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Safaricom Plc

“Is Safaricom losing its grip?”

Part 5: Fixed Data - “The New Growth Frontier”

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Executive Summary

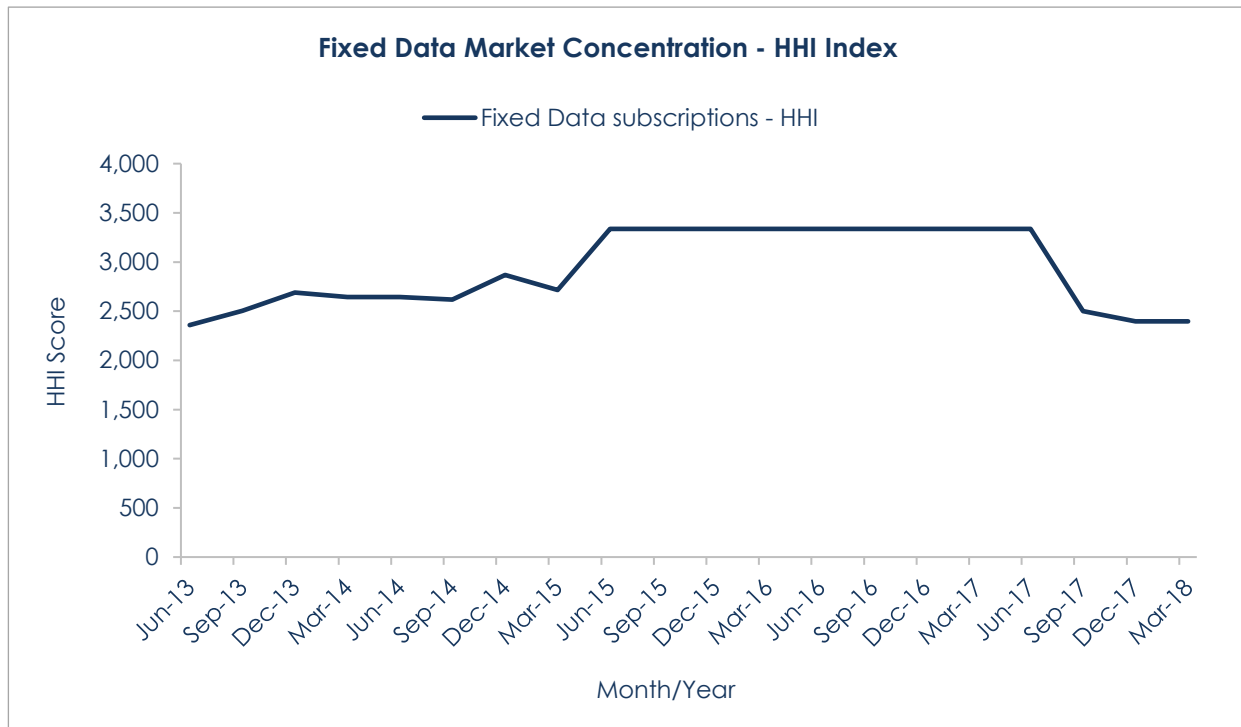
- **Fixed Data - “The new growth frontier”** is the 5th part of our 6 part series report titled **“Is Safaricom losing its grip?”**
- In the 1st part - **“Pricing Power Explained”** we explained the concept of “pricing power” which we defined as the ability of a company to raise prices over time without reducing demand for its products.
- We used the Herfindahl Hirschman Index (HHI) theoretical framework to determine each business line’s concentration levels and mentioned in brief the services in which Safaricom has or does not have pricing power.
- The report identifies the fixed data market as having low market concentration with the Wananchi Telecom the current market leader losing market share rapidly.
- On price wars, we do not see this as a likelihood but see network coverage and service reliability as the main sources of competitive advantage.
- Our conclusion is that Safaricom currently **holds some degree pricing power in fixed data business in spite of not holding a dominant market position.**
- However, recent market share gains could make it the dominant player in the medium term with a high level of pricing power should the trend continue.
- Fixed data revenues growth will remain strong supported by growth in subscriber numbers and overall market share growth.

“Is Safaricom losing its grip?”	Report Title
Part 1	“Pricing Power Explained”
Part 2	Voice Calls - “Dialing the Wrong Number”
Part 3	SMS - No one’s texting”
Part 4	Mobile Data - “Losing its byte”
Part 5	Fixed Data - “The New Growth Frontier”

Fixed Data - The new growth frontier

- Market concentration of the fixed data business as indicated by HHI has increased gradually over the last 5 years (2358.7 in June 2013 to 2397.2 in March 2018) but remains relatively low compared to any of the other service lines (Fig.1).
- This suggests that the market leader Wananchi Telecom is losing market share to other fixed data service providers and in particular Safaricom.
- Safaricom's relatively fast subscriber growth has been driven by network reliability and coverage across the country and this explains why it is able to charge a premium rate for the service and still gain market share.
- However, we cannot explicitly conclude that fixed data customers are insensitive to price variations as it is a big consideration when selecting a provider.

