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# Telecommunications

## FY2018/19 Earnings Update

**“Mob money & bytes drive revenue”**

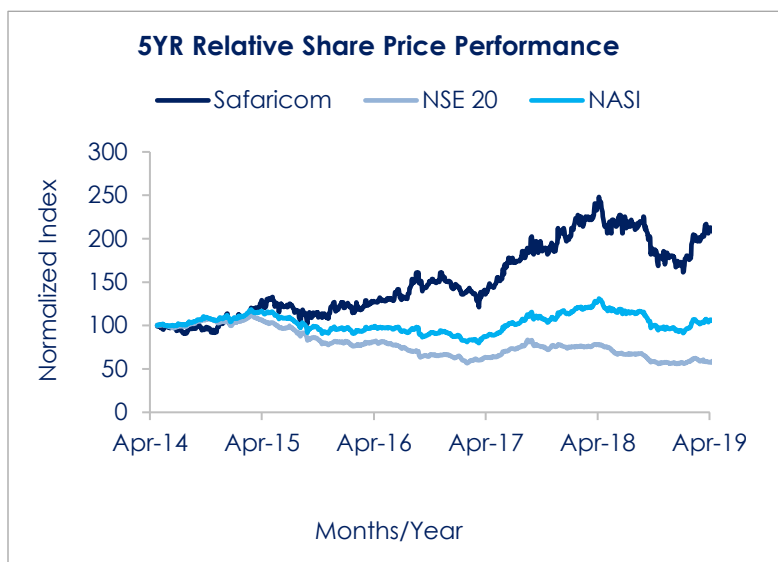
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## Table of Contents

Executive Summary .....	2
A) Overall Financial Performance.....	3
B) Service Revenue Performance - Trend in line with expectations .....	5
1) Voice - Revenue reaches its peak as marginal growth is reported .....	5
2) Messaging (SMS) - Revenues decline, downward trend expected to persist .....	5
3) M-Pesa - Remains a key revenue driver.....	5
4) Mobile Data - Revenue growth positive but at a slower pace .....	6
5) Fixed Data - Fastest growing service revenue, market leadership within sight .....	6
6) E-Commerce (Masoko) - The struggles continue .....	6
C) Operating Expenditure - OPEX slows down, falls below forecast .....	6
D) Capital Expenditure - Modest growth reported .....	7
Financial Summary .....	8
Disclosures .....	9
Ownership and material conflicts of interest:.....	9

## Executive Summary

- Safaricom Plc has released its financial results FY2018/19 **posting a 14.7% increase in Profit After Tax (PAT) to KES.63.4Bn.**
- **Total Service Revenue** grew 7% during the period to **KES.240.3Bn** with Fixed Data, M-Pesa, and mobile data posting strong results during the period in consideration.
- As predicted, **voice and messaging revenues have peaked and are on a decline** due to a combination of competition and changes in tastes and preferences.
- **Mobile data revenue growth has declined** as the effect of price competition adversely impacts revenues.
- **Operating expenses rose** particularly in the second half of the year while and capital expenditure rose as the company invested extensively in its network.
- We consider the overall performance fairly good in light of a challenging operating and competitive environment and maintain our **HOLD** recommendation with a fair value estimate of **KES.30.01.**

**Fig.1: Safaricom share performance**


Source: Nairobi Securities Exchange

### Share Data

NSE Code	SCOM
Bloomberg Code	SCOM:KN
Current Price (KES)	29.25
Target Price	30.01
Upside/ (Downside) (%)	↑6.1%
Recommendation	<b>HOLD</b>
Market Cap (KES. Bn)	1,120
Free Float (%)	25%
Price Change YOY (%)	↑2.6
Price Change YTD (%)	↑31.5
52 Week High/Low (KES)	32.50 -21.00
P/E (X)	18.5
P/B (X)	8.2

