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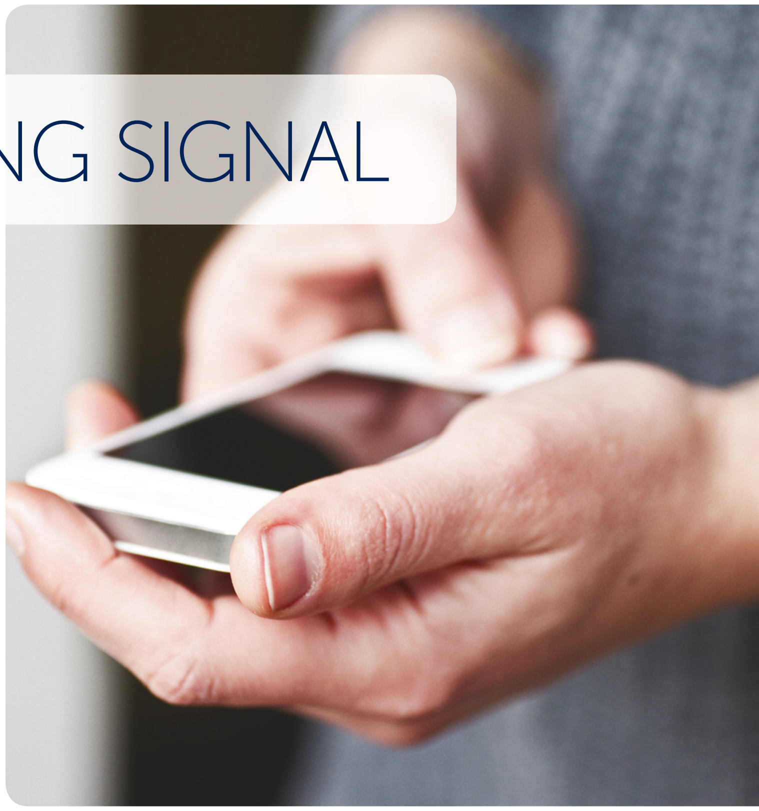
SENDING A STRONG SIGNAL



As part of the investment process at Tantalum Capital, we extract tremendous value from comparing and contrasting companies listed in South Africa with their international peers. In the case of Vodafone, apart from gaining valuable insights into Vodacom and the potential future evolution of the South African Telecommunications (Telco) market, we unearthed a great investment opportunity.

Vodafone is one of Europe's largest mobile operators, with operations in Germany, Italy, the UK and Spain as well as India and South Africa. Vodafone's EBITDA (Earnings before Interest, Tax Depreciation and Amortisation) is split between Europe (65%) and Emerging Markets (35%).

Seven years of famine, a business on death's door?

After nine months of fevered speculation, when Vodafone confirmed that it was in advanced discussions to dispose of its 45% stake in Verizon Wireless (a leading US mobile operator) for $130 billion during September 2013, the implied valuation for the remaining Vodafone business was 3.7x Enterprise Value to EBITDA (Enterprise Value (EV) is the sum of the company's market capitalisation and all outstanding debt less the cash resources on hand). In Vodafone's case this implied that its total debt and equity could be repaid from operating earnings in less than 4 years. This distressed valuation suggested that investors had very little confidence in the long term profit stream, and indeed the viability of Vodafone.

Vodafone's European service revenues for the year ended March 2015 are 8% less than the level recorded in 2009 despite the acquisition of three fixed line operators in the interim. European service revenue has not recorded positive year on year growth since 2008! This industry-wide decline in mobile revenue has been driven by regulated declines in voice and roaming tariffs and further exacerbated by fierce competition. Growth in data revenues somewhat offset the losses on the voice side. Positive year on year revenue growth is expected to materialise only in 2016.

An industry constrained

For much of the past decade the European regulator has swayed too far towards consumer protection and price minimisation and decimated the profitability of the telco industry. Facing significant revenue declines over a long period, only two things can recover the situation: an increase in revenues, or a decrease in costs. Mergers neatly address both concerns. After a merger, competitive intensity declines. This leads to higher selling prices and consequently, industry revenues. Additionally, duplicate operating costs and investment spending can be eliminated which ultimately leads to better networks, customer experience and operator profits. The European market is extraordinarily fragmented with 100 fixed and mobile operators serving 500 million people. Compare this with China, where a billion people are covered by 3 networks or America where 90% of the population is serviced by 1 of 4 operators.

