86	0.75	0.65	0.57	0.50
PV of FCFF		**2,701.98**	**2,639.01**	**2,350.51**	**2,189.83**	**1,932.08**	**16,005.95**
Value of Operations	27,819.37						
Value of Non-operating assets	5,071.95						
Enterprise Value	32,891.32						
Non-Equity claims	4,616.00						
Equity Value	28,275.32						
Shares Outstanding	3,758.00						
Equity Value per Share	**7.52**						

VALUATION SUMMARY		
Techniques	**USD**	**Weight**
Enterprise DCF	7.52	25%
Equity DCF	0.21	25%
DDM	0.57	25%
Relative Valuation	3.39	25%
Blended Valuation (USD)	**2.92**	
Exchange Rate	**415.10**	
Blended Valuation (NGN)	**1,213.41**	

Financial Statement						
USD'mn	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Revenue	**3,077**	**3,422**	**3,908**	**4,629**	**4,958**	**5,208**
Direct Network operating cost	558	628	694	810	868	911
Operating Expenses	1,796	1,906	2,119	2,416	2,586	2,716
EBITDA	**1,307**	**1,533**	**1,800**	**2,231**	**2,392**	**2,510**
Operating Profit	734	901	1,119	1,424	1,498	1,530
Profit before taxation	348	598	697	1,076	1,126	1,162
Profit for the year	**426**	**408**	**415**	**667**	**698**	**720**
Total Non-Current Assets	7,685	7,654	8,087	8,274	8,591	8,926
Total Current Assets	1,421	1,671	1,905	1,941	2,035	2,105
Total Assets	**9,106**	**9,325**	**9,992**	**10,215**	**10,625**	**11,030**
Total Equity	**2,430**	**3,281**	**3,353**	**3,640**	**3,905**	**4,176**
Total Non-Current Liability	3,577	3,556	3,135	3,049	2,947	2,834
Total Current Liability	3,099	2,488	3,504	3,526	3,773	4,020
Total Liabilities	**6,676**	**6,044**	**6,639**	**6,576**	**6,720**	**6,854**

Ratios						
EBITDA Margin	42.48%	44.80%	46.06%	48.20%	48.25%	48.20%
Net Margin	13.84%	11.92%	10.62%	14.41%	14.08%	13.83%
ROA	4.68%	4.38%	4.15%	6.53%	6.57%	6.53%
ROE	17.53%	12.44%	12.38%	18.33%	17.87%	17.25%
Asset Turnover	0.34x	0.37x	0.39x	0.47x	0.47x	0.47x
Leverage	3.75x	2.84x	2.98x	2.81x	2.72x	2.64x

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Company	Disclosure
MTN Nigeria Communications Plc	
Airtel Africa Plc	

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