Source: Nairobi Securities Exchange, Bloomberg & Sterling Capital Research

## A) Overall Financial Performance

- Safaricom reported a 14.7% growth in Profit After Tax (PAT) to KES.63.4Bn below our KES.67.6Bn estimate.
- KES.1.58 Earnings Per Share (EPS) reported lower than our KES.1.65 estimate.
- This deviation was largely on account of our aggressive mobile data service revenue growth estimate (13.8% compared to 6.4%) and direct costs which rose 1.8% to KES.71.8% against our projected 3% decline to KES.68.1Bn.
- Our total service and total revenue estimates were largely in line with actual results reported with a marginal increase and decline in voice calls and messaging revenues reported respectively.
- With a 19.9% growth in revenues to KES.75Bn, M-Pesa outperformed our KES.73Bn forecast (inclusive of Fuliza revenue).
- Fixed data revenue reported the highest growth rate amongst the service lines (22.7%) to KES.8.2Bn against our estimated 20% growth to KES.8Bn.
- Operating costs rose 5.8% to KES.53.7Bn compared to our KES.54.8Bn forecast Main operating expenses.
- Subject to shareholder approval, the company intends to issue a KES.1.25 dividend per share a 13.6% increase from the KES.1.10 issued the previous year.
- A special dividend of KES.0.62 per share is was also proposed.
- Our service revenue contribution estimates are similar to the actual numbers with the main deviation being voice call service revenue which is lower at 36.6% than estimated (39.7%).

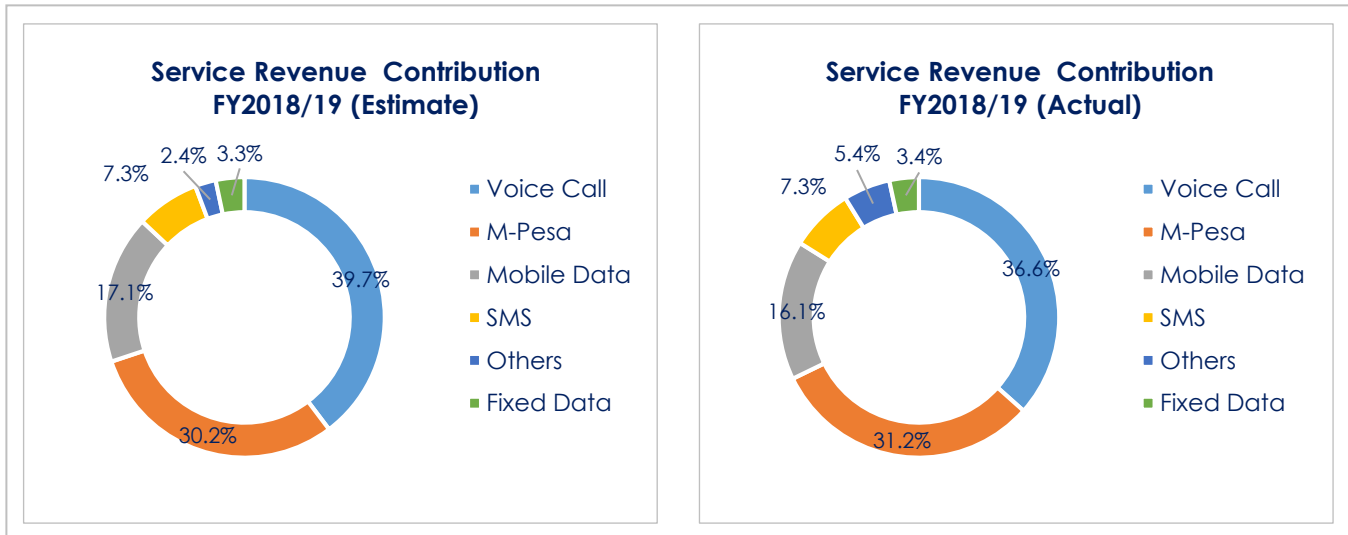
- In our earnings expectations note, we said we expected this service revenue line to fall below M-Pesa in the next 2-3 years. The latest results show that this could happen in the next operating period.
- Overall we are impressed by the company's financial results and maintain a positive outlook FY2019/20 in spite of competitive and operating environment challenges.