On the face of it, Europe is not an attractive regulatory environment in which to consider cross-border mergers. The 28 nations which form the European Union each have a separate competition commission and telecommunications regulator. Additionally, the European Commission (EC) is the ultimate arbiter of deals. As a consequence, no major mergers and acquisitions occurred between 2008 and 2013. As recently as 2012 an attempt by Vodafone to consolidate the Greek market was rebuffed. The desperation encapsulated in the Vodafone valuation was not unwarranted. The diseconomies of scale of such a fragmented market is enormous. An official European regulatory report released in 2013 estimated that €80 billion of cost synergies could theoretically be extracted from industry consolidation.

At the edge of a precipice, sanity prevails

Telco operators could not rationally invest any money into their networks as they were not earning a return on their investments. This throttling of capex affected the quality of Europe's telecommunications infrastructure, and were it to persist, European productivity and economic growth would be impaired when measured against global competitors. This view gained gradual traction, and has now been widely embraced by most analysts and finally also politicians and regulators.

From 2013, Germany has asserted its authority on this issue, and encouraged a more investment friendly regulatory stance. Both Angela Merkel and Jean-Claude Juncker (the new president of the EC) have come out on numerous occasions to say that Europe needs investment policies aimed at fostering additional investment in telco infrastructure. It is their hope that this will increase European competitiveness, productivity and economic growth.

During February 2014 the consolidation of the Austrian market was allowed by the EC on the condition that spectrum was set aside for a fourth competitor and that a new virtual operator be allowed to operate. In an unusual move the EC declared itself the competent authority and brushed aside concerns from local Austrian competition authorities. No company took up the spectrum offer and prices rose immediately after the deal was cleared. On 2 July 2014 the EC approved another transaction, allowing the German market to consolidate from 4 to 3 players. This was our cue that consolidation was finally being accepted and viewed favourably by regulators, and that pan-European market repair was in sight.

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MARKET EVOLUTION

Globally the media, internet and telecommunications arena is evolving rapidly. The notion of the internet and technology permanently changing society and with it ways of living and doing business led to the great technology stock bubble of 1999-2001. This reality has now arrived. Taken alone, the changes occurring in the sector is worthy of a full quarterly newsletter. However, these are some of the trends and debates that we are monitoring closely:

The rise of platforms

Facebook and Twitter did not exist a decade ago. Today, they offer content of interest to users whilst gathering insights into their users preferences. Powerful network effects exist which lock clients into this ecosystem. Their revenue model is currently skewed towards advertising. Growth in the user base is so important to Facebook that they are looking to subsidise consumers' internet usage in underdeveloped markets. Similarly, Google, the dominant search engine company, is doing extensive research into alternative network deployment technologies and even the connected car. The strategic importance of networks and the desire of platforms to create some form of leverage against the providers of existing networks is palpable.

Content access and usage patterns are changing

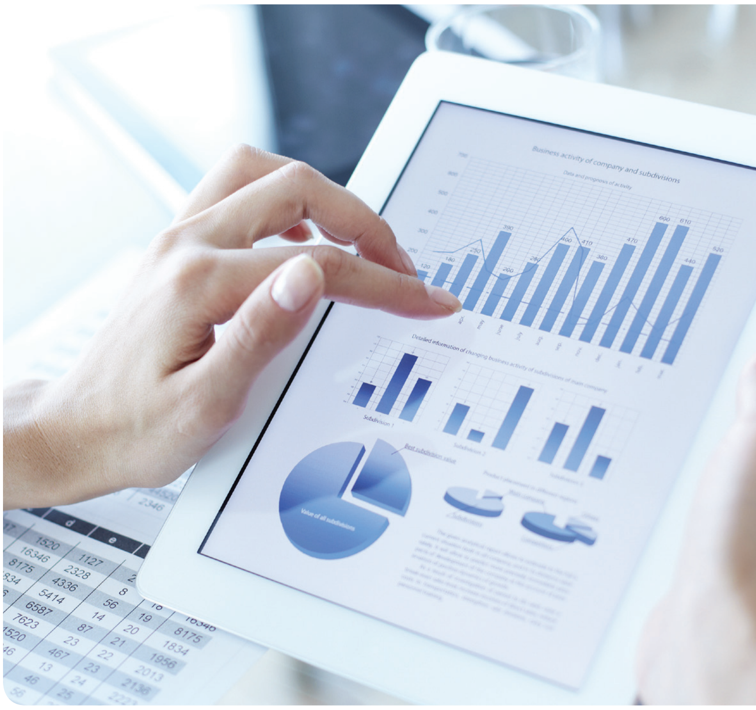
High resolution video drives the growth in demand for data services. Apart from the obvious need to communicate and find information, increasingly the internet also entertains people. Piracy websites called "torrents" and the wildly successful Netflix service allow users to see what they want, when they want, on a device of their choosing, without advertising. Consumers are willing to pay to be entertained as they experience the tangible benefit of enhanced leisure time. The provision of content over the internet disintermediates traditional satellite and cable television providers. Increasingly, in terms of drawing advertising revenues, live events and sporting content will become more valuable due to the reality that fans want to be involved in the action as it happens.