Fig.1: Fixed data market has low concentration & stiff competition amongst the main players



Source: Company filings & Sterling Capital estimates

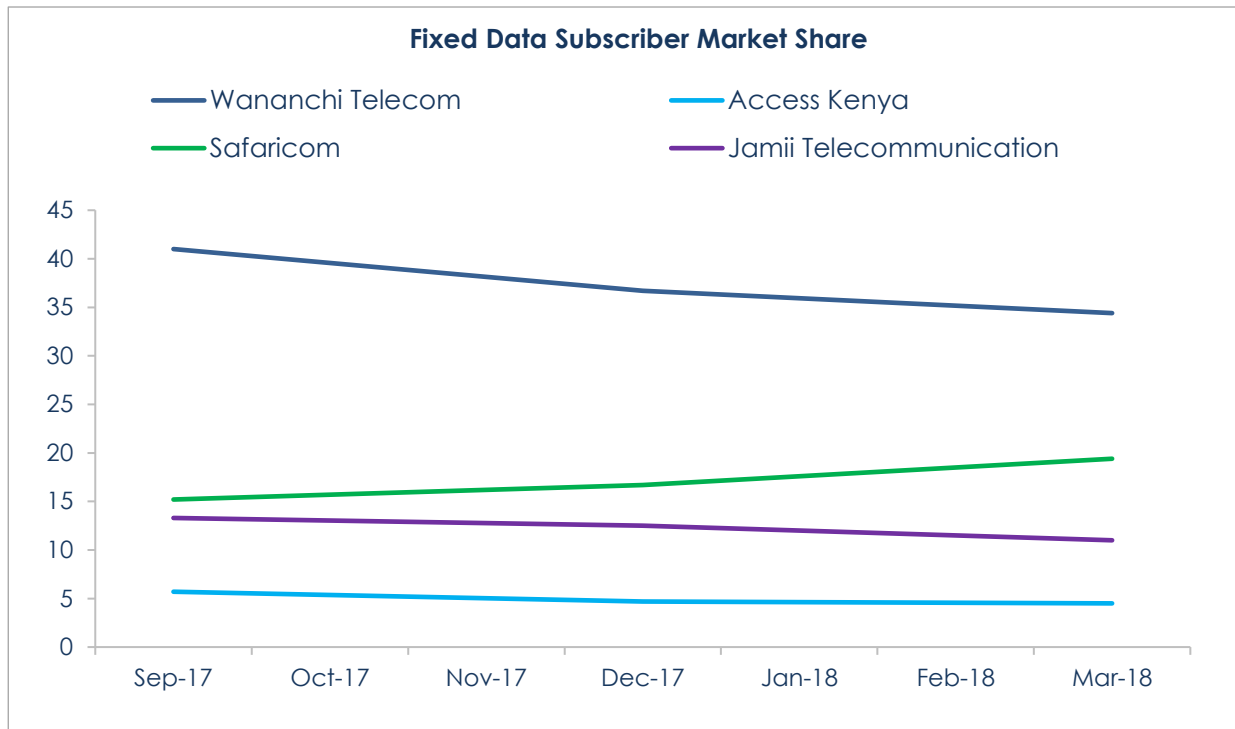
Not dominant but holds pricing power

- To determine whether Safaricom has pricing power in the fixed data business we take into consideration the Competition Authority of Kenya's definition of **market dominance**:
- **A company is dominant if "...it produces, supplies or distributes more than half (50%) of the total goods that are produced, supplied or distributed or controls not less than half (50%) of the services that are rendered."**
- This is the case with all Safaricom's business lines with the exception of fixed data where it controls 19.4% (March 2018).
- The Authority however further states that **"Where company has less than 50% market share, the Authority will consider whether it has or has the ability to exercise market power. It may consider whether it can set prices, outputs or trading terms without being effectively constrained by its customers or competitors in the relevant market."**
- This means that **Safaricom is not dominant but still possesses market power in effectively giving it a degree of pricing power in the fixed data business.**
- We believe that Safaricom is fast getting into a market position where it can set prices (fixed data tariffs), output (service coverage) and trading terms with minimal constraint by its customers or competitors.
- The reason for this being its superior network quality, fast increasing coverage, brand name override the comparatively higher price it charges its customers for the service.