**Table.1: Financial results snapshot**

Financial Year	2016/17	2017/18	2018/19E	2018/19A	% YOY Growth
Total Service Revenue	204.1	224.5	241.9	240.3	7.0
Total Revenue	212.9	234.2	251.2	251.0	7.1
Direct Costs	(66.8)	(70.6)	(68.1)	(71.8)	1.8
Operating Costs	(44.9)	(50.6)	(54.8)	(53.7)	5.8
EBITDA	103.6	112.8	128.6	124.9	10.7
EBIT	70.4	89.0	95.5	89.6	13.1
Profit After Tax	48.4	55.3	67.6	63.4	14.7
EPS	1.21	1.38	1.69	1.58	14.7
DPS	0.97	1.10	1.35	1.25*	13.4

Source: Safaricom Plc & Sterling Capital Research

**Fig.1: Our FY2018/19 service contribution forecasts are in line with actual results**



Source: Safaricom Plc & Sterling Capital Research

## **B) Service Revenue Performance - Trend in line with expectations**

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- Total service revenue FY2018/19 at KES.240.3Bn a 7% growth over the previous year Voice revenues declined 0.3% FY2018/19 to KES.95.9Bn against our projected growth estimate of 0.5% to KES.96.1Bn.
- This decline is largely attributable to stiff price competition from rival mobile operators Airtel and Telkom.

### **1) Voice - Revenue reaches its peak as marginal growth is reported**

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- Voice revenues declined 0.3% FY2018/19 to KES.95.9Bn against our projected growth estimate of 0.5% to KES.96.1Bn.
- This decline is largely attributable to stiff price competition from rival mobile operators Airtel and Telkom.
- In spite of the decline in contribution to total service revenue to 36.6% from 39.7%, voice remains the biggest contributor to service revenues.
- We expect a further decline in voice calls revenue FY2019/20 (estimate KES.95.7Bn) due to a combination of stiff competition and overall industry decline in voice call traffic.

### **2) Messaging (SMS) - Revenues decline, downward trend expected to persist**

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- Messaging revenue FY2018/19 declined 1.3% to KES.17.5Bn lower than our KES.17.6Bn forecast for the period.
- Decline in revenues attributed to intense competition from data supported Over the Top (OTT) services such as WhatsApp, Facebook messenger etc.
- Safaricom's loss of market share also a direct result of comparatively higher mobile data tariffs than the competition resulting in a loss of subscriber market share.
- SMS contribution to total service revenue over the period in focus declined to 7.3% from 7.9%.
- We forecast a further decline in SMS revenues FY2019/20 to about KES.17.3Bn due to the reasons mentioned above.

### **3) M-Pesa - Remains a key revenue driver**

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- M-Pesa service revenues grew 19.2% to KES.75Bn driven by a 27.9% growth in 30-Day active M-Pesa subscribers to 22.6Mn and a 22.1% increase in the number of M-Pesa transactions.
- The value of M-Pesa transactions rose by 27.9% y/y while the number of 30-Day active M-Pesa customers went up by 10.2% to 22.6Mn.
- M-Pesa revenues now accounts for 31.2% of service revenues, slightly above 30.1 projection%.
- During the period in focus, savings and lending via M-Shwari, KCB M-Pesa and "Fuliza" grew by 25.6%.
- 8.8Mn customers registered for "Fuliza" with KES.29Bn disbursed and KES.0.3Bn reported by Safaricom in the 3 months since inception.



- We forecast 13.1% growth in revenues FY2019/20 driven by an increase in subscribers, money transfer and payment transactions supported by mobile credit ("M-Shwari, KCB M-Pesa, Fuliza) and other strategic business partnerships (PayPal, Google Playstore, Western Union and Ali Express).

#### **4) Mobile Data - Revenue growth positive but at a slower pace**

- Mobile data revenues recorded a 6.4% increase to KES.38.7Bn a slowdown compared to a 24% growth rate over the previous period.
- Our optimistic KES.41.4Bn revenue forecast was adversely impacted by intense competitive activity and the imposition of new taxes on data.
- Mobile data accounted for 16.1% of service revenue a marginal decline from 16.2% in the previous reporting period.
- We forecast FY2019/20 revenues at around KES.40Bn.

#### **5) Fixed Data - Fastest growing service revenue, market leadership within sight**

- Fixed service revenue exhibited a strong 22.7% growth to KES.8.2Bn during the period in focus against our KES.8Bn expectation.
- This was attributed to a steep growth in home connections.
- We expect fixed service revenue to continue growing at a fast pace due to increased investment in fibre broadband, higher market penetration driven by growing population and favorable demographics.
- Fixed data contributed 3.4% to total service revenue compared to from 3.0% the previous year and our forecast FY2019/20 - 4%.
- We anticipate a revenue growth of 20% to KES.9.8Bn FY2019/2020.

