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# Topical Note

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### Safaricom Plc

**“Is Safaricom losing its grip?”**

**Part 2: Voice Calls - “Dialing the Wrong Number”**

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## Executive Summary

- **Voice Calls - “Dialing the wrong Number”** is the 2<sup>nd</sup> part of our 6 part series report titled **“Is Safaricom losing its grip?”**
- In the 1<sup>st</sup> part - **“Pricing Power Explained”** we explained the concept of “pricing power” which we defined as the ability of a company to raise prices over time without reducing demand for its products.
- We used the **Herfindahl Hirschman Index (HHI)** theoretical framework to determine the each business line’s concentration levels and mentioned in brief the services in which Safaricom has or does not have pricing power.
- In this report, we conclude that the **voice call market is highly concentrated** by analyzing voice call traffic market share with Safaricom clearly the dominant market player.
- However, it **does not hold pricing power** as recent tariff adjustments by other mobile operators has resulted in a significant loss of market share as customers are highly price sensitive.
- A brief comparison of prepaid voice call tariffs shows that Safaricom is comparatively more expensive than its competitors and this explains the loss of market share in recent months.
- The negative impact of Over the Top Services (OTT) such as skype, Facebook messenger and other data driven mobile device applications on voice calls traffic has also been mentioned.
- Finally, we conclude by showing the impact of loss of market share on voice call revenues.

<b>“Is Safaricom losing its grip?”</b>	<b>Report Title</b>
Part 1	“Pricing power explained”
<b>Part 2</b>	<b>Voice Calls - “Dialing the wrong number”</b>

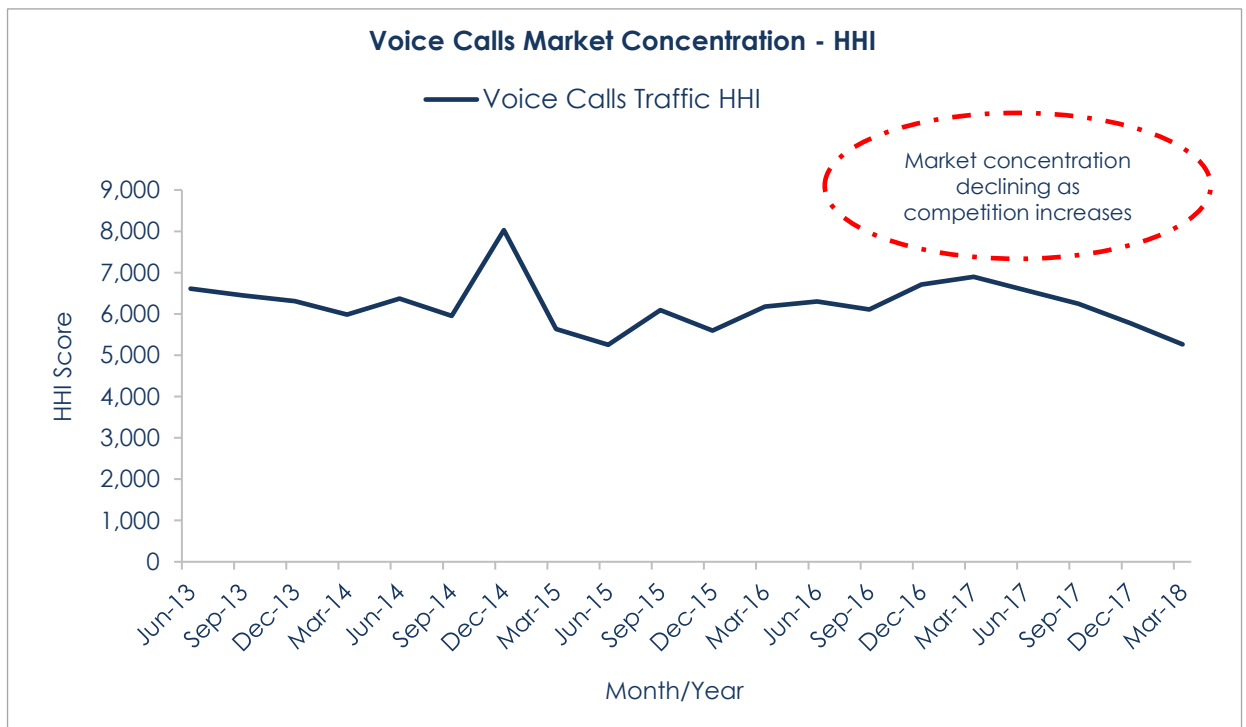
## Voice Calls - Dialing the Wrong Number