Are we likely to see "price wars" in the fixed data business?

- We do not anticipate price wars in the fixed data business in the short term as Safaricom's biggest competitive advantage lies in its investment in network coverage infrastructure.
- We therefore do not believe that any of its main competitors can erode this advantage in the near term
- Attempts by competitors to reduce fixed data tariffs would depress margins further especially as most players continue to see a decline in subscriber numbers.
- Here, we also take into consideration an increase in excise duty on internet services from 10% to 15% with Safaricom responding by increasing its internet service tariffs and expect the other market players to follow suit.
- We believe that Safaricom's current market share is sustainable in the medium term and we predict further gains in subsequent periods.
- The market for fixed data is in the growth phase and new subscribers are likely to choose Safaricom as the provider of the service on the basis of network reliability and coverage rather than pricing.
- This further emphasizes its pricing power in the fixed data business.

Fig.2: Safaricom is fast gaining market share of fixed data subscribers

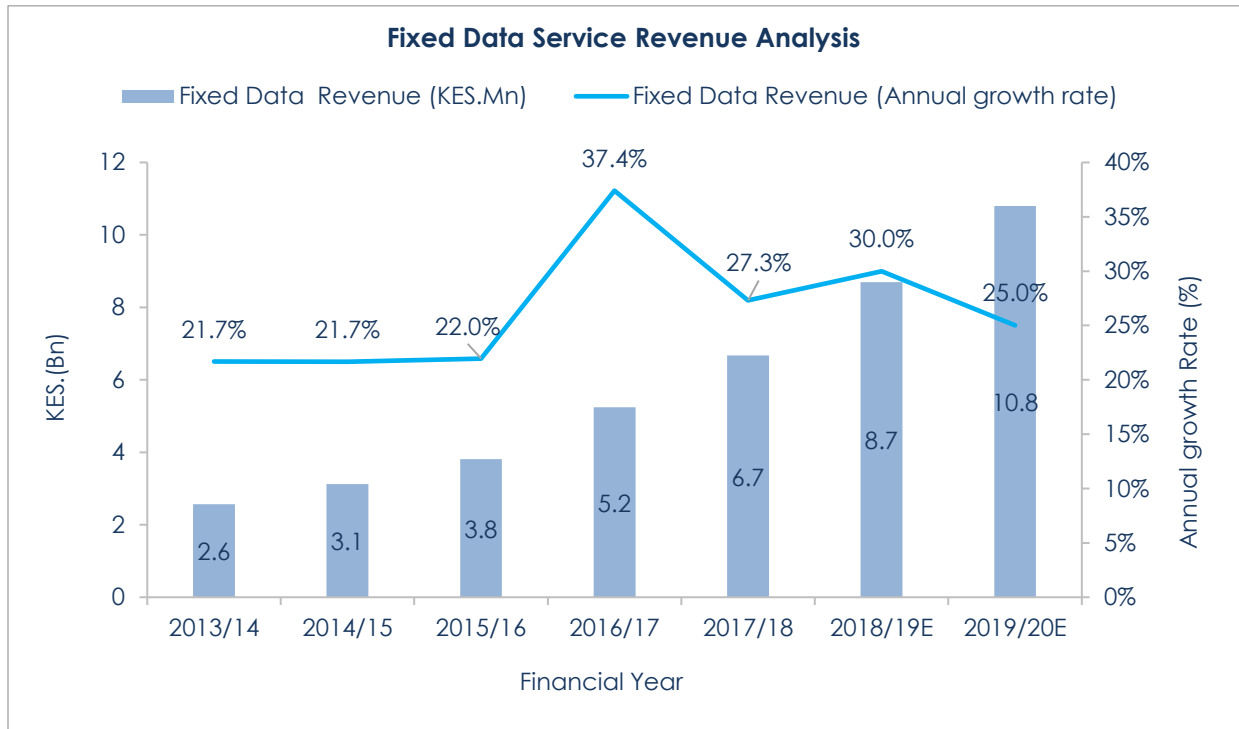


Source: Communications Authority

Fixed data opportunities rising and revenues growing

- We forecast 30% growth in fixed data service revenue to KES.8.7Bn FY2018/19 and 25% growth FY2019/20 to KES.10.8Bn on account of increased subscriber numbers.
- Fixed data contribution to total service revenue FY2018/19 and FY2019/20 forecasted at 3.6% and 4.2% respectively.

Fig.3: Fixed data is Safaricom's fastest growing service revenue line



Source: Company filings & Sterling Capital estimates

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