#### **6) E-Commerce (Masoko) - The struggles continue**

- Little was mentioned of "Masoko" during the financial results release.
- We believe that the service has yet to break-even due to Kenyan's preference for in store shopping.
- "Masoko" makes up for a rather small portion of Safaricom's service revenue, however, we will continue monitoring its progress.

#### **C) Operating Expenditure - OPEX slows down, falls below forecast**

- Operating expenses (OPEX) rose 5.8% to KES.53.7Bn a decline in the growth rate from 12.7% FY2018. This was also lower than our forecast. (KES.54.8Bn).
- Other operating costs recorded the biggest increases at 50.4% to KES.6.2Bn.

**Table.2: Operating Expenditure**

Financial Year	2017/18A	2018/19E	2018/19A
<b>Operating Expenditure (KES.Bn)</b>	<b>50.6</b>	<b>54.8</b>	<b>53.7</b>
Growth Rate	12.7%	8.2%	5.8%

Source: Safaricom Plc & Sterling Capital Research

#### **D) Capital Expenditure - Modest growth reported**

Capital expenditure (CAPEX) increased 2.3% to KES.37.3Bn above our KES.36.3Bn projection.

- CAPEX intensity (CAPEX/Revenue) declined to 14.9% FY2019 from 15.6% FY2018.
- A bulk of the capex (43.1%) was spent on improving radio access, 14.1% on IT systems, 13.4% on fixed network and 13.3% on transmission.
- Safaricom expects CAPEX to range between KES.36-39Bn as the company targets to accelerate the 4G roll out to 5,000 sites countrywide.

**Table.3: Operating Expenditure**

Financial Year	2017/18A	2018/19E	2018/19A
<b>Operating Expenditure (KES.Bn)</b>	<b>36.4</b>	<b>36.3</b>	<b>37.3</b>
Growth Rate	3.1%	2.3%	2.3%

Source: Safaricom Plc & Sterling Capital Research



## Financial Summary

Financial Year	2017/18	2018/19A	Growth (%)
Total Service Revenue	224.54	240.30	7.0
Voice Revenues	95.64	95.94	0.3
Contribution Margin (%)	42.6	36.6	6.0
SMS Revenues	17.72	17.50	1.3
Contribution Margin (%)	7.9	7.3	0.6
Mobile data Revenues	36.36	38.69	6.4
Contribution Margin (%)	16.2	16.1	0.1
Fixed service Revenue	6.67	8.19	22.7
Contribution Margin (%)	3.0	3.4	0.4
M-Pesa Revenue	62.91	74.99	19.2
Contribution Margin (%)	28.0	31.2	3.2
Other service Revenue	5.24	5.00	4.5
Non-service Revenue	9.18	10.66	16.1
Total Revenue	233.72	250.96	7.4
Other Income	0.51	0.46	9.8
Direct Costs	70.56	71.82	1.8
Gross Profit	163.47	178.54	9.2
Operating Expenses	50.64	53.59	5.8
EBITDA	112.83	124.94	10.7
EBITDA Margin (%)	48.2	49.9	1.7
Depreciation & Amortization	33.57	35.33	5.2
EBIT	79.27	89.61	13.1
EBIT Margin (%)	33.9	35.8	1.9
PBT	79.91	91.86	14.9
PAT	55.29	63.40	14.7
EPS	1.38	1.58	14.5
DPS	1.10	1.25	13.6
Special DPS	-	0.62	

Source: Company Filings

Financial Year	2017/18	2018/19A	Growth (%)
<b>Equity</b>			
Share capital & Premium	4.20	4.20	0.0
Retained Earnings	75.64	64.12	15.2
Proposed dividends	44.07	50.05	13.6
<b>Total Equity</b>	<b>123.91</b>	<b>143.24</b>	<b>15.6</b>
<b>Current Assets</b>			
Inventories	1.61	1.77	10.6
Receivables and prepayments	15.85	18.03	13.7
<b>Total Current Assets</b>	<b>27.46</b>	<b>47.88</b>	<b>74.3</b>
<b>Total Assets</b>	<b>167.44</b>	<b>189.43</b>	<b>13.1</b>
<b>Current Liabilities</b>			
Payables & Accrued expenses	26.47	28.61	8.1
Borrowings	4.04	4.03	0.2
<b>Total Current Liabilities</b>	<b>43.53</b>	<b>44.55</b>	<b>2.4</b>

Source: Company Filings

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