- Our analysis of historical voice minutes traffic data helps us determine the extent to which Safaricom holds pricing power in this service.
- We acknowledge industrywide trends on voice calls where Over the Top Services (OTT) such as WhatsApp and Skype are fast gaining popularity due to the comparative cost advantages.
- These are responsible for exerting pressure on Safaricom's voice traffic and revenues

## Voice calls - Safaricom must bow down to price pressure & review tariffs downwards

- The voice call market concentration has been declining (Fig.1) a trend attributable to Safaricom's loss of market share to both Airtel & Telkom over the last two years.
- Airtel and Telkom's low cost pricing strategies aimed at acquiring both new and existing mobile phone subscribers have been effective.
- Drawing from our HHI analysis below, we conclude that the potential for a single operator to develop pricing power in the voice calls business has declined significantly over the last 4 years as subscribers are highly price sensitive.

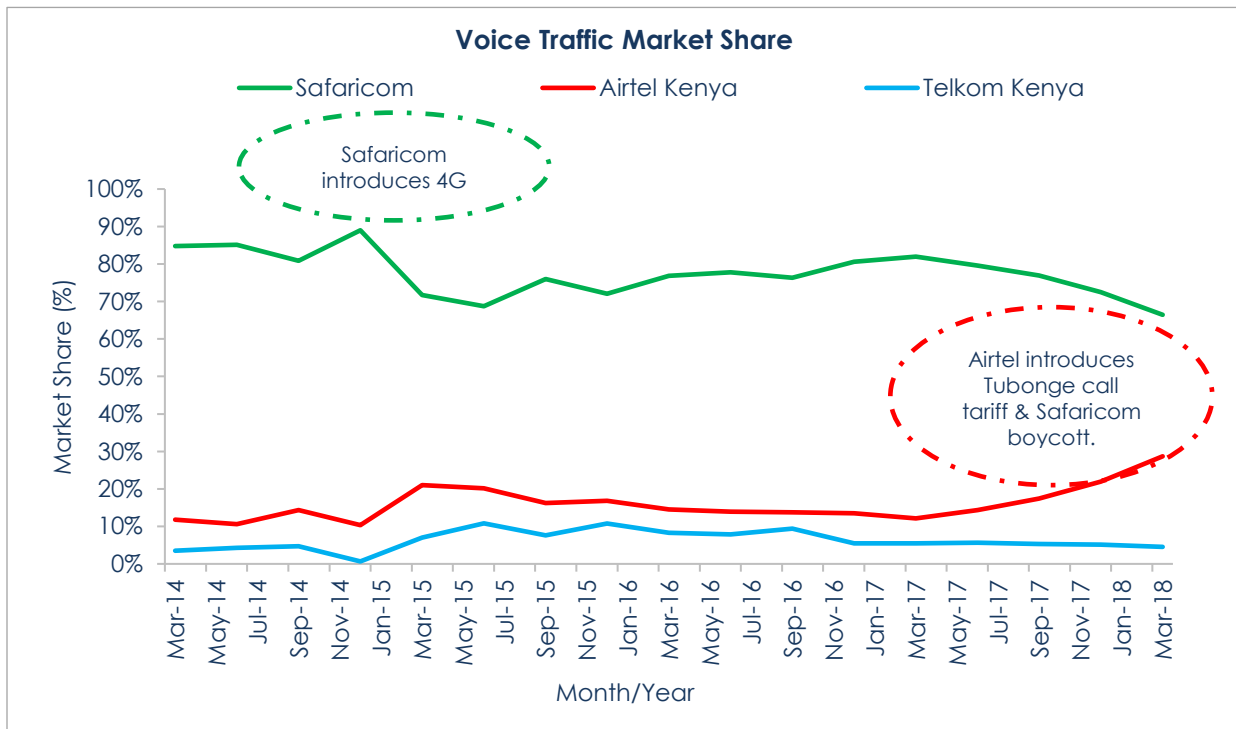
**Fig.1: Voice calls market concentration on a decline as competition intensity increases**



Source: Communications Authority of Kenya (CA), Sterling Research & CFA Institute

- The price sensitivity of voice call customers is best illustrated by a comparison of voice calls market share data as at Q3 2017/18 and Q3 2018/19, a period during which both Airtel and Telkom introduced and aggressively promoted new cheaper voice call tariffs.
- The reduction in Safaricom's market share of voice traffic from 82% to 66.5% over the same period (Fig.2) was also compounded by political factors where the opposition political parties called for a boycott of Safaricom products.
- We predict a further decline in Safaricom's market share in the voice calls business in the next 3-6 months with a market share loss of between 2% and 3%.
- This is however unlikely to breach 60% in the near term as we expect the company to implement several customer acquisition and retention strategies such as (promotions and discounts) to protect its market share.