A prime example of leveraging the power of a platform into content provision is Tencent's Weixin (or WeChat). It started as a free messaging application and has evolved into the go-to portal for a range of services and content serving 550 million people. Weixin is responsible for 30% of all mobile data consumption in China. Apart from mobile gaming and social networking Weixin houses or offers links to a suite of nascent opportunities. This includes shopping, payments, financial services (wealth management, auto financing, Webank), taxi hailing (think Uber), restaurant bookings and other services ranging from traffic fine payment to electricity purchases.

The more data heavy offerings include China's largest mobile video site (a combination of Netflix and Youtube), the number one online literary site (think Kindle), as well as a rapidly growing music offering (think Spotify). Weixin is a key part of an increasingly data-hungry puzzle.

Our investment in Vodafone

During July 2014, we bought our stake in Vodafone at 190 pence at a dividend yield well in excess of 6%. This apparent attractive valuation had to be balanced against the knowledge that European revenues were still declining at 8.7% annualised, making the market consolidation theme an imperative for our investment. Based on our conviction on the prospects for a value unlock, it was and still is our largest offshore holding in those funds where our mandates allow for offshore exposure. Vodafone is presently trading at 230 pence and our investors have already received nearly 15 pence in dividends during our holding period.



Looking ahead, we continue to believe that Vodafone is a good investment organically for the following reasons:

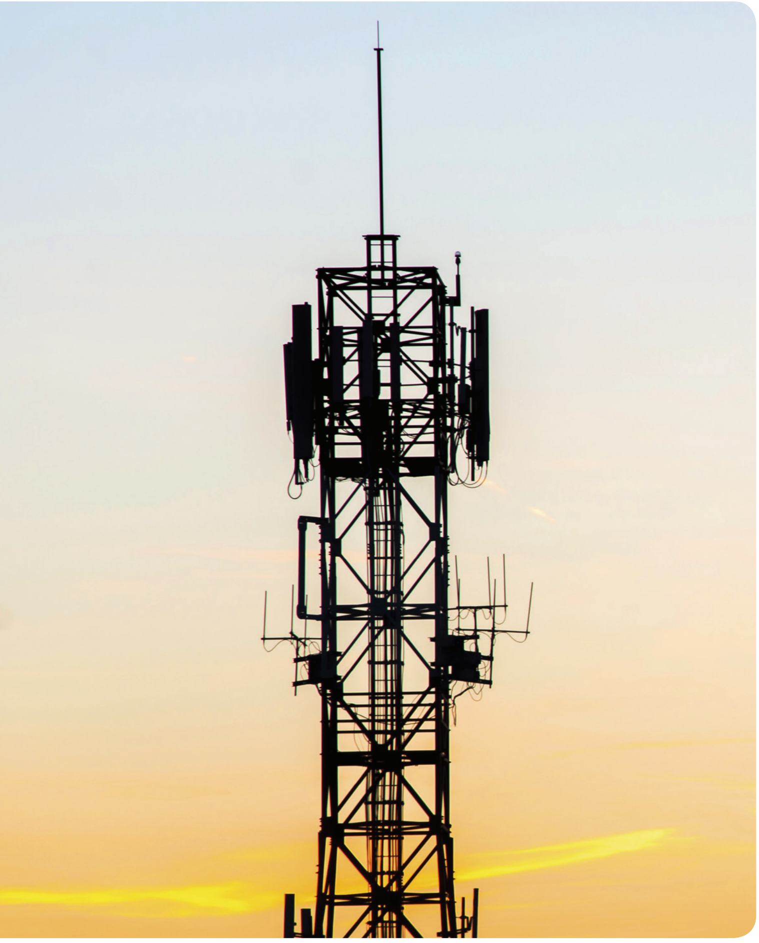
• The European market is consolidating apace with twelve deals done since the first deal passed in Austria. As a Pan-European giant, Vodafone is one of the key beneficiaries of this trend with large stakes in the biggest markets where the benefits of market repair are going to be most material from a financial perspective. With cost discipline imposed by years of decline, increasing revenues should flow straight to the bottom line.

