# Market Review: Telecoms dial up Recovery
Ahmed Tabaqchali, 06 December 2018

Average daily turnover in November continued to improve, increasing 24% on the back of October's 24% month-on-month growth. However, the recovery is coming from an incredibly low base and still shows the average daily turnover in-line with the dismal levels of September, which were among the lowest for some time (chart below).

With the gradual recovery in turnover, the market, as measured by the RSISUSD Index, moderated its month-on-month declines, down -1.7% for the month- continuing to test the major bottom of May 2016.
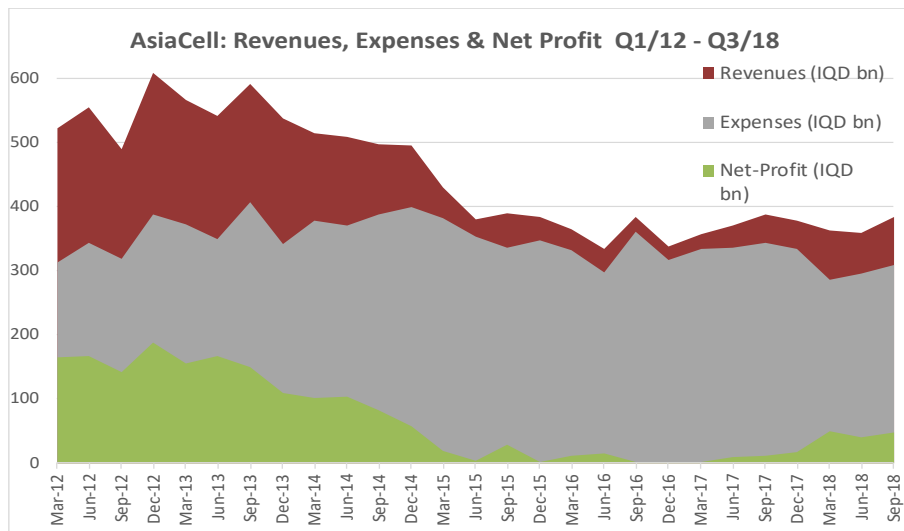
However, the end the Arbaeen, summer, and the government formation are yet to mark the end of the period of, probably, the lowest daily trading volumes on the Iraq Stock Exchange (ISX) since it first witnessed an expansion in volumes in 2010. The anomaly and un-sustainability of these low levels was discussed last month, and logic continues to argue for a reversion to the mean.
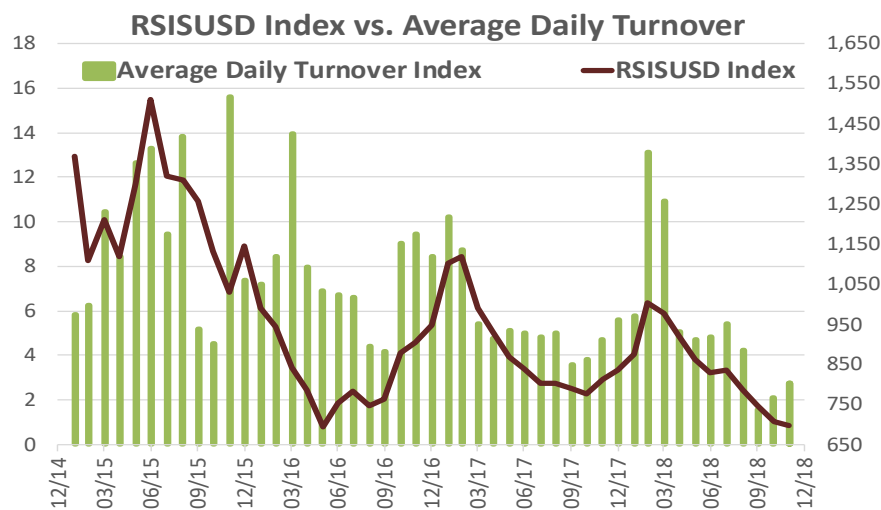
(Source: Iraq Stock Exchange, Rabee Securities, Asia Frontier Capital)

It was also argued last month that an uptick in M2 (broad money and a proxy for economic activity) could imply that liquidity, brought on by a two-year recovery in government finances, has finally begun to filter down into the economy – which should accelerate as the new government begins to act on its spending programme.

A nascent recovery in telecoms adds support to this line of reasoning. The two major mobile operators out of three national operators, reported Q3/2018 earnings that display the markers of recovery in earnings, margins and profits. Of the two, AsiaCell (TASC) has been listed since 2013 and as such its reported earnings span the period 2012-2018, and thus reflects the operating environment before, during and just after the ISIS conflict.

AsiaCell: Revenues, Expenses & Net Profit Q1/12 - Q3/18

- Revenues (IQD bn)
- Expenses (IQD bn)
- Net-Profit (IQD bn)

(Sources: Rabee Securities, ISX, Company reports, Asia Frontier Capital)

TASC's earning's profile marked by rapidly increasing revenues - driven by the country's adoption of mobile phones – peaked in 2013. The turn for the worst started in late 2013 with the increasing violence before the May 2014 elections, which accelerated by mid-2014 with the ISIS invasion and the loss of over a third of the country, and with that a significant loss in TASC's subscriber base.

The roll out of 3G in early 2015 brought its own set of problems. The amortization of the fees of $307 million (on top of fees of $1,250 million in 2007 for a 15-year licence) to access the 3G spectrum increased costs meaningfully. While, revenues took a hit as free IP voice telephony soon replaced most expensive regular telephony-especially for international calls, while data fees could not fully replace these lost voice revenues. This was compounded by increased competition among the three mobile operators as they sought to replace both lost consumers and voice revenues through competitive price offerings to lure consumers from each other.

Capping the woes of mobile operators was the severe economic decline brought about by the ISIS conflict and the collapse oil prices as non-oil GDP declined by -3.9%, -9.6% and -8.1% for 2014, 2015 and 2016, respectively. Finally, the resultant weaknesses in both consumer and business demand was made much worse with the introduction of 20% VAT on phone cards in the summer of 2016.

For TASC, the revenue decline, while cost increases crushed its profits (as the chart above shows), however this decline in profits was moderated by very strict cost controls and decreasing capital expenditures reflecting an earlier heavy investment in infrastructure.

The bottoming in revenues over the last few years came to end in late 2017 with the liberation of Mosul and the gradual return of customers which contributed to the recovery in profitability. The company signalled its confidence in its future outlook with a distribution of a 12% dividend on the back of last year's 14% dividend - however, in absolute terms the dividend is about one third higher than that of last year. The grandfathering of the transition to 3G, the amortization of the licence and the effects of the VAT introduction, all coupled with the return of customers as well as the expected growth in data usage should lead to a healthy period of resumed earnings growth.

The next few quarters should see a similar recovery for the battered banking sector, with probably the first to recover being the quality of loans. A return of liquidity and an economic pick-up should be followed by a recovery in the quality of bad loans and the reversal of NPL's (non-preforming loans) with past provisions becoming earnings, thus providing the first boost to earnings recovery. This should be followed by growth in loans and deposits, as should growth in trade finance revenue, and therefore similarly to the case of telecom should lead to a resumption of a period of earnings growth,

and with-it better stock price performance. For more details on the banks see "Of Banks and Budget Surpluses".

Recovery, in frontier markets, is a mirror image of Mark's Twain's phrase on going broke, in that recovery happens gradually and then suddenly. If similar experiences in other frontier markets of declining prices while fundamentals point to a start of a gradual recovery, then the trend of the last few months could be followed by a sharp reversal to the upside.

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