**Fig.2: Downward price revisions distorting voice call traffic market share**



Source: Communications Authority of Kenya (CA) & Sterling Research

- A comparison of voice call tariffs (Table.1) shows the difference in voice call tariffs amongst the main mobile operators.
- In October, Safaricom announced an upward revision of voice call tariffs following an increase in excise duty from 10% to 15%. The company had revised its tariffs downwards in September 2018.
- It is our view that the duty increment reduces the likelihood of Airtel and Telkom Kenya reducing their tariffs any further as this would make tariffs unsustainable for the two loss making companies.

**Table.1: Airtel Kenya & Telkom Kenya pre-paid tariffs lower than Safaricom**

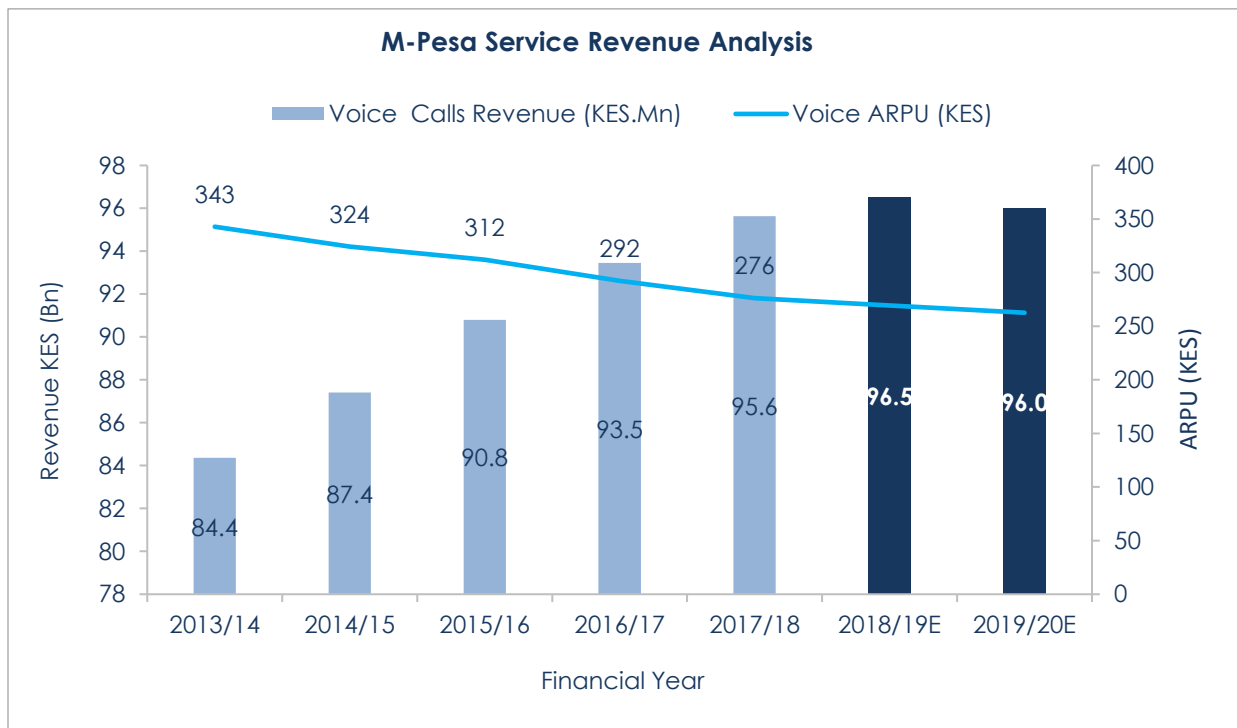
Calls Rate (KES)	Safaricom	Airtel	Telkom
Off-Network	KES.4.30	KES.2.00	KES.2.00
On-Network	KES.4.30 - 8am - 10pm KES.2.20 - 10pm - 8am	KES.2.00	Free

Source: Company tariff guides

**Voice calls service revenue expected to decline gradually as a result of competitive threats & OTT services**

- We expect Safaricom's voice revenues to increase albeit at a declining growth rate FY2018/19 to KES.96.5Bn as the company faces steep competition from other operators and the effect of growing customer preference for the use of OTT services, before declining gradually beginning FY2019/20 (Fig.3).
- Voice contribution to total revenue is expected to decline from 42.6% FY2017/18 to 39.3% and 35.9% FY2018/19 and FY2019/20 respectively.

**Fig.3: Voice call revenue expected to come under pressure**



Source: Company filings & Sterling Capital estimates

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