• In the latest results Germany disappointed with significant downward repricing of Vodafone's customer base. Germany is Vodafone's largest profit pool. We are assured that Germany is on track to deliver renewed growth and that the market will reward this growth once it materialises.

• Through monetary stimulus the European economy is starting to expand. In the long term, telco revenue growth is highly correlated with economic growth. Recent indicators are that we may have reached a trough in consumer spend in Europe, and any improving macro backdrop would be positive for the sector.

• Project Spring is a once off investment in network capacity (both mobile base stations and fixed line assets) entering its second year. This is a Vodafone investment programme designed to cater for increased data demand of customers. With 4G penetration (allowing superfast data connections and devices) still low in Europe, a significant increase in data demand is expected as consumers migrate from 3G technology. With its bundling strategy Vodafone is well positioned to profit from this trend. The investment is being made, while the benefits have not yet been harvested.

• India is a large market with great upside potential for Vodafone. They are one of the largest players in the market. Despite the positive news out of Europe, management are adamant that India is their most exciting growth vector. Mobile data has a long runway; 3G has only recently been launched and with a large unbanked population, the learnings from Vodafone's vastly successful MPesa venture in Kenya (through Safaricom) provides additional optionality.



Barbarians at the gate?

Additionally, there is a good possibility that Vodafone may be involved in accretive M&A. Although this angle is not core to our investment case, it does provide a measure of free optionality and a valuation underpin. Why would/could this happen?

- Interest rates are low and the regulatory environment allows for it.
- Vodafone has huge unutilised tax losses equalling £63 billion in Luxembourg and £15 billion in Germany. Adding additional profits will expedite the usage of these losses and is value accretive.
- Vodafone owns strategically important assets that form an integral part of any potential quadplay offering. Quadplay involves providing a client with a service that addresses both a client's communication and entertainment needs in one package. It consists of mobile voice and data, fixed voice, fixed data and TV or content.
- Both AT&T and Liberty Global have openly been associated with possible deals involving Vodafone in the recent past.

In summary, we believe that our funds are invested in a well managed company where the stars are in the process of aligning in our favour. Despite already realising hard currency returns bordering on 30% in under a year, we believe there is more value to be unlocked as the market has consistently undervalued this company. Today, Vodafone still only trades at 6.5x EV:EBITDA and a normalised 6% free cashflow yield. Comparing Vodafone to the broader European market and other defensive sectors such as Consumer Staples, Pharmaceuticals and Utilities the valuation still appears attractive: Vodafone offers nearly one and a half times the dividend yield and is on roughly a 30% discount considering EV:EBITDA. It offers compelling value and further positive optionality.

Net neutrality

Netflix is responsible for in excess of 40% of data traffic on US networks. For relatively little capital employed, Netflix has a market capitalisation of $40 billion. The network operators have invested in networks (without which Netflix could not reach their clients), and potentially want the ability to prioritise traffic and charge variable prices for the provision of data to clients at variable speeds. Should net neutrality continue to be enforced, this would be negative for telcos.

Fixed/Mobile Convergence

Mobile Virtual Network Operators (MVNO's) are businesses which pay a fixed price to mobile networks for a certain amount of minutes and data. Simplistically, a retailer may repackage the data and airtime to their clients at some margin and provide the requisite customer service to the end client. MVNO's are often a tool used by fixed line operators to sweeten the deal for their clients. Because the fixed operator makes all its revenues and profits in another part of their business they "give the mobile away". This is an acceptable outcome for the fixed operator but forces the mobile operator to price its mobile offering closer to the new price created by the MVNO or risk alienating their clients. The largest fixed line operator in Britain, BT is presently in the process of acquiring the largest mobile network, EE.

Quadplay

In a further extension of the convergence theme, telco operators may acquire content or content companies and bundle it with their connectivity and data offering to the client. This dynamic is generally deflationary as clients are getting more for less. However, the benefit is that this "packaging" does drive data usage. Should providers structure their products appropriately, they may in time realise increased revenue off the back of increased usage. In this regard, Sky Europe is discussing a commercial partnership with Vodafone. In the American market, content and telco mergers are being consummated and this will surely follow in Europe. A recent example is AT&T's acquisition of DISH in America and BT's well documented acquisition of some of the British Premier